

NO. A11-11

State of Minnesota
In Supreme Court

Vy Thanh Ho and Lein Ho,
Appellants/ Cross-Respondents,
vs.

Bakita Isaac,
Respondent,
and

Auto Club Insurance Association,
Respondent/ Cross-Appellant.

**BRIEF, ADDENDUM, AND APPENDIX OF
APPELLANTS/CROSS-RESPONDENTS VY THANH HO AND LEIN HO**

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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 THE LEGAL ISSUES

- I. WHETHER THE LOWER COURTS ERRED BY HOLDING THAT A UIM SUBSTITUTION DEFEATS A SETTLEMENT AGREEMENT BETWEEN THE PLAINTIFF AND THE DEFENDANTS, WHO DID NOT AGREE THAT THE UIM CARRIER'S SUBSTITUTED PAYMENT WOULD VOID THE SETTLEMENT.

Description of how the issue was raised in the lower court

Appellants/Cross-Respondents raised this issue in their Brief, Addendum, and Appendix and a Reply Brief filed with the Minnesota Court of Appeals.

Concise statement of the lower court's rulings

The Minnesota Court of Appeals affirmed the district court, erroneously holding that this Court's decision in *Schmidt v. Clothier*, 338 N.W.2d 256 (Minn. 1983) and its progeny allowed the UIM carrier to void the unconditional settlement agreement by substituting its money for the consideration Plaintiff agreed to accept to settle her claims against the Defendants.

Description of how the issue was preserved for appeal to this Court

Appellants/Cross-Respondents preserved this issue for appeal by timely serving and filing a Petition for Review of Decision of Court of Appeals and Appendix within 30 days of the decision by the Minnesota Court of Appeals, which this Court granted.

Apposite cases, constitutional, and statutory provisions

Washington v. Milbank Insurance Company, 562 N.W.2d 801 (Minn. 1997)

Gusk v. Farm Bureau Mutual Insurance Company, 559 N.W.2d 421 (Minn. 1997)

Employers Mutual Companies v. Nordstrom, 495 N.W.2d 855 (Minn. 1993)

Schmidt v. Clothier, 338 N.W.2d 256 (Minn. 1983)

II. WHETHER THE COURT OF APPEALS CORRECTLY HELD THAT THE UIM CARRIER HAD NO SUBROGATION RIGHT AGAINST THE DEFENDANTS WHO WERE NOT UNDERINSURED.

Description of how the issue was raised in the lower court

Appellants/Cross-Respondents raised this issue in their Brief, Addendum, and Appendix filed with the Minnesota Court of Appeals.

Concise statement of the lower court's ruling

The Minnesota Court of Appeals reversed the district court, correctly holding that a UIM claim does not arise and the UIM carrier's right of subrogation does not mature where the defendant tortfeasor is not underinsured.

Description of how the issue was preserved for appeal

Respondent/Cross-Appellant preserved this issue for appeal by timely serving and filing a Response to the Petition for Review of Decision of Court of Appeals and Petition for Cross-Review within 20 days of service of Appellants/Cross-Respondents' Petition for Review, which this Court granted.

Apposite cases, constitutional, and statutory provisions

Gusk v. Farm Bureau Mutual Insurance Company, 559 N.W.2d 421 (Minn. 1997)

Schmidt v. Clothier, 338 N.W.2d 256 (Minn. 1983)

Iowa National Mutual Insurance Co. v. Liberty Mutual Insurance Co.,
464 N.W.2d 564 (Minn.App. 1990)

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377 N.W.2d 460 (Minn.App. 1985)

STATEMENT OF THE CASE

This appeal arises from negligence-based personal injury litigation before the Hennepin County District Court, the Honorable John Q. McShane presiding. Respondent Bakita Isaac (“Isaac”) commenced this action against Appellants/Cross-Respondents Vy Ho and Lein Ho (“the Hos”) on January 29, 2009, alleging only the Hos’ negligence and damages and making no claim for UIM benefits. *See* Appellant’ Appendix (“AA”) at 1-3. On or about October 2, 2009, Isaac’s counsel and the Hos’ insurer, Progressive Preferred Insurance Company (“Progressive”), engaged in settlement negotiations in which Isaac’s counsel represented that Isaac would accept \$10,665.00 to settle her negligence claims against the Hos. *See id.* at 16-17, 32. Progressive sent Isaac’s counsel a settlement check in that amount. *See id.* at 20-21.

On October 7, 2009, Isaac’s counsel provided *only* Respondent/Cross-Appellant Auto Club Insurance Association (“Auto Club”), Isaac’s UIM carrier, with a *Schmidt-Clothier* notice. *See id.* at 37-38. Auto Club substituted its check for Progressive’s settlement payment. *See id.* at 43. It intervened in the action between Isaac and the Hos on October 26, 2009 for the purpose of protecting its potential underinsured motorist (“UIM”) exposure. *See id.* at 57-59.

On February 23, 2010, the Hos moved for summary judgment pursuant to Minn.R.Civ.P. 56.02 and 56.03, arguing that Isaac unconditionally settled her claims against them. *See id.* at 14-15. The district court denied that motion on May 4, 2010. *See* Addendum at 1. Trial commenced on May 24, 2010. The Jury returned a Special Verdict in Respondent Isaac’s favor. *See* AA at 140-142.

On June 29, 2010, the Hos moved for collateral source offsets. *See id.* at 80-81. On September 15, 2010, the Hos moved for judgment as a matter of law pursuant to Minn.R.Civ.P. 50.02 on the same grounds as their summary judgment motion. *See id.* at 114-115. On November 1, 2010, the district court denied the Hos' post-trial motion for judgment as a matter of law without ordering that judgment be entered. *See Addendum* at 7. It granted in part and denied in part the Hos' collateral source offset motion and ordered entry of judgment on November 15, 2010. *See id.* at 15.

On November 17, 2010, the Hennepin County District Court entered a non-money judgment in Isaac's favor. On December 28, 2010, the district court issued an Amended Order which specifically directed entry of judgment: (a) in Isaac's favor in the amount of \$45,765.08 and (b) in Auto Club's favor in the amount of \$11,152.70. *See id.* at 12. The Hennepin County District Court entered Amended Judgments in Respondents' favor on December 29, 2010. *See id.* at 27-28. The Hos appealed from the judgments, the district court's Orders denying post-trial judgment as a matter of law and summary judgment, as well as the district court's Order partially denying the Hos' motion for collateral source offsets.

On August 8, 2011, the Minnesota Court of Appeals issued its decision from which this appeal is taken. *See Addendum* at 1. The Court of Appeals affirmed the Hennepin County District Court's decisions which allowed Auto Club to void the unconditional settlement agreement between Isaac and the Hos by substituting its money for what Progressive paid to settle Isaac's claims against its insureds. *See id.* at 4. The Court of Appeals reversed the Hennepin County District Court's decision which

permitted Auto Club to recover its UIM substitution by way of subrogation from the Hos despite the fact that they were not underinsured. *See id.* at 5.

The Hos filed a timely Petition for Review with this Court on or about September 2, 2011, seeking reversal of the decision by the Court of Appeals to the extent it affirmed the Hennepin County District Court's rulings. Auto Club filed a timely Response to the Petition for Review and Cross-Petition for Review on or about September 20, 2011. This Court granted both the Petition and Cross-Petition for Review on October 26, 2011.

STATEMENT OF THE FACTS

On September 9, 2007, Isaac was involved in a motor vehicle accident with Vy Ho. Lein Ho owned the vehicle Vy Ho operated at the time of the accident. *See AA* at 1-2. Progressive was at all times material to this action the Hos' automobile liability insurer, and insured them under a policy having a \$50,000 limit. *See AA* at 16-17.

After commencing this action against the Hos, Isaac served the Hos with an offer of judgment for \$16,457.83 pursuant to Rule 68 of the Minnesota Rules of Civil Procedure on or about July 14, 2009. *See AA* at 33-34. On July 23, 2009, The Hos served Isaac with a Total Obligation Offer of Settlement for \$7,400.00 pursuant to the same rule which contained no language making settlement contingent on the UIM carrier's decision to substitute. *See id.* at 137. Five days later, on July 28, 2009, Isaac's counsel served the Hos with a second offer of judgment for \$11,929.14. *See id.* at 35-36. Isaac's offers of judgment contained this contingency: "This offer of judgment is subject only to proper notice to the underinsured motorist carrier(s) to allow them to exercise

their right to stop the settlement by substituting their check pursuant to *Schmidt v. Clothier and Safeco*, 338 N.W.2d 256 (Minn. 1983) and its progeny.” *See id.* at 33, 35.

On October 2, 2009, Timothy Pothen, a Progressive claims adjuster, called Isaac’s counsel and unconditionally offered \$9,400.00 to settle Isaac’s claims against the Hos. *See id.* at 16-17. Isaac’s counsel told Pothen he would recommend that Isaac settle with the Hos for \$10,665.00, which represented the difference between Isaac’s last offer of judgment and the amount Pothen offered. *See id.* at 16-17, 32. During those negotiations, Isaac’s counsel never conditioned the agreement to settle on Auto Club’s decision not to exercise its substitution rights. *See id.* Rather, Isaac’s counsel acknowledges that he “may have said something to the effect of ‘I will get [Respondent Isaac] to take it.’” AA at 32. Progressive then tendered to Isaac’s counsel a settlement check for \$10,665.00, which Isaac’s counsel received on October 6, 2009. *See id.* at 20-21.

On October 7, 2009, Isaac’s counsel unilaterally drafted and sent a *Schmidt-Clothier* notice to Auto Club, advising it of the \$10,665.00 settlement between Isaac and the Hos.¹ *See* AA at 37-38. The notice gave Auto Club “thirty (30) days in which to either acquiesce in that settlement and lose [its] right to subrogation or to prevent such settlement by exchanging [its] draft for that of Progressive Insurance Company in the amount of the proposed settlement.” AA at 37. The notice concluded: “If [Respondent

¹ Isaac’s counsel did not send a copy of the *Schmidt-Clothier* notice to the Hos’ counsel or Progressive. While Appellants acknowledge Isaac’s counsel was not obligated to provide them with a copy of this notice, the Hos regard this fact as significant because the Minnesota Court of Appeals’ decision to affirm the district court seems to rest in part on the terms of this notice. *See* Addendum at 3.

Auto Club] does not intend to substitute its draft, please notify me immediately so that we can finalize the settlement with Progressive without further delay.” *Id.* Within the allotted time, Auto Club substituted its check for Progressive’s check. *See* AA at 43. On October, 27, 2009, Isaac’s counsel returned Progressive’s settlement check advising that Auto Club had exercised its substitution rights. *See id.* at 139.

Although she agreed to settle her claims against the Hos for \$10,665.00 and retained the \$10,665.00 Auto Club sent her, Isaac did not voluntarily withdraw her claims against the Hos. The Hos, therefore, moved for summary judgment on February 23, 2010. *See id.* at 4-15. In its decision, the Hennepin County District Court acknowledged that footnote 3 in *Washington v. Milbank* “correctly lays out the current state of the law with respect to the effect of underinsurer substitutions on settlement agreements under *Schmidt v. Clothier.*” Addendum at 5. That footnote reads:

Technically, no settlement is reached when the UIM carrier follows the Schmidt-Clothier procedure and substitutes its draft for that of the tortfeasor’s insurance company. However, the UIM carrier’s substitution operates as the equivalent of a settlement between the party claiming damages and the tortfeasor *because the tortfeasor is released from further liability to the party claiming damages*, but, at the same time, the UIM insurer retains a subrogation right against the tortfeasor’s insurance company.

Washington v. Milbank, 562 N.W.2d 801, 806 n.3 (Minn. 1997) (emphasis added); *see also* Addendum at 9 (quoting *Washington*). Nevertheless, the district court found “no basis for extending that general rule to the present case, *where the parties explicitly conditioned their settlement agreement on the waiver of Auto Club’s subrogation rights, and thereby voluntarily granted Auto Club the power to terminate the tentative*

settlement.” Addendum at 10 (emphasis added). In other words, despite the fact that the settlement agreement negotiated by Isaac’s counsel and Progressive contained no contingencies, the district court held that “the [settlement] agreement . . . explicitly provided Auto Club with the right to stop the settlement from taking place.” *Id.*

Trial commenced on May 24, 2010. Isaac presented the claims she had agreed to settle against the Hos. Auto Club appeared as an intervenor. On May 26, 2010, the Jury returned a Special Verdict, finding Vy Thanh Ho negligent in causing permanent injury to Isaac. *See* AA at 140. The Jury determined Vy Thanh Ho was 95 percent at fault and awarded \$56,420.97 in gross damages. *See id.* at 141-142.

The Hos moved the district court for post-trial judgment as a matter of law pursuant to Rule 50.02 of the Minnesota Rules of Civil Procedure. *See* AA at 114-115. They argued that no record evidence supported the view that Isaac’s final agreement to resolve her claims against them hinged on Auto Club’s decision not to exercise its substitution rights. *See id.* at 131-132. They further argued that Auto Club’s substitution cannot force parties who agreed to settle their differences to try their claims to conclusion because a UIM substitution does no more than preserve a UIM carrier’s subrogation rights. *See id.* at 173-179. The district court rejected those arguments, holding that no settlement occurred because “[Isaac] and [Appellants] explicitly provided Auto Club the right to stop the settlement by substituting its draft.” *See* Addendum at 17.

The Hos also moved the district court for collateral source offsets. *See* AA at 80-81. They asked the district court to deduct the \$10,665.00 that Auto Club paid Isaac from the gross amount because that amount constituted a settlement payment for purposes of

Minn. Stat. § 604.01. *See* AA at 87-88. The district court disallowed that collateral source deduction, holding that Isaac and the Hos had reached no settlement. *See* Addendum at 23-24. The district court held that Auto Club was entitled to recover this amount from the Hos under principles of equitable subrogation because it paid Isaac that money to preserve its subrogation rights against them. *See id.* at 26-27.

The district court did deduct other items as collateral sources. Pursuant to Minn. Stat. § 548.251, it deducted \$87.61 for past wage loss, \$10,000.00 for past health care expenses, and \$2,565.88 for past diagnostic studies paid by no-fault insurance. *See id.* at 24-25, 31. Finding that Isaac paid \$423.80 to secure no-fault benefits during the two years immediately prior to the accrual of this action, the court added that amount to the verdict pursuant to Minn. Stat. § 548.251, subd. 2(2). *See* Addendum at 25, 31. Then the district court deducted from the verdict \$2,325.49, which represented Isaac's 5 percent comparative fault. *See id.* These adjustments left Isaac with a net damage award of \$44,184.26, exclusive of costs and interests. *See id.* at 31.

The district court then awarded costs and interests. *See id.* It awarded Isaac \$205.50 in statutory costs pursuant to Minn. Stat. § 549.09, \$5,625.48 in disbursements pursuant to Minn. Stat. § 549.09, and \$4,167.65 in double costs pursuant to Minn.R.Civ.P. 68. *See id.* The district court also awarded Auto Club its statutory costs pursuant to Minn. Stat. § 549.09 for \$205.50. *See id.* All of these adjustments resulted in a final money judgment in favor of Auto Club for \$11,152.70 and in favor of Isaac for \$45,765.97. *See id.*

The Minnesota Court of Appeals affirmed the district court's decision that Isaac could proceed with her personal injury claim against the Hos despite her unconditional agreement to settle that claim, holding that this result accords with this Court's decision in *Schmidt v. Clothier* and its progeny. See Addendum at 4. The Minnesota Court of Appeals reversed the district court's decision that Auto Club could recover its UIM substitution from the Hos by way of subrogation, holding that Auto Club's subrogation right did not mature because the Hos were not underinsured. See *id.* at 5. The Hos appeal from the Court of Appeals' decision that the UIM substitution voided the unconditional settlement between themselves and Isaac. The Hos, who are not underinsured, also respectfully ask this Court to affirm the Court of Appeals' decision that Auto Club is not entitled to recover its UIM substitution by way of subrogation.

LEGAL ARGUMENT

No party to this appeal disputes the fact that Isaac agreed to settle her claims against the Hos for \$10,665. Nor does the record evidence provide any valid basis for disputing the terms of their settlement agreement. The Hos' dispute with Isaac and Auto Club really focuses on what legal effect, if any, Auto Club's substitution had on the settlement that Isaac's counsel negotiated with Progressive, the Hos' insurer. Isaac and Auto Club take the position that Auto Club's substituted payment of \$10,665.00 to Isaac voided the settlement agreement between Isaac and the Hos.

Their position, which the Minnesota Court of Appeals accepted, rests on two flawed premises. The first flawed premise supporting the lower court decisions is that terms contained in two prior offers of judgment and Isaac's *Schmidt-Clothier* notice

somehow *became* settlement terms. The Hos had rejected Isaac's first offer of judgment with their own offer of settlement, and the second offer of judgment had expired by the time Isaac's counsel negotiated the settlement with Progressive. The record evidence concerning the settlement negotiations between Isaac's counsel and Progressive shows that those negotiations never included any terms from Isaac's prior offers of judgment. The terms of Isaac's *Schmidt-Clothier* notice to Auto Club also never factored into the parties' settlement negotiations because Isaac's counsel sent that notice *only* to Auto Club and *after* he negotiated the settlement with Progressive. There was no meeting of the minds between Isaac and the Hos relative to *any* contingencies arguably expressed in the *Schmidt-Clothier* notice.

The second flawed premise is that Auto Club's substitution legally *required* Isaac to try her claims against the Hos because UIM substitutions "stop settlements." No Minnesota appellate court has ever previously held that a UIM substitution destroys, alters, or changes the terms of the underlying settlement agreement between the plaintiff and the defendant tortfeasor. Rather, this Court previously has stated that a UIM substitution does not deprive settling parties of the benefit of their settlement bargain. *See Gusk v. Farm Bureau Mutual Insurance Company*, 559 N.W.2d 421, 424 (Minn. 1997). Moreover, in *Washington v. Milbank*, this Court noted that a UIM substitution operates as *the equivalent of a settlement* because the plaintiff *releases* tortfeasor from further liability. *See* 561 N.W.2d 801, 806 n.3 (Minn. 1997). Here, Isaac did not release the Hos from further liability after taking Auto Club's substituted check. Instead, she kept that money and continued to litigate her personal injury claims against the Hos.

Respondents' position in this litigation is troubling for public policy reasons. In *Schmidt*, this Court recognized UIM substitutions as the means for a UIM carrier to preserve its potential subrogation rights when the plaintiff and the defendant unconditionally settle an automobile accident claim. Now, the lower courts recognize UIM substitutions for another purpose, namely to permit a plaintiff who settles an automobile accident claim to avoid the settlement and use the UIM substitution money to fund third-party litigation against the defendant despite the settlement agreement's terms. Despite the favorable regard Minnesota courts have for settlements and alternative dispute resolution as a means for alleviating over-burdened dockets and underfunded courts, the potential for a UIM substitution voiding an agreed-upon settlement discourages any defendant from making a meaningful effort to settle an automobile accident claim.

No matter how badly the plaintiff and the defendant may wish to settle, the UIM carrier—a nonparty to their settlement negotiations—can *always* frustrate the settlement by substituting its check and forcing the plaintiff and the defendant to try their claims. The plaintiff bears no risk because he or she collects UIM substitution money to fund the litigation against the defendant. The UIM carrier also would bear no risk if this Court agrees with Auto Club's position on appeal because, under Auto Club's view of the world, it may recover its substitution even if the defendant is not underinsured. The defendant alone bears the risk, not only the risk that a jury will find the defendant liable to the plaintiff, but also the risk of having to pay additional litigation expenses that a settlement otherwise would avoid. For all the reasons set forth herein, this Court must

reverse the lower courts' rulings concerning the legal effect of UIM substitutions and affirm the Court of Appeals' decision that Auto Club is not entitled to recover its UIM substitution via subrogation from the Hos where were not underinsured.

I. THE COURT OF APPEALS' DECISION THAT AUTO CLUB'S UIM SUBSTITUTION VOIDED THE SETTLEMENT AGREEMENT BETWEEN ISAAC AND THE HOS ENJOYS NO SUPPORT IN LAW OR FACT AND AMOUNTS TO BAD PUBLIC POLICY IF AFFIRMED BY THIS COURT.

The Minnesota Court of Appeals affirmed the Hennepin County District Court, holding that Auto Club's substitution required Isaac to try her claims against the Hos, despite the fact that she had agreed to settle them subject to no conditions. *See* Addendum at 4. De novo review of this ruling necessitates reversal for three reasons. First, the record evidence provides no support for the view that Isaac and the Hos (through Progressive) agreed to forego settlement if Auto Club substituted its check for Progressive's settlement payment. Second, a UIM substitution cannot deprive settling parties of their settlement bargain absent an agreement to that effect because a UIM substitution merely protects a UIM carrier's potential subrogation rights. Third, the decision by the Minnesota Court of Appeals discourages settlement of automobile liability cases by shifting all the risks of litigation to defendants and their liability insurers.

A. The De Novo Standard Of Review Applies To This Issue Arising From District Court Rulings On Motions For Summary Judgment And Post-Trial Judgment As A Matter Of Law.

The Hos challenged Isaac's and Auto Club's position that the UIM substitution voided the settlement between the plaintiff and defendants through a motion for summary

judgment and a post-trial motion for judgment as a matter of law. The *de novo* standard of review applies to appellate review of the district court's denial of Appellants' summary judgment motion and their post-trial motion for judgment as a matter of law. See *Longbehn v. Schoenrock*, 727 N.W.2d 153, 159 (Minn.App. 2007) (applying *de novo* review standard to motions for judgment as a matter of law); *Riverview Muir Doran, LLC v. JADT Development Co., LLC*, 790 N.W.2d 167, 170 (Minn. 2010) (summary judgment decisions reviewed under *de novo* standard). Because the issue the Hos present on appeal involves a pure legal question, this Court owes the lower court decisions no deference. See *Frost-Benco Electrical Association of Minnesota v. Minnesota Public Utilities Commission*, 358 N.W.2d 639, 642 (Minn. 1984).

B. The Record Evidence Provides No Support For The View That Isaac And The Hos (Through Progressive) Agreed To Forego Settlement If Auto Club Substituted Its Check For Progressive's Settlement Payment.

The Minnesota Court of Appeals notes that the district court held, in part, that Isaac and the Hos (acting through Progressive) contracted outside the scope of *Schmidt* by permitting Auto Club to prevent the settlement with its substituted draft. See Addendum at 3. This statement infers that the settlement terms negotiated between Isaac's counsel and Progressive somehow dictated that Isaac would preserve her claims against the Hos if Auto Club substituted its check for Progressive's settlement payment. The undisputed material facts simply do not support that inference, the district court's holding, or the Minnesota Court of Appeals' affirmance of that holding.

An examination of the parties' settlement negotiations is necessary to a proper assessment of whether the lower court rulings have merit. Settlements are contracts. "It is well settled that a compromise and settlement of a lawsuit is contractual in nature and that a full and enforceable settlement requires offer and acceptance so as to constitute a meeting of minds on the essential terms of the agreement." *Ryan v. Ryan*, 292 Minn. 52, 55, 193 N.W.2d 295, 297 (1971). "[W]here one to whom an offer is made goes ahead and performs in accordance with the offer his act is an acceptance." *Johnson v. O'Neil*, 182 Minn. 232, 235, 234 N.W. 16, 17 (1931). Valid settlements do not and cannot include terms not agreed upon by the parties. See *In re Pfenninger's Estate*, 135 Minn. 192, 197, 160 N.W. 487, 490 (1916).

The record evidence shows that Isaac served the Hos with an offer of judgment on or about July 14, 2009. See AA at 33-34. On July 23, 2009, the Hos served Isaac with a Total Obligation Offer of Settlement. See *id.* at 137. Five days later, on July 28, 2009, Isaac's counsel served the Hos with a second offer of judgment. See *id.* at 35-36. The Hos never responded to Isaac's second offer of judgment. The record provides no factual basis for challenging these facts.

Minnesota courts construe offers of judgment according to ordinary contract principles. See *Jacobs v. Cable Constructors, Inc.*, 704 N.W.2d 205, 208 (Minn.App. 2005). An offer of judgment creates a binding contract *only if* its acceptance complies *exactly* with the terms of the offer. *Minar v. Skoog*, 235 Minn. 262, 265, 50 N.W.2d 300, 302 (1951). In accordance with Rule 68.02(d), both of Isaac's offers of judgment

provided that each offer would be deemed “revoked, null, and void” if not accepted within ten days of receipt.

The record evidence shows that the Hos rejected the first offer of judgment by responding with an offer of settlement. *See Health and Welfare Plan for Employees of REM, Inc. v. Ridler*, 942 F.Supp. 431, 434 (D.Minn. 1996), *aff’d.*, 124 F.3d 207 (8th Cir. 1997) (counter-offer on terms different than original offer constitutes rejection of that offer). They undisputedly never accepted the second offer of judgment. By its own terms and the language of Rule 68.02(d), Isaac’s second offer of judgment was deemed rejected and automatically withdrawn after 10 days. *See* Minn.R.Civ.P. 68.02(d). Nothing in the record challenges this conclusion. Accordingly, there is no basis for concluding that the rejected and withdrawn offers of judgment legally and logically could have any effect on continued settlement negotiations unless the parties resurrected their terms during the negotiations.

Neither Isaac’s counsel nor Progressive’s adjuster, Timothy Pothen, discussed the terms of Isaac’s rejected and withdrawn offers of judgment during their settlement negotiation which ensued on October 2, 2009. Mr. Pothen unconditionally offered to settle Isaac’s claims against Appellants for \$9,400.00. Isaac’s counsel unconditionally countered that he would recommend his client settle the claims for \$10,665.00. He also acknowledges that he “may have said something to the effect of ‘I will get [Respondent Isaac] to take it.’” AA at 32. The parties do not dispute these facts.

Progressive tendered a check in that amount, indicating its acceptance of Isaac’s counsel’s unconditioned demand in response to the unconditional representation that

Isaac's counsel would get his client to accept \$10,665.00 in settlement of her claims. *See id.* at 21. The letter accompanying that check contains no language indicating that the parties had bargained for a settlement conditioned on Auto Club's actions. *See id.* None of the settlement proposals exchanged during these negotiations renewed any contingency terms contained in the rejected and withdrawn offers of judgment.

The offer to settle for \$10,665.00 was an unconditional offer to settle, not a proposal contingent to Auto Club's substitution as the Court of Appeals has characterized it. *See Addendum at 4.* Progressive issued payment in accordance with Isaac's unconditional demand. Thus, contrary to Respondents' unsupported argument to the contrary, the record evidence shows that Isaac agreed to settle her claims against the Hos unconditionally for \$10,665.00. In their negotiations neither Isaac's counsel nor Progressive had any discussion about the settlement being "contingent," "tentative," or in any way dependent upon Auto Club's decision to substitute its check for Progressive's settlement payment.

Isaac's post-settlement *Schmidt-Clothier* notice to Auto Club cannot infuse those contingency terms into the parties' negotiations. The settlement negotiations between Isaac's counsel began and ended on October 2, 2009. *See AA at 16-17.* Acceptance occurred on October 6, 2009, when Progressive sent its check to Isaac's counsel. *See id.* The *Schmidt-Clothier* notice is dated October 7, 2009, one day after Progressive tendered payment under the terms that Isaac's counsel discussed with Progressive's agent. *See id.* at 19-20. After receiving Progressive's settlement payment, Isaac's counsel provided Auto Club with a *Schmidt-Clothier* notice telling Auto Club that it could "either

acquiesce in [the] settlement and lose [its] right to subrogation or prevent such settlement by exchanging [its] draft for that of Progressive Insurance Company in the amount of the proposed settlement.” AA at 37-38. Progressive did not receive a copy of that notice contemporaneous with the settlement negotiations, although the record is unclear about exactly when Progressive or defense counsel actually received the notice.² The fact that Progressive received a copy of the *Schmidt-Clothier* notice after it accepted Isaac’s settlement offer through performance cannot alter the settlement terms negotiated by Isaac’s counsel and Progressive. See *In re Pfenninger’s Estate*, 135 Minn. at 197, 160 N.W. at 490. Therefore, the record evidence simply does not support the notion that Isaac and Progressive agreed that their settlement agreement was contingent on Auto Club’s decision to protect its potential subrogation rights.

C. A UIM Substitution Cannot Deprive Settling Parties Of Their Settlement Bargain Absent An Agreement To That Effect Because A UIM Substitution Merely Protects A UIM Carrier’s Potential Subrogation Rights.

Having established that the record evidence provides no support for the position that Isaac, Auto Club, and the lower courts have taken, we now turn to whether *Schmidt* and its progeny provide any *legal* support for their position. The Minnesota Court of Appeals affirmed the district court’s dispositive motion rulings, reasoning that under *Schmidt* and its progeny settlements of automobile accident claims are “tentative” and,

² The Minnesota Court of Appeals stated: “Appellants received a copy of Isaac’s letter to Auto Club. Addendum at 3. The record evidence fails to support the notion that the Hos, or their legal counsel had Isaac’s *Schmidt-Clothier* notice during settlement negotiations, such that one could legitimately argue that Progressive should have anticipated Respondents’ position concerning the effect of Auto Club’s substitution and thus understood that the settlement’s success depended on Auto Club’s actions.

therefore, subject to fail if the UIM carrier substitutes its check. *See* Addendum at 3. That reasoning directly conflicts with the rationale the Minnesota Court of Appeals expressed in *Schulte v. LeClaire*, 2000 LEXIS 23 (Minn.App. Jan. 11, 2000) (unpublished). *See* AA at 186-187. There the court of appeals stated: “While the *Schmidt* court did not discuss the issue of notice that must be supplied to the *tortfeasor* during such negotiations, *no language in that or later opinions suggests that the basic principals of contract law are now subservient to a ‘tentative’ settlement* as a result of the *Schmidt* holding.” AA at 187 (emphasis added). The decision of the court of appeals here directly conflicts with its decision in *Schulte*, although neither of these unpublished decisions is precedential. *See* Minn. Stat. § 480A.03, subd. 3 (2011).

Nevertheless, *Schulte* and the decision of the court of appeals in this action raise an important issue: What legal effect, if any, do UIM substitutions have on the terms of a settlement negotiated between the plaintiff and the defendant in an automobile accident case? Respondents and the lower courts take the position that UIM substitutions destroy that kind of settlement given its so-called “tentative” nature. But as the *Schulte* court properly observed, *Schmidt* and its progeny do not make ordinary contract law principles applicable to settlements subservient to the notion that UIM substitutions make automobile accident settlements voidable absent the settling parties’ agreement to that effect. *See* AA at 187. Relevant decisions of this Court support the *Schulte* court’s conclusion. The intermediate appellate court authorities relied upon by Respondents and the lower courts do not support the view that UIM substitutions destroy settlements *ipso facto*.

- 1. This Court's relevant decisions show that the only purpose UIM substitutions serve is to preserve the UIM carrier's potential subrogation rights.**

An insured who releases a tortfeasor from liability destroys the insurer's right of subrogation against the tortfeasor. *See Great Northern Oil Company v. St. Paul Fire and Marine Insurance Company*, 291 Minn. 97, 102, 189 N.W.2d 404, 408 (1971). Consequently, when a party injured in an automobile accident settles with the tortfeasor, the settlement destroys the UIM carrier's right of subrogation against the tortfeasor. Despite this rule, "settlement and release of an underinsured tortfeasor does not preclude recovery of underinsurance benefits." *Schmidt v. Clothier*, 338 N.W.2d 256, 262 (Minn. 1983). Previously this state of affairs presented a problem for a UIM carrier because an injured party could settle an automobile accident claim with the defendant tortfeasor, provide the tortfeasor with a release which destroyed the UIM carrier's potential subrogation rights, and then make a claim for UIM benefits. If the UIM claim succeeded, the injured party's release precluded the UIM carrier from making a subrogation claim against the tortfeasor.

This Court fixed that problem in *Schmidt* when it approved a procedure allowing a UIM carrier to preserve its subrogation rights despite the fact that the injured party settles with the tortfeasor. *See id.* at 263. According to that procedure, the plaintiff gives the UIM carrier "notice of the tentative settlement agreement and a period of time in which to assess the case." *Schmidt*, 338 N.W.2d at 263. Upon receipt of that notice, the UIM carrier can "evaluate relevant factors, such as the amount of the settlement, the amount of liability insurance remaining, if any, the amount of assets held by the tortfeasor and the

likelihood of their recovery via subrogation, the total amount of the insured's damages, and the expenses and risks of litigating the insured's cause of action." *Id.* If the UIM carrier thinks a UIM claim is likely and the tortfeasor has substantial assets, it can "substitute its payment to the insured in an amount equal" to the settlement reached between its insured and the defendant tortfeasor. *Id.* A UIM carrier who substitutes its payment in an equal amount of the settlement protects its subrogation rights. *See id.* The *Schmidt-Clothier* procedure, thus, protects a UIM carrier's potential subrogation rights.

Certainly *Schmidt* characterized the settlement as a "tentative settlement." *Schmidt*, 338 N.W.2d at 263. But nothing in the text of *Schmidt* even suggests that the settlement is "tentative" in the sense that the UIM carrier's substitution *resurrects claims* the injured party agreed to settle. The settlement is only "tentative" in the sense that *Schmidt* requires the injured party to provide the UIM carrier with notice and a reasonable opportunity to protect its potential subrogation rights by substituting its check for the tortfeasor's settlement payment. No language in the *Schmidt* opinion supports the conclusion that a UIM substitution forces the injured party to abandon the "best settlement" option for district court litigation against the tortfeasor. Thus, the Minnesota Court of Appeals erred when it held that the Hennepin County District Court's dispositive motion rulings were consistent with *Schmidt*. *See Addendum at 4.*

The same conclusion follows from this Court's description of the *Schmidt* settlement procedure in *American Family Mutual Insurance Company v. Baumann*, 459 N.W.2d 923 (Minn. 1990). There, as in *Schmidt*, this Court described the settlement as "tentative." *See Baumann*, 459 N.W.2d at 925. The manner in which this Court

described the *Schmidt* settlement procedure shows that the settlement is “tentative” only in the sense that an insured wishing to settle with the defendant tortfeasor must provide the UIM carrier “notice which would give the underinsurer an opportunity to protect its potential right of subrogation by paying underinsurance benefits *before release of the tortfeasor.*” *Baumann*, 459 N.W.2d at 925 (emphasis added). “If, within the 30-day period, underinsurance benefits were paid and the tortfeasor notified, the *subsequent release of the tortfeasor* would not defeat subrogation.” *Id.* (emphasis added). This Court added: “*Schmidt* requires 30 days’ written notice *before the insured releases an underinsured tortfeasor in order to give the underinsurer suitable opportunity to protect its potential right of subrogation if it chooses to do so.*” *Id.* (emphasis added). Nothing about this language so much as suggests that a UIM substitution *forces* an injured party who unconditionally agrees to settle an automobile accident claim to abandon the “best settlement” option and litigate the personal injury against the tortfeasor. In fact, *Baumann* actually states that the injured party’s execution of a release in the tortfeasor’s favor subsequent to payment of UIM benefits “would not defeat subrogation” regardless of its terms. *Id.* UIM substitutions simply protect the UIM carrier’s potential subrogation rights by giving the UIM carrier an *equitable* right to subrogation even if a release destroys its legal right to subrogation.

The same conclusion follows from this Court’s decision *Employers Mutual Companies v. Nordstrom*, 495 N.W.2d 855 (Minn. 1993). This Court accepted review in *Nordstrom* “to clarify the timing of an underinsured motorist claim in personal injury auto litigation.” *Nordstrom*, 495 N.W.2d at 856. In that decision, this Court

characterized *Schmidt* as “important because it allowed an underinsured claim to be maintained when the tort action is settled for less than the tort liability insurance limits.”

Id. “The *Schmidt* decision . . . approved a notice procedure whereby the underinsurer could meet and pay the tortfeasor’s proposed settlement offer; the underinsured benefits claim would then proceed, after which the underinsurer might, as subrogee, maintain claimant’s tort action against the tortfeasor to recoup all or a portion of the sums the underinsurer had paid the injured claimant.” *Id.* That procedure, held this Court, gave an insured wishing to present a UIM claim two options for doing so:

[T]he injured claimant can either (1) pursue a tort claim to a conclusion in a district court action, and then, if the judgment exceeds the liability limits, pursue underinsured benefits; or (2) settle the tort claim for “the best settlement,” give a *Schmidt-Clothier* notice to the underinsurer, and then *maintain a claim for underinsured benefits*.

Id. at 857 (emphasis added). *Nordstrom* reaffirmed the rule that an insured must first recover from the tortfeasor’s liability insurer, either by way of verdict or settlement, before making a UIM claim. *See id.* at 858. But nothing in *Nordstrom* supports the view that UIM substitutions void settlements between the injured party and the tortfeasor where the settling parties make no agreement to that effect. *Nordstrom* merely spoke of the *Schmidt* settlement procedure as allowing the UIM carrier to preserve its subrogation rights against the tortfeasor when the injured party settles with the tortfeasor for less than the tortfeasor’s liability insurance limits. *See id.* at 856.

The notion that UIM substitutions force settling parties to litigate automobile accident claims also enjoys no support in *Gusk v. Farm Bureau Mutual Insurance Company*, 559 N.W.2d 421 (Minn. 1997). *Gusk* involved a situation in which a UIM

carrier, like Auto Club, paid more money than what it was worth to protect its potential subrogation rights. *See Gusk*, 559 N.W.2d at 422. Farm Bureau, the UIM carrier, argued that its \$80,000 substitution payment should offset its contractual liability to Gusk under its UIM policy. *See id.* at 422. This Court rejected that argument, holding that “a subsequent jury verdict less than the amount of a *Schmidt v. Clothier* substitution cannot justify a ‘refund’ of that substitution.” *Gusk*, 559 N.W.2d at 424.

Gusk is relevant to this appeal, not so much because of its holding, but because of its rationale. This Court reasoned that because a UIM “substitution is a payment to the plaintiff for the protection of the insurer’s potential right of subrogation; its creation was not intended to deprive insureds of the benefit of their tentative settlement bargain.” *Id.* It logically and necessarily follows that a UIM substitution does not deprive the defendant tortfeasor of its settlement bargain either. Nothing in *Gusk* supports the view that a UIM substitution forces the injured party and the tortfeasor to litigate where both agree to settle.

Of course *Gusk* also states “that *Schmidt v. Clothier* substitutions, by their very nature, prevent settlements between insureds and tortfeasors.” *Id.* This language is *obiter dictum*, which means “[a] judicial comment made while delivering a judicial opinion, but one that is unnecessary to the decision in the case and therefore not precedential (although it may be considered persuasive).” BLACK’S LAW DICTIONARY 1177 (Ninth Edition). *Obiter dictum* “implies an opinion uttered by the way.” *Wandersee v. Brellenthin Chevrolet Company*, 258 Minn. 19, 28, 102 N.W.2d 514, 520

(1960). Such statements “lack the force of an adjudication.” *Id.* (quoting *Barrows v. Garvey*, 67 Ariz. 202, 206, 193 P.2d 913, 915 (1948)).

Nevertheless, we must understand *Gusk*'s obiter dictum within the context of this Court's previous statements in *Schmidt*, *Baumann*, and *Nordstrom* concerning the “tentative” nature of personal injury settlements of automobile accident claims. These settlements are “tentative” only in the sense that the injured party must give the UIM carrier an opportunity to protect its subrogation rights. *In that sense only* does a UIM substitution “prevent” a settlement because it avoids the legal effect which ordinarily follows when the injured party releases the tortfeasor from further liability. But one cannot legitimately read *Gusk* as suggesting that a UIM substitution voids an injured party's unconditional agreement to settle claims against the tortfeasor and forces the injured party to litigate those claims. Understanding a UIM substitution's legal effect in that way contradicts this Court's plain statement that UIM substitutions do not deprive parties of their settlement bargain. *Gusk*, 559 N.W.2d at 424.

This Court's decision in *Washington v. Milbank* emphasizes the point that UIM substitutions merely protect a UIM carrier's potential subrogation rights without disturbing or altering the settling parties' agreement. In *Washington* this court explained the “best settlement” option, saying:

Technically, no settlement is reached when the UIM carrier follows the *Schmidt-Clothier* procedure and substitutes its draft for that of the tortfeasor's insurance company. However, the UIM carrier's substitution *operates as a settlement* between the party claiming damages and the tortfeasor because *the tortfeasor is released from further liability to the party claiming damages*, but, at the same time, the UIM insurer retains a subrogation right against the tortfeasor's insurance company.

Id. at 806 n.3 (emphasis added). This language is not *obiter* but *judicial dictum*, “an expression of opinion on a question directly involved and argued by counsel though not entirely necessary to the decision.” *State v. Rainer*, 258 Minn. 168, 177, 103 N.W.2d 389, 396 (1960). The language of footnote 3 is *judicial dictum* because it explains the procedure for making a UIM claim, the very question that *Washington* addressed. *See Washington*, 562 N.W.2d at 804. As *judicial dictum*, footnote 3 “is entitled to much greater weight than mere *obiter dictum* and should not be lightly disregarded.” *Rainer*, 258 Minn. at 177, 103 N.W.2d at 396.

There technically is no settlement when a UIM carrier substitutes its check for the settlement payment the tortfeasor (or its insurer) tenders. Provided the injured party and the tortfeasor make no contrary agreement, however, the UIM carrier’s substitution does not prevent the transaction from *operating as a settlement*. The UIM carrier’s substitution does not require the injured party to abandon the “best settlement” option and litigate claims against the tortfeasor because the tortfeasor still obtains a release from further liability to the injured party despite the UIM carrier’s substitution. Thus, *Washington’s* explanation of the “best settlement” option recognizes that a UIM substitution merely protects the UIM carrier’s potential subrogation rights without disturbing the injured party’s agreement to forego litigating that party’s claims against the tortfeasor.

2. The intermediate appellate court authorities relied upon by Respondents and the lower courts do not support the view that UIM substitutions destroy settlements ipso facto.

In affirming the Hennepin County District Court, the Minnesota Court of Appeals relied on its own prior decisions in *Husfeldt v. Willmsen*, 434 N.W.2d 480 (Minn.App. 1989) and in *Traver v. Farm Bureau Mutual Insurance Company*, 418 N.W.2d 727 (Minn.App. 1988). The court of appeals seems to have relied on these cases as support for the proposition that the district court did not have to dismiss the Hos from this action after Isaac agreed to settle her claims against them. *See* Addendum at 4. But neither of these decisions addressed what legal effect a UIM substitution has on the settlement of an automobile accident claim between an injured party and the tortfeasor. Consequently, neither decision supports the notion that a UIM substitution requires a injured party who settles with the tortfeasor to litigate those claims.

Husfeldt does not apply because it involved different facts and different issues. In that action, “the transcript of the settlement proceeding reflected” that preservation of Husfeldt’s UIM claim was a condition to the settlement between the plaintiff and the defendant. *See Husfeldt*, 434 N.W.2d at 481. In other words, the settling parties in *Husfeldt* evidently agreed that the UIM carrier’s substitution would destroy their agreement to settle the injured party’s claims against the tortfeasor. As noted above, Isaac and the Hos made no similar agreement here. Moreover, the only issue presented for appeal in *Husfeldt* was whether the district court erred by denying the UIM carrier’s motion to intervene as a party defendant. *See id.*

Traver does not apply because it involved different issues and distinct facts. Its issues were (1) whether a defendant tortfeasor's agreement to confess liability destroys the UIM carrier's subrogation rights against the defendant tortfeasor and (2) whether the UIM carrier who substituted its check to preserve its subrogation rights, but did not intervene, was bound by the judgment ultimately entered against the defendant tortfeasor. *See Traver*, 418 N.W.2d at 730. Neither of these issues has any bearing on the issue central to this appeal, namely whether a UIM substitution vitiates Isaac's unconditional agreement to resolve her claims against Appellants through settlement. *Traver* simply did not decide, much less even mention, that issue.

Traver also is factually distinct from this action. There, the UIM carrier "substituted its \$50,000 check in order to protect its potential subrogation rights." *Traver*, 418 N.W.2d at 729. Furthermore, "[t]he Travers and Renner (the tortfeasor) eventually reached an agreement whereby Renner would confess judgment in the amount of \$300,000 per person." *Id.* As part of that agreement, the Travers agreed "to seek satisfaction of said judgment from proceeds of any applicable insurance," meaning that the Travers intended to seek recovery from the UIM carrier. *Id.* Here, the settling parties made no similar agreements.

The Minnesota Court of Appeals never referenced its prior decision in *Steward v. Anderson*, 478 N.W.2d 527 (Minn.App. 1991), although the district court and the Respondents evidently felt it was applicable. *Steward* in reality has nothing to do with the issue the Hos ask this Court to decide. In that action, the defendant's insurance carrier offered to settle with the plaintiff for \$25,000. *See Steward*, 478 N.W.2d at 528. The

plaintiff failed to respond to that offer but did give a *Schmidt-Clothier* notice to her UIM carrier, who substituted its check to preserve its subrogation rights against the defendant. *See id.* *Stewart* presented this Court with only two issues involving prejudgment interest. The first was whether the defendant's insurer's settlement offer constituted a complete offer for purposes of Minn. Stat. § 549.09, subd. 1(b). *See id.* The second was whether the district court erred by determining that the plaintiff's failure to respond to that offer terminated her entitlement to prejudgment interest after that date. *See id.* Neither of these issues addresses the question of whether a UIM substitution vitiates Isaac's unconditional agreement to resolve her claims against Appellants through settlement.

Yet again, the district court evidently thought *Stewart* applicable merely because litigation continued after the UIM substitution. *See* Addendum at 13. The bare fact that litigation continued following a UIM substitution does not require this court to affirm the district court's denial of post-trial judgment as a matter of law. *Stewart*, like the other cases the district court relied upon, never addressed whether a UIM substitution required a plaintiff to try an automobile accident claim after unconditionally agreeing to resolve that claim through settlement. The district court misapprehended the scope of *Stewart's* holding. Accordingly, *Stewart* presented no valid legal basis for denying the Hos' post-trial motion for judgment as a matter of law. Therefore, established precedent provides no support for the decisions of the Minnesota Court of Appeals and the district court, which permits Isaac and other plaintiffs in automobile accident cases to use UIM substitutions to avoid settlements and fund personal injury litigation against defendant tortfeasors when they agreed to settle their claims.

D. Respondents' Position Discourages Settlement Of Automobile Liability Cases By Shifting All The Risks Of Litigation To Defendants And Their Liability Insurers.

This Court has held that the “[s]ettlement of claims is encouraged as a matter of public policy.” *VoiceStream Minneapolis, Inc. v. T-Mobile*, 743 N.W.2d 267, 271 (Minn. 2008). Indeed, “[t]his [C]ourt has always supported a strong public policy favoring the settlement of disputed claims without litigation.” *Hentschel v. Smith*, 278 Minn. 86, 92, 153 N.W.2d 199, 204 (1967). “In the interest of judicial economy, parties should be encouraged to compromise their differences and not to litigate them.” *Karon v. Karon*, 435 N.W.2d 501, 504 (Minn. 1989). Courts, therefore, “have an interest in encouraging settlement, because settlement lessens the burden on judicial resources.” *In re Buckmaster*, 755 N.W.2d 570, 579 (Minn.App. 2008). The decision by the Minnesota Court of Appeals in this action, though not precedential, is troubling as a matter of public policy because it actually impedes the settlement of automobile accident claims.

The court of appeals has held, in effect, that a UIM substitution *requires* litigation of an automobile accident claim despite the injured party’s and the tortfeasor’s unconditional intention to resolve their differences without litigation. *See* Addendum at 4. That position, coupled by a reversal in favor of Auto Club on the issue it raises, shifts all the risk of litigation to the defendant tortfeasor. The injured plaintiff bears no risk because he or she collects UIM substitution money to fund the litigation against the defendant tortfeasor. The UIM carrier would bear no risk because, under Auto Club’s view of the world, it may recover its substitution even if the defendant is not underinsured. Only the defendant bears risks, which include not only the risk of liability

to the plaintiff, but also the risk of having to pay additional litigation expenses that a settlement otherwise would avoid. Settlement provides the defendant tortfeasor with no means for avoiding these risks because a UIM carrier always can frustrate the settlement by substituting its check for the settlement payment tendered by the defendant tortfeasor or that party's automobile liability insurer. Under these circumstances, the defendant tortfeasor has little or no incentive to settle claims with plaintiffs in automobile accident cases. Thus, the decision of the Minnesota Court of Appeals in this action actually dissuades defendants from making a good faith effort to resolve personal injury claims arising from automobile accidents because a UIM substitution always will deprive the defendant of the benefit of its settlement bargain. Therefore, the decision of the Minnesota Court of Appeals in this action merits reversal to the extent it affirmed the district court's dispositive motion decisions.

II. THE COURT OF APPEALS CORRECTLY HELD THAT AUTO CLUB HAD NO SUBROGATION RIGHT AGAINST THE HOS WHO WERE NOT UNDERINSURED.

Auto Club challenges the decision of the Minnesota Court of Appeals to the extent it reversed the district court's determination that Auto Club could recover its UIM substitution via subrogation from the Hos despite the fact that they were not underinsured. *See* Response to Petition for Review of Decision of Court of Appeals and Petition for Cross-Review at 3-5. The Minnesota Court of Appeals properly decided that Auto Club had no basis for subrogation recovery because the net total judgment in Isaac's favor was less than the limits of the Hos' liability policy limit of \$50,000, holding that Auto Club's subrogation right never matured because no UIM claim arose. *See*

Addendum at 5. De novo review shows that the Minnesota Court of Appeals properly decided this legal issue in accordance with existing precedent.

A. The Standard Of Review For Purely Legal Issues Is *De Novo*.

The Minnesota No-Fault Automobile Liability Insurance Act defines an “underinsured motor vehicle” as “a motor vehicle . . . to which a bodily injury liability policy applies at the time of the accident but its limit for bodily injury liability is less than the amount needed to compensate the insured for actual damages.” Minn. Stat. § 65B.43, subd. 17 (2010). Whether the Hos were underinsured does not turn on any fact question. That question involves no more than the application of law to undisputed facts. Under such circumstances, the *de novo* standard of review applies. See *Weston v. McWilliams & Associates, Inc.*, 716 N.W.2d 634, 638 (Minn. 2006) (de novo standard of review applies to application of statute to undisputed facts); *Morton Buildings, Inc. v. Commissioner of Revenue*, 488 N.W.2d 254, 257 (Minn. 1992) (application of law to facts presents a freely reviewable legal question); *Frost-Benco Electric Association*, 358 N.W.2d at 642; *Engler v. Wehmas*, 633 N.W.2d 868, 872 (Minn.App. 2001) (reviewing court need not defer to district court’s application of law to undisputed facts).

B. The Hos Are Not Underinsured.

Progressive insured the Hos under a liability insurance policy having a \$50,000.00 limit. See AA at 16-17. Although the Jury awarded \$56,420.97 in gross damages, the district court diminished that award by deducting Isaac’s comparative fault and collateral sources from the gross award. See Addendum at 25-26. Pursuant to Minn. Stat. § 548.251, it deducted \$87.61 for past wage loss, \$10,000.00 for past health care expenses,

and \$2,565.88 for past diagnostic studies paid by no-fault insurance. *See id.* at 26. Finding that Isaac paid \$423.80 to secure no-fault benefits during the two years immediately prior to the accrual of this action, the court added that amount to the verdict pursuant to Minn. Stat. § 548.251, subd. 2(2). *See id.* Then the district court deducted from the verdict \$2,325.49, which represented Isaac's 5 percent comparative fault. *See id.* These adjustments left Isaac with a net damage award, exclusive of costs and interests, of \$44,184.26. *See id.* The net verdict amount is well under Progressive's \$50,000 liability policy limit. Thus, the Hos were not underinsured.

C. Auto Club's Subrogation Rights Were Not Triggered Because The Hos Are Not Underinsured.

This Court has held that “[a UIM] substitution is a payment to the plaintiff for the protection of the insurer's *potential right* of subrogation . . .”. *Gusk*, 559 N.W.2d at 424 (emphasis added). After substitution, the UIM claim proceeds, “*after which* the underinsurer *might*, as subrogee, maintain claimant's tort action against the tortfeasor to recoup all or a portion of the sums the underinsurer has paid the injured claimant.” *Nordstrom*, 495 N.W.2d at 856 (emphasis added). Nothing in *Schmidt* or its progeny supports the notion that a UIM carrier, such as Auto Club, is entitled to make a subrogation claim against a tortfeasor who is not underinsured. *Schmidt* holds that an “underinsurer may recover underinsurance benefits where the total damages sustained (as determined by either arbitration or judgment) *exceed* the limits of the tortfeasor's liability policy even where the insured settles with the tortfeasor for less than the liability limits.” *Schmidt*, 338 N.W.2d at 261 (emphasis added).

In *Gusk*, this Court held that “[a] substitution is a payment to the plaintiff for the protection of the insurer’s *potential* right of subrogation . . .”. *Gusk*, 559 N.W.2d at 424 (emphasis added). The UIM carrier’s subrogation right is only a *potential* right when the substitution occurs because the defendant’s underinsured status has yet to be determined. “The focus of underinsurance is . . . the amount of damages an insured party suffers for which the tortfeasor is not insured.” *Progressive Casualty Co. v. Kraayenbrink*, 370 N.W.2d 455, 461 (Minn.App. 1985) *rev. den’d.* (Minn. Sept. 19, 1985). “The underinsurer is therefore liable only for the damages suffered in excess of the tortfeasor’s liability limits, for it is only in this amount that the tortfeasor is truly ‘underinsured.’” *Hedlund v. Citizens Security Mutual Insurance Company of Red Wing*, 377 N.W.2d 460, 463 (Minn.App. 1985). Where offsets reduce the damages award to an amount less than the defendant’s liability insurance policy limits, there is no UIM coverage or exposure. *See Richards v. Milwaukee Insurance Co.*, 518 N.W.2d 26, 28 (Minn. 1994). If there is no UIM exposure, the UIM carrier has no basis for subrogation.

“Subrogation is a limited, not absolute, right that comes into existence only after the insurer has paid *benefits* to its insured . . .”. *Id.* at 261 (emphasis added). “The key element in subrogation cases is whether the party seeking subrogation *was compelled* to pay another’s debt.” *Iowa National Mutual Insurance Co. v. Liberty Mutual Insurance Co.*, 464 N.W.2d 564, 566 (Minn.App. 1990). Subrogation does not lie where the party seeking subrogation lacks any interest requiring protection. *See id.* at 567. A UIM carrier has no subrogation rights against the defendant tortfeasor at all if it is not compelled to pay UIM benefits to its insured. A UIM carrier’s substitution becomes a

voluntary payment if the plaintiff cannot establish that the defendant tortfeasor is underinsured.

Here, there was neither claim nor proof that the Hos were underinsured. Because they are not underinsured, Auto Club's contractual obligation to pay UIM benefits to Isaac never was triggered. Accordingly, Auto Club's substitution amounts to a voluntary payment over which Auto Club has no subrogation rights. Therefore, this Court necessarily must affirm the ruling of the Minnesota Court of Appeals on this issue.

CONCLUSION

UIM substitutions do nothing more than allow a UIM insurer to preserve its potential right of subrogation when a plaintiff settles an automobile accident claim with the defendant. Absent the parties' agreement to the contrary, a UIM substitution does not void, alter, or change the terms of the settling parties agreement. The record evidence fails to support the notion that Plaintiff and the Hos, acting through Progressive, *agreed* that Auto Club's substitution would destroy their settlement agreement. The Minnesota Court of Appeals erred by affirming the Hennepin County District Court's decision that Auto Club's substitution allowed Isaac to avoid settlement with the Hos.

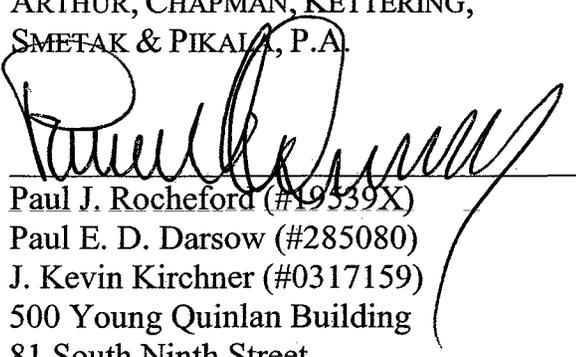
A UIM carrier has no claim for subrogation where the defendant tortfeasor is not underinsured. The record evidence clearly shows that the Hos were not underinsured. Under those circumstances, no claim for UIM benefits ever could arise. Accordingly, Auto Club's potential subrogation rights never matured. Therefore, the Minnesota Court of Appeals properly reversed the district court, holding that Auto Club could not recovery is UIM substitution from the Hos because they were not underinsured as a matter of law.

Respectfully submitted,

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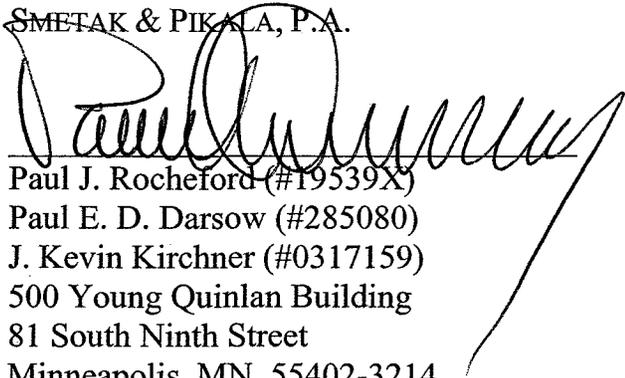
CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing Brief of Appellants Vy Thanh Ho and Lein Ho conforms to Minn.R.Civ.App.P. 132.01, subd. 3(a)(1), for a brief produced with proportionally spaced font.

There are 9,714 words in this Brief, not including the Table of Contents and the Table of Authorities. The word processing software used to prepare this Brief was Microsoft® Office Word 2007.

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