CHAPTER 6

DUTY TO DEFEND

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6.1 § BASIS OF DUTY

A. Contractual in Nature

An insurer's obligation to defend its insured is contractual in nature. *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 390 (Minn. 1979); *see also Indus. Door Co. v. The Builders Group*, No. A09-2065, 2010 WL 2900312 (Minn. Ct. App. July 27, 2010) (unpublished opinion) (reiterating that the duty to defend is contractual in nature and may not be based on the equitable ground that the insurer failed to timely respond to the insured's tender). In addition to providing an obligation to indemnify an insured, liability policies contain a provision outlining the insurer's rights and duties to defend the insured. For example, the current Insurance Services Office (ISO) commercial general liability (CGL) policy contains the following provision regarding defense duties:

> STANDARD POLICY LANGUAGE
>
> **DEFENSE DUTIES**
>
> **Insuring Agreement**
>
> a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend any "suit" seeking those damages. We may at our discretion investigate any "occurrence" and settle any claim or "suit" that may result. But:
>
> (1) The amount we will pay for damages is limited as described in LIMITS OF INSURANCE (SECTION III); and
>
> (2) Our right and duty to defend end when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverage A or B or medical expenses under Coverage C.
>
> No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under SUPPLEMENTARY PAYMENTS – COVERAGES A AND B.

Other types of liability policies contain similar provisions. For example, the automobile insurance policy at issue in *American Standard Insurance Co. v. Le*, 539 N.W.2d 810, 812 (Minn. Ct. App. 1995) stated, "We will pay compensatory damages an insured person is legally liable for because of bodily injury and property damage due to the use of a car or utility trailer. We will defend or settle, as we think proper, any suit or claim for damages payable under this policy." Similarly, the homeowners insurance policy involved in *S.G. v. St. Paul Fire & Marine Insurance Co.*, 460 N.W.2d 639, 643 (Minn. Ct. App. 1990) contained the following provision regarding defense obligations: "We'll defend any suit for damages against you or anyone else insured even if it's groundless or fraudulent. And we'll investigate, negotiate and settle on your behalf any claim or suit if that seems to us proper and wise."

While nearly all liability policies contain a provision regarding the insurer's defense obligations, whether an insurer actually owes a duty to defend will depend on the facts of each case. As the above provisions indicate, a duty to defend only exists if a claim against the insured is within the scope of the policy's indemnity coverage. An obligation to defend will exist if any part of a claim against the insured is arguably within the scope of the indemnity coverage.

B. Statutory Basis for Duty to Defend

1. Minnesota Unfair Claims Practices Act

There is no Minnesota statute that requires an insurer to defend its insured or outlines what such duty would entail. The closest such statutes are Minnesota Statutes section 72A.17 *et seq*., commonly referred to as the Minnesota Unfair Claims Practices Act. "Claim," as that term is used in the Act, includes a request made to an

insurer for the "provision of services under the terms of any policy…." MINN. STAT. § 72A.201, SUBD. 3. Presumably, services under a policy would include the defense of a lawsuit. Even with that broad definition of "claim" in the Act, there is no provision in the Act that could serve as a basis for a duty to defend. At most, the Act merely reiterates common law obligations of the insurer, or defers to existing law or the policy itself.

In addition to the wording of the Act, case law strongly suggests that the Act cannot serve as the basis of a duty to defend. *See Morris v. Am. Family Mut. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986) (holding that a private party does not have a cause of action under the Act); *see also TGA Dev., Inc. v. N. Ins. Co. of N.Y.*, 62 F.3d 1089 (8th Cir. 1995) (an insurer is not estopped to deny coverage because it allegedly violated the Act by not specifying the policy provision upon which the denial was based).

2. Minnesota No-Fault Act

Although the Minnesota No-Fault Act does not mandate a duty to defend, it does allow for that right. Specifically, Minnesota Statutes section 65B.49, subdivision 3(3)(c) provides that insurers "shall have the right to settle any claim covered by the residual liability insurance policy, and if such settlement is made in good faith, the amount thereof shall be deductible from the limits of liability for the accident out of which such claim arose."

While the Minnesota No-Fault Act has no provisions requiring an insurer to defend, the No-Fault Act could affect the duty to defend. The Minnesota courts have set aside exclusions in automobile liability policies that conflict with the No-Fault Act. *See generally Hime v. State Farm Fire & Cas. Co.*, 284 N.W.2d 829, 831 (Minn. 1979) (stating in the syllabus by the court that the application of Minnesota no-fault law to set aside a Florida automobile liability insurance contract clause, which excluded coverage for intra-family claims, was proper under Minnesota choice-influencing considerations); *Safeco Ins. Co. v. Diaz*, 385 N.W.2d 845, 849 (Minn. Ct. App. 1986) (an exclusionary clause that denies liability coverage to the named insured conflicts with the No-Fault Act and is therefore void).

Thus, where an insurer denies a duty to defend based on an exclusion that conflicts with the No-Fault Act, the court may find the exclusion void and require a defense. But in recent years, the Minnesota Supreme Court has emphasized that exclusions to liability coverage are less likely to be contrary to the No-Fault Act than are exclusions to first-party coverage. *See Lobeck v. State Farm Mut. Auto. Ins. Co.*, 582 N.W.2d 246, 250-51 (Minn. 1998) (an automobile insurance policy that excludes liability coverage for an insured party who uses another person's automobile without permission is valid and enforceable); *see also Latterell v. Progressive N. Ins. Co.*, 801 N.W.2d 917, 922 (Minn. 2011) (stating that because the "No-Fault Act's primary purpose is to ensure the availability of first-party benefits," Minnesota courts are more likely to invalidate exclusions to first-party coverage than to third-party coverage) (quoting *Lobeck*, 582 N.W.2d at 250).

At Minnesota Statutes section 65B.49, subdivision 3(3)(a), the No-Fault Act creates a potential obstacle to an insurer that seeks to deny coverage and a defense based on an insured's acts following an occurrence. That section provides that liability coverage becomes absolute whenever injury or damage occurs, and that no violation of a policy shall void the policy. *See State Farm Mut. v. Cincinnati Ins. Co.*, 666 N.W.2d 334 (Minn. 2003) (noting that Minnesota Statutes section 65B.49, subdivision 3(3)(a) provides that liability coverage becomes absolute with the occurrence of a motor vehicle accident and cannot thereafter be canceled or annulled by the actions of the insured).

6.2 § BURDEN OF PROVING DUTY TO DEFEND

A. Burden of Proof

Once an insured comes forward with facts showing arguable coverage, or the insurer becomes independently aware of such facts, the insurer has the burden of proving that no duty to defend exists. *See SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 316 (Minn. 1995). The Minnesota Court of Appeals has described this burden as a

"heavy burden." *In re Liquidation of Excalibur Ins. Co.*, 519 N.W.2d 494, 497 (Minn. Ct. App. 1994) (citing *Hecla Mining Co. v. N.H. Ins. Co.*, 811 P.2d 1083, 1089 (Colo. 1991)). Similarly, the Eighth Circuit, applying Minnesota law, has held that the burden is on the insurer to prove that it has no duty to defend and has also described this as a "heavy burden." *Eyeblaster, Inc. v. Fed. Ins. Co.*, 613 F.3d 797, 801 (8th Cir. 2010) (citing *Murray v. Greenwich Ins. Co.*, 533 F.3d 644, 648-49 (8th Cir. 2008)). An insurer seeking to avoid affording a defense must establish that all parts of the cause of action fall clearly outside the scope of coverage. *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co*., 819 N.W.2d 602, 616 (Minn. 2012); *see also Grain Dealers Mut. Ins. Co. v. Cady*, 318 N.W.2d 247, 251 (Minn. 1982); *Murray*, 533 F.3d at 648. The requirement that all parts of the cause of action fall clearly outside the scope of coverage stems from the oft-stated rule that the duty to defend is broader than the duty to indemnify. As discussed later in this chapter, the duty to defend exists if any part of the cause of action arguably falls within the scope of coverage. Thus, where an insurer establishes that all but one part of a cause of action falls outside the scope of coverage, it would be required to defend the insured. Although the insurer would have to defend all claims, it could preserve its denial to indemnify the insured for non-covered claims through a reservation of rights. *See supra* chapter 2.

If an insured fails to meet its burden of presenting a covered claim through a complaint or extrinsic evidence, an insurer need not speculate about facts that trigger its duty to defend. *Travelers Prop. Cas. Co. v. Gen. Cas. Ins. Co.*, 465 F.3d 900, 903 (8th Cir. 2006) (citing *St. Paul Mercury Ins. Co. v. Dahlberg, Inc.*, 596 N.W.2d 674, 676-77 (Minn. Ct. App. 1999)).

B. Doubt Resolved in Favor of Insured

Whether an insurer is under an obligation to defend is not always free from doubt until the case is actually tried. Such doubts should be resolved in favor of the insured. *Crum v. Anchor Cas. Co.*, 119 N.W.2d 703, 711 (Minn. 1963).

Resolving doubt in favor of the insured is consistent with the rule that the insurer has the burden of proving that no duty to defend exists. This rule is particularly applicable when the insurer and the insured have compelling but conflicting evidence on a relevant factual issue. But there should be limits to the application of this rule. When the evidence offered by the insured fails to raise a doubt, either because it lacks credibility or because it fails to meet the pertinent rules of evidence or rules of civil procedure, there should be no reason to resort to this rule. *See generally Haarstad v. Graff*, 517 N.W.2d 582, 585 (Minn. 1994) (holding no duty to defend even though the insured, who had punched someone, claimed that the incident was "just a reaction" and that he did not know what he did or why); *Banbury v. Omnitrition Int'l, Inc.*, 533 N.W.2d 876, 881 (Minn. Ct. App. 1995) (a self-serving affidavit that contradicts earlier damaging deposition testimony is not sufficient to create a genuine issue of material fact).

C. Duty to Defend is Subject to De Novo Review

As previously noted, the insurer's obligation to provide a defense is contractual in nature. Not surprisingly then, the Minnesota Supreme Court has stated that the interpretation of an insurance policy, including whether a legal duty to defend or indemnify arises, is subject to de novo review. *Auto-Owners Ins. Co. v. Todd*, 547 N.W.2d 696, 698 (Minn. 1996) (citing *Iowa Kemper Ins. Co. v. Stone*, 269 N.W.2d 885 (Minn. 1978)); *see also Kroschel v. City of Afton*, 524 N.W.2d 719, 721 (Minn. 1994) (stating that the interpretation of language in an insurance policy is a question of law); *CPT Corp. v. St. Paul Fire & Marine Ins.*, 515 N.W.2d 747 (Minn. Ct. App. 1994) (stating that whether an insurer has a duty to defend is an issue of policy interpretation).

6.3 § BASIS FOR DETERMINING WHETHER DUTY TO DEFEND EXISTS

A. Complaint

1. A Duty to Defend May Be Determined by Comparing Allegations of the Complaint with Relevant Policy Language

While liability policies contain a provision regarding the insurer's duty to defend, whether a defense is actually due will depend on the circumstances of each case. The most obvious starting point in determining whether a defense is due is the complaint or other pleading against the insured in the underlying lawsuit. *See Franklin v. W. Nat'l Mut. Ins. Co.*, 574 N.W.2d 405, 407 (Minn. 1998). The court in *Franklin* held that a counterclaim for trespass against the insured arising from a lease dispute over advertising structures, which plainly indicated that the litigation concerned the terms of the lease agreement, did not trigger an insurer's duty to defend under an insurance policy covering "wrongful entry … or other invasion of the right of private occupancy." 574 N.W.2d 405, 407. Nor did the same counterclaim involve an "accidental occurrence" so as to trigger the insurer's duty to defend under the property damage provisions of the CGL policy.

An insurer's obligation to defend may be determined simply by comparing the allegations of the complaint with the relevant policy language. *See Garvis v. Employers Mut. Cas. Co.*, 497 N.W.2d 254, 256 (Minn. 1993); *see also Metro. Prop. & Cas. Ins. Co. v. Miller*, 589 N.W.2d 297, 300 (Minn. 1999) (the plain language of the policies provided no coverage for injury in the form of sexual molestation regardless of whether the injury was caused by the insured or the injury could have been prevented by the insured's spouse); *Ross v. Briggs & Morgan*, 540 N.W.2d 843, 847-48 (Minn. 1995) (stating that a duty to defend may be established if there is a semantic connection between the policy's enumerated offenses and the claims made in the underlying case); *Fallon McElligott, Inc. v. Seaboard Sur. Co.*, 607 N.W.2d 801 (Minn. Ct. App. 2000) (holding that an insurer had no duty to defend or indemnify its insured after comparing the underlying claim to the policy language).

Where an insured's liability policy covers only consequential damages, and the underlying lawsuits against the insured exclude consequential damages from the relief sought, the insurer has no obligation to defend or indemnify the insured in those lawsuits. *St. Paul Fire & Marine Ins. Co. v. Microsoft Corp.*, 102 F. Supp. 2d 1107 (D. Minn. 1999), *aff'd*, 220 F.3d 943 (8th Cir. 2000). Similarly, a title insurer has no duty to defend its insured in a bankruptcy trustee's preference action because the preference action did not implicate the marketability of title to the real property or other risks specified in the title insurance policy. *Rechtzigel v. Fid. Nat'l Title Ins. Co. of N.Y.*, 748 N.W.2d 312 (Minn. Ct. App. 2008).

An insurer that issued a real estate professional errors and omission policy had no duty to defend real estate agents in light of the claims by the plaintiff in the underlying case. *Murray v. Greenwich Ins. Co.*, 533 F.3d 644 (8th Cir. 2008). The policy in *Murray* excluded coverage for claims "based on or arising out of" failure to safeguard funds held for others. After noting that Minnesota courts have construed broadly the phrase "arising out of," the court concluded that all claims, including the claim of negligent misrepresentation, arose out of the insured's failure to return deposited funds. *Id*. at 649, 650. Therefore, the exclusion applied and there was no duty to defend. *Id*. at 650.

In determining whether there is coverage, the court bases its decision on the causes of action alleged in the complaint, not on what could have been alleged. *Bethel v. Darwin Select Ins. Co.,* 735 F.3d 1035, 1040 (8th Cir. 2013); *Reinsurance Ass'n of Minn. v. Timmer*, 641 N.W.2d 302, 311 (Minn. Ct. App. 2002); *see also Hometown Am., LLC v. Liberty Ins. Corp.*, No. A10-36, 2010 WL 3306942 (Minn. Ct. App. Aug. 24, 2010) (unpublished opinion) (stating that although an insurer can and should compare the allegations of a complaint with the relevant policy language, it does not have to speculate as to what other claims might have been made). *But cf. Pac. Ins. Co. v. Burnet Title, Inc.*, 380 F.3d 1061, 1065 (8th Cir. 2004) (stating that where a complaint does not distinguish between intentional and negligent conduct, it can "'reasonably be construed to include both'" (quoting *Timmer*, 641 N.W.2d at 312)).

In *Bethel,* the plaintiff in the underlying lawsuit alleged that the defendants, a title insurance agency and its employees, failed to record mortgage instruments in order to facilitate the misappropriation of customer funds. *Bethel*, 735 F.3d at 1040. Although the plaintiff included in its complaint a negligence count, the court noted that all

of the counts, including the negligence count, concerned conduct that was related to the "general scheme to misappropriate escrowed funds." *Id*. at 1038. In light of a "customer funds exclusion" in the professional liability insurance policy, which excluded coverage for, among other things, claims arising out of improper use of customer funds, the court held that there was no duty to defend the title insurance agency and its employees. In reaching its decision, the court noted that it would "not imagine allegations that [the plaintiff] could have made merely because its actual allegations went beyond the bare minimum of notice pleading." *Id*. at 1040 (citing *Timmer*, 641 N.W.2d at 311).

In *Timmer*, the court noted that the plaintiffs in the underlying lawsuit "studiously avoided making any claims for ordinary negligence, perhaps to avoid the limitations on economic loss damages." 641 N.W.2d at 311. The court in *Timmer* felt that Minnesota law did not allow it to determine coverage on the basis of claims that could have been made but were not.

2. The Complaint Controls Unless Facts Contradicting the Complaint Are Presented

While an insurer may deny a defense based on the allegations of the complaint, Minnesota case law makes clear that an insurer may not ignore facts outside the complaint once they are brought to its attention by the insured. *See Johnson v. Aid Ins. Co.*, 287 N.W.2d 663, 665 (Minn. 1980); *see also Travelers Prop. Cas. Co. v. Gen. Cas. Ins. Co.*, 465 F.3d 900, 903 (8th Cir. 2006) (stating that if a complaint fails to establish coverage, an insurer still must accept a tender of defense if the insurer has independent knowledge of facts that may establish coverage). Where an insurer denies a defense based on the allegations of a complaint, it is incumbent upon the insured to alert the insurer to facts outside the complaint that trigger the duty to defend. Once the insurer denies a defense based on the complaint, it has no duty to investigate further to verify the denial. *See Garvis*, 497 N.W.2d at 258.

Garvis involved an action to determine a comprehensive general liability insurer's duty to defend and indemnify a claim for emotional distress. The court held that while emotional distress with appreciable physical manifestations would qualify as "bodily injury" within the meaning of the policy, emotional distress without such manifestations would not. Because the complaint only alleged extreme and severe emotional distress without any allegation of physical manifestations, the court concluded that the insurer could rightfully refuse to defend based on the complaint. The insurer was not required to assume that there were physical manifestations. Having denied coverage on the basis of the pleadings, the insurer was not obligated to participate in subsequent discovery proceedings, during which allegations of physical manifestations arose.

In ruling for the insurer, the court made clear that the insurer could not rely solely on the complaint to deny a defense if it were aware of facts outside the complaint that would give rise to a duty to defend. If the insured informed the insurer of such facts, or if the insurer had independent knowledge of such facts, it would either have to accept the tender or investigate further. *Id*. The problem for the insured in *Garvis* was that while there were facts outside the complaint which could have triggered a defense duty, those facts (the claims of the physical manifestations of the emotional distress) were never conveyed to the insurer after the denial. Nor did the insured offer any reason for its failure to inform the insurer of those facts after they surfaced during discovery. Because the insurer properly denied a defense based on the allegations in the complaint, and was never subsequently informed of the claims of the physical manifestations, the insured was not entitled to a defense.

PRACTICE TIP

The obvious lesson from *Garvis* is that an insured should keep the insurer advised of developing facts, even after a defense is denied. In addition to discovery responses, the insured should forward to the insurer as soon as possible any correspondence, investigation, affidavits, or other evidence that would support a claim of coverage.

The Eighth Circuit and the Minnesota Court of Appeals have reaffirmed the *Garvis* rule that once an insurer denies a defense based on the complaint, it has no duty to investigate further to verify the denial. *See*

COMSAT Corp. v. St. Paul Fire & Marine Ins. Co., 246 F.3d 1101 (8th Cir. 2001); *St. Paul Mercury Ins. Co. v. Dahlberg, Inc.*, 596 N.W.2d 674 (Minn. Ct. App. 1999). *COMSAT* involved a CGL policy that provided coverage for personal injury and advertising injury liability occurring while the policy was in effect. "Personal injury" included libel, slander, and written or spoken material made public that belittled the products or work of others. The policy specifically excluded coverage for personal or advertising injury that resulted from written or spoken material if the material was first made public before the policy went into effect.

The insurer denied a defense or coverage on the grounds that the conduct alleged in the amended complaint against the insured did not occur while the CGL policy was in effect. The denial was based on the pleadings, the insurance policy, and a letter from the insured tendering the suit. No other information was submitted by the insured in support of its tender.

After the denial of a defense and coverage, the insured engaged in discovery in the underlying lawsuit. During discovery, the party suing the insured alleged in interrogatory answers that the insured had disparaged it after the CGL policy became effective. However, the insured did not inform the insurer of these interrogatory answers until six years after the denial and two years after the insured successfully defended the underlying lawsuit.

Because the insured failed to notify the insurer of the allegations contained in the interrogatory answers, the court affirmed the trial court's summary judgment in favor of the insurer. In so doing, the court stated the following:

> If an insurer has no knowledge to the contrary, it can make an initial determination, whether to defend or to conduct a further investigation, from the facts in the complaint. *See Garvis v. Employers Mut. Cas. Co.*, 497 N.W.2d 254, 258 (Minn. 1993). The insurer's duty to defend is to be determined as of the time the claim was tendered to it by the insured, and it is the insured's obligation to provide information that would trigger coverage. [Citation omitted.] If the insured fails to provide such information, the insurer "need not speculate about facts that may trigger its duty to defend." *St. Paul Mercury Ins. Co. v. Dahlberg, Inc.*, 596 N.W.2d 674, 677 (Minn. Ct. App. 1999).

COMSAT, 246 F.3d at 1105; *see also St. Paul Mercury Ins. Co. v. Dahlberg, Inc.*, 596 N.W.2d 674 (Minn. Ct. App. 1999) (holding that to trigger an insurer's contractual duty to defend, an insured must present to the insurer a covered claim through facts in a complaint or extrinsic evidence; an insurer's knowledge of claims dropped in a related lawsuit is insufficient to trigger its duty to defend).

3. Duty Not Dependent on Merits of the Claim

Whether the allegations against an insured are true or not may be irrelevant to whether a defense is due. *See Truchinski v. Cashman*, 257 N.W.2d 286, 287 (Minn. 1977); *Republic Vanguard Ins. Co. v. Buehl*, 204 N.W.2d 426, 430 (Minn. 1973) (insurer has duty to defend if allegations of suit are within policy coverage, even if allegations may later prove to be groundless); *Denike v. W. Nat'l Mut. Ins. Co.*, 473 N.W.2d 370 (Minn. Ct. App. 1991). The irrelevancy of the merits of any claim against an insured is evident from the language in many liability policies, which agree the insurer will provide a defense even if the suit is "groundless, false, or fraudulent."

The real issue then is whether a claim arguably falls within the scope of coverage, not whether the claim has merit. Thus, where a claim of negligence against the insured arguably falls within the coverage, a defense is due. Of course, if it is ultimately determined that the insured was not negligent, a defense would still be due, but no liability would exist, thereby precluding a duty to indemnify. *Accord Econ. Fire & Cas. Co. v. Iverson*, 445 N.W.2d 824, 827 (Minn. 1989) (insurer liable for defense costs incurred prior to settlement of tort action where plaintiff alleged negligence and intentional assault, even though jury verdict in declaratory judgment action found insured

lawfully assaulted plaintiff in self-defense, thereby relieving insured and insurer of liability to plaintiff), *overruled in part on other grounds by Am. Standard Ins. Co. v. Le*, 551 N.W.2d 923 (Minn. 1996). Conversely, if the only claim against the insured does not arguably fall within the scope of coverage (such as a claim of sexual assault), no defense would be due, even if the insured denied the sexual assault. *See FACE, Festivals & Concert Events, Inc. v. Scottsdale Ins. Co.*, 632 F.3d 417 (8th Cir. 2011).

What if a plaintiff's lawsuit against an insured was based on a novel legal theory that had not been recognized by the Minnesota courts? Would an insurer have to defend such a case if its policy provided it would pay damages "where recovery is permitted by law?" That issue was addressed in *Industrial Door Co. v. The Builders Group*, No. A09-2065, 2010 WL 2900312 (Minn. Ct. App. July 27, 2010) (unpublished opinion). In *Industrial Door*, an employee brought a tort action for personal injuries against his employer. Because Minnesota law provides that the employee's exclusive remedy is through the workers' compensation system, the employee sought to carve out an exception to the exclusive remedy. To do so, he advanced a new theory – dual capacity. Because the insurer's policy only provided for payment of damages "where recovery is permitted by law," and because Minnesota had not recognized the dual-capacity exception to the exclusive remedy, the insurer argued that no duty to defend existed. The Minnesota Court of Appeals disagreed, stating the following:

> We cannot conclude that coverage was not arguable simply because Peterson appeared to be invoking a theory that few jurisdictions have adopted as an exception to workers' compensation's exclusivity. Peterson's case could have presented the courts with an opportunity to adopt the theory in Minnesota. Even if a claim would fall within the scope of coverage only through a development in the law, the insurer still has the obligation to develop the facts and argue against adoption of the proposed doctrine.

2010 WL 2900312 at *4.

B. Facts Outside Complaint

The allegations in a complaint are not controlling when actual facts clearly establish the existence or nonexistence of an obligation to defend. *AMCO Ins. Co. v. Inspired Techs., Inc.*, 648 F.3d 875, 881 (8th Cir. 2011) (citing *Farmers & Merchs. State Bank of Pierz v. St. Paul Fire & Marine Ins. Co.*, 242 N.W.2d 840, 842 (Minn. 1976)). The court in *Inspired Technologies* held that interrogatory answers qualify as actual facts. *Id*.

The underlying case in *Inspired Technologies* involved claims by 3M of unfair advertising. Among other claims, 3M alleged Inspired Technologies falsely advertised that its painter's tape was superior to 3M's tape. 3M served answers to interrogatories in which it stated that Inspired Technologies used manipulated images of 3M tape in order to deceive and confuse potential customers of 3M. *Id*. at 879. In light of the answers to the interrogatories, the district court granted the insurer summary judgment, concluding that it did not owe a duty to defend the underlying case because of a "knowledge of falsity" exclusion.

The appellate court, applying Minnesota law, reversed on the grounds that the complaint in the underlying case contained allegations of intentional misrepresentation, as well as allegations of conduct that could have been intentional or merely negligent. *Id*. at 882. In so ruling, the court noted that while the district court properly relied on 3M's answers to interrogatories, summary judgment was not appropriate because the district court had focused on only some of Inspired Technologies' conduct, rather than on the global claim itself. *Id*.

While an insurer can initially deny a defense based on allegations in a complaint, Minnesota case law is clear that the insurer may not stand by its denial when it learns of facts indicating that a claim against the insured arguably falls within coverage. *See Travelers Prop. Cas. Co. v. Gen. Cas. Ins. Co.*, 465 F.3d 900, 903 (8th Cir. 2006); *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 316 (Minn. 1995); *Lanoue v. Fireman's Fund Am. Ins. Co.*, 278

N.W.2d 49, 51 (Minn. 1979), *overruled in part on other grounds by Am. Standard Ins. Co. v. Le*, 551 N.W.2d 923 (Minn. 1996); *Crum v. Anchor Cas. Co.*, 119 N.W.2d 703, 712 (Minn. 1963).

In *Crum*, a tenant and part-time employee of an apartment building sued her landlord after she fell down a stairway in the apartment. Although the tenant's original complaint made no mention of any employment relationship with the landlord, she subsequently filed an amended complaint alleging a cause of action based on the Workers' Compensation Act. The landlord's insurer, which had been defending the landlord, withdrew its defense based on two exclusions that excluded coverage for obligations under workers' compensation law or any injury arising out of employment with the landlord.

After noting that the tenant's deposition conclusively established that the fall did not occur while she was employed by the landlord, the Minnesota Supreme Court made clear that the insurer could not rely solely on the allegations of the complaint:

> It must be kept in mind that in situations of this kind, the insured who has been sued has no control over the allegations of the complaint. We think the better rule is that, if the insurer is advised by the insured what he claims the facts to be or the insurer by an independent investigation ascertains that the facts are in conflict with a complaint, and, if established, will present a potential liability on the part of the insured covered by the insurance contract, the insurer is obligated to undertake the defense.

Crum, 119 N.W.2d at 712; *see also SCSC Corp.*, 536 N.W.2d at 316 (letters from insured regarding actions and findings by the Minnesota Pollution Control Agency (MPCA) provided insurer with sufficient information to trigger a defense or further investigation by the insurer); *Lanoue*, 278 N.W.2d at 53 (stating that where an insurer was told the entire story of the incident giving rise to the lawsuit and where it conducted its own investigation, the insurer could not ignore facts outside the complaint).

As the foregoing decisions indicate, the allegations of a complaint do not control where facts outside the complaint, including deposition testimony and information provided by the insured or the insured's counsel, arguably bring a claim within the scope of coverage. Conversely, where a complaint's allegations trigger a defense, an insurer is allowed to look to facts outside the complaint. *See St. Paul Fire & Marine Ins. Co. v. Nat'l Computer Sys., Inc.*, 490 N.W.2d 626, 632 (Minn. Ct. App. 1992). And where facts outside the complaint conclusively establish that the claim is not covered, the insurer has no duty to defend. *See Haarstad v. Graff*, 517 N.W.2d 582 (Minn. 1994); *see also State Farm Fire & Cas. Co. v. Williams*, 355 N.W.2d 421, 425 (Minn. 1984) (examination of complaint, depositions and stipulated facts clearly showed intentional acts excluded under homeowners policy); *Iowa Kemper Ins. Co. v. Stone*, 269 N.W.2d 885, 886-87 (Minn. 1978) (holding that although the complaint alleged negligence and assault, the trial court properly ruled the intentional acts exclusion applied, based on briefs, depositions and exhibits); *Farmers & Merchants State Bank v. St. Paul Fire & Marine Ins. Co.*, 242 N.W.2d 840, 843 (Minn. 1976).

In *Haarstad*, Brian Graff punched John Haarstad in the face several times, ultimately breaking his jaw in two places. Haarstad then sued Graff, alleging that Graff had "negligently and carelessly engaged in a course of conduct that resulted in bodily injury." 517 N.W.2d at 583. Graff's homeowners insurer denied coverage under the intentional acts exclusion of the policy and refused to defend, basing its denial on the results of its investigation, which included a statement from Graff. After entering into a *Miller-Shugart* agreement with Graff, Haarstad served a supplemental complaint against the homeowners insurer. At the trial that followed, the jury found that Graff did not act intentionally. The trial court then ruled that the claim was covered and ordered the homeowners insurer to pay the attorneys' fees of both Graff and Haarstad. The court of appeals affirmed the award of attorneys' fees, but reversed the trial court with respect to the duty to indemnify, holding as a matter of law that because Graff acted intentionally, there was no coverage.

On appeal, Haarstad argued that the homeowners insurer could not have conclusively known that Graff's acts were not covered, because Graff had told the insurer that his striking of Haarstad was just a reaction and that he did not know what he did or why he did it. The Minnesota Supreme Court disagreed and reversed the award of attorneys' fees:

> Here, there is no duty to defend because the claim is clearly outside the coverage provided by the policy. At the time [the insurer] determined it had no duty to defend, it had ample information before it to make that determination. Based on its interview of Graff, [the insurer] knew Graff had gone uninvited to Schumacher's house at a very early hour, had decided to search a bedroom he had no business searching, and had crossed from the door of the room to the bed to attack the man he found there, a man who had in no way threatened or provoked Graff.
>
> Given the viciousness of Graff's unprovoked assault on Haarstad, the resulting injuries were either expected or intended by Graff and are, therefore, clearly outside the coverage of the policy.

Id. at 585.

Like the insurer in *Haarstad*, the insurer in *Bituminous Casualty Corp. v. Bartlett* was allowed to deny a defense based on facts outside the complaint. 240 N.W.2d 310, 313-14 (Minn. 1976) (no duty to defend claims of negligent masonry and cement work where building owner testified at deposition that during construction he had informed insured of chipped bricks, and the insured admitted that walls were intentionally run out of plumb), *overruled in part on other grounds by Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979); *see also Weis v. State Farm Mut. Auto Ins. Co.*, 64 N.W.2d 366, 368 (Minn. 1954) (holding that an insurer had no duty to defend a lawsuit in which it was alleged that the insured had negligently and deliberately struck the rear of the plaintiff's car, where the insured stated to the insurance adjuster that he had acted deliberately).

C. Guilty Plea by Insured

The Minnesota Supreme Court has previously indicated that an insured's guilty plea to an assault charge does not collaterally estop the insured from re-litigating the issue of intent. *See Glens Falls Group Ins. Corp. v. Hoium*, 200 N.W.2d 189, 192 (Minn. 1972). During the guilty plea in *Glens Falls*, the insured was evasive with regard to his intent to inflict harm. But where an insured admits to an intentional assault during the guilty plea, he may be estopped from re-litigating the issue of intent. *See State Farm Fire & Cas. Co. v. Haulcy*, No. CX-00-740 (Minn. Ct. App. Nov. 7, 2000) (unpublished opinion). The insured in *Haulcy* plead guilty to assault in the fourth degree, but unlike the insured in *Glen Falls*, he readily admitted under oath that he had intentionally assaulted two police officers. Although the officers attempted to raise a fact issue with regard to intent by offering the insured's deposition transcript, the court in *Haulcy* concluded that the conflicting deposition testimony did not create a question of fact and was insufficient to defeat the summary judgment. *Id.* (citing *Banbury v. Omnitrition Int'l, Inc.*, 533 N.W.2d 876, 881 (Minn. Ct. App. 1995)). *But See Ill. Farmers Ins. Co. v. Reed*, 662 N.W.2d 529 (Minn. 2003) (an insured's criminal conviction may not collaterally estop a third-party victim in certain circumstances).

A guilty plea may preclude a duty to defend under a criminal acts exclusion. *Progressive N. Ins. Co. v. McDonough*, 608 F.3d 388 (8th Cir. 2010). In *McDonough*, Nicolaus Morelli drove his vehicle off the road and struck Sean McDonough, severely injuring him. Initially, Morelli told the investigating officer that the accident occurred because he was distracted by a ringing cell phone. But later, when he pled guilty, he acknowledged that he intentionally drove off the road and into a group of people. After Sean McDonough commenced a personal injury lawsuit against Morelli, Morelli's insurer refused to defend him on the grounds that there was no coverage due to the intentional acts exclusion and the criminal acts exclusion. Both the trial court and the appellate court concluded that Progressive owed no duty to defend in light of the criminal acts exclusion. The appellate court noted that the plain

language of the criminal acts exclusion did not require intent. Absent such language, Minnesota courts refused to imply an intent requirement to that exclusion. *Id*. at 391; *see also Secura Supreme Ins. Co. v. M.S.M.*, 755 N.W.2d 320, 325 (Minn. Ct. App. 2008); *Liebenstein v. Allstate Ins. Co.*, 517 N.W.2d 73, 75-56 (Minn. Ct. App. 1994).

D. Insurer Not Estopped from Denying Defense Based on Agent's Statements

An agent's representations cannot form the basis for a duty to defend. *See Walker v. State Farm Fire & Cas. Co.*, 569 N.W.2d 542, 545 (Minn. Ct. App. 1997). The insured in *Walker* argued that the insurer was estopped from denying coverage, including its duty to defend, because its agent had allegedly represented that the insured would be fully insured for all liabilities. The court disagreed, stating that the duty to defend is governed by the terms of the insurance policy and not by statements made by an insurance agent. *Id.*

6.4 § COLLATERAL ESTOPPEL

The doctrine of collateral estoppel applies to insurance contracts if the insured gives the insurer notice of the pendency of the action and an opportunity to defend on his behalf. *Senger v. Minn. Lawyers Mut. Ins. Co.*, 415 N.W.2d 364, 368 (Minn. Ct. App. 1987) (citing *Brown v. State Auto. & Cas. Underwriters*, 293 N.W.2d 822, 825 (Minn. 1980)). Where the insurer refuses to defend an action properly tendered to it, the issues necessarily decided in that litigation are conclusively established against the insurer. *Senger*, 415 N.W.2d at 368. Privity in these circumstances exists as a matter of law. *Id.; cf*. *Brown v. State Auto. & Cas. Underwriters*, 293 N.W.2d 822, 825 (Minn. 1980) (holding that where the issue of intent to injure was not a necessary or essential issue in the determination of the insured's liability in the underlying lawsuit, the insurer was entitled to relitigate that issue). *But see Weis v. State Farm Mut. Auto Ins. Co.*, 64 N.W.2d 366 (Minn. 1954) (judgment in underlying lawsuit did not collaterally estop insurer from arguing that insured's act was intentional because judgment was inconsistent with the insured's own admissions that he had deliberately struck other car).

Collateral estoppel has been applied to preclude coverage under the intentional acts exclusion. *See Am. Family Mut. Ins. Co. v. M.B.*, 563 N.W.2d 326, 330 (Minn. Ct. App. 1997). In *American Family*, two models were sexually harassed and assaulted by a photographer employed by a modeling company, an insured under a business owners' general liability insurance policy. A jury ultimately found that the modeling company had acted with deliberate disregard for the safety of the models and awarded $50,000 in punitive damages pursuant to Minnesota Statutes section 549.20, subdivision 1(b).

In the subsequent declaratory judgment action, the trial court concluded that there was no coverage due to the intentional acts exclusion and the jury's finding in the underlying lawsuit. In affirming, the Minnesota Court of Appeals noted a high degree of similarity between the exclusion and Minnesota Statutes section 549.20, subdivision 1:

> The jury found that [the modeling company] knew facts that created a probability of injury to the safety of [the models] and acted either in conscious disregard of or with indifference to the high probability of injury to their safety when it placed them in repeated contact with Palmieri. This language closely resembles that used in the definition of "expected": "knew or should have known that there was a substantial probability that certain consequences will result from his actions."

Id. (citing *Diocese of Winona v. Interstate Fire & Cas. Co.*, 89 F.3d 1386, 1391 (8th Cir. 1996)).

An insured's criminal conviction may not collaterally estop a third-party victim from litigating in a civil action the issue of the insured's intent and coverage under a policy. *Ill. Farmers Ins. Co. v. Reed*, 662 N.W.2d 529 (Minn. 2003). In that case, one-year-old Jordan Peschong was seriously injured while under the care of Janet Reed, who operated a day care service. Reed was subsequently convicted of assault in the first degree and malicious

punishment of a child. At the criminal trial, the state alleged that Reed had shaken Jordan and that the shaking led to his severe, life-threatening injuries.

Following the criminal conviction, Reed's homeowners insurer commenced a declaratory judgment action asserting that there was no coverage because the injuries were intentionally caused by Reed. In concluding that Peschong was not collaterally estopped from relitigating the issue of Reed's intent, the Minnesota Supreme Court first noted that collateral estoppel was only appropriate when the following four elements were met: (1) the issue was identical to one in a prior adjudication; (2) there was a final judgment on the merits; (3) the estopped party was a party or in privity with a party to the prior adjudication; and (4) the estopped party was given a full and fair opportunity to be heard on the adjudicated issue. The court concluded that collateral estoppel did not apply, in part, because Peschong, as the victim of the crime, did not have an opportunity to present his case at the criminal trial. Consequently, Peschong did not have an opportunity to cross-examine Reed or present his own evidence or experts. Further, the court noted that Reed's Fifth Amendment right not to testify in the criminal proceeding and the negative inference that could be drawn from that decision could result in substantially different evidence being offered at the civil trial.

The court also based its decision in part on section 85, comment f of the Restatement (Second) of Judgments, which reads as follows:

> *f. Judgment for prosecution: preclusion against third party.* Under some circumstances the criminal judgment may be preclusive as to issues not only against the defendant in the criminal case but also against those "in privity" with him, as privity is defined in §§ 46, 48, 56(1), and 59-61, or analogous rules. The relationship with the criminal defendant must be sufficiently close that it would be unjust to allow the third party to prevail notwithstanding the judgment for the prosecution.

As the foregoing passage indicates, a third party could be collaterally estopped by a conviction of a defendant if the relationship was sufficiently close. But the court in *Reed* noted that where the relationship between the defendant and third party is that of a perpetrator and victim, collateral estoppel would be inappropriate. In support of its reasoning, the court quoted the illustration following the above-quoted Restatement section reading as follows:

> D inflicts a blow on X as a result of which X dies. D is convicted of intentional homicide. P, administrator of X's estate, brings an action against D for wrongful death, alleging D's act was negligent. I had previously issued a policy of liability insurance to D, insuring liability for D's negligent acts but excluding intentional acts. In P's action against D, P is not precluded by the criminal conviction from showing that D's act was negligent rather than intentional.

RESTATE (SECOND) OF JUDGMENTS § 85 cmt. f, illus. 10 (1982).

6.5 § WHEN CAN OR SHOULD DETERMINATION OF DEFENSE DUTIES BE MADE?

There is no one time during a lawsuit that a decision must be made regarding a duty to defend. Determination of the duty to defend is a fluid process, which can be made as early as when tender is made but later changed depending on the evidence developed during pre-trial discovery or at trial.

A. At Time of Tender or Commencement of Suit

Generally, the duty to defend is determined at the time the insured tenders the defense to the insurer. *Jostens Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 166 (Minn. 1986). As noted previously, an insurer may deny a defense based on the allegations of the complaint against the insured. *See Garvis v. Employers Mut. Cas. Co.*, 497 N.W.2d

254, 256 (Minn. 1993). If, after the denial of a defense, the insurer does not learn of facts outside the complaint that would give rise to a duty to defend, the denial remains valid. *Id.*

Where the only claim that arguably falls within the coverage of a liability policy is dismissed prior to tender of the defense, the insurer's duty to defend is evaluated at the time of the tender. *See Pedro Co. v. Sentry Ins.*, 518 N.W.2d 49, 51 (Minn. Ct. App. 1994).

While *Garvis* and *Pedro* allow for a determination of defense obligations at the time of tender or commencement of a lawsuit, as discussed below, that determination will often be affected by evidence developed after commencement of the suit.

B. After Commencement of Suit but Before Trial

A determination of defense obligations can be made after commencement of a suit and before trial. Evidence developed or uncovered during the discovery stage of a case may serve as the basis for a denial. *See Haarstad v. Graff*, 517 N.W.2d 582, 584-85 (Minn. 1994) (denial of defense supported by insurer's investigation, including statement obtained from insured after commencement of suit); *State Farm Fire & Cas. Co. v. Williams*, 355 N.W.2d 421, 425 (Minn. 1984) (complaint, depositions, and stipulated facts supported denial of defense); *Iowa Kemper Ins. Co. v. Stone*, 269 N.W.2d 885, 886-87 (Minn. 1978) (despite allegations in complaint of negligence, denial of defense support by briefs, depositions and exhibits). Similarly, a duty to defend may be established by evidence developed or uncovered after commencement of a suit. *See SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 316 (Minn. 1995) (letters from insured regarding actions and findings of the MPCA clearly gave insurer sufficient information to conclude that insured had presented a claim for arguable coverage); *Lanoue v. Fireman's Fund Am. Ins. Co.*, 278 N.W.2d 49, 51 (Minn. 1979) (duty to defend existed where insured related the entire story concerning the incident giving rise to the lawsuit to his insurance agent, who relayed it to the insurer); *Crum v. Anchor Cas. Co.*, 119 N.W.2d 703, 712 (Minn. 1963) (insurer obligated to provide defense where insurer learns of facts through investigation or from the insured which conflict with the allegations in the complaint).

Generally, where questions of fact need to be discovered to determine if an insurer has a duty to indemnify, a duty to defend exists. *Westfield Ins. Co. v. Kroiss*, 694 N.W.2d 102, 106 (Minn. Ct. App. 2005) (citing *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979) and *Reins. Ass'n of Minn. v. Timmer*, 641 N.W.2d 302, 311-15 (Minn. Ct. App. 2002)).

C. After Trial

While the insurer's defense obligations will often become clear once pre-trial discovery is completed, the Minnesota Supreme Court has indicated that on occasion, the insurer's obligation to defend will not be clear until after the case is actually tried. *See Crum*, 119 N.W.2d at 711 (stating that whether an insurer is under an obligation to defend may not always be free from doubt until the case is actually tried).

A duty to defend and indemnify may be determined by the Minnesota workers' compensation courts as part of, and after, a determination of an employee's claim for workers' compensation benefits. *See Giersdorf v. A&M Constr., Inc.*, 820 N.W.2d 16 (Minn. 2012) (the workers' compensation courts had subject-matter jurisdiction to hear an employer's petition for a declaration of insurance coverage because the underlying claim in the petition involved insurance coverage, not a breach of contract).

6.6 § NECESSITY OF TENDER

A. No Duty to Defend Until Tender Made

To invoke the duty to defend, the insured must properly tender its defense request to its insurer. *SCSC Corp. v. Allied Mut. Ins. Co.*, 533 N.W.2d 603, 605 (Minn. 1995). A formal tender of a defense is a condition precedent to the recovery of attorneys' fees incurred by the insured. *Id.* at 614; *see also Ross v. Briggs & Morgan*, 540 N.W.2d 843, 847 (Minn. 1995) (stating in dicta that insurer had no obligation to defend until defense was tendered to it); *Pedro Cos. v. Sentry Ins.*, 518 N.W.2d 49, 51 (Minn. Ct. App. 1994) (stating that the tender of a defense is a condition precedent to the duty to defend); *accord Seifert v. Regents of Univ. of Minn.*, 505 N.W.2d 83, 87 (Minn. Ct. App. 1993) (stating a tender of defense is a condition precedent to the creation of an obligation to indemnify). *But see State Farm Mut. v. Cincinnati Ins. Co.*, 666 N.W.2d 334 (Minn. 2003). In *State Farm v. Cincinnati*, both the trial court and the court of appeals held that a tender of defense was a prerequisite to an insurer's duty to defend its insured. The insurer had refused to participate in inner-company arbitration regarding property damage from a motor vehicle accident, as its insured had instructed it not to defend or indemnify. The Minnesota Supreme Court reversed, concluding that the insurer was required by the Minnesota No-Fault Act to participate in inner-company arbitration. *Id*. at 337.

In *SCSC*, the insured was notified of possible groundwater contamination by a letter from the MPCA dated October 26, 1988. However, the insured did not inform its CGL insurer of the MPCA's actions until October 6, 1989, when it formally requested in a letter that the insurer indemnify it for all costs associated with the investigation, defense and resolution of the claims by the MPCA. Although the Minnesota Supreme Court held that the insured was entitled to a defense, it concluded that the insured had not invoked the duty to defend until it properly tendered the defense in the October 6, 1989 letter. Consequently, the court reversed that portion of the award of attorneys' fees incurred prior to the October 6, 1989 letter. 533 N.W.2d at 615.

An insured may not recover defense costs incurred prior to a formal tender, even where extraordinary efforts are required to uncover insurance records dating back many years. *See Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 739 (Minn. 1997). In *Domtar*, the MPCA sent notice to Domtar of its potential liability on November 28, 1990. Domtar spent several months searching its insurance records and did not tender its defense request until July 2, 1991. Initially, the Minnesota Court of Appeals allowed Domtar to recover pre-tender costs, noting that the insured's operations dated back to 1924 and that it required "extraordinary efforts" to determine insurance coverage dating back that far. *Domtar, Inc. v. Niagara Fire Ins. Co.*, 552 N.W.2d 738 (Minn. Ct. App. 1996). The Minnesota Supreme Court, however, reversed. In doing so, it noted that there might be circumstances justifying a departure from the general rule requiring a formal tender. But the Minnesota Supreme Court concluded that there were no such compelling circumstances in the case before it. *Domtar*, 563 N.W.2d at 739.

The requirement of a formal tender has been enforced even where the underlying lawsuit has proceeded at a "quick pace." *See Cellex Biosciences v. St. Paul Fire*, 537 N.W.2d 621, 624 (Minn. Ct. App. 1995). In the underlying lawsuit in *Cellex*, the plaintiff sought to prevent the insured from using a similar corporate name. The lawsuit was commenced on June 24, 1993. The next day, a federal magistrate conducted an emergency hearing. Three days after commencement of the lawsuit, the plaintiff brought a motion for a preliminary injunction. The following month, the motion for the preliminary injunction was denied. The insured then notified its insurer of the lawsuit on August 25, 1993.

Because of the quick pace of the litigation that followed commencement of the lawsuit, the insured urged the court to carve out an exception to the general rule requiring formal tender of a defense. Although the court acknowledged that the quick and successful response of the insured's attorneys to the motion for a preliminary injunction undoubtedly contributed significantly to the ultimate resolution of the underlying lawsuit, it concluded that the quick pace of the litigation did not absolve the insured from tendering its defense. The court based its ruling on the language found in the syllabus in *SCSC*. Although the *SCSC* opinion stated that "generally" a formal tender was necessary, the *Cellex* court emphasized that the syllabus to that opinion was unequivocal in its requirement of a tender. Specifically, paragraph 4 of the syllabus in *SCSC* stated that an insured "must" properly tender its defense as a condition precedent to invoking the duty to defend.

PRACTICE TIP

In light of the tender rule in *SCSC*, an insured would be well-advised to determine as early as possible all available liability policies and tender the defense to all insurers issuing those policies, even those with policies that do not by their terms appear to apply to the claims. If the insured fails to do so, and facts later surface that arguably bring a claim within the coverage of a policy, the insured may be barred from recovering attorneys' fees due to failure to tender the defense.

B. What Constitutes Proper Tender?

In *Home Insurance v. National Union Fire*, 658 N.W.2d 522 (Minn. 2003), the Minnesota Supreme Court addressed what constitutes a legal tender of defense. The insured in that case, Cargill, was served with a complaint in May 1993. In July 1993 it forwarded to one of its insurers, National Union, a copy of the complaint. National Union had issued an excess policy, as well as gap-filling coverage for certain occurrences not covered by the primary insurer. In addition to forwarding the complaint, Cargill placed National Union "on notice of potential excess exposure." 658 N.W.2d at 526.

After Cargill successfully defended itself, it sought to recover defense costs from its insurers, including National Union. National Union denied it owed any defense costs because Cargill never gave a formal tender of defense. The trial court agreed, concluding that Cargill was required to make an express request for a defense. The Minnesota Court of Appeals reversed, concluding that Cargill's notice of the lawsuit to National Union with an opportunity to defend was sufficient. The Minnesota Supreme Court agreed. The court noted three broad reasons for its decision: first, it clarifies the duties of the parties early in the litigation; second, it acknowledges the greater knowledge and sophistication of the insurer; and third, it places no significant burden on insurers. In reaching its decision, the court emphasized that when an insured pays for an insurer's promise to defend covered claims, the insured's ignorance regarding the technical language necessary to invoke a defense should not negate the bargain. Once notice of a lawsuit is given, even without an express request for a defense, it should be the responsibility of the insurer to contact the insured to determine whether the insurer's assistance in the suit is required. *Home Ins.*, *supra*; *cf. Owatonna Clinic v. The Med. Protective Co.*, Civ. No. 08-417, 2009 WL 2215002 (D. Minn. July 22, 2009) (determining that the Minnesota Supreme Court would adopt a substantial compliance standard for the notice requirement in a claims-made insurance policy); *St. Paul Fire v. Metro. Urology*, 537 N.W.2d 297, 300 (Minn. Ct. App. 1995) (where an insured under a claims-made policy gives a partial or defective notice that gives the insurer sufficient information to conclude that there may be a covered claim, the insurer has a duty to investigate the claim).

Where an insurance policy requires that the insured notify the insurer of a lawsuit, the mention of a lawsuit to an insurance agent does not constitute proper tender of the defense. *Hooper v. Zurich Am. Ins. Co.*, 552 N.W.2d 31, 36 (Minn. Ct. App. 1996). In *Hooper*, the insured was sued in both state court and federal court. The CGL insurers were not notified of the lawsuits until after judgment was entered against the insured in the federal action, and the state action was resolved with a settlement unfavorable to the insured. Nevertheless, the insured argued that he had tendered his defense when he mentioned the lawsuits in a conversation with his insurance agent. According to the insured, he had pointed to a pile of papers on his desk at a meeting when he allegedly told his agent about the lawsuits.

Although the CGL policies in *Hooper* provided that the insured could give notice of an occurrence to either the company or any authorized agent, the court noted that the policies required notice to the insurance company in the event of a lawsuit. The court therefore held that the insured did not have the option of tendering defense by mentioning the lawsuit to the insured's insurance agent. *Id*. The court also held that where defense of a lawsuit is not tendered until after entry of judgment, the insurer is prejudiced as a matter of law. *Id.* at 32, 37.

6.7 § SCOPE OF DUTY TO DEFEND

A. What Constitutes "Suit"?

As previously noted, liability policies typically provide that the insurer will defend any "suit." In the current ISO commercial general liability policy, "suit" is defined as follows:

> STANDARD POLICY LANGUAGE
>
> **DEFINITION OF "SUIT"**
>
> "Suit" means a civil proceeding in which damage because of "bodily injury," "property damage," "personal injury" or "advertising injury" to which this insurance applies are alleged. "Suit" includes:
>
> a. An arbitration proceeding in which such damages are claimed and to which you must submit or do submit with our consent; or
>
> b. Any other alternative dispute resolution proceeding in which such damages are claimed and to which you submit with our consent.

While in most cases, there will be little doubt whether or not a suit has been commenced, that issue was litigated in a case involving groundwater contamination. *See SCSC Corp. v. Allied Mut. Ins. Co.*, 533 N.W.2d 603 (Minn. 1995). There, the CGL insurer argued that a request for information (RFI) issued by the MPCA did not constitute a suit. The insurer characterized the RFI as a "claim" that did not invoke the duty to defend because it did not carry the threatening, coercive tone of a lawsuit. Stating that the issue was one of first impression for Minnesota courts, the Minnesota Supreme Court disagreed. In ruling that suit included action taken by the MPCA in the form of an RFI, the court cited with approval *Aetna Casualty & Surety Co. v. Pintlar Corp.*, 948 F.2d 1507 (9th Cir. 1991), which held that a potential responsible party letter issued by the Environmental Protection Agency constituted a "suit" because an ordinary person would perceive such a letter as notice of the effective commencement of a suit necessitating a legal defense. *SCSC*, 533 N.W.2d at 613. *See also Land O' Lakes, Inc. v. Employers Ins. Co. of Wausau*, 728 F.3d 822 (8th Cir. 2013). In *Land O' Lakes,* the court held that a potentially-responsible-party letter from the EPA to the insured constituted a suit that triggered the insurer's duty to defend, which the insurer breached. *Id.* at 828–29 But since the insured failed to commence suit for the breach of the duty to defend within six years of the breach, the claim was barred by the statute of limitations. *Id*. at 829.

B. What Constitutes "Seeking Damages"?

1. Damages Not Sought

The typical liability policy requires a defense for suits seeking damages because of bodily injury or property damage. Thus, where a suit does not seek damages for bodily injury or property damage, but instead seeks to compel initiation of condemnation proceedings, a duty to defend does not exist. *See City of Thief River Falls v. United Fire & Cas. Co.*, 336 N.W.2d 274, 276 (Minn. 1983). *But cf. Indep. Sch. Dist. v. St. Paul Fire & Marine Ins. Co.*, 515 N.W.2d 576, 580-81 (Minn. 1994) (holding that insurer had duty to defend lawsuit by former principal and teacher for reinstatement even though no money damages were sought because of the policy's unusually broad coverage language, which did not limit recovery to suits "seeking damages").

In *Thief River Falls*, a grocery store petitioned for a writ of mandamus compelling the city to initiate proceedings to condemn the property's easement of ingress and egress. After the city's insurer rejected the tender of defense, the city prevailed in the suit by the store owners. The city then commenced an action to recover its attorneys' fees, costs and disbursements. In ruling that a defense was not due, the Minnesota Supreme Court acknowledged that the store owners could have subjected the city to a suit for damages. However, the court concluded that the possible lawsuit for damages was irrelevant because the store owners had elected to proceed by mandamus rather than at law for damages.

Like a lawsuit seeking a writ of mandamus to compel condemnation proceedings, a lawsuit seeking only declaratory relief does not constitute a suit for damages. *See Kroschel v. City of Afton*, 524 N.W.2d 719, 721 (Minn. 1994). In *Kroschel*, the mayor and two city council members were sued under the open meeting law. The plaintiffs in the underlying lawsuit sought imposition of a $100 "civil penalty" as well as declaratory relief in the form of a determination that: (1) the officials were ineligible to sit on the city council; (2) the officials violated the Uniform Municipal Contracting Law; and (3) the mayor entered into the well drilling contract without authority from the city council. In ruling that there was no duty to defend, the Minnesota Supreme Court emphasized the language in the covenants of the self-insured program at issue. Specifically, the court noted that the duty to defend existed only for suits seeking damages. "Damages" was defined as money damages, which included attorneys' fees with respect to federal civil rights suits and state human rights suits. A covenant in the self-insured program specifically excluded from the definition of "damages" any fines or penalties imposed by law. The court concluded that because the underlying lawsuit sought only declaratory relief and the imposition of a $100 "civil penalty," it was not a "suit" seeking "damages" and was therefore not a covered claim. *Id*.

2. Damages Sought

Expenditures mandated by the MPCA necessary to clean up contamination that has occurred to the state's water resources are "damages because of property damage." *See Minn. Mining & Mfg. Co. v. Travelers Indem. Co.*, 457 N.W.2d 175, 184 (Minn. 1990). In *Minnesota Mining*, the insurers argued that the consent orders and the requests for response action issued by the MPCA, which required the insured to clean up contaminated sites, were akin to injunctive orders. Further, the insurers asserted that their coverage would only apply where the MPCA sought compensation for the monetary value of any permanent damage to the natural resources. The Minnesota Supreme Court disagreed and held that the mandated expenditures constituted damages because of property damage. In so ruling, the court distinguished the facts before it with those in *Thief River Falls*. The court noted that unlike in *Thief River Falls*, property damage had occurred in *Minnesota Mining* that gave rise to claims against the insureds for reimbursement and payment necessary to restore the property to its pre-polluted condition. *Id.* at 179. The state constituted the injured third party asserting claims against the insureds for the damage to the groundwater. *Id.* at 182.

In ruling against the insurers, the court concluded that the policy language, "damages because of … property damage," was ambiguous with regard to the costs of the MPCA-mandated cleanup. The court was quick to note, however, that it was not "opening the door" to insurance coverage of other government-mandated business expenses such as the cost of complying with Occupational Safety and Health Administration safety regulations or orders of a fire marshal. The court noted that these types of costs would not be covered because such cases would not involve property damage. *Id.* at 184.

C. Insurer May Refuse Defense Until Commencement of Litigation

Even where a claim asserted against an insured is covered under a policy, the insurer may refuse to provide a defense until suit is commenced. *See S.G. v. St. Paul Fire & Marine Ins. Co.*, 460 N.W.2d 639, 642-43 (Minn. Ct. App. 1990). In *S.G.*, the insured was accused of negligently transmitting genital herpes. Although the insurer indicated that coverage might be denied under an intentional acts exclusion, it nevertheless agreed to provide a defense "if and when a complaint is made." *Id*. at 641. Before suit was commenced, the insured settled with the plaintiffs and thereafter sought reimbursement of both his attorneys' fees and the settlement amount. Although the court held that the claims were covered, it ruled that the insurer had no contractual duty to assume the defense before litigation was commenced. *Id.* at 643. In so ruling, the court noted that parties to an insurance policy could agree to a duty to defend before commencement of a suit. But it concluded that the language in the policy in question only required the insurer to settle pre-litigation claims if it felt such action was "proper and wise."

D. Insurer May Withdraw Defense Once All Arguably Covered Claims Have Been Resolved with Finality

It has been widely acknowledged in other jurisdictions that an insurer may withdraw its defense when claims against the insured have been narrowed so that none fall within the terms of coverage. *See* BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES 161-62 (8th ed. 1995). Similar to other jurisdictions, Minnesota courts have indicated that an insurer may withdraw a defense after claims have been narrowed so that none fall within the terms of coverage. *See Grain Dealers Mut. Ins. Co. v. Cady*, 318 N.W.2d 247, 251 (Minn. 1982) (insurer would be relieved from proceeding further with the insured's defense if the court determined that joint venture exclusion applied); *Iowa Kemper Ins. Co. v. Stone*, 269 N.W.2d 885, 887-88 (Minn. 1978) (allegations of negligence in a personal injury complaint can impose no continuing obligation where coverage has been declared excluded in a separate judicial proceeding); *Franklin v. W. Nat'l Mut. Ins. Co.*, 558 N.W.2d 277, 280 (Minn. Ct. App. 1997) (duty to defend lasts until proceedings reach a stage where it is clear that no element of the subject matter of the suit is within the scope of the policy).

In *Meadowbrook, Inc. v. Tower Insurance Co.*, 559 N.W.2d 411 (Minn. 1997), the Minnesota Supreme Court provided guidelines as to when an insurer can withdraw a defense. Specifically, the court held that an insurer who undertakes an insured's defense under a reservation of rights can withdraw its defense once all arguably covered claims have been dismissed with "finality." 559 N.W.2d at 416. The court further held that the insurer could not withdraw from a defense until there was no further right to appeal any claims that were arguably covered under the insurer's policy. *Id.* at 417.

In *Meadowbrook*, suit was commenced against the insured alleging various claims, including sexual harassment, various discrimination claims, and defamation. Because the defamation claims were arguably covered under the general business liability policy held by the insured, the insurer assumed the defense of the entire claim under a reservation of rights. In 1992, the trial court in the underlying lawsuit dismissed the defamation claims. The insurer then withdrew its defense of the entire action, after which the insurer brought a declaratory judgment action.

In the declaratory judgment action, the trial court denied the insurer's motion for summary judgment on the grounds that the dismissal of the defamation claims was not final under Minnesota Rule of Civil Procedure 54.02. Thereafter, the insurer settled the defamation claims (and some of the other claims) with the plaintiffs in the underlying lawsuit in 1993.

After noting that an insurer's duty to defend is not an interminable one, the Minnesota Supreme Court ruled that the insurer was entitled to withdraw its defense once the defamation claims were settled in 1993. But the court rejected the insurer's argument that it was entitled to withdraw its defense earlier when the defamation claims were dismissed in 1992. In rejecting the insurer's argument, the court stated that the duty to defend extends through the appellate process. *Id.* at 416. Only after all claims arguably within a policy's coverage were concluded as a matter of law could the insurer withdraw its defense. Thus, the insurer was not entitled to withdraw its defense until the right to appeal the claims arguably covered under the policy had been completely extinguished.

Although the insured argued that the insurer should not be allowed to unilaterally settle only the arguably covered claims, the court disagreed, stating:

> Meadowbrook contends that the insurer in the instant case operated against the insured's best interest by negotiating a settlement of the arguably covered claims "behind the back" of the insured. But such an argument is without merit. Even though the insurer agreed to defend the entire claim against the insured, its duty extended only to those claims arguably covered by the policy. Once the insurer settled and paid those claims, it had completely performed its contractual duty. The insured assumes he had a right to force the insurer to defend claims not arguably covered by the policy, but he did not. Regardless of the insurer's motivation in settling the defamation claims, the fact remains that the insurer's action relieved the insured of any liability resulting from those arguably covered claims.

Id. at 417.

For a settlement to extinguish the duty to defend, the insured must actually agree to the settlement. *See Gen. Cas. Co. v. Four Seasons Greetings*, Nos. A04-518, A04-920, 2004 WL 2987796 (Minn. Ct. App. Dec. 28, 2004) (unpublished opinion).

PRACTICE TIP

In light of *Meadowbrook*, dismissal of all covered claims will have limited benefit to an insurer seeking to withdraw its defense. If a final judgment is not entered pursuant to Minnesota Rule of Civil Procedure 54.02, the period in which to appeal the dismissal will not begin to run until the conclusion of the case at the trial level. Even if a final judgment is entered, there is a real possibility the underlying lawsuit will be concluded before the appeal of the judgment of dismissal is resolved, as an appeal before the Minnesota Court of Appeals will typically take a year to complete due to the time allowed for the various stages of an appeal.

In light of the foregoing, the only effective way of withdrawing a defense is by settling the covered claims with the plaintiff in the underlying lawsuit. Although *Meadowbrook* allows for the piecemeal settlement of covered claims, negotiations regarding covered claims should be initiated and handled by the insurer's claims representative as opposed to the insurer-appointed defense counsel. The claims representative's involvement is necessitated by the conflict of interest that arises in the context of *Meadowbrook* and the ethical obligations of the insurer-appointed defense counsel. Obviously, in a case involving covered and non-covered claims, the insured typically would not want the covered claims settled, while the insurer would want them settled in order to withdraw its defense. In previous decisions, the Minnesota Supreme Court has emphasized that an insurer-appointed defense counsel owes its allegiance to the insured. *See Miller v. Shugart*, 316 N.W.2d 729, 733 (Minn. 1982) (attorneys hired by the insurer to represent the insured owe their allegiance to the insured); *Newcomb v. Meiss*, 116 N.W.2d 593, 598 (Minn. 1962) (counsel who undertakes to represent a policyholder owes to the policyholder the same "undeviating and single allegiance" that counsel would owe to the client if retained and paid by the insured rather than the insurer).

In light of the conflicting interests of the insured and insurer, and the ethical obligations noted above, negotiations regarding covered claims would best be avoided by the insurer-appointed defense counsel.

E. Duty to Appeal

As noted *supra* in the previous section, the duty to defend extends through the appellate process. *Meadowbrook*, 559 N.W.2d at 416. Thus, even when all covered claims are dismissed, an insurer must continue to defend the remaining non-covered claims until there is no further right to appeal the dismissal of the covered claims, or until the covered claims are settled.

The circumstances in *Meadowbrook* are relatively novel. There, the insured in the underlying lawsuit "succeeded" in obtaining dismissal of the covered claims. In essence, the insurer in *Meadowbrook* had a duty during the appellate process to defend any appeal that the plaintiff in the underlying lawsuit might pursue regarding the covered claims. More frequently, the issue of the insurer's duty to appeal arises in cases where covered claims are not dismissed. The question then is whether the insurer must pursue an appeal of a judgment against the insured based on covered claims. As suggested by *Meadowbrook*, and as recognized by most courts, an insurer has a duty to appeal a judgment against the insured where there are reasonable grounds for appeal. *See* OSTRAGER & NEWMAN, *supra*, at 164.

An issue that remains in the aftermath of *Meadowbrook* is the extent of an insurer's duty to appeal where a judgment is entered only on non-covered claims. Must the insurer pursue an appeal of the judgment based on the non-covered claims? If the plaintiff in the underlying lawsuit appealed any covered claims decided adversely to him or her, the insurer would presumably have a duty to defend the appeal in light of *Meadowbrook*. But under that

scenario, would the insurer have a concurrent duty to pursue an appeal of the judgment on the non-covered claims? Or could the insurer insist that the insured's personal counsel handle the appeal of the non-covered claims? Although *Meadowbrook* did not directly address this issue, a court in another jurisdiction has suggested that there would be no duty on the part of the insurer to pursue such an appeal. *See Crist v. Ins. Co. of N. Am.*, 529 F. Supp. 601, 606 (D. Utah 1982) (an insurer has no obligation to appeal from an adverse ruling against its insured on a claim which is not covered).

Another scenario *Meadowbrook* did not address is the case where judgment is entered on both covered and non-covered claims. Assume hypothetically that a judgment was entered for $5,000 on a covered claim and $50,000 on a non-covered claim. What would be the insurer's obligations under those circumstances? If the plaintiff was willing to accept the $5,000 amount for the covered claim, the insurer would presumably have no further duty to appeal under *Meadowbrook*. As the court in *Meadowbrook* noted, once the insurer paid the covered claims (through settlement) it had completely performed its contractual duties and owed no further duty to defend. Presumably the same result would follow if the plaintiff chose not to appeal the judgment in the foregoing hypothetical. Under that scenario, payment of the $5,000 judgment based on the covered claims, like settlement of the covered claims before judgment, would conclude the insurer's duty to defend. What if the plaintiff was unwilling to accept $5,000 as payment of the judgment for the covered claims, and instead chose to appeal the amount recovered for the covered claim? Again, in light of *Meadowbrook*, the insurer would most likely have a duty to defend the appeal. But a question remains whether that insurer would owe a concurrent duty to pursue an appeal of the judgment based on the non-covered claims.

6.8 § DUTY TO DEFEND IS BROADER THAN THE DUTY TO INDEMNIFY

A. Duty to Defend Exists if Any Part of a Cause of Action Arguably Falls Within the Scope of Coverage

One of the most frequently stated rules is that an insurer will owe a duty to defend if any part of the cause of action against the insured in the underlying lawsuit arguably falls within the scope of coverage. *See, e.g., Auto-Owners Ins. Co. v. Todd*, 547 N.W.2d 696 (Minn. 1996); *Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 165-66 (Minn. 1986); *City of Thief River Falls v. United Fire & Cas. Co.*, 336 N.W.2d 274, 275 (Minn. 1983); *Johnson v. AID Ins. Co.*, 287 N.W.2d 663, 665 (Minn. 1980). Thus, if the insurer cannot prove that *all* claims against the insured fall outside the scope of coverage, it must provide a defense. *Auto-Owners*, *supra*, at 698; *Jostens*, *supra*, at 165-66; *AMCO Ins. Co. v. Inspired Techs., Inc.*, 648 F.3d 875, 882–83 (8th Cir. 2011).

The duty to defend is broader than the duty to indemnify in three ways: (1) the duty to defend extends to every claim that arguably falls within the scope of coverage; (2) the duty to defend one claim creates a duty to defend all claims; and (3) the duty to defend exists regardless of the merits of the underlying claims. *Wooddale Builders, Inc. v. Md. Cas. Co.*, 722 N.W.2d 283, 302 (Minn. 2006) (citing *Meadowbrook, Inc. v. Tower Ins. Co.*, 559 N.W.2d 411, 415-19 (Minn. 1997)).

While an insurer may be forced to defend all claims, including those that clearly fall outside coverage, it can avoid an obligation to indemnify the insured for the non-covered claims via a reservation of rights letter. *See supra* chapter 2.

B. Duty to Defend May Exist Even if It is Ultimately Determined There is No Duty to Indemnify

An insurer will owe a duty to defend if any part of a cause of action arguably falls within the scope of coverage, even if it is ultimately determined there is no duty to indemnify. *See Econ. Fire & Cas. Co. v. Iverson*, 445 N.W.2d 824, 827 (Minn. 1989). In *Economy Fire*, the court held that the insurer was liable for defense costs incurred prior to settlement of a tort action where the plaintiff alleged both negligence and intentional assault. The court held that the insurer owed a duty to defend even though a jury in a declaratory judgment action found that the insured lawfully assaulted the plaintiff in self-defense. Although the jury's verdict relieved the insurer of a duty to indemnify, it did not

relieve the insurer of a duty to defend. *Id.; see also St. Paul Fire & Marine Ins. Co. v. Nat'l Computer Sys., Inc.*, 490 N.W.2d 626, 632 (Minn. Ct. App. 1992) (stating that even a subsequent determination that the insured's conduct was excluded by the policy will not extinguish duty to defend if any allegations in the complaint were arguably within the scope of coverage). *But see Knapp v. Commonwealth Land Title Ins. Co.*, 932 F. Supp. 1169 (D. Minn. 1996) (insurer that had paid insured's attorneys' fees in a land title dispute after issuing a reservation of rights letter was entitled to reimbursement of those fees once the insurer was legally freed of any coverage duty).

C. Duty to Defend After Tender of Policy Limits

Since 1966, the ISO standard CGL policy has stated, "The Company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the Company's liability has been exhausted by the payment of judgments or settlements."

The majority view is that an insurer cannot tender its policy limits and thereby discharge its defense obligations, unless the policy expressly authorizes tender. *See* OSTRAGER & NEWMAN, *supra*, at 167. Any settlement for the policy limits that does not include a complete release of the insured for pending claims will ordinarily not terminate the insurer's defense obligations. *See id.* at 170.

6.9 § RIGHT TO SELECT COUNSEL AND CONTROL LITIGATION

A. Insurer's Right to Select Counsel

An insurer may select counsel unless an actual conflict of interest exists. *See Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365, 368 (Minn. Ct. App. 1991). The appearance of a conflict of interest is insufficient to allow an insured to select counsel. *Id.* In *Luetmer*, the insured was first sued for conspiring to deprive the plaintiff of ownership interest in hauling routes. After the insured denied coverage on the ground that there was no bodily injury or property damage, the first lawsuit was dismissed for failure to state a claim. Before dismissal of the first lawsuit, the plaintiff commenced a slander action against the insured. Defense of this action was tendered and accepted by the insurer under a reservation of rights. In addition to retaining an attorney to represent the insured in the slander action, the insurer retained another attorney to commence a declaratory judgment action.

Eventually, a dispute arose between the insurer and the insured as to who could select defense counsel in the slander action. After the trial court ordered the insurer to reimburse the insured for legal fees of its personal counsel, the insurer appealed. In reversing, the Minnesota Court of Appeals concluded that before an insured could select defense counsel, there would have to be an actual conflict of interest, as opposed to an appearance of a conflict of interest. The appellate court went on to state the following:

> We believe the trial court erred in finding a conflict of interest on the facts of this case: [insurer-selected defense counsel's] prior representation of MSI in a declaratory judgment action, MSI's intended involvement in the litigation of the main action and MSI's insistence on selecting defense counsel. A finding of conflict of interest must rest on more substantial evidence, such as actions which demonstrate a greater concern for MSI's interests than respondents' interests.

Id. at 369. In reaching its decision, the appellate court declined to follow the *Cumis* decision in California, which allows the insured to select defense counsel on the premise that any attorney selected by the insurer could not avoid favoring the insurer. *See San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*, 208 Cal. Rptr. 494 (Cal. Ct. App. 1984).

The court in *Luetmer* also cited *Prahm v. Rupp Construction Co.*, 277 N.W.2d 389 (Minn. 1979). In *Prahm*, unlike *Luetmer*, there was no declaratory judgment action. Instead, the insurer, after denying the insured's tendered defense, was impleaded as a third-party defendant in the underlying lawsuit.

In requiring the insurer to reimburse the insured for reasonable attorneys' fees, the court in *Prahm* noted the conflict faced by the insurer as a third-party defendant, stating, "We recognize that requiring Great American to defend the suit against Rupp creates a conflict of interest for Great American because it would be required to take opposing positions at trial to defend Rupp against plaintiffs' claim and, at the same time, to defend itself on the coverage question." 277 N.W.2d at 391. The *Prahm* court also noted, however, that no such conflict would occur if the insured (or presumably the insurer) had brought a declaratory judgment action prior to the trial. *Id.* at n. 2; *see also Miller v. Shugart*, 316 N.W.2d 729, 733 (Minn. 1982) (insurer that had assigned defense counsel for the insured and retained another attorney for a declaratory judgment action had not breached its duty to defend).

B. Insurer's Right to Control Litigation

Most liability policies contain a clause that prohibits the insured from voluntarily assuming any liability, settling any claims, incurring any expenses, or negotiating any settlement without the insurer's consent. As one commentator has noted:

> Clauses are usually found in policies of liability insurance giving the insurer the right to make such investigation, negotiation, and settlement of any claim or suit as it deems expedient. Such policies usually also contain a clause which prohibits the insured from voluntarily assuming any liability, settling any claims, incurring any expense, or interfering in any legal proceedings or negotiations for settlement, unless with the consent of the insurer. The settlement clause gives the insurer the exclusive right to make any settlement of a claim for which it is liable. By virtue of this provision, the insured may not negotiate and effect a settlement on his own initiative, and if the conduct of the insured is clearly in violation of the clause under discussion, the insurer is relieved of all liability for the claim.

14 COUCH ON INSURANCE) 51.22 §2d ed. 1982).

An insurer's right to control litigation includes its right to bring appropriate motions, including a motion to vacate a default judgment on behalf of the insured, even where there is no showing that the insured agreed to or supported the motion. *See Bryan v. Anfield*, No. C8-98-1206, 1998 WL 912142 (Minn. Ct. App. Jan. 5, 1999) (unpublished opinion).

Generally, liability policies contain language reserving for the insurer the right to control litigation. But where such language is omitted or modified, the insured may have a right to settle a claim over the objection of an insurer. *See Zurich Reins. Ltd. v. Canadian Pac. Ltd.*, 613 N.W.2d 760 (Minn. Ct. App. 2000). In *Zurich*, a 16-year-old was horribly burned and disfigured in an explosion outside his home when a train derailed. It was determined that the failure of Canadian Pacific to properly maintain the track led to the accident. Canadian Pacific was self-insured for the first $7,274,000 of liability. Zurich provided part of the next $10,911,000 of excess coverage. The insurance policies in question gave Zurich the right to "associate with [Canadian Pacific] in the defense and control of any claim," to have access to records, and to be kept informed. 613 N.W.2d at 762. Zurich and Canadian Pacific were required to cooperate in the defense of any claims. The policies did not have a clause requiring Zurich's consent before Canadian Pacific could settle the claim.

Several people who evaluated the claim for Canadian Pacific estimated possible jury verdict for compensatory damages ranging from $15,000,000 to $27,000,000. During a day-long mediation conducted by a U.S. magistrate judge, the case was settled for $24,000,000.

Following the settlement, Zurich sought a declaratory judgment that the settlement was unreasonable, improper, and not binding on it. Zurich argued, among other things, that Canadian Pacific acted in bad faith in settling the lawsuit despite Zurich's rejection of the settlement terms. In rejecting the argument, the court emphasized that the insurance contract lacked a consent clause. The court went on to state that "without a clause requiring consent, agreeing to a settlement despite an insurer's opposition does not amount to bad faith in the absence of evidence of intent to defraud or collude." *Id*. at 765 (citing *St. Paul Fire & Marine Ins. Co. v. Perl*, 415 N.W.2d 663, 667 (Minn. 1987)).

In most policies, the insurer also has a duty to exercise good faith when considering settlement offers. *See supra* chapter 4. Thus, Minnesota courts have stated that an insurer's right to control settlement negotiations is subordinated to the purpose of the insurance contract – to defend and indemnify the insured. *Short v. Dairyland Ins. Co.*, 334 N.W.2d 384, 387 (Minn. 1983). The duty of good faith is breached when the insured is clearly liable and the insurer's refusal to settle within the policy limits is not based upon reasonable grounds to believe that the amount demanded is excessive. *See Kissoondath v. U.S. Fire Ins. Co.*, 620 N.W.2d 909, 916 (Minn. Ct. App. 2001).

In 2009, the Minnesota Court of Appeals analyzed whether an insurer-appointed defense counsel could defend an insured when that attorney could not locate the insured. *See Hornberger v. Wendel*, 764 N.W.2d 371 (Minn. Ct. App. 2009). In *Hornberger*, the plaintiff could not find and serve defendant Corey Seymour, and therefore served Seymour by publication. Thereafter, Seymour's insurer, Progressive, appointed William Strifert to defend him. Although Mr. Strifert never made contact with Seymour, he served an answer on his behalf and eventually moved to dismiss the lawsuit on the grounds of insufficient service of process and lack of jurisdiction. At the motion hearing, the trial court concluded that Seymour had been served by publication and that Strifert did not have authority to act on behalf of Seymour because: (1) no attorney-client relationship had been created; and (2) Strifert had not made contact with Seymour, and therefore, he had not obtained from Seymour his informed consent to represent both Progressive and Seymour. *Id*. at 374. The trial court further ordered Strifert to pay attorneys' fees and costs as a sanction for his unauthorized representation of Seymour. *Id*. Thereafter, when Seymour failed to appear for a subsequently noted deposition, the trial court ordered Seymour's answer stricken and entered judgment by default.

On appeal, the Minnesota Court of Appeals reversed, concluding that the attorney-client relationship between an insurer-appointed defense counsel and the insured was not nullified because counsel had not contacted the insured regarding the defense of the claim. *Id*. at 373. In reaching its decision, the court of appeals noted, "[O]nce an insurer received notice of a suit, it is responsible for defending the insured unless the insured explicitly refuses the insurer an opportunity to defend." *Id*. at 376 (quoting *Home Ins. Co. v. Nat'l Union Fire Ins. of Pittsburgh*, 658 N.W.2d 522, 533 (Minn. 2003)). The court of appeals further noted that in Minnesota, the well-established rule was that the insurer-appointed defense counsel represents the insured and owes his or her duty of undivided loyalty to the insured. *Id*. (citing *Pine Island Farmers Coop. v. Erstad & Riemer, P.A.*, 649 N.W.2d 444, 449 (Minn. 2002)).

C. Effect of Insured Settling Claim Before Notice

As one would expect, an insurer's right to control litigation encompasses not only the right to defend but also the right to settle. An insured who defends itself before notice to the insurer will lose the right to reimbursement of those defense costs. *See Cellex Biosciences v. St. Paul Fire*, 537 N.W.2d 621, 623 (Minn. Ct. App. 1995). An insured who goes a step further and settles a claim before notice runs even a greater risk. In addition to losing the right to reimbursement of defense costs, an insured who settles a claim before notice to its insurer will absolve its insurer of both the duty to defend and the duty to indemnify. *See Ross v. Briggs & Morgan*, 540 N.W.2d 843, 847 (Minn. 1995); *accord Hooper v. Zurich Am. Ins. Co.*, 552 N.W.2d 31 (Minn. Ct. App. 1996) (where two lawsuits are resolved before notice and tender to insurer, one by judgment and the other by settlement unfavorable to insured, there is no duty to defend or indemnify). The insurer's duty to indemnify will be extinguished, even if the claim was within the coverage of the liability policy. *Ross*, 540 N.W.2d at 847.

In *Ross*, a physician settled claims brought by his former professional association. The claims were based on the physician's actions in establishing his own practice after termination of the relationship with the association. Following the settlement, the physician brought a legal malpractice action against his law firm, based on the law firm's failure to tender defense of the claims to the physician's insurer. The law firm in turn brought a third-party claim against the physician's insurer, asserting that the law firm's liability, if any, would only be based upon a determination that the insurer had a duty to defend and/or indemnify the physician. *Id.* at 846-47.

Both the law firm and the insurer moved for summary judgment. The insurer asserted, among other things, that any obligation it might have owed the physician was extinguished when he breached the policy by settling the claim without first notifying and obtaining the insurer's consent. *Id.* at 847. The insurer's argument was based on language in its policy providing that the insured could not "assume any financial obligation or pay out any money without our consent." *Id.* at 846.

Ultimately, the supreme court held that the law firm's failure to tender the defense did not constitute negligence because the claims in the underlying lawsuit fell outside the enumerated offenses contained in the insurance policy. In so ruling, the supreme court indicated that had it ruled otherwise, the insurer still would not have been a viable third-party defendant due to the physician's pre-notice defense efforts and settlement:

> Furthermore, even if the [professional association's] claim had come within the coverage of the insurance policy, the settlement of that claim and the payment of or assumption of the obligation to pay $40,000 before the Fire & Marine was notified of the existence of the claim and given the opportunity to undertake defense of the claim constituted a breach of the insurance contract by the insured.

Id. at 847 n.4.

D. Insured May Not Settle Claim After Notice Unless Insurer Denies Existence of Any Coverage

While an insured may not settle a claim before giving notice to the insurer of the claim, there are occasions when an insured may settle a claim after such notice. Under the proper circumstances, an insured may settle a claim even when it runs counter to the wishes of its insurer. *See generally Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982). The insurer's right to control litigation and the insured's duty to cooperate will not preclude an insured from settling a claim against the wishes of the insurer where circumstances as those in *Miller* exist. *Id.* at 733-34.

In *Miller*, the insurer provided a defense to the driver of a car sued as a result of a motor vehicle accident. At the same time, the insurer commenced a declaratory judgment action, alleging that the driver was not an agent of the car's owner and therefore not covered under its policy. *Id.* at 732. While an appeal of the declaratory judgment action was pending, the driver and car owner signed a stipulation for settlement in which they confessed judgment for twice the limit of the liability policy. The agreement provided that the plaintiff would collect only from the insurer.

Following the settlement, the insurer argued that the insureds had breached their duty to cooperate. The supreme court disagreed, concluding that because the insurer was contesting coverage, the insureds were entitled to protect themselves from personal liability. *Id.* at 733-34. Furthermore, the supreme court held that the insurer, which was disputing coverage, could not compel the insureds to forego a settlement until after resolution of the declaratory judgment action. *Id.*

The limits of an insured's right to settle over the objection of the insurer were tested in *Buysse v. Baumann-Furrie & Co.*, 448 N.W.2d 865 (Minn. 1989). Unlike the insurer in *Miller*, the insurer in *Buysse* did not contest coverage. Instead, the insurer acknowledged coverage but disputed the limits of liability. Specifically, the insurer contended that the limit of liability was $500,000, while the insured claimed that the limit of liability was $1,000,000. 448 N.W.2d at 866-67.

Despite the fact that the insurer had acknowledged coverage and had even offered to settle for $500,000, the insured entered into a *Miller-Shugart* settlement. The settlement, which was not approved by the insurer, included a request that the trial court issue findings of fact, conclusions of law and entry of judgment to the effect that the insured's negligence had proximately caused the plaintiff's damages in excess of $1,000,000. After entry of judgment, the insured successfully moved for summary judgment that the limit of liability was $1,000,000.

Despite *Miller*, the court in *Buysse* held that the insurer was not bound by its insured's settlement. In so ruling, the court stated the following:

> Only the insurer's denial of the existence of *any* coverage for the claim and the resultant exposure of the insured to liability for the entire amount of any damage award provide a basis for requiring the insurer's right to the insured's cooperation to yield to the insured's need to extricate himself or herself without the insurer's agreement.
>
> * * *
>
> This stipulation for settlement, executed by [the insured] over its insurer's protest, is the coup d'etat by which the insured has wrested control of the lawsuit from the insurer, stripping it of its contractual right to defend and settle the action, and thus violating the insured's covenants.

Id. at 872-73 (emphasis in original); *see also Sargent v. Johnson*, 551 F.2d 221 (8th Cir. 1977) (holding that an insurer that had never denied all liability was not bound by its insured's settlement) (applying Minnesota law).

The court in *Buysse* went on to state that when an insurer acknowledges coverage but is deprived of its contractual right to defend and settle a lawsuit, that deprivation prejudices the insurer and voids the policy coverage. *Id.* at 874. Because the record on appeal was unclear whether the insurer had agreed that its liability limit of $500,000 should remain in force despite the *Miller-Shugart* settlement, the supreme court remanded the case with directions to the trial court to determine that fact issue. The court noted that absent any such agreement, the policy would be void. *Id.* at 874-75. In a subsequent decision, the supreme court determined that the $500,000 liability limit remained available for garnishment. *Buysse v. Baumann-Furrie & Co.*, 481 N.W.2d 27, 30 (Minn. 1992). In concluding that the stipulation of settlement did not jeopardize the $500,000 liability limit, the court emphasized the fact that the insurer's attorney signed the stipulation despite the insurer's objection to it. *Id.* at 29-30.

Following *Buysse*, the Minnesota Court of Appeals addressed the insured's right to settle after a reservation of rights by the insurer. *See S.G. v. St. Paul Fire & Marine Ins. Co.*, 460 N.W.2d 639 (Minn. Ct. App. 1990). The insured in *S.G.* was accused of negligently transmitting genital herpes. The insurer agreed to investigate the claims under a full reservation of rights based on the intentional acts exclusion. The insurer also agreed to provide a defense if and when a complaint was made. Before suit was commenced, the insured settled with the plaintiffs. Although the court held that no duty to defend existed prior to commencement of the lawsuit, it concluded that the insurer owed a duty to indemnify.

After discussing both *Miller* and *Buysse*, the court concluded that the facts before it were more similar to those in *Miller*. In particular, the court noted that the insurer, through its reservation of rights, had indicated that it might deny coverage altogether and had never retracted its position before the settlement. The court emphasized that the insurer had never stated what coverage, if any, it would agree to provide. *Id.* at 643.

Judge Thoreen, who dissented in *S.G.*, felt that the unilateral settlement by the insured should have voided the insurance policy. He noted that the insurer had not denied coverage, but had only issued a reservation of rights, and had agreed to defend if a lawsuit was started. He also concluded that the insurer had been unable to investigate the claims sufficiently to determine liability or evaluate damages due to the insured's failure to cooperate. *Id.* at 646.

PRACTICE TIP

In light of *S.G.*, an insurer issuing a reservation of rights must be careful not to issue a full reservation of rights where some claims clearly fall within the scope of coverage. In that situation, the insurer should be sure to limit the reservation of rights to only those claims it believes are excluded.

An insurer that does not defend an underlying action and commences a declaratory judgment action denying coverage is entitled to raise coverage defenses in the declaratory action. *Parr v. Gonzalez*, 669 N.W.2d 401 (Minn. Ct. App. 2003). But that same insurer is not permitted to raise defenses that go to the merits of the underlying claim in a subsequent garnishment proceeding. *Id*.

6.10 § DAMAGES RECOVERABLE FOR BREACH OF DUTY TO DEFEND

A. Attorneys' Fees Incurred in Underlying Lawsuit

An insured may recover from its insurer attorneys' fees that the insured has incurred defending itself against claims by a third party when the insurer has a contractual duty to defend the insured but has refused to do so. *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 316 (Minn. 1995). An insurer who has wrongfully refused to defend must reimburse not only attorneys' fees but also costs and disbursements incurred by the insured in his defense. *Lanoue v. Fireman's Fund Am. Ins. Co.*, 278 N.W.2d 49, 50 (Minn. 1979). In pollution cases, defense costs include investigation and compliance costs incurred by an insured in an effort to minimize the potential scope and magnitude of its liability for a site, and as such, are not subject to the policy limits as would be the case for indemnity payments. *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 739 (Minn. 1997); *see also Westling Mfg. Co. v. W. Nat'l Mut. Ins. Co.*, 581 N.W.2d 39, 47 (Minn. Ct. App. 1998).

An insured is also entitled to recover prejudgment interest on the attorneys' fees, but interest only begins to accrue after the bills for the fees are submitted to the insurer. *Jostens, Inc. v. CNA Ins.*, 336 N.W.2d 544 (Minn. 1983).

B. Attorneys' Fees Incurred in Declaratory Judgment Action

In addition to recovering attorneys' fees incurred in defending itself, an insured is entitled to recover attorneys' fees incurred in a declaratory judgment action if the insurer has breached its duty to defend. The seminal case regarding liability for attorneys' fees in declaratory judgment actions is *Morrison v. Swenson*, 142 N.W.2d 640 (Minn. 1966). In *Morrison*, the insurer denied that its policy was in force at the time of the accident and therefore refused to defend the insured. The insured successfully brought a declaratory judgment action. The court in *Morrison* concluded that the legal fees incurred in the declaratory judgment action constituted damages arising directly as the result of the insurer's breach of its policy. Therefore, the court ruled that the insured was entitled to recover whatever expenses he had been compelled to incur in asserting his rights, including his attorneys' fees in the declaratory judgment action. 142 N.W.2d at 647.

The Minnesota Supreme Court has declined to expand the rule first enunciated in *Morrison*. In *In re Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405 (Minn. 2003), the insured, 3M, argued that various insurers had breached their contractual duties to reimburse 3M for its defense costs in the underlying lawsuit (as opposed to breaching a duty to provide a defense), and therefore, the insurers had acted in violation of their implied covenant of good faith and fair dealing. 3M therefore requested an award of attorneys' fees incurred in the declaratory judgment action. *Silicone*, 667 N.W.2d at 424 (citing *Am. Standard Ins. Co. v. Le*, 551 N.W.2d 923, 927 (Minn. 1996)).

In refusing to award 3M attorneys' fees incurred in the declaratory judgment action, the Minnesota Supreme Court emphasized that an insured is not entitled to recover attorneys' fees incurred in maintaining or defending a

declaratory action to determine the question of coverage unless the insurer has breached the insurance contract in some respect – usually by wrongfully refusing to defend the insured. *Id*.

Attorneys' fees incurred in a declaratory judgment action involving multiple insurers may be recovered entirely from just one of the insurers. *Domtar*, 563 N.W.2d at 740-41. The court in *Domtar* reasoned that it would be difficult for the insured to retroactively segregate its billing for attorneys' fees by individual insurers, particularly because the declaratory judgment action involved many legal issues common to all of the insurers. *Id.*; *see also Redeemer Covenant Church v. Church Mut. Ins. Co.*, 567 N.W.2d 71, 82-83 (Minn. Ct. App. 1997). *But see Diocese of Winona v. Interstate Fire & Cas. Co.*, 916 F. Supp. 923 (D. Minn. 1995), *aff'd in part, rev'd in part*, 89 F.3d 1386 (8th Cir. 1996) (stating that under Minnesota law, in allocating litigation expenses incurred by insureds in securing declaratory judgment against insurers for liability arising from sexual abuse, the insurers would not be held liable for expenses allocated to those policy periods in which "sexual abuse" exclusion was in force); *Indus. Door Co. v. The Builders Group*, No. A09-2065, 2010 WL 2900312 (Minn. Ct. App. July 27, 2010) (unpublished opinion) (insured could not recover from the breaching insurer legal fees in the declaratory judgment action that related to other insurers that owed no duty to defend).

The insured's right to recover attorneys' fees in a declaratory judgment action extends to the fees incurred on appeal. *See Brown v. State Auto. & Cas. Underwriters*, 293 N.W.2d 822, 825 (Minn. 1980); *Lanoue*, 278 N.W.2d at 55; *Retail Systems v. CNA Ins. Co.*, 469 N.W.2d 735, 738-39 (Minn. Ct. App. 1991).

Attorneys' fees incurred in a declaratory judgment action to establish first-party insurance coverage are not recoverable, even if the insured is successful. *Garrick v. Northland Ins. Co.*, 469 N.W.2d 709, 713-14 (Minn. 1991).

C. Amount of Attorneys' Fees Recoverable

While an insured is entitled to recover attorneys' fees incurred in a declaratory judgment action, the insured is not entitled to recover enhanced attorneys' fees. *See SCSC*, 536 N.W.2d at 319. After the insured in *SCSC* prevailed in the declaratory judgment action, the trial court applied a multiplier of 1.5 to the fees actually incurred by the insured. The Minnesota Supreme Court concluded that while public policy favors enhanced fees in civil rights lawsuits, no similar policy exists in insurance coverage actions. *Id.*

In determining the reasonableness of attorneys' fees, the court may consider: (1) the fee customarily charged in the locality for similar legal services; (2) the novelty and difficulty of the questions involved; (3) the experience, reputation, and ability of the attorney; and (4) the results obtained. *Domtar*, 563 N.W.2d at 741 (legal fees between $400 and $475 per hour deemed reasonable); *Holt v. Swenson*, 252 Minn. 510, 517, 90 N.W.2d 724, 728 (1958).

Appellate review of an award of attorneys' fees and costs is limited to an abuse-of-discretion standard. *Westling Mfg. Co.*, 581 N.W.2d at 48 (citing *Domtar*, 563 N.W.2d at 740); *see also Becker v. Alloy Hardfacing & Eng'g*, 401 N.W.2d 655, 651 (Minn. 1987) (appellate court will not reverse a trial court's award or denial of attorneys' fees absent an abuse of discretion); *Auto-Owners Ins. Co. v. NewMech Cos.*, 678 N.W.2d 477 (Minn. Ct. App. 2004) (trial court did not abuse its discretion in awarding $36,765.25 in costs and attorneys' fees without allowing the insurer an evidentiary hearing to test the reasonableness of the costs and attorneys' fees.)

D. No Right to Attorneys' Fees in Declaratory Judgment Action when Insurer Provides Defense in Underlying Lawsuit

In order for an insured to recover attorneys' fees in a declaratory judgment action, there must be a breach of a contractual duty or statutory authority for attorneys' fees. *See Am. Standard Ins. Co. v. Le*, 551 N.W.2d 923, 927 (Minn. 1996). Where an insurer provides a defense in the underlying lawsuit, the insured may not recover attorneys' fees in a declaratory judgment action because no breach occurred. Attorneys' fees are not recoverable even where the insured prevails in the declaratory judgment action. *Id. See also Spicer, Watson & Carp v. Minn. Lawyers Mut.*

Ins. Co., 502 N.W.2d 400, 404-05 (Minn. Ct. App. 1993) (holding that an insured, which had prevailed in a declaratory judgment action, was not entitled to attorneys' fees because the insurer had provided a full defense in the underlying action).

An insured may recover its attorneys' fees incurred in a successful declaratory judgment action even where other insurers defended it in the underlying liability case. *Westfield Ins. Co. v. Kroiss*, 694 N.W.2d 102 (Minn. Ct. App. 2005).

6.11 § APPORTIONMENT OF DEFENSE COSTS BETWEEN COVERED AND NON-COVERED CLAIMS

This chapter has already addressed whether an insurer can withdraw its defense after all arguably covered claims are resolved with finality. *See supra* section 6.7(D). A related issue is whether an insurer may apportion defense costs between covered and non-covered claims, where the covered claims were never dismissed or settled before the conclusion of the defense.

A. Defense Costs May Not Be Apportioned When it is Unclear Whether Some of the Claims Will Fall Outside the Policy's Coverage

An insurer may not shift defense costs to the insured for claims it believes are not covered, unless it is "free from doubt" that those claims fall outside the insurance policy's coverage. *See Jostens, Inc. v. CNA Ins.*, 336 N.W.2d 544, 545 (Minn. 1983), *appeal after remand*, 386 N.W.2d 257 (Minn. Ct. App. 1986), *aff'd in part, rev'd in part*, 403 N.W.2d 625 (Minn. 1987); *cf. St. Paul Fire & Marine Ins. Co. v. Flynn*, No. C8-96-990 (Minn. Ct. App. Oct. 29, 1996) (unpublished opinion) (apportionment of defense costs not appropriate where claims against the insured arose out of the same set of facts and depended on resolution of a common factual issue). *Jostens* involved a class action sex discrimination lawsuit. Although the insurer acknowledged coverage for unintentional sex discrimination, it alleged that there was no coverage for the claims of intentional discrimination or for injunctive relief requested in the action. Also, the insurer's policy was in effect for only four of the six years during which the discrimination occurred. Thus, the insurer argued that the defense costs should be apportioned.

The Minnesota Supreme Court denied apportionment because it was not "free from doubt" whether some of the class action claims would fall outside of policy coverage or outside the policy period. *Jostens*, 336 N.W.2d at 545. In particular, the court noted that it was still uncertain whether the alleged unlawful practices of the insured where intentional or unintentional. *Id.*

Implicit in the *Jostens* opinion is that an insurer may apportion defense costs once it is free from doubt that certain claims fall outside the insurance coverage. The court in *Jostens*, however, provided no guidelines as to when or how such doubt would be resolved. Following *Jostens*, the Minnesota Court of Appeals indicated that, in the context of advertising injury, an insurer's obligation to defend would be limited to injuries caused by the advertising, and would not extend to injuries caused by other activities that where coincidentally advertised. *See Polaris Indus. v. Cont'l Ins. Co.*, 539 N.W.2d 619, 620 (Minn. Ct. App. 1995), *review denied* (Minn. Jan. 25, 1996). In *Polaris*, the insured allegedly misappropriated information regarding electronic fuel-injected systems for snowmobiles. A complaint filed against the insured contained the following claims: (1) unfair competition; (2) misappropriation of confidential and proprietary information; (3) breach of contract; (4) tortious interference with prospective business advantage; (5) unjust enrichment; (6) patent infringement; (7) violation of the Sherman Act; and (8) violation of the Colorado Consumer Protection Act.

The trial court found that there was no duty to defend. On appeal, the Minnesota Court of Appeals noted that the insured's alleged misappropriation of information was the underlying cause of the first seven claims noted above. The court concluded that misappropriated information that is later advertised does not, by itself, trigger advertising

injury coverage under the policy. *Id.* The court nevertheless reversed and remanded the case to the trial court for a determination whether any policy exclusions applied to the eighth claim.

While the *Polaris* opinion did not specifically discuss the insurer's duty to defend, the court, in its syllabus, stated, "An insurer's obligation to defend an insured against advertising injury arising out of conduct during the course of the insured's advertising activities is limited to injury caused by the advertising and does not extend to injury caused by other activities that are coincidentally advertised." *Id.* at 620.

In California, that state's highest court has held that an insurer has a right to seek reimbursement of uncovered defense costs if notice is given to the insured in a reservation of rights letter. *Buss v. Superior Court of Los Angeles County*, 65 Cal. Rptr. 2d 366 (Cal. 1997). The court reasoned that payment of defense costs for claims that are not covered under a policy would be "unjust" because such costs reflect a benefit to the insured that the policy was not intended to provide. Minnesota appellate courts have yet to expressly approve or disapprove of the *Buss* decision.

B. Apportionment Permitted on a Temporal Basis

One commentator has suggested that where a lawsuit involves a series of similar incidents, some covered and some not, apportionment should be allowed:

> In the typical situation, suit will be brought as the result of a single incident, and only some of the damages sought will be covered under the policy. In that event, apportionment of defense costs between the insured claim and the uninsured claim will likely not be practical. When, however, suit is brought for a series of similar incidents, some of which are covered and some of which are not, a reasonable apportionment can be made. This is not to say, of course, that two separate counsel cannot be hired, one by the insured and one by the insurer, to represent the insured; but there is no reason why defense costs that are incurred by a single counsel could not be prorated between the insurer and the insured, in accordance with the percentage of alleged incidents covered by the policy.

ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES 203 (3rd ed. 1995).

The above principle was followed in *National Union Fire Insurance Company v. Evenson*, 439 N.W.2d 394 (Minn. Ct. App. 1989), *review denied* (Minn. July 12, 1989). *But cf. Jostens, Inc. v. CNA Ins.*, 403 N.W.2d 625, 631 (Minn. 1987) (refusing to allocate defense costs based on a percentage of uninsured settlement amounts or uninsured time periods, particularly because a great deal of defense costs were incurred in the general defense preparation and could not be separated by claimants or time periods), *overruled on other grounds by N. States Power Co. v. Fid. & Cas. Co. of N.Y.*, 523 N.W.2d 657, 664 (Minn. 1994). In *Evenson*, an insurance agent obtained a workers' compensation policy, a general liability policy and an umbrella liability policy for his client. Although the client had also requested a fidelity bond, the agent, who had little experience in the placement of fidelity bonds, tried but failed to obtain a bond. Despite the failure to obtain a fidelity bond, the agent delivered to his client an insurance summary listing a fidelity bond from a named insurer. Subsequently, the client suffered a cash loss, which was caused by an employee who had been fired by the client. Three days after the loss, on November 9, 1984, the insurance agent created a false certificate of insurance that purported to provide a fidelity bond through another named insurer and delivered it to one of the client's customers. Following delivery of the false certificate of insurance, the client suffered a second cash loss on November 30, 1984, caused by the fired employee.

After the client commenced a lawsuit against the insurance agent, the agent's errors and omissions insurer commenced a declaratory judgment action. The insurer asserted that it had no duty to defend based on an exclusion in its policy for dishonest, criminal, or fraudulent acts. The trial court in the declaratory judgment action concluded

that the agent's conduct prior to November 9, 1984 constituted negligence. But the trial court further concluded that the agent's conduct on and after November 9, 1984 was dishonest and fraudulent.

On appeal, the Minnesota Court of Appeals held that the insurer had duty to defend and indemnify the agent for claims and losses occurring prior to November 9, 1984, but had no such duty after that date. *Evenson*, 439 N.W.2d at 400. In reaching its decision, the court noted that while the agent could have engaged in both negligent conduct and fraudulent conduct prior to the second loss of November 30, it concluded that "the fraud clearly is the overriding cause of [the client's] loss on November 30 of $82,000." *Id*. at 399.

C. Apportionment Permitted for Counterclaims and "Satellite Litigation"

Even when an insurer owes a duty to defend, that duty does not extend to the insured's counterclaims. *See St. Paul Fire & Marine Ins. Co. v. Nat'l Computer Sys., Inc.*, 490 N.W.2d 626, 632 (Minn. Ct. App. 1992). The insured in *National Computer* was sued for misappropriation of confidential proprietary information. Although the appellate court concluded that the misappropriation did not constitute property damage within the meaning of the insurance policy, the court held that the insurer owed a duty to defend because the insured presented a colorable claim for a defense. *Id.* The court concluded, however, that the duty to defend did not extend to the attorneys' fees and costs related to the insured's counterclaim in the underlying lawsuit. Similarly, the court ruled there was no duty to defend what it termed "satellite litigation." Specifically, the court held that the insured could not recover its attorneys' fees and costs incurred when it intervened in a related administrative proceeding to protect its federal contract, which had allegedly been obtained with the aid of the confidential proprietary information. In remanding the case, the appellate court instructed the trial court to separate and disallow any fees associated with the counterclaim "to the extent it [was] possible." *Id*.

6.12 § DEFENSE OBLIGATIONS IN THE CONTEXT OF MULTIPLE INSURERS AND SELF-INSURED RETENTION

A. Multiple Insurers

For many years, Minnesota courts held that an insurer that provided a defense had no right to seek contribution of its defense costs from another insurer that also provided coverage. The seminal case on that issue was *Iowa National Mutual Insurance Co. v. Universal Underwriters Ins. Co.*, 150 N.W.2d 233 (Minn. 1967).

In *Iowa National*, an excess insurer that had defended the insured sought reimbursement of defense costs. In denying reimbursement, the court concluded that reimbursement could not be supported on the basis of a contribution claim because the two insurers had no joint liability or common obligation. Nor could reimbursement be based on principles of subrogation, because each company had a separate and distinct obligation to defend. 150 N.W.2d at 237. The court also denied reimbursement on the basis that the defense costs incurred by the excess insurer were primarily expended to protect its own interest, as opposed to paying a debt for which another was primarily liable. The court termed the defense costs as the excess insurer's cost of doing business. *Id*. at 238. *See also Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 166 (Minn. 1986) (an insurer that assumes a defense has no cause to complain because it is protecting its own interest and is only doing what it agreed and was paid a premium to do).

Following *Iowa National*, the Minnesota Supreme Court held that an insurer that steps in and defends an insured can avoid the effect of the *Iowa National* rule by using a loan receipt agreement, by which the defending insurer would agree to "loan" to the insured the money necessary for the defense. In return, the insured would agree to commence a lawsuit against the non-defending insurer for breach of its duty to defend. If the suit was successful, the amounts recovered would go to the defending insurer. *See Jostens*, *supra*.

In 2010, the Minnesota Supreme Court overruled *Iowa National* and held that a primary insurer that has a duty to defend, and whose policy is triggered for defense purposes, has an equitable right to seek contribution for defense costs from any other insurer who also has a duty to defend the insured and whose policy has been triggered for defense purposes. *Cargill, Inc. v. Ace Am. Ins. Co.*, 784 N.W.2d 341 (Minn. 2010). Under such circumstances, a loan receipt would no longer be necessary.

In *Cargill*, the State of Oklahoma sued Cargill in 2005 for violations of its waste disposal and pollution laws. Eventually, one of Cargill's insurers, Liberty Mutual, offered to assume Cargill's defense on the condition that Cargill sign a loan receipt agreement. But Cargill refused to do so, based on its concern that it might have to share in some of the defense costs in light of several policies that were only "fronting policies." The trial court ruled that it would be inequitable to force Liberty Mutual to pay for Cargill's defense without any right of contribution. The trial court therefore declared that a loan receipt was not necessary, or in the alternative, that the court could constructively impose a loan receipt agreement between Liberty Mutual and Cargill.

On appeal, the Minnesota Court of Appeals affirmed. In doing so, it noted that while the *Iowa National* rule applied to the case, Cargill had a duty to cooperate under the Liberty Mutual policy, and as part of that duty, it had an obligation to enter into a neutral loan receipt agreement with Liberty Mutual.

The Minnesota Supreme Court granted further review and affirmed. In doing so, the court overturned *Iowa National* after noting that the *Iowa National* rule did little to encourage insurers to promptly resolve defense obligations. The court ruled that without a loan receipt agreement, a primary insurer that has a duty to defend and whose policy is triggered for defense purposes has an equitable right to seek contribution for defense costs from other insurers who owe a duty to defend and whose policies have been triggered. *Cargill,* 784 N.W.2d at 354. The decision noted further that equitable contribution would allow for an insurer to seek reimbursement from a co-insurer for sums that were paid in excess of the insurer's proportionate share of the common obligation. *Id*. at 353 n. 11.

Although a loan receipt is no longer a prerequisite to recovery of defense costs by one insurer from another, the Minnesota Supreme Court made clear that the right to equitable contribution would only exist if the insurer seeking contribution had not breached its duty to defend and the insurer from which contribution was sought had received notice of the suit and opportunity to defend. *Id*. at 354 n. 14.

In 2006, the Minnesota Supreme Court ruled that when no insurer provides a defense to the insured, the insured may recover its defense cost from any one of the insurers and, as between the insurers, there is equal liability for defense cost. *Wooddale Builders, Inc. v. Md. Cas. Co.*, 722 N.W.2d 283, 303 (Minn. 2006). When liability is allocated pro rata by time on the risk and the insurers on the risk have participated to some degree in providing a defense to their common insured, defense costs should be apportioned equally. *Id*.

Where one of two insurers is not a party to a declaratory judgment action because of a personal jurisdiction dispute, the court may award defense costs against the insurer that is a party. *Domtar v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 739 (Minn. 1997). The remedy, if any, available to the insurer against which defense costs have been awarded is to seek contribution against the non-party insurer. *Id.*

While the *Jostens* court indicated that co-insurers, each of which arguably had primary coverage, must split the cost of the insured's attorneys' fees in the declaratory judgment action, a subsequent case has indicated that in a pure primary/excess situation, the excess insurer will have no liability for the insured's attorneys' fees. *See Seaway Port Auth. v. Midland Ins. Co.*, 430 N.W.2d 242, 252 (Minn. Ct. App. 1988) (holding that the trial court did not err in awarding the insured's attorneys' fees incurred in the declaratory judgment action against the primary insurers but not against the excess insurer, because the excess insurer was not liable for the insured's claims).

In addition to the loan receipt used in *Jostens*, an insurer has attempted unsuccessfully to use a *Miller-Shugart* settlement agreement in the context of multiple insurers. *See Burbach v. Armstrong Rigging & Erecting, Inc.*, 560

N.W.2d 107 (Minn. Ct. App. 1997). At the time of the *Miller-Shugart* settlement, the posture in *Burbach* differed from that in *Jostens*. In *Jostens*, the loan receipt was used after the insured had already settled the underlying lawsuit. In *Burbach*, the *Miller-Shugart* settlement was used to accomplish settlement of the plaintiff's lawsuit against the insured. Under the *Miller-Shugart* settlement, the plaintiff released the insured from any personal liability and agreed to seek recovery from a non-settling insurer, which had previously denied a tender of defense. Like the typical *Miller-Shugart* settlement, the insured stipulated to a judgment against it. However, unlike the typical *Miller-Shugart* settlement, there was also a loan receipt whereby the settling insurer loaned the plaintiff $212,000 but agreed that if the plaintiff recovered nothing from the non-settling insurer, the plaintiff would not have to repay the loan.

Following the *Miller-Shugart* settlement, the trial court granted summary judgment in favor of the plaintiff and against the non-settling insurer, concluding that the insured was covered under the non-settling insurer's policy and that the *Miller-Shugart* agreement was reasonable. In reversing the trial court, the Minnesota Court of Appeals concluded that the agreement was not a valid *Miller-Shugart* settlement and therefore was unenforceable. In reaching its decision, the court disapproved of the use of a *Miller-Shugart* to shift the risk of defense and coverage from one insurer to another:

> We agree with the *Koehnen* [*v. Harold Fire Ins. Co.*, 89 F.3d 525 (8th Cir. 1996)] court that it was never the intent of *Miller-Shugart* to shift the risk of defense and coverage from one insurer to another, and we declined to extend *Miller-Shugart* to the facts of this case. We leave such an extension to the supreme court, should it be so inclined.

Id. at 110.

B. Excess Insurer's Defense Obligations Following *Loy-Teigen* Settlement with Primary Insurer

The Minnesota Supreme Court has approved of a procedure whereby a primary insurer can settle with an injured plaintiff and thereafter withdraw from the case, leaving the excess insurer to defend the case. *See Drake v. Ryan*, 514 N.W.2d 785 (Minn. 1994). *Drake* involved a motor vehicle accident. The defendant, who was driving his brother's car, had primary liability coverage in the amount of $30,000 through his brother's insurer (Dairyland), and excess liability coverage in the amount of $50,000 under his parents' insurer (State Farm). After a lawsuit was commenced, the plaintiffs, defendants and Dairyland entered into a release patterned after the release used in *Loy v. Bunderson*, 320 N.W.2d 175 (Wis. 1982). Under the release, Dairyland tendered $20,000 of its $30,000 liability coverage in exchange for an agreement by the plaintiffs to release the defendants from any personal liability and to release Dairyland from any further obligations under its insurance policy. The plaintiffs also reserved their right to satisfy any judgment against State Farm's limits, with a $30,000 offset for Dairyland's liability limits. *Drake,* 514 N.W.2d at 786.

Following the release, State Farm assumed defense of the negligence claim. *Id.* at 787. Thereafter, the defendant and State Farm moved for summary judgment on the grounds that the defendant was no longer a proper party, having been released from all personal liability. The Minnesota Supreme Court disagreed and concluded that the release was enforceable in Minnesota. *Id.* at 790. In so ruling, however, the court left for another day the issue of whether a release could be used by a primary insurer to shift the costs of defense to a true umbrella insurer. The court noted that the case before it did not involve such a situation, because the State Farm policy was a standard automobile policy that provided primary coverage but only became excess due to the facts of the case. Unlike a true umbrella insurer, therefore, State Farm could not claim its premiums were based on the expectation that a primary insurer would be responsible for defense costs. *Id.* at 789.

Following *Drake*, the Minnesota Court of Appeals addressed a *Loy* release in the context of a true umbrella insurer. *Cincinnati Ins. Co. v. Franck*, 644 N.W.2d 471 (Minn. Ct. App. 2002). In that case, the plaintiffs entered into a *Loy*-type release, whereby the primary insurer agreed to pay $425,000 of the $500,000 of primary liability coverage in exchange for an agreement by the plaintiff to release the defendants from personal liability and further releasing

the primary insurer. Following the settlement, the excess insurer exercised its option to assume the defendants' defense, and thereafter commenced a declaratory judgment action asserting that there was no coverage under the umbrella policy because the primary insurer had not paid its policy limits. Because the excess insurer had assumed the defense, the focus of *Franck* was on the duty to indemnify, not on the duty to defend.

The court in *Franck* ruled that the coverage under the umbrella policy became available after the *Loy*-type settlement. In so ruling, the court emphasized that the plaintiffs had agreed to absorb the gap between the settlement amount and the primary policy limits, and further emphasized that such settlements would foster "effective and expeditious resolution of lawsuits," which would "not only benefit the parties involved, but the justice system as a whole." *Id*. at 475.

After the Minnesota Supreme Court granted further review of *Franck*, the case was voluntarily dismissed on November 14, 2002 without a hearing.

PRACTICE TIP

In light of the *Drake* court's decision to reserve for another day the issue of enforceability of a *Loy* release involving a true umbrella insurer, and the fact the *Franck* case was granted further review but then dismissed, an insurer primary to an umbrella insurer would be well-advised to include in any *Loy* release a provision similar to the one in *Drake*, whereby a plaintiff agreed to forever forego any action against the defendants or Dairyland in the event the agreement was not construed in accordance with *Loy* and *Teigen v. Gelco of Wisconsin, Inc.*, 367 N.W.2d 806 (Wis. 1985).

Where the umbrella insurer's liability limits are substantial and the plaintiff's injuries are significant, a plaintiff will likely not agree to the above provision. In that case, if the parties still wish to enter into a *Loy* release, the best approach would be to commence a declaratory judgment action and request a judicial determination as to the enforceability of the proposed release.

If a plaintiff enters into a typical *Drake-Ryan* release, and it is subsequently determined that there is no excess insurance coverage, the release will resolve all claims against the insured, thereby precluding a lawsuit against the released insured's principal. *Booth v. Gades*, 788 N.W.2d 701 (Minn. 2010).

C. Self-Insured Retention

A recent federal decision held that an additional insured under a liability policy, which was self-insured for the first $1,000,000, was responsible for its defense costs, and that the excess insurer's obligation to defend would not be triggered until exhaustion of the retained limit. *See Hormel Foods Corp. v. Northbrook Prop. & Cas. Ins. Co.*, 938 F. Supp. 555 (D. Minn. 1996). In *Hormel Foods*, Hormel was listed as self-insured for $1,000,000 per occurrence. The court concluded that under the language of the policy, Hormel's $1,000,000 retained limit was primary as opposed to Northbrook's coverage.

In ruling that Northbrook had no obligation to defend until the self-insured retention was exhausted, the court noted that schedule A of the policy stated, "Expenses including defense are in addition to the [self-insured retention]." *Id.* at 560 n.1. The court interpreted that language to mean that in determining whether the $1,000,000 threshold had been reached, costs incurred in defending the action were to be considered separately, thus suggesting that the costs would be borne by Hormel itself. The court also distinguished between a self-insured retention and a deductible, noting that under a self-insured retention, the insured typically assumed the obligation of providing itself a defense until the retention is exhausted. *Id.* at 560 (citing ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES 348 (3rd ed. 1995)).

D. Recoupment of Defense Costs

An insurer that provides a defense to an insured may not recoup the defense costs after prevailing in a declaratory judgment action. *See Westchester Fire Ins. Co. v. Wallerich*, 563 F.3d 707 (8th Cir. 2009). In *Westchester Fire*, the insured explicitly rejected the insurer's reservation of rights letter, in which it stated that it would seek reimbursement of defense fees if it prevailed in a subsequent declaratory judgment action. *Id*. at 719. However, an insurer can seek reimbursement where the insurance policy specifically allows for recoupment. *See Northstar Educ. Fin. v. St. Paul Mercury Ins. Co.*, No. A12-0959, 2013 WL 141712, at *11 (Minn. Ct. App. Jan. 14, 2013) (unpublished opinion) (recoupment allowed when the policy provided, "to the extent that it is finally established that any such Defense Costs are not covered under this Policy, the Insureds … agree to repay the Insurer such Defense Costs").

6.13 § INSOLVENT INSURERS AND INSURANCE GAPS

A. Insolvent Insurers

Where a primary insurer becomes insolvent, an excess insurer is not required to provide "drop-down" coverage where the language of the excess policy unambiguously limits the excess insurer's liability to claims in excess of $250,000 per occurrence. *See Seaway Port Auth. v. Midland Ins. Co.*, 430 N.W.2d 242, 249 (Minn. Ct. App. 1988). In *Seaway*, the insured sought reimbursement of defense costs from two primary insurers, both of which became insolvent, and an excess insurer. In ruling that the excess insurer was not required to provide drop-down coverage, the court noted that there was nothing in the language of the excess policy that would reasonably have led the insured to expect that the excess insurer would be liable for the insured's losses in the event the primary insurers became insolvent. *Id.; see also Am. Hoist & Derrick Co. v. Employers' of Wausau*, 454 N.W.2d 462, 468 (Minn. Ct. App. 1990) (holding that the doctrine of reasonable expectations did not obligate a fourth-level excess insurer to provide drop-down coverage at the second and third levels of excess coverage after the insurers at those levels became insolvent).

B. Insurance Gaps

In cases where an insured is self-insured for part of the period that damages occurred, the weight of authority is that the insured must bear a pro rata share of the defense costs. *See* OSTRAGER & NEWMAN, *supra*, at 212. In a toxic tort case involving insurance gaps, a federal court held that "the insured must bear its share of those costs determined by the fraction of time of injurious exposure in which it lacked coverage." *Gulf Chem. & Metallurgical Corp. v. Associated Metals & Minerals Corp.*, 1 F.3d 365, 372 (5th Cir. 1993). In remanding the case, the court directed that pending a determination of the appropriate allocation, the defense costs would be shared equally by the five insurers and the insured. *Id.* at 373; *see also Commercial Union Ins. Co. v. Sepco Corp.*, 765 F.2d 1543 (11th Cir. 1985) (holding that the insured was required to reimburse its insurers on a pro rata basis based on the number of months that the insured was self-insured).