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No. A10-1992

**STATE OF MINNESOTA
IN COURT OF APPEALS**

Remodeling Dimensions, Inc.

Plaintiff/Respondent,

vs.

Integrity Mutual Insurance Company,

Defendant/Appellant.

APPELLANT'S BRIEF AND ADDENDUM

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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).

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

STATEMENT OF THE ISSUES 1

STATEMENT OF THE FACTS 2

STATEMENT OF THE CASE 11

STANDARD OF REVIEW 13

ARGUMENT 14

I. The trial court erred in failing to conclude that the policy did not afford coverage as a matter of law and Integrity Mutual is therefore entitled to summary judgment. 14

 A. The Business Risk Doctrine Precludes Insurance Coverage for claims arising out of Remodeling Dimensions work on the addition. 15

 B. Insurance coverage is precluded for allegations that Remodeling Dimensions failed to discover or report defects in the original construction because these claims neither constitute an “occurrence” nor are there covered damages. 19

II. The Trial Court erred in holding that Remodeling Dimensions should be liable for the arbitration award where there was no evidence of any negligent conduct and where reliance on foreign cases was misplaced. 25

 A. The trial court erred in finding that the attorney for Remodeling Dimensions at the underlying arbitration had a duty to request a reasoned award. 26

 B. The trial court erred in applying case law from other jurisdictions which would alter long standing Minnesota case law relating to insurer bad faith claims. 31

CONCLUSION 37

ADDENDUM INDEX v

TABLE OF AUTHORITIES

Cases

<i>Aetna Cas. & Sur. Co. v Protective Nat. Ins. Co. of Omaha</i> , 631 So.2d 305 (Fla. 3d D.C.A. 1993)	35
<i>American Family Ins. Co. v. Walser</i> , 628 N.W.2d 605, 610 (Minn. 2001)	20
<i>Anderson v. Liberty Lobby, Inc.</i> , 477 U.S. 242, 248-49 (1986)	13
<i>Attleboro Mfg. Co. v. Frankfort Marine, Acc. & Plate Glass Ins. Co.</i> , 240 F. 573 (1 st Cir. 1917)	33
<i>Blakely v. American Employers' Ins. Co.</i> , 424 F.2d 728, 733-34 (5 th Cir. 1970)	33
<i>Bob Useldinger & Sons, Inc. v. Hangsleben</i> , 505 N.W.2d 323 (Minn. 1993)	14
<i>Bor-Son Building Corp. v. Employers Commercial Union</i> , 323 N.W.2d 58, 61 (Minn. 1982)	1, 16
<i>Boyd Bros. Transp. Co., Inc. v. Fireman's Fund Ins. Co.</i> , 729 F.2d 1407, 1410 (11 th Cir. 1984)	33
<i>Brown v. Guarantee Inc. Co.</i> , 155 Cal.App.2d 679 (1957)	1, 33
<i>Brown v Lumbermens Mut. Cas. Co.</i> , 90 N.C.App. 464, 369 S.E.2d 367, 371 (1988)	36
<i>Celotex Corp. v. Catrett</i> , 477 U.S. 317, 323 (1986)	13
<i>Continental Ins. Co. v Bayless & Roberts, Inc.</i> 608 P.2d 281 (Alaska 1980)	33
<i>Crum v. Anchor Cas. Co.</i> , 119 N.W.2d 703, 712 (Minn. 1963)	27, 29
<i>Fairview Hospital and Health Care Services v. St. Paul Fire & Marine Ins. Co.</i> , 5 35 N.W.2d 335, 341 (Minn. 1995)	30

Feliberty v. Damon, 72 N.Y.2d 112, 531 N.Y.S.2d 778,
527 N.E. 2d 261 (1988) 35

Hartford Accident & Indemnity Co. v. Case Found. Co.,
10 Ill. App. 3d 115, 294 N.E.2d 7, 13 (1973) 24

Hauenstein v. Saint Paul-Mercury Indem. Co.,
65 N.W.2d 122, 126 (Minn. 1954) 1, 20

Horwitz v. Holabird & Root,
212 Ill.2d 1, 287 Ill. Dec. 510, 816 N.E.2d 272 (2004) 36

Hommel v. George, 802 P.2d 1156, 1158 (Colo.Ct. App. 1990). 24

In re Rules of Prof'l Conduct, 299 Mont. 321, 2 P.3d 806, 814 (2000) 27

Ingersoll-Rand Equipment Corp., v. Transportation Ins. Co.,
963 F.Supp 452, (M.D. Pa. 1997) 36

Knutson Construction Company v. St. Paul Fire and Marine Insurance Company,
396 N.W.2d 229, 235 (Minn. 1986) 1, 16, 18

L. Ray Packing Co. v. Commercial Union Ins. Co.,
469 A.2d 832, 835 (Me. 1983) 24

Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,
477 U.S. 574, 586 (1986) 14

Merritt v. Reserve Insurance Co., 34 Cal.App.3d 858 (1973) 1, 33, 35

Miller v. Shugart, 316 N.W.2d 729, 733 (Minn. 1982) 27

Nat'l Farmers Union Prop. & Cas. Co. v. O'Daniel,
329 F.2d 60, 65-66 (9th Cir. 1964) 33

Pacific Employers Ins. Co. v. P.B. Hoidale Co.,
789 F. Supp. 1117, 1122-23 (D. Kan. 1992) 33

Short v. Dairyland Ins. Co., 334 N.W.2d 384 (Minn. 1983) 36-37

Sphere Drake Ins. Co. v. Tremco, Inc., 513 N.W.2d 473, 477
(Minn. Ct. App. 1994) 1, 17-18

Smoot v. State Farm Mutual Automobile Insurance Co.,
299 F.2d 525, 530 (5th Cir. 1962) 1, 31-33, 36

STAR Centers, Inc. v. Faegre & Benson, L.L.P., 644 N.W.2d 72, 76-77
(Minn. 2003) 13

State by Cooper v. French, 460 N.W.2d 2, 4 (Minn. 1990) 13

Stumpf v. Continental Cas. Co., 794 P.2d 1228 (Or. Ct. App. 1989) 1, 31, 33, 36-37

Thiele v. Stich, 425 N.W.2d 580 (Minn. 1988) 14

Travelers Indemnity Co. v. State, 140 Ariz. 194, 680 P.2d 1255, 1257
(App. 1984) 24

STATEMENT OF ISSUES

- I. Where a policy does not provide indemnification for any of the claims made against an insured at an underlying arbitration, coverage must be precluded for any damages awarded by the arbitrator. The trial court held that the arbitration award was ambiguous and that it could not determine whether coverage was precluded. Did the trial court err in failing to conclude that the policy did not afford coverage as a matter of law?**

The trial court held that the arbitration award contains no explanation as to the damages and it therefore could not determine whether coverage was precluded.

Knutson Construction Company v. St. Paul Fire and Marine Insurance Company, 396 N.W.2d 229, 235 (Minn. 1986).

Bor-Son Building Corp. v. Employers Commercial Union, 323 N.W.2d 58, 61 (Minn. 1982).

Sphere Drake Ins. Co. v. Tremco, Inc., 513 N.W.2d 473, 477 (Minn. Ct. App. 1994).

Hauenstein v. Saint Paul-Mercury Indem. Co., 65 N.W.2d 122, 126 (Minn. 1954).

- II. In Minnesota, an insurer is not vicariously liable for the decisions of counsel retained by the insurer to represent the insured. The trial court determined that Integrity Mutual was vicariously liable for the decision of Remodeling Dimension's counsel not to obtain a reasoned arbitration award. Did the trial court err in determining that (1) counsel for Remodeling Dimensions was obligated to obtain a reasoned arbitration award, or (2) that Integrity Mutual was liable for any decision not to obtain a reasoned arbitration award?**

The trial court held that the decision not to request a reasoned arbitration award, made by counsel retained by Integrity Mutual to represent Remodeling Dimensions, constituted a breach of contract and that Integrity Mutual should therefore be vicariously liable for any damages assessed against Remodeling Dimensions.

Brown v. Guarantee Inc. Co., 155 Cal.App.2d 679 (1957)

Merritt v. Reserve Insurance Co., 34 Cal.App.3d 858 (1973)

Stumpf v. Continental Cas. Co., 794 P.2d 1228 (Or. Ct. App. 1989)

Smoot v. State Farm Mutual Automobile Insurance Co., 299 F.2d 525, 530 (5th Cir. 1962).

STATEMENT OF FACTS

A. Original Construction of Home

The residence that is the subject matter of this dispute is located at 1025 Lake Beach Drive, Shoreview, Minnesota, 55126 (hereinafter "Residence"). (Summary of Claims, AA0012-17). It was originally constructed by LeGran Homes in August of 1993. (*Id.*) The Residence is a two-story wood frame construction with an exterior primarily consisting of Masonite siding. (*Id.*)

B. Work completed by Remodeling Dimensions

On January 23, 2003, Remodeling Dimensions entered into a construction agreement with Mike and Peggy Provenzano. (Pl. Comp. at 4, AA0002; Construction Agreement, AA0026-33). Under the contract, Remodeling Dimensions agreed to build a lower level flat roof addition on the east side of the Residence. (*Id.*) The addition included a bedroom, entertainment room, 700 square foot flat roof, deck, and removal and installation of window trim around windows on the original section of the Residence. (*Id.*) The agreement provided that any dispute arising out of the parties' relationship would be submitted to binding arbitration with the American Arbitration Association. (Pl. Comp., AA0001-11; Construction Agreement, AA0026-33). During the addition project, the Provenzanos asked Remodeling Dimensions to remove a master bedroom window in the original portion of the house to allow the Provenzanos to move an armoire into the master bedroom. (Pl. Comp. at 5, AA0002). The removal of the master bedroom

window was not contemplated in the original construction agreement. (*Id.*) Remodeling Dimensions, however, agreed to complete the additional work, removing the window and reinstalling it for the Provenzanos. Remodeling Dimensions completed the construction addition project in June 2003. (*Id.* at 6, AA0002).

C. Discovery of Alleged Defects at the Residence

In May of 2004, the Provenzanos had the original roof on the home replaced after it sustained storm damage. (Pl. Comp., AA0001-11). Soon after the roof work was completed, the Provenzanos noticed siding damage, which they attributed to the roof work. In investigating the siding issues, the Provenzanos hired Private Eye to conduct a moisture inspection on July 16, 2004. (*Id.*) Private Eye submitted a report, which provides that caulk was missing in various areas and that siding was decayed in other locations. It further provided, “Repairs and/or modifications are needed to protect the home from moisture.” (Remodeling Dimensions’ Response to Claims, AA0018-0033)

Despite the Private Eye Report, which indicated damage in areas of the original construction, the Provenzanos did no further investigation until the Spring of 2006. (Pl. Comp. at 12, AA0003). At that time, the Provenzanos hired Northwest Diversified Services to investigate the moisture issues at the Residence. Northwest submitted a report opining that moisture was invading the structural parts of the Provenzanos’ home and causing substantial damage. (*Id.*)

D. Arbitration between the Provenzanos and Remodeling Dimensions

The Provenzanos commenced an arbitration proceeding against Remodeling Dimensions, claiming Remodeling Dimensions was liable for property damage associated with problems at the Residence based on two theories: (1) that there were defects in the addition project constructed by Remodeling Dimensions; and (2) that Remodeling Dimensions was negligent for failing to discover or inform the Provenzanos of defects with the original construction of the home. (Pl. Comp. at 13, AA0003-4)¹. Total damages sought by the Provenzanos was \$264,100.00. (*Id.* at 14, AA0004).

On January 22 and 23, 2007, an arbitration hearing was conducted before John G. Patterson, the arbitrator. (Pl. Comp. at 19, AA0005). Regarding the alleged defects in the addition project completed by Remodeling Dimensions, the owner of Remodeling Dimensions, Bruce Lyons, testified that Remodeling Dimensions does not use subcontractors to complete any significant work. (Arb. Transcript p. 484, AA0153). Rather, Remodeling Dimensions completed all of the work on the addition, with the exceptions of electrical work, lighting fixtures, and painting – work unrelated to any of the moisture intrusion damages that were being claimed. (*Id.* at pp. 484, 503-505, AA0153, 0154-156). The only subcontractor retained at the project in areas of alleged damages was a subcontractor retained for the limited purpose of installing the membrane

¹The ten year statute of repose barred any claim against LeGran Homes.

on the flat roof. However, no deficiencies were identified relating specifically to the flat roof membrane. (See Claimant's Summary of Claims, AA0012-17).

Regarding the allegation that Remodeling Dimensions was negligent in failing to discover and inform of the defects, the testimony shows that Provenzanos were not claiming that Remodeling Dimensions work caused any damages, but that the Provenzanos were unable to pursue claims against the original builder because they were not placed on notice of the problems.

[Arbitrator]: I'm struggling with the portion of the claim that Remodeling Dimensions should be responsible for portions of this house that they had no, you know, involvement in. They didn't build it. They didn't repair it.

[Pirjevec]: Yeah.

[Arbitrator]: And I think what the claim is, is that once you open up a particular part of the house and see some apparent deficiencies, you have a duty to notify the homeowner before you do whatever you're going to do and then repair it?

[Pirjevec]: Yes, sir.

[Arbitrator]: Is that basically the theory?

MR. RUCKER: [Provenzanos' Attorney] I would agree with that.

[Pirjevec]: Yeah

MR. RUCKER: - - as their attorney, at least. A legal theory? Yes.

(Arb. Transcript at 396-97, AA0150-51). Likewise, Mr. Fahlk, the Provenzanos other

expert, testified that the allegations, as they related to the master bedroom window, were that Remodeling Dimensions failed to inform the Provenzanos of alleged defects:

Q: As part of the 2003 remodeling project, the master bedroom window was removed and reinstalled. Have you considered that an act by Remodeling Dimensions as part of your expert reports. And if so, what opinion, if any, do you have concerning that and what Remodeling Dimensions would have learned in doing that?

A: Yes. What Remodeling Dimensions would have learned removing the master bedroom window or the installation of the armoire or for whatever reason, was that the window had been installed in a manner which was not consistent with the window manufacturer's instructions.

They would have found that the window installation did not conform with the then current 2003 residential code and that the window would have had to be reinstalled in a manner that was code compliant and that the Provenzanos should have been informed of those changes rather than the window being installed in a manner that did not meet codes.

(Fahlk Report at 224-225, AA0145-46).

On February 23, 2007, the arbitrator, John Patterson, issued an Arbitration Award, providing, in part,

I hereby find for Claimants as follows:

Basic house repairs	\$45,000.00
Flat roof repair	\$2,000.00
Replacement window costs	0
Final Cleaning	\$1,000
NDS inspection costs	0
Design Costs	0
Construction management fees	<u>\$3,000.00</u>

Total Award: \$51,000.00

(Arb. Award, AA0097-98). After the Arbitration, Remodeling Dimensions requested further explanation of the Arbitration Award. (Ltr. of Arbitrator, AA0217). However, as

no request for an explanation of the Award was made in writing prior to the appointment of the arbitrator, the arbitrator declined to provide any further explanation of the award.

(Id.)

E. Remodeling Dimensions' Insurance Policy

Remodeling Dimensions was insured under a Business Owners Policy ("BOP") issued by Integrity Mutual from 2002 until 2005. (BOP, AA0034-90). The BOP issued by Integrity Mutual contains the following insuring clause:

We will pay those sums that the Insured becomes legally obligated to pay as damages because of "bodily injury", "property damage", . . . to which this insurance applies.

b) This insurance applies:

(1) to "bodily injury" and "property damage" only if:

- (a) the "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the coverage territory; and
- (b) the "bodily injury" or "property damage" occurs during the policy period.

(BOP Coverage form at p. 1, AA0079)

"Property damage" is defined as, "physical injury to tangible property, including all resulting loss of use of that property".

...

"Occurrence" is defined as, "an accident including continuous or repeated exposure to substantially the same general harmful conditions."

(BOP Coverage form at pp. 11-12, AA0089-90).

The BOP also contains the following exclusions for which claims are not covered:

This insurance does not apply to:

- k. “Property damage” to:
 - ...
 - (5) That particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.
- l. “Property damage” to “your product” arising out of it or any part of it.
- m. “Property damage” to “your work” arising out of it or any part of it and included in the “products–completed operations hazard” paragraph.

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.
- n. “Property damage” to “impaired property” or property that has not been physically injured, arising out of:
 - (1) A defect, deficiency, inadequacy or dangerous condition in “your product” or “your work”; or
 - (2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

(*Id.* at p. 4-5, AA0082-83)

F. Reservation of Rights/Declination of Coverage

After receiving notice of the arbitration, Remodeling Dimensions submitted a claim to Integrity Mutual under the policy. (Pl. Comp. at 16, AA0005). Integrity Mutual agreed to defend Remodeling Dimensions in the arbitration and hired an attorney for the defense. (*Id.* at 17, AA0005). Integrity Mutual’s defense was subject to a reservation of rights of which Remodeling Dimensions was informed by letter of September 22, 2006.

(Ltr. of Integrity Mutual, AA0091-92). Prior to the arbitration, on January 10, 2007, Integrity Mutual sent a supplemental reservation of rights letter to Remodeling Dimensions, clarifying that it would be Remodeling Dimensions' responsibility to fashion the arbitration in such a way to address the coverage issues.² (Ltr. of Integrity Mutual, AA0093-94). The letter clarified that upon the information at hand, coverage was precluded for both of the damage *claims* being made by the Provenzanos. (*Id.*) Thus, Integrity Mutual informed Remodeling Dimensions that it was their burden to provide information indicating that the claims were covered. (*Id.*) Integrity Mutual asked Remodeling Dimensions to inform them of any subcontractor whose work allegedly is responsible for claimed damages. (*Id.*) The letter further provided,

It will be up to you and your counsel to fashion an arbitration award form that addresses the coverage issues and your respective burden. If, for example, the arbitration award ultimately rendered makes it impossible to determine whether any of the damages awarded involve "property damage" that occurred during the Integrity Mutual policy period, Integrity Mutual will not be responsible to indemnify an ambiguous award. Also, by way of further illustration but not limitation, Integrity Mutual will not be responsible for an ambiguous award of an arbitrator that fails to identify the subcontractor found to be liable and the damages allocated specifically to that subcontractor.

(*Id.*)

No reasoned arbitration award was requested by Remodeling Dimensions or its attorney prior to the arbitration of January 22 and 23, 2007. (Ltr. of Arbitrator Patterson,

²Integrity Mutual was not a party to the underlying arbitration and had no right to participate in the proceedings.

AA0217). However, at the time Integrity Mutual requested that Remodeling Dimensions procure a reasoned arbitration award, the deadline for requesting such an award under R-42(b) of the rules of the American Arbitration Association (“AAA”) had expired. (*Id.*)

After the Arbitration Award of February 23, 2007, Integrity Mutual issued a declination of coverage letter. (Ltr. of Integrity Mutual, AA0095-96). In declining coverage for the award, Integrity Mutual explained that the damages claimed related directly to the work of Remodeling Dimensions. (*Id.*) The declination letter provided,

We are in receipt of the Arbitration Award dated February 23, 2007. As a part of our continuing investigation of the claims, we have studied the Exhibits comprising the documents that were introduced at the arbitration hearing held on January 22 and January 23 of 2007 as well as the 683 page transcript recording the testimony of the witnesses and the parties. We have now completed our investigation and have again carefully considered the claims of the Provenzanos and whether they trigger any duty to defend and/or are subject to indemnification pursuant to the terms and conditions of the applicable policy referenced above. Having done so, we are constrained to conclude that coverage is not afforded.

(*Id.*) The letter further clarified that any damages awarded related directly to the work of Remodeling Dimensions and that no damages were awarded for the Provenzanos allegations of defects in the original construction. (*Id.*) Even if the damages awarded were based on defects in the original construction, no coverage would be afforded as the claim involves neither an occurrence nor any activity subject to the “products completed operations hazard.” (*Id.*) The declination was not based upon any decision not to request a reasoned arbitration award. (*Id.*)

STATEMENT OF THE CASE

Remodeling Dimensions brought an action against Integrity Mutual on May 17, 2010 claiming Integrity Mutual breached its contract with Remodeling Dimensions. (Pl. Comp., AA0001-11). In its Complaint against Integrity Mutual, Remodeling Dimensions alleged,

13. On or about July 14, 2006, the Provenzanos commenced an arbitration proceeding against Remodeling Dimensions, claiming Remodeling Dimensions was liable for the property damage associated with the moisture problems based on two different theories.
 - I. The Provenzanos claimed that there were a number of defects in the addition project constructed by Remodeling Dimensions.
 - II. That when Remodeling Dimensions removed the master bedroom window from the existing home, it should have recognized that the original construction (performed by another contractor years before) was defective, that water was invading the structure of the original home and causing damage to the home. The Provenzanos' claimed that Remodeling Dimensions' was negligent in its failure to recognize the situation and report it to the Provenzanos.

(*Id.* at 13, AA 0003-4)(emphasis added). Integrity Mutual and Remodeling Dimensions brought cross motions for summary judgment.

Integrity Mutual argued that the arbitration award was not important where no coverage was afforded for *any* of the damages claims made by the Provenzanos at the underlying arbitration. Thus, Integrity Mutual argued that it was entitled to summary

judgment. (See Memoranda of Integrity Mutual, AA0237-54, 0275-87, 0294-0300).

Remodeling Dimensions argued that it was entitled to summary judgment because the arbitration award did not specify the damages awarded and because ambiguity in the award should be construed against Integrity Mutual. Remodeling Dimensions further argued that Integrity Mutual should be liable for the award where the attorney for the insured did not request a reasoned arbitration award. (See Memoranda of Remodeling Dimensions, 0255-65, 0266-74, 0288-93).

On September 20, 2010, the trial court granted Remodeling Dimension's motion for summary judgment. On October 6, 2010, the court entered judgment against Integrity Mutual in the amount of \$49,000.00. (Order and Memorandum of Court, AA0301-11). In reaching its decision, the court held that it could not determine if the damages awarded against Remodeling Dimensions were covered by its insurance policy. (*Id.*) Specifically, the court provided, "the Court cannot determine exactly what the damages were awarded for, why they were awarded and what the arbitrator considered when making the award." (*Id.*) Rather than focusing on whether coverage existed for any of the claims at the underlying arbitration, the court focused its decision on a lack of any reasoned award from the arbitrator, finding that prior to the arbitration, no request was made of the arbitrator to issue a reasoned award. (*Id.*) The court concluded that the insurer should be responsible for the lack of a reasoned award and that failure to request this award, "represented a breach of the contract between the parties." (*Id.*)

STANDARD OF REVIEW

The Court of Appeals must consider two questions on appeals from summary judgment. First, whether there are any genuine issues of material fact, and second, whether the lower court erred in its application of the law. *State by Cooper v. French*, 460 N.W.2d 2, 4 (Minn. 1990). The Court of Appeals reviews the district courts application of the law *de novo*. *STAR Centers, Inc. v. Faegre & Benson, L.L.P.*, 644 N.W.2d 72, 76-77 (Minn. 2003).

The United States Supreme Court has clarified the role and importance of summary judgment proceedings. In noting the need for disposing of weak cases, the Court stated:

In our view, the plain language of Rule 56(c) mandates the entry of summary judgment after adequate time for discovery and upon motion, against the party who fails to make a showing sufficient to establish the existence of an element essential to the party's case, and on which the party will bear the burden of proof at trial.

Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986) (emphasis added).

The substantive law will identify which facts are material. Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment. Factual disputes that are irrelevant or unnecessary will not be counted.

Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248-49 (1986).

“[T]here is no issue for trial unless there is sufficient evidence favoring the non-moving party for a jury to return a verdict for that party.” *Id.* at 250. “If the evidence is merely colorable, . . . or is not significantly probative, . . . summary judgment may be

granted.” *Id.* Where the record as a whole could not lead a rational finder of fact to find for the non-moving party, there is no genuine issue for trial.” *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 477 U.S. 574, 586 (1986).

This perspective, concerning the utility of summary judgment proceedings, has been cited favorably by the Minnesota Supreme Court. *See Thiele v. Stich*, 425 N.W.2d 580 (Minn. 1988). “Summary judgment is not to be avoided simply because there is some metaphysical doubt as to a factual issue. The non-moving party must demonstrate that there is indeed a genuine issue of material fact.” *Bob Useldinger & Sons, Inc. v. Hangsleben*, 505 N.W.2d 323 (Minn. 1993).

ARGUMENT

I. The trial court erred in failing to conclude that the policy did not afford coverage as a matter of law and Integrity Mutual is therefore entitled to summary judgment.

The trial court erred in failing to conclude that the policy did not afford coverage for the claims made against Remodeling Dimensions at the underlying arbitration. Rather than examining the damages *claims* made at the arbitration, the court instead focused on the *arbitration award*. However, the arbitration award is a red herring. Where there is no coverage under the policy for any of the *claims* made against Remodeling Dimensions, the award is of no moment. Thus, Summary judgment in favor of Integrity Mutual is appropriate as there is no claim subject to indemnification coverage under the policy.

As alleged by Remodeling Dimensions, the claims asserted by the Provenzanos were twofold, (1) there were defects in the addition project constructed by Remodeling

Dimensions, and (2) Remodeling Dimensions should have recognized that the original construction was defective so the Provenzanos could have brought claims against the original builder, LeGran Homes. However, coverage is not afforded for either of these claims. First, the business risk doctrine and the “your work” exclusion preclude insurance coverage for the claims arising out of work completed by Remodeling Dimensions. Secondly, the alleged failure to discover or inform the Provenzanos of an alleged defect in the original construction is not a covered claim under the policy. It is not an “occurrence,” as a failure to inform the homeowners of potential defects in the original construction is not an “accident.” Moreover, the damages alleged by the Provenzanos were not damages to property, but lost opportunity damages, which are not a covered damage under the policy. Thus, no coverage exists under the Integrity Mutual policy for any of the claims made by the Provenzanos at the underlying arbitration.

A. The Business Risk Doctrine Precludes Insurance Coverage for claims arising out of Remodeling Dimensions work on the addition.

Where the claims made at the arbitration were for the defects in the addition at the residence, and where all of the allegedly defective work was completed by Remodeling Dimensions, the business risk doctrine precludes insurance coverage for the claims.

The business risk doctrine is the expression of a public policy derived from the fundamental principle of insurance law that insurers should not be held liable for risks within the direct control of the insured. The risk intended to be insured against is the possibility that the products or work of the insured will cause bodily injury or damage to

property other than to the product or completed work itself. The risk that a contractor's work is defective or otherwise unsuitable is a risk which is inherent in the construction business, and the contractor retains the risk that it may be necessary to replace or repair its products or work. This risk on the contractor may extend to an obligation to completely replace or rebuild the deficient product or work. The doctrine is intended to keep the moral hazard of shoddy work on the contractor.

One of the fundamental purposes of insurance is the transfer of risks which are beyond the effective control of the insured. Workmanship is within the contractor's control. It is a "business risk," not an insurable risk. When the workmanship and materials used on a project fail, the consequences of the failure is one of the business risks of a commercial undertaking. *Knutson Construction Company v. St. Paul Fire and Marine Insurance Company*, 396 N.W.2d 229, 235 (Minn. 1986) citing *Weedo v. Stone-E-Brick*, 81 N.J. 233, 405 A.2d 788 (1979). Recognizing this well-established insurance principle, the Minnesota Supreme Court held that claims for damage to the contractors project itself are not covered under the contractor's insurance policy. *Bor-Son Building Corp. v. Employers Commercial Union*, 323 N.W.2d 58, 61 (Minn. 1982). In *Bor-Son*, the Minnesota Supreme Court labeled these types of claims "business risk." *Bor-Son Building Corp.*, 323 N.W.2d at 61. Reduced to its simplest terms, the risk that an insured's work or product will not meet the contractual standards is a business risk not covered by an insurance policy. *Id.* at 63.

Under the business risk doctrine, harm to property of a third party *caused* by the

insured's defective work is covered. *Sphere Drake Ins. Co. v. Tremco, Inc.*, 513 N.W.2d 473, 477 (Minn. Ct. App. 1994) *review denied* (Minn. Apr. 28, 1994). In *Sphere Drake*, the policy also contained an exclusion for damage to work performed by the insured.

513 N.W.2d at 477. The *Sphere Drake* court explains that a policy:

is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained. When the insured's faulty workmanship results in damage to the property of a third party other than to the completed work itself, such third-party property damage is not excluded from coverage by business risk doctrine.

Id. at 478-79. In contrast, the risk that is protected does not encompass damage to the "work" or "product" *itself*— the risk only covers damage or economic loss *resulting* from the faulty workmanship.

In the policy at issue here, the "business risk" exclusions can be found in exclusions "k", "l," "m" and "n." (BOP Coverage Form at 4-5, AA0082-83). These exclusions operate to exclude coverage for claims arising out of the insured's work or product when the claim for relief seeks replacement or repair of the work or product itself.

Here, the underlying claims of the Provenzanos regarding the construction of the addition relate only to the work of Remodeling Dimensions. Remodeling Dimensions did not hire subcontractors to complete any of the carpentry on the addition. (Arb. Transcript pp. 484, 503-5, AA0153, 0154-56). Rather, it was completed by Remodeling Dimension carpenters. (*Id.*) While they hired electricians and other interior subcontractors, there

were no claims that the electrical or other interior work was defective. (*Id.*, see also Remodeling Dimensions' Response to Claims, AA 0012-17). There is no evidence that damage occurred to other property because of the construction of the addition. Rather, the only alleged damages resulted directly from the construction of the addition. Accordingly, the only property damage alleged by the Provenzanos resulting from the addition was for defects in the addition, which is damage to the "product" or "work" of Remodeling Dimensions. Thus, the business risk exclusions, consistent with the business risk doctrine articulated in *Sphere Drake*, operate to preclude coverage for the replacement of the "work" or "product" that is deemed deficient or defective.

In the underlying arbitration, the Provenzanos claimed that Remodeling Dimensions constructed a defective addition. (Pl. Comp. at 13a, AA0004-5). *Knutson* made clear that where a contractor bears ultimate contractual responsibility for a project, that project is the product of the contractor. 396 N.W.2d at 232. Thus, the product of Remodeling Dimensions is the addition. Exclusion "l," states that the policy does not apply to "property damage" to "your product" arising out of it or any part of it, and exclusion "m" states that the policy does not apply to "property damage" to "your work." Thus, any damages associated with replacement or repair of the addition would be precluded from coverage as also made clear by *Sphere Drake*.

B. Insurance coverage is precluded for allegations that Remodeling Dimensions failed to discover or report defects in the original construction because these claims neither constitute an “occurrence” nor are there covered damages.

Insurance coverage is also precluded for any award resulting from claims that Remodeling Dimensions failed to discover or report defects in the original construction when removing a master bedroom window. For insurance to apply, there must be an “occurrence” and “property damage.” Where neither of these elements is present for the claims of the failure to report defects, coverage is precluded.

The BOP issued by Integrity Mutual contains the following insuring clause:

We will pay those sums that the Insured becomes legally obligated to pay as damages because of “bodily injury”, “property damage”, . . . to which this insurance applies.

b) This insurance applies:

(1) to “bodily injury” and “property damage” only if:

- (a) the “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the coverage territory; and
- (b) the “bodily injury” or “property damage” occurs during the policy period.

(BOP Coverage Form at p. 1, AA0079).

“Property damage” is defined as, “physical injury to tangible property, including all resulting loss of use of that property”.

...

“Occurrence” is defined as, “an accident including continuous or repeated exposure to substantially the same general harmful conditions.”

(Id. at pp. 11-12, AA0089-90).

Under the BOP policy issued to Remodeling Dimensions, “Occurrence” is defined as, “an accident including continuous or repeated exposure to substantially the same general harmful conditions.” (*Id.*) The policy does not define “accident.” However, the Minnesota Supreme Court stated that, an “accident, as a source and cause of damage to property, within the terms of an accident policy, is an unexpected, unforeseen, or undesigned happening or consequence from either a known or an unknown cause.” *Hauenstein v. Saint Paul-Mercury Indem. Co.*, 65 N.W.2d 122, 126 (Minn. 1954)(emphasis added). Because the policy does not provide its own definition of accident, then the *Hauenstein* definition applies. *American Family Ins. Co. v. Walser*, 628 N.W.2d 605, 610 (Minn. 2001). Thus, to be an accident under the policy, the work of Remodeling Dimensions must be both (1) a “source and cause of damage to property,” and (2) it must also cause “unexpected, unforeseen or undesigned happening or consequence.” Here, the failure to discover or communicate any defects in the original construction was neither the “source and cause of damage to property” nor did it cause “unexpected, unforeseen or undesigned happenings or consequences. The alleged damage to the property had nothing to do with Remodeling Dimensions’ failure to discover the defects. It was caused by deficiencies in the original 1993 construction of the home.

The Provenzanos’ expert testified that the alleged failure to discover problems with the original construction stemmed from Remodeling Dimensions’ removal of a bedroom window to facilitate the removal of an armoire. However, he did not claim that the work was a “source and cause” of the problems. Rather, he testified that Remodeling

“would have learned” that the window had been installed improperly and that

Remodeling Dimensions should have informed the Provenzanos of this issue. He

testified:

Q: As part of the 2003 remodeling project, the master bedroom window was removed and reinstalled. Have you considered that an act by Remodeling Dimensions as part of your expert reports. And if so, what opinion, if any do you have concerning that and what Remodeling Dimensions would have learned in doing that?

A: Yes. What Remodeling Dimensions would have learned removing the master bedroom window or the installation of the armoire or for whatever reason, was that the window had been installed in a manner which was not consistent with the window manufacturer’s instructions.

They would have found that the window installation did not conform with the then current 2003 residential code and that the window would have had to be installed in a manner that was code compliant and that the Provenzanos should have been informed of those changes rather than the window being installed in a manner that did not meet current codes.

Q: Have you done any forensic testing around that window?

A: Yes. Forensic cuts were made at the lower margin; and I believe the vertical – the left vertical trim board of that window, I believe, is photo – it’s in the part – it’s part of the photographs.

It shows that the Bildrite sheathing is present by trade – by trade stamp on it. It shows that the Bildrite is scored, and it shows that the window has been installed – has been dry fitted into the window assembly.

Q: So when you say that, you’re saying now as it exists, the window has been dry fitted into the wall assembly?

A: Yes, sir.

(Arb. Transcript at 221-225, AA0142-46). In his report, the expert further opined,

In the original construction surface staining was noted on the Bildrite fiberboard sheathing below and adjacent to the vertical nailing flange. The nail slots in the nailing flange were only partially used. The window was dry fitted into the rough opening omitting: 1) sill pan flashing; 2) rough opening drainage plane back wrap; 3) a sealant bead around the sides of the window unit; and, 4) barrier-coated reinforced flashing paper. This method of construction allowed water that penetrated the lap siding to contact the sheathing and intrude within the wall assembly. The installation methods omitted are common industry practices and normal manufacturer's specifications. Left unattended, the problem will consume the wall assembly and cause substantial damage to the wall assembly and structure of the home. The windows observed were not installed so as to provide a waterproof barrier for the exterior structural wall system.

(Fahlk Report, AA0199). This testimony demonstrates that the claim against Remodeling Dimensions was solely for its failure to inform the Provenzanos about the defects in the initial construction. He did not state that it was a "source and cause" of the damage. Additionally, the arbitrator later asked for clarification from the Provenzanos' expert and their attorney. The following testimony clarified the claims:

[Arbitrator]: I'm struggling with the portion of the claim that Remodeling Dimensions should be responsible for portions of this house that they had no, you know, involvement in. They didn't build it. They didn't repair it.

[Pirjevec]: Yeah.

[Arbitrator]: And I think what the claim is, is that once you open up a particular part of the house and see some apparent deficiencies, you have a duty to notify the homeowner before you do whatever you're going to do and then repair it?

[Pirjevec]: Yes, sir.

[Arbitrator]: Is that basically the theory?

MR. RUCKER: [Provenzanos' Attorney] I would agree with that.

[Pirjevec]: Yeah

MR. RUCKER: - - as their attorney, at least. A legal theory? Yes.

(Arb. Transcript at 396-97, AA0150-51).

Thus, it cannot be said that this failure to communicate represents an accident. The claim was not that Remodeling Dimensions' work was a "source and cause of damage to property." Rather, the testimony explicitly states that the source and cause of the damage was the work of the original builder in 1993. Nor was there an allegation that the work of Remodeling Dimensions caused "unexpected, unforeseen or undesigned happening or consequence." Again, the claim was that the cause of the consequence was the work of the original builder in 1993. As there is no accident, there can be no occurrence for which coverage can be imposed.

Moreover, even if this event could somehow constitute an accident, there is no property damage stemming from either the failure to discover the defects or communicate the defects to the Provenzanos. The policy only applies to an "occurrence" which causes "property damage." "Property damage" is defined by the policy as, "physical injury to tangible property, including all resulting loss of use of that property". (BOP Coverage Form at 11-12, AA0089-90). The Provenzanos did not allege that property damage resulted from the failure of Remodeling Dimensions to discover the defects. Rather, the

claim was clearly explained in the testimony,

[Arbitrator]: And I think what the claim is, is that once you open up a particular part of the house and see some apparent deficiencies, you have a duty to notify the homeowner before you do whatever you're going to do and then repair it?

[Pirjevec]: Yes, sir.

[Arbitrator]: Is that basically the theory?

MR. RUCKER: [Provenzanos' Attorney]
I would agree with that.

(Arb. Transcript at 397-97, AA0150-51). Thus, the claim was for the lost opportunity to bring a claim against the original builders. However, loss of opportunity is not “physical injury to tangible property.” Thus, these are not covered damages under the policy.

Numerous courts have found that similar types of damages are intangible. For example, a general rule is that loss of investment does not constitute damage to tangible property. *Travelers Indemnity Co. v. State*, 140 Ariz. 194, 680 P.2d 1255, 1257 (App. 1984); *Hommel v. George*, 802 P.2d 1156, 1158 (Colo.Ct. App. 1990)(pure economic losses are intangible); *Hartford Accident & Indemnity Co. v. Case Found. Co.*, 10 Ill. App. 3d 115, 294 N.E.2d 7, 13 (1973)(investments, anticipated profits, and business ventures are intangibles); *L. Ray Packing Co. v. Commercial Union Ins. Co.*, 469 A.2d 832, 835 (Me. 1983)(mere economic damage is not loss of use of tangible property). Thus, where the alleged damages are not for damage to property, but for the loss of the opportunity to bring a suit against the original builder, these are not “physical injuries to tangible property” and are therefore not covered under the policy.

Indeed, by the Provenzanos' allegations, the damage occurred due to work that was completed before Remodeling Dimensions ever worked on the home. Thus, the damages sought in the underlying claim were not for damages arising out of any work of Remodeling Dimensions, but damages that occurred long before Remodeling Dimensions ever worked at the home.

In conclusion, the alleged failure to communicate defects was not an accident, and therefore was not an occurrence under the policy. For this reason, the trial court erred and Integrity Mutual is entitled to summary judgment. Even if one does determine that this was an accident, it nevertheless does not constitute an occurrence because the damages alleged are for lost opportunity, which is not a covered damage under the policy. Thus, coverage was precluded for all of the claims made against Remodeling Dimensions at the underlying arbitration and the trial court erred in failing to grant summary judgment in favor of Integrity Mutual.

II. The Trial Court erred in holding that Remodeling Dimensions should be liable for the arbitration award where there was no evidence of any negligent conduct and where reliance on foreign cases was misplaced.

The trial court premised its decision to grant Remodeling Dimensions' motion for summary judgment on its holding that the failure of Remodeling Dimensions' attorney to request a reasoned arbitration award constituted a breach of contract. This holding constitutes error for numerous reasons. First, the court's holding presupposes that the failure to request a reasoned explanation of the award, which it attributed to Integrity Mutual, was unintentional, negligent, or not in the Remodeling Dimensions' best interest.

There is no evidence, however, that requesting a reasoned arbitration award would be consistent with the insured's best interest, as it would have clarified that coverage was precluded for the awarded damages. In fact, the declination of coverage was not based upon the lack of a reasoned arbitration award, but upon the absence of any damage claims subject to indemnification.

Moreover, the court's decision was based upon case law from foreign jurisdictions holding an insurer vicariously liable for the negligent acts of counsel retained by the insurer to represent the insured. However, there is no allegation here that failing to request a reasoned arbitration award was negligent. The cases relied upon by the trial court concern bad faith claims against the insurer, in which an insured was exposed to damages in excess to their policy limits. This is not the case here. Applying the cases relied upon by the court would greatly expand the long standing case law relating to bad faith in Minnesota. Thus, if need be, this Court should apply the majority rule from other jurisdictions, that an insurer is not vicariously liable for the negligence of retained counsel because the attorney is an independent contractor. Such a determination would be in line with Minnesota's bad faith case law and would place the fault for any negligence on the party responsible for any negligent acts.

A. The trial court erred in finding that the attorney for Remodeling Dimensions at the underlying arbitration had a duty to request a reasoned award.

The trial court erred in finding that the attorney for Remodeling Dimensions had a duty to request a reasoned award where there is no evidence, much less an allegation, that

the failure to request a reasoned award was negligent or otherwise inconsistent with the best interests of the insured. Moreover, Integrity Mutual's declination of coverage was not based on the lack of a reasoned arbitration award, but on the lack of any covered claims.

It is well-established under Minnesota case law that defense counsel hired by an insurer to defend a claim against its insured represents the insured. *See Miller v. Shugart*, 316 N.W.2d 729, 733 (Minn. 1982); *Crum v. Anchor Cas. Co.*, 119 N.W.2d 703, 712 (Minn. 1963). The court in *Crum* explained:

[A]n attorney retained by an insurer to defend its insured, as long as he represents the insured, is under the same obligations of fidelity and good faith as if the insured had retained the attorney personally. The relationship of client and attorney exists the same in one case as in the other.

119 N.W.2d at 712. However, in the context of the tripartite relationship in an insurance defense scenario, there exist potential for conflicts in every case.

Courts and commentators recognize universally that the tripartite relationship between insured, insurer, and defense counsel contains rife possibility of conflict' and that the relationship between an insurer and insured is permeated with potential conflicts.

In re Rules of Prof'l Conduct, 299 Mont. 321, 2 P.3d 806, 814 (2000). While this potential for conflict exists in all insurance defense scenarios, the law is clear, an attorney retained by an insurer to defend its insured, is not permitted to take a position adverse to the interest of his client. *Crum*, 119 N.W.2d at 712. Here, there is no evidence, much less an allegation, that the attorney retained to represent Remodeling Dimensions in the underlying arbitration took a position adverse to the interests of his client.

The trial court provided:

. . . the Court cannot determine exactly what the damages were awarded for, why they were awarded and what the arbitrator considered when making the award. . . This Court can, however, determine why the award of damages for such a complex claim contained no explanation . . . no such request was made prior to the appointment of the arbitrator.

. . .

[the attorney] was appointed to represent Plaintiff in this matter on or before September 7, 2006 – giving him at least thirteen days to review the case, appreciate its complexity and request a reasoned award pursuant to Rule 42(b). [The attorney] either chose to ignore Rule 42(b) or was unaware of it. Because of this, the Court finds that the lack of an explanation of the award was directly attributable to the inaction of [the attorney].

. . .

And, because Defendant agreed to provide Plaintiff with legal representation, the failure to request a reasoned award pursuant to Rule 42(b) represented a breach of the contract between the parties. Therefore, the Court grants summary judgment in favor of Plaintiff.

(Cite to Order at p. 9-10). The court therefore determined that Integrity Mutual was “liable for the actions” of the attorney hired to represent Remodeling Dimensions in the underlying arbitration. (*Id.*) However, this decision was an error where there is no evidence, much less an allegation, that the failure to request a reasoned award was negligent or otherwise not in the best interest of the insured. Thus, the trial court erred in holding the failure to request a reasoned arbitration award was a breach of contract.

The record is completely silent as *why* no reasoned arbitration award was requested. It could have been that the attorney, after discussing the issue with the insured, determined that requesting such a reasoned award was not in the insured’s best interest.

After all, had the arbitrator provided a reasoned award, explicit findings would clearly show that indemnification coverage was precluded. This would certainly not be in the best interest of the insured. In support of its motion for summary judgment, Remodeling Dimensions submitted an affidavit of its owner, Bruce Lyons. (Aff. of Lyons, AA0233). The affidavit set forth the claims made against Remodeling Dimensions by the Provenzanos, when the claim was submitted to Integrity Mutual, and various other facts relating to the underlying arbitration. (*Id.*) However, the affidavit is silent as to the decision not to obtain a reasoned arbitration award. It simply cannot be said that this decision was contrary to the insured's best interest.

An attorney retained by an insurer to defend its insured is not permitted to take a position adverse to the interest of his client. *Crum*, 119 N.W.2d at 712. Here, the attorney, after determining that requesting a reasoned award would be adverse to the position of his client, would have a duty to the insured *not* to request such an award. Integrity Mutual did not request a reasoned award until January 10, 2007, long after the deadline for requesting such an award under the AAA rules. At that time, the attorney could not have requested a reasoned award. Thus, it is unclear on what basis the trial court determined that the attorney for Remodeling Dimensions had some duty to request a reasoned arbitration award.

Finally, the Trial Court Order presupposes that the lack of a reasoned arbitration award was the reason for the declination of coverage. However, Integrity Mutual did not couch its declination of coverage on the decision not to request a reasoned arbitration

award. (Declination Ltr. of Integrity Mutual, AA0095-96b). Rather, the decision was based on an extensive review of the *claims* made and the evidence submitted at the arbitration. (*Id.*) Integrity Mutual therefore declined coverage on the grounds that “. . . none of the *claims against* Remodeling Dimensions are covered by the above described policy.” (Declination Ltr. of Integrity Mutual, AA0095-96)(emphasis added).

In deciding a summary judgment motion, the court is required to view the evidence in the light most favorable to the nonmoving party. *Fairview Hospital and Health Care Services v. St. Paul Fire & Marine Ins. Co.*, 535 N.W.2d 335, 341 (Minn. 1995). Under the evidence presented at summary judgment, it could only be determined that the retained attorney for Remodeling Dimensions concluded that requesting such an award would be adverse to the interest of his client. Indeed, had the attorney requested a reasoned arbitration award, it could have ultimately been used as a sword against his client, as providing undisputed evidence that coverage was precluded for the categories of damages awarded.

Thus, the trial court’s determination that the attorney’s decision not to request a reasoned arbitration award constituted a breach of contract is error. Where there is no evidence that the decision not to request a reasoned arbitration award was negligent or not in Remodeling Dimensions’ best interest, there can be no finding that Integrity Mutual breached the contract with Remodeling Dimensions.

B. The trial court erred in applying case law from foreign jurisdictions which would alter long standing Minnesota case law relating to bad faith claims.

After errantly finding that the failure to request a reasoned arbitration award was negligence, the trial court applied case law from other jurisdictions in holding that the failure constituted a breach of contract for which Integrity Mutual should be vicariously liable. However, the cases relied upon are from foreign jurisdictions and only apply to bad faith claims. This is not a bad faith claim. Moreover, this is not the law in Minnesota and such a holding would improperly expand Minnesota's long standing case law regarding bad faith claims. Instead, this Court should adopt case law holding that an insurer is not vicariously liable for the negligence of an attorney hired to represent an insured.

In finding that the attorney's decision not to request a reasoned arbitration award constituted a breach of contract, the court relied on two foreign cases from other jurisdictions, which related to bad faith claims against the insurer, *Stumpf v. Continental Cas. Co.*, 794 P.2d 1228 (Or. Ct. App. 1989) and *Smoot v. State Farm Mutual Automobile Insurance Co.*, 299 F.2d 525, 530 (5th Cir. 1962).

Stumpf involved a medical malpractice claim against an insured physician, Dr. Stiff. Plaintiff sought damages against Dr. Stiff in the amount of \$3,000,000.00, but offered to settle the claim for the policy limits of \$1,000,000.00. The insurance company, based on the evaluation of counsel retained to represent the insured, declined the settlement offer. The jury ultimately returned a verdict against Dr. Stiff in the amount of

\$3,000,000.00. Dr. Stiff then assigned his excess liability claim against defendant to Plaintiffs, who brought a suit against the insurer alleging that the negligent evaluation, investigation, and negotiation of a claim by the attorney retained by the insurance company resulted in a judgment of \$2,000,000.00 in excess of the policy limits. A jury found that the insurer was vicariously liable for the negligent acts of counsel and awarded over \$2,000,000.00 to plaintiffs. The insurer appealed. In affirming the verdict, The Oregon Court of Appeals applied the rule from *Smoot*, providing that “an insurer may be vicariously liable for the actions of its agents, including counsel that it hires to defend its insured.” *Id.* at 1233(citing *Smoot*, 299 F.2d 525, 530 (5th Cir. 1962)).

Similarly, *Smoot* also involved an action against an insurer to recover the excess of a damage judgment over the face amount of an insurance policy. *Smoot*, 299 F.2d at 525. There, the insured brought a suit against his insurer to recover the excess damage suit judgment over the face value of the policy alleging that the negligence of his attorney, retained by the insurer, caused the damages. *Id.* at 527. The insurer brought a motion to dismiss for failure to state a claim for which relief may be granted. The trial court granted the insurer’s motion. The insured appealed. On appeal, the insured took the position that “it ha[d] no responsibility for damage sustained by the Assured even if it should be caused by legally culpable neglect or bad faith on the part of the attorney supplied by it to maintain the defense.” *Id.* at 530. The Fifth Circuit Court of Appeals disagreed, finding that “[t]hose whom the Insurer selects to execute its promises, whether attorneys, physicians, no less than company-employed adjusters, are its agents for whom

it has the customary legal liability.” *Id.* at 530.

However, these cases involve insurers who defended in bad faith, exposing the Insured to liability above and beyond the insurance policy.³ Moreover, other jurisdictions have held that an attorney retained by the insurer is an independent contractor and that the insurer is not vicariously liable for the negligence of the attorney retained to represent the insured, even in cases where bad faith is alleged. *Merritt v. Reserve Insurance Co.*, 34 Cal.App.3d 858 (1973).

Like the courts in *Smoot* and *Stumpf*, California courts have recognized that liability may be imposed upon a carrier for rejection of a claimant’s offer to settle within policy limits when the carrier has rejected the offer in bad faith. *Brown v. Guarantee Inc. Co.*, 155 Cal.App.2d 679 (1957). However, California has declined to extend that reasoning to those instances in which the carrier did not act in bad faith, but merely relied on the advice of attorneys hired to defend the insurer. *Merritt v. Reserve Insurance Co.*, 34 Cal.App.3d 858 (1973)

In *Merritt*, an insurer declined to settle an action within policy limits where it had been advised on numerous occasions by counsel retained by the insurer that, “[t]he case is ‘an absolute case of nonliability.’” *Id.* at 865. Relying on this advice, the insurer declined

³See *Attleboro Mfg. Co. v. Frankfort Marine, Acc. & Plate Glass Ins. Co.*, 240 F. 573 (1st Cir. 1917); *Boyd Bros. Transp. Co., Inc. v. Fireman’s Fund Ins. Co.* 729 F.2d 1407, 1410 (11th Cir. 1984); *Blakely v. American Employers’ Ins. Co.*, 424 F.2d 728, 733-34 (5th Cir. 1970); *Nat’l Farmers Union Prop. & Cas. Co. v. O’Daniel*, 329 F.2d 60, 65-66 (9th Cir. 1964); *Pacific Employers Ins. Co. v. P.B. Hoidale Co.*, 789 F. Supp. 1117, 1122-23 (D. Kan. 1992).; *Continental Ins. Co. v Bayless & Roberts, Inc.* 608 P.2d 281 (Alaska 1980).

to settle the lawsuit within policy limits and a jury later returned a verdict of approximately \$300,000.00 in excess of the policy limits. *Id.* at 862. The judgment was assigned and the assignee brought suit against the insurer and recovered a verdict of \$499,000.00. *Id.* at 867. The insurer appealed. The California Court of Appeals held that while an insurer could be held liable for negligent performance of its own duties or for bad faith, it did not accept the claim that an insurer could be held liable for the negligence of independent trial counsel. The court determined that independent trial counsel act only in the capacity of independent contractors, responsible for the results of their conduct and not subject to the control and direction of their employer over the details and manner of their performance. *Id.* at 880. It divided the duties between the insurer and counsel as follows:

[The insurer] assumed three principal duties in relation to the assured: (1) to make immediate inquiry into the facts of any serious accident as soon as practicable after its occurrence; (2) on the filing of suit against its assured to and to provide counsel with adequate funds to conduct the defense of the suit; (3) to keep abreast of the progress and status of the litigation, including the amount and extent of discovery, the interrogation, evaluation and selection of witnesses, the employment of experts, and the presentation of the defense in court, remains he responsibility of trial counsel, and this is true both on plaintiff's side and on defendant's side of the case.

Id. at 882 (emphasis added). The court therefore held that the insurer was not responsible for the negligent acts of the attorneys retained to represent the insured, providing,

[h]aving chosen competent independent counsel to represent the insured in litigation, the carrier may rely upon trial counsel to conduct the litigation, and the carrier does not become liable for trial counsel's legal malpractice. If trial counsel negligently conducts the litigation, the remedy for this negligence is found in an action against counsel for malpractice and not in a

suit against counsel's employer to impose vicarious liability.

Id. at 881-82.

The holding in *Merritt* has been adopted and applied in many other jurisdictions in cases, such as the instant case, that do not involve claims of bad faith against the insurance company. In *Feliberty v. Damon*, 72 N.Y.2d 112, 531 N.Y.S.2d 778, 527 N.E.2d 261 (1988), a physician brought claims against his medical malpractice insurer, alleging that the insurer was liable for the legal malpractice of the attorneys retained by the insurer to represent him. The court applied the rule in *Merritt* holding that the attorney retained to represent the insured was an independent contractor and that there was no justification to impute defense counsel's alleged negligence to the insurer. *Id.* at *Id.* at 265. The court therefore held that an insurer is not vicariously liable for the alleged negligence of an attorney retained to represent the insured. The court concluded that such a decision would create an untenable situation where the insurer, who could not directly control the litigation, would however be charged with responsibility for the day-to-day professional judgments made by counsel retained to represent the insurer. *Id.*

Similarly, in *Aetna Cas. & Sur. Co. v Protective Nat. Ins. Co. of Omaha*, 631 So.2d 305 (Fla. 3d D.C.A. 1993), the court held that the defendant insurance company was not vicariously liable for the negligence of the attorney it selected to defend the insured when the attorney failed to raise a meritorious statute of limitations defense in a personal injury suit. *Aetna Cas. & Sur. Co.*, 631 So. 2d 305 at 306. Indeed, numerous other jurisdictions have held that in cases not involving bad faith claims, the insurer is not

vicariously liable for the alleged negligence of an attorney retained to represent the insured. See *Ingersoll-Rand Equipment Corp., v. Transportation Ins. Co.*, 963 F.Supp 452, (M.D. Pa. 1997)(holding that insurer is not vicariously liable for negligence of attorneys retained to represent insured when attorneys negligently failed to raise statute of limitation defenses, as attorney is independent contractor); *Brown v Lumbermens Mut. Cas. Co.*, 90 N.C.App. 464, 369 S.E.2d 367, 371 (1988)(holding that alleged negligence of attorneys hired by automobile liability insurer to defend motorist in accident litigation could not be imputed to insurer, as attorney was independent contractor). *Horwitz v. Holabird & Root*, 212 Ill.2d 1, 287 Ill. Dec. 510, 816 N.E.2d 272 (2004)(holding that when an attorney acts pursuant to the exercise of independent professional judgment, he or she acts presumptively as an independent contractor).

Here, the trial court erred in applying the rule set forth in *Smoot* and *Stumpf*. Those cases both involve bad faith claims for failure to settle a claim within policy limits. In this case, however, there are no claims of bad faith. Moreover, the application of the holdings in *Smoot* and *Stumpf* would have the effect of greatly expanding the potential for bad faith claims in Minnesota. In Minnesota, the test to determine when an insurer has acted in bad faith in failing to settle a lawsuit within policy limits, and therefore exposing the insured to excess exposure, is quite narrow,

[t]he insurer's duty of good faith is breached in situations in which the insured is clearly liable and the insurer refuses to settle within the policy limits and the decision not to settle within the policy limits is not made in good faith and is not based upon reasonable grounds to believe that the amount demanded is excessive.

Short v. Dairyland Ins. Co., 334 N.W.2d 384 (Minn. 1983). Thus, Minnesota has a long standing rule applying to bad faith claims. Adopting the rule set forth in *Stoop* or *Stumpf* would alter this long standing case law, and would significantly broaden the potential liability of insurers. Rather than being able to rely on counsel to provide them information necessary to make a good faith evaluation, insurers would also have to protect themselves from the potential that counsel had improperly evaluated the case. This would significantly expand the potential liability of insurers regarding a determination of settling cases. Applying the rule set forth in *Merritt* and in other jurisdictions, however, would not pose these adverse effects. Under those holdings, the attorney, not the insurer, would be liable for the negligence of the attorney. Thus, insurer's liability would not be greatly expanded, and the duty to provide proper counsel to a client would remain upon the attorney.

Thus, the trial court erred in applying *Stoop* and *Stumpf* in determining that the insurer should be vicariously liable for the decision not to request a reasoned arbitration award.

CONCLUSION

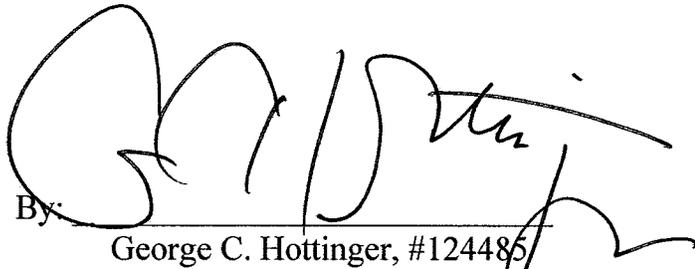
The trial court erred in failing to grant summary judgment in favor of Integrity Mutual where coverage is precluded for all claims made against Remodeling Dimensions at the underlying arbitration. Instead, Integrity Mutual is entitled to summary judgment.

Moreover, the trial court erred in determining that Integrity Mutual was vicariously liable for the actions of the attorney hired to represent Remodeling Dimensions. First,

there is no evidence that the decision not to request a reasoned arbitration award was negligent or not in the insured's best interest. Moreover, the court improperly applied case law from other jurisdictions that if adopted would greatly expand Minnesota's long standing case law regarding bad faith claims against insurers. Instead, the majority rule holding that an insurer is not vicariously liable for the fault of retained counsel is in line with Minnesota's long standing case law controlling bad faith claims against insurers. Since Integrity Mutual is not vicariously liable for the alleged negligence of the attorney retained to represent Remodeling Dimensions, Integrity Mutual is entitled to summary judgment.

Respectfully Submitted,

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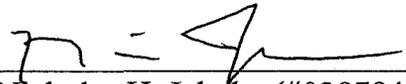
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CERTIFICATION OF COMPLIANCE WITH WORD COUNT LIMIT

This brief contains 9,943 words as confirmed by the Document Information Tool of Corel Word Perfect 9, which word-processing software was used to prepare this brief. This brief also complies with the typeface requirements of Rule 132.01 of the Minnesota Rules of Civil Appellate Procedure as the printed material appears in 13- point proportional font.



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