

NO. A11-11

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State of Minnesota  
*In Supreme Court*

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Vy Thanh Ho and Lein Ho,  
*Appellants/ Cross-Respondents,*

vs.

Bakita Isaac,

*Respondent,*

and

Auto Club Insurance Association,

*Respondent/ Cross-Appellant.*

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**RESPONDENT/CROSS-APPELLANT AUTO CLUB INSURANCE  
ASSOCIATION'S PRINCIPAL AND RESPONSE BRIEF**

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## Statement of the Issues

- I. WHETHER THE LOWER COURTS ERRED IN THEIR DETERMINATION THAT THE PARTIES CONDITIONED SETTLEMENT ON AUTO CLUB'S DECISION TO SUBSTITUTE ITS DRAFT.

Description of how the issue was raised in the lower court:

Appellants/Cross-Respondents, Vy Ho and Lein Ho, 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 ruling:

The Minnesota Court of Appeals affirmed the district court, finding that the agreement between then plaintiff Bakita Isaac and then defendants Vy Ho and Lein Ho contained an unambiguous condition under which Respondent Auto Club could prevent the settlement by substituting its check in the amount of that tentative settlement.

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:

*Morrisette v. Harrison Intern. Corp.*, 486 N.W.2d 424 (Minn. 1992)

*Husfeldt v. Willmsen*, 434 N.W.2d 480 (Minn. App. 1989)

*Nord v. Herreid*, 305 N.W.2d 337 (Minn. 1981)

*Triple B & G, Inc. v. City of Fairmont*, 494 N.W.2d 49 (Minn. App. 1992)

II. IS A TORTFEASOR ENTITLED TO BE DISMISSED WHEN AN UNDERINSURED CARRIER, IN RESPONSE TO A *SCHMIDT V. CLOTHIER* NOTICE, SUBSTITUTES ITS DRAFT AND PREVENTS SETTLEMENT BETWEEN THE TORTFEASOR AND PLAINTIFF?

Description of how the issue was raised in the lower court:

Appellants/Cross-Respondents, Vy Ho and Lein Ho, 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 ruling:

The Minnesota Court of Appeals affirmed the district court, correctly holding that nothing in this Court's decision in *Schmidt v. Clothier*, 338 N.W.2d 256 (Minn. 1983) or its progeny requires dismissal of a tortfeasor when a UIM carrier prevents consummation of a tentative settlement between an injured party and tortfeasor by substituting its check in an amount equal to the tentative settlement.

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:

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

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

*Van Kampen v. Waseca Mut. Ins. Co.*, 754 N.W.2d 578 (Minn. App. 2008)

*Dohney v. Allstate Ins. Co.*, 632 N.W.2d 598 (Minn. 2001)

III. WHETHER THE COURT OF APPEALS ERRED WHEN IT HELD THAT AUTO CLUB'S SUBSTITUTION OF ITS DRAFT PURSUANT TO *SCHMIDT-CLOTHIER* WAS INSUFFICIENT TO PRESERVE ITS SUBROGATION RIGHTS.

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 ruling:

The Minnesota Court of Appeals reversed the district court, incorrectly holding that a substitution pursuant to *Schmidt v. Clothier* is insufficient to preserve a UIM carrier's subrogation rights.

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

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:

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

*American Family Mut. Ins. Co. v. Baumann*, 459 N.W.2d 923 (Minn. 1990)

*Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d 421 (Minn. 1997)

*Commercial Union Ins. Co. v. Minnesota School Bd. Ass'n.*,  
600 N.W.2d 475 (Minn. App. 1999)

## STATEMENT OF THE CASE

Appellants/Cross-Respondents Vy Ho and Lein Ho (“the Hos”) provide a detailed and accurate Statement of the Case with one exception. The Hos accurately report that Auto Club intervened in the action on October 26, 2009. However, Auto Club’s Notice of Intervention states that it intervened both to protect its potential underinsured motorist exposure *and* to protect its subrogation interest against Appellants/Cross-Respondents. *See* Appellants’ Appendix (“AA”) at pgs. 57-59. No party objected to the intervention on those grounds.

Respondent/Cross-Appellant Auto Club (“Auto Club”) is otherwise satisfied with the Hos’ Statement of the Case and will make no further statement pursuant to Rules 128.02, subd. 2 and 131.01, subd. 5(d)(2) of the Rules of Civil Appellate Procedure.

## STATEMENT OF THE FACTS

The Hos also provide a detailed and accurate Statement of the Facts with one exception. The Hos assert that the settlement agreement negotiated between Isaac’s counsel and Progressive was unconditional and contained no contingencies. *See* Appellants/Cross-Respondents’ Brief (“A/C-R Brief”), at 8, 10. The existence of a contingency was a disputed fact. *See* AA, at 26-30. The district court reviewed the disputed facts and determined that a contingency existed under which “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.” *See* Appellants/Cross-Respondents Addendum (“A/C-R Add.”), at 10.

Auto Club is otherwise satisfied with The Hos' Statement of the Facts and will make no further statement pursuant to Rules 128.02, subd. 2 and 131.01, subd. 5(d)(2) of the Rules of Civil Appellate Procedure.

## ARGUMENT

### I. INTRODUCTION

This case involves the competing interests of an injured party, a tortfeasor and her liability insurer, and the injured party's underinsured motorist carrier. Following an accident, the injured party, Bakita Isaac ("Isaac") brought suit against the Hos. After exchanging several settlement offers, the Hos, through their insurer Progressive, offered to settle the claim for \$10,665, 21% of the available policy limit if \$50,000. Isaac's attorney indicated that Isaac would accept the offer. He then notified Isaac's insurer, Auto Club, that he believed Isaac's damages exceeded \$50,000 and he intended to bring a claim for underinsured motorist ("UIM") coverage against Auto Club. Auto Club substituted its check in an amount equal to the proposed settlement pursuant to *Schmidt v. Clothier*, 338 N.W.2d 256 (Minn. 1983) and intervened in the suit between Isaac and the Hos.

The question presented by this appeal is: what should have happened next?

What did happen is that the Hos sought to be dismissed from the suit. The district court denied that motion and the case went to trial. The jury returned a verdict favorable to Isaac. After adjusting for collateral source offsets, the district court determined that Isaac's damages totaled \$44,184.26, less than the Hos' policy limits. After adding costs

and interest the district court entered a judgment in favor of Isaac for \$45,765.97 and in favor of Auto Club for \$11,152.70.

The Hos disagreed with this outcome and filed post-judgment motions and an appeal. The Hos have consistently argued two points. First, that they should have been dismissed from the suit and therefore the judgment in favor of Isaac should be vacated. Second, that the trial proved the Hos were not underinsured, so the judgment in favor of Auto Club should be vacated.

In short, the Hos' position is that they should have to pay nothing as a result of this accident despite the fact that a jury determined that Vy Ho's negligence caused Isaac to suffer damages in an amount of over \$40,000.

This case presents three issues. The first two involve the effect of Auto Club's substitution pursuant to *Schmidt v. Clothier*. The final issue involves Auto Club's right to recover that substitution payment.

The first question is whether the district court abused its discretion when it determined that the terms of the oral agreement reached by Isaac's attorney and the Hos' insurer were contingent on Auto Club's right to substitute its check in the amount of the proposed settlement. The district court determined that "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." *See A/C-R Add.*, at 10; *see also Id.*, at 16-17. While the court of appeals based its decision on other grounds, it indicated that it agreed with the district court's findings of fact. *See*

A/C-R Add., at 3. As will be discussed below, both lower courts decided this issue correctly.

The second issue concerns whether, in the absence of a specific agreement between the parties regarding the impact of a *Schmidt* substitution, an injured party is required to dismiss the underlying suit against the tortfeasor following such a substitution. The court of appeals determined that the injured party is not required to dismiss the suit against the tortfeasor. *See Id.*, at 4. In their brief, the Hos have attempted to turn this question on its head by suggesting that the court of appeals' decision would force an injured party to continue its suit. *See A/C-R Brief*, at 12. That was not the issue presented to the court of appeals. The court of appeals specifically noted that the Hos' argument was "that dismissal of a tortfeasor is required after a UIM carrier substitutes its draft for the proposed liability settlement amount." *See A/C-R Add.*, at 4. This brief will detail why the decision by the court of appeals was correct based on existing precedent and good public policy.

The final issue concerns whether Auto Club has a right to recover the amount it paid in substitution of the proposed liability settlement. The district court determined that Auto Club had a right to recover its substitution under a theory of equitable subrogation. *See Id.*, at 26. The court of appeals disagreed and determined that a UIM carrier's subrogation interest does not mature until there is a determination that a tortfeasor is underinsured. *See Id.*, at 5. The decision by the court of appeals relies almost entirely on a misreading of this Court's decision in *Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d 421, 423 (Minn. 1997). This brief will show that the court of appeals' decision does not

follow existing precedent and creates an unworkable model that places unreasonable burdens on UIM carriers.

**II. THE HOS AND ISAAC ENTERED INTO AN AGREEMENT THAT WAS CONTINGENT ON AUTO CLUB'S RIGHT TO STOP A SETTLEMENT BY SUBSTITUTING ITS CHECK IN AN AMOUNT EQUAL TO THE PROPOSED SETTLEMENT.**

The district court determined that the agreement between Isaac and the Hos allowed Auto Club to stop the settlement by substituting its check in an amount equal to the proposed settlement. *See A/C-R Add.*, at 10, 16-17. The court of appeals agreed with that determination. *See Id.*, at 3. The district court's determination of the terms of the contract were not clearly erroneous, and this court should uphold the court of appeals' decision affirming the district court's order.

**A. THE EXISTENCE AND TERMS OF A CONTRACT ARE QUESTIONS OF FACT AND MUST BE REVIEWED UNDER THE CLEARLY ERRONEOUS STANDARD.**

Where there is a dispute about the existence and terms of a contract, those issues present questions of fact. *Morrisette v. Harrison Intern. Corp.*, 486 N.W.2d 424, 427 (Minn. 1992). A district court's determination of questions of fact should only be overturned where they are clearly erroneous. *Fletcher v. St. Paul Pioneer Press*, 589 N.W.2d 96, 101 (Minn. 1999).

**B. THE AGREEMENT BETWEEN ISAAC AND THE HOS ALLOWED AUTO CLUB TO PREVENT A SETTLEMENT BY SUBSTITUTING ITS CHECK.**

Settlement agreements are contractual in nature. *Beach v. Anderson*, 417 N.W.2d 709, 711 (Minn. App. 1988). In order to create an enforceable contract, there "must be

such a definite offer and acceptance that it can be said that there has been a meeting of the minds on the essential terms of the agreement.” *Jallen v. Agre*, 119 N.W.2d 739, 743 (Minn. 1963). In addition, “an agreement should be upheld where, despite some incompleteness and imperfection of expression, the court can reasonably find the parties’ intent by applying the words as the parties must have understood them.” *Triple B & G, Inc. v. City of Fairmont*, 494 N.W.2d 49, 53 (Minn. App. 1992) (*citations omitted*). The question of whether a contract arose depends on an objective evaluation of the parties’ actions and words. *Thomas B. Olson & Assoc., P.A. v. Leffert, Jay & Polglaze, P.A.*, 756 N.W.2d 907, 918 (Minn. App. 2008). The “existence and terms of an oral contract are issues of fact, generally to be decided by the fact finder.” *Rios v. Jennie-O Turkey Store, Inc.*, 793 N.W.2d 309, 315 (Minn. App. 2011). When there is a dispute as to whether a settlement has been reached, the district court should serve as the finder of fact. *Jallen*, at 743. That is, “[t]he trial court acts as a finder of fact in disputes concerning pretrial settlements.” *Wildman v. K-Mart Corp.*, 556 N.W.2d 10, 13 (Minn. App. 1996). If there is reasonable evidence that tends to support the district court’s findings of fact, the reviewing court should not reverse those findings. *Riley Bros. Constr., Inc. v. Shuck*, 704 N.W.2d 197, 202 (Minn. App. 2005).

A settlement, like a contract, can require that an event take place before the contract right or duty accrues. *Carl Bolander & Sons v. United Stockyards Corp.*, 215 N.W.2d 473, 476 (Minn. 1974). This “condition precedent is one which is to be performed before the agreement of the parties becomes operative.” *Hanson v. Moeller*, 376 N.W.2d 220, 225 (Minn. App. 1985). A factfinder can consider parol evidence to

determine whether a condition precedent exists. *Nord v. Herreid*, 305 N.W.2d 337, 339 (Minn. 1981). Parol evidence can take the form of prior oral or written agreements and negotiations. See: *Alpha Real Estate Co. of Rochester v. Delta Dental Plan of Minnesota*, 664 N.W.2d 303, 312 (Minn. 2003); *Hruska v. Chandler Associates, Inc.*, 372 N.W.2d 709, 712 (Minn. 1985).

In particular, an injured party and tortfeasor can condition their settlement on a preservation of the injured party's right to pursue UIM benefits. In *Husfeldt v. Willmsen*, 434 N.W.2d 480 (Minn. App. 1989), the Husfeldts brought suit against the estate of Walter Willmsen on the theory that Willmsen's negligence caused their injuries. *Id.* at 480-81. Willmsen's policy limits were \$100,000, and Willmsen's insurer offered to settle for \$60,000. *Id.* at 481. The Husfeldts informed their insurer that they intended to bring a claim for UIM benefits, and the insurer substituted its check in an amount equal to the tentative settlement. *Id.* The Husfeldts' attorney accepted the substituted check and returned the original check to Willmsen's insurer. *Id.* Willmsen responded by filing a motion to dismiss the suit, claiming that the settlement had been finalized. *Id.* The district court denied the motion after finding that preservation of the UIM claim "was a condition to settlement." *Id.* Willmsen did not appeal that decision.

In contrast, parties are also free to agree that the settlement waives an injured party's rights to seek UIM benefits. *Schulte v. LeClaire*, 2000 WL 16302 (Minn. App. Jan 11, 2000); See AA, 183-87. In that case, Schulte was injured in an auto accident and brought suit against LeClaire. *Id.* at \*1. The parties discussed settlement by phone and agreed to settle the case for \$15,000. *Id.* The parties then disagreed about the terms of

their agreement. *Id.* Specifically, the parties disagreed regarding whether Schulte could accept a substitution check from her own insurer. *Id.* The district court heard arguments on the issue, determined that the settlement agreement was “full and final,” and enforced that agreement. *Id.* The court of appeals reviewed the district court’s right to serve as the finder of fact in determining the terms of the settlement, and deferred to those findings since they were not clearly erroneous. *Id.* at \*1-2.

In this case, the Hos and Isaac engaged in ongoing settlement negotiation during which Isaac’s counsel, Jason Vohnoutka, sent two offers of judgment. *See* AA, at 33, 35. Those offers both contained identical clauses which said:

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.*

After Isaac’s counsel sent both of the offers of judgment, an adjuster for the Hos’ insurance company, Timothy Pothen of Progressive, contacted Isaac’s counsel. *See Id.*, at 16, 32. Mr. Pothen and Mr. Vohnoutka agreed to settle the case for \$10,665.00. *See Id.* Neither Isaac nor the Hos dispute that they had reached a tentative settlement agreement.

Neither party memorialized the agreement in writing. An attorney representing Progressive sent a letter containing a check for \$10,665.00, a release, and a stipulation of dismissal with prejudice. *See Id.*, at 21. The letter said:

Enclosed, please find Progressive Preferred Insurance Company's check in the amount of \$10,665.00 which represents our agreed upon settlement regarding the above-referenced matter.

*See Id.* The release which accompanied the letter was never signed and has never been made part of the record.

Subsequently, Isaac's attorney wrote Jamie McCutcheon at Auto Club, informed him of the tentative settlement, and indicated that Auto Club had 30 days to prevent the settlement by exchanging its draft for that of Progressive. *See Id.*, at 37. Auto Club substituted its draft and Isaac's attorney returned the check that Progressive had sent. *See Id.* at 32. Neither Isaac nor her attorney signed the stipulation for dismissal which was sent with Progressive's check.

The Hos brought a motion for summary judgment. *See Id.*, at 4-5. The district court found that the Hos and Isaac had entered into a valid settlement agreement that "explicitly provided Auto Club with the right to stop the settlement from taking place." *See A/C-R Add.*, at 10. In reaching that determination, the district court exercised its right to review parol evidence when considering whether the settlement contained a condition precedent. *Nord v. Herreid*, 305 N.W.2d at 339. Specifically, the court reviewed the two offers of judgment Isaac's counsel sent to the Hos' insurer and the letter Isaac's counsel sent to Auto Club, and determined that the settlement agreement contained a condition precedent. Based on the determination that the settlement included a condition precedent, the district court determined that Auto Club terminated the tentative settlement agreement when it substituted its check and denied The Hos' motion for summary judgment. *See A/C-R Add.*, at 11.

Following a trial on the merits, the district court issued an order addressing the Hos' motion for judgment as a matter of law. *See Id.*, at 12. The court's memorandum reiterated the earlier finding of facts and emphasized that the proposed settlement "was expressly conditioned on Auto Club's agreement to waive its subrogation interest." *See Id.*, at 13-14, 15-16.

The Hos argue that the tentative settlement reached with Isaac was unconditional. *See A/C-R Brief*, at 17. Their brief does not acknowledge that the district court had the authority to make findings of fact or that a reviewing court should only overturn those findings if they were clearly erroneous. Instead, the Hos argue that settlement negotiations began and ended on a single day: October 2, 2009. *See Id.* That argument ignores the fact that the parties had been engaged in ongoing negotiations for several months. *See AA*, at 33-36; *A/C-R Brief*, at 5-6. The telephone call on October 2, 2009 was clearly a part of ongoing settlement negotiations. In fact, during the call the parties referenced their earlier negotiations and Isaac's attorney specifically referenced his prior Rule 68 offer. *See AA*, at 32. As Judge Learned Hand famously noted, "words are chameleons, which reflect the color of their environment." *C.I.R. v. National Carbide Corp.*, 167 F.2d 304, 306 (2<sup>nd</sup> Cir. 1948). The October telephone conversation did not take place in a vacuum; it was a continuation of the prior negotiations. The negotiations on October 2<sup>nd</sup> were colored by those earlier discussions. It is undisputed that the financial portion of the settlement evolved from Isaac's Rule 68 offer, and the district court determined that the conditions of the agreement were also based on that Rule 68 offer.

A district court should make findings of fact regarding the terms of a contract, and the district court did so here. *Morrisette v. Harrison Intern. Corp.*, 486 N.W.2d at 427. The district court determined that the settlement agreement contained a condition precedent under which Auto Club could prevent a settlement by substituting its check in an amount equal to the amount of the proposed settlement. That finding has support in the record. The court of appeals agreed that the record supported the district court's decision. *See A/C-R Add.*, at 3. That court said, "the settlement proposed by appellants was not full and final and was instead subject to acquiescence by Auto Club." *See Id.* Therefore, the decision of the district court is not clearly erroneous and should be affirmed. *Fletcher v. St. Paul Pioneer Press*, 589 N.W.2d at 101.

**III. NOTHING IN *SCHMIDT* OR ITS PROGENY REQUIRES AN INJURED PARTY TO DISMISS ITS SUIT AFTER A UIM CARRIER SUBSTITUTES ITS PAYMENT.**

**A. THE APPROPRIATE STANDARD OF REVIEW IS *DE NOVO*.**

Review of an order denying summary judgment is *de novo*, and addresses the questions of "whether there are any genuine issues of material fact and whether the lower courts erred in their application of the law." *Howard v. Minnesota Timberwolves Basketball Ltd. Partnership*, 636 N.W.2d 551, 555 (Minn. App. 2001). Review of the district court's decision regarding a judgment as a matter of law is also *de novo*, and requires the reviewing court to apply the same standards as the district court. *Bahr v. Boise Cascade Corp.*, 766 N.W.2d at 919. Where the only questions before the Court are questions of law, the Court does not need to give deference to the decision of the district court. *Hubred v. Control Data Corp.*, 442 N.W.2d 308, 310 (Minn. 1989). The question

before the Court is whether the district court erred in its application of the *Schmidt v. Clothier* procedure. That question of law should receive *de novo* review.

**B. WHEN A UIM CARRIER SUBSTITUTES ITS CHECK, THAT SUBSTITUTION PREVENTS A SETTLEMENT BETWEEN THE INJURED PARTY AND TORTFEASOR.**

There are no statutes or case law in Minnesota that say an injured party must dismiss a suit against a tortfeasor when that injured party's insurer substitutes a check pursuant to *Schmidt v. Clothier*. In support of their position that the injured party, Isaac, should have been compelled to dismiss her claims against the tortfeasors, the Hos argue that (1) the court of appeals' holding in this case conflicts with its holding in *Schulte v. LeClaire*, 2000 WL 16302 (Minn. App. Jan 11, 2000), (2) the words "prevent" and "tentative" should not be given their standard dictionary definitions, (3) the guidance in multiple other decisions by the court of appeals are not relevant, and (4) transforming a single lawsuit into multiple suits facilitates judicial economy. As will be discussed below, the Hos' assertions lack a legal and logical basis.

**1. There is no conflict between the court of appeals' decision in this case and its decision in *Schulte*.**

The Hos assert that there is a conflict between the court of appeals' decision in this case and its earlier decision in *Schulte*. A careful reading of the two decisions shows that there is no conflict. As discussed above, *Schulte* involved a dispute regarding a settlement agreement. 2000 WL 16302 at \*1; *See* AA, at pgs. 183-87. The appellant, *Schulte*, asked the court of appeals to rule that all settlement negotiations that involve the potential of a UIM claim are tentative. *Id.* at \*2. The court refused to rule on that

question. *Id.* The court acknowledged that *Schmidt v. Clothier* described settlement agreements in suits involving a potential UIM claim as “tentative.” *Id.* However, the court said that it was “sufficient for the disposition of this case to affirm the district court’s order enforcing the full and final settlement between the parties.” *Id.* at \*3. Since the parties were free to contract outside the restrictions of *Schmidt v. Clothier*, the terms of their agreement controlled the court’s decision.

In contrast, the court of appeals’ decision in this case did address the position of the parties in a situation where the parties did not contract outside of *Schmidt v. Clothier*. While the court of appeals agreed with the district court’s determination that the settlement was “subject to acquiescence by Auto Club,” the decision added that the agreement between Isaac and the Hos was tentative “under the principles outlined in *Schmidt*.” *See* A/C-R Add., at 3. The court relied on those “well-established principles outlined in *Schmidt* and its progeny” to determine that “the proposed settlement agreement between Isaac and [the Hos] was just that: a proposed agreement.” *See Id.*, at 4. In short, the court of appeals determined that Isaac and the Hos did not contract outside *Schmidt*. Rather, their agreement tracked the holding of that case.

The decision in this case presents a different set of facts from the *Schulte* case, and the holdings by the court of appeals do not conflict. In *Schulte*, the district court found that the parties reached a full and final settlement with no contingencies. The court of appeals affirmed that determination and declined to address the question of what position the parties would have held if the settlement had not been full and final. In contrast, the district court in this case found that the settlement between the parties did have a

contingency. The court of appeals affirmed that determination and added that the contingency in question, an agreement that the settlement was tentative and subject to acquiescence by Auto Club, accurately described the positions the parties would have held in the absence of a full and final settlement that specifically eliminated the “tentative” nature of the settlement. The Hos are incorrect in their assertion that these two decisions directly conflict. The facts are different, and application of the facts demanded different results.

**2. Under the plain language of *Schmidt* and its progeny, the agreement between Isaac and the Hos was tentative, and Auto Club had the ability to prevent the settlement from taking place.**

The Hos primary argument focuses on the question of what this Court and the court of appeals meant in earlier decisions that characterize an agreement between an injured party and tortfeasor as “tentative,” and state that the injured party’s UIM insurer can “prevent the settlement” by substituting its check in the amount of the proposed settlement. *See e.g. Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d 421, 423-24 (Minn. 1997). In the Hos’ view, the agreement is tentative only in that it is not consummated immediately. *See A/C-R Brief*, at 25. The Hos suggest that the word “tentative” merely means “delayed.” The Hos address the phrase “prevent the settlement” which appears throughout *Schmidt* and its progeny by implying that it appears only in the *Gusk* decision, appears as obiter dictum, and therefore carries no weight. In addition to ignoring the plain language of the earlier decisions, the Hos misconstrue the holding of the court of appeals in this case, repeatedly and incorrectly stating that an injured party will now be

“forced” to litigate the underlying suit with the tortfeasor to conclusion. Compounding their misreading of the decision in this case, the Hos’ brief attempts to place the tortfeasor in the same position as the injured party by suggesting that the *Schmidt* substitution procedure exists to protect a tortfeasor and his or her insurer, not the injured party and his or her UIM insurer. Addressing these claims requires (a) a review of the development of the *Schmidt-Clothier* substitution procedure, (b) analysis of the court of appeals’ decision in this case, and (c) definition of the words “tentative” and “prevent.”

*a. Development of the Schmidt-Clothier procedure*

For several decades, the courts and Legislature have sought to find a balance between injured parties, UIM insurers, and the insurers of tortfeasors. *See, Dohney v. Allstate Ins. Co.*, 632 N.W.2d 598 (Minn. 2001). On one side, there are the interests of the No-Fault Act which include:

relieving the economic hardships encountered by uncompensated accident victims, Minn. Stat. § 65B.42(1), encouraging proper medical treatment by assuring prompt payment for such treatment, Minn. Stat. § 65B.42(3), and speeding the administration of justice and easing the burden of litigation on the courts of this state, Minn. Stat. § 65B.42(4).

*Schmidt*, 338 N.W.2d at 260. On the other side is the concern that allowing an insured to settle with the tortfeasor and then immediately pursue UIM benefits creates a situation where “the insured would have no incentive to obtain the best settlement.” *Id.*, at 261.

In *Schmidt*, this Court examined insurance policies which contained “exhaustion” clauses which prevented an insured from recovering UIM benefits unless that insured recovered the tortfeasor’s entire policy limits through settlement or trial. *Id.*, at 260.

This Court determined that exhaustion clauses are void as against public policy, but also sought to create a situation that encouraged an injured party to obtain the best settlement from the tortfeasor. *Id.*, at 261. This Court balanced those concerns by holding that UIM coverage only applied for damages greater than the tortfeasor's policy limits. *Id.* That is, the insured could not recover the difference between a settlement amount and the tortfeasor's liability limits from the UIM carrier. *Id.* That amount has become known as the "gap." Under the arrangement described in *Schmidt*, the actual amount of a settlement between the insured and the tortfeasor would have no impact on the amount a UIM insurer might have to pay. However, the UIM insurer might believe that the tortfeasor had personal assets, or that the insured was likely to settle for less than the tortfeasor's policy limits, and wish to preserve its right to pursue recovery from the tortfeasor. *Id.*, at 263. In those situations, the UIM insurer could substitute its check in an amount equal to the tentative settlement and then attempt to obtain a better settlement from the tortfeasor or proceed to trial against the tortfeasor. *Id.*

In *Broton v. Western Nat. Mut. Ins. Co.*, 428 N.W.2d 85, 89-90 (Minn. 1988), this Court recognized that a change in the No-Fault Act resulted in the closing of the "gap," and allowed an injured party to recover the difference between a settlement amount and the tortfeasor's liability limits from the UIM carrier. This Court acknowledged that the change increased the likelihood of "underinsurance becoming primary coverage, which would be contrary to the designed role of underinsurance and to the underwriting principles on which it is written." *Employers Mut. Companies v. Nordstrom*, 495 N.W.2d 855, 858 (Minn. 1993).

The procedure established in *Schmidt v. Clothier*, has undergone several adjustments since its inception. *See, Dohney v. Allstate Ins. Co.*, 632 N.W.2d 598 (Minn. 2001). However, the basic premise remains the same. When an injured party who might wish to seek UIM benefits reaches a tentative settlement with a tortfeasor, the injured party must notify the UIM carrier of the potential settlement. *Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d at 423. The UIM carrier can then protect its subrogation rights by either (1) substituting “a payment to the insured equal to the tentative settlement amount,” or (2) paying UIM benefits. *Id.* If the UIM carrier substitutes its check, that act prevents a settlement between the injured party and tortfeasor. *Schmidt*, at 258.

The UIM carrier cannot place restrictions on the substitution payment. *See e.g., Malmin v. Minnesota Mut. Fire & Cas. Co.*, 552 N.W.2d 723, 728 (Minn. 1996). In particular, the UIM carrier cannot substitute a loan agreement for an exhaustion clause and force a plaintiff to pursue the underlying suit between the plaintiff and tortfeasor to trial. *Washington v. Milbank*, 562 N.W.2d 801, 806 fn. 4 (Minn. 1997).

***b. The court of appeals’ decision in this case does not “force” an injured party to pursue its claim against the tortfeasor to trial.***

The Hos’ brief repeatedly claims that the court of appeals’ decision in this case forces an injured party to pursue litigation against the tortfeasor following a *Schmidt* substitution. *See A/C-R Brief*, at 12, 21, 23, 24, 25. The Hos’ desire to frame the issue in this way is understandable given the fact that this Court’s decisions in *Schmidt v. Clothier* and *Washington v. Milbank* establish that a UIM substitution cannot force an injured party to pursue its claim against a tortfeasor to trial. *Schmidt*, at 261; *Washington*, at 806

fn. 4. However, the Hos' repetition of their claim does not make it true, and the their brief fails to cite any language in the court of appeals' decision that supports their claim.

The court of appeals described the Hos' argument as a claim "that dismissal of a tortfeasor is required after a UIM carrier substitutes its draft for the proposed liability settlement amount." *See A/C-R Add.*, at 4. The court rejected that argument, noting that there was no authority that supported it. *See Id.* The court found that "the district court's decision is supported by the well-established principles outlined in *Schmidt* and its progeny." *See Id.* In short, "the proposed settlement agreement between Isaac and appellants was just that: a proposed agreement." *See Id.* Therefore, "there was no error in the district court's denial" of the Hos motion that they should be dismissed from the negligence lawsuit. *See Id.* The court of appeals was not presented with facts under which an injured party was forced to pursue a claim to trial against its will, the court did not address that question at any time, and the holding of the court does not require an injured party to pursue such a claim.

Significantly, Isaac has never argued that she was forced to litigate her claim. There are no orders or agreements in this case that required Isaac to litigate her claim. There is nothing that prevented Isaac from voluntarily dismissing her claim against the Hos. Even if such an order or agreement existed, the Hos would almost certainly lack standing to raise the issue. In their brief, the Hos have attempted to place themselves in the position of Isaac by replacing the word "insured" (meaning Isaac) with "settling parties" (meaning Isaac and the Hos) when they summarized this Court's statement in *Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d 421, 424 (Minn. 1997); *See A/CR Brief*, at

11. In truth, the Hos are attempting to limit the rights of Isaac. As the court of appeals noted, their argument has consistently been “that dismissal of a tortfeasor is required after a UIM carrier substitutes its draft for the proposed liability settlement amount.” *See A/C-R Add.*, at 4. The Hos’ attempt to present themselves as Isaac’s champion is, at best, inaccurate.

The decision of the court of appeals does not require injured parties to pursue litigation against tortfeasors following a *Schmidt* substitution. As a result, the decision does not conflict with this Court’s decisions in *Schmidt v. Clothier*, *Malmin v. Minnesota Mut. Fire & Cas. Co.*, 552 N.W.2d 723, or *Washington v. Milbank*, 562 N.W.2d 801. Therefore, this Court should affirm the court of appeals’ decision.

***c. The plain meaning of the words “tentative” and “prevent” support the court of appeals’ decision.***

In deciding this case, the court of appeals’ reviewed the applicable case law and noted that the decisions consistently described the agreement between a tortfeasor and an injured party who intends to make a UIM claim as “tentative.” *See A.C-R Add.*, at 3. The court also noted that a substitution payment acts to “prevent” the settlement. *See Id.* Based on those descriptions of the procedure, the court determined that “[c]ontrary to [the Hos’] arguments, the proposed settlement between them and Isaac was only tentative at the time that Auto Club was provided with the *Schmidt* notice; Auto Club’s draft substitution operated to prevent their settlement from becoming final.” *See Id.* The decision is consistent with existing case law and the plain meaning of the words “tentative” and “prevent.”

Beginning with *Schmidt*, this Court and the court of appeals have described the agreement between an injured party and tortfeasor as “tentative.” *See Schmidt*, at 263. In *American Family Mut. Ins. Co. v. Baumann*, 459 N.W.2d 923, 925 (Minn. 1990), this Court addressed the question of whether a letter sent to a UIM insurer before the injured party reached any agreement with the tortfeasor provided the UIM insurer with sufficient notice for that insurer to protect its interests. In reaching the determination that the letter was sufficient, this Court referred to the agreement as a “tentative settlement” and noted that the *Schmidt* decision did not describe “what constitutes a ‘tentative settlement agreement’ with any particularity.” *Id.*, at 925, 926. In *Gusk*, this Court again described agreements subject to substitution by a UIM carrier as “tentative.” *Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d at 423, 424.

Similarly, the statement that a UIM carrier’s substitution prevents a settlement between a tortfeasor and an injured party appears regularly in the cases that address the substitution procedure. In *Schmidt*, this Court noted in the syllabus that “[a]n insured must give the underinsurer written notice of a tentative settlement agreement, after which the underinsurer has 30 days in which to...prevent the settlement by exchanging its draft for the amount of the settlement offer.” *Schmidt*, at 258. In *Richards v. Milwaukee Ins. Co.*, 518 N.W.2d 26, 27 fn. 1 (Minn. 1994), this Court described the *Schmidt v. Clothier* procedure in a footnote and reiterated that an injured party can only settle the case with the tortfeasor if the UIM carrier does not substitute its check:

This notice allows the UIM carrier to preserve its subrogation rights by either paying the UIM benefits or by substituting its draft for that of the tortfeasor's liability insurer. If the UIM carrier does not

substitute its draft within 30 days, the claimant is free to settle with the defendant, execute a general release, and still pursue a claim for UIM benefits.

Later, this Court wrote, “*Schmidt v. Clothier* substitutions, by their very nature, prevent settlements between insureds and tortfeasors.” *Gusk*, at 424. Similarly, in *Ruddy v. State Farm Mut. Auto Ins. Co.*, 596 N.W.2d 679, 684 (Minn. App. 1999), this Court noted that the UIM carrier could have substituted its check “thereby preventing the settlement” between the plaintiff and tortfeasor. More recently, this Court noted that, under the procedure in *Schmidt*, a UIM insurer “can object to the settlement and prevent an insured from settling the claim.” *Van Kampen v. Waseca Mut. Ins. Co.*, 754 N.W.2d 578 (Minn. App. 2008).

In response to the summaries provided by these cases, the Hos rely on the third footnote in this Court’s decision in *Washington v. Milbank*, 562 N.W.2d 801 (Minn. 1997). As the court of appeals noted, the *Washington* decision focused on “Milbank’s assertion that under *Nordstrom*, a UIM claimant must first obtain a judgment against the tortfeasor or reach a settlement at least equal to the tortfeasor’s liability limits.” *See A/C-R Add.*, at 4. The footnote provides a two-sentence summary of the impact of a substitution:

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.

*Id.* at 806 fn. 3.

In isolation, the footnote certainly provides some support for the Hos' position. However, it seems unlikely that this short summary was intended to replace the numerous decision that discuss the *Schmidt v. Clothier* procedure at length. In addition, the brief summary in the *Washington* footnote says that the UIM insurer retains a subrogation right against the tortfeasor's *insurance company*. *Schmidt* allows a UIM carrier to proceed directly against the tortfeasor to recover either from the remaining liability limits of the tortfeasor's insurer, or from the personal assets of the tortfeasor. *Schmidt*, at 263; *Illinois Farmers Ins. Co. v. Nash*, 651 N.W.2d 205, 207 (Minn. App. 2002) (Where the respondent UIM carrier paid underinsurance benefits to an insured, "in equity, respondent became entitled to pursue [the insured's] right to recover the amount of that payment from appellant [tortfeasor], i.e., to subrogate."). If the Hos argued that a UIM carrier could not pursue a subrogation action against a tortfeasor, the statement in the *Washington* footnote would clearly be insufficient to overcome the plain language of *Schmidt* and other cases which confirm that the UIM carrier has a right of subrogation against the tortfeasor. The footnote provides some support for the Hos' position in this case, but it should not trump the plain language of other decisions by this Court and the court of appeals.

Unless they are defined elsewhere, words and phrases should be given their plain meaning. See *i.e. Mutual Service Cas. Ins. Co. v. Wilson Tp.*, 603 N.W.2d 151, 154 (Minn. App. 1999) (addressing the phrase "in the business of" which appeared in an insurance contract); *Chapman v. Commissioner of Revenue*, 651 N.W.2d 825, 831 (Minn.

2002) (“In construing the meaning and scope of a statute, the words of the statute govern and are given their common and approved usage.”). Merriam-Webster defines “tentative” as “not fully worked out or developed.” *Merriam-Webster Online Dictionary* (visited December 16, 2011) <<http://www.merriam-webster.com/dictionary/tentative>>. The definition of “prevent” is “to deprive of power or hope of acting or succeeding; to keep from happening or existing.” *Merriam-Webster Online Dictionary* (visited December 16, 2011) <<http://www.merriam-webster.com/dictionary/prevent>>.

In short, case law consistently describes the agreement between a tortfeasor and an injured party who intends to pursue UIM benefits as an agreement that is not fully worked out, and says that the UIM carrier can keep the settlement from happening or existing. The parties can avoid this situation by contracting outside of *Schmidt*. *Schulte v. LeClaire*, 2000 WL 16302 (Minn. App. Jan 11, 2000); *See* AA, at 183-87. However, if the parties do not contract outside of *Schmidt*, the settlement agreement is tentative and the UIM carrier can prevent the settlement. In affirming the district court, the court of appeals applied the plain meaning of the words “tentative” and “prevent.” That portion of the decision follows established case law and should be affirmed.

#### *d. Summary*

The substitution procedure described in *Schmidt* protects injured parties by allowing them to recover payment for their damages in a timely fashion without placing any other restrictions on their rights. In particular, a UIM substitution cannot force an injured party to either pursue its claim against a tortfeasor, or dismiss its claim against that tortfeasor. The Hos’ make repeated and unsupported claims that the court of

appeals' decision in this case forces an injured party who to litigate its claim against a tortfeasor following a UIM substitution. That is not an accurate description of the decision in this case. In its decision, the court of appeals applied standard definitions to phrases that appear throughout *Schmidt* and its progeny and concluded that there is no authority that requires an injured party to dismiss its claim against the tortfeasor following a substitution. This Court should affirm that part of the court of appeals' decision.

### 3. Related decisions

The district court found guidance in the description of how other district courts had handled similar situations. See A/C-R Add., at 18-19. The court of appeals also found guidance from some of those decisions. See *Id.*, at 4. There are three cases in question:

- In *Traver v. Farm Bureau Mut. Ins. Co.*, 418 N.W.2d 727, 729 (Minn. App. 1988), the tortfeasor's insurance company offered its policy limits and the injured party's UIM insurer substituted its check. The injured party did not dismiss the suit following the substitution, and the original suit between the injured party and tortfeasor proceeded to trial. *Id.*
- In *Stewart v. Anderson*, 478 N.W.2d 527 (Minn. App. 1991), the injured party's UIM carrier substituted its check. *Id.* at 528. The suit continued following that substitution. *Id.*
- In *Husfeldt v. Willmsen*, 434 N.W.2d 480, 481 (Minn. App. 1989), the defendant argued that a substitution check finalized the settlement between

the injured party and tortfeasor. The defendant filed a motion to dismiss, but the district court denied the motion. *Id.*

None of the defendants in *Traver*, *Stewart* or *Husfeldt* raised the issue of whether a UIM substitution requires dismissal of the original suit on appeal. Therefore, none of these cases hold that an injured party has a right to proceed to trial following a UIM carrier's substitution payment, and none of them hold that an injured party must dismiss its claim against a tortfeasor. However, they provide examples of how attorneys and judges of district court interpreted *Schmidt* and found that a UIM substitution does not require dismissal of the original suit. In this case, the district court and court of appeals found these cases to be persuasive in the absence of any cases holding that a plaintiff must dismiss its case when the UIM carrier substitutes its check.

**4. The decision by the court of appeals satisfies the policy concerns raised in *Schmidt* and will not discourage settlement or increase litigation.**

The purpose of UIM benefits is to compensate an injured party for damages that exceed the tortfeasor's liability limits. *Dohney v. Allstate Ins. Co.*, 632 N.W.2d 598, 601 (Minn. 2001). In addressing issues related to UIM coverage, the Legislature and courts have sought to find a balance between competing interests. *See: Dohney*, 632 N.W.2d 598. As discussed above, there is tension between the No Fault Act and assuring that an injured party pursues the best settlement available from the tortfeasor. *Schmidt*, 338 N.W.2d at 260-61. After the "gap" closed, this Court acknowledged that elimination of the "gap" increased the likelihood of "underinsurance becoming primary coverage, which would be contrary to the designed role of underinsurance and to the underwriting

principles on which it is written.” *Employers Mut. Companies v. Nordstrom*, 495 N.W.2d 855, 858 (Minn. 1993).

In short, there is an ongoing balance between several policy goals which include: (1) providing the insured with timely and adequate benefits, (2) holding the tortfeasor properly liable for any damages he or she caused, (3) protecting the UIM carrier from becoming primary insurance, and (4) easing the burden of litigation.

The Hos focus only on the burden of litigation. They argue that allowing an injured party’s suit against a tortfeasor to continue after the UIM carrier substitutes its check would frustrate the sound public policy supporting settlement of lawsuits. However, the court of appeals’ decision will not have a negative impact on settlements and, even if the lawsuit between Isaac and the Hos had been dismissed, one or more lawsuits involving the same parties litigating the same issues would have taken its place.

The Hos reassert their claim that the decision by the court of appeals requires an injured party to maintain its suit against a tortfeasor following a *Schmidt* substitution. As discussed above, that is not the holding or impact of the decision in this case. Based on this faulty assertion, the Hos argue that injured parties will be less likely to settle their claims with tortfeasors. Again, the court of appeals’ decision has not broken any new ground. Since the decision does not mark a change in the law, it will not result in a change in settlements.

If this decision has any impact on settlement negotiations, it will serve as a reminder that tortfeasors and their insurers should not be able to obtain bargain basement settlements on the assumption that a UIM insurer will also offer to settle the case. That

scenario, which effectively converts a UIM insurer to a primary insurer, could have taken place in this case. The proposed settlement in this case was for \$10,660 of a \$50,000 policy. A settlement for 21% of the tortfeasor's liability policy begs the question of whether the tortfeasor was underinsured. *See: Royal-Milbank Ins. Co. v. Busse*, 474 N.W.2d 441 (Minn. App. 1991). If Auto Club had offered to contribute to a settlement in this case which totaled less than \$50,000, they would have been acting as a primary insurer.

In addition, a settlement for such a low amount establishes that there is a significant amount of coverage that remains available under the tortfeasor's liability policy. Remaining liability coverage is one of the reasons cited in *Schmidt* for which a UIM insurer would want to substitute its check and pursue a subrogation action. *Schmidt*, at 263. Had the Court dismissed the Hos from this suit, Isaac had already indicated an intent to pursue a UIM claim. *See AA*, at 37-38. Auto Club would have likely denied that claim and either joined the Hos as third-party defendants, or pursued the Hos in a third action after that suit. *See Singh v. State Farm Mut. Auto Ins. Co.*, 523 N.W.2d 348, 349 (Minn. App. 1994); *Commercial Union Ins. Co. v. Minnesota School Bd. Ass'n*, 600 N.W.2d 475 (Minn. App. 1999). The likely outcome would have been one or more trials involving the same parties and the same issues.

Here, a jury has already listened to the evidence and determined both damages and liability. *See AA*, at 140-42. There was nothing that limited any party's ability to prevent evidence or make arguments to that jury.

As discussed above, the policy goals surrounding the *Schmidt-Clothier* procedure include: (1) providing the insured with timely and adequate benefits, (2) holding the tortfeasor properly liable for any damages he or she caused, (3) protecting the UIM carrier from becoming primary insurance, and (4) easing the burden of litigation. *See e.g., Nordstrom*, 495 N.W.2d at 858; *Schmidt*, 338 N.W.2d at 260-61. In this case, the plaintiff, Isaac, received early payments which partially reimbursed her for her damages, and ultimately received a verdict that fully reimburses her. The trial proceedings determined the amount of damage caused by the tortfeasor, and required the tortfeasor to pay those damages. The UIM carrier was not required to become a primary insurer. Finally, the Court resolved this case in a single lawsuit, instead of allowing it to turn into two or three suits. The procedure employed by the Court eased the burden of litigation. Therefore, the procedure used by the district court satisfied all of the policy considerations.

### C. SUMMARY

No cases hold that an injured party must dismiss a suit against the tortfeasor following a *Schmidt* substitution. The court of appeals followed the guidance of multiple cases that say the agreement between the injured party and tortfeasor is tentative, and that a substitution prevents a settlement. The decision is consistent with existing case law and properly balances the policy concerns described in those cases. Therefore, this Court should affirm the court of appeals' decision on this issue.

**IV. THE COURT OF APPEALS' DECISION THAT AUTO CLUB CANNOT RECOVER THE AMOUNT IT PAID TO PROTECT ITS SUBROGATION INTERESTS IS CONTRARY TO ESTABLISHED LAW.**

Under the procedure established in *Schmidt*, a UIM insurer wishing to protect its subrogation rights “may either substitute a payment to the insured equal to the tentative settlement amount, or pay out underinsurance benefits owed the insured.” *Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d at 423. Either procedure protects a UIM carrier’s subrogation rights. *Id.* There are no decisions holding that the UIM carrier’s substitution pursuant to *Schmidt* is insufficient to establish the UIM carrier’s subrogation rights.

Despite the clear direction from *Schmidt* and its progeny, the court of appeals reversed the decision of the district court in this case and found that Auto Club forfeited its substitution payment because a jury determined that the Hos were not underinsured. In reaching that decision, the court of appeals did not address the guidance of this Court, relied almost exclusively on a misapplication of this Court’s decision in *Gusk v. Farm Bureau Mut. Ins.*, relied in part on a section of this Court’s decision in *Schmidt v. Clothier* which was taken out of context, and created an unworkable arrangement. In an attempt to support the court of appeals’ decision, the Hos change a key word in a quotation from this Court’s decision in *Schmidt*, rely exclusively on unrelated cases, and present a situation in which they would not pay for the damages they caused. Application of this Court’s earlier decisions and a fair weighing of the equities shows that Auto Club is entitled to its subrogation claim, the court of appeals’ decision should be reversed, and the district court’s judgment in Auto Club’s favor should be reinstated.

**A. THE APPROPRIATE STANDARD OF REVIEW IS *DE NOVO*.**

The question of whether a party has a subrogation right is a question of law subject to *de novo* review. *Suchy v. Illinois Farmers Ins. Co.*, 574 N.W.2d 93, 95 (Minn. App. 1998).

**B. A SUBSTITUTION PURSUANT TO *SCHMIDT V. CLOTHIER* IS SUFFICIENT TO ESTABLISH A UIM CARRIER'S SUBROGATION RIGHTS.**

Minnesota recognizes the existence of equitable subrogation. *Commercial Union Ins. Co. v. Minnesota School Bd. Ass'n.*, 600 N.W.2d 475, 478 (Minn. App. 1999). Equitable subrogation is a common law right that seeks to compel the payment of a debt by one who ought to pay it. *Id.* In *Schmidt*, this Court explained that, in cases like this, “the equities to be balanced are those between the underinsurer, which has paid benefits, and the underinsured tortfeasor, who has not paid for the damages he or she has caused. Between these two parties, the equities balance in favor of the underinsurer.” *Schmidt*, 338 N.W.2d at 262-63. The *Schmidt* decision noted that the right of subrogation only comes into existence “after the insurer has paid benefits to its insured.” *Id.*, at 261. In seeking the appropriate balance between competing interests, this Court created the substitution process, determining that when a UIM carrier substituted its payment in the amount of the tentative settlement, “the underinsurer's payment would protect its subrogation rights to the extent of the payment.” *Id.*, at 263. That is, a UIM carrier's substitution of its own check in an amount equal to a tentative settlement protected the UIM carrier's subrogation rights in the same way that payment of UIM benefits would

protect those rights. The *Schmidt* decision notes that both of these options are available to the UIM carrier. *Id.*, at 263.

*Schmidt* does not require anything else to preserve a subrogation right. A UIM carrier has two options to preserve its subrogation rights: “the underinsurer may either substitute a payment to the insured equal to the tentative settlement amount, or pay out underinsurance benefits owed the insured.” *Gusk v. Farm Bureau Mut. Ins.*, 559 N.W.2d at 423.

A UIM carrier may elect to pay UIM benefits to protect its subrogation interest where the carrier believes that a plaintiff’s damages exceed the tortfeasor’s policy limits. *American Family Mut. Ins. Co. v. Baumann*, 459 N.W.2d 923, 925 (Minn. 1990). However, where there is a dispute about whether a plaintiff is underinsured, the underinsurer can substitute its draft in the amount of the tentative settlement:

If the parties could not agree on the *existence* or extent of underinsurance benefits due, the underinsurer could, if it deemed the right of subrogation of sufficient value, substitute its payment to the insured in an amount equal to the tentative settlement.

*Id.* (*emphasis added*). In short, the substitution procedure exists in part to allow a UIM carrier to protect its subrogation interests in cases where it does not believe the tortfeasor was underinsured.

Quite simply, “[i]f the UIM insurer wants to preserve its subrogation rights, it must pay the insured the amount of the proposed settlement.” *Van Kampen v. Waseca Mut. Ins. Co.*, 754 N.W.2d at 583. Put another way, after a UIM insurer substitutes its draft, “it could then take action against the tortfeasor and her insurer.” *Dohney v. Allstate*

*Ins. Co.*, 632 N.W.2d at 601. In *George v. Evenson*, 754 N.W.2d 335, 341 (Minn. 2008), this Court noted that the UIM insurer can substitute its check and the “as subrogee, maintain the insured’s tort action against the tortfeasor.”

There are no cases that require anything but a substitution payment for a UIM carrier to protect its subrogation rights.

**C. THE COURT OF APPEALS’ DECISION RELIES ON A MISAPPLICATION OF THIS COURT’S DECISION IN *GUSK*.**

In determining that Auto Club did not establish its subrogation rights when it substituted its draft in an amount equal to the tentative settlement between Isaac and the Hos, the court of appeals relied almost exclusively on this Court’s decision in *Gusk v. Farm Bureau Mut. Ins. Co.*, 559 N.W.2d 421 (Minn. 1997). A careful review of that decision shows that the facts support Auto Club’s position, and that the holding of that decision is not relevant to this case.

**1. The facts of *Gusk* show that a UIM carrier’s substitution protects its subrogation rights even where the tortfeasor is not underinsured.**

In *Gusk*, there was an accident that involved three parties. *Id.* at 422. *Gusk*, the injured party, was riding his bicycle. *Id.* An unidentified driver nearly hit him, and *Gusk* lost control of his bicycle. *Id.* A second car, driven by Spencer, then struck *Gusk*. *Id.*

Since the first driver could not be identified, *Gusk* brought suit against his own insurer, Farm Bureau, for a uninsured motorist (“UM”) claim, alleging that the unidentified driver was negligent. *Id.* *Gusk* also brought suit against Spencer, alleging that Spencer was negligent. *Id.* Spencer’s insurer offered to settle the case for \$80,000

of a \$100,000 policy. *Id.* Gusk's insurer, Farm Bureau substituted its check in an amount equal to the proposed settlement, and the case went to trial. *Id.*

At trial, the jury returned a total verdict of over \$122,000. *Id.* However, after adjustments for collateral source offsets, \$78,462.74 remained to be divided based on comparative fault. *Id.* The jury found that Gusk's share of fault was 20%, Spencer's share was 30%, and the unidentified driver's share was 50%. *Id.* In short, before adjustments for costs or interest, Spencer's share of the damages was \$23,528.02. The decision notes that the judgment for Spencer's share was \$29,815.85. *Id.*

The limits of Spencer's policy was \$100,000. *Id.* Since his share of damages was less than his policy limits, he was not underinsured. *See Richards v. Milwaukee Insurance Co.*, 518 N.W.2d 26, 28 (Minn. 1994). Indeed, after the reduction of collateral sources, the total of Gusk's damages, \$78,462.74, is less than the limits of Spencer's policy.

Despite the fact that Spencer was not underinsured, this Court noted that the final determination of fault left "Spencer's insurer liable to Farm Bureau as subrogee for \$29,815.85 (*i.e.*, Spencer's share of liability)." *Gusk*, at 422.

That is, the UIM carrier's substitution payment was sufficient to protect its subrogation interest. The fact that a jury determined that the tortfeasor was not underinsured did not defeat the UIM carrier's subrogation interest. The UIM carrier was permitted to recover an amount equal to the tortfeasor's share of damages plus costs and/or interest. Since that judgment was less than the tortfeasor's policy limits, the tortfeasor's insurer had to pay the amount of the judgment to the UIM insurer.

Those facts in *Gusk* are nearly identical to this case. Here, as in *Gusk*, the UIM carrier substituted its check. Here, as in *Gusk*, the jury determined that the tortfeasor was not underinsured. Here, as in *Gusk*, the district court recognized that the substitution payment preserved the UIM carrier's subrogation rights and entered a judgment in favor of the UIM carrier. See A/C-R Add., at 20, 25-27, 30-31. In its decision, the court of appeals reviewed the facts in *Gusk*. See *Id.*, at 4. However, their description does not include the fact that the district court entered judgment against the tortfeasor's insurer and in favor of the UIM carrier. See *Id.* Instead, as will be discussed below, the court of appeals relied on a section of *Gusk* that is irrelevant to this case. See *Id.* The facts of *Gusk* support the district court's order, and this Court should reverse the court of appeals and reinstate the district court's judgment in Auto Club's favor.

**2. The portion of *Gusk* cited by the court of appeals is irrelevant to this case.**

The court of appeals placed great weight on *Gusk*. See *Id.*, at 4-5. However, the section cited by the court of appeals is not relevant to this case. The issue examined by this Court in *Gusk* was that Farm Bureau sought to offset the amount it owed in UM benefits for the fault of the unidentified driver by the total amount it had paid in substitution to protect its subrogation interests. *Gusk*, at 422. The district court denied that argument, finding that the UIM substitution "had no effect on Farm Bureau's contractual duty to compensate Gusk for injuries attributable to the *uninsured* motorist." *Id.* The court of appeals agreed with that determination, finding that the obligations for underinsured and uninsured benefits were separate. *Id.*, at 423. Farm bureau sought

review of that decision. *Id.* This Court noted that the issue on appeal was “whether Farm Bureau’s *Schmidt v. Clothier* substitution, which protected its subrogation rights as an *underinsurer*, limits Farm Bureau’s contractual obligation to compensate Gusk for damages attributable to an *uninsured* motorist.” *Id.* This Court determined that a substitution payment “does not preclude recovery of uninsured motorist benefits after a jury verdict.” *Id.* at 425.

Unlike *Gusk*, this case does not involve multiple tortfeasors. Unlike *Gusk*, there is no judgment against Auto Club for UM benefits. Unlike *Gusk*, Auto Club did not pay more in its substitution than the tortfeasor’s share of fault. The issues raised on appeal in *Gusk* do not appear in this case.

However, the court of appeals selected two sentences from this Court’s decision and presented those sentences as support for its determination that Auto Club was not entitled to recover its substitution payment. *See A/C-R Add.*, at 4. In their entirety, those sentences say:

As an initial matter, it should be clear that a subsequent jury verdict less than the amount of a *Schmidt v. Clothier* substitution cannot justify a ‘refund’ of that substitution. A 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.

*Gusk*, at 424. In this case, the amount of Auto Club’s substitution was \$10,665. *See AA*, at 32. The jury’s verdict against the Hos exceeded \$40,000. *See Id.*, at 140-42. The verdict in this case was more than the amount of the substitution. Therefore, the portion of *Gusk* cited by the court of appeals is irrelevant to this case.

In fact, the section in *Gusk* cited by the court of appeals addressed this Court's concern that Farm Bureau would argue that it should be able to recover some amount from Gusk. This Court noted that it did not need to address that concern because Farm Bureau conceded "that a substitution provides a 'floor' for compensation to the insured." *Gusk*, at 424. In this case, Auto Club has not sought recovery of its substitution payment from Isaac. Indeed, since the verdict against the Hos exceeded the amount of the substitution payment, the concern this Court raised in *Gusk* does not appear here. This section of *Gusk* is not relevant to this case.

The court of appeals determined that a UIM insurer's subrogation rights only exist if the tortfeasor is underinsured. *See A/C-R Add.*, at 5. They further noted that a UIM insurer assumes some risk that it might have to forfeit a substitution payment. *See Id.* The two sentences the court of appeals cites from the *Gusk* decision do not support that determination. Those sentences concern a situation where the amount of the substitution exceeds the verdict against the tortfeasor, an issue unrelated to the issue presented in this case. Therefore, the court of appeals' reliance on those two sentences is misplaced.

### **3. Summary**

This Court's decision in *Gusk* does not address the issue presented in this case. However, this Court's summary of the facts in that case is instructive. That summary shows that, even where a jury determines that a tortfeasor is not underinsured, that tortfeasor and the tortfeasor's insurer are still liable to the UIM carrier for the lesser of (1) the amount of the substitution, or (2) the judgment against the tortfeasor. In this case, the

district court followed the procedure described in *Gusk* and awarded a judgment in Auto Club's favor. This Court should reinstate that judgment.

**D. THE COURT OF APPEALS DECISION RELIES ON A STATEMENT IN *SCHMIDT* THAT IS NOT PLACED IN ITS PROPER CONTEXT.**

In addition to its reliance on *Gusk*, the court of appeals supported its decision in this case by summarizing one sentence of this Court's decision in *Schmidt*. See A/C-R Add., at 5. That sentence notes that subrogation is a right "that comes into existence only after the insurer has paid benefits to its insured." *Schmidt v. Clothier*, 338 N.W.2d at 261. The court of appeals determined that this statement means "that if the tortfeasor is not underinsured, a UIM claim does not arise and the UIM carrier's right of subrogation does not mature." See A/C-R add., at 5. The court of appeals' interpretation of this single sentence in the *Schmidt* decision ignores the context of that statement.

In the section of *Schmidt* identified by the court of appeals, this Court discussed the manner in which a UIM insurer could preserve its subrogation rights. The decision determined that a UIM insurer had two options: it could pay UIM benefits, or it could substitute its draft in an amount equal to the tentative settlement between the injured party and the tortfeasor. *Schmidt*, at 263. *Schmidt* and its progeny treat these two options as equals. There is nothing in *Schmidt* that supports the court of appeals' holding. Rather, *Schmidt* stands for the proposition that a substitution is sufficient to preserve a UIM carrier's subrogation claim. Therefore, this Court should reverse the decision by the court of appeals and reinstate the judgment in Auto Club's favor.

**E. THE DECISION BY THE COURT OF APPEALS IN THIS CASE PLACES AN UNREASONABLE BURDEN ON UIM INSURERS.**

The court of appeals ruled that Auto Club assumed risk when it substituted its check. *See A/C-R Add.*, at 5. It is certainly true that a UIM insurer assumes the risk that a jury verdict will be less than the substitution amount. *Gusk*, at 424. However, the court of appeals' determination that a UIM carrier must prove to a jury that the tortfeasor was underinsured before the insurer's subrogation rights mature is unprecedented. *See A/C-R Add.*, at 5. This unprecedented requirement will create significant confusion regarding a UIM carrier's subrogation rights.

For example, a UIM carrier would be unable to recover any amount in subrogation following a judgment for \$.01 less than a tortfeasor's policy limits. The tortfeasor's insurer would not have to pay any amount in damages. That insurer would receive a windfall because, "contrary to the designed role of underinsurance and to the underwriting principles on which it is written," the UIM coverage would become primary. *Employers Mut. Companies v. Nordstrom*, 495 N.W.2d 855, 858 (Minn. 1993).

Conversely, if the judgment was for \$.01 more than the tortfeasor's policy limits, it is not clear whether the UIM carrier would be able to recover \$.01 (the amount by which the tortfeasor was underinsured) or the entire amount of its *Schmidt* substitution. The decision puts UIM carriers in the position of arguing to a jury that the plaintiff's damages exceeded the tortfeasor's liability limits, but does not give any guidance on the actual effect of a verdict that exceeds those limits. The court of appeals' decision creates

an unworkable situation that places an unreasonable burden on UIM carriers. Therefore, this court should reverse that decision and reinstate the judgment in Auto Club's favor.

**F. THE HOS MISQUOTE THIS COURT'S DECISION IN *SCHMIDT* TO SUPPORT THEIR POSITION.**

In *Schmidt*, this Court determined that exhaustion clauses in an insurance contract are void because they are against the policies of the no-fault act. *Schmidt*, at 261.

Because the exhaustion clauses were not valid, this Court said:

The insured 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.

*Id.* This portion of the decision addressed when an insured could recover UIM benefits from his or her insurer.

The Hos present this sentence in a very different context. On page 33 of their brief, they print a sentence which they present as this quotation from *Schmidt*. However, in addition to adding emphasis to the word "exceed," the Hos change the words "The insured" to the word "underinsurer."

By misquoting this Court's decision in *Schmidt*, the Hos create support for their position where none actually exists. The Hos do not provide any context for their misquote. As noted above, the context would show that this Court was discussing the rights of insureds in this section of its decision. This section of *Schmidt*, as written by this Court, does not support the Hos' position.

**G. THE HOS DO NOT CITE ANY CASE LAW THAT SUPPORTS THEIR POSITION.**

With the exception of the quote they manufactured, the Hos cannot identify any case law that supports their proposition that a UIM carrier's subrogation rights do not mature unless the tortfeasor is underinsured.

The Hos seek support from the *Gusk* decision. They note that *Gusk* refers to a "potential right of subrogation." *Gusk*, at 424. They place emphasis on the word "potential," but ignore that the same decision describes the subrogation rights without referring to them as potential: "Farm Bureau's substitute payment protected a right of subrogation against Spencer as an *underinsured* motorist." *Id.* The Hos suggest that the right is potential because there has been no determination that the tortfeasor is underinsured at that time. The Hos offer no support for that interpretation. As discussed above, the description of the facts in *Gusk* shows that a UIM carrier has a subrogation interest after it makes its substitution payment, even where a later jury verdict determines that the tortfeasor was not underinsured. *Id.*, at 422. The *Gusk* decision supports the district court's ruling in this case.

The Hos next seek support from *Progressive Cas. Ins. Co. v. Kraayenbrink*, 370 N.W.2d 455 (Minn. App. 1985) *rev. den'd.* (Minn. Sept. 19, 1985). In the section from which they quote, the court of appeals was addressing a set-off provision under which Progressive would not pay UIM benefits if the tortfeasor's policy limits exceeded the UIM limits. *Id.*, at 460-61. The court of appeals noted that Progressive's UIM benefits were equal to the statutory minimum of liability coverage, meaning that, under the set-off

provision, Progressive would never have to pay UIM benefits. *Id.*, at 461. That issue is not relevant to this case, and the quotation presented by the Hos does not support their position.

The Hos next seek support from *Hedlund v. Citizens Sec. Mut. Ins. Co. of Red Wing*, 377 N.W.2d 460 (Minn. App. 1985). The quote the Hos isolate comes from a portion of *Hedlund* in which the court of appeals applied the *Schmidt* determination that an injured party could not recover the “gap” between a settlement amount and the tortfeasor’s policy limits. *Id.*, at 463. The legislature later closed this “gap.” *Broton v. Western Nat. Mut. Ins. Co.*, 428 N.W.2d 85, 89-90 (Minn. 1988). Therefore, the sentence quoted by the Hos is irrelevant to this case.

In *Richards v. Milwaukee Ins. Co.*, 518 N.W.2d 26, 28 (Minn. 1994), this Court clarified that a jury verdict must be reduced by the amount an injured party received in no-fault benefits before determining if the tortfeasor was underinsured. The case did not address any issue related to a *Schmidt* substitution. The Hos imply that this case supports the position that a UIM carrier has no basis for subrogation where the tortfeasor is not underinsured, but they cannot point to any portion of the case that actually supports their claim. Again, the *Richards* case is not relevant to the issues presented here.

The final case cited by the Hos is *Iowa Nat. Mut. Ins. Co. v. Liberty Mut. Ins. Co.*, 464 N.W.2d 564 (Minn. App. 1990) *rev. den’d* (March 15, 1991). That case deals with multiple construction subcontractors, not *Schmidt* substitutions. *Id.*, at 565. The decision does address subrogation rights and notes that subrogation “is an equitable doctrine which compels the ultimate payment of a debt by the one who, in justice and good

conscience, ought to pay it.” *Id.* The Hos cite this case for the proposition that a party that is not compelled to make a payment cannot later return to claim a subrogation right. They suggest that Auto Club was not compelled to make a payment here. However, it is well established in *Schmidt* and its progeny that a UIM carrier that fails to either pay UIM benefits or substitute its check in an amount equal to the tentative settlement forfeits its subrogation rights. *See Gusk*, 599 N.W.2d at 423. Therefore, since Auto Club clearly did not believe that the Hos were underinsured, Auto Club was compelled to substitute its check.

In summary, the Hos cannot identify any case law that says a *Schmidt* substitution is inadequate to preserve the UIM carrier’s subrogation rights. This Court should follow its previous decisions, find that Auto Club took the action needed to preserve its subrogation rights, reverse the court of appeals’ decision, and reinstate the judgment in Auto Club’s favor.

**H. UNDER THE POSITION ADOPTED BY THE HOS, THE TORTFEASORS IN THIS CASE WOULD NOT MAKE ANY PAYMENTS FOR THE DAMAGES THEY CAUSED.**

The Hos argue that Auto Club made a voluntary payment to Isaac, and that the payment is now forfeit because the Hos were not underinsured. *See A/C-R Brief*, at 34-35. That position is coupled with their argument that they should have been dismissed from the underlying action after Auto Club substituted its check in the amount of the tentative settlement between Isaac and the Hos. *See Id.* Taken together, these arguments combine to create a situation in which the tortfeasors, the Hos, would not pay any amount to Isaac for the damages they caused. Instead, the Hos expect Auto Club, Isaac’s insurer,

to reimburse Isaac for the damages the Hos caused. Their position is unreasonable and irresponsible.

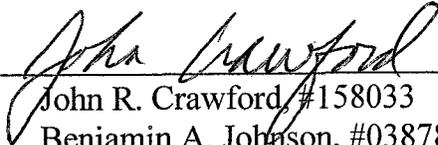
### CONCLUSION

The district court did not err in refusing to grant the Hos' motion for summary judgment or motion for judgment as a matter of law because the tentative settlement agreement between the Hos and Isaac contained a condition precedent which allowed Auto Club to prevent the settlement by substituting its draft, and the court of appeals properly upheld the district court's determination. However, it was unnecessary for Isaac and the Hos to expressly condition their tentative settlement on Auto Club's right to prevent the settlement because there is nothing in the *Schmidt v. Clothier* procedure that prevents an injured party from pursuing the underlying lawsuit once a UIM carrier substitutes its draft. Finally, the court of appeals' determination that Auto Club's subrogation rights did not arise because the Hos were not underinsured is not supported by the relevant case law and creates an unworkable situation that places an unreasonable burden on UIM carriers. Therefore, this Court should affirm the underlying rulings of the district court by affirming the court of appeals' decision that nothing compels an injured party to dismiss its suit against a tortfeasor following a *Schmidt* substitution, and reversing that court's determination that Auto Club's subrogation rights were contingent on a determination that the Hos were underinsured.

Respectfully submitted,

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Dated: December 21, 2011

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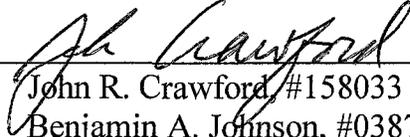
## CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing Brief of Respondent Auto Club conforms to Minn.R.Civ.App.P. 131.01, subd. 5(7), for a brief produced with a proportionally spaced font.

There are 12,793 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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