

NO. A04-1713

State of Minnesota
In Supreme Court

Jose Padilla individually and as assignee of
Bloomington Steel and Supply Co.,

Appellant,

vs.

The Travelers Indemnity Company and
The Charter Oak Fire Insurance Company,

Respondents.

APPELLANT'S BRIEF AND APPENDIX

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STATEMENT OF ISSUES

- I. WHETHER THE INTENT OR KNOWLEDGE OF AN AGENT OF A CORPORATION MAY BE IMPUTED TO THE CORPORATION FOR THE PURPOSES OF DETERMINING WHETHER BODILY INJURY WAS EXPECTED OR INTENDED FROM THE STANDPOINT OF THE CORPORATION.**

STATEMENT OF THE CASE

This is an appeal from a final judgment resulting from the ruling of the Honorable Robert A. Blaeser of the Fourth Judicial District.

Respondents¹, Travelers, issued commercial general liability and umbrella insurance coverage to Bloomington Steel and Supply Company, a corporation. Cecil Reiners was an employee of Bloomington Steel, and he was also the owner of the stock of the company. Reiners, while acting in the course of his employment, assaulted Appellant Jose Padilla causing serious brain injuries. Padilla sued Reiners for assault and battery. Against Bloomington Steel, Padilla brought claims of Respondeat Superior liability and negligent hiring, retention and supervision.

Travelers sued for a declaration that they had no responsibility to defend or indemnify Bloomington Steel for the claims brought by Padilla. The Honorable Robert A. Blaeser granted summary judgment to Travelers. Judge Blaeser held 1.) that Bloomington Steel had not acted intentionally to cause injury; but 2.) Reiner's actions were foreseeable due to his history of violence; and 3.) Reiner's actions

¹ Respondents are two separate insurance companies, The Travelers Indemnity Company and Charter Oak Fire Insurance Company. Throughout this brief they will be collectively referred to as Travelers.

were therefore “expected” under the terms of the policies; and therefore, 4.)

Padilla’s claims were not covered by Travelers.

The Court of Appeals affirmed the trial court’s decision. Specifically, they held that the co-mingled identity of Reiners and Bloomington Steel required a finding that Bloomington Steel expected the actions of Reiners.

STATEMENT OF FACTS

I. Bloomington Steel & Supply Co.

Bloomington Steel & Supply Co. is a corporation under the laws of Minnesota. The company was first incorporated in 1962. Reiners began his employment with Bloomington Steel in 1968. *See* Defendant Padilla’s Exhibit 1, p. 6. He began his employment as a draftsman, and eventually increased his responsibility with the company. *See Id.*, p. 9-11. He was on the board of directors of the company long before he ever had any ownership interest. *See Id.*, p. 23. In 1987, Reiners purchased 50% of the stock of Bloomington Steel from John Mauher. In 1991, Reiners purchased John Mauher’s remaining 50% of the stock. It is undisputed that from that point forward Reiners was the sole stockholder of Bloomington Steel. *See Id.*, p. 14-15.

Reiners understood that he acted in a dual capacity of director and employee. *See Id.*, p. 24-25. He understood that he had a fiduciary duty to the company with respect to acts performed in his capacity as the director of the company, and had to put aside his personal interests and act in the best interest of the company. *See Id.*, p. 24-25. Reiners always operated the company pursuant to

corporate formalities because he knew that corporate status was important to protect him from personal liability. *See Id.*, p. 16. Reiners never co-mingled personal funds and business funds. In fact, when the business was strapped for cash, he formally loaned the company money from his 401K. *See Id.*, p. 17.

Reiners understood that making good decisions in the retention and supervision of employees was important for the good of the company. *See Id.*, p. 26. He understood unfit employees could harm the company by causing workplace accidents and causing poor morale amongst the other workers. *See Id.*, p. 26. He understood that the company could be sued for damages caused by retaining an unfit employee. *See Id.*, p. 27.

II. Employment status of Cecil Reiners

In January of 2000, Bloomington Steel entered into a contract with PSI Services to lease employees. In essence, this meant that PSI Services took over all the paperwork regarding the employees, i.e. payroll and taxes. *See Defendant Padilla's Exhibit 5, p. 7.* All of Bloomington Steel's employees were leased from PSI. Reiners himself was leased by PSI to work as an employee for Bloomington Steel. The insurance policies issued by Travelers define "employee" to include leased workers. *See Defendant Padilla's Exhibit 10.* PSI did not have the ability to control Reiners or other employees leased to Bloomington Steel. *See Id.*, p. 18.

III. The argument between Reiners and Padilla

On October 18, 2000, Jose Padilla was working for Key Star. Key Star and Bloomington Steel shared a common work area, and employees of the two companies interacted frequently.

Sometime before noon on October 18, 2000, Reiners stopped by the joint work area to check on two projects that were due at noon. *See* Defendant Padilla's Exhibit 9, p.858. When Reiners went into the shop, he saw Padilla speaking to another employee in Spanish. Defendant Padilla's Exhibit 4, p. 44. Reiners approached the two men and told Padilla not to speak Spanish here. *Id.* Reiners was informed that Padilla worked for Keystar. Reiners then told Padilla he should be in his work area and not bothering Bloomington Steel employees.

Reiners then returned to the office. He was upset because his employees were standing around talking with Padilla, instead of getting their work done. *See* Defendant Padilla's Exhibit 9, p. 858. While in the office, he spoke to Charlotte Krueger, his bookkeeper of 10 years. Reiners asked Krueger to call Alden Starkey, the owner of Key Star, to ask him to take care of the problem with Padilla. *See Id.*, p.862. Starkey told Krueger that Padilla would be fired. *Id.* 863

After lunch Reiners went to the shop to check on his employees' progress. Padilla was still in the shop. Padilla was sitting at a table with two employees of Bloomington Steel. Defendant Padilla's Exhibit 3, p. 58. Reiners confronted Padilla and asked what he was still doing there. *Id.*, p. 59. Another worker told Reiners that Padilla was taking a lunch break. Reiners stated, "He had forfeited

his rights to be in the building, because he had been bothering my employees.”

Id., p.60. They then argued regarding whether Reiners had the right to eject Padilla from the premises. *Id.*

The argument escalated. Reiners picked up a piece of wood and smashed Padilla’s skull. *See* Defendant Padilla’s Exhibit 8, p. 778. Padilla then stood up and began shaking until he fell to the ground bleeding profusely. *See Id.*, p. 779. As a result of the attack, Padilla suffered a serious brain injury.

IV. Reiners’ History of Violence

Reiners did have a history of problems controlling his temper and becoming violent. Extensive discovery revealed four incidents of violence at the work place. Lonny Menard, an employee of Keystar, alleged that he had been assaulted by Reiners. Defendant Padilla’s Exhibit 1, p. 33. Albert Eggrolla an employee of Bloomington Steel alleged that Reiners threatened to kill him with a hammer. No actual assault occurred. Defendant Padilla’s Exhibit 6, p. 17-18; Defendant Padilla’s Exhibit 1, p.31. Dana Novacek, a temporary employee assigned to Bloomington Steel, quit her job because she felt uncomfortable around Reiners. When she left she had a representative of the temporary agency gather her belongings, because she feared Reiners. No actual assault ever took place. Defendant Padilla’s Exhibit 6, p. 19-20, Defendant Padilla’s Exhibit 1, p. 32. Finally, Bob Teivet, an employee of Bloomington Steel, alleged that Reiners became angry with him and threw rocks at his car. Defendant Padilla’s Exhibit 1, p. 34.

Reiners had similar episodes in his personal life. His wife, Diana Reiners, had filed a petition seeking a protective order against Reiners. In her affidavit, she alleged that Reiners could be prone to violent behavior and had problems with alcohol. Defendant Padilla's Exhibit 7. She alleged Reiners was abusive towards her, but did not allege any specific assaults. *Id.*²

V. Coverage in Dispute

Travelers issued both a commercial liability and an umbrella policy to Bloomington Steel. There is no dispute that the coverage was in effect at the time of the occurrence. The terms of both policies are virtually identical. The applicable provisions are as follows:

Insuring Agreement

We 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...

This insurance applies to "bodily injury" or "property damage" only if:

- (1) the "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the coverage territory...

Occurrence

"occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

² The Trial Court in the underlying case had ruled it was unlikely that the evidence of Ms. Reiners' affidavit would be admissible at the time of trial due to the lack of any connection to the workplace.

Exclusions

This insurance does not apply to:

a. **Expected or Intended Injury**

“bodily injury” or “property damage” expected or intended from the standpoint of the insured. This exclusion does not apply to “bodily injury” or “property damage” resulting from the use of reasonable force to protect persons or property.

Separation of Insureds.

Except with regard to the Limits of Insurance and any rights or duties specifically assigned in this Coverage Part to the first Named Insured, the insurance applies:

- a. As if each Named Insured were the only Named Insured; and
- b. Separately to each insured against whom claim is made or “suit” is brought.

VI. Procedural History

Padilla sued Reiners and Bloomington Steel & Supply Co. on October 22, 2001. Bloomington Steel tendered the defense of the lawsuit to Travelers. Travelers did take up the defense of the named insured, Bloomington Steel, but they refused to defend Reiners. By taking such actions, Travelers recognized that Reiners and Bloomington Steel were separate entities that needed to be dealt with individually. *See Cedrick Kushner Promotions v. Don King*, 121 S. Ct. 2087, 2091 (2001) (Holding that a corporation and its sole shareholder are separate entities under RICO, because incorporation’s basic purpose is to create a distinct legal entity with different rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs.)

Bloomington Steel, through the actions of counsel hired by Travelers, moved the Court for an order granting summary judgment alleging that the assault was not committed within the course and scope of Reiners' employment. In addition, they alleged that Bloomington Steel could not be liable for negligence in the hiring, retention or supervision of Reiners, because Reiners was the sole stockholder of the company. In essence, they told the Court that Reiners and Bloomington Steel were one and the same, and the corporate status of Bloomington Steel should be disregarded.

On October 9, 2002, the Honorable Catherine Anderson denied Bloomington Steel's motions. *See* Defendant Padilla's Exhibit 11. She found that there were questions of fact as to whether the assault occurred within the scope of employment. She also found that the corporate status of Bloomington Steel was legitimate in the eyes of the law, and that the corporation could be liable for negligence in retention or supervision of Reiners. The case was then set for trial.

Therefore, on December 5, 2003, Travelers brought this declaratory judgment action seeking a determination that Travelers had no duty to defend or indemnify either Reiners or Bloomington Steel. The Honorable Robert A. Blaeser granted Travelers' motion for summary judgment. He held that coverage was precluded because the actions of Cecil Reiners were foreseeable and thus "expected."

Following the denial of coverage, Bloomington Steel and Padilla entered into a *Miller v. Shugart* agreement. Judgment was entered against Bloomington

Steel for Padilla's damages, and Padilla took an assignment of Bloomington Steel's claims against Travelers.

The declaratory judgment in favor of Travelers was then appealed to the Court of Appeals. There, the judgment of the district court was affirmed.

STANDARD OF REVIEW

The district court can properly determine the construction and interpretation of insurance policies on a motion for summary judgment and appellate courts will review the district court's decision de novo. See *Brown v. State Auto. & Cas. Underwriters*, 293 N.W.2d 822 (Minn.1980). Interpretation of an insurance policy and application of the policy to the facts in a case are questions of law that are reviewed de novo. *Franklin v. Western Nat'l Mut. Ins. Co.*, 574 N.W.2d 405, 406 (Minn.1998); *Am. Family Ins. Co. v. Walser*, 628 N.W.2d 605, 609 (Minn.2001).

The language in an exclusionary provision is construed in accordance with the expectations of the insured party. *Id.* at 613. Exclusions are also construed strictly against the insurer. *Id.* If the terms of the policy are plain and unambiguous, their plain meaning should be given effect. Any ambiguity should be construed in favor of the insured and against the insurer. See *Fillmore v. Iowa National Mutual Insurance Co.*, 344 N.W.2d 875, 877 (Minn.Ct.App.1984). In determining the severability of an insurance contract, courts are to construe insurance policies liberally in favor of the insured. *Olson v. Blue Cross and Blue Shield*, 269 N.W.2d 697, 700 (Minn.1978). In addition, ambiguities, particularly in exclusions, are to be interpreted against the insurer. *Caspersen v. Webber*, 213

N.W.2d 327, 330 (Minn. 1973). Language in an insurance policy is to be construed liberally in favor of the insured. *Olson v. Blue Cross & Blue Shield*, 269 N.W.2d 697, 700 (Minn.1978). This is especially true when public policy protects the insured. *Id.* When reasonably possible, words must be so construed as to make effective the general insurance purpose of the contract. *Gabrelcik v. National Indem. Co.*, 131 N.W.2d 534 (Minn. 1964).

ARGUMENT

The issue presented is whether for the purposes of interpreting an insurance policy, the knowledge or intent of an agent may be imputed to the corporate insured.

The Court should look to the terms of the policy to resolve the issue. Whenever a court interprets an insurance policy the role of the court is to determine what the parties' agreement is and to enforce it. In this case, the intentional acts exclusion is to be viewed from the standpoint of "the" insured seeking coverage. Further, the parties agreed that each insured seeking coverage would be treated as if they were the only insured and the coverage would apply separately to each insured. Clearly, the parties' agreement prohibits imputing of knowledge or intent from one insured to the other.

In the absence of contractual terms to the contrary, public policy supports the ability of a corporation to insure itself for liability created by the intentional acts of its agents. The State of Minnesota has expressed a public policy of allowing a corporation to insure itself against vicarious liability for damages. That

public policy would be frustrated if the intent or knowledge of a corporate agent was to be imputed for purposes of interpreting an insurance policy.

I. THE PARTIES TO AN INSURANCE CONTRACT ARE FREE TO CONTRACT AS THEY WISH, AND THE TERMS OF THEIR AGREEMENT GOVERN WHETHER KNOWLEDGE OR INTENT OF AN AGENT CAN BE IMPUTED TO THE CORPORATE INSURED.

It is a fundamental principle that an insurance contract is a matter of agreement between the parties, and the role of the court is to determine what the agreement is and to enforce it. *Fillmore v. Iowa Nat. Mut. Ins. Co.*, 344 N.W.2d 875 (Minn. App. 1984); *Grossman v. American Family Mut. Ins. Co.*, 461 N.W.2d 489 (Minn. App. 1990). In general, an insurer's liability is determined by the insurance contract as long as that insurance policy does not omit coverage required by law and does not violate applicable statutes. *Kelly v. State Farm Mut. Auto Ins. Co.*, 666 N.W.2d 328 (Minn. 2003).

Travelers and Bloomington Steel were free to enter into an insurance contract that they both agreed to. As long as the contract did not omit coverage required by law or violate any applicable statutes, the terms of their bargain must be enforced. Travelers could certainly have contracted for imputation of knowledge or intent of a corporate agent. However, Bloomington Steel was also entitled to contract for protection from liability based upon acts of its agent.

The court must examine the parties' agreement and determine if the issue of imputation of knowledge or intent of an agent was addressed. If it was then the court must enforce the terms of the agreement.

An examination of the terms of the contract reveals that imputation of intent or knowledge from one insured to another is prohibited. Travelers promised to pay damages that that Bloomington Steel was legally obligated to pay. Of course, the insurance contract excluded bodily injury that is “expected or intended from the standpoint of the insured.” Travelers then broadened their promise by agreeing that the policy would apply separately to each insured and as if the insured seeking coverage was the only insured. These terms require that the conduct of each insured be analyzed separately and independently when applying the exclusions from coverage. Imputation of knowledge or intent would have the effect of joining the insureds for purposed of applying the exclusions.

A. THE EXCLUSION MUST BE APPLIED ONLY FROM THE STANDPOINT OF “THE” INSURED.

Travelers chose the language of the exclusion for expected or intended injury. The language they chose was narrow. The exclusion reads as follows:

Exclusions

This insurance does not apply to:

a. Expected or Intended Injury

“bodily injury” or “property damage” expected or intended from the standpoint of **the** insured. This exclusion does not apply to “bodily injury” or “property damage” resulting from the use of reasonable force to protect persons or property.

Emphasis added.

Travelers promised that they would apply the exclusion from the viewpoint of “the” insured. This means that the insured seeking coverage would be entitled to coverage if he himself did not have knowledge of the impending injury or if he himself did not intend the injury. If Travelers is now allowed to impute the knowledge or intent of one insured to another, then their promise is illusory.

Travelers could have broadened the scope of the exclusion. They could have agreed that the exclusion would be interpreted from the standpoint of “any” insured. Travelers could have agreed to exclude coverage for any injury “arising from” or “resulting from” an intentional act. Travelers could have excluded all damages caused by assault and battery. The distinction between exclusions that contain the words “arising out of” and those that do not may be a fine one, but it is appropriate and sound. *Redeemer Covenant Church of Brooklyn Park v. Church Mutual Ins. Co.*, 567 N.W.2d 71, 77 (Minn. Ct. App. 1997). Insurers are free to draft lawful exclusions as they see fit. *Id.* The holding in *Redeemer* underscores a recognition that narrowly drafted exclusions apply only to what they specifically exclude. *Id.* at 77.

Any of those alternatives would have resulted in a contractual imputation of knowledge or intent from one insured to another. Absent such a contractual agreement, Travelers should not be allowed to impute intent or knowledge of one insured to another.

B. THE SEPARATION OF INSUREDS CLAUSE PROHIBITS IMPUTATION OF INTENT OR KNOWLEDGE FROM ONE INSURED TO ANOTHER.

Travelers and Bloomington Steel agreed that each insured under the policy would be entitled to separate and independent coverage. The policies at issue contain a separation of insureds clause. The clause states:

Separation of Insureds.

Except with regard to the Limits of Insurance and any rights or duties specifically assigned in this Coverage Part to the first Named Insured, the insurance applies:

- c. As if each Named Insured were the only Named Insured; and
- d. Separately to each insured against whom claim is made or "suit" is brought.

This clause requires any analysis regarding the coverage provided to be made separately for each insured. Severability is a widely recognized doctrine that acknowledges the separate and distinct obligations the insurer undertakes to the various insureds, both named and unnamed. *See, e.g., Utica Mut. Ins. Co. v. Emmco Ins. Co.*, 243 N.W.2d 134 (Minn. 1976); *Morgan v. Greater New York Taxpayers Mut. Ins. Ass'n*, 305 N.Y. 243, 248-49, 112 N.E.2d 273, 275 (1953); *Allstate Ins. Co. v. Mangum*, 299 S.C. 226, 229, 383 S.E.2d 464, 466 (S.C.Ct.App.1989).

The intent of a severability clause is to provide each insured with separate coverage, as if each were separately insured with a distinct policy, subject to the liability limits of the policy. *United States Fidelity & Guar. Co. v. Globe Indem.*

Co., 60 Ill.2d 295, 299, 327 N.E.2d 321, 323 (1975). Thus, severability demands that policy exclusions be construed only with reference to the particular insured seeking coverage. See *Utica Mut. Ins. Co.*, at 140; see also 13 Appleman, *Insurance Law & Practice* § 7486 at 633 (rev.ed. 1976).

The Supreme Court of Minnesota has previously interpreted a separation of insureds clause as follows:

The policy states: "This insurance applies separately to each insured." A reasonable interpretation of these words leads to the obvious and singularly correct conclusion that each insured must be treated as if each were insured separately, applying exclusions individually as to the insured for whom coverage is sought... The doctrine of severability limits application of the exclusion to the insured claiming coverage and those deriving their insured status from that insured claiming coverage. There would be no point to a severability clause if it did not provide [coverage] separately to each named insured.

American National Fire Insurance Company v. Estate of Fournelle, 472 N.W.2d 292, 294 (Minn. 1991).

Under the terms of the policy both Cecil Reiners and Bloomington Steel are "insureds". Thus, the analysis as to whether either should be afforded coverage must be made for each insured, Reiners and Bloomington Steel, separately and independently of the other. The conduct of each must be examined separate from the conduct of the other to determine if coverage applies. If intent or knowledge were imputed to the corporate insured, the severability clause would become a nullity.

The separation of insureds clause stands in contrast to a "joint obligations" clause, which states that the responsibilities, acts or failure to act of a person

defined as an insured will be binding on all other insureds. *See Allstate Ins. Co. v. Steele*, 74 F.3d 878 (8th Cir. 1996). A joint obligations clause would have had the effect of contractually imputing intent or knowledge of one insured to another. Travelers could have employed a joint obligations clause to restrict the coverage, but here Travelers chose to use the separation of insureds clause and provide broader coverage.

This is not a situation where the language of the policy is contorted to create coverage. Insurance companies know how to draft a policy that imputes knowledge or intent from one insured to another. They do it all the time. If an insurer wants a joint analysis of all insured's conduct all they have to do is use the joint obligations clause. When they instead use the separation clause, the result is that each insured is entitled to a separate analysis of coverage. Travelers made the choice of which clause to use. They should not now be allowed to contort the policy language in their favor.

A comparison of two cases, *Mork Clinic v. Fireman's Fund Insurance Co.*, 575 N.W.2d 598 (Minn. Ct. App. 1998) and *Allstate Ins. Co. v. Steele*, 74 F.3d 878 (8th Cir. 1996)³ illustrates the effect of the separation of insureds clause. Both cases presented with similar facts, a corporate insured was sued for negligence that

³ Although *Mork* and *Steele* interpret the occurrence language of the policy rather than the intentional acts exclusion, this court has previously acknowledged that accidental conduct and intentional conduct are opposite sides of the same coin. The scope of occurrence language in many respects defines the scope of the intentional acts exclusion. *American Family Ins. Co. v. Walser*, 628 N.W.2d 605, 611 (Minn. 2001).

led to an intentional sexual assault by an employee. In *Mork* the Court found coverage for the corporate insured because the policy contained a separation of insureds clause, while in *Steele*, the Court found no coverage for the corporate insured because the policy contained a joint obligations clause.

In *Mork Clinic v. Fireman's Fund Insurance Co.*, 575 N.W.2d 598 (Minn. Ct. App. 1998) a declaratory judgment action was brought to determine coverage for an employee's alleged sexual abuse of patients. The plaintiffs in that action claimed negligence in the hiring, supervision and retention of the employee. There was no dispute that the underlying act of the employee was intentional, and the definition of an occurrence was identical in that case to the definition in Travelers' policies. Finally, like the present situation, the policy contained a separation of insureds clause.

In *Mork* the insurer argued that negligent retention claims depend on an accompanying intentional tort, and alleged that the two acts are so interrelated and coexistent that neither can be viewed separately. The insurer argued that the clinic's alleged negligence was subsumed into the intentional act of its employee, so that neither action was an "occurrence" under appellant's policy. Travelers argues similarly that the conduct of Reiners and Bloomington Steel are interrelated and they should not be viewed separately.

The *Mork* Court found that the separation of insureds clause in the policy supported the conclusion that the employer's negligence was a causative occurrence, " Appellant suggests that the employer's alleged wrongdoing is

interrelated with the employee's intentional act, but the severability clause calls for separate examination of the duties of each insured.” *Mork* at 602.

Thus, the Court held that there was coverage for the negligence claims that had been presented against the employer. *Id.* This was true even if the employee was not separately covered for his intentional act.

Steele was also a sexual molestation case involving claims of negligence against the named insured. The Court held in *Steele* that the intentional act of one insured had to be imputed to the named insured, and therefore no coverage existed to indemnify the named insured. The difference in *Steele* was the language of the policy.

There, the policy contained a joint obligations clause rather than a separation of insureds clause. It was that language that made the difference. The joint obligation clause allowed the insurer to impute the intent of one insured to another.

The Eighth Circuit later reiterated the distinction when they decided *American Employers Ins. Co. v. John Doe* 3B, 165 F.3d 1209 (8th Circ. 1999). The case presented with similar facts: one insured acted intentionally to sexually abuse the plaintiff while the named insured was sued for negligent hiring and supervision. The insurance policy at issue however had a separation of insureds clause rather than a joint obligations clause. When that policy provision was given effect, the court came to the conclusion that the negligent insured was entitled to coverage. *Id.* at 1212.

Other jurisdictions agree the separation of insureds clause prohibits imputing the knowledge or intent of one insured to another. The Supreme Court of Texas took up the issue in *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185 (Tex. 2002). King had been sued for negligently hiring an employee that intentionally injured another person. Dallas Fire refused to defend and indemnify alleging that the employee's intentional conduct could not be an occurrence under the terms of the policy. The policy had a separation of insureds clause that is identical to the one in Travelers' policy.

In deciding the case, the court examined the reasoning of two Fifth Circuit cases⁴ that had concluded that one insured's intentional conduct determined that there could be no coverage for any insured. The Texas Supreme Court rejected the reasoning of those cases:

We conclude that the Fifth Circuit's rule improperly imputes the actor's intent to the insured. That is to say, whether one who contributes to an injury is negligent is an inquiry independent from whether another who directly causes the injury acted intentionally. Essentially, the actor's intent is not imputed to the insured in determining whether there was an occurrence. We conclude this is the better approach.

King at 191-92.

The Eighth Circuit has followed suit. In *Silverball Amusement, Inc. v. Utah Home Fire Ins. Co.*, 842 F. Supp. 1151 (W.D. Ark. 1994) *aff'd*, 33 F.3d 1476 (8th Cir. 1994), the appellate court adopted the opinion of the District Court, and

⁴ *American States Ins. Co. v. Bailey*, 133 F.3d 363 (5th Circ. 1998); *American Guar. & Liab. Ins. Co. v. 1906 Co.*, 129 F.3d 802 (5th Circ. 1997).

rejected prior decisions that refused to separate the conduct of two insureds. The District Court reasoned as follows:

The Ultimate effect of such opinions as *Sky*⁵ leads to a metamorphosis in which certain negligent actions are transformed by the court into intentional actions for the purposes of deciding negligent hiring cases involving sexual abuse. Such a decision effectively dissolves the distinction between intentional and negligent conduct, allowing the intentional act to devour the negligent act for the purpose of determining coverage. The correct method of analyzing this issue in cases with the factual setting and insurance policy provisions involved in Utah Home would deal with each act on its own merits and recognize that employers who make negligent hiring decisions clearly do not intend the employees to inflict harm.

Silverball at 1163. Judge Wilson also indicates that one of the reasons for his decision was the presence of the separation of insureds clause. *Id.* at 1160.

In the present case, Travelers made a choice to write a broader form of coverage. Rather than use the more restrictive joint obligation clause, they chose the separation of insureds clause. They should not now seek to impute knowledge or intent from the employee to the corporate insured. They agreed to interpret the policy separately and independently for each insured seeking coverage. The court should enforce that agreement.

II. PUBLIC POLICY CONCERNS MANDATE THAT, FOR PURPOSES OF INTERPERTING AN INSURANCE CONTRACT, KNOWLEDGE OR INTENT OF AN EMPLOYEE SHOULD NOT BE IMPUTED TO A CORPORTATE INSURED ABSENT AGREEMENT OF THE PARTIES.

Absent an agreement of the parties, public policy supports an insured's ability to insure against liability imposed by law as a result of an agent's actions.

⁵ *Commercial Union Insurance Companies v. Sky, Inc.*, 810 F. Supp. 249 (W.D. Ark. 1992).

In that situation the employer is innocent, and has not itself acted intentionally or recklessly. Rather, it is only by operation of law that the employer is liable. If knowledge or intent of the agent is imputed to the employer, absent agreement of the parties, then the employer will be unable to protect itself by purchasing adequate liability insurance.

A. PUBLIC POLICY SUPPORTS FREEDOM OF CONTRACT.

There are several public policy considerations that must be considered when the court decides if it is proper to impute knowledge or intent of an agent to the employer for the purposes of interpreting insurance coverage. First, parties are free to contract as they wish. If the parties to an insurance contract agree that the acts of the agent are to be imputed to the corporate insured, then that agreement should be enforced. Likewise, if they agree that each insured is entitled to an independent assessment of coverage, then that agreement should also be enforced. So long as the contract does not omit coverage required by law or violate any applicable statutes the parties are free to contract as they desire. *Kelly v. State Farm Mut. Auto Ins. Co.*, 666 N.W.2d 328 (Minn. 2003).

As has been discussed above it is not as if insurers do not know how to contract for imputation of knowledge and intent. Numerous times have the courts had the opportunity to assess coverage for negligent hiring and supervision when the contract contained a joint obligations clause. Courts have uniformly enforced the terms of the contract and denied coverage. *See Commercial Union Insurance Companies v. Sky, Inc.*, 810 F. Supp. 249 (W.D. Ark. 1992); *Allstate Ins. Co. v.*

Steele, 74 F.3d 878 (8th Cir. 1996). When the parties agree to contract terms with the opposite effect, the court should also enforce the terms of the contract and find coverage for the negligent insured.

B. THE PUBLIC POLICY BEHIND TORT LAW IS TO PROVIDE A SOURCE OF COMPENSATION FOR INJURED PERSONS.

There is also a general state policy that tort victims should be compensated for their injuries. *See Tuenge v. Konetski*, 320 N.W.2d 420, 422 (Minn. 1982). It is that public policy that has resulted in employers being liable for the actions of their employees. Under the well-established principle of respondeat superior an employer is vicariously liable for the torts of an employee committed within the course and scope of employment. *Schneider v. Buckman*, 433 N.W.2d 98, 101 (Minn.1988). Such liability stems not from any fault of the employer, but from a public policy determination that liability for acts committed within the scope of employment should be allocated to the employer as a cost of engaging in that business. *See Lange v. National Biscuit Co.*, 211 N.W.2d 783, 785 (Minn. 1973).

The rationale for imputing liability to the employer is to properly allocate the risk. The risk of loss should be placed upon the enterprise that profits from the activity as a cost of doing business. It is then understood that the employer will absorb those costs through the price of goods and the purchase of liability insurance. *See Prosser and Keeton on Torts*, Fifth Edition, W. Page Keeton, §69 1984.

Respondeat superior is a type of vicarious liability. The liability of the

employer is imputed to the employer. Thus for public policy reasons of creating a source of compensation for victims, the conduct of the employee is imputed to the employer. This is different than the concept of derivative liability of the employer which is based wholly on the conduct of the employer.

The concept of employer liability was later expanded to include the ability to sue the employer for their own negligence in the hiring, supervision and retention of an employee. *Ponticas v. K.M.S. Investments*, 331 N.W.2d 907 (Minn. 1983). This is known as derivative liability as opposed to vicarious liability as discussed above. Today derivative liability is recognized as the rule in the majority of the jurisdictions and recognized as the law by *Restatement (Second) Agency* § 213 (1958) which states:

A person conducting an activity through servants or other agents is subject to liability for harm resulting from his conduct if he is negligent or reckless:

(b) in the employment of improper person or instrumentalities in work involving risk of harm to others.

It should be noted that derivative liability for negligence of the employer in the hiring, retention or supervision of employees represents a direct duty running from the employer to the general public. Liability is premised upon the conduct of the employer not the behavior of the employee. Under these theories of liability there is no imputation from the employee to the employer. Thus, it is distinguishable from liability imputed to an employer as a result of the doctrine of respondeat superior. See Note, *The Responsibilities of Employers for the Actions of Their Employees: The Negligent Hiring Theory of Liability*, 53 Chi-Kent L.Rev.

717, 717-19 (1977); 9 U.Balt.L.Rev. 438, 439 (1979).

So it is based upon public policy that liability has been created for employers for damages arising from the intentional actions of their employees. Why then would we adopt policy that would effectively prevent an employer from being able to protect itself from such liability through the purchase of insurance? That would be the result if we adopt a rule that imputes the knowledge or intent of an agent to the employer for the purposes of interpreting the policy of insurance.

C. PUBLIC POLICY SUPPORTS THE ABILITY OF A CORPORATION TO PROTECT ITSELF FROM VICARIOUS OR DERIVATIVE LIABILITY BY PURCHASING ADEQUATE LIABILITY INSURANCE.

There are also public policy considerations that counsel against providing insurance for an intentional act. It has long been the policy of Minnesota that one may not insure himself for his own intentional conduct. That policy is carried out by way of an intentional acts exclusion which is intended to remove a license for the insured to commit wanton and malicious acts. *Farmers Ins. Exchange v. Stipple*, 255 N.W.2d 373 (Minn. 1997) (reversed on other grounds).

However, it is quite another thing to suggest there is public policy against a corporation insuring itself for vicarious or derivative liability for an employee that intentionally injures another. In that situation, the insured corporation has not acted intentionally or recklessly. Rather, the corporation has either liability for their own negligence or liability is imputed for public policy reasons.

To the contrary, it would be extremely unsound policy for the courts to impose liability upon a corporation based upon its own negligent conduct or public policy and then on the other hand refuse to allow that corporation to insure itself for that liability. Such policy would not only frustrate the ability of tort victims to be compensated, but it would also prevent the business world from spreading the risk through the purchase of liability insurance.

A typical negligent hiring and supervision case provides a useful illustration. An employer hires an employee with a criminal background or a history of violence. Evidence reveals that the employer was negligent in that they did a poor job of selecting its agent or perhaps they failed to provide supervision for their employee. Although the employer certainly did not expect or intend for its employee to cause bodily injury to another person, the injured party proves that some harm was foreseeable to the employer.

Even though the employee acted intentionally to cause injury to plaintiff, for public policy reasons we have decided that the employer can be sued for the damages that arise from the intentional act of its employee. Therefore the employer then faces legal liability for perhaps significant damages.

No doubt the employer will then seek the protection of the insurance coverage for which it has paid an ever increasing premium to obtain. The employer took the care to purchase a contract of insurance that specifically prohibited the imputation of intent or so they thought. The policy provided that each insured seeking coverage would be entitled to a separate and independent

analysis of the available coverage. Further, the policy provides that only those damages that were expected or intended from the viewpoint of “the” insured seeking coverage would be excluded.

Under the rule proposed by Travelers, the insurer could properly refuse to defend and indemnify their insured. Although the named insured that has spent premiums to obtain the protection of the policy did not expect or intend any harm, the insurer would be allowed to impute the intent and knowledge of the employee to the corporation. In effect, the employer would be unable to purchase insurance to protect itself from negligent hiring or supervision claims.

Should we turn our back on those employers and leave them unable to protect themselves?

The legislature has recognized this concern by expressing a public policy of allowing insurance for vicarious liability. They did so by enacting the following statute:

60A.06 Kinds of insurance permitted

Subd. 4. Vicarious liability; punitive damages. Any insurance corporation or association may insure against vicarious liability for punitive and exemplary damages within any of the kinds of business pertaining to the issuance of liability insurance that the insurance corporation or association is authorized to transact under subdivision 1 or 2.

Minn. Stat. §60A.06 Subd. 4 (Laws 2000).

As illustrated by the above statute, Minnesota has decided to allow employers to insure themselves for vicarious liability. This is true even if the conduct is severe enough to warrant punitive damages. As was discussed above,

vicarious liability results from imputation of the actions of the employee to the employer. If we are to allow insurance for vicarious liability for punitive damages, then why would we not allow insurance for vicarious or derivative liability for compensatory damages?

If the employee's actions are extreme enough to create liability for punitive damages, then we know that the employee has acted with willful indifference to the rights of others. If that malice is imputed to the employer, then the employer would not be able to insure itself, because coverage would be excluded by "occurrence" language or the intentional acts exclusion. Such a rule would run afoul of the specific statute allowing the sale of insurance coverage for such liability.

The court should continue the long tradition of allowing insurers to write coverage however they and their customers agree. As long as the agreement does not omit coverage required by law or violate any statutes, the parties are free to draft the agreement as they see fit. The role of the court is to determine what the agreement is and to enforce it.

CONCLUSION

To determine whether to impute the intent or knowledge of one insured to another, the court should look to the terms of the policy of insurance. That approach would be consistent with the long established rules of insurance contracts and with the public policy of allowing an employer to insure itself for vicarious liability for the actions of its agents.

Appellant respectfully requests the court to reverse the judgment of the district court and the Court of Appeals and remand with direction to enter judgment in favor of Appellant.

Respectfully submitted.

Dated: 8-17-05

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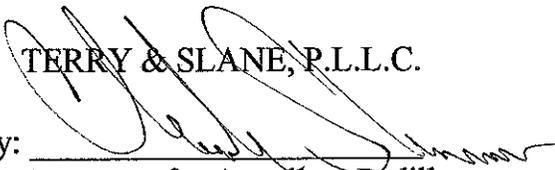
CERTIFICATION OF BRIEF LENGTH

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01 Subd. 1 and 3, for a brief produced with proportional font. The length of the brief is 688 lines and 6,897 words. This brief was prepared using Microsoft Word 2003.

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).