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Case No. A10-2146

*State of Minnesota*

# *In Supreme Court*

*RAM Mutual Insurance Company,*

*Appellant,*

*vs.*

*Rusty Rohde, d/b/a Studio 71 Salon,*

*Respondent.*

## RESPONDENT RUSTY ROHDE, D/B/A STUDIO 71 SALON'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).

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## STATEMENT OF LEGAL ISSUE

**WHETHER APPELLANT RAM MUTUAL INSURANCE COMPANY CAN SUSTAIN A SUBROGATION LAWSUIT AGAINST ITS INSURED'S TENANT, RESPONDENT ROHDE, WHERE NO EXPRESS PROVISION EXISTED IN THE LEASE TO DEFINE WHICH PARTY WOULD SECURE FIRST-PARTY PROPERTY DAMAGE COVERAGE.**

The trial court, Honorable Thomas P. Knapp presiding, determined that such a claim is barred by the *Bruggeman* case and its progeny, cited below, because *Bruggeman* identifies Rohde as an insured of RAM's for the losses at issue, and because Appellant RAM is prohibited from initiating a subrogation action against a party it insures. As a result, Judge Knapp dismissed RAM's case in its entirety as a matter of law upon Rohde's Motion for Summary Judgment.

The Minnesota Court of Appeals affirmed.

Most apposite cases:

*United Fire & Casualty v. Bruggeman*, 505 N.W.2d 87 (Minn. Ct. App. 1993)

*Blohm v. Johnson*, 523 N.W.2d 14 (Minn. Ct. App. 1994

*Sutton v. Jondahl*, 532 P.2d 478 (Okla. Ct. App. 1975)

*DiLullo v. Joseph*, 792 A.2d 819 (Conn. 2002)

## STATEMENT OF CASE

This is a subrogation lawsuit initiated by Appellant RAM Mutual Insurance Company ("RAM") against its insured's lessee, Respondent Rusty Rohde d/b/a Studio 71 Salon ("Rohde"). Rohde respectfully asks this Court to affirm the lower courts' rulings that RAM is barred as a matter of law from bringing its subrogation action against Rohde.

This lawsuit stems from water damage to the premises at issue which was allegedly the result of Rohde's negligence. RAM's insured, JD Property Management, LLC ("JD Property") owns the property. The property is located in Sauk Centre, Minnesota and is a multi-unit complex containing three business suites. One of the units in the complex was rented to Rohde. Rohde's possession of the unit was governed by a Commercial Lease Agreement dated December 12, 2004 (the "lease"). App-53-57. Rohde operated his hair salon at the property in question.

While the lease was in force, Rohde replaced a pedicure chair in his salon and installed the water line which served the chair. Shortly thereafter, the new water line allegedly burst, causing a water leak in the salon.

Because the lease did not require Rohde to do so, he did not obtain primary first-party insurance coverage on the rented premises.[1] Despite RAM's suggestions otherwise, the lease was silent with regard to any party's duty to obtain first-party property damage

[1] The only first-party insurance coverage obtained by Rohde was excess coverage for damage to the building, which provides coverage only when a primary policy's limits of coverage have been exhausted. For reasons discussed later in this Brief, RAM's assertion that its policy also provided "excess" coverage on the same level as Rohde's policy is incorrect. The RAM policy provided primary coverage for the alleged damage to the building.

coverage for the premises at issue. If anything – by specifically stating that Rohde should inquire of a "Tenant's Policy of Insurance" if he "desired" insurance coverage – the terms of the lease implied that JD Property was obligated to obtain coverage for damage to the building itself. App-55, ¶25.

Rohde moved for summary judgment on the sole issue of whether RAM's subrogation claims are barred by Minnesota common law as stated in *United Fire & Casualty v. Bruggeman*, 505 N.W.2d 87 (Minn. Ct. App. 1993). *Bruggeman* bars subrogation claims by a landlord's insurer against the lessee for physical damage to the rented premises where the lease is silent as to which party shall obtain first-party property damage insurance. *Bruggeman* provides that a tenant who is not required under the provisions of its lease to obtain first-party property damage coverage is a co-insured under the landlord's policy covering the same, but only for the purposes of subrogation claims by the landlord's insurer. Despite the fact that *Bruggeman* dealt with a fire loss, the trial court here determined that the principles set forth in *Bruggeman* applied equally to the circumstances of the instant case as a consequence of the parties' relative interests in the real property at issue. Add-13.

The only defense RAM presented to the trial court to Rohde's summary judgment motion was that the case of *Osborne v. Chapman*, 574 N.W.2d 64 (Minn. 1998) is more apposite to the instant matter than *Bruggeman*. The trial court dismissed this argument and correctly noted that *Osborne* is distinguishable because it dealt with a different category of damages – consequential damages of lost rental income – as compared to *Bruggeman* and the instant matter, which involves the cost of repair following physical

damage to the rental property. RAM's arguments to the trial court were completely devoid of reference to any method of analysis other than what is set forth in the *Bruggeman* case and its progeny.[2]

After being provided notice of Rohde's summary judgment motion, RAM decided to bring its own cross motion for summary judgment. Add-2. RAM essentially sought partial summary judgment declaring that Rohde had breached the lease by installing an "improvement" to the property without the permission of JD Property. The trial court essentially denied RAM's motion as moot because its claims – all of which were brought as subrogee of JD Property – are barred under *Bruggeman*. Add-13.

RAM appealed to the Minnesota Court of Appeals, which, in a published opinion, affirmed the dismissal of RAM's claims for nearly identical reasons as those stated in the trial court's Order and Memorandum. *RAM Mut. Ins. Co. v. Rohde*, 805 N.W.2d 554 (Minn. Ct. App. 2011), review granted (Nov. 15, 2011).

## STATEMENT OF FACTS

RAM's Complaint alleges that, on February 4, 2008, a water line which feeds a pedicure chair at Rohde's Studio 71 Salon burst, causing damage to the real property. App-3-4. The leased premises are located at 201 Main Street, Suite #2 in Sauk Centre, Minnesota ("Suite #2"). App-53. Because the water line had been installed by Rohde,

[2] In other words, RAM has raised new issues on appeal because it did not raise to the trial court the issues that it now raises to this Court; namely, (1) whether this case should be analyzed according to the "anti-*Sutton*" or "case-by-case" approaches or (2) whether this case should be excepted from the rules set forth in *Bruggeman* simply because the instant matter deals with a commercial lease. Furthermore, neither of these issues had been raised to the Minnesota Court of Appeals upon RAM's initial appeal of these issues.

RAM's Complaint alleges causes of action for (1) breach of contract, (2) negligence and (3) promissory estoppel.[3] App-4-6. As subrogee of JD Property, RAM seeks recovery of the payment it made to JD Property for repair of the property damage allegedly suffered at the insured premises in the amount of $17,509.38. App-7.

The lease agreement between JD Property and Rohde identified certain obligations for obtaining (1) first-party insurance coverage for damages to personal property and (2) third-party liability coverage. The section of the lease entitled "Insurance" states, *in its entirety*:

> **Insurance**
>
> 25. The Tenant is hereby advised and understands that the personal property of the Tenant is not insured by the Landlord for either damage or loss, and the Landlord assumes no liability for any such loss. The Tenant is advised that, if insurance coverage is desired by the Tenant, the Tenant should inquire of Tenant's insurance agent regarding a Tenant's Policy of Insurance.[[4]]
>
> 26. The Tenant is responsible for insuring the Premises for liability insurance for the benefit of the Tenant and the Landlord.
>
> 27. The Tenant will provide proof of such insurance to the Landlord upon the issuance or renewal of such insurance.

App-55. The characteristic of the lease which is most significant to the instant matter is that it is *silent* as to any duty to obtain first-party property damage coverage for the

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[3] Although Defendant has generally denied the allegations against him, only limited discovery has been conducted thus far. In any case, evaluation of liability is irrelevant to Rohde's summary judgment motion, which is based exclusively on the law barring subrogation claims such as those made by RAM in this case.

[4] Interestingly, RAM's purported verbatim reproduction of this paragraph of the lease in its Brief omits the first sentence. Appellant's Brief, p. 5.

building itself.[5] The choice-of-law provisions of the lease identify the laws of the State of Minnesota as the governing law when interpreting the agreement. App-56.

Defendant Rohde obtained the insurance policies required of him pursuant to the lease. At the time of the alleged incident, Defendant Rohde was insured under an American Family Businessowners Policy with effective dates of June 1, 2007 to June 1, 2008 ("American Family policy"). App-137-212. This policy provided the requisite third-party liability coverage as required by the lease agreement and also covered Rohde's "business personal property." App-140-141.

The American Family policy also provided property damage coverage for the building, but only in excess of any such coverage afforded by RAM on the same premises; i.e. Suite #2 of the property in question. In this regard, the following provisions are found under the heading, "Section III – Common Policy Conditions (Applicable to Section I – Property and Section II – Liability)" in the American Family policy:

> **H. Other Insurance**
>
> 1. If there is other insurance covering the same loss or damage, we will pay only for the amount of covered loss or damage in excess of the amount due from that other insurance, whether you can collect on it or not.
>
> . . .

[5] As discussed, *infra*, RAM's assertion that the lease speaks to a requirement to obtain first-party property damage coverage (1) misconstrues terms of the lease which have no relation to insurance requirements and (2) is based on lease language which was not discussed by the parties or the trial court in the summary judgment phase of trial and cannot be considered by this Court on appeal.

App-178. To summarize, (1) Defendant Rohde had no contractual duty to obtain primary first-party coverage on his rented premises and (2) as a result, Rohde did not obtain primary insurance coverage on the premises.

## ARGUMENT

### I. STANDARD OF REVIEW.

When reviewing the dismissal of claims pursuant to Minn. R. Civ. P. 56, this Court reviews de novo "whether a genuine issue of material fact exists" and "whether the district court erred in its application of the law." *STAR Ctrs., Inc. v. Faegre & Benson, L.L.P.*, 644 N.W.2d 72, 77 (Minn. 2002). "A motion for summary judgment shall be granted when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that either party is entitled to a judgment as a matter of law." *Fabio v. Bellomo*, 504 N.W.2d 758, 761 (Minn. 1993) (citation omitted).

### II. MOST OF RAM'S ARGUMENTS ARE RELATED TO NEW ISSUES AND THEORIES IMPROPERLY RAISED FOR THE FIRST TIME ON APPEAL.

In its Brief, RAM makes two primary requests of this Court, while at the same time acknowledging that *United Fire & Casualty v. Bruggeman*, 505 N.W.2d 87 (Minn. Ct. App. 1993) should not be overruled; (1) to differentiate the law on subrogation claims by a landlord's insurance company against an allegedly negligent tenant based on whether the lease was for residential or commercial tenancy, and (2) to implement a "case-by-case" approach to the issues at hand as opposed to the so-called "no subrogation" rule described in the *Bruggeman* case. Appellant's Brief, p. 39. *Neither* of

these legal theories had been presented to the district court in response to Respondent's summary judgment motion. RA-1-11.

"A reviewing court must generally consider 'only those issues that the record shows were presented and considered by the trial court in deciding the matter before it.'" *Thiele v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988) (quoting *Thayer v. American Financial Advisers, Inc.*, 322 N.W.2d 599, 604 (Minn.1982))(citation omitted). "Nor may a party obtain review by raising the same general issue litigated below but under a different theory." *Thiele*, 425 N.W.2d at 582. In *Thiele*, a plaintiff's claims in a legal malpractice case were dismissed by the trial court for violation of the statute of limitations. *Id.* at 581. On appeal, the plaintiff argued a different theory as to when her cause of action accrued; a theory which would have rendered service proper. *Id.* But this Court did not allow the plaintiff to pursue the new theory on appeal, despite the fact that the parties had "obviously litigated the statute of limitations question in trial court . . ." *Id.* at 582. This Court observed that, "[h]aving lost on the theory under which she argued the case, Thiele plainly raised an alternative theory for the first time on appeal." *Id.*

In this case, like in *Thiele*, the general issue of whether the principles in *Bruggeman* should apply was "obviously litigated"; but the legal theories on which RAM relies have changed almost entirely. Here, the trial court was not presented with – nor did it decide upon – the two primary theories listed above. In fact, much of the district court's Memorandum in this case is a word-for-word replica of the arguments made in Rohde's Memorandum of Law in Support of his Motion for Summary Judgment.

*Compare* Add-3-15 *with* App-119-129.[6] RAM seems to have anticipated this argument and makes a circuitous argument that by referencing a certain footnote in the case of *Osborne v. Chapman*, 574 N.W.2d 64 (Minn. 1998), it raised the issue of the "case-by-case" approach. Appellant's Brief, p. 7. But, even if that was so, the trial court's Memorandum made no reference to legal theories discussed in *Osborne*. The trial court merely distinguished *Osborne* as providing no authority because it was not a subrogation case and it dealt with a category of damage – lost rental income – which was altogether different than the damage to real property at issue here. *See* Add-8-10. There is, thus, no indication that the trial court considered any alternatives to the "no subrogation" rule – first set forth in *Sutton v. Jondahl*, 532 P.2d 478, 482 (Okla. Ct. App. 1975) (the "*Sutton*" rule) – when making its ruling.

In contrast to its Brief in this matter, RAM presented the trial court with only two reasons that the legal principles in *Bruggeman* should not be applied; (1) that this loss was caused by water as opposed to fire and (2) that, by purchasing third-party liability insurance, Rohde was somehow purchasing the required property damage coverage to benefit the landlord. RA-6. RAM has now almost abandoned the former argument; the water versus fire argument has been relegated to a single paragraph in RAM's Brief. Appellant's Brief, pp. 25-26. The latter argument has also taken a back seat to RAM's new theories of distinguishing commercial and residential leases and adopting the "case-

[6] This explains what might otherwise be seen by this Court as potentially disturbing similarities between some of the contents of this Brief and the trial court's Order and Memorandum. Any contents herein which mirror excerpts from the trial court's Memorandum were the original work of Rohde's attorney.

by-case" approach. Appellant's Brief, pp. 33-34. Nevertheless, these are the only two legal theories which were considered and decided by the trial court. This Court's review of the instant case should be limited to these two theories and should not extend to questions involving the "case-by-case" analysis or a distinction between residential and commercial leases.[7]

## III. RAM'S SUBROGATION CLAIMS AGAINST ITS INSURED'S TENANT ARE BARRED.

### A. The Case of *United Fire & Casualty v. Bruggeman* Bars RAM's Claims.

The case of *United Fire & Casualty v. Bruggeman*, 505 N.W.2d 87 (Minn. Ct. App. 1993), review denied (Oct. 19, 1993), sets forth the Minnesota case law which is relevant to this matter. The holding of *Bruggeman* has been followed numerous times in this jurisdiction, as discussed *infra*. In *Bruggeman*, as here, a landlord's insurer brought a subrogation action against a tenant alleging negligence for damage to the building. *Id.* at 88. No agreement had been reached between the landlord and tenant relating to insurance coverage on the premises. *Id.* The landlord had obtained first-party fire insurance protection. *Id.* That policy ultimately provided coverage for the actual losses suffered in that case. *Id.* The Minnesota Court of Appeals affirmed the trial court's determination that the tenants were co-insureds under the landlord's first-party insurance policy and, therefore, could not be sued by the landlord's insurer on a subrogation basis.

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[7] Due diligence requires, however, that Rohde address the new legal theories raised by RAM. Each of Rohde's arguments on these new theories, which are set forth, *infra*, are made in the alternative to the argument that the new theories or issues should not be given any consideration.

*Id.* at 89-90. In reaching this decision, this Court, citing the majority position on the subject, stated the following:

> The *Sutton* court recognized the landlord and the tenant were co-insureds because each had an insurable interest in the property – the landlord a fee interest and the tenant a possessory interest. In *Sutton*, as here, the party with the fee interest purchased fire insurance,
>
> > [a]nd as a matter of sound business practice the premium paid had to be considered in establishing the rent rate on the rental unit. Such premium was chargeable against the rent as an overhead or operating expense. And of course it follows then that the tenant actually paid the premium as part of the monthly rental.
>
> [*Sutton*, 532 P.2d at 482.] This sharing of proprietary interests and the expenses associated with protecting them gives rise to the co-insured relationship.

*Id.* at 89. The *Bruggeman* court limited its holding to the subrogation context.[8] *Id.*

The notion that a tenant effectively pays the cost of first party insurance coverage for the property was not novel to Minnesota when *Bruggeman* was decided. More than 40 years prior to *Bruggeman*, the Eighth Circuit, applying Minnesota law, stated the following in a case involving a claim against a commercial tenant – General Mills – of a premises which had been damaged by fire:

> The circumstances also indicate the intention that the cost of the insurance would be taken out of the rentals. The investing for income purposes of their own and the borrowed money by the plaintiff's predecessors necessarily involved computing the rentals promised in the lease and deducting the cost of fire insurance at the applicable high rate. They could not estimate the income without

[8] As reasoning for this, the *Bruggeman* court commented that, while the insurable risk of property damage to the premises is the same to the landlord and tenant, those parties would instead have separate insurable risks for damages as a result of loss of use of the property; i.e. rental income versus business income. *Bruggeman*, 505 N.W.2d at 89.

> considering both factors. They necessarily consciously figured on the rentals to be paid by the tenant as the source of the fire insurance premiums and intended that the cost of insurance was to come from the tenants. **In practical effect the tenant paid the cost of the fire insurance.**

*Gen. Mills v. Goldman, Ind. Lumbermens Mut. Ins. Co. of Indianapolis, Ind., Intervener*, 184 F.2d 359, 366 (8th Cir. 1950) (emphasis added).

In reaching its decision, the Minnesota Court of Appeals in *Bruggeman* discussed – and ultimately dismissed – the minority position[9] on the subject by focusing on the case of *Neubauer v. Hostetter*, 485 N.W.2d 87 (Ia. 1992); a case on which RAM relies in this matter. *See* Appellant's Brief, pp. 19, 21. The *Bruggeman* court acknowledged *Neubauer's* emphasis on equitable concerns and placing the burden of loss "where it ought to be – on the negligent party[,]" but found the rationale of *Sutton* more tenable. *Bruggeman*, 505 N.W.2d at 89. It specifically found fault with *Neubauer's* disregard of the co-insured status which results from a tenant's indirect payment of the landlord's insurance premiums; a principle which the Minnesota Court of Appeals found more compelling. *Id.* The *Bruggeman* court found further fault in *Neubauer's* concern that a co-insured relationship interferes with an insurance company's ability to limit its risk. *Id.* Instead, according to *Bruggeman*, "The insurer knows the risk it is undertaking when insuring a rental property. It insures the building for the use for which it is intended.

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[9] In its Brief, RAM discusses at length the possibility that the *Bruggeman* and *Sutton* cases now represent the minority rule. Appellant's Brief, pp. 20-24 (placing primary reliance on *Rausch v. Allstate Ins. Co.*, 882 A.2d 801 (Md. 2005)). However, a South Dakota Supreme Court case which is was decided later in time than *Rausch* refers to the *Sutton* rule as the majority rule. *See Am. Family Mut. Ins. Co. v. Auto-Owners Ins. Co.*, 757 N.W.2d 584, 589 n.3 (S.D. 2008) (identifying "at least fifteen jurisdictions" which have adopted *Sutton*).

While it may not have control over who the individual tenants are, it can increase its premiums to reflect increased risks presented by changing tenant use." *Id.*

The reasoning in *Bruggeman* was again relied upon by the Minnesota Court of Appeals in a later case entitled *Bigos v. Kluender*, 611 N.W.2d 816 (Minn. Ct. App. 2000). In *Bigos*, as in *Bruggeman*, a landlord's insurance company had already reimbursed the landlord for losses as a result of property damage to rented premises and was pursuing a subrogation claim against the allegedly-negligent tenants. *Bigos*, 611 N.W.2d at 822-823. The *Bigos* court began its analysis on the subject by stating, "An insurance company cannot subrogate against its own insured under general principles of insurance law." *Id.* at 822; *citing United States Fire Ins. Co. v. Ammala*, 334 N.W.2d 631, 634 (Minn. 1983). As was the case in *Bruggeman*, the *Bigos* court determined that no express agreement existed between the landlord and tenants which obligated the tenants to obtain their own fire insurance. *Id.* at 823. On these facts, the *Bigos* court determined that the situation was the same as that in *Bruggeman* and affirmed the trial court's dismissal of the subrogation action. *Id.* In reaching this decision, this Court concluded that the case relied upon by the landlord's insurer, *Osborne v. Chapman*, 574 N.W.2d 64 (Minn. 1998), was distinguishable and did not overrule *Bruggeman* because the *Osborne* opinion dealt with a direct claim by a landlord against a tenant and did not involve a subrogation claim. *Bigos*, 611 N.W.2d at 823.

Yet another case which supports affirmation of the district court's dismissal of RAM's claims, and which was decided on the principles of *Bruggeman*, is *Blohm v. Johnson*, 523 N.W.2d 14 (Minn. Ct. App. 1994). In fact, *Blohm* presents the most

analogous situation to the instant case with regard to the lease language requiring certain forms of insurance coverage. As with the cases discussed above, *Blohm* dealt with a subrogation action by a landlord's insurance company against the allegedly-negligent tenants for property damage to the premises due to fire. *Id.* at 15. A written lease existed in *Blohm*, "which obligated Johnson, as tenant, to 'carry his own liability and other insurance coverage for his business operations.'" *Id.* at 16. Blohm's insurer argued that the *Bruggeman* holding was limited to situations in which no written lease existed between the landlord and tenant. *Id.* The *Blohm* court disagreed, stating the following:

> The holding of *Bruggeman* was not so limited. Rather, *Bruggeman* applies to any landlord/tenant situation where there is no express agreement covering the provision of fire insurance for the building. *Bruggeman*, 505 N.W.2d at 89. **The lease agreement here required Johnson to maintain insurance for his business operations but not fire insurance for the building.**

*Id.* (emphasis added). The *Blohm* court thus upheld the dismissal of the subrogation action against the tenant pursuant to *Bruggeman*. *Id.*

The instant matter is analogous to *Bruggeman*, *Bigos*, and *Blohm* in all key respects. Here, as in those cases, a subrogation lawsuit was commenced by the landlord's insurer against the tenant for physical damage to the rented premises.[10] The cases are

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[10] It is inconsequential that the damages suffered in the instant matter were a result of water leakage as compared to the fire damage in the cases discussed herein. Both perils are covered under first-party property damage insurance – as evidenced by the fact that RAM paid JD Property for the loss. The only significant facts relating to the nature of the loss are that all of the cases – including the instant matter – resulted from property damage to the rented premises, which was covered by the landlord's first-party insurance policy. Both the trial court and appellate court in the instant matter have found no significance of the fact that the damage here was caused by water as opposed to fire. *See* Add-9; *see also Rohde*, 805 N.W.2d at 556.

also similar because the lease agreement between RAM's insured, JD Property, and Rohde did not contain any requirement that Rohde obtain primary insurance coverage for such losses. This fact makes the instant matter particularly similar to the *Blohm* case, in which the lease was silent as to the need for first-party property damage coverage, but where similar provisions existed in the lease requiring the tenant to carry liability insurance and other coverages pertaining to the tenant's operations. Even so, RAM argues that the *Bruggeman* case is not applicable here because the lease agreement between JD Property and Rohde required Rohde to obtain certain insurance coverage for the benefit of both parties.

Contrary to RAM's arguments, the insurance requirements in the lease at issue only apply to liability insurance. As discussed above, the lease is completely silent as to the need for first-party property damage coverage to the building itself (or "fire insurance" as it is referred to in *Bruggeman* and *Blohm*). JD Property seems to have intended this omission from the lease because the lease does make a point to require that first-party property damage coverage for the tenant's personal property was to be obtained by the tenant, if desired. The fact that the lease specifically notifies the tenant of its duty to obtain coverage for personal property, while remaining silent on the need for insurance coverage on the building itself, can only lead to the conclusion that the lease implies an obligation on the landlord to obtain coverage on the building, and that JD Property thus intended its policy with RAM to provide first-party coverage for damage to the premises. Regardless of how the facts are viewed in this case, there is no evidence

that Rohde had an obligation under the lease to obtain first-party coverage for damage to the premises.

Another similarity between the above cases and the instant matter is that, here, the landlord indeed obtained the first-party insurance policy from RAM which provided coverage for the claimed water damage. Furthermore, the landlord, JD Property, and tenant, Rohde, had the same insurable interest in the rented premises with regard to damage to the real property. JD Property's interest in the property was one of fee ownership and Rohde's interest was possession of the property. As discussed in *Bruggeman*, it would have been redundant and a waste of resources for both JD Property and Rohde to obtain primary first-party coverage for property damage to the rented premises. Indeed, Rohde did not obtain primary coverage for such losses and instead elected only to obtain coverage which was "excess" over other available coverage. Thus, the fact that Rohde obtained excess first-party property damage coverage is inconsequential because it did not provide the same coverage as was obtained by JD Property from RAM. Rohde did not obtain primary coverage on the same level as the RAM policy, despite RAM's arguments otherwise.[11]

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[11] In a footnote to Appellant's Brief, RAM incorrectly argues that its policy also provided "excess" coverage for damage to the premises at issue. Appellant's Brief, p. 34 n.1 (citing App-249). RAM's insurance policy is primary according to the following language:

> **a. Primary Insurance**
>
> This insurance is primary except when **b.** below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. . . .

For the above reasons, under the rationale of *Bruggeman*, which has been consistently applied for nearly 20 years in Minnesota, Rohde's rent payments contributed to the premium payments on the RAM first-party insurance policy, which renders Rohde a co-insured under that policy. According to the general principles of insurance law, RAM cannot bring a subrogation claim against Rohde on behalf of Rohde's co-insured, JD Property. The Minnesota Court of Appeals was correct to affirm the trial court's order granting summary judgment to Rohde. This Court should also affirm on these grounds.

### B. The Question of whether the Premises at Issue was Completely Destroyed is Immaterial to the Issue on Appeal.

As the purported basis for rendering *Bruggeman* inapplicable to the instant case, RAM points out that Studio 71 Salon was not completely destroyed as a result of the water leak and that Rohde did not lose his possessory interest in the property after the water leak at issue. Appellant's Brief, pp. 26-27. Because Rohde did not entirely lose a possessory interest in the property, argues RAM, *Bruggeman* should not apply. But these arguments ignore the clear holding and rationale of *Bruggeman* and its progeny. There is no discussion in any of the cases relied upon by Rohde that subrogation claims such as the one by RAM in this case are barred *only* when a property is completely destroyed. The principles of the above cases rest simply on the fact that both the landlord and tenant have an interest in a property which is physically damaged. Nothing in those cases requires an analysis of the extent of damage or relative impact of the losses.

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App-249 (emphasis in original). The provisions of paragraph b do not apply. App-249.

### C. The *Osborne* Case on which RAM Relies is Distinguishable.

The only Minnesota state court case on which RAM directly relies is *Osborne v. Chapman*, 574 N.W.2d 64 (Minn. 1998). But, as both lower courts have found, *Osborne* is distinguishable because it deals with a category of damages – lost rent – which is altogether different in nature than the damages at issue in the instant matter – the cost of physical repairs to real property. This Court stated in *Osborne* that the facts therein were distinguishable from the *Bruggeman* case (and, thus, the instant case) because the landlord and tenant do not share an insurable interest in lost future rents as they do with regard to the "respective real property interests of landlords and tenants." *Id.* at 67. While *Bruggeman* dealt with insurance coverage for physical damage to the real property, which benefitted both the tenant and landlord, *Osborne* dealt with coverage for lost rental income, which benefitted only the landlord. *Id.* On this point, this Court stated, "Such coverage plainly exists for the benefit of the landlord, not the tenant, for it is the landlord whose income from the rental property is cut off when a casualty renders the premises uninhabitable." *Id.*

The instant matter is on-point with *Bruggeman* and its progeny because it deals with the same type of loss – physical repairs to real property – for which *both* the landlord and tenant have an insurable interest. None of the damages claimed by RAM in this case represent anything other than the cost of repairing physical damage to real property.[12]

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[12] In its Brief, RAM alleges that a tenant in a unit neighboring Rohde's, AFLAC Insurance, suffered temporary business interruption as a result of the water leak at issue

Unlike in *Osborne*, none of the claimed damages here are for lost rent or other loss of use of the property, which are damages only suffered by the landlord or third parties. As a result, *Osborne* provides no authority to the instant matter. For these reasons, this Court should rely on the principles of *Bruggeman* and affirm the dismissal of RAM's claims as a matter of law.

### D. The Fact that the Property Damage at Issue in the Instant Matter was Caused by Water as Opposed to Fire is Inconsequential and does not Render the *Bruggeman* Opinion Inapplicable.

In its Brief, RAM relies on the fact that the property damage at issue in this case was caused by water as opposed to fire; yet RAM offers no explanation for why principles of insurance law should be applied differently in cases involving damage to a physical structure resulting from fire as opposed to damage to a structure resulting from a water leak where both were the alleged result of a tenant's negligence. Both scenarios involve the loss of control of a natural element which caused damage to real property. RAM has provided no case law or other authority for the proposition that damages to real property resulting from a water leak should be treated any differently than damages to real property from fire. The rationale for the *Bruggeman* opinion should apply equally to water damage as it does for fire damage; that is, that a landlord's insurer cannot subrogate against an alleged negligent tenant for the cost of repair of the premises where no

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in this case. Appellant's Brief, p. 3. But a review of the record on appeal reveals that the monies demanded by RAM in its Complaint in the instant lawsuit constitute only the estimated cost of repairs of the building itself. App-60-69 Because no consequential damages – such as AFLAC's business interruption losses – are part of this lawsuit, it cannot be said that any of the damages in this case are similar to the consequential damages for lost rental income in *Osborne*.

agreement existed between the two as to which was obligated to carry first-party property damage insurance.

### E. Plaintiff Misconstrues the Insurance Requirements in the Lease.

RAM's arguments pertaining to the section of the lease entitled "Tenant's Repairs and Alterations" misconstrues the requirements of the lease as it pertains to insurance coverage on the rented premises. The lease language at issue provides:

> **Tenant's Repairs and Alterations**
>
> 35. The Tenant covenants with the Landlord to occupy the Premises in a tenant-like manner and not to permit waste. The tenant will at all times and at its sole expense, subject to the Landlord's repair, maintain and keep the Premises, reasonable wear and tear, damage by fire, lightning, tempest, structural repairs, and repairs necessitated from hazards and perils against which the Landlord is required to insure excepted. . . .

App-56. RAM attempts to argue that the above language somehow requires the landlord, JD Property, to obtain fire insurance coverage but not other forms of first-party property damage coverage. But the plain language of this section says nothing of which types of insurance is required under the lease. Furthermore, the language does not identify fire damage as a "peril against which the Landlord is required to insure." That phrase and the phrase "damage by fire" are two entirely separate items on the list of perils which do not trigger a duty of repair by the tenant. If RAM's rationale on this point is taken to conclusion, the above language would also have required JD Property to obtain insurance coverage for "reasonable wear and tear;" another exception listed in the above paragraph. Reasonable wear and tear is not an item of economic loss which can be insured against.

The Court of Appeals properly recognized this shortcoming in RAM's analysis. *Rohde*, 805 N.W.2d at 557 ("And one item on the list of exceptions—'reasonable wear and tear'—is not a cost that the landlord can insure against.").

To the contrary, based on Rohde's interpretation of other lease provisions, the above language instead supports the notion that Rohde was an insured of RAM's for the water loss at issue. Recall that the lease includes a separate section relating to insurance which is silent as to which party is to obtain first-party property damage coverage of any kind. Also recall that under Rohde's interpretation of the insurance provisions of the lease, obtaining first-party property damage coverage was implicitly the responsibility of JD Property. It follows, then, that language in the above lease provision – which states, "and repairs necessitated from hazards and perils against which the Landlord is required to insure excepted" – also references damage by water leak. JD Property, thus, assumed responsibility for such damage.

### F. Outside Jurisdictions have Identified Further Rationale for Adopting the *Sutton* Rule.

The Supreme Court of Connecticut in 2002 adopted the *Sutton* rule, but for reasons other than those relied upon in *Bruggeman*. *See DiLullo v. Joseph*, 792 A.2d 819 (Conn. 2002). In *DiLullo*, a commercial tenant was allegedly negligent in causing a fire in the rental unit where he operated a business known as Random Remnants. *Id.* at 820. In answering the question of whether a right of subrogation existed against the tenant, the Court was tasked with choosing whether to adopt the *Sutton* rule or the case-by-case approach in the "default" situation where a lease does not allocate risks and coverages by

specific agreements. *Id.* at 821. Consistent with the result of *Sutton* – and, thus, *Bruggeman* – the *DiLullo* court stated, "Our strong public policy against economic waste, and the likely lack of expectations regarding a tenant's obligation to subrogate his landlord's insurer, lead us to conclude that, as a default rule, no such right of subrogation exists."

In its analysis in *DiLullo*, the Supreme Court of Connecticut identified several cases in which courts had adopted the *Sutton* rule, as well as an endorsement in a treatise on insurance law, which stated:

> "The possibility that a lessor's insurer may proceed against a lessee almost certainly is not within the expectations of most landlords and tenants unless they have been forewarned by expert counseling. When lease provisions are either silent or ambiguous in this regard – and especially when a lessor's insurance policy is also silent or ambiguous – courts should adopt a rule against allowing the lessor's insurer to proceed against the tenant."

*Id.* at 822 (quoting R. Keeton & A. Widiss, Insurance Law (1988) § 4.4(b), pp. 340-41). After it also acknowledged the "minority of courts" which adopted a case-by-case analysis instead of the *Sutton* rule, the *DiLullo* court then criticized both the *Sutton* rationale and the case-by-case approach. *Id.* In the end, though, the court adopted the *Sutton* result. *Id.*

The *DiLullo* court's decision was based, "in large part" on the idea that subrogation invokes matters of policy and fairness. *Id.* The court explained that, from a fairness standard, it agreed with the concerns of Judge Keeton and Professor Widiss, quoted *supra*. *Id.* at 823. The court also discussed, at length, the serious policy concerns of economic waste which would result from a case-by-case approach, stating:

> This strong public policy convinces us that it would be inappropriate to create a default rule that allocates to the tenant the responsibility of maintaining sufficient insurance to cover a claim for subrogation by his landlord's insurer. Such a rule would create a strong incentive for every tenant to carry liability insurance in an amount necessary to compensate for the value, or perhaps even the replacement cost, of the entire building, irrespective of the portion of the building occupied by the tenant. That is precisely the same value or replacement cost insured by the landlord under his fire insurance policy. Thus, although the two forms of insurance would be different, the economic interest insured would be the same. This duplication of insurance would, in our view, constitute economic waste and, **in a multiunit building, the waste would be compounded by the number of tenants.**

*Id.* at 822-823 (emphasis added).

The principles of policy and equity which formed the basis of the *DiLullo* decision would apply to the instant matter in the same way. In fact, because Rohde rented a portion of a multi-unit complex, the instant matter is a better example of the *DiLullo* court's concerns of economic waste as compared to the facts of that case. There is no indication in *DiLullo* that the rented premises at issue in that case was located in a multi-unit commercial complex. Here, though, if each of JD Property's three tenants were also required to provide first-party property damage coverage, three duplicative policies would have existed in addition to the RAM policy.

*DiLullo* also highlights the equity concerns in the instant matter because the rental agreement in that case contained very similar provisions as the lease between Rohde and JD Property. In *DiLullo*, like here, the tenant was not required to obtain insurance on the building, but was requested by the landlord to obtain personal property coverage. *Id.* at

820. Furthermore, the tenant in *DiLullo* provided proof of such insurance to the landlord; a requirement which also exists in the lease in this case. *Id.*

If this Court determines that the underlying principles of *Sutton* and *Bruggeman* are unsound, it should nevertheless affirm the use of the *Sutton* rule in Minnesota for the reasons set forth in *DiLullo*. In such a situation, the trial court's grant of summary judgment in favor of Rohde should be affirmed.

## IV. THE CASE-BY-CASE METHOD SHOULD NOT BE ADOPTED.

RAM primarily relies on the case of *Rausch v. Allstate Ins. Co.*, 882 A.2d 801 (Md. 2005) in its endorsement of the "case-by-case" method. But even the *Rausch* court identified the problems relating to multi-unit complexes if the *Sutton* rule is not followed, stating:

> If the leased premises is a unit within a multi-unit structure, absent a clear, enforceable provision to the contrary, a court may properly conclude that the parties anticipated and reasonably expected that the landlord would have in place adequate fire insurance covering the entire building and, with respect to damage caused by the tenant's negligence to parts of the building beyond the leased premises, would look only to the policy, to the extent of its coverage, for compensation.

*Id.* at 716. Recall that both the Supreme Court of Connecticut in *DiLullo* and the Minnesota Court of Appeals in *Bruggeman* had serious concerns of the waste which results in the case of multi-unit buildings which would be insured several times over if the *Sutton* rule is not followed. *DiLullo*, 792 A.2d at 822-823; *Bruggeman*, 505 N.W.2d at 89.

The *Rausch* court also unfairly criticized the *Sutton* rule when it stated, "If the tenant were a co-insured, he/she would be entitled to some part of the proceeds, which even the Sutton followers have not suggested." *Rausch*, 882 A.2d at 814. What the *Rausch* court fails to recognize is that, in a sense, the tenant *does* receive some benefit from the payment of the insurance proceeds; it is the tenant – not the landlord - which occupies the newly-repaired premises and, thus, has the benefit of possessing real property which was recently improved. Such a shared benefit between the landlord and tenant is consistent with the underlying rationale for the co-insured status of the tenant; that both the tenant and landlord have an interest in the physical state of the real property.

The Iowa Supreme Court in *Neubauer* also used a similar and incomplete rationale for rejecting the *Sutton* rule by refusing to accept that "fire insurance on an entire dwelling includes the interest of both landlord and tenant as a matter of law." *Neubauer*, 485 N.W.2d at 90. That argument, it said, "disregards the fact that these are separate estates capable of being separately valued and separately insured." *Id.* Although as a whole the estates of the landlord and tenant are obviously different, the value of each shares its reliance on the condition of the real property at issue. For example, in the instant case, both the value of JD Property's business as a commercial landlord and Rohde's hair styling business is dependent upon the condition of the unit which Rohde rented from JD Property. Again, these principles of a shared interest in the property are consistent with the rationale in *Sutton* and *Bruggeman* for considering the tenant as a co-insured.

## V. IF THIS COURT ADOPTS THE CASE-BY-CASE METHOD OF ANALYSIS, RAM'S CLAIMS ARE SUBJECT TO DISMISSAL THEREUNDER.

The Illinois Supreme Court case of *Dix Mutual Insurance Company v. LaFramboise*, 597 N.E.2d 622 (Ill. 1992) is a factually similar case to the instant matter and is one in which the court: (1) used the case-by-case approach and (2) determined that the landlord's insurer could not bring a subrogation action against the allegedly-negligent tenant for damage to the rented premises. *LaFramboise* involved a lease with similar risk of loss provisions as in the instant matter. In that case, the lease was silent as to who would obtain coverage on the building itself, but specifically identified the tenant as accepting the risk of loss of his personal property. *Id.* at 625. The court stated:

> We find it significant that the parties, who obviously considered the possibility of fire, expressly provided for the tenant's personal property but failed to do so with respect to the leased premises. This fact indicates to us that the parties intended for each to be responsible for his own property. This conclusion is supported by the landlord's conduct in taking out a fire insurance policy to cover the leased premises.

*Id.* at 626. In similar fashion, the parties to the instant case contemplated damage to Rohde's personal property and identified a tenant's policy of insurance as providing the proper coverage for Rohde. Such lease language, like the language in *LaFramboise*, leads to the conclusion that the parties "intended for each to be responsible for his own property."

More specifically, the lease provisions in this case include an implied requirement that JD Property provide the first-party property damage insurance. While staying silent on which party is to obtain such coverage, the lease specifically instructs the tenant,

Rohde, that (1) his "personal property" . . . is not insured by the Landlord" and (2) that if he desires insurance he should "inquire of Tenant's insurance agent regarding a Tenant's Policy of Insurance." App-55. These lease terms imply that JD Property had the obligation to insure against damage to the property with the exception of Rohde's personal property. Furthermore, the Department of Commerce of the State of Minnesota explains on its website on the subject of "renters insurance"[13] that such insurance "protects your personal property against damage or loss, and insures you in case someone is injured while on your property[,]" and that, "*[y]our landlord's coverage will take care of damage to the building's structure.*" Renter's Insurance, Minnesota Dept. of Commerce Website (accessed January 12, 2012), *at* http://mn.gov/commerce/insurance/topics/home-property/renters-insurance.jsp (emphasis added). As a result, even if the lease between JD Property and Rohde as a whole is analyzed under the case-by-case framework to determine whether a subrogation cause of action exists, RAM's claims should be dismissed as consistent with the result in *LaFramboise* because JD Property intended to hold responsibility for damage to the rented premises.

One of the cases relied upon by RAM on this subject is worthy of comment merely because it does not reach the conclusion which RAM claims it does. In its Brief, RAM references the Eighth Circuit case of *General Mills v. Goldman* and states, "Interestingly, with respect to this lease provision the Court stated 'that in its absence the tenant would have been liable to the landlord's insurer under the doctrine of

[13] Rohde assumes "renters insurance" describes identical coverage as does the phrase "Tenant's Policy of Insurance," which is used in the lease at issue.

subrogation.'" Appellant's Brief, p. 28 (quoting *Goldman*, 184 F.2d at 572-573). But the language purported to be quoted from *Goldman* cannot be found in that opinion; nor does the *Goldman* opinion include pages numbered 572 or 573. Even if one assumes a typographical error in RAM's citation to the page numbers, and instead meant to refer to pages 372 and 373 of the *Goldman* opinion, no such statement by the *Goldman* court can be found; indeed, pages 372 and 373 are embedded within the dissenting opinion in *Goldman*. *See Goldman*, 184 F.2d at 372-373. Therefore, *Goldman* should not be considered to provide the direct support for RAM's position that RAM purports to exist.

For the above reasons, this Court should affirm the dismissal of RAM's subrogation claims against Rohde, even if a case-by-case analysis is conducted and the lease involving Rohde is analyzed in its entirety.

## VI. THERE IS NO BASIS FOR DISTINGUISHING THE LEASE IN THIS CASE FROM THE RESIDENTIAL LEASES AT ISSUE IN THE RELEVANT CASES DISCUSSED HEREIN.

This Court should not, as RAM suggests, carve out an exception to the *Bruggeman* principles for the lease at issue in this case for the sole reason that it is a commercial lease. The Minnesota common law on which RAM relies on this point is not relevant to the instant matter. Appellant's Brief, p. 25 (citing *Alpha Systems Integration, Inc. v. Silicon Graphics, Inc.*, 646 N.W.2d 904, 910 (Minn. Ct. App. 2002)). The *Alpha Systems* case only identified a presumption that "corporations" are sophisticated parties. *Alpha Systems*, 646 N.W.2d at 910. Respondent Rohde does not control or own a corporation. At relevant times, he ran a small hair salon in Central Minnesota under the assumed name of Studio 71 Salon. RAM has otherwise presented no evidence that Mr. Rohde is a

sophisticated businessperson who would understand the intricacies of insurance coverage on the property. Minnesota courts have made no presumptions that a small business owner is in all respects to be presumed a sophisticated party relative to insurance coverage issues.

Additionally, the *Barbosa* case relied upon by RAM on this topic seems to be alone in distinguishing commercial and residential leases. *See Seaco Ins. Co. v. Barbosa*, 761 N.E.2d 946 (Mass. 2002)("The cases that follow *Sutton* include commercial as well as residential tenancies, and no distinction is made between the tenancies")(citing 6A J.A. Appleman & S. Liebo, Insurance Law and Practice § 4055 (Supp.2001)). The Connecticut case of *DiLullo v. Joseph*, discussed *supra*, also involved a commercial lease and was decided on the same principles as if it were a residential lease. *See DiLullo*, 792 N.E.2d at 819-820.

## CONCLUSION

For the above reasons and those presented at the oral argument on these matters, Respondent Rusty Rohde d/b/a Studio 71 Salon respectfully requests that this Court affirm the district court's summary judgment order in which Appellant's claims were dismissed in full.

Dated this 17th day of January, 2012.

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