

STATE OF MINNESOTA
IN SUPREME COURT

CASE NO. A10-1992

REMODELING DIMENSIONS, INC.,

Appellant,

vs.

INTEGRITY MUTUAL INSURANCE COMPANY,

Respondent,

RESPONDENT'S BRIEF

D. Clay Taylor (#204857)
Josiah R. Friction (#388823)
D. CLAY TAYLOR, P.A.
1300 Nicollet Mall
Suite 5002
Minneapolis, MN 55402
(612) 904-7376

*Attorneys for Appellant
Remodeling Dimensions, Inc.*

George C. Hottinger, #124485
Nicholas H. Jakobe, #0387840
ERSTAD & RIEMER, P.A.
200 Riverview Office Tower
8009 - 34th Avenue South
Minneapolis, MN 55425
(952) 896-3700

*Attorneys for Respondent
Integrity Mutual Insurance
Company*

TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

STATEMENT OF THE ISSUES 1

STATEMENT OF THE FACTS 2

STATEMENT OF THE CASE 11

ARGUMENT 15

I. Where Integrity Mutual properly afforded a defense and reserved its rights to challenge indemnity, the Court of Appeals correctly held that Integrity Mutual was not prevented from denying coverage on the ground that retained counsel did not timely request a reasoned arbitration award. 16

 A. Integrity Mutual provided a proper defense in the underlying arbitration.. 17

 B. In Minnesota, when coverage issues are not necessary or essential to the issue of an insured’s liability in the underlying action, they must be determined in a subsequent proceeding. Thus, Integrity Mutual was neither required to request coverage determinations nor would it have been bound by any unnecessary coverage determinations. 18

 C. Despite Appellant’s assertions, the denial of coverage was not based on the lack of a reasoned arbitration award, but on the claims made and evidence adduced at the underlying arbitration 21

II. Imposing upon insurers a duty to request and shape a reasoned arbitration award within the duty to defend, as suggested by Remodeling Dimensions, is unnecessary, would be contrary to well settled Minnesota law, and would significantly and negatively expand the duty to defend in Minnesota 23

 A. Absent a claim of bad faith or negligence, foreign case law relied upon by Remodeling Dimensions does not support expanding the duty to defend and conflicts with controlling Minnesota law 23

B.	Requiring retained counsel to attempt to fashion awards to address coverage would present an inherent conflict of interest and would be contrary to Minnesota case law controlling the tripartite relationship and the duty to defend	27
III.	The Court of Appeals correctly held that the policy did not afford coverage as a matter of law and Integrity Mutual is therefore entitled to summary judgment	33
A.	Remodeling Dimensions does not challenge the Court of Appeals' determinations regarding the "your work" exclusion on the addition or the failure to warn claim	33
B.	There were no claims at the underlying arbitration that Remodeling Dimensions' removal and re-installation of the master bedroom window caused any damage to other property	34
	CONCLUSION	42

TABLE OF AUTHORITIES

Cases

Aetna Cas. & Sur. Co. v Protective Nat. Ins. Co. of Omaha,
631 So.2d 305 (Fla. 3d D.C.A. 1993) 25

American Family Ins. Co. v. Goetzke,
416 N.W.2d 1 (Minn. Ct. App. 1987) 1, 17

American Family Ins. Co. v. Walser,
628 N.W.2d 605, 610 (Minn. 2001) 2, 36

Atlanta Intern. Ins. Co. v. Bell,
475 N.W. 2d 294 (Mich. 1994) 28

Attleboro Mfg. Co. v. Frankfort Marine, Acc. & Plate Glass Ins. Co.,
240 F. 573 (1st Cir. 1917) 24

Blakely v. American Employers' Ins. Co.,
424 F.2d 728 (5th Cir. 1970) 24

Boyd Bros. Transp. Co., Inc. v. Fireman's Fund Ins. Co.,
729 F.2d 1407, 1410 (11th Cir. 1984) 24

Brown v Lumbermens Mut. Cas. Co.,
90 N.C.App. 464, 369 S.E.2d 367, 371 (1988) 25

Brown v. State Auto. & Cas. Underwriters,
293 N.W.2d 822 (Minn. 1980) 1, 18-21, 23, 29

Continental Ins. Co. v Bayless & Roberts, Inc.,
608 P.2d 281 (Alaska 1980) 24

Crum v. Anchor Cas. Co.,
119 N.W.2d 703, 712 (Minn. 1963) 1, 27-28, 31-32

Day Masonry v. Independent Sch. Dist. No. 347,
781 N.W.2d 321, 330-32 (Minn. 2010) 34

<i>Feliberty v. Damon</i> , 72 N.Y.2d 112, 531 N.Y.S.2d 778, 527 N.E. 2d 261 (1988)	25
<i>Hauenstein v. Saint Paul-Mercury Indem. Co.</i> , 65 N.W.2d 122, 126 (Minn. 1954)	2, 36
<i>Horwitz v. Holabird & Root</i> , 212 Ill.2d 1, 287 Ill. Dec. 510, 816 N.E.2d 272 (2004)	25
<i>Ingersoll-Rand Equipment Corp. v. Transportation Ins. Co.</i> , 963 F.Supp 452 (M.D. Pa. 1997)	25
<i>Itasca Paper Co. v. Niagara Fire Ins. Co.</i> , 220 N.W.2d 425 (Minn. 1928).	1, 19
<i>Magnum Foods, Inc. v. Continental Casualty Co.</i> , 36 F.3d 1491 (10 th Cir. 1994)	18
<i>Merritt v. Reserve Insurance Co.</i> , 34 Cal.App.3d 858 (1973)	25
<i>Miller v. Shugart</i> , 316 N.W.2d 729 (Minn. 1982)	1, 27
<i>Mork v. Eureka-Security Fire & Marine Ins. Co.</i> , 42 N.W.2d 33 (Minn. 1950)	19
<i>Nat'l Farmers Union Prop. & Cas. Co. v. O'Daniel</i> , 329 F.2d 60 (9 th Cir. 1964)	24
<i>Pacific Employers Ins. Co. v. P.B. Hoidale Co.</i> , 789 F. Supp. 1117 (D. Kan. 1992)	24
<i>Pacific Indem. Co. v. Llinn</i> , 766 F.2d 754 (3 rd Cir. 1985)	18
<i>Pine Island Farmers Coop v. Erstad & Riemer, P.A.</i> , 649 N.W.2d 444 (Minn. 2002)	1, 28-32
<i>Prahn v. Rupp Const. Co.</i> , 277 N.W.2d 389 (Minn. 1979)	1, 17

<i>Quade v. Secura Ins.</i> , 792 N.W.2d 478 (Minn. Ct. App. 2011)	19-21
<i>Shelby Mutual Insurance Co. v. Kleman</i> , 255 N.W.2d 231 (Minn. 1977)	28
<i>Short v. Dairyland Ins. Co.</i> , 334 N.W.2d 384 (Minn. 1983)	1, 17, 26
<i>Smoot v. State Farm Mutual Automobile Insurance Co.</i> , 299 F.2d 525 (5 th Cir. 1962)	24-26
<i>State by Cooper v. French</i> , 460 N.W.2d 2 (Minn. 1990)	33
<i>STAR Centers, Inc. v. Faegre & Benson, L.L.P.</i> , 644 N.W.2d 72 (Minn. 2003)	33
<i>Stumpf v. Continental Cas. Co.</i> , 794 P.2d 1228 (Or. Ct. App. 1989)	24-26
<i>United States Fid. & Guar. Co. v. Louis A. Roser Co.</i> , 585 F.2d 932 (8 th Cir. 1978)	29-30

Secondary Authority

Allan D. Windt, <i>Insurance Claims and Disputes</i> 60 (3 rd ed. 1995)	17
Ronald E. Mallen & Jeffrey M. Smith, 4 Legal Malpractice § 29.16, at 325 (5 th ed. 2000)	29

STATEMENT OF ISSUES

- I. Where Integrity Mutual properly afforded a defense and reserved its rights to challenge indemnity, the Court of Appeals correctly held that Integrity Mutual was not prevented from denying coverage on the ground that retained counsel did not timely request a reasoned arbitration award.**

Pursuant to long-standing Minnesota law, Integrity Mutual met its duty to defend Remodeling Dimensions by providing Remodeling Dimensions with an attorney, paying for the attorney, and issuing a reservation of rights letter. The Court of Appeals correctly found that the trial court erred in grafting a duty to request a reasoned arbitration award onto this duty to defend.

Prahm v. Rupp Const. Co., 277 N.W.2d 389 (Minn. 1979).

American Family Ins. Co. v. Goetzke, 416 N.W.2d 1 (Minn. Ct. App. 1987).

Brown v. State Auto. & Cas. Underwriters, 293 N.W.2d 822 (Minn. 1980).

Itasca Paper Co. v. Niagara Fire Ins. Co., 220 N.W.2d 425 (Minn. 1928).

- II. Imposing upon insurers a duty to request and shape a reasoned arbitration award within the duty to defend, as suggested by Remodeling Dimensions, is unnecessary and would be contrary to well-settled Minnesota law and would significantly and negatively expand the duty to defend in Minnesota.**

Minnesota law provides that coverage issues not necessary for a determination in the underlying dispute are to be preserved for a determination by the district courts. Moreover, retained counsel has a duty of loyalty only to the insured. The Court of Appeals correctly held that requiring retained counsel to seek reasoned arbitration awards to assist with coverage determinations creates an inherent conflict of interest and is contrary to Minnesota law.

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

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

Crum v. Anchor Cas. Co., 119 N.W.2d 703 (Minn. 1963).

Pine Island Farmers Coop v. Erstad & Riemer, P.A., 649 N.W.2d 444 (Minn. 2002).

Brown v. State Auto. & Cas. Underwriters, 293 N.W.2d 822 (Minn. 1980).

III. The Court of Appeals correctly held that the policy did not afford coverage as a matter of law and Integrity Mutual is therefore entitled to summary judgment.

The Court of Appeals properly found that the record conclusively established there was no coverage for any of the claims made against Remodeling Dimensions at the underlying arbitration. Where the only claim relating to the original construction was a failure-to-warn claim, and there was no claim that any of Remodeling Dimension's work caused damage to other property, there was no coverage as a matter of law.

Hauenstein v. Saint Paul-Mercury Indem. Co., 65 N.W.2d 122 (Minn. 1954).
American Family Ins. Co. v. Walser, 628 N.W.2d 605 (Minn. 2001).

STATEMENT OF FACTS

A. Original Construction of Home

The residence that is the subject matter of this dispute is located at 1025 Lake Beach Drive, Shoreview, Minnesota, 55126 (hereinafter "Residence"). (Summary of Claims, AA125-132) It was originally constructed by LeGran Homes in August of 1993. (*Id.*) The Residence is a two-story wood frame construction with an exterior primarily consisting of Masonite siding. (*Id.*)

B. Work completed by Remodeling Dimensions

On January 23, 2003, Remodeling Dimensions entered into a construction agreement with Mike and Peggy Provenzano. (Pl. Compl. at 4, AA203; Construction Agreement, AA119-126) Under the contract, Remodeling Dimensions agreed to build a lower level flat roof addition on the east side of the Residence. (*Id.*) The addition

included a bedroom, entertainment room, 700 square foot flat roof, deck, and removal and installation of window trim around windows on the original section of the Residence.

(*Id.*) The agreement provided that any dispute between the parties would be submitted to binding arbitration with the American Arbitration Association. (Pl. Compl., AA203-210; Construction Agreement, AA119-126) During the addition project, the Provenzanos asked Remodeling Dimensions to remove a master bedroom window in the original portion of the house to allow the Provenzanos to move an armoire into the master bedroom. (Pl. Compl. at 5, AA204) The removal of the master bedroom window was not contemplated in the original construction agreement. (*Id.*) Remodeling Dimensions, however, agreed to complete the additional work, removing the window and reinstalling it for the Provenzanos. Remodeling Dimensions completed the construction addition project in June 2003. (*Id.* at 6, AA204)

C. Discovery of Alleged Defects at the Residence

In May of 2004, the Provenzanos had the original roof on the home replaced after it sustained storm damage. (Pl. Compl., AA203-211) Soon after the roof work was completed, the Provenzanos noticed siding damage, which they attributed to the roof work. In investigating the siding issues, the Provenzanos hired Private Eye to conduct a moisture inspection on July 16, 2004. (*Id.*) Private Eye submitted a report, which provides that caulk was missing in various areas and that siding was decayed in other locations. It further provided, “[r]epairs and/or modifications are needed to protect the

home from moisture.” (Remodeling Dimensions’ Response to Claims, AA133-140)

Despite the Private Eye report, which indicated damage in areas of the original construction, the Provenzanos did no further investigation until the Spring of 2006. (Pl. Compl. at 12, AA0205) At that time, the Provenzanos hired Northwest Diversified Services to investigate the moisture issues at the Residence. Northwest submitted a report opining that moisture was invading the structural parts of the Provenzanos’ home and causing substantial damage. (*Id.*)

D. Arbitration between the Provenzanos and Remodeling Dimensions

The Provenzanos commenced an arbitration proceeding against Remodeling Dimensions, claiming Remodeling Dimensions was liable for property damage associated with problems at the Residence based on two theories: (1) that there were defects in the addition project constructed by Remodeling Dimensions; and (2) that Remodeling Dimensions was negligent for failing to discover or inform the Provenzanos of defects with the original construction of the home. (Pl. Compl. at 13, AA205-206)¹ Total damages sought by the Provenzanos was \$264,100.00. (*Id.* at 14, AA206)

On January 22 and 23, 2007, an arbitration hearing was conducted before John G. Patterson, the arbitrator. (Pl. Compl. at 19, AA0005) Regarding the alleged defects in the addition project completed by Remodeling Dimensions, the owner of Remodeling Dimensions, Bruce Lyons, testified that Remodeling Dimensions does not use

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

subcontractors to complete any significant work. (Arb. Tr. at 484, RA109) Rather, Remodeling Dimensions completed all of the work on the addition, with the exceptions of electrical work, lighting fixtures, and painting – work unrelated to any of the moisture intrusion damages that were being claimed. (*Id.* at 484, 503-505, RA109-112) The only subcontractor retained at the project providing services in areas of alleged damages was a subcontractor retained for the limited purpose of installing the membrane on the flat roof. However, no deficiencies were identified relating specifically to the flat roof membrane. (*See* Claimant’s Summary of Claims, AA127)

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

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

[Pirjevec]: Yeah.

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

[Pirjevec]: Yes, sir.

[Arbitrator]: Is that basically the theory?

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

[Pirjevec]: Yeah

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

(Arb. Tr. at 396-97, RA106-107) Likewise, Mr. Fahlk, the Provenzanos other expert, testified that the allegations, as they related to the master bedroom window, were that Remodeling Dimensions failed to inform the Provenzanos of alleged defects:

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

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

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

(Arb. Tr. at 224-225, RA101-102)

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

I hereby find for Claimants as follows:

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

Total Award: \$51,000.00

(Arb. Award, AA196-197) After the Arbitration, Remodeling Dimensions requested further explanation of the Arbitration Award. (Ltr. of Arbitrator, AA198) However, as no request for an explanation of the Award was made in writing prior to the appointment of the arbitrator, the arbitrator declined to provide any further explanation of the award.

(Id.)

E. Remodeling Dimensions’ Insurance Policy

Remodeling Dimensions was insured under a Business Owners Policy (“BOP”) issued by Integrity Mutual from 2002 until 2005. (BOP, RA001-054)² The BOP issued by Integrity Mutual contains the following insuring clause:

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

b) This insurance applies:

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

²The business owners policy included in Remodeling Dimensions’ Appendix is incomplete, as it does not contain the Businessowners Liability Coverage Form, which was included as an exhibit at both the trial and appellate courts and is included in Respondent’s Appendix.

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

(BOP Liability Coverage form at 1, RA043)

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

...

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

(BOP Coverage form at 11-12, RA053-54)

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

This insurance does not apply to:

- k. “Property damage” to:
 - ...
 - (5) That particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.
- l. “Property damage” to “your product” arising out of it or any part of it.
- m. “Property damage” to “your work” arising out of it or any part of it and included in the “products–completed operations hazard” paragraph.
This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.
- n. “Property damage” to “impaired property” or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in “your product” or “your work”; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

(*Id.* at 4-5, RA046-47)

F. Reservation of Rights/Declination of Coverage

After receiving notice of the arbitration, Remodeling Dimensions submitted a claim to Integrity Mutual under the policy. (Pl. Compl. at 16, AA207) Integrity Mutual agreed to defend Remodeling Dimensions in the arbitration and hired an attorney for the defense. (*Id.* at 17, AA207) Integrity Mutual’s defense was subject to a reservation of rights of which Remodeling Dimensions was informed by letter of September 22, 2006. (Ltr. of Integrity Mutual, AA192-193) Prior to the arbitration, on January 10, 2007, Integrity Mutual sent a supplemental reservation of rights letter to Remodeling Dimensions, clarifying that it would be Remodeling Dimensions’ responsibility to fashion the arbitration in such a way to address the coverage issues.³ (Ltr. of Integrity Mutual, AA194-95) The letter clarified that upon the information at hand, coverage was precluded for both of the damage *claims* being made by the Provenzanos. (*Id.*) Moreover, Integrity was not a party to the underlying arbitration and had no right or ability to participate in the proceedings. Integrity Mutual asked Remodeling Dimensions

³Integrity Mutual was not a party to the underlying arbitration and had no right to participate in the proceedings.

to inform them of any subcontractor whose work allegedly is responsible for claimed damages. (*Id.*) The letter further provided,

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

(*Id.*)

No reasoned arbitration award was requested by Remodeling Dimensions or its attorney prior to the arbitration of January 22 and 23, 2007. (Ltr. of Arbitrator Patterson, AA198) However, at the time Integrity Mutual requested that Remodeling Dimensions procure a reasoned arbitration award, the deadline for requesting such an award under R-42(b) of the rules of the American Arbitration Association (“AAA”) had expired. (*Id.*)

After the Arbitration Award of February 23, 2007, Integrity Mutual issued a declination of coverage letter. (Ltr. of Integrity Mutual, AA200-202) In declining coverage for the award, Integrity Mutual explained that the damages claimed related directly to the work of Remodeling Dimensions. (*Id.*) Despite Remodeling Dimensions’ assertions, the declination letter was not based upon the lack of a reasoned arbitration award. Rather, the declination letter was based upon the claims made and evidence introduced at arbitration. The declination letter provided,

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

(*Id.*) The letter further clarified that any damages awarded related directly to the work of Remodeling Dimensions and that no damages were awarded for the Provenzanos' allegations of defects in the original construction. (*Id.*) Even if the damages awarded were based on defects in the original construction, no coverage would be afforded as the claim involves neither an occurrence nor any activity subject to the "products completed operations hazard." (*Id.*)

STATEMENT OF THE CASE

Remodeling Dimensions brought an action against Integrity Mutual on May 17, 2010 claiming Integrity Mutual breached its contract with Remodeling Dimensions. (Pl. Compl., AA203) In its Complaint against Integrity Mutual, Remodeling Dimensions alleged,

13. On or about July 14, 2006, the Provenzanos commenced an arbitration proceeding against Remodeling Dimensions, claiming Remodeling Dimensions was liable for the property damage associated with the moisture problems based on two different theories.
 - I. The Provenzanos claimed that there were a number of defects in the addition project

constructed by Remodeling Dimensions.

- II. That when Remodeling Dimensions removed the master bedroom window from the existing home, it should have recognized that the original construction (performed by another contractor years before) was defective, that water was invading the structure of the original home and causing damage to the home. The Provenzanos' claimed that Remodeling Dimensions' was negligent in its failure to recognize the situation and report it to the Provenzanos.

(*Id.* at 13, AA205-206)(emphasis added) Integrity Mutual and Remodeling Dimensions brought cross motions for summary judgment.

Integrity Mutual argued that the arbitration award was not important where no coverage was afforded for *any* of the *claims* for damages made by the Provenzanos at the underlying arbitration. Thus, Integrity Mutual argued that it was entitled to summary judgment. (*See* Memoranda of Integrity Mutual, AA229-41, 248-65, 274-80)

Remodeling Dimensions argued that it was entitled to summary judgment because the arbitration award did not specify the damages awarded and because ambiguity in the award should be construed against Integrity Mutual. Remodeling Dimensions further argued that Integrity Mutual should be liable for the award where the attorney for the insured did not request a reasoned arbitration award. (*See* Memoranda of Remodeling Dimensions, AA218-28, 242-47, 266-73)

On September 20, 2010, the trial court granted Remodeling Dimensions' motion for summary judgment. On October 6, 2010, the court entered judgment against Integrity

Mutual in the amount of \$49,000.00. (Order and Memorandum of Court, AD1-11) In reaching its decision, the court held that it could not determine if the damages awarded against Remodeling Dimensions were covered by its insurance policy. (*Id.*) Specifically, the court provided, “the Court cannot determine exactly what the damages were awarded for, why they were awarded and what the arbitrator considered when making the award.” (*Id.*) Rather than focusing on whether coverage existed for any of the claims at the underlying arbitration, the court focused its decision on a lack of a reasoned award from the arbitrator, finding that prior to the arbitration, no request was made of the arbitrator to issue a reasoned award. (*Id.*) The court concluded that the insurer should be responsible for the lack of a reasoned award and that failure to request this award, “represented a breach of the contract between the parties.” (*Id.*)

Integrity Mutual appealed. The Court of Appeals reversed the trial court and held that the trial court erred in determining retained counsel’s failure to timely request a reasoned arbitration award precluded a denial of coverage. (AD12-31) In so holding, the Court of Appeals found that the foreign cases relied upon by Remodeling Dimensions and the trial court were inapplicable and inconsistent with Minnesota law. (AD19-22) The Court of Appeals reasoned that since there had been no dual representation, the attorney retained by Integrity Mutual to defend Remodeling Dimensions owed no duty of care or loyalty to the insurer as a matter of law. (*Id.*) Conversely, the Court of Appeals held that the trial court erred in determining that Integrity Mutual was restrained from denying coverage premised solely upon defense counsel’s failure to request a reasoned arbitration

award. (*Id.*)

The Court of Appeals further held that the trial court erred because there was no genuine issue of material fact and Integrity Mutual was entitled to judgment as a matter of law. (AD22-31) The court held that under either of the claims asserted against Remodeling Dimensions at the underlying arbitration, coverage was precluded as a matter of law. (*Id.*) First, the claim that Remodeling Dimensions failed to identify and inform the homeowners of the alleged defects at the master bedroom window was not an “occurrence” as a matter of law. Thus, Remodeling Dimensions’ duty-to-inform claim was barred.⁴ (AD23) Second, the only other claims for damages were precluded by the business-risk doctrine as 1) there was no dispute that the addition work was Remodeling Dimensions’ product and that any damages to the addition were excluded by the business-risk doctrine and 2) Remodeling Dimensions’ contention that removal and re-installing a master bedroom window caused damage to the original portion of the home was without merit. The court provided,

[t]he flaw in RDI’s contention is that it is outside the scope of its pleadings. In its complaint, RDI never alleged that its liability to the Provenzanos arose from property damage to the original part of the home that was caused by its own defective work. Rather, RDI alleged that it was liable to the Provenzanos on only two theories: first, for its failure to inform the Provenzanos of pre-existing property damage to the original part of the home and, second, for its defective work on the addition. These are the only two theories for which RDI sought indemnification from Integrity Mutual.

⁴Remodeling Dimensions does not challenge the conclusion of the Court of Appeals that the failure to warn does not constitute an occurrence. (App. Br. at 15).

(AD29) Furthermore, the court provided, “RDI’s counsel conceded at oral argument in this court that the Provenzanos’ expert’s report stated that the only property damage to the original portion of the home arose from RDI’s failure to report pre-existing construction defects.” (*Id.*)

Thus, the Court of Appeals held that while the district court did not reach the issue of whether there existed coverage for the claims, the issues were nevertheless fully presented to the district court and Integrity Mutual was entitled to summary judgment.

ARGUMENT

The dispute at the heart of this appeal is how much power an insurer should have in controlling the defense of the litigation against its insured. Despite Remodeling Dimensions’ contentions, this is not a novel issue. While the specific facts of this case may be unique, Minnesota law already controls the duty to defend, the tripartite relationship, and the power of an underlying court or arbiter to make coverage decisions when they are unnecessary to the underlying action. Thus, this matter was properly determined by the appellate court by applying existing Minnesota law. Remodeling Dimensions does not seek a decision on a novel issue of law, but instead seeks to alter the current law. Ironically, the insured/Appellant now claims that the insurer should have more control than currently allowed under Minnesota law. This posture is the result of a flawed decision by the district court, which was based not upon an analysis of the coverage dispute but the perceived breach of the insurer’s duty to defend. The Court of Appeals, however, reversed the trial court’s determination, holding that there was no legal

basis for expanding the insurer's control. Indeed, increasing the control as proposed by Remodeling Dimensions is directly opposed to long-standing Minnesota law.

If the trial court had examined the record, as did the Appellate Court, the above-referenced determination relating to a duty to defend would have been unnecessary. As the Court of Appeals confirmed, Integrity Mutual's denial of indemnification was premised not upon a lack of a reasoned arbitration award, but upon the irrefutable fact that coverage did not exist for any of the claims made at the arbitration.

The Court of Appeals, therefore, properly reversed the trial court, holding there was no basis for the contention that Integrity Mutual breached the duty to defend. Nor was there support for the trial court's belief that the duty to defend includes requesting the issuance of a reasoned arbitration award. Since the record was unequivocal that there were no claims triggering the duty to indemnify, the Court of Appeals properly granted summary judgment in favor of Remodeling Dimensions.

I. Where Integrity Mutual properly afforded a defense and reserved its rights to challenge indemnity, the Court of Appeals correctly held that Integrity Mutual was not prevented from denying coverage on the ground that retained counsel did not timely request a reasoned arbitration award.

Despite Remodeling Dimensions' contentions, this is not a novel issue. The law in Minnesota relating to how insurers properly fulfill the duty to defend in the context of coverage disputes is clear. What is also clear is that Integrity Mutual complied with the law. Thus, the Appellate court properly held that Integrity Mutual was not precluded from denying coverage on the grounds that retained counsel did not timely request a

reasoned arbitration award.

A. Integrity Mutual provided a proper defense in the underlying arbitration.

The obligation to defend an insured is contractual in nature and is determined by the allegations in the complaint and the indemnity coverage of the policy. *Prahm v. Rupp Const. Co.*, 277 N.W.2d 389, 390 (Minn. 1979). If any part of a cause of action is arguably within the scope of coverage, an insurer must defend. *Id.* Once a liability insurer assumes the defense, it has the duty to exercise ‘good faith.’ *Short v. Dairyland Ins. Co.*, 334 N.W.2d 384, 387 (Minn. 1983). The company must also notify its insured of the company’s position regarding coverages afforded under the claim or suit. *Id.* Where there is some doubt whether coverage exists for the claim, the company must issue a reservation of rights letter. *American Family Ins. Co. v. Goetzke*, 416 N.W.2d 1 (Minn. Ct. App. 1987). The purpose of the reservation-of-rights letter is to enable insureds to make informed decisions as to whether they should take some action in order to protect their interests because of the existence of conflicts of interest between themselves and their insurers. Allan D. Windt, *Insurance Claims and Disputes* 60 (3rd ed. 1995). Thus, by retaining an attorney to represent Remodeling Dimensions in the underlying arbitration, paying for that attorney, and issuing reservation of rights letters, Integrity Mutual followed these precepts.

- B. In Minnesota, when coverage issues are not necessary or essential to the issue of an insured's liability in the underlying action, they must be determined in a subsequent proceeding. Thus, Integrity Mutual was neither required to request coverage determinations nor would it have been bound by any unnecessary coverage determinations.**

Remodeling Dimensions incorrectly states that this is a matter of first impression in Minnesota, arguing that the duty to defend should include the requirement that the insurer, through retained counsel, request a reasoned award to ensure that the award is also determinative of any coverage dispute. It relies on numerous foreign cases for the assertion that the duty to defend contains some duty to request a reasoned award. (App. Br. at 20, citing *Magnum Foods, Inc. v. Continental Casualty Co.*, 36 F.3d 1491, 1498-99 (10th Cir. 1994); *Pacific Indem. Co. v. Llinn*, 766 F.2d 754 (3rd Cir. 1985)). However, Minnesota case law deals directly with this issue. It provides that when coverage issues are not necessary or essential to the determination of an insured's liability in the underlying action, they must be resolved in a subsequent proceeding. Thus, Integrity Mutual properly provided a defense, and coverage issues were preserved for a later proceeding.

In Minnesota, when issues in a coverage dispute are not necessary or essential to the determination of an insured's liability in the underlying action, an insured and insurer must be given the opportunity to litigate the coverage issue. *Brown v. State Auto. & Cas. Underwriters*, 293 N.W.2d 822 (Minn. 1980). A determination of damages in an underlying action does not preclude the insurer from subsequently having the issue of whether the policy affords coverage later determined. *Itasca Paper Co. v. Niagara Fire*

Ins. Co., 220 N.W.2d 425, 427 (Minn. 1928). The Minnesota Court of Appeals, very recently, on January 11, 2011, confirmed this proposition, providing,

when an insurer claims that building damage is entirely attributable to conditions falling within a policy exclusion and not covered, it is within the district court's jurisdiction to determine the meaning and interpretation of the insurance contract and the application of coverage and exclusion clauses; these issues are not properly resolved by appraisers measuring the "amount of loss."

Quade v. Secura Ins., 792 N.W.2d 478, 479 (Minn. Ct. App. 2011). Liability under a policy is a judicial determination reserved for the courts. *Mork v. Eureka-Security Fire & Marine Ins. Co.*, 42 N.W.2d 33, 35 (Minn. 1950). Thus, in Minnesota, when an insurer provides a defense subject to a reservation of rights, issues relating to the duty to indemnify are preserved for findings by a district court.

This case is quite similar to *Brown*. 293 N.W.2d 822. In *Brown*, the insured attempted to leave an airport with a piece of luggage without first producing a baggage claim ticket. *Id.* at 823. The baggage clerk and Brown struggled with the bag; Brown injured his hand and struck the clerk. *Id.* Brown argued that he struck the clerk reflexively as a result of the cut on his hand. *Id.* The clerk filed a complaint and the insurer declined to defend on the basis that Brown's act fell under the intentional-acts exclusion. *Id.* The court awarded the clerk damages. The insurer refused to satisfy the judgment and Brown sought a declaratory judgment that the insurer breached its duties to defend and indemnify. *Id.* at 824. In the declaratory action, the district court granted summary judgment in the insured's favor. The district court held that the insurer

breached its duty to defend the insured because it failed to resolve the pleading's ambiguity in the insured's favor. The district court further held that the insurer breached its duty to indemnify the insured. Finally, the district court collaterally estopped the insurer from litigating the issue of intent to injure, resolved in the insured's favor in the underlying action and made it determinative on the issue of coverage afforded by the policy. The insurer appealed. *Id.* This Court reversed, determining that the issue of intent to injure was not a necessary or essential issue in the determination of Brown's liability to the clerk, and that the district court improperly denied the insurer the opportunity to litigate that issue. *Id.* at 825. The intent to injure was not required for the clerk to recover on an assault and battery theory; only that Brown intended to do the act of striking the clerk. *Id.* Therefore, the issue of intent to injure was not necessary or essential to the determination of Brown's liability. *Id.* But whether Brown intended to cause injury was an issue necessary and essential to the determination of whether the act fell under an intentional-acts exclusion in his insurance policy. *Id.*

Quade is also instructive. 792 N.W.2d 478. In *Quade*, the insured sought coverage for roofs that were damaged. A disagreement ensued as to whether the damage was attributable to a storm or a failure to maintain. The insurer argued that the appraisal clause of the policy was triggered and was the proper mechanism to employ in determining any obligation it had for the loss. However, the Court of Appeals observed:

[n]either the district court nor respondent identifies a fact question free of confusion with regard to legal issues such that if an appraisal occurred, the appraiser would not have to engage in accessing the law and interpreting the

policy. In the instant case, questions of fact regarding the effects of a storm and the effects of faulty maintenance are entangled with questions of law respecting the meaning of the contract, the interplay of coverage and exclusions, shifting burdens of proof, and causation, which must be addressed as a matter of law. Determining coverage, causation, and the operation of the exclusion provision requires the attention of the court in a fashion normal for causation questions. . . because this dispute goes to whether the loss suffered by appellants is covered by the policy, it can be resolved only by analysis and application of the policy by the district court.

Quade, 792 N.W.2d at 482. (emphasis added)

Here, the contract between the Provenzanos and Remodeling Dimensions dictated that those parties resolve their dispute in arbitration. Ultimately, the arbitrator only had to decide whether the Provenzanos were entitled to make a recovery from Remodeling Dimensions and the extent of that recovery. Thus, the four corners of the arbitration award is rather circumspect in detailing the nature of the recovery. The arbitrator had no need to go beyond the scope of this inquiry so as to render findings explaining whether under the policy an occurrence was involved, whether the occurrence was subject to the policy period that was in effect, whether the completed operations hazard of the policy applied, whether any damage allowed was subject to a policy exclusion, and so on. Thus, under *Brown*, even if a reasoned arbitration award was requested by defense counsel, it would not have been binding on any determination by Integrity Mutual.

C. Despite Remodeling Dimensions' assertions, the denial of coverage was not based on the lack of a reasoned arbitration award, but on the claims made and evidence adduced at the underlying arbitration.

After receiving notice of the claims from Remodeling Dimensions, and prior to the arbitration hearing, Integrity Mutual issued reservation of rights letters of September 22,

2006, and January 10, 2007. (AA192-93)⁵ After the Arbitration Award of February 23, 2007, Integrity Mutual issued a declination of coverage letter. (Ltr. of Integrity Mutual, AA200-202) In declining indemnification for the award, Integrity Mutual explained that a review of the arbitration transcript indicated that the damages claimed related directly to the work of Remodeling Dimensions. (*Id.*) The declination letter provided,

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

(*Id.*)(emphasis added) The declination was not based upon any failure to request or obtain a reasoned arbitration award. (*Id.*) Rather, it was based upon the complete absence of any covered claims being made at the arbitration. (*Id.*)

Thus, Integrity Mutual did not breach any duty to defend. The Court of Appeals correctly held that the trial court erred in basing its decision on only its examination of the award, rather than on a study of the claims made at the arbitration.

⁵While the second letter requested that a reasoned arbitration award be requested, there is nothing in the record indicating why a reasoned arbitration award was requested. While the insurer provided that it would not be bound by a vague award, the declination letter made it clear that the insurer based its coverage determination on the claims made at the arbitration rather than the award.

II. Imposing upon insurers a duty to request and shape a reasoned arbitration award within the duty to defend, as suggested by Remodeling Dimensions, is unnecessary, would be contrary to well settled Minnesota law, and would significantly and negatively expand the duty to defend in Minnesota.

Remodeling Dimensions invites this Court to follow law from foreign jurisdictions in a fashion that would graft upon the duty to defend the requirement to obtain a reasoned arbitration award. It argues that “[b]ound up in the exclusive right to investigate, settle or defend these claims was the corresponding obligation to ensure that a reasoned award was issued which would allow a coverage determination.” (Appellant’s Br. p. 21) Thus, Remodeling Dimensions not only argues that an insurer should have a duty to request an award, but they also have a duty to ensure that this award would allow for a coverage determination. However, such a contention is contrary to Minnesota law. First, coverage matters not necessary for a determination in the underlying action must be preserved for a later determination by the district courts. *Brown*, 293 N.W.2d at 825. Moreover, such a ruling would be opposed to Minnesota law governing the duty to defend and the tripartite relationship as it would greatly expand the duty to defend in Minnesota and create an inherent conflict of interest.

A. Absent a claim of bad faith or negligence, foreign case law relied upon by Remodeling Dimensions does not support expanding the duty to defend and conflicts with controlling Minnesota law.

Remodeling Dimensions relies upon foreign case law for the proposition that an insurer can be held liable for retained counsel’s decision not to obtain a reasoned arbitration award. However, the cases relied upon by Remodeling Dimensions only apply

to claims involving bad faith or attorney malpractice. Indeed, without claims of bad faith or negligent representation, the law from these foreign jurisdictions is clear: an insurer is not liable for the acts of retained counsel. Moreover, adopting the rule proposed by Remodeling Dimensions would directly conflict with Minnesota's bad faith laws.

Respondent relies heavily on two foreign cases in arguing that an insurer's duty to defend should contain within it a duty to ensure that a reasoned award is requested, *Stumpf v. Continental Cas. Co.*, 794 P.2d 1228 (Or. Ct. App. 1989) and *Smoot v. State Farm Mutual Automobile Insurance Co.*, 299 F.2d 525, 530 (5th Cir. 1962).⁶ However, these cases relate only to claims of bad faith of an insurer or malpractice of retained counsel. No such claims are not made here.⁷ Remodeling Dimensions cites no case law providing that in the absence of bad faith or negligent representation, an insurer can be held liable for retained counsel's decision not to request a reasoned arbitration award.

While other courts have recognized that liability may attach when the carrier has rejected a settlement offer in bad faith, these courts have declined to impose liability in

⁶Remodeling Dimensions also cites, by way of footnote, numerous other cases for the proposition that an insurer could be held liable for the actions of retained counsel. However, as with *Smoot* and *Stumpf*, all of the cases relied upon by Remodeling Dimensions relate to bad faith or attorney malpractice claims. See *Attleboro Mfg. Co. v. Frankfort Marine, Acc. & Plate Glass Ins. Co.*, 240 F. 573 (1st Cir. 1917); *Boyd Bros. Transp. Co., Inc. v. Fireman's Fund Ins. Co.* 729 F.2d 1407, 1410 (11th Cir. 1984); *Blakely v. American Employers' Ins. Co.*, 424 F.2d 728, 733-34 (5th Cir. 1970); *Nat'l Farmers Union Prop. & Cas. Co. v. O'Daniel*, 329 F.2d 60, 65-66 (9th Cir. 1964); *Pacific Employers Ins. Co. v. P.B. Hoidale Co.*, 789 F. Supp. 1117, 1122-23 (D. Kan. 1992).; *Continental Ins. Co. v Bayless & Roberts, Inc.* 608 P.2d 281 (Alaska 1980).

⁷Remodeling Dimensions expressly provides that this case does not involve an issue of attorney malpractice or allegations of bad faith. (App. Br. p. 24)

those instances when the carrier merely relied on the advice of those attorneys hired to defend the insurer.⁸ These courts reason that, absent bad faith, extending liability against an insurer for acts of retained counsel would impose an undue burden on insurers.

Rather, if there is an allegation of negligent conduct on the part of retained counsel, the remedy for this negligence is found in an action against counsel for malpractice and not in a suit against the insurer based upon vicarious liability or a breach of the duty to defend.

There are no claims of bad faith or attorney malpractice here. Nor is there any evidence of bad faith or attorney malpractice. In absence of any claims for bad faith or malpractice, there is no support for Remodeling Dimensions' proposition that an insurer should be liable for retained counsel's determination not to request a reasoned arbitration award. While inapposite, injecting the rules set forth in *Stumpf* and *Smoot*, even though

⁸ *Merritt v. Reserve Ins. Co.*, 34 Cal. App. 3d 858 (1973)(holding that negligent acts of trial counsel cannot be imputed upon an insurer in the absence of bad faith); *Feliberty v. Damon*, 72 N.Y.2d 112, 531 N.Y.S.2d 778, 527 N.E. 2d 261 (1988)(holding that the attorney retained to represent the insured was an independent contractor and imputing defense counsel's alleged negligence to the insurer would create an untenable situation where the insurer would be charged with responsibility for the day-to-day professional judgments made by counsel retained to represent the insurer); *Aetna Cas. & Sur. Co. v Protective Nat. Ins. Co. of Omaha*, 631 So.2d 305, (Fla. 3d D.C.A. 1993)(holding that the defendant insurance company was not vicariously liable for the negligence of the attorney it selected to defend the insured when the attorney failed to raise a meritorious statute of limitations defense in a personal injury suit.); *Ingersoll-Rand Equipment Corp., v. Transportation Ins. Co.*, 963 F.Supp 452, (M.D. Pa. 1997)(holding that insurer is not vicariously liable for negligence of attorneys retained to represent insured when attorneys negligently failed to raise statute of limitation defenses, as attorney is independent contractor); *Brown v Lumbermens Mut. Cas. Co.*, 90 N.C.App. 464, 369 S.E.2d 367, 371 (1988)(holding that alleged negligence of attorneys hired by automobile liability insurer to defend motorist in accident litigation could not be imputed to insurer, as attorney was independent contractor). *Horwitz v. Holabird & Root*, 212 Ill.2d 1, 287 Ill. Dec. 510, 816 N.E.2d 272 (2004)(holding that when an attorney acts pursuant to the exercise of independent professional judgment, he or she acts presumptively as an independent contractor).

no bad faith or attorney malpractice is alleged, would represent a radical departure from Minnesota law.

What is the nature of the rule or test that Remodeling Dimensions seeks? While it claims that Integrity Mutual should be liable because of the lack of a reasoned arbitration award, there is simply no basis for imposing such liability. In Minnesota, the only way to create insurer liability, where a defense has been provided, is upon a showing of bad faith on the part of the insurer. The test to determine when an insurer has acted in bad faith in failing to settle a lawsuit within policy limits is more rigorous:

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

Short v. Dairyland Ins. Co., 334 N.W.2d 384 (Minn. 1983). However, as there is no claim of bad faith here, the rules set forth in *Stoop* or *Stumpf* are inapplicable, as is the rule set forth in *Short*. Remodeling Dimensions, instead, seeks to create insurer liability even when there is no claim of attorney negligence or bad faith. There is no support for the adoption of such a rule of law.

Under such a rule, insurers could no longer rely on counsel to provide them information necessary to make a good faith evaluation. Insurers would instead have to protect themselves from the potential that counsel had improperly evaluated the case, failed to request a reasoned award, or took any action that the insured subsequently perceived as negatively affecting the outcome. This untenable position is exactly why

Minnesota and other jurisdictions have declined to adopt a rule that would impose liability against an insurer absent a showing of bad faith. Without a showing of bad faith, an insurer is not liable to the insurer for the actions or inactions of retained counsel.

B. Requiring retained counsel to attempt to fashion awards to address coverage would present an inherent conflict of interest and would be contrary to Minnesota case law controlling the tripartite relationship and the duty to defend.

Remodeling Dimensions argues that the insurer should have the duty, through retained counsel,⁹ not only to request, but also to ensure that a reasoned award clarifies issues for a later coverage determination. However, adopting such a rule would place retained counsel in an inherent conflict between the insurer and the insured anytime coverage was in question, as it was here. When a conflict of interest exists between the insurer and the insured, Minnesota law provides that defense counsel cannot represent the insurer. Thus, as a matter of law, when coverage is disputed, retained counsel's duty flows solely to the insured, and not to the insurer. In this instance, the insurer has no right to control the litigation and liability cannot attach because of determinations made by retained counsel.

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

⁹Minnesota is not a direct action state, so the only way an insurer could act to shape an award is through counsel retained to represent the insured.

(Minn. 1963). The court in *Crum* explained:

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

119 N.W.2d at 712. However, in the context of the tripartite relationship, there exists potential for conflicts in every case.

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

Pine Island Farmers Coop v. Erstad & Riemer, P.A., 649 N.W.2d 444, 449 (Minn. 2002)(citing *Atlanta Intern. Ins. Co. v. Bell*, 475 N.W. 2d 294, 297 (Mich. 1994)). While this potential for conflict exists in all insurance defense scenarios, the law is clear, an attorney retained by an insurer to defend its insured is not permitted to take a position adverse to the interest of his client. *Crum*, 119 N.W.2d at 712. This Court has noted, “[w]hen the interests of the insurer differ from those of the insured, defense counsel who represents both may find itself in what we have called ‘an exceedingly awkward position.’” *Pine Island*, 649 N.W.2d at 449 (citing *Shelby Mutual Insurance Co. v. Kleman*, 255 N.W.2d 231 (Minn. 1977)). These rules are in place because,

the nature of the tripartite relationship makes it likely that defense counsel will tend to favor the interests of the insurer at the expense of those of the insured. As one commentator has stated, defense counsel “may be tempted to help the client [the insurer] who pays the bills, who will send further business, and with whom long-standing personal relationships have developed.

Id. at 450. (citing *Ronald E. Mallen & Jeffrey M. Smith*, 4 *Legal Malpractice* § 29.16, at 325 (5th ed. 2000).

Even the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interests of his real client - the one who is paying his fee and from whom he hopes to receive future business - the insurance company.

Id. at 450-51 (citing *United States Fid. & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932, 938 n. 5 (8th Cir. 1978)). Thus, the duty of retained counsel runs solely to the insured and an attorney may not take a position that conflicts with the interests of the insured.

Remodeling Dimensions, however, claims that the Court of Appeals erred in relying on *Pine Island* and now advocates enlarging the duty to defend to include a duty that the insurer, through retained counsel, be charged with the responsibility of procuring and shaping arbitration awards, verdicts, and the like. It argues that this would enable later coverage determinations during a declaratory judgment action. However, this creates an impossible position for retained counsel and is contrary to Minnesota law governing the duty to defend. On one hand, counsel has a duty to represent his client, and it would therefore be his duty to obtain findings of fact that are favorable and that would ultimately provide coverage to his client, the insured.¹⁰ On the other hand, the insurer is paying for the attorney's services and is the one presumably with whom the attorney has a long standing relationship. Thus, if the duty to defend also entails requesting a reasoned

¹⁰Under *Brown*, 293 N.W.2d 822, an insurer or insured cannot be bound, in a declaratory action, by findings made at the underlying action that were not necessary for a determination in that action.

arbitration award when coverage is in dispute, there would arise inherent conflicts for retained counsel in every action in which coverage had been called into question.

In addition, *Remodeling Dimensions* does not explain how the award or verdict questions should have been framed. Is retained counsel supposed to submit the coverage questions to which the arbitrator must respond? If so, how can retained counsel shape those questions in a way that does not breach the duty of undivided loyalty to the insured? While counsel's duty flows only to the insured, a long-standing relationship with an insurer could influence the shaping of the award in such a way that favors the insurer's interests. What if defense counsel does not believe the special interrogatories to be in the insured's best interests? Must they be requested anyway? What if the special interrogatories conclusively establish that coverage is precluded? Is the attorney then liable for malpractice?

These are exactly the problematic scenarios that the current Minnesota law seeks to avoid. This Court has provided,

Even the most optimistic view of human nature requires us to realize that an attorney employed by an insurance company will slant his efforts, perhaps unconsciously, in the interests of his real client – the one who is paying his fee and from whom he hopes to receive future business – the insurance company.

Pine Island Farmers Coop, 649 N.W.2d at 450-51 (citing *United States Fid. & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932, 938 n. 5 (8th Cir. 1978)). Indeed, *Pine Island* is designed to prevent such a scenario from occurring. *Pine Island* creates a rule which ultimately protects insureds from having retained counsel make decisions that benefit the

insurer at the cost of the insured. This is accomplished by the rule that retained counsel has no duty to the insurer when a conflict exists. Thus, *Pine Island* provides that an insured and insurer cannot become co-clients of defense counsel where there exists a conflict of interest. *Pine Island*, 649 N.W.2d at 452. The *Pine Island* Court provided,

Based on these circumstances, we hold that, in the absence of a conflict of interest between the insured and the insurer, the insurer can become a co-client of defense counsel based upon a tort theory if two conditions are satisfied.

Id.(emphasis added) Absent an attorney client relationship between the insurer and retained counsel, the only duty of retained counsel flows solely to the insured. *Crum*, 119 N.W.2d at 712.

Applying this rule, the Court of Appeals correctly reasoned that under Remodeling Dimensions' argument – that Integrity Mutual should have required defense counsel to request a reasoned award – a conflict necessarily existed between Integrity Mutual and Remodeling Dimensions. (AD21) Thus, the Court of Appeals held that under *Pine Island*, as a matter of law, retained counsel had no duty to act for the insurer. (*Id.*)

Indeed, application of Remodeling Dimensions' proposed expansion of the duty to defend would obfuscate, if not obliterate, the rules set forth in *Pine Island* and *Crum* as it would effectively force counsel to act both for the insurer and the insured, despite an inherent conflict. Defense counsel could not place the rights of the insured first if also required to represent the insurer. In a situation such as this, the insurer's interest would include obtaining an award that precludes coverage. The insured, on the other hand,

would either oppose or want an award that somehow created coverage. These competing demands upon counsel cannot be reconciled.

Ultimately, Remodeling Dimensions' argument is not grounded in fact or logic. First, it presupposes that the lack of a reasoned arbitration award was the sole basis for the declination of coverage. There is no evidence supporting this contention. Second, it assumes that the insurer controlled the actions of defense counsel in the underlying arbitration.¹¹ However, there is absolutely no evidence in the record that Integrity Mutual directed or dictated how defense counsel was to protect Remodeling Dimensions relating to later coverage determinations.¹² Finally, if requesting a reasoned arbitration award can only assist the insurer, doing so would have been in direct conflict with the rights and interests of the insured and a violation of Minnesota law.

Adopting an expanded duty to defend, as suggested by Remodeling Dimensions, places retained counsel in an inherent conflict and this violates the rule set forth in *Crum* and *Pine Island*.

¹¹Remodeling Dimensions states, without any factual support, "Integrity hired Mr. Elliot and assumed exclusive control over the litigation and the defense of the claims brought by the Provenzanos." (App. Br. p. 21) There is no evidence in the record that Integrity controlled or dictated how Mr. Elliot was to best protect the insured in the underlying litigation.

¹²While Remodeling Dimensions argues that the Court of Appeals erred in finding that the record was devoid of any evidence of an attorney-client relationship between Integrity Mutual and retained counsel, this was mere dicta, as the court had already correctly determined that there could be no dual representation, as a matter of law, in instances where coverage was in dispute under *Pine Island*. Moreover, Remodeling Dimensions had the burden to establish a record at the trial court showing that an attorney-client relationship existed between the insurer and defense counsel. No such evidence was presented.

III. The Court of Appeals correctly held that the policy did not afford coverage as a matter of law and Integrity Mutual is therefore entitled to summary judgment.

The Court of Appeals correctly reviewed the trial court's summary judgment decision in determining that the trial court erred in its application of the law and that Integrity Mutual was therefore entitled to summary judgment.

The Court of Appeals must consider two questions on appeals from summary judgment. First, whether there are any genuine issues of material fact, and second, whether the lower court erred in its application of the law. *State by Cooper v. French*, 460 N.W.2d 2, 4 (Minn. 1990). The Court of Appeals reviews the district courts application of the law *de novo*. *STAR Centers, Inc. v. Faegre & Benson, L.L.P.*, 644 N.W.2d 72, 76-77 (Minn. 2003). The issues were fully briefed at the district court, there existed no genuine issue of material fact, and there existed no claims at the underlying arbitration for which coverage was afforded. The trial court simply erred in its application of the law. The Court of Appeals therefore correctly reversed the trial court in directing judgment in favor of Integrity Mutual.

A. Remodeling Dimensions does not challenge the Court of Appeals' determinations regarding the "your work" exclusion on the addition or the failure to warn claim.

As alleged by Remodeling Dimensions, the claims asserted by the Provenzanos at the underlying arbitration were twofold, (1) there were defects in the addition project constructed by Remodeling Dimensions, and (2) Remodeling Dimensions should have recognized that the original construction was defective so the Provenzanos could have

brought claims against the original builder, LeGran Homes. The Court of Appeals held that, as a matter of law, there existed no coverage for either of these claims.

Remodeling Dimensions does not challenge the Court of Appeals finding that the work of Remodeling Dimensions on the addition project is precluded by the “your work” exclusion in the policy. Moreover, Remodeling Dimensions concedes that the failure to recognize and repair an existing defect did not constitute an occurrence under the policy and no coverage could apply. (Appellant’s Br. at 15, n. 10, 11). Rather, the only issue for this appeal is Remodeling Dimensions’ assertion that it completed work on the master bedroom window causing damage to other property. There is simply no support for this contention and the Court of Appeals therefore correctly dismissed this claim.¹³

B. There were no claims at the underlying arbitration that Remodeling Dimensions’ removal and re-installation of the master bedroom window caused any damage to other property.

Remodeling Dimensions’ contention that it completed work on the master bedroom window that caused damage to other property is opposed to the specific language of its Complaint, the evidence adduced at the arbitration,¹⁴ and Remodeling

¹³As the issues of coverage and exclusions were fully briefed in the district court, the Court of Appeals, despite Remodeling Dimensions’ claims, did not exceed its jurisdiction in determining that no genuine issues of material fact existed and that the trial court erred in its application of law. The Court of Appeals was within its jurisdiction and rights in determining that Integrity Mutual was entitled to summary judgment. *Day Masonry v. Independent Sch. Dist.* No. 347, 781 N.W.2d 321, 330-32 (Minn. 2010)(considering statute-of-repose issue presented to the district court, even though district court did not decide issue).

¹⁴Remodeling Dimensions fails to identify or attach the transcript of the arbitration proceedings, which demonstrates that the only claim at the underlying arbitration relating to the master bedroom window was a failure to warn claim.

Dimensions' concession to the Court of Appeals (that the expert's report stated that the only property damage to the original portion of the home arose from RDI's failure to report or repair these pre-existing construction defects). Indeed, there is no evidence in the record indicating that there was an allegation that the work of Remodeling Dimensions, in removing and replacing the master bedroom window to facilitate moving an armoire, caused damage to the original construction.

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

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

b) This insurance applies:

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

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

(BOP Liability Coverage Form at 1, RA043).

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

...

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

(*Id.* at 11-12, RA053-54)

Under the BOP policy issued to Remodeling Dimensions, "Occurrence" is defined

as, “an accident including continuous or repeated exposure to substantially the same general harmful conditions.” (*Id.*) The policy does not define “accident.” However, the Minnesota Supreme Court stated that, an “accident, as a source and cause of damage to property, within the terms of an accident policy, is an unexpected, unforeseen, or undesigned happening or consequence from either a known or an unknown cause.” *Hauenstein v. Saint Paul-Mercury Indem. Co.*, 65 N.W.2d 122, 126 (Minn. 1954)(emphasis added). Because the policy does not provide its own definition of accident, then the *Hauenstein* definition applies. *American Family Ins. Co. v. Walser*, 628 N.W.2d 605, 610 (Minn. 2001). Thus, to be an accident under the policy, the work of Remodeling Dimensions must be both (1) a “source and cause of damage to property,” and (2) it must also cause “unexpected, unforeseen or undesigned happening or consequence.” Here, there is simply no claim that the work of remodeling dimensions caused any damage. Instead, the allegation was that the damage was caused by deficiencies in the original 1993 construction of the home.

The Court of Appeals properly determined that the only claim asserted at the underlying arbitration and in Remodeling Dimensions complaint, relating to the master bedroom window, was a failure to warn claim. There was no assertion in Remodeling Dimensions’ own complaint or evidence in the underlying arbitration that any claim was made that Remodeling Dimensions’ work on the master bedroom window caused damage to other property. As the Court of Appeals properly stated, Remodeling Dimensions conceded this at oral argument. Moreover, Remodeling Dimensions’ Complaint asserted,

in the relevant portions:

4. On or about January 23, 2003, Remodeling Dimensions entered into a construction agreement with Mike and Peggy Provenzano (the “Provenzanos”) whereby Remodeling Dimensions agreed to build a lower level, flat roof addition (“the addition project”) on to the east side of the Provenzanos’ home in Shoreview, Minnesota. Contained in the agreement was a provision that any dispute arising out of the parties’ relationship would be submitted to binding arbitration with the American Arbitration Association.

5. During the addition project, the Provenzanos asked Remodeling Dimensions to remove a master bedroom window in the original portion of the house to allow the Provenzanos to move an armoire into the master bedroom. The removal of the master bedroom window was not contemplated in the original construction agreement. Remodeling Dimensions agreed to the additional work; removed the window; and reinstalled it to accommodate the Provenzanos.

- ...

13. On or about July 14, 2006, the Provenzanos commenced an arbitration proceeding against Remodeling Dimensions, claiming Remodeling Dimensions was liable for the property damage associated with the moisture problems based on two different theories.
 - a. The Provenzanos claimed that there were a number of defects in the addition project constructed by Remodeling Dimensions.

 - b. That when Remodeling Dimensions removed the master bedroom window from the existing home, it should have recognized that the original construction (performed by another contractor years before) was defective, that water was invading the structure of the original home and causing damage to the home. The Provenzanos’ claimed that Remodeling Dimensions’ was negligent in its failure to recognize the situation and report it to the Provenzanos.

(Complaint of Remodeling Dimensions at 13, AA205-206)(emphasis added). The claims

at issue are those that the Provenzanos actually made. As the Complaint provides and as the Court of Appeals pointed out, Remodeling Dimensions never asserted any theory that the removal and reinstallation of the master bedroom window caused damage; because the Provenzanos made no such claim against Remodeling Dimensions nor did the Provenzanos proffer any evidence of such claims at the underlying arbitration.

Despite the contention of Remodeling Dimensions, the expert report of the Provenzanos did not opine that the work of Remodeling Dimensions caused damage. Rather, the expert report provides that the work previously completed by another contractor caused damage and that Remodeling Dimensions, upon removal of the window, should have discovered and reported this damage.

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

(Fahlk Report at 19, AA159) This finding in the report was supported by the arbitration testimony.

The expert for the Provenzanos testified that the alleged failure to discover problems with the original construction stemmed from Remodeling Dimensions' removal

of a bedroom window to facilitate the removal of an armoire. However, he did not claim that the Remodeling Dimensions' work caused these problems. Rather, he testified that Remodeling "would have learned" that the window had been installed improperly and that Remodeling Dimensions should have informed the Provenzanos of this issue. At the arbitration, he testified:

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

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

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

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

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

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

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

A: Yes, sir.

(Arb. Transcript at 221-225, RA098-102) This testimony demonstrates that the claim against Remodeling Dimensions was solely for its failure to inform the Provenzanos about the defects in the initial construction. The expert did not state that the failure to inform was a “source and cause” of the damage. Additionally, the arbitrator later asked for clarification from the Provenzanos’ expert and their attorney. The following testimony clarified the claims:

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

[Pirjevec]: Yeah.

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

[Pirjevec]: Yes, sir.

[Arbitrator]: Is that basically the theory?

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

[Pirjevec]: Yeah

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

(Arb. Transcript at 396-97, RA106-107)

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

Moreover, even if this event could somehow constitute an accident, there is no property damage stemming from either the failure to discover the defects or communicate the defects to the Provenzanos. The policy only applies to an "occurrence" which causes "property damage." "Property damage" is defined by the policy as, "physical injury to tangible property, including all resulting loss of use of that property". (BOP Liability Coverage Form at 11-12, RA053-054) The Provenzanos did not allege that property damage resulted from the failure of Remodeling Dimensions to discover the defects. Rather, the claim was clearly explained in the testimony,

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

[Pirjevec]: Yes, sir.

[Arbitrator]: Is that basically the theory?

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

(Arb. Transcript at 397-97, RA106-107) Thus, these are not covered damages under the policy.

There exists no support for Remodeling Dimensions' contention that any damage to the existing structure was caused by its work. Remodeling Dimensions' Complaint as well as the arbitration record conclusively establish that there was no claim made at the underlying arbitration, that the work of Remodeling Dimensions at the master bedroom window caused any damage which would have triggered coverage. The only claim made was that Remodeling Dimensions failed to discover damage created by others. As Remodeling Dimensions does not contest this finding, there can be no dispute that there exists no coverage as a matter of law.

CONCLUSION

Despite Remodeling Dimensions' contentions, this matter does not present a novel issue of law. Rather, the law is well-settled and was properly applied by the Court of Appeals. Adopting the rules or duty urged by Remodeling Dimensions would greatly alter and expand Minnesota's duty to defend and bad faith law. It would create inherent conflicts of interest between retained counsel and insureds. The Court of Appeals therefore properly concluded that the trial court erred in determining that retained counsel's failure to request a reasoned arbitration was a breach of the insurer's duty to defend.

The Court of Appeals also properly examined the claims made at the underlying arbitration in determining there were no claims that work of Remodeling Dimensions

caused damage to other property. Indeed, Remodeling Dimensions conceded as much at oral argument. Accordingly, this Court should dismiss the appeal and summarily affirm the Court of Appeals.

Respectfully Submitted,

ERSTAD & RIEMER, P.A.

Dated:

11-18-11

By:



George C. Hottinger, #124485

Nicholas H. Jakobe, #0387840

Attorneys for Respondent

Integrity Mutual Insurance Company

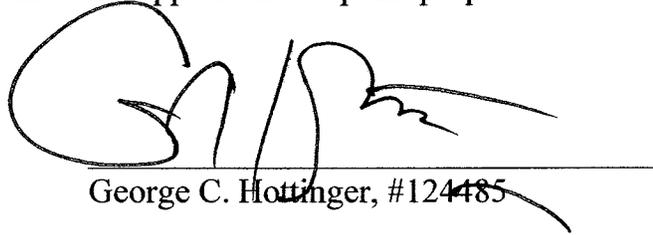
8009 - 34th Avenue South, Suite 200

Minneapolis, MN 55425

(952) 896-3700

CERTIFICATION OF COMPLIANCE WITH WORD COUNT LIMIT

This brief contains 11,645 words as confirmed by the Document Information Tool of Corel Word Perfect 9, which word-processing software was used to prepare this brief. This brief also complies with the typeface requirements of Rule 132.01 of the Minnesota Rules of Civil Appellate Procedure as the printed material appears in 13- point proportional font.



George C. Hottinger, #124485