

A10-714

State of Minnesota  
In Supreme Court

*David and Melynda Quade,*

Respondents,

vs.

*Secura Insurance,*

Appellant.

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**RESPONDENTS' BRIEF, ADDENDUM AND APPENDIX**

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**Richard D. Snyder (#191292)**  
FREDRIKSON & BYRON, P.A.  
200 South Sixth Street, Suite 4000  
Minneapolis, MN 55402-1425  
Telephone: (612) 492-7145  
Facsimile: (612) 492-7077

*Attorneys for Respondents*  
*David and Melynda Quade*

**Andrea E. Reisbord (#22411X)**  
**Dawn L. Gagne (#158550)**  
COUSINEAU MCGUIRE CHARTERED  
1550 Utica Avenue South, Suite 600  
Minneapolis, MN 55416-5318  
Telephone: (952) 546-8400  
Facsimile: (952) 546-0628

*Attorneys for Appellant*  
*Secura Insurance*

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).

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## STATEMENT OF ISSUES<sup>1</sup>

- I. Whether the District Court erred by ordering the parties to appraise an insurance coverage dispute.

Authority:

- *Mork v. Eureka-Security Fire & Marine Ins. Co.*, 230 Minn. 382, 384, 42 N.W.2d 33 (1950)
- *Glidden Co. v. Retail Hardware Mut. Fire Ins. Co. of Minn.*, 233 N.W. 310 (Minn. 1930)
- *Johnson v. Mutual Service Cas. Ins. Co.*, 732 N.W.2d 340 (Minn. Ct. App. 2007) *rev. denied* (Minn. 2007)

- II. Whether the District Court erred by dismissing the Complaint with prejudice.

Authority:

- Minn. R. Civ. P. 41.02(c)

- III. Whether the District Court erred by concluding that an appraisal would be governed by the Uniform Arbitration Act.

Authority:

- *Johnson v. Mutual Service Cas. Ins. Co.*, 732 N.W.2d 340 (Minn. Ct. App. 2007) *rev. denied* (Minn. 2007)

## STATEMENT OF THE CASE

The Quades commenced a breach of contract action against Secura on June 26, 2009. (A. App. 1.) The Quades moved to compel discovery, and Secura defended the motion by arguing that the district court lacked jurisdiction over the case because of the existence of the appraisal clause, and therefore could not compel discovery. The district court disagreed, and on October 14, 2009 issued an order concluding that Secura was

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<sup>1</sup> The issues were preserved below in the briefing and arguments presented to the district court and the court of appeals.

contesting its liability in the case, not the amount of the loss, and therefore the court had jurisdiction. (R. Addendum 1.) Secura then filed a petition for writ of prohibition in the court of appeals. *In re Secura Insurance*, No. A09-2002. On December 15, 2009, the court of appeals denied the petition, concluding (as the district court had concluded) that Secura was contesting its own liability under the policy, an issue for the court to resolve, not appraisers. (R. Addendum 4.)

While its petition for a writ of prohibition was pending in the court of appeals, Secura filed a motion for summary judgment, seeking to dismiss the Complaint, and seeking an order compelling the Quades to participate in an appraisal proceeding. The motion was heard by a different district court judge on December 3, 2009, and the court issued its order dismissing the Complaint “with prejudice” on February 22, 2010. (A. Addendum 11.) Judgment was entered on February 23, 2010. The Quades timely filed their notice of appeal on April 20, 2010. The court of appeals reversed.

### **STATEMENT OF THE FACTS**

#### **A. A Storm Causes Extensive Damage to The Quades’ Farm.**

On July 10, 2008, a major storm hit the Quades’ farm in Hastings, Minnesota. (A. App. 1-2.) The storm’s high winds were strong enough to push the feed silo five feet off its base and push another structure four inches off its foundation. (R. App. 33.) The winds tore the sliding door off the cow barn and tore off a large section off the feeding structure and other structures. (R. App. 29-30.) The winds were strong enough to

overturn loaded semitrailers that were parked on the property, and completely leveled buildings on a neighbor's farm. (R. App. 22, 31-32.)

In addition to other damage, the high winds caused extensive damage to metal roofs on three of the structures on the farm.<sup>2</sup> (A. App. 2.) On the horse barn, the winds lifted and pushed the roof, tore the roof off of its fasteners, pulled purlins off of the trusses to which they were attached, broke A-frame truss supports, damaged other trusses, and caused the metal roof itself to be significantly deformed. (*Id.*, ¶ 8; R. App. 23, 25, 26, 28.) On the warehouse building on the farm, the high winds separated the seams of the roof, separated the roof from its fasteners, deformed the roof, and allowed substantial water intrusion. (A. App. 2, ¶ 8, R. App. 24, 27.) Similar damage and deformation was caused to the roof of the cow barn. (*Id.*)

**B. The Insurance Policy.**

The Quades were insured under a “Special Farm Owners Protector Policy” that they purchased from Appellant Secura Insurance. (R. App. 43.) “Coverage D” of the policy insures, on a replacement cost basis, “farm barns, buildings and structures” against direct physical loss caused by “windstorm or hail” among other listed perils. (R. App. 85.) The policy also includes certain coverage exclusions. The “maintenance” exclusion

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<sup>2</sup> See R. App. 23 (showing the holes in one of the roofs created by the roof fasteners when the wind lifted the roof up); R. App. 24 (showing deformation of the roof line); R. App. 25 (showing that the purlins supporting the roof were ripped away from the roof joists); R. App. 26 (showing that the force of the winds broke interior roof supports); R. App. 27 (showing deformation in the seams of the roof caused by the wind); R. App. 28 (showing further deformation in one of the roofs). Secura's assertion that the winds caused no damage whatsoever to the roofs of the buildings is completely unsupported.

at issue in this case provides: “We do not insure for loss to property caused by . . . faulty, inadequate or defective . . . maintenance of part or all of any property . . .” (R. App. 91-92.)

**C. Secura Denies Coverage for Damage to the Roofs.**

The Quades submitted a replacement cost claim for the roof damage.<sup>3</sup> They included in their claim replacement cost estimates for the three roofs that were damaged by the storm. (R. App. 37-42.) Secura paid for part of the damage to *other* structures on the farm, but refused to pay *anything* for the damage that the storm caused to the roofs of the three buildings. In its denial letter dated May 11, 2009, Secura stated that the claim for roof damage was not covered because of an exclusion in the policy:

Your farm policy excludes “loss to property caused by any of the following . . . (4) Maintenance”. This is stated in your policy on page 14 (copy enclosed). I am sorry but we are unable to honor your claim for damage to the roof of the buildings.

(A. App. 46.)

This exclusion was the *sole* basis for Secura’s denial of the claim. Secura did not dispute that the roofs were, in fact, damaged. Its denial letter admits the existence of damage, but contends the damage allegedly was caused by an excluded peril. Importantly, Secura also never challenged, rejected or disagreed with the Quades’ replacement cost estimates for the three roofs. Secura never said that the estimates were inaccurate, never said they were unreasonable, and never said the estimates were

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<sup>3</sup> The Quades also submitted claims for damage to other structures. Those claims are not at issue in this case.

anything other than the actual cost to replace the roofs. Significantly, Secura never offered its own, different estimate for the cost of replacing the roofs.

Simply stated, Secura has never disagreed with the Quades' valuation of the damage -- the replacement cost of the roofs. Instead, Secura's sole reason for refusing to pay anything for the roof damage is that the loss is allegedly not covered by the insurance policy.

After denying the claim based on an exclusion in the policy, and *not* based on any difference of opinion about the amount of loss, Secura stated that if the Quades disagreed with its coverage denial, they could request an appraisal pursuant to the appraisal clause in the policy. (A. App. 48.) The appraisal clause provides:

**Appraisal.** If you and we fail to agree on *the amount* of loss,<sup>4</sup> either may demand an appraisal of the loss. In this event, each party will choose a competent appraiser within 20 days after receiving a written request from the other. The two appraisers will choose an umpire. If they cannot agree upon an umpire within 15 days, you and we may request that the choice be made by a judge of a court of record in the state where the residence premises is located. The appraisers will separately set *the amount of loss*. If the appraisers submit a written report of an agreement to us, the amount agreed upon will be the amount of loss. If they fail to agree, they will

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<sup>4</sup> The policy does not say the amount of "covered" loss, just the amount of loss. Had Secura wanted a general arbitration provision to address whether something constitutes a "covered" loss under the policy, it could have included such a provision. Having included a much narrower appraisal provision concerning only the "amount" of loss, Secura cannot now argue that the provision broadly encompasses coverage issues. See *Secord v. Chartis, Inc.*, 2011 WL 814743 (S.D.N.Y. March 7, 2011) at \*3 ("The problem with [the magistrate judge's analysis] is that he considers what the parties could have done, not what they did. AIU could have included a general arbitration clause in its Policy, but it did not. Alternatively, the parties could have expressly authorized the appraisers to decide scope and coverage issues in determining loss amount, but they did not").

submit their differences to the umpire. A decision agreed to by any two will set the amount of loss. Each party will:

- a. pay its own appraiser; and
- b. bear the other expense of the appraisal and umpire equally.

(R. App. 94.) (Emphasis added.) However, because no disagreement existed as to the “amount” of replacement costs for the roofs, and instead, the only disagreement was whether the “maintenance” exclusion in the policy applied to the admitted damage to the roofs, there was nothing to appraise, so the Quades commenced the present breach of contract action. (A. App. 1.)

**D. The Court of Appeals Agrees That No Dispute Exists to Appraise.**

A discovery dispute thereafter arose in the district court proceedings. When Secura served its Answer, it raised various defenses, including coverage defenses. For example, Secura asserted in its Answer that the Quades’ claim is “excluded” under the terms of Secura’s policy. (A. App. 7, ¶18.) Secura asserted a total of 13 affirmative defenses.<sup>5</sup> (A. App. 6-7.) To explore the purported bases for Secura’s coverage defenses, the Quades served requests for production of documents and interrogatories. (R. App. 3-14.) The discovery specifically requested the factual basis for the coverage defense that Secura relied upon in denying the Quades’ claim. (R. App. 13, Interrogatory No. 22.)

Secura refused to respond to discovery about its coverage defenses (or anything else), so the Quades filed a motion to compel discovery which was heard by the Dakota

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<sup>5</sup> Secura has not waived any of its defenses in this case, and continues to assert the applicability of policy exclusions and other defenses.

County District Court, Hon. Michael J. Mayer on October 12, 2009. Secura argued in opposition to the motion that the appraisal clause in the policy divested the district court of jurisdiction. In an order dated October 13, 2009, the district court ordered Secura to answer the discovery and expressly rejected Secura's argument that its coverage defense could be resolved by appraisers instead of by the court. (R. Addendum 1.) The court found that "Defendant has clearly asserted exclusions to the insurance policy as a defense against the Plaintiffs' claim. This necessitates the interpretation of the insurance policy contract, which is the province of the Court not the appraisal process." (R. Addendum 2.) The court directed Secura to answer the discovery requests.

Secura failed to comply with the district court's order. On November 3, 2009, after it was already in violation of the order, Secura filed a petition for a writ of prohibition in the court of appeals, making the exact same argument it made, and lost, in the district court -- that the appraisal clause in the policy divested the district court of jurisdiction to hear the Quades' breach of contract claim. As the district court had done, the court of appeals rejected Secura's argument:

But petitioner [Secura] denied coverage on respondents' claim based on an exclusion in the policy and has not genuinely challenged the amount of the claimed loss. "It is well settled that appraisal does not determine liability under a policy. Liability depends on a judicial determination." *Johnson v. Mut. Serv. Cas. Ins. Co.*, 732 N.W.2d 340, 346 (Minn. Ct. App. 2007) *rev. denied* (Minn. Aug. 21, 2007). The district court had jurisdiction over the lawsuit.

*In re Secura Insurance*, No. A09-2002 (Minn. Ct. App. Dec. 15, 2009). (R. Addendum 5.)

**E. The District Court Dismisses the Action and Orders the Parties to Appraise the Coverage Dispute.**

While its petition for a writ of prohibition was pending, Secura filed a motion in the district court seeking summary judgment dismissing the Complaint. The motion was heard by the Hon. Martha Simonett. The district court granted the motion and dismissed the Complaint “with prejudice.” (A. Addendum 11.) The court of appeals reversed. (A. Addendum 1.)

**ARGUMENT**

**I. THE COURT OF APPEALS CORRECTLY CONCLUDED THAT THE DISTRICT COURT HAD ERRED IN ORDERING THE PARTIES TO APPRAISE A COVERAGE DISPUTE.**

**A. This Appeal Is Reviewable Under a *De Novo* Standard of Review.**

Secura brought its motion as a summary judgment motion under Minn. R. Civ. P. 56. Review of a summary judgment under Rule 56 is *de novo*. The role of the Court is to “review two determinations: whether a genuine issue of material fact exists, and whether an error in the application of the law occurred.” *Fairview Hosp. v. St. Paul Fire & Marine Ins. Co.*, 535 N.W.2d 337, 341 (Minn. 1995).

Here, the facts concerning the cause of the damage to the roofs are highly disputed. Secura contends that the roofs were damaged by lack of maintenance, and the Quades contend the roofs were damaged by the storm. The district court held that the disputed causation issue must be resolved in an appraisal process. Because that decision was based on the court’s interpretation of the policy, it presents a question of law for this Court to review *de novo*. *Nathe Bros., Inc. v. American Nat’l Fire Ins. Co.*, 615 N.W.2d 341, 344 (Minn. 2000).

**B. The Issue of Whether an Insurer Is Liable for a Loss Must Be Resolved by the Court, Not by Appraisers.**

An appraisal is “a valuation or an estimation of value of property by disinterested persons of suitable qualifications.” BLACK’S LAW DICTIONARY 92 (5<sup>th</sup> Ed.). It is a “determination of what constitutes a fair price, valuation or estimation of worth.” Law & Starinovich, *What is it Worth? A Critical Analysis of Insurance Appraisal*, 13:2 CONN. INS. LAW J. 291 (2007). An appraisal is *not* designed for or suitable for resolving issues of liability, such as whether a particular loss falls within the coverage of an insurance policy. Instead:

[a]ppraisal is designed to provide an inexpensive determination of the amount of loss *where coverage is conceded*. Allowing, or even requiring, parties to appraise a loss that involves other issues, such as *liability or causation*, can create multiple proceedings and inefficiencies.

*Id.* at 296-97. (Emphasis added.) Language in an appraisal clause authorizing appraisers to determine the “amount of loss” is construed by courts “as a limitation on the appraiser’s authority which precludes her from resolving issues of law such as those pertaining to coverage, liability, *causation*, and *exclusions*.” Parker, *Understanding the Insurance Policy Appraisal Clause: A Four-Step Program*, 37 UNIV. OF TOLEDO L. REV. 931, 946 (2006)(emphasis added). Thus, an appraisal “only determines the *amount* of an *acknowledged liability* which has not been agreed upon by the parties.” *Id.* at 933. It does not determine liability issues such as coverage, causation or the applicability of exclusions.

The rule that appraisals are intended to determine only the amount of an “acknowledged” or “conceded” liability, not whether liability exists, is the majority rule

followed by nearly all courts.<sup>6</sup> The rationale for the rule is sound. Appraisers are not trained in the law. They are not trained or experienced in resolving contract interpretation issues or applying legal principles to determine the liability of a party to a contract. Typically they are building contractors. They are experienced in valuation issues -- how much something is worth, or how much it would cost to repair or replace it. Also, appraisals are informal proceedings, not governed by procedural or evidentiary rules. Appraisers are not required to hold hearings and are not required to base their decisions on record evidence. Indeed, appraisers are expected to resolve valuation issues based on their own knowledge and experience, and on information available to them from a variety of outside sources. *Hartford Lloyd's Ins. Co. v. Teachworth*, 898 F.2d 1058, 1062 (5th Cir. 1990).

An informal appraisal is not the proper place to resolve complex liability issues. Resolving the liability dispute in this case will require an analysis of the provisions of the policy, including the maintenance exclusion. Any time an insurer's liability depends on the application of a policy exclusion to the facts, the decisionmaker not only has to

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<sup>6</sup> See e.g. *Johnson v. Nationwide Mut. Ins. Co.*, 828 So.2d 1021 (Fla. 2002); *Auto-Owners Ins. Co. v. Kwaiser*, 476 N.W.2d 467 (Mich. Ct. App. 1991) ("Matters of an insurance policy's coverage are generally for a court and not for appraisers"); *HHS Associates v. Assurance Co. of America*, 256 F.Supp.2d 505, 511 (E.D. Va., 2003); *Wausau Ins. v. H. Halperin Distribution Corp.*, 664 F.Supp. 987 (D. Md., 1987); *Munn v. National Fire Ins. Co. of Hartford*, 115 So.2d 54, 55, 58 (1959); *Rogers v. State Farm Fire and Cas. Co.*, 984 So.2d 382 (Ala. 2007); *Kendall Lakes Townhomes Developers, Inc. v. Agricultural Excess & Surplus Lines Ins. Co.*, 916 So.2d 12, 15 (Fla. Dist. Ct. App. 2005); *Jefferson Ins. Co. v. Superior Court of Alameda County*, 3 Cal.3d 398, 90 Cal. Rptr. 608, 475 P.2d 880, 883 (1970); *State Farm Lloyds v. Johnson*, 290 S.W.3d 886 (Tex. 2009); 1 DOMKE ON COMMERCIAL ARBITRATION (3rd Ed.) § 1.3 at p. 1-10; 15 COUCH ON INSURANCE § 209:8; 17 COUCH ON INSURANCE § 245:13.

interpret the language used in the exclusion, but also must navigate the shifting burdens of proof which are part of the liability determination under an insurance policy. “In an action to determine coverage, the initial burden of proof is on the insured to establish a prima facie case of coverage.” *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 311 (Minn. 1995). Establishing a prima facie case of the insured’s liability includes “causation” -- i.e., establishing that the loss was caused by a covered event. *Id.* at 312. “[O]nce the insured has established a prima facie case of coverage it is entitled to go to the jury.” *Id.* at 313 (quotation omitted).

The burden of proof then shifts. “If the policy contains an exclusion clause, the burden then shifts to the insurer to prove the applicability of the exclusion as an affirmative defense.” *SCSC Corp.*, 536 N.W.2d at 313. Moreover, if the exclusion contains an exception, the burden of proof then shifts back to the insured to establish the applicability of the exception to the exclusion. *Id.* at 314.

If the damage is brought about by two or more causes, the insurer’s burden of proof is to show that an excluded cause was “overriding,” i.e., “that an overriding cause, not covered under the provisions of the policy, caused the alleged damages . . .” *Id.* at 314. Establishing an overriding cause is “an affirmative defense available to the insurer, rather than a prima facie requirement for the insured.” *Id.* at 314 (citing *Henning Nelson Constr. Co. v. Fireman’s Fund Amer. Life Ins. Co.*, 383 N.W.2d 645, 653 (Minn. 1986)). It is the insurer’s burden “to show that an excluded cause was the overriding cause of the damages even if other covered causes contributed.” *Id.* Thus, if both defective

maintenance and a storm contributed to the damage in this case, Secura would have to prove that the inadequate maintenance was the overriding cause of the loss.

In addition to navigating the shifting burdens of proof to establish an insurer's liability under its policy, the decisionmaker also has to apply rules of construction to policy language, including the rule that "exclusions are narrowly interpreted against the insurer." *SCSC Corp.*, 536 N.W.2d at 314 (citing *Bob Useldinger & Sons, Inc. v. Hangsleven*, 505 N.W.2d 323, 327 (Minn. 1993)). Also, disputes concerning an insurer's liability are subject to public policy considerations. "Minnesota embraces a strong policy of extending coverage rather than allowing confusing or ambiguous language to restrict coverage." *Safeco Ins. Co. v. Lindberg*, 380 N.W.2d 219, 221 (Minn. Ct. App. 1986) *aff'd*, 394 N.W.2d 146 (Minn. 1986).

Finally, the decisionmaker's task may be further complicated by an "ensuing loss" clause in the policy's exclusions. An "ensuing loss clause . . . brings within coverage a loss from a covered peril that follows as a consequence of an excluded peril." *Sentinel Mgmt. Co. v. New Hampshire Ins. Co.*, 563 N.W.2d 296, 301 (Minn. Ct. App. 1997). "An ensuing loss is covered even if an excluded peril is a 'but for' cause of the loss." *Id.* Secura's policy contains an ensuing loss provision. The maintenance exclusion applies to "loss to property caused by . . . faulty, inadequate or defective . . . maintenance . . ." but the exclusion also states that "any *ensuing loss* to property which would otherwise be covered by the policy . . . is covered." (R. App. 91-92) (emphasis added).

The complexity of determining an insurer's liability justifies the rule that courts, not appraisers, must make liability determinations. Applying shifting burdens of proof,

applying the proper construction of insurance policy language, determining if an excluded cause is the “overriding cause” of the loss or just one of several proximate causes, determining if the loss is an “ensuing loss” which follows an excluded peril, and applying public policy in favor of coverage are all matters that courts are equipped to address, not appraisers. Appraisers are expected to have knowledge about what something is worth or how much it would cost to repair or replace it. They are not expected to engage in the complex analysis that goes into determining an insurer’s liability. These are all issues that are properly resolved by courts, as a long line of cases in Minnesota have held. The requirement that liability determinations be resolved by courts, not appraisers, cannot be so easily sidestepped, as Secura is attempting to do here, simply by characterizing the liability dispute as one about the “amount” of covered loss.

These factors all justify the majority rule that important liability issues should be resolved by judges trained in the law, not by appraisers in an informal appraisal processes. Most importantly however, the majority rule is justified by the fact that the *contract* does not say that liability, coverage or causation issues are to be resolved by appraisers -- just the “amount” of loss. Nothing in the language of an appraisal clause even remotely suggests that the parties have agreed to relinquish their right to have liability disputes (including causation) resolved by a court.

The majority rule -- that courts, not appraisers, must resolve liability issues, including causation -- has been strictly followed in Minnesota. *Mork v. Eureka-Security Fire & Marine Ins. Co.*, 42 N.W.2d 33, 35 (Minn. 1950); *Glidden Co. v. Retail Hardware Mutual Fire Ins. Co. of Minn.*, 233 N.W. 310 (Minn. 1930); *Johnson v. Mutual Service*

*Cas. Ins. Co.*, 732 N.W.2d 340, 346 (Minn. Ct. App. 2007) *rev. denied* (Minn. 2007).

Thus, if there is a coverage dispute (i.e. a dispute about whether the insurer is liable for the loss), it is an issue for a court to resolve. If a dispute exists as to the “amount” of the loss, only *that* issue may be subject to appraisal.

**C. The Only Dispute in This Case Concerns Liability, Not the “Amount” of the Loss.**

The “amount” of the loss is not in dispute in this case and, therefore, nothing exists to appraise. The Quades submitted to Secura replacement cost estimates from their roofing contractor setting forth the amount of the loss. (R. App. 37-42.) Secura has never disputed the amount of the claimed loss. It has never stated that the claimed charges for labor and materials are excessive. It has never said that the damage could be repaired or replaced in a less costly way.<sup>7</sup> It has never submitted its own estimate of the cost of replacing the roofs. Having never submitted an alternative replacement estimate, there is no dispute about the “amount” of the loss to appraise.

Instead, what Secura is contesting, and what it wants to appraise, is a *liability* issue -- whether the damage to the roofs (damage that Secura admits is present) is excluded by the “maintenance” exclusion in the insurance policy. The maintenance exclusion was the *only* reason given by Secura for its refusal to pay the claim:

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<sup>7</sup> That was the issue in dispute in *Sampson v. Horace Mann Ins. Co.*, 2003 WL 22234692 (Minn. Ct. App. Sept. 30, 2003), a decision that Secura heavily relies upon. Both the insurer and the insured in that case acknowledged that a hail storm had, in fact, damaged the siding of the insured’s house, and both agreed that the insurer was liable. The parties merely disputed the method (and therefore the cost) of fixing the damage. The court held that how much it would cost to fix the admittedly covered damage was an issue for appraisal since the insurer had admitted liability.

Your farm policy excludes “loss to property caused by any of the following . . . (4) Maintenance”. This is stated in your policy on page 14 (copy enclosed). I am sorry but we are unable to honor your claim for damage to the roof of the buildings.

(A. App. 46.) Secura did not dispute that the roofs were, in fact, damaged. It simply stated that the damage was from an excluded cause.<sup>8</sup> That is a liability issue which is not subject to appraisal. Thus, the parties have not “fail[ed] not to agree on the amount of loss.” Instead, they have failed to agree only on whether the loss is covered. The district court erred in dismissing the Quades’ Complaint and ordering them to participate in an appraisal of their coverage dispute. The court of appeals was correct to reverse that ruling

**D. “Causation” Questions Which Are Determinative of Liability Are for Courts to Resolve.**

The district court erroneously concluded that the “causation” question -- i.e. whether the damage was caused by a peril that is covered by the insurance policy or excluded from coverage -- is a question about the “amount” of loss that is subject to appraisal. (A. Addendum 13-14.) That conclusion is incorrect. Causation questions of this type -- whether damage was caused by a covered peril or an excluded peril -- are inherently questions of liability. Causation questions of this kind go to the heart of the insurer’s liability, not to the “amount” of damage. An appraiser with knowledge about the costs of building or repairing property is not equipped to resolve coverage issues that

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<sup>8</sup> When denying an insurance claim, insurers are required by law to provide a full explanation of the reasons for the denial, and to identify all provisions of the insurance policy that the insurer is relying upon. Minn. Stat. §72A.201, subd. 8. The “maintenance” exclusion is all that Secura identified when it denied the claim.

depend on causation, and an insured should not be forced to have important insurance coverage and liability issues resolved by the type of people who typically serve as appraisers -- building contractors having no legal training.

The district court cited no Minnesota cases to support its holding that a “causation” issue which bears upon ultimate coverage for a loss must be determined by appraisers. None exist.<sup>9</sup> In fact, in *Mork v. Eureka-Security Fire & Marine Ins. Co.*, 230 Minn. 382, 384, 42 N.W.2d 33, 35 (1950), this Court determined that appraisers were *not* qualified to resolve a causation issue. The coverage issue in that case was whether the property damage to the insured’s home (frozen pipes) was caused by a covered peril (explosion in the boiler) or by an uncovered peril (temperature change). The Court vacated the appraisers’ ruling that there was no coverage for the loss, and held that the question of whether the loss was caused by a covered peril was properly submitted to the jury for determination.

The result in *Mork* is consistent with the holdings by courts in other jurisdictions that disputed causation issues are liability questions that must be resolved by courts, not

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<sup>9</sup> *Secura* relies on dictum in *American Central Ins. Co. v. District Court*, 125 Minn. 374, 147 N.W. 242 (1928) to argue that causation questions are for the appraisers to resolve. However, that issue was not before the court in *American Central*. The question in that case was whether, under the standard fire insurance statute, an attorney was a “competent” appraiser. The parties were not disputing causation for the loss, and any discussion of an appraiser’s authority to determine issues of causation was dictum. That dictum was reiterated in *Itasca Paper Co., Inc. v. Niagara Fire Ins. Co.*, 175 Minn. 73, 220 N.W.2d 425, 427 (1928). In that case, the insured’s stock of wood products was damaged by fire. The existence of a covered cause (fire) was not disputed and therefore the Court’s quotation of the dictum in *American Central* that appraisers could determine “whether the damage resulted from causes covered by the policy or from other causes not covered thereby” was not an issue before the Court.

by appraisers.<sup>10</sup> For example, in *Johnson v. Nationwide Mut. Ins. Co.*, 828 So.2d 1021 (Fla. 2002), the Florida Supreme Court reviewed two cases in which the cause of damage to the insureds' property was disputed. In one case, the insureds contended that cracks in the foundation of their home were caused by nearby blasting (a covered peril), but the

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<sup>10</sup> See e.g. *Kawa v. Nationwide Mut. Ins. Co.*, 664 N.Y.S.2d 430 (N.Y. Sup. Ct. 1997) (holding that an insurer was contesting its own liability rather than just the "amount" of the loss when it contended that damage to siding was "the result of age, wear and tear and/or poor or improper maintenance" rather than the result of a windstorm, and therefore the issue was for the court to resolve, not the appraisers); *HHS Assoc. v. Assurance Co. of America*, 256 F.Supp.2d 505, 511 (E.D. Va., 2003) ("courts have found consistently that whether coverage was properly denied is a legal issue reserved for the court alone" including "questions of fact regarding the cause of the damage to the [insured's] building"); *Wausau Ins. v. H. Halperin Distrib. Corp.*, 664 F.Supp. 987 (D. Md. 1987) (appraisers could not decide whether the damage to roof was from an excluded cause); *Munn v. National Fire Ins. Co. of Hartford*, 115 So.2d 54, 55, 58 (1959) ("The chancellor should have judicially determined what force caused the walls to lean and twist[;][t]hat was not a question for the appraisers to decide. If that damage was the result of the storm, then the appraisers should have been directed to estimate the value of the loss occasioned by the walls being damaged."); *Rogers v. State Farm Fire and Cas. Co.*, 984 So.2d 382 (Ala. 2007) ("the parties . . . were not in agreement as to the cause of the damage to the brick veneer or to the foundation. The determination of the causation of these matters is within the exclusive purview of the courts, not the appraisers"); *Kendall Lakes Townhomes Developers, Inc. v. Agricultural Excess & Surplus Lines Ins. Co.*, 916 So.2d 12, 15 (Fla. Dist. Ct. App. 2005) ("because the insurer has not wholly denied that there is a covered loss, causation is an amount-of-loss question for the appraisal panel, not a coverage question that can only be decided by the trial court"); *Erickson v. Farmers Mut. Ins. Co.*, 311 N.W.2d 579 (N. Dak. 1981) (appraisers cannot determine whether damage was caused by an insured peril, and insurer's act of invoking appraisal served to concede that causation was present); *Merrimack Mut. Fire Ins. Co. v. Batts*, 59 S.W.3d 142 (Tenn. Ct. App. 2001) *rev. denied* (Tenn. 2001) (appraisers "did not have the prerogative to determine whether any particular loss claimed by [the insured] was caused by the tornado"); *State Farm Lloyds v. Johnson*, 290 S.W.3d 886, 892 (Tex. 2009) ("when different causes are alleged for a single injury to property, causation is a liability question for the courts"); *Wells v. American States Preferred Ins. Co.*, 919 S.W.2d 679 (Tex. App. 1996) *writ denied* (appraisers' causation determinations impermissibly decided coverage issue when the award stated that foundation damage due to plumbing leaks (a covered peril) was "0" but damage due to settling (an excluded peril) was \$22,875).

insurer denied all liability, contending that the cracks were caused by settling (an excluded peril). In the other case, the insurer claimed that damage was caused by earth movement (an excluded peril) and the insured claimed the damage was caused by a sinkhole (a covered peril). The court concluded that these causation issues were, in fact, liability issues that had to be resolved by a court, not by appraisers, because if the insurer prevailed, it would be absolved of all liability. Similarly, in the recent case *Secord v. Chartis, Inc.*, 2011 WL 814743 (S.D.N.Y. March 7, 2011) at \*3, the court explained that only *after* causation is determined by the court can an appraisal occur if a dispute still remains at that point about the amount of loss:

The appraisers will be able to determine the amount of the loss only after this Court separates the losses attributable to the blasting activities (covered) from those attributable to general wear and tear (not covered). To direct the parties to proceed with an appraisal, before the exact contours of insurer liability have been judicially established, would place the proverbial cart before the horse.

The cases relied upon by Secura involve express causation concessions by the insurers. For example, in *Sampson v. Horace Mann Ins. Co.*, 2003 WL 22234692 (Minn. Ct. App. 2003) the court noted that “both sides agree that damage occurred to the siding of Appellant’s home as a result of the hail storm, and that the Appellant has suffered a loss under the terms of the policy.” The court noted that “there is no dispute as to liability.” *Id.* The only dispute was how much it would cost to repair the admitted storm damage. See also *QBE Ins. Co. v. French Ridge Homeowner’s Assoc.*, 778 N.W.2d 393, 399 (Minn. Ct. App. 2010) (“in this case, the insurer has conceded that causation exists for purposes of coverage . . .”); *Cigna Ins. Co. v. Didimoi Property Holdings*, 110 F.

Supp. 2d 259, 263 (D. Del. 2000)(“Cigna does not contest that the policy covers fire and that a fire damaged the building.”) In the two cases Secura has cited here or below where the insurer did *not* concede covered causation, the courts held that an appraisal was improper. *Johnson v. Nationwide Mut. Ins. Co.*, 828 So.2d 1021 (Fla. 2002) (“the issue . . . was not appraising the amount of a loss which the insurer admitted was covered” and therefore the “coverage issues were to be judicially determined by the court and were not subject to determination by appraisers”); *Gonzalez v. State Farm Fire and Cas. Co.*, 805 So.2d 814, 816 (Fla. Ct. App. 2000) (“Since State Farm's position is that this entire loss falls within a policy exclusion, this defense is a judicial question and not a question for the appraisers.”).<sup>11</sup>

Here, Secura most decidedly has *not* conceded causation. In the face of graphic evidence that the roofs were damaged by wind (R. App. 22-34), Secura took the untenable position that the roofs were spared of *any* damage from the storm, and that the sole cause of the damage on the roofs was lack of adequate maintenance, an excluded cause.<sup>12</sup> (A. App. 46.) Had it conceded that some portion of the loss was from a covered

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<sup>11</sup> Although Secura relies on *Itasca Paper Co. v. Niagra Fire Ins. Co.*, 175 Minn. 73, 220 N.W.425 (1928), causation was not at issue in that case. The property damage was concededly caused by fire. The coverage issue was whether the property was within the definition of covered property, which this Court held was ultimately an issue for a court to resolve. The “amount” of loss, i.e., how much of the wood product had actually been damaged by the fire and its value, was property resolved by appraisers.

<sup>12</sup> Secura argues that the Quades are improperly “parsing” their claim on a building by building basis in arguing that Secura has denied liability for the damage to the three roofs. However, it was Secura that treated the damage to the roofs of the three structures differently -- denying liability for the roof damage because of the maintenance exclusion. Secura did not claim that its liability for damage to other structures was negated by a

cause, Secura may have been able to take advantage of the appraisal process to determine the amount of the admittedly covered loss. However, having chosen to deny all liability, Secura has no right to insist upon an appraisal. It has made its own bed and now must lie in it.

**E. Secura Cannot Simply Recharacterize the Dispute Over Its Coverage Defense as a Dispute About the “Amount” of “Covered” Loss.**

Secura’s approach in this case has been to recharacterize the dispute over liability as a dispute over the “amount” of covered loss. Secura argues that because it values the “covered” damage to the roof at \$0, the dispute really is about the “amount” of the loss. Secura’s novel argument, if accepted, would eviscerate the rights of insureds to have liability issues resolved by courts. Any coverage or liability issue could be recharacterized as a dispute about the “amount” of covered loss, as Secura has attempted to recharacterize the coverage issue in this case. For example, a pure coverage dispute about the applicability of a pollution exclusion in a policy could be, under Secura’s reasoning, submitted to the appraisers to determine the “amount” of non-pollution damages (with the insurer arguing that \$0 in covered damage exists, as Secura is arguing here). The coverage issue in the present case is whether the damage to the roofs of the farm structures -- damage that Secura admits exists -- is excluded from coverage under the “maintenance” exclusion. Secura cannot escape having that coverage issue resolved in court by simply recharacterizing the coverage dispute as a dispute about the “amount” of covered damage.

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policy exclusion. It admitted liability and paid for damage elsewhere, but denied liability for damage to the roofs.

## **II. THE DISTRICT COURT ERRED BY DISMISSING THE COMPLAINT.**

### **A. Standard of Review.**

A district court's decision to dismiss a complaint is reviewable *de novo*. *Barton v. Moore*, 558 N.W.2d 746 (Minn. 1997).

### **B. The District Court Erred in Dismissing the Complaint Because Disputes Between the Parties Which Are Not Subject to Appraisal Remain for Resolution by the Court.**

The legal basis for the district court's decision to dismiss the Complaint was not made express in the court's order. The court never explained whether the dismissal was for failure to state a claim upon which relief may be granted pursuant to Minn. R. Civ. P. 12.02(e), or whether the facts were undisputed under Rule 56.

In any event, dismissal of the entire action was improper. Regardless of whether an appraisal occurs, there are many disputes between the parties that remain for judicial resolution. The Quades have asserted a breach of contract claim in their Complaint. They seek damages for Secura's breach, seek costs and prejudgment interest, and may seek the statutory costs permitted for a violation of Minn. Stat. § 604.18. Secura has raised coverage defenses, including its claim that the loss is excluded by the "maintenance" exclusion, and has also asserted 13 affirmative defenses in its Answer to the Complaint. Secura has not waived any of its defenses, and apparently will continue asserting its defenses even after an appraisal. Issues and defenses raised by both parties remain to be resolved by the court, irrespective of an appraisal about the "amount" of loss (assuming that such a dispute about the "amount" actually existed).

Accordingly, even if some issue were subject to appraisal, other disputes remain for the district court to resolve. While it may have been permissible for the court to stay proceedings pending the outcome of an appraisal (if any disputes subject to appraisal actually existed), it was improper to dismiss the entire action.<sup>13</sup> The court of appeals was correct to reverse the dismissal of the action, and even if this Court concludes that an appraisal is required, the dismissal order must nevertheless be reversed.

**C. The District Court Erred by Dismissing the Complaint “With Prejudice.”**

The district court also offered no explanation for why it dismissed the Complaint “with prejudice.” A dismissal “with prejudice” is a final resolution of a dispute on the merits. *Firoved v. General Motors Corp.*, 152 N.W.2d 364, 368 (Minn. 1977). It generally precludes any further litigation of the same issue. Here, there has been no final adjudication of the merits of the parties’ disputes. The merits have yet to be reached at all. Indeed, the district court even acknowledged in its order that further disputes exist between the parties, and that the parties may need to “bring[] a declaratory judgment action on any coverage dispute” following an appraisal. (A. Addendum 11.) The court did not intend to cut off the Quades’ right to litigate the remaining issues -- and would have no legal basis to do so. The dismissal “with prejudice” was improper.

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<sup>13</sup> Even if the Uniform Arbitration Act applied, the remedy is to stay judicial proceedings, not dismiss them, pending the arbitration. Minn. Stat. § 572.09(d).

**III. THE DISTRICT COURT ERRED IN CONCLUDING THAT AN APPRAISAL WOULD BE GOVERNED BY MINNESOTA'S UNIFORM ARBITRATION ACT.**

**A. Standard of Review.**

The interpretation of a statute is an issue that the Court reviews *de novo*. *Moriarty v. Minneapolis Employees Retirement Bd.*, 516 N.W.2d 207 (Minn. Ct. App. 1994).

**B. An Appraisal Clause Is Not an Agreement to Arbitrate All Disputes.**

The district court's order provides that after an appraisal award is made, judicial review of the award will be limited to the grounds for confirming or vacating an award under the Minnesota Uniform Arbitration Act, Minn. Stat. §§572.18 and 572.19. (A. Addendum 12.) That part of the district court's ruling is also erroneous because appraisals are not arbitrations and are not governed by Minnesota's Uniform Arbitration Act ("UAA").

As the court of appeals has properly held, "the statutorily required appraisal provision [in an insurance policy] is *not* an agreement to arbitrate governed by the Uniform Arbitration Act." *Johnson v. Mutual Serv. Cas. Ins. Co.*, 732 N.W.2d 340, 346 (Minn. Ct. App. 2007) *rev. denied* (Minn. 2007) (emphasis added).<sup>14</sup> While older cases sometimes use incorrect terminology in referring to an appraisal process as "arbitration," courts in Minnesota and elsewhere recognize that an appraisal procedure is not an arbitration. *See generally*, 15 COUCH ON INSURANCE § 209:8 ("Although the terms

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<sup>14</sup> In *Qbe Ins. v. French Ridge Homeowners Ass'n*, 778 N.W.2d 393, 398 (Minn. Ct. App. 2010) the court stated in dicta that "[a]ppraisal decisions are subject to Minn. Stat. § 572.08-.30 (2008), the arbitration statute." That issue was not essential to the court's ultimate holding, and therefore amounts to dictum.

appraisal and arbitration are sometimes used interchangeably, appraisal is distinguished by its more limited role,” and therefore the statutes and rules applicable to arbitrations do not apply). *Johnson*, 732 N.W.2d at 345 (acknowledging that the terms “appraisal” and “arbitration” have been used interchangeably in some prior decisions, but are not the same thing).<sup>15</sup>

Recognizing the distinction between appraisal and arbitration is important because “the distinction between arbitration and appraisal can have ramifications on the authority of the court.” 15 COUCH ON INSURANCE § 209:10. In an arbitration, the parties have specifically contracted to have their disputes fully resolved by a private arbitrator and the court has no jurisdiction to address either the factual or legal merits of the parties dispute, and has only limited authority, after the fact, to vacate the award on limited grounds

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<sup>15</sup> See e.g., *Minot Town & Country v. Fireman’s Fund Ins. Co.*, 587 N.W.2d 189 (N.D. 1998) (“Generally, arbitration is a quasi-judicial proceeding that ordinarily will decide the entire controversy. . . . Conversely, appraisal establishes only the amount of a loss and not liability for the loss under the insurance contract”); *Hartford Lloyd’s Ins. Co. v. Teachworth*, 898 F.2d 1058 (5th Cir. 1990) (“While both procedures aim to submit a dispute to a third party for speedy and efficient resolution without recourse to the courts, there are significant differences between them. For example, an arbitration agreement may encompass the entire controversy between parties . . . . In contrast, an appraisal determines only the amount of loss, without resolving issues such as whether the insurer is liable under the policy. Additionally, an arbitration is a quasi-judicial proceeding, complete with formal hearings, notice to parties, and testimony of witnesses. Appraisals are informal. Appraisers typically conduct independent investigations and base their decisions on their own knowledge, without holding formal hearings.”); *Elberon Bathing Co., Inc. v. Ambassador Ins. Co., Inc.*, 389 A.2d 439 (N.J. 1978) (“The distinctions are significant. An agreement for arbitration ordinarily encompasses the disposition of the entire controversy between the parties, and judgment may be entered upon the award, whereas an appraisal establishes only the amount of loss and not liability.”); *Kawa v. Nationwide Mut. Fire Ins. Co.*, 664 N.Y.S.2d 430 (N.Y.Sup., 1997); *Merrimack Mut. Fire Ins. v. Batts*, 59 S.W.2d 142 (Tenn. App. 2001).

specified by statute. Minn. Stat. § 572.19. This is deemed to be fair because it is what the parties contracted for when they choose to have *all* disputes between them resolved through arbitration.

By contrast, an appraisal clause is not an agreement to have all disputes between the parties resolved by a private arbitrator. An appraisal clause is a very limited agreement to have a single issue -- the “amount” of the loss -- resolved through appraisal. The Eighth Circuit Court of Appeals, applying Minnesota law, has put the issue this way:

In general, where parties to a contract, before a dispute and in order to avoid one, provide for a method of ascertaining the value of something related to their dealings, the provision is one for an appraisal and not for an arbitration.

*Sanitary Farm Dairies v. Gammel*, 195 F.2d 106, 113 (8th Cir. 1952) Under the common law, parties to a binding appraisal process typically have very limited grounds on which to challenge an award, usually limited to “fraud or corruption, or partiality or malfeasance.” *Id.* It is unnecessary to use the judicial review procedures outlined in the UAA. It is also confusing and inadvisable to say that appraisals will be governed by the review procedures in the UAA. An appraisal clause is not intended to address other disputes such as whether the policy covers the loss in the first place.

The issue of whether the UAA governs judicial review of a determination by appraisers as to the “amount of loss” is a peripheral issue in this case. If the decision of the court of appeals is affirmed, and issue of Secura’s liability is remanded to the district court for resolution, then it will be unnecessary to resolve the issue of what procedures govern the review of an award by appraisers. Nevertheless, it may be appropriate for this

Court to clarify this issue, since it appears to be the subject of conflicting language in decisions from lower courts. *Compare Johnson*, 732 N.W.2d at 346 with *QBE Ins. Co.*, 778 N.W.2d at 398

### CONCLUSION

Had Secura ever disputed the “amount of loss,” there would be something to appraise, and an appraisal could go forward. However, Secura is disputing coverage, not the amount of loss, as is evident from its claim denial letter. Secura is not permitted to resolve coverage or liability issues by submitting them to appraisers rather than to the court. The court of appeals reached the correct result. The district court then got it wrong when it dismissed the action with prejudice, and ordered the parties to appraise their coverage dispute. The decision of the court of appeals should be affirmed, and the case should be remanded to the district court for further proceedings.

Respectfully submitted,



Richard D. Snyder (#191292)  
**FREDRIKSON & BYRON, P.A.**  
200 South Sixth Street, Suite 4000  
Minneapolis, MN 55402-1425  
Telephone: (612) 492-7145  
Facsimile: (612) 492-7077

*Attorneys for Respondents  
David and Melynda Quade*

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