

NO. A11-1376

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State of Minnesota
In Court of Appeals

Columbia Casualty Company, and
Continental Casualty Insurance Company,

Respondents,

v.

3M Company,

Appellant,

and

ACE American Insurance Company,

Respondents.

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STATEMENT OF THE ISSUE

1. **Do the allegations in 3M's Counterclaim and Cross-Claims against its insurers for breach of the implied covenant of good faith and fair dealing state a claim for relief under Minnesota law?**

The trial court dismissed the claims under Rule 12.02 of the Minnesota Rules of Civil Procedure.

Apposite Authorities:

In re Hennepin Cnty. 1986 Recycling Bond Lit., 540 N.W.2d 494 (Minn. 1995).

Larson v. Anchor Cas. Co., 249 Minn. 339, 82 N.W.2d 376 (1957).

Cargill, Inc. v. ACE American Ins. Co., 766 N.W.2d 58 (Minn. App. 2009), *aff'd on other grounds*, 784 N.W.2d 341 (Minn. 2010).

White Stone Partners, LP v. Piper Jaffray Cos., Inc., 978 F. Supp. 878 (D. Minn. 1997).

STATEMENT OF THE CASE AND OF THE FACTS

This case centers on the obligations of insurers in 3M's coverage program who have refused to perform their longstanding obligations relating to 3M's asbestos-related liabilities. 3M alleges that these insurers – plaintiffs Columbia Casualty Company and Continental Insurance Company (collectively “CNA”) and most of those that remain as defendants after the settlement dismissals of many that had been named by CNA – not only breached their contract obligations, but have taken affirmative steps to harm 3M. Among other things, they have acted to unjustifiably hinder 3M's performance of 3M's obligations under the insurance policies, and CNA has conjured up a dispute between 3M and other insurers where none would otherwise exist. 3M therefore responded to CNA's lawsuit (one that 3M had worked diligently to avoid) with allegations that these insurers have acted in breach of the implied covenant of good faith and fair dealing.

Minnesota law has long held that contracts include an implied obligation of good faith and fair dealing on the part of both contracting parties. *See, e.g., In re Hennepin Cnty. 1986 Recycling Bond Lit.*, 540 N.W.2d 494, 502 (Minn. 1995) (“*Hennepin County*”). With insurance contracts in particular, the insurer's obligation of good faith is an important protection for the policyholder. It permeates the insurer's contractual obligations throughout the investigation, defense and payment of claims. *See Larson v. Anchor Cas. Co.*, 249 Minn. 339, 349-50, 82 N.W.2d 376, 383 (1957). Conversely, as decided recently by this Court in *Cargill, Inc. v. ACE American Ins. Co.*, 766 N.W.2d 58 (Minn. App. 2009), *aff'd on other grounds*, 784 N.W.2d 341 (Minn. 2010), the implied

covenant can be applied *against* the policyholder. *Cargill* affirms, moreover, that the implied covenant is not a rigid, moribund doctrine, but rather one that depends for its application on the circumstances of each case and that permits a range of claims and remedies. In *Cargill*, breach of the covenant provided the basis for imposing on the policyholder specific terms of a loan receipt agreement designed to achieve an equitable allocation of costs among insurers. *Id.* at 64-66.

The respondent insurers (“Insurers”) moved under Rule 12 to dismiss Count III of 3M’s Counterclaim and Cross-Claims, which alleged breach of the implied covenant. The district court acknowledged misgivings on the issue but, in the end, granted their motions. It did so despite its obligations to assume 3M’s allegations are true and to give them the benefit of all favorable and reasonable inferences. The district court’s order incorrectly applied *Hennepin County and Wild v. Rarig*, 302 Minn. 419, 234 N.W.2d 775 (1975), and failed to heed the implications of *Cargill*. It would allow insurers to actively work against an insured’s interests – harming its defense of claims, scuttling its dealings with other insurers – with impunity. It suggests, in effect, a transformation of the implied covenant of good faith, long recognized as a protection for policyholders, into a doctrine that applies only *against* policyholders. This is not the law in Minnesota. “[G]ood faith and fair dealing are . . . correlative obligations between the insurer and the insured.” *Larson*, 249 Minn. at 351-353, 82 N.W.2d at 384-85.

A. History and status of this coverage litigation

Over the past 30 years, 3M has spent more than \$750 million defending and settling hundreds of thousands of claims alleging injurious exposure to asbestos, silica

and other dusts. (AA 61.) The claims have arisen out of the alleged use of masks and respirators or asbestos-containing products allegedly designed, manufactured, or sold by 3M. (AA 63.) The claims are generally referred to as the Mask/ACP Claims. 3M continues to receive new claims and incur costs to defend and resolve them.

Since the 1950s (when many of the injurious exposures allegedly began), 3M has purchased large quantities of product liability insurance from many different domestic and foreign insurers. (AA 64.) 3M has worked with its insurers since the Mask/ACP Claims activity began to obtain reimbursements and resolve any coverage and allocation issues. (AA 62.) Many insurers have settled with 3M with regard to the Mask/ACP Claims. (*Id.*) Others have provided funding on an interim basis without final coverage resolution. (*Id.*) The total reimbursements to 3M from settlements and interim funding now exceed \$500 million. (*Id.*)

Unfortunately CNA and some other insurers still refuse to pay. In January 2007, CNA brought this action for declaratory judgment in Hennepin County District Court, naming 3M and 63 of its other insurers (many of whom had already settled with 3M) as defendants. 3M promptly obtained a transfer of the case to the asbestos court in Ramsey County District Court. CNA challenged the transfer, which was affirmed by the Supreme Court in June 2008. *See In re Continental Cas. Co. v. 3M Company*, 749 N.W.2d 797 (Minn. 2008).

On remand, CNA filed an Amended Complaint, but not until April 2009, after the asbestos judge had reached his announced retirement date and the case had been re-assigned to asbestos judge Dale B. Lindman. (AA 53.) In the meantime, all parties had

agreed there would be no responsive pleadings filed until service of an Amended Complaint.

In the Amended Complaint, CNA named a different collection of 3M insurers as defendants, this time 72 in number. (AA 17-35.) By the end of June 2009, 3M had procured the stipulated dismissal of 47 of these defendant insurers because they had already settled with 3M. (*See, e.g.*, Stipulation and Notice of Voluntary Dismissal, June 30, 2009.)

Later in 2009, the district court granted 3M's motion to dismiss allegations relating to underlying claims against 3M other than the Mask/ACP Claims and thereby limit the coverage litigation to the Mask/ACP Claims. (Order filed December 28, 2009.) Case management and scheduling orders have been issued, and document productions have been substantial. No depositions have yet been taken or scheduled. The case is set for trial in September 2012.

B. Allegations by CNA and the Other Respondents

In its Amended Complaint, CNA seeks a declaration on which policies are triggered, how 3M's defense and settlement costs should be allocated to insurers and whether "pollution" or other policy exclusions apply. (AA 51-52.) It also alleges that 3M gave late notice of claims, failed to cooperate with CNA and made voluntary payments to settle Mask/ACP Claims. (AA 40-44.) Finally, it claims that 3M expected or intended to injure the individuals who asserted the underlying claims against 3M. (AA 39-40, 45.)

Having been sued by CNA regarding their respective obligations to 3M and the manner of apportioning their liabilities among each other, the defendant insurers answered the Amended Complaint with laundry lists of affirmative defenses. The typical insurer pleading includes defenses numbering in the twenties or thirties. Several insurers assert more than 40 defenses. (*See, e.g.*, Defendant Evanston Insurance Company's Answer, Affirmative Defenses Counterclaim and Cross-Claim, June 31, 2009.)

C. 3M's Implied-Covenant Allegations

In its own responsive pleading, 3M seeks declaratory judgment in Count I and alleges breach of contract in Count II. (AA 8-10, 12-13.) 3M allege generally that the Insurers are obligated to defend and/or reimburse 3M for its costs and expenses in defending the Mask/ACP Claims, and to provide indemnity to 3M for all sums it becomes obligated to pay as a result of the Mask/ACP Claims. (*Id.* ¶¶ 38-41, 62-65.) 3M further alleges that it provided timely notice to the Insurers and complied with all of its other obligations under the policies and made demands for defense and indemnity. (*Id.* ¶¶ 39, 42-43, 63, 66-67.) Despite these demands, the Insurers refused to honor their coverage obligations and have failed to defend or reimburse 3M for its defense costs, and failed to indemnify 3M for settlements resolving these claims. (*Id.* ¶¶ 44, 68.) The Insurers have therefore breached their insurance contracts with 3M, and 3M has been damaged. (*Id.* ¶¶ 46-51, 70-75.)

In Count III of its Counterclaim (against CNA) and of its Cross-Claims (against the other Respondent Insurers), 3M also alleges breach of the implied covenant of good faith and fair dealing. (AA 10-11, 14-15.) This is the claim at issue in this appeal. The

allegations for this claim are not based upon the express terms of the insurance contracts and are not duplicative of the breach-of-contract claim.

Specifically, 3M alleges that, rather than honoring their obligations, the Insurers have engaged in a course of conduct with the purpose of:

- Evading for as long as possible their obligations to 3M for defense and indemnity in connection with the Mask/ACP Claims; and
- Gaining leverage on 3M in order to extract compromises or concessions so that the Insurers may avoid defending and indemnifying 3M to the full extent of their obligations under their policies.

(*Id.* ¶¶ 54, 77.) Through their conduct, the Insurers have also, among other things:

- Placed their interests above 3M's;
- Engaged in deceptive and bad faith conduct toward 3M;
- Acted contrary to 3M's justified and reasonable expectations;
- Engaged in subterfuges and evasions, lack of diligence, and rejection of performance for unstated and unsupported reasons; and
- Taken or participated in actions designed to harm 3M generally and in 3M's defense of the Mask/ACP Claims.

(*Id.* ¶¶ 55, 78.)

In addition, with respect to CNA in particular, 3M alleges that CNA *knew* it was obligated to provide 3M with a defense and/or to reimburse 3M for its defense and to indemnify 3M for liability in connection with the Mask/ACP Claims. (*Id.* ¶ 53.) 3M further alleges that CNA conjured up a pretended dispute, attempted to create undue delay and cost to 3M, and attempted to create confrontation and dispute between 3M and its other insurers where none would otherwise exist. (*Id.* ¶¶ 54, 55.) With respect to all

of these allegations, 3M alleges that the Insurers' wrongful conduct has caused 3M substantial damage. (¶¶ 57, 80.)

It is instructive to describe certain of 3M's allegations in more detail.

1. The Insurers rejected 3M performance for unstated and unsupported reasons.

The nature of this claim is self-evident. Once an insurer receives notice of a claim, it has an implied duty to investigate coverage, respond promptly, and most importantly, articulate the information it needs from the policyholder to make a coverage decision.¹ Here the Insurers went long periods of time without identifying the additional information they claimed to need, yet later relied on their own silence as a basis for asserting that 3M failed to provide the allegedly needed information. (*See, e.g.*, AA 40-44.) In so doing, the Insurers have frustrated 3M's own performance and thereby breached the implied covenant of good faith and fair dealing.

2. The Insurers conjured up a pretended dispute.

Even though 3M maintains that it gave timely and adequate notice and information, the Insurers lay in the weeds and did not request participation in the defense, or input into settlements. Instead, in most cases, the claim notices and updates were met by stony silence or occasional blanket reservation-of-rights letters. These same Insurers now claim they were not permitted to participate or associate in the defense or consent to

¹ *See also* Minn. Stat. § 72A.201, subd. 4(3) (making it an unfair settlement practice for the insurer to fail, unless provided otherwise by law or in the policy, to complete its investigation and inform the insured or claimant of acceptance or denial of a claim within 30 business days after receipt of notification of claim unless the investigation cannot be reasonably completed within that time).

settlements, which, they claim, comprised a breach by 3M of its own contract obligations. (*See, e.g.*, AA 40-44.) Again, their duplicitous stance hindered the ability of 3M to meet contract obligations the Insurers later claimed were violated.

3. CNA has attempted to create confrontation and dispute between 3M and its other insurers where none would otherwise exist.

The other insurers of 3M (who are no longer parties to this case) have honored their obligations, working with 3M to resolve any coverage and allocation issues. (AA 62.) 3M alleges, however, that CNA has interfered with potential settlements and with good-faith relationships between 3M and other of its insurers both before and during this lawsuit. (AA 10.) Such conduct comprises a breach of the implied covenant.

4. The Insurers have taken or participated in actions designed to harm 3M generally and in its defense of the Mask/ACP Claims.

3M alleges that the Insurers – CNA in particular – have intentionally disclosed to the underlying plaintiffs the Insurers’ contentions that 3M somehow expected or intended to injure the underlying plaintiffs who have made claims against 3M. (AA 10-11.) 3M further alleges that the Insurers have made such poisonous disclosures with the deliberate purpose of forcing 3M to settle with them for a fraction of what the Insurers are obligated to pay. (*Id.*)

D. The Motions to Dismiss and Subsequent Proceedings.

CNA moved to dismiss Count III of 3M’s Counterclaim under Minn. R. Civ. P. 12.02(f). (*See* AA 69.) The other respondents joined in that motion and moved in a companion motion to dismiss Count III of 3M’s Cross-Claims. The motions were argued

after this Court's decision in *Cargill* and while the Supreme Court's review was pending. (See November 18, 2009 Hearing Transcript.)

The district court granted CNA's motion by Order dated June 16, 2010, and granted the motion of the other insurers by Order dated July 9, 2010. (ADD 1-8.) The court then granted 3M leave to move for reconsideration, after the Supreme Court had affirmed *Cargill* on other grounds. (ADD 16.) Throughout the process, the district court expressed uncertainty about the issue and whether 3M should be entitled to proceed with Count III. (See, e.g., February 24, 2011 Hearing Transcript.) Ultimately, on June 3, 2011, it denied reconsideration, but in doing so acknowledged the following question as "important and doubtful" under Minn. R. Civ. App. P. 103.03(i):

May a party maintain at the same time both a claim for breach of contract and a separate and distinct claim for breach of an implied covenant of good faith and fair dealing based on the same conduct?

(ADD 18.) In the same order, the district court determined there was no just reason for delay and directed the entry of partial final judgment on the prior dismissals under Minn. R. Civ. P. 54.02. (*Id.*) Judgment was entered on July 20, 2011.²

² 3M filed this appeal under Rule 103.03(a) and not under 103.03(i) despite the district court's certification, because the court's orders granted, and did not deny, the motions to dismiss for failure to state a claim upon which relief can be granted. The issue identified as important and doubtful is, moreover, an unduly narrow one in that it incorrectly assumes 3M's covenant claims are based only on the same conduct as its breach-of-contract claims.

STANDARD OF REVIEW

The standard of review for dismissal under Minn. R. Civ. P. 12.02(f) is *de novo*. *Bodah v. Lakeville Motor Express, Inc.*, 663 N.W.2d 550, 553 (Minn. 2003). In reviewing the pleadings, the Court must accept 3M's allegations as true, and 3M is entitled to the benefit of all favorable and reasonable inferences. *Pullar v. Ind. Sch. Dist.*, 582 N.W.2d 273, 275-76 (Minn. App. 1998). The only question for the Court is whether 3M's pleading states legally sufficient claims for relief. *Elzie v. Comm'r of Public Safety*, 298 N.W.2d 29, 32 (Minn. 1980). 3M's claims may be dismissed only if it is certain that no facts can be produced consistent with its claims. *Northern States Power Co. v. Franklin*, 265 Minn. 391, 394, 122 N.W.2d 26, 29 (1963).

As a notice-pleading state, Minnesota requires only that 3M's pleadings give the insurers fair notice of 3M's theory. *Barton v. Moore*, 558 N.W.2d 746, 749 (Minn. 1997); Minn. R. Civ. P. 8.01. 3M is not required to allege facts to support every element of its cause of action. *Northern States Power*, 122 N.W.2d at 29.

ARGUMENT

3M has alleged conduct sufficient to constitute a breach by its insurers of the implied covenant of good faith and fair dealing. Such a claim is well founded in established Minnesota law. It was most recently given significant effect by this Court in the *Cargill* insurance coverage litigation. The district court erred in granting a Rule 12 dismissal of 3M's claims, because it misconstrued 3M's allegations and mis-applied Minnesota law, including *Cargill*.

I. The implied covenant of good faith and fair dealing has long been recognized in Minnesota and applies to dealings between insurers and their policyholders.

Contracting parties, including parties to insurance contracts, are subject not only to obligations they expressly assume in the contract, but also to obligations implied by law. For more than half a century, the Minnesota Supreme Court has recognized that an insurer has duties that go beyond those specified in the contract:

[I]t is the duty of the insurance company to exercise good faith toward the insured, both in the investigation under a liability policy and in the defense of the lawsuit and in the payment of its obligations under the insurance contract.

Larson v. Anchor Cas. Co., 249 Minn. 339, 349-50, 82 N.W.2d 376, 383 (1957). *See also Short v. Dairyland Ins. Co.*, 334 N.W.2d 384, 387-88 (Minn. 1983) (the duty to exercise good faith obligates the insurer to give equal consideration to the financial exposure of the insured).

The leading Minnesota case on the implied covenant of good faith and fair dealing is *Hennepin County*. The Supreme Court ruled in *Hennepin County* that separate claims

for breach of express and implied contract provisions were both sufficient to withstand Rule 12 motions to dismiss. It held that a covenant of good faith and fair dealing is implicit in every contract. The Court recognized an independent, contractual cause of action for breach of the implied covenant.

In *Hennepin County*, bondholders alleged that a deliberate lapse of the letter of credit securing the County's obligations was an "intentional obstruction" and a pretext to redeem the bonds prematurely without paying a redemption premium, comprising both a breach of contract and a breach of the implied covenant. 540 N.W.2d at 496, 501. The district court dismissed the claim for breach of contract but permitted the bondholders to maintain their implied-covenant claim. The Supreme Court reinstated the claim for breach of contract but also affirmed the district court's conclusion that the bondholders properly stated a claim for breach of the implied covenant, thus allowing both breach claims to go forward. *Id.* at 503.

The Supreme Court reasoned that even if the County's actions were ultimately found not to violate express contract terms, the bondholders might nevertheless obtain contractual relief on the basis of their implied-covenant claim. *Id.* at 503. It expressed no concern that both breach claims were based on the same conduct. The Court made no mention of *Wild v. Rarig* and did not treat the implied-covenant claim as one sounding in tort or require the bondholders to demonstrate a basis for a tort recovery. The Court stated:

Under Minnesota law, every contract includes an implied covenant of good faith and fair dealing requiring that one party not "unjustifiably hinder" the other party's performance of the contract.

Zobel & Dahl Constr. v. Crotty, 356 N.W.2d 42, 45 (Minn. 1984); see also *Haase v. Stokely-Van Camp, Inc.*, 257 Minn. 7, 13, 99 N.W. 2d 898, 902 (1959); Restatement (Second) of Contracts § 205 (1981). Similarly, we have held that the party to a contract cannot take advantage of the failure of a condition precedent when the party itself has frustrated performance of that condition. *Space Center*, 298 N.W.2d at 449; *Nodland v. Chirpich*, 307 Minn. 360, 366-67, 240 N.W.2d 513, 516 (Minn. 1976).

In Minnesota, the implied covenant of good faith and fair dealing does not extend to actions beyond the scope of the contract. Here, however, the bondholders' implied covenant claims are based on the underlying bond agreements. To allege an implied covenant claim the bondholders need not first establish an express breach of contract claim – indeed, a claim for breach of an implied covenant of good faith and fair dealing implicitly assumes that the parties did not expressly articulate the covenant allegedly breached. *Metropolitan Life*, 716 F. Supp. at 1516.

Id. at 502-03.

In its reliance on the Restatement (Second) of Contracts § 205 (1981), the Supreme Court recognized the broad scope of the covenant. As the Restatement explains:

The phrase 'good faith' is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for a breach of the duty of good faith also varies with the circumstances.

Id., Cmt. a. The Restatement further explains that good faith precludes “subterfuges and evasions” as well as “evasion of the spirit of the bargain, lack of diligence and slacking

off, willful rendering of imperfect performance . . . and interference with or failure to cooperate in the other party's performance." *Id.*, Cmt. d.

In a recent and significant decision, this Court reaffirmed in *Cargill* that the implied covenant applies to parties to an insurance contract. The decision is noteworthy not only because it enforced the implied covenant *against* the policyholder, but also for the nature of the remedy it imposed for breach of the covenant.

Cargill had sued numerous insurers to determine their obligations relating to Cargill's environmental liabilities. Multiple primary insurers had a duty to defend Cargill. Relying on the "*Iowa National* rule," Cargill demanded that one of the insurers, Liberty Mutual, be responsible for the entire defense.³ Liberty Mutual in turn demanded a loan receipt agreement (so that it could seek contribution from other insurers with a duty to defend), but Cargill objected to certain terms insisted upon by Liberty Mutual. In affirming the trial court, this Court concluded that, while it was constrained by *Iowa National* and could not authorize contribution claims by Liberty Mutual in the absence of a loan receipt agreement, it would impose on Cargill the terms demanded by Liberty Mutual as a remedy for a breach by Cargill of the implied covenant. Cargill, this Court found, had breached the implied covenant of good faith and fair dealing by refusing to accept what it called the "neutral" provisions demanded by Liberty Mutual:

By declining to execute a neutral loan receipt agreement . . ., Cargill has acted in bad faith. *Sterling Capital Advisors, Inc. v. Herzog*, 575

³ Under *Iowa National Mut. Ins. Co. v. Universal Underwriters Ins. Co.*, 276 Minn. 362, 150 N.W.2d 233 (1967), one insurer with a duty to defend has no right to seek contribution from another insurer that also has a duty to defend unless the insurer seeking contribution has a loan receipt agreement with its insured

N.W. 2d 121, 125 (Minn. App. 1998) (stating that bad faith occurs when a party refuses to fulfill some duty or contractual obligation based on an ulterior motive, not an honest mistake regarding one's rights or duties).

766 N.W.2d at 65. This remedy, the Court held, would “preserve Liberty Mutual’s opportunity to obtain an ultimately equitable apportionment of defense costs among insurers with a duty to defend.” *Id.* at 66.

The Supreme Court affirmed on other grounds, by overruling *Iowa National*, explaining that the rule enunciated there “is ill-suited for the complexity of modern mass torts, multiple-party litigation, and disputes involving consecutive liability policies and injuries with long latency periods.” 784 N.W.2d at 352. In making no mention of the implied-covenant approach taken by this Court to reach the same result, the Supreme Court left untouched this Court’s application of the implied covenant in *Cargill*. Whatever is made of the Supreme Court’s silence on the issue, this Court’s decision in *Cargill* appears in any event to represent its view of the breadth of implied-covenant obligations and remedies – a much broader view than that taken by the trial court in dismissing 3M’s claims.

II. 3M’s allegations are sufficient to state a claim upon which relief can be granted.

In light of *Hennepin County* and *Cargill*, 3M has pled a legally sufficient claim for breach of the implied covenant. 3M’s allegations must, moreover, be accepted as true and must receive the benefit of all favorable and reasonable inferences. 3M’s claims may not be dismissed if facts can be produced that are consistent with those claims. Here the

district court has precluded 3M even from taking discovery to determine the extent to which it can substantiate its claims.

3M alleges that the plaintiffs, two affiliated CNA companies, have attempted to create conflict and dispute between 3M and its other insurers where none would otherwise exist – that CNA has interfered with potential settlements and relationships between 3M and its other insurers, both before and during this lawsuit. 3M further alleges that the Insurers have taken and participated in actions designed to harm 3M's very defense of the Mask/ACP Claims, and that the Insurers have taken a position that is in bad faith: it is not simply that they breached the insurance policies (and the law) by failing to investigate, respond to the information provided by 3M or provide coverage; they then attempted to use their own failures as a springboard for complaining that 3M has somehow not cooperated.

These and the remaining allegations in Count III involve conduct that does not violate express terms of the policies, but violates the good-faith covenant inherent in them. Policyholders should not have to worry that their insurer would deliberately undermine settlement negotiations with other insurers, intentionally foment unnecessary conflict between the policyholder and its other insurers or take actions to prejudice their defense of underlying lawsuits. Such conduct contravenes the very protections sought by the policyholder in purchasing liability insurance, and effectively leaves the policyholder with less than it bargained for – not only under the coverage issued by the offending insurers, but under every other policy that has been the subject of those insurers'

interference. In addition to violating accepted standards of fairness and reasonableness, such conduct hinders other parties' performance under their contracts.

The Insurers' attempt to use their own failures as a basis for asserting that 3M breached the cooperation clause is a breach of the implied covenant in numerous ways. It violates the covenant that one party may not unjustifiably hinder the other party's performance of the contract. *See Hennepin County*, 540 N.W.2d at 502. Indeed, taken to its logical conclusion, the Insurers' position regarding their inactivity and silence would render 3M's performance impossible, for 3M can never do more than guess why the Insurers persistently fail to respond to 3M's communications and requests. Such actions comprise "subterfuges and evasions" as well as an "evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance . . . and interference with or failure to cooperate in the other party's performance" – all deemed violations of the implied covenant under the Restatement (Second) of Contracts. *See* § 205, Cmt. d.⁴

⁴ In prior litigation between 3M and CNA and most of the other respondents regarding coverage for the silicone gel breast implant claims, Ramsey County District Judge M. Michael Monahan allowed the development of a full record on 3M's implied-covenant allegations. In an order that discussed *Hennepin County*, Restatement (Second) § 205 and other authority in detail, Judge Monahan ultimately found CNA and the other insurers to have acted in breach of the covenant by virtue of conduct similar to that alleged by 3M here. *See First State Ins. Co. et al. v. 3M Company, et al.*, File No. C3-00-1644, Order No. 159 (AA-125.). The findings were left intact on appeal, though the district court's award to 3M of its coverage litigation attorneys' fees as a remedy for breach of the covenant was reversed. *In re Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405, 422-25 (Minn. 2003).

III. 3M is entitled to plead a breach of the implied covenant based on allegations that include those which support its breach-of-contract claim.

The district court's principal rationale – in its original order and in the order denying reconsideration – was that a breach of the implied covenant cannot be based on the same conduct as a claim for breach of contract. This is the “important and doubtful” question posed in the district court's June 3, 2011 order. The ruling is erroneous for two reasons: first, it incorrectly applies Minnesota law, particularly as established by *Hennepin County*; and second, it misconstrues 3M's implied-covenant factual allegations, which describe conduct that goes considerably beyond that which would establish a simple breach of contract.

The district court relied heavily on *Wild v. Rarig*, 302 Minn. 419, 442, 234 N.W.2d 775, 790 (1975), where the Supreme Court precluded a tort-based recovery of punitive damages for a “malicious” breach of contract. (See June 16, 2010 Order at 5.) Conduct comprising a breach of contract may not yield a tort remedy “except in exceptional cases where the defendant's breach of contract constitutes or is accompanied by an independent tort.” 302 Minn. at 440, 234 N.W.2d at 789. In subsequent decisions, Minnesota courts have continued to apply the *Wild v. Rarig* rule and declined to allow extracontractual, or tort damages for breach of contract or breach of the implied covenant in the absence of an independent tort – even if the breach is malicious.⁵

⁵ See, e.g., *Morris v. American Mutual Ins. Co.*, 386 N.W.2d 233, 237 (Minn. 1986) (declining to recognize private cause of action against insurer for violation of Unfair Claims Practices Act, in part because it might in effect change common law rule that bad faith breach of contract does not convert breach of contract into a tort); *Pillsbury Co. v. National Union Fire Ins. Co.*, 425 N.W.2d 244, 249-50 (Minn. App. 1988), appeal

Minnesota has never adopted a rule, however, that would bar implied-covenant claims sounding in contract rather than in tort, or that would preclude an implied-covenant claim merely because it derives from conduct the same as or similar to that which supports a contemporaneous claim for breach of contract. The covenant of good faith and fair dealing is implied in every contract, and contract-based implied-covenant claims seeking contractual or equitable remedies *are* allowed. This was made clear by the Supreme Court in *Hennepin County* and followed by this Court in *Cargill*.

On the question of remedies, it is of course premature to determine what remedy might be imposed should 3M establish breach by the Insurers of the implied covenant. 3M endeavored, however, in the district court to make it clear that *Wild v. Rarig* does not apply because 3M is not seeking a tort remedy. 3M explained that its contract-based covenant allegations might, if proven, support the imposition of an equitable remedy – citing *Cargill* and the remedy described by the Court there as one that would “preserve Liberty Mutual’s opportunity to obtain an ultimately equitable apportionment of defense costs among insurers with a duty to defend.” 766 N.W.2d at 66. In this case, the principal issue is likely to be the manner of apportioning 3M’s defense and settlement costs among the insurers and the role, if any, that equity should play in that apportionment. *See SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 318 (Minn. 1995) (describing the Supreme Court’s allocation decision in *Northern States Power Co.*

dismissed (Minn. Mar. 13, 1989) (refusing to recognize bad-faith denial of insurance claim as a tort); *In re Silicone Implant Insurance Coverage Litigation*, 652 N.W.2d 46, 74-76 (Minn. App. 2002), *aff’d in part, rev’d in part*, 667 N.W.2d 405 (Minn. 2003) (breach of implied covenant by insurers not the “exceptional case” in which claim for punitive damages should be allowed).

v. Fidelity and Casualty Co. of N.Y., 523 N.W.2d 657 (Minn. 1994) as “an equitable decision based upon the complexity of proving in which policy periods covered property damages arose”). The trial court was therefore wrong, 3M submits, when it stated that *Cargill* did not involve imposition of an equitable remedy and that “potential future equitable remedies” would be “contrary to Minnesota law.” (ADD 19-20.)

Under the analysis in *Hennepin County* and the Restatement, the conduct alleged by 3M in Count III comprises a breach of the implied covenant inherent in the insurance contracts. In *White Stone Partners, LP v. Piper Jaffray Cos., Inc.*, 978 F. Supp. 878, 885 (D. Minn. 1997) (J. Tunheim) (applying Minnesota law), the court relied on *Hennepin County* and Restatement § 205 in holding that an implied-covenant claim was sufficiently pled based on allegations that the defendant invoked the contract’s escape clause dishonestly. The court reasoned that “the Minnesota Supreme Court would require a party to exercise good faith in exercising an unlimited discretionary power over a term of the contract if necessary to effectuate the parties’ intent and to save a contract from being held to be illusory.” *Id.* at 882. *See also Sterling Capital Advisors, Inc. v. Herzog*, 575 N.W.2d 121, 125 (Minn. App. 1998), cited by this Court in *Cargill* (observing that “[b]ad faith’ is defined as a party’s refusal to fulfill some duty or contractual obligation based on an ulterior motive, not an honest mistake regarding one’s rights or duties.”). *Hennepin County* establishes, moreover, that breach of the implied covenant is an independent, contractual cause of action that may be pursued *along with* a claim for breach of contract. As discussed above, both claims in *Hennepin County* were premised

on the same conduct, and the Supreme Court allowed both to go forward. This decision remains the cornerstone of-implied covenant claims that do not seek a tort recovery.

In *Cargill*, this Court did not even consider whether the insurers could demonstrate an independent basis to support a tort recovery. And Liberty Mutual's implied-covenant argument *directly paralleled its claim for breach of contract*. Not only did this prove to be unproblematic, this Court *bolstered* its decision to achieve the equitable allocation it ordered under the implied covenant by pointing out that doing so “comports with the terms of the cooperation clause contained in the . . . insurance policy.” *Id.* at 62, 65. In other words, the fact that the insurer may have had a remedy available to it under the *express* terms of the contract did not subsume – but rather *supported* – the implied-covenant claim.⁶

In any event, *Hennepin County* and *Cargill* directly and affirmatively answer the question the district court identified as “important and doubtful.” *Cargill* is but the latest decision recognizing that implied-covenant claims can coexist, side-by-side with breach-of-contract claims; that the same or similar conduct can support both; and that it not necessary for a claimant to allege an independent tort in order to obtain contract-based or equitable relief for breach of the implied covenant of good faith and fair dealing.

⁶ *Cargill's* insurer argued to the Supreme Court that the Court of Appeals decision was fully consistent with Minnesota law: “Use of the implied covenant of good faith and fair dealing to impose upon *Cargill* an obligation to cooperate by entering into a neutral loan receipt agreement . . . was in complete harmony with the scope of the covenant's principles under Minnesota law and the parties' contracts.” Brief for Appellee, Liberty Mutual Insurance Company, at 48, *Cargill, Inc. v. Ace Am. Ins. Co.*, No. A08-1082 (Minn. 2009).

IV. While 3M alleges unjustifiable hindrance by the Insurers of 3M's performance, Minnesota law does not confine the implied covenant to that particular conduct.

The district court also erred in concluding: (a) that Minnesota law does nothing more than preclude a party from unjustifiably hindering the other party's performance of the contract, and (b) that 3M's Count III includes no such allegation. *See* July 19, 2011 Order at 4.

It is true the Supreme Court stated in *Hennepin County* that “[u]nder Minnesota law, every contract includes an implied covenant of good faith and fair dealing requiring that one party not ‘unjustifiably hinder’ the other party’s performance of the contract.” 540 N.W.2d at 502. The Court was dealing only with that type of fact situation, however. It gave no indication that the covenant implied into every contract would apply only in such circumstances. Restatement § 205, relied upon in *Hennepin County*, contains no such limitation. It states simply, “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement” and then provides lengthy comments including those cited above.

In *Cargill*, this Court described *Hennepin County* as “providing that ‘every contract includes an implied covenant of good faith and fair dealing.’” 766 N.W. 2d at 65. Its decision includes no suggestion that the covenant is limited as viewed by the trial court here.

Yet, even if this Court were to agree with the constrained interpretation applied by the district court, it would have to conclude that 3M's pleading satisfies that test. As recited above, Count III includes allegations effectively stating that the Insurers' conduct

unjustifiably hindered 3M's performance by, among other things, refusing to tell 3M what the Insurers required to determine coverage and then blaming 3M for not providing it and thereby breaching its own contract obligations. In addition, the Insurers unjustifiably placed their own interests ahead of 3M, potentially scuttled settlement opportunities between 3M and its other insurers and deliberately attempted to damage 3M in its defense of the Mask/ACP Claims.

These allegations – and, for that matter, all of the allegations in Count III – go much further to the heart of both the “unjustifiably hinder” standard and the remaining aspects of the covenant set forth in the Restatement (Second) than the conduct considered in *Cargill*.

CONCLUSION

The implied-covenant claims here withstand Rule 12 scrutiny, just as they did in *Hennepin County*. Whether the evidence will in the end be sufficient, and whether a contract-based equitable remedy will be considered should the evidence establish the conduct alleged by 3M are issues for another day. The issue at this juncture is only whether 3M's allegations, taken as true and with 3M having the benefit of all favorable and reasonable inferences, were properly dismissed because no facts can conceivably be produced consistent with the cause of action.

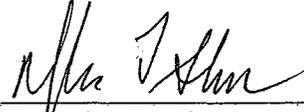
3M's claims were not properly dismissed. 3M requests that this Court reverse the court below and allow 3M to plead and go forward with its claims for breach of the implied covenant of good faith and fair dealing as alleged in Count III of its Counterclaim and Cross-Claims.

Respectfully submitted,

Dated: September 7, 2011

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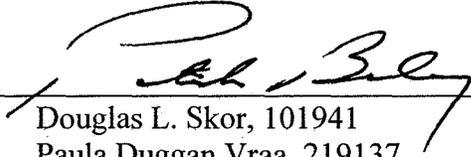
CERTIFICATION OF BRIEF LENGTH

Pursuant to Rule 132.01, subd. 3(a)(1), the undersigned set the type of the foregoing brief in Times New Roman, a proportional 13-point font, on 8 ½ x 11 inch paper with written matter not exceeding 6 ½ by 9 ½ inches. The resulting principal brief contains 6,523 words, as determined by employing the word counter of the word-processing software, Microsoft Word XP, used to prepare it.

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