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# State of Minnesota
# In Supreme Court

Mark Schmitt,

*Employee/Respondent,*

vs.

Innovative Lawn Systems, and Total Repair Services,

*Employers/Respondents,*

and

American Interstate Insurance Co.,

*Insurer/Respondent,*

and

West Bend Mutual Insurance Co.,

*Insurer/Relator-Appellant,*

and

MN Dept. of L & I Rehab Unit, MN Dept. of Human Services,
St. Paul Radiology, and Regions Hospital,

*Intervenors,*

and

Special Compensation Fund,

*Respondent.*

## REPLY BRIEF OF APPELLANT WEST BEND MUTUAL INSURANCE COMPANY

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## ARGUMENT

The purpose of this brief is to reply to selected arguments raised in the response briefs of Innovative Lawn Systems and American Interstate. In addition, West Bend submits this brief in response to ILS' appeal of the lower courts' denial of attorney fees.

**I. Contrary to Innovative Lawn Systems' arguments, American Interstate's coverage is not secondary to West Bend, and therefore, Innovative Lawn Systems could not have relied on West Bend's agent to its detriment, if it was still insured by American Interstate at the time of the Employee's injury.**

In arguing that American Interstate's coverage would be secondary to West Bend, ILS appears to ignore West Bend's primary argument that there is no basis to apply promissory estoppel, if ILS continued to be insured by American Interstate at the time of the Employee's injury. Assuming ILS was insured by American Interstate due to American Interstate's failure to properly terminate its coverage, then the Employee's claim will be covered by American Interstate and it does not matter whether ILS mistakenly thought it had a workers' compensation policy with West Bend. It seems a bit peculiar that ILS would argue to the contrary, since this argument is actually favorable to ILS in that it is premised on a finding that ILS was insured by American Interstate. It is even more peculiar that ILS would claim West Bend is making this argument for the first time. Though the Workers' Compensation Court of Appeals ignored it, West Bend clearly asserted this argument on page twelve of its brief to the Workers' Compensation Court of Appeals:

Because American still insured ILS at the time of the Employee's injury, ILS could not have relied on West Bend's agent to its detriment. The agent's failure to write a workers' compensation policy for ILS did not harm ILS because it already had coverage with American. As discussed immediately below, harm is a necessary element to applying equitable estoppel. Therefore, if the compensation judge's ruling pertaining to American is reversed, so should his use of promissory estoppel against West Bend.

## II. American Interstate insured ILS for workers' compensation.

### A. American Interstate failed to comply with Minn. Stat. § 176.185 because it did not provide notice of termination to the Employer and the commissioner.

At least to the extent American Interstate failed to file a notice of termination of insurance with the commissioner, it is undisputed it failed to comply with the notice requirements set forth in Minn. Stat. §176.185. In an effort to avoid its statutory responsibilities, American Interstate claims "the sole purpose of Minn. Stat. §176.185 is to provide employers with timely notice of an intent to cancel a policy." Not only does this argument fail for trying to create an exception to a clearly drafted statute, it is simply untrue. The notice provision not only protects employers, but also assists the department of labor and industry in its efforts to assure a maximum number of employers are insured and a maximum number of injured workers receive their entitled benefits without relying on the special compensation fund. According to *Zakrajshek v. Shuster*, 239 N.W.2d 919 (Minn. 1976), Minn. Stat. § 176.185 is "intended to provide the employer a reasonable opportunity to obtain replacement insurance before his coverage is terminated and to provide the department a reasonable time to see that he does."

Unfortunately, American Interstate never filed its notice, so the department was unable to do its part to assure that the Employer obtained coverage.

**B. Valley Erosion and Innovative Lawn System are the same.**

In an additional effort to avoid the statutory notice requirements, on page sixteen of its brief, American Interstate argues: "The only reason the two companies are even remotely connected is that Innovative Lawn Systems was created under the shell of Valley Erosion company, presumably in order to avoid the expense associated with incorporating a brand new company." First, there is no evidence in the record the name change was done to save expenses. Second, the companies share more than a "shell". After Valley Erosion changed its name to ILS, Jeff Trog maintained a 50% ownership interest. Furthermore, ILS continued to perform lawn care and snow removal. Regardless any changes that occurred after the name change, the statute certainly does not provide any exceptions to the notice requirement just because a business changes ownership or some of its activities. Such an exception would serve no purpose. For example, in the present case, the name change did not prevent American Interstate from providing notice to the department.

## III. Innovative Lawn Systems did not reasonably rely to its detriment on the misrepresentations of West Bend's agent.

**A. American Interstate Argument.**

In its response brief, American Interstate implies that the agent must have thought ILS had workers' compensation insurance with West Bend because the

agent instructed John Trog to submit the Employee's claim to West Bend. However, considering the agent never wrote a West Bend workers' compensation policy for ILS, the only reasonable interpretation of his actions is that the agent thought the Employee was working for Total Repair, which was Jeff Trog's other company located at the same address. Such a mistake seems very likely considering the agent did not know ILS had any employees. (Just deposition T. 86 and 94-95; and Just deposition Exhibits 19 and 20.)

**B. Innovative Lawn Systems' Argument.**

Innovative Lawn Systems claims on page nineteen of its response brief that West Bend "fail(ed) to explain how the failure to inform Mr. Just that ILS had employees has anything to do with (ILS) reliance on … the certificates of insurance." Apparently, ILS is overlooking the fact that its reliance must be reasonable. See *Eide v. State Farm Mutual Automobile Ins. Co.*, 492 N.W.2d 549, 556 (Minn. Ct. App. 1992). The compensation judge's finding that ILS' reliance was reasonable should be reversed because ILS relied on the agent without ever informing the agent that it had employees. It may have been reasonable for ILS to rely on the certificates for their limited purpose of securing business, but it was certainly unreasonable to rely on certificates of insurance to assume its employees were covered when the agent had no way of knowing ILS had employees.

Regarding the standard of review, ILS is correct that promissory estoppel is a question of fact, and therefore, is typically reviewed under the *Hengemuhle* standard. However, West Bend is arguing as a matter of law the compensation judge should not

have been able to hold ILS' reliance on West Bend's agent was reasonable when ILS failed to notify the agent that it had any employees. In other words, it would be appropriate for this Court to create a bright line rule that a party cannot rely on promissory estoppel to claim an insurer is estopped from denying coverage when the party fails to disclose the object of insurance.

## IV. Innovative Lawn Systems is not entitled to an award of attorney fees and costs from West Bend.

Innovative Lawn Systems relies heavily on *Morrison v. Swenson*, 274 Minn. 127, 142 N.W.2d 640 (1966) to argue it is entitled to attorney fees, if it prevails in this coverage dispute. However, the clear holding in *Morrison* is that attorney fees "are generally not recoverable unless there is either contractual or statutory authority to do so. *See Garrick v. Northland Ins. Co.*, 469 N.W.2d 709 (Minn. 1991), citing *Morrison* at 137-138, 640-647. In the present case, there is neither statutory nor contractual authority to order West Bend to pay ILS' attorney fees and costs.

### A. ILS is not entitled to attorney fees from West Bend because the legislature did not provide for them in the workers' compensation statute.

Absent a statutory or contractual obligation, parties are typically responsible for their own attorney fees. *Lanoue v. Fireman's Fund Am. Ins. Cos.*, 278 N.W.2d 49, 54 (Minn. 1979). In *Sazama Excavating, Inc. v. Wausau Insurance Cos.*, 521 N.W.2d 379, 383-384 (Minn. Ct. App. 1994), the Minnesota Court of Appeals already confirmed the fact there does not exist a statutory basis for awarding attorney

fees in workers' compensation coverage disputes. In *Sazama*, the Court of Appeals upheld a declaratory action in which the district court ordered the workers' compensation insurer to cover a claim due to its failure to properly serve notice of the cancellation of its policy. However, the Court of Appeals reversed the district court's finding that the insurer owed a duty to defend. The court reasoned that a workers' compensation claim is a creation of statute, while the attorney fee exception is a creation of common law. As a matter of statute, new rights and obligations of the parties should only be created by the legislature. This is simply a case where a legitimate dispute existed between multiple parties. As with most legal disputes, regardless the outcome, all the parties had some part in creating the dispute. Therefore, unless the statute indicates otherwise, it is only fair that all the parties are responsible for their own defense costs.

On page twenty-six of its brief, ILS urges the Court to ignore the *Sazama* decision and in doing so argues that other common law exceptions exist in workers' compensation: estoppel, res judicata, apportionment, attorney-client privilege, and principles of common law fraud. Creating a common law duty to defend exception would be drastically different than the exceptions ILS relies upon. The duty to defend is a duty in and of itself, which is not referenced in the workers' compensation statute. In contrast, the examples provided by ILS involve determining when and how to apply the rights and duties that already exist within the workers' compensation statute. Though it is a difficult distinction to explain, it is very significant. All of the examples cited by ILS involve a form of interpretation or

a manner of application of the statutory rights, duties, and benefits created by the legislature. For example, promissory estoppel is a common law rule used to create contractual obligations between parties. In the case of workers' compensation, it can be used to create coverage without a policy. However, it does not create new types of benefits or duties beyond those already contained in the workers' compensation statute.

**B. West Bend cannot be held responsible for ILS' attorney fees and costs because ILS does not have a workers' compensation policy with West Bend, and therefore, no contractual duty to defend exists.**

In *Morrison*, this Court awarded attorney fees as a damage arising directly from the breach of contract. In contrast, as the compensation judge noted in Finding 22, there was no insurance policy between West Bend and ILS. Therefore, there was no contract under which the duty to defend could arise. The compensation judge held West Bend is estopped from denying coverage for this claim. He did not hold that a workers compensation policy exists between West Bend and ILS. West Bend is only responsible for the Employee's benefits and to that extent will be responsible for defending against any disputed benefits the Employee may claim. However, the case before the compensation judge did not involve defending against the Employee's claim. The only issue was the coverage dispute between ILS, American Interstate, and West Bend. As such, the American Rule for attorney fees shall apply. There is no basis for an exception. This was not a frivolous case. A legitimate dispute existed, which each of the parties were at least in part responsible for creating. Though the prevailing parties will have incurred legal expenses, at least it

will be money well spent. On the other hand, it would be an unfair and unjust penalty to the losing party to award attorney fees that arose from a legitimate legal dispute following what appears to be an honest misunderstanding.

Innovative Lawn Systems argues on page twenty-four of its brief: "When an insurer breaches its contract by failing to provide a defense to an arguably covered claim, and litigation is required for the insured to enforce its right to a defense and indemnification, the insured is generally awarded fees and costs." In support of this argument Innovative Lawn Systems relies on *Morrison*. However, *Morrison* is readily distinguishable on the grounds it involved a coverage dispute between an insurer and an insured. In contrast, West Bend and ILS are not insurer and insured. The court in *Morrison* held the insurer had a contractual obligation to insure the claim. The duty to defend stemmed from this contractual agreement. Similarly, ILS claims this case is analogous to case law involving no-fault coverage disputes. However, ILS failed to point out that those disputes pertain to automobile policies between insureds and insurers. As such, an attorney fee award can be considered contractual. In the present case, the Court did not find a contractual agreement existed between West Bend and ILS.

Though there might be an equitable argument in favor of awarding attorney fees, in the past this Court has declined to award fees when a contractual duty to defend does not exist. *Garrick* at 714. "For over 100 years, the law in Minnesota has been that, absent a contractual agreement or statute, a party cannot collect attorney fees." Id, citing *Frost v. Jordon*, 37 Minn. 544, 546, 36 N.W. 713, 714

(1887). According to *Garrick*: "If the change in Minnesota's historical doctrine is to be made, it seems to us that this argument ought to be directed to the legislature." Id.

## CONCLUSION

As argued above and in its original brief, Appellant respectfully requests the Court to reverse the decisions of the Workers' Compensation Court of Appeals and the compensation judge. West Bend cannot be estopped from denying coverage because American Interstate insured ILS at the time of the Employee's injury. In the alternative, West Bend cannot be estopped from denying coverage because it was unreasonable, as a matter of law, for ILS to rely on the misrepresentations of West Bend's agent when ILS failed to disclose essential information necessary for the agent to assess ILS' coverage needs.

Furthermore, Appellant respectfully requests the Court to uphold the lower court holdings denying attorney fees to ILS.

Respectfully submitted,

Dated: 8-28-07

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