

NO. A04-1713

State of Minnesota
In Supreme Court

Jose Padilla, individually and as assignee of
Bloomington Steel and Supply Co.,

Appellant,

vs.

The Travelers Indemnity Company and
The Charter Oak Fire Insurance Company,

Respondents.

APPELLANT'S REPLY BRIEF

Charles D. Slane (#270374)
TERRY & SLANE P.L.L.C.
7760 France Avenue South
Suite 610
Bloomington, MN 55435
(952) 820-4605

Duana J. Grage (#277137)
Holly J. Tchida (#322994)
HINSHAW & CULBERTSON LLP
3100 Campbell Mithun Tower
222 South Ninth Street
Minneapolis, MN 55402
(612) 333-3434

Attorney for Appellant

Attorneys for Respondents

Charles A. Bird (#8345)
BIRD, JACOBSEN & STEVENS, P.C.
300 Third Avenue S.E.
Suite 305
Rochester, MN 55904
(507) 282-1503

*Attorney for Amicus Curiae
Minnesota Trial Lawyers Association*

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INTRODUCTION

Travelers' motion to strike MTLA's brief should not be considered.

Travelers fails to acknowledge that the issue of imputation of knowledge or intent is raised in the context of interpretation of an insurance policy and therefore requires application of the terms of the policy. Further, Travelers offers a significant control test which will lead to inconsistent results, erode the purpose of incorporation and render the terms of the policy meaningless.

I. MTLA'S BRIEF PROPERLY DISCUSSED THE ISSUE OF IMPUTATION IN THE CONTEXT OF THE TERMS OF THE POLICY.

MTLA properly briefed the issues in this case. When MTLA petitioned for permission to file a brief, they informed the Court that the issue of imputation had to be addressed in the context of interpretation of an insurance contract. Their brief does just that. It is Travelers' failure to honor the commitments made in their contract that is the crux of this dispute.

II. WHILE AGENCY PRINCIPLES GOVERN LIABILITY DETERMINATIONS, THE TERMS OF THE POLICY GOVERN THE COVERAGE ANALYSIS.

Travelers cites to numerous tort cases that establish that knowledge and intent of a corporation's employees is imputed to the corporation to determine the corporation's liability. That is a basic principle of agency law that is beyond dispute. 3 *W. Fletcher, Cyclopedia of the Law of Private Corporations*, §790 (rev. ed. 1999). Padilla does not ask the Court to disturb this basic principle.

Padilla simply suggests that coverage determinations require an application of the terms of the policy rather than agency principles.

It is a fundamental principle that an insurance contract is a matter of agreement between the parties, and the role of the court is to determine what the agreement is and to enforce it. *Fillmore v. Iowa Nat. Mut. Ins. Co.*, 344 N.W.2d 875 (Minn. App. 1984); *Grossman v. American Family Mut. Ins. Co.*, 461 N.W.2d 489 (Minn. App. 1990). In general, an insurer's liability is determined by the insurance contract as long as that insurance policy does not omit coverage required by law and does not violate applicable statutes. *Kelly v. State Farm Mut. Auto Ins. Co.*, 666 N.W.2d 328 (Minn. 2003). An examination of the arguments made by Travelers reveals their complete betrayal of the terms of their policy. Travelers has contorted the broadest possible coverage into a narrow promise. They fail to separate their insureds and focus the attention on the assault rather than the covered occurrence, negligent retention and supervision.

A. TRAVELERS FAILS TO SEPARATE THEIR INSURED.

When Travelers chose the separation of insureds clause, they made separate promises to each of their insureds, Reiners and Bloomington Steel. They promised to defend and indemnify each separate insured for legal liability caused by an occurrence unless that specific insured intended or expected the injury at the time of the occurrence.

Travelers claims that they have honored the separation of insureds clause and further that the trial court and the Court of Appeals also honored said clause.

See Respondent's Brief, p. 29. Yet, the trial court found that Travelers met their burden of proving the applicability of the exclusion given the intentional nature of **Reiners' assault**. *See Appellant's Appendix*, p. A144. emphasis added. Then, the Court of Appeals supports their opinion with the telling statement, "The identities of Reiners and Bloomington Steel are commingled." *Travelers v. Bloomington Steel*, 695 N.W.2d 408, 411 (Minn. Ct. App. 2005). Now, Travelers exclaims, "Reiners was Bloomington Steel. The two cannot be separated for the purposes of the issues before the Court". *See Respondent's Brief*, p. 36. This is a dishonest rendition of the final judgment in the tort action. Their inconsistency is revealing. Travelers understands that the only way they prevail is if the Court disregards the separation of insureds clause.

For that reason, Travelers asks the Court to impute intent or knowledge of one insured to another, in an attempt to void the separation of insureds clause. Any true separation of the insureds would require a separate examination of the conduct of each insured. Negligence claims would be examined separate from the assault claim. Imputation of intent or knowledge joins the insureds and examines both insureds conduct in combination with each other.

Other courts have determined that enforcing the terms of the policy is the better approach. *See e.g. King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185 (Tex. 2002); *Silverball Amusement, Inc. v. Utah Home Fire Ins. Co.*, 842 F. Supp. 1151 (W.D. Ark. 1994) *aff'd*, 33 F.3rd 1476 (8th Circ. 1994). These other jurisdictions looked to the terms of the contract and held that the separation of insureds clause was

controlling. Specifically, they held that the separation of insureds clause prohibited any imputation of intent, and that each insured's act, whether intentional or negligent, must be evaluated on its own merits. *King* at 191-92; *Silverball* at 1163.

Travelers attempts to distinguish those cases by asserting that they were duty to defend cases. While it is true that those cases address a duty to defend, that is a distinction without a difference. Whether there is a duty to defend is simply determined at an earlier time. At that earlier point in time all that is known of the claims is what is contained in the pleadings.

Here it is true that we must examine the actual facts to determine a duty to indemnify not solely the allegations of the complaint. *See Reinsurance Ass'n of Minnesota v. Timmer*, 641 N.W.2d 302 (Minn. Ct. App. 2002). The actual facts are undisputed. Bloomington Steel has legal liability for negligently supervising and retaining its employee Cecil Reiners. The district court denied Bloomington Steel's motion for summary judgment. The court held Bloomington Steel, a separate insured from Reiners, had a legal duty to exercise reasonable care in the supervision and retention of Reiners. *See Respondents' Appendix*, RA001-006. A final judgment for liability caused by the occurrence, negligence in supervision and retention, was entered against Bloomington Steel. Travelers voluntarily chose not to appeal that judgment. As a result, they may not now reargue the facts.

Travelers made a promise to both of their insureds. They committed that any interpretation of the policy would be performed separately for each insured.

Now, Travelers seeks to void the terms of the policy and join the conduct of both insureds. This is done for the express purpose of transgressing their contractual obligations. They have betrayed their commitment to separate their insureds. The Court should enforce Travelers' promise, and separate the insureds.

B. TRAVELERS FAILS TO PROPERLY IDENTIFY THE "OCCURRENCE".

Travelers argues that the "assault" was not an occurrence. *See Respondent's Brief*, p. 19. While they are correct that the assault was not an occurrence, they lose sight of the real issue: is there coverage for the occurrence of negligence in supervision and retention? By focusing attention on the assault rather than the negligent supervision and retention, Travelers improperly frames the issue.

As amicus MTLA points out, the focus must be on the occurrence that qualifies for coverage in the first place, the negligent supervision and retention. It was that occurrence that required Travelers to undertake the defense of the underlying tort action. *See Respondents' Appendix*, RA188-192. Only then can the analysis move on to the exclusion.

By focusing on the actual occurrence, the flaws in Travelers' arguments become clear. The exclusion must be applied at the time of the covered occurrence. At the time of the negligence in supervising and retaining the employee, Bloomington Steel did not control the risk of loss. The corporate insured made no purposeful decision to cause a loss. Bloomington Steel had no

intent to cause harm when they chose not to supervise Reiners. Travelers focuses on the assault to effectively change the time of applying the exclusion. They wish to view the occurrence at the time Reiners smashed Padilla's skull. Yet, the covered occurrence had taken place long before that fateful moment.

III. THE PROPOSED SIGNIFICANT CONTROL TEST WILL LEAD TO INCONSISTENT RESULTS, ERODE THE PURPOSE OF INCORPORATION AND RENDER POLICY LANGUAGE IRRELEVANT.

Travelers suggests that intent or knowledge of an agent should be imputed to the corporate insured only if the agent has significant control of the corporation. On the surface this suggestion seems reasonable. Upon closer examination it is clear Travelers' test would lead to inconsistent results because significant control would be difficult to define. Also, Travelers' test will erode the purpose of incorporation. Finally, the proposed test would nullify the agreement between the insurer and the insured.

A. THE SIGNIFICANT CONTROL TEST WILL LEAD TO INCONSISTENT RESULTS.

What is significant control? It is easy to say that a person that wholly owns a corporation exercises significant control, but where do you draw the line? What if there are two owners, or three? What if there are multiple stockholders but one person owns the great majority of the stock? What if a high level manager does not have an ownership interest, but he has authority to run the company?

The point is that there are an infinite number of possibilities to consider. There is little doubt that such a loosely defined test will lead courts to enforce the

equities of the particular case. That is not good policy. Litigants need to have a clear rule to apply.

B. THE SIGNIFICANT CONTROL TEST WILL ERODE THE PURPOSE OF INCORPORATION.

The significant control test will also erode the purpose of incorporation.

The basic purpose of incorporation is to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural persons who created it, who own it, or whom it employs. *United States v.*

Bestfoods, 118 S. Ct. 1876 (1998); *Burnet v. Clark*, 53 S. Ct. 207 (1932); 1 *W.*

Fletcher, *Cyclopedia of the Law of Private Corporations*, §§ 7, 14 (rev. ed. 1999).

A corporation is distinct from its owners/employees, a legally different entity with different rights and responsibilities due to its different legal status. *Cedrick*

Kushner Promotions v. Don King, 121 S. Ct. 2087 (2001) (Holding that a

corporation and its sole shareholder are separate entities under RICO, because incorporation's basic purpose is to create a distinct legal entity with different

rights, obligations, powers, and privileges different from those of the natural

individuals who created it, who own it, or whom it employs.) A closely held

corporation is still a corporation with all of the rights and limitations proscribed by the legislature. *Wessin v. Archives Corp.*, 592 N.W.2d 460, 466 (Minn. 1999).

Under the proposed significant control test, corporate status would be ignored. If the insurer could establish that the intentional act was committed by a person with "significant control", then the corporate status would be irrelevant.

The significant control test would destroy the very purpose of incorporation. No longer would incorporation allow you to be treated as a separate person from the business entity. Rather, the individual and the corporation would become one.

C. THE SIGNIFICANT CONTROL TEST WILL RENDER POLICY TERMS IRRELEVANT.

It is a fundamental principle that an insurance contract is a matter of agreement between the parties, and the role of the court is to determine what the agreement is and to enforce it. *Fillmore v. Iowa Nat. Mut. Ins. Co.*, 344 N.W.2d 875 (Minn. App. 1984); *Grossman v. American Family Mut. Ins. Co.*, 461 N.W.2d 489 (Minn. App. 1990). In general, an insurer's liability is determined by the insurance contract as long as that insurance policy does not omit coverage required by law and does not violate applicable statutes. *Kelly v. State Farm Mut. Auto Ins. Co.*, 666 N.W.2d 328 (Minn. 2003).

Insurers and their customers have always been free to negotiate the terms of their agreement. One of those terms has been whether to join or separate multiple insureds when interpreting the policy. If the Court adopts a significant control test, then those agreements are meaningless.

An example illustrates the problem. If a large company has an employee that intentionally causes injury to a customer, and that employee does not have significant control over the company, then, under the proposed significant control test, there should be coverage for the negligence in hiring, supervision and retention. What if the policy contained a joint obligations clause? Would the

terms of the policy be enforced to deny coverage or would the significant control test still be employed?

If we were to enforce the terms of the policy in order to deny coverage, then why would we ignore the terms of the policy when they would maintain coverage? The test should be consistent. That is accomplished by enforcing the terms of the policy to determine if intent or knowledge is imputed. If instead of a large corporation, the insured is a closely held company, and if instead of a joint obligations clause the policy contains a separation of insureds clause, then coverage should exist for the negligence of the company.

If we simply apply the terms of the policy to determine if intent or knowledge is imputed, then we allow both insurers and insureds to determine for themselves what coverages they wish to purchase or sell.

There is no doubt that because Reiners was the sole stockholder the issue is murky. It is easy for Travelers to scream that the two insureds are in reality one and the same. Yet, there is also no doubt that a corporation is a separate legal entity from its owners. *Cedrick Kushner Promotions v. Don King*, 121 S. Ct. 2087 (2001). Tempting as it may be to ignore the corporate status of Bloomington Steel, the Court should resist that temptation because bad facts make bad law. *See Dougherty v. State Farm Mutual Ins. Co.*, 699 N.W.2d 741, 746 (Minn. 2005).

The actual reason advanced to deny coverage to Bloomington Steel for their negligence in retention and supervision is the fact that Reiners is the sole

stockholder--bad facts. Employing a significant control test to determine whether to impute intent will make the terms of the insurance contract irrelevant--bad law.

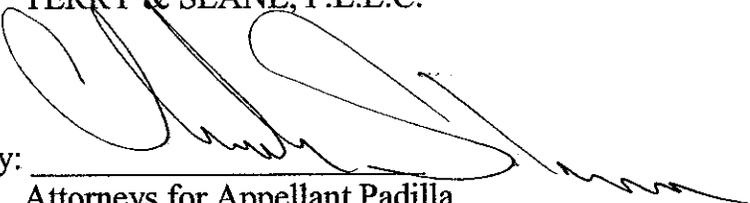
CONCLUSION

The Court should enforce the terms of the policy of insurance. Travelers made a commitment to separate their insureds when they interpreted the contract. True separation of the insureds means there can be no imputation of intent or knowledge from one insured to another.

Appellant respectfully requests that the judgment of the Court of Appeals and the trial court be reversed and that the case be remanded with instructions to enter judgment in favor of Padilla.

Respectfully submitted.

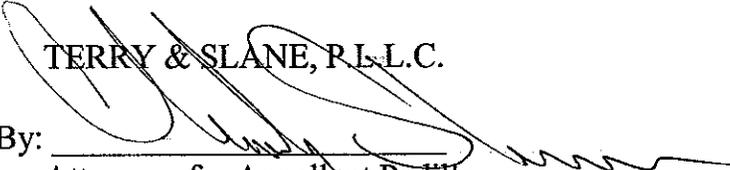
Dated: 9-23-05

TERRY & SLANE, P.L.L.C.

By: _____
Attorneys for Appellant Padilla
Charles D. Slane (#270374)
7760 France Avenue South
Suite 610
Bloomington, MN 55435
Phone: 952-832-5800
Fax: 952-835-8900

CERTIFICATION OF BRIEF LENGTH

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01 Subd. 1 and 3, for a brief produced with proportional font. The length of the brief is 230 lines and 2,428 words. This brief was prepared using Microsoft Word 2003.

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TERRY & SLANE, P.L.L.C.
By: _____
Attorneys for Appellant Padilla
Charles D. Slane (#270374)
7760 France Avenue South
Suite 610
Bloomington, MN 55435
Phone: 952-832-5800
Fax: 952-835-8900