

A05-862
A05-871

STATE OF MINNESOTA
IN COURT OF APPEALS

Commercial Associates, Inc.

Respondent (A05-862)
Appellant (A05-871)

v.

The Work Connection, Inc.,

Appellant (A05-862),
Respondent (A05-871)

RESPONDENT THE WORK CONNECTION, INC.'S REPLY BRIEF

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REPLY TO STANDARD OF REVIEW

I. Standard of Review for Disgorgement of Commissions Issue.

Commercial Associates argues that this Court's review of the trial court's post-trial award of \$483,000 to The Work Connection is *de novo*. But an action for breach of fiduciary duty is an equitable claim.¹ The granting of equitable relief is within the sound discretion of the trial court; only a clear abuse of discretion will result in reversal.²

II. Standard of Review for Refusal to Submit Contract Theory to Jury.

Commercial Associates cites cases indicating that the trial court has broad discretion in framing the questions to be submitted to the jury on special verdict forms. This is the correct standard in cases challenging the accuracy of a jury instruction, but not where the trial court refused to submit *an entire claim* to the jury. Failure to submit a claim to the jury is the equivalent of a grant of summary judgment on that claim, and the standard of review is therefore the same: The trial court must be reversed if the record contained evidence supporting a legally cognizable claim.³

¹ *Shepherd of the Valley v. Hope Lutheran Church*, 626 N.W.2d 436, 443 (Minn. App. 2001).

² *State v. Ambaye*, 616 N.W.2d 256, 261 (Minn. 2000); *Nadeau v. County of Ramsey*, 277 N.W.2d 520, 524 (Minn. 1979); *Dain Bosworth, Inc. v. Goetze*, 374 N.W.2d 467, 471 (Minn. App. 1985); *City of Cloquet v. Cloquet Sand & Gravel, Inc.*, 312 Minn. 277, 279, 251 N.W.2d 642, 644 (1977).

³ *See Sandhofer v. Abbott-Northwestern Hosp.*, 283 N.W.2d 362, 367 (Minn. 1979).

REPLY ARGUMENT

I. THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN ORDERING FORFEITURE OF COMPENSATION.

The Work Connection's initial brief demonstrated that for over 100 years, Minnesota law has, without exception, ordered forfeiture of all compensation received by duplicitous double agents who take money from both sides in a commercial transaction without disclosure to both. The law is the same in other states. The Work Connection further demonstrated that Commercial Associates' failure to disclose its secret commissions was fraudulent as a matter of law, and that the jury's findings of negligence make no difference – there is no such thing as a negligent breach of fiduciary duty. Whatever Commercial Associates' subjective state of mind was, its objective actions constituted a breach of the duty of loyalty. Finally, the brief explored the result that would follow even if the *Gilchrist v. Perl* scaled fee-forfeiture rule applied to the facts of this case, and demonstrated that the outcome would still be a total forfeiture of compensation.

Commercial Associates makes three substantive arguments in response: (1) Commercial Associates' conduct is more akin to that of the hapless attorney in *Gilchrist* than to the fiduciary misconduct in cases resulting in total fee forfeiture, so *Gilchrist's* scaled-forfeiture rule should apply; (2) The Work Connection waived any argument for an equitable remedy by not raising it in the trial court and by submitting the issue of damages to the jury; (3) The jury's award of no damages was an application of the scaled-fee forfeiture remedy in *Gilchrist v. Perl*.

A. Commercial Associates' Conduct is Not Akin to That in *Gilchrist*.

Commercial Associates' breach was of the duty of loyalty – it was secretly being paid by both sides of a commercial transaction. By contrast, the lawyer in *Gilchrist* breached his duty to disclose material information – a business relationship with an insurance adjuster who was responsible for the clients' personal injury claims. Courts have held that the remedy of forfeiture is particularly appropriate in cases of breach of loyalty – i.e., when the fiduciary is a duplicitous double agent.⁴ No cases have been identified by either party in which a court did *not* order forfeiture in a case where the fiduciary was found to have breached the duty of loyalty.

Although there are very few cases applying either *Rice v. Perl* or *Gilchrist v. Perl*, those cases endorsing a scaled-forfeiture approach – like *Gilchrist* – involve a breach of the duty to disclose material facts and conflict of interest, not a breach of the duty of loyalty.⁵ Commercial Associates faults The Work Connection for not locating a case since *Rice v. Perl* applying the absolute fee forfeiture rule in circumstances similar to the present, but Commercial Associates fails to identify a case applying *Gilchrist* on facts remotely similar to this case.

While accusing The Work Connection of recasting the facts, Commercial Associates invents a new finding by the jury, i.e., that Commercial Associates

⁴ *Hendry v. Pelland*, 73 F.3d 397, 401-02 (D.C. Cir. 1996).

⁵ See *Matter of Boss*, 487 N.W.2d 256, 262 (Minn. App. 1992) (trustee attorney concealed existence and effect of amendment making trust irrevocable and that attorney drafted amendment from which he stood to gain as a potential beneficiary); *Fiedler v. Adams*, 466 N.W.2d 39, 43 (Minn. App. 1991)(undisclosed business relationship with adverse party and conflicts of interest).

“attempted, but negligently fail[ed],” to disclose its commissions.⁶ In fact, there was no evidence, and no finding, of any attempt by Commercial Associates to disclose the full basis of its compensation. Certainly Commercial Associates cites to none in its brief. All the evidence was to the contrary.

By statute, Commercial Associates was required to disclose the entire basis of its compensation in writing each time it obtained a policy for The Work Connection.⁷ Commercial Associates purported to comply with this statute exactly once: in 1996, in the exhibit that disclosed it was taking an agency fee but not commissions.⁸ Commercial Associates had an affirmative duty to disclose commissions if it intended to take them. By failing to disclose the commissions, therefore, Commercial Associates affirmatively represented that it was *not* taking commissions. Commercial Associates actually told The Work Connection and others repeatedly that it was not taking commissions on workers compensation policies. It deleted references to its commissions in insurance proposals presented to The Work Connection.

The jury’s finding that Commercial Associates lacked fraudulent intent when it failed to disclose the commissions presumably stems from the absence of direct evidence of Jerry Crandall’s state of mind at the time he told The Work Connection he was not taking commissions. Because the misconduct is fraudulent by its very nature, the jury’s finding on that point is irrelevant and must be disregarded.

⁶ CA Reply Brief p. 1.

⁷ Minn. Stat. § 60K.46, subd. 2.

⁸ See A14 (Trial Exhibit 37 and 63).

Commercial Associates says the jury's finding of no fraudulent intent is legally significant – it is the primary basis for its argument that the scaled-forfeiture remedy in *Gilchrist* should apply. But the Minnesota Supreme Court specifically rejected this argument in *Rice v. Perl*. There, the court said the absolute fee forfeiture remedy follows “even though the principal . . . cannot prove . . . that the agent committed an intentional fraud.”⁹ *Gilchrist* repeated that exact phrase, thus indicating its intent not to change settled law by adding a requirement of intentional fraud before forfeiture is imposed.¹⁰

Commercial Associates had an affirmative duty as a fiduciary to fully disclose the basis of its compensation – a duty that is actually codified in a statute to emphasize the importance of the public policy underlying it. As the Supreme Court said in *Tarnowski v. Resop*, payment of a secret commission to an agent is “nothing more or less than a bribe to perform his duties in the manner desired by the person who gave the bribe.”¹¹ The duplicitous double agent is guilty of fraud *as a matter of law*.¹² Consequently, the good faith or bad faith of the fiduciary is irrelevant.

Commercial Associates suggests that *Rice v. Perl* was radically altered or overruled by *Gilchrist v. Perl*. But no court has so held, and *Gilchrist* contains no hint that it is abandoning its holding in *Rice v. Perl*. To the contrary, *Gilchrist* expressly

⁹ 320 N.W.2d 407, 411 (1982) (quoting *Anderson v. Anderson*, 293 Minn. 209, 216, 197 N.W.2d 720, 724 (1972)).

¹⁰ 387 N.W.2d at 415.

¹¹ 236 Minn. 33, 51 N.W.2d 801, (1952).

¹² *Doyen v. Bauer*, 211 Minn. 140, 300 N.W. 451, 455 (1941).

reaffirmed the holding in *Rice v. Perl* that in cases involving actual fraud or bad faith, the usual rule of total forfeiture would continue to apply.¹³

The *Gilchrist* decision held that the scaled-forfeiture remedy would be appropriate in cases where (1) there was no actual bad faith or fraud; (2) the breach did not cause any harm to the principals, and (3) where there were multiple principals.¹⁴ All three criteria must be present.

This case has none of those criteria. Commercial Associates assumes that its conduct was not “actual fraud” as *Gilchrist* uses the term. But the *Gilchrist* decision listed cases involving what it considered “actual fraud” justifying total fee forfeiture.¹⁵ Those cases all involve the duplicitous double agent fact pattern present in this case. One of them, *Anderson v. Anderson*, specifically dealt with the argument Commercial Associates makes here, i.e., that the fiduciary did not commit an intentional fraud. *Gilchrist* reaffirms that the total fee forfeiture rule was appropriately applied in *Anderson* even where the principal cannot prove intentional fraud.¹⁶

By its very nature, the fiduciary breach found by the jury in this case is “actual fraud” within the meaning of *Gilchrist*. The jury’s finding that the breach was negligent does not change the character of the breach because Commercial Associates had an *affirmative duty* to disclose its compensation. Commercial Associates knew that it was taking compensation from both sides of the transactions and knew that it had not

¹³ 387 N.W.2d 412, 417 (Minn. 1986).

¹⁴ 387 N.W.2d at 417.

¹⁵ 387 N.W.2d at 415.

¹⁶ 387 N.W.2d at 415.

disclosed its commissions to The Work Connection. That places this case in the category of “actual fraud” cases deserving of the total forfeiture remedy.

Nor is the second *Gilchrist* criterion satisfied. The Work Connection paid twice as much to Commercial Associates for its services as it disclosed. The Work Connection’s Jeff Wold quite reasonably testified that had he known Commercial Associates was taking commissions, he would not have agreed to pay the annual fees.¹⁷ Because of Commercial Associates’ misconduct, The Work Connection was never given an opportunity to contest the commissions or to look for cheaper insurance services elsewhere. The absence of evidence of precisely how things would have been different had The Work Connection known about the undisclosed commissions was apparently enough to persuade the jury to find no consequential damages. But it underscores the reason why a breach of the duty of loyalty requires total fee forfeiture without proof of actual harm. *Gilchrist* contemplates total forfeiture in cases even where the client “cannot prove actual injury to himself.”¹⁸

The third criterion for application of *Gilchrist*’s scaled-forfeiture rule is also absent. This case involves a single claimant, not a legion of Dalkon Shield plaintiffs. Lacking even one of the three foundations for application of *Gilchrist*’s scaled-forfeiture rule, total fee forfeiture is required.

¹⁷ T. 298.

¹⁸ 387 N.W.2d at 415.

Commercial Associates suggests that if *Gilchrist* applies, the result would be a scaled-fee forfeiture, “measured to the harm caused.”¹⁹ But *Gilchrist* does not limit recovery to proximately-caused damages. It says that in certain cases, the forfeiture remedy should be scaled to the level of misconduct by reference to the statutory factors used to determine punitive damage awards. The amount of proximately-caused damages is not among the factors *Gilchrist* says should be considered. Rather, the factors include such things as “the profitability of the misconduct to the defendant,” “the seriousness of the hazard to the public,” and so on. As shown in The Work Connection’s initial brief, consideration of the punitive damages factors under *Gilchrist* would compel total fee disgorgement as a matter of law.

B. The Work Connection Did Not Waive its Claim for Equitable Relief.

Commercial Associates argues that by submitting damages claims to the jury, and by asking for post-trial relief “as a matter of law,” The Work Connection waived its present argument for equitable relief.²⁰ A fiduciary claim is an equitable claim, and is not converted to a legal claim merely by being submitted to the jury as part of a special verdict form. The Work Connection’s post-trial motion for the equitable remedy of forfeiture “as a matter of law” merely meant that the decision should be made by the Court. It was not intended to imply that the post-trial motion was premised on legal

¹⁹ CA Reply Brief p. 1.

²⁰ CA Reply Brief p. 6.

principals as opposed to equitable ones. The Work Connection has throughout this litigation sought recovery of the amounts it paid Commercial Associates while the latter was in breach of its fiduciary duties. It has preserved both legal and equitable theories to achieve that result.

The trial court may properly separate legal and equitable issues for trial purposes, and submit legal issues to the jury and retain equitable issues for decision by the court.²¹ The trial court may also separate questions of law from questions of fact, with the judge determining questions of law and the jury determining questions of fact.²²

In this case, the trial court crafted a special verdict form that answered the questions that it considered to be disputed. Commercial Associates has apparently never disputed, and on appeal does not dispute, that it received commissions and fees on insurance procured for The Work Connection in the amount sought here.

Among the questions submitted to the jury was whether The Work Connection was damaged “as a result of Commercial Associates’ failure to disclose that it was taking commissions on workers’ compensation policies in addition to charging an agency fee.”²³ The trial court’s charge to the jury explained: “In deciding damages, decide the amount of money which will fairly and adequately compensate The Work Connection for damages directly caused by relying on Jerry Crandall’s misrepresentations, if any.”²⁴

²¹ 1A D. Herr & R. Haydock, *Minnesota Practice Series: Civil Rules Annotated* § 38.4, p. 256 (4th ed. 2003).

²² *Id.* (citing *Mathews v. Mills*, 288 Minn. 16, 178 N.W.2d 841 (1970)).

²³ Special Verdict Question 15 (A-11).

²⁴ T. 443.

Thus, the jury was asked to determine whether The Work Connection had suffered damages “directly” resulting from Commercial Associates’ failure to disclose the fact that it was taking commissions on top of annual fees. The jury was not asked, and it would not have been appropriate to ask it, whether forfeiture of compensation was appropriate. As the cases say over and over again, forfeiture is “automatic” upon a finding of breach of fiduciary duty. It is not a jury question.

Commercial Associates’ waiver argument may be a garbled interpretation of the “election of remedies” defense which, when it applies, requires a party to adopt one of two or more coexisting and inconsistent remedies which the law affords to the same set of facts.²⁵ The purpose of the doctrine is not to prevent recourse to any particular remedy, but to prevent double redress of a single wrong.²⁶

However, if inconsistent remedies are sought and it is doubtful which one will bring relief, a party may claim either or both alternatively until one remedy is pursued to a determinative conclusion.²⁷ A party is therefore not bound by an election unless it has pursued the chosen course to a determinative conclusion or has procured advantage therefrom, or has thereby subjected its adversary to injury.²⁸

Merely stating the election of remedies doctrine accurately demonstrates why it does not apply. The Work Connection had not pursued its legal claims to a determinative conclusion at the time of the forfeiture award, and is therefore not precluded from

²⁵ *Christensen v. Eggen*, 577 N.W.2d 221, 221 (Minn. 1998).

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

arguing for different remedies arising out of the same course of conduct. Only if one remedy had already been awarded would an election of remedies issue arise, in order to prevent a double recovery.

Further, this Court recently held that election of remedies is an affirmative defense that must be raised in the pleadings.²⁹ Commercial Associates did not raise a defense of election of remedies in its reply to The Work Connection's counterclaims, nor did it raise the issue in the trial court at any time.

Finally, even if the matter were properly before this Court, The Work Connection expressly preserved its right to pursue equitable remedies. The breach of fiduciary duty claim was first made in The Work Connection's counterclaim. After the close of evidence, and before the case went to the jury, The Work Connection moved for a directed verdict on all its claims, including the claim for breach of fiduciary duty.³⁰ The trial court denied the motion. The Work Connection therefore preserved its right to argue for judgment as a matter of law as to its fiduciary claims. The Work Connection did not waive its right to seek equitable relief based on the jury's finding of a breach of fiduciary duty by Commercial Associates.

²⁹ *Loppe v. Steiner*, 699 N.W.2d 342, 348 (Minn. App. 2005).

³⁰ T. 428.

C. **The Jury Did Not Intuitively Apply *Gilchrist* in Finding No Consequential Damages.**

Commercial Associates suggests that the jury's finding of no damages was a result of its application of *Gilchrist*'s scaled-forfeiture rule. But the jury was not instructed on the *Gilchrist* factors, and therefore could not have applied them in finding no damages. Instead, the jury was asked to determine whether The Work Connection was damaged "as a result of Commercial Associates' failure to disclose that it was taking commissions on workers' compensation policies in addition to charging an agency fee."³¹ The trial court's charge to the jury explained: "In deciding damages, decide the amount of money which will fairly and adequately compensate The Work Connection for damages directly caused by relying on Jerry Crandall's misrepresentations, if any."³²

Because the issue of forfeiture was a question for the trial court, no party asked that the jury be instructed on the *Gilchrist* factors. The jury was asked to determine whether consequential damages flowing from Commercial Associates' breach of fiduciary duty had been shown, and determined they had not. This is not at all inconsistent with the trial court's forfeiture award. No reported Minnesota court decision has apparently ever delegated that question to a jury.

³¹ Special Verdict Question 15 (A-11).

³² T. 443.

II. THE TRIAL COURT ABUSED ITS DISCRETION BY NOT ORDERING FORFEITURE OF COMMISSIONS TOO.

Commercial Associates declines to argue in support of the trial court's theory that the commissions are not forfeit because they represent compensation from a third party. All profits gained by an agent in the course of representing the principal belong to the principal, whether they are fruits of performance or of violation of the agent's duty.³³ After summarily dismissing the cases cited in The Work Connection's initial brief because they involve different types of fiduciaries, Commercial Associates complains that the only case cited by The Work Connection in support of its position is one from an Ohio court.

But Commercial Associates misses the point. The cited cases show that courts everywhere follow the rule that secretly taking commissions from a third party is a breach of the duty of loyalty, and that total fee forfeiture is the inevitable and automatic remedy. The rule applies regardless of whether the fiduciary is a real estate broker, an attorney, an insurance agent or something else. Those are not material distinctions. Minnesota has traditionally followed the "no-secret-commissions" rule embodied in those cases, and there is no reason to suppose that *Gilchrist* changed that bright-line approach in cases involving breach of the duty of loyalty.

³³ *Tarnowski v. Resop*, 236 Minn. 33, 51 N.W.2d 801, 802 (1952).

Application of the total forfeiture rule in this case would not be an “expansion” of *Rice v. Perl*, as Commercial Associates says. It would be the *usual* result. By contrast, application of the *Gilchrist* scaled-fee forfeiture rule to a case involving a breach of the duty of loyalty would be a first for Minnesota and possibly the nation.

Commercial Associates states that the trial court “observed that The Work Connection was attempting to retain the benefit of insurance without having to pay for it.”³⁴ The cited portion of the transcript has Judge Monahan asking whether such is The Work Connection’s position, and The Work Connection’s response that it contends only that both forms of compensation received by Commercial Associates must be disgorged.³⁵ Lest there be any doubt, the present claim for disgorgement of fees and commissions pertains only to money paid to Commercial Associates for its services, net of the premiums passed on to the insurers.

III. THE TRIAL COURT ERRED BY REFUSING TO SUBMIT THE WORK CONNECTION’S BREACH OF CONTRACT THEORY TO THE JURY.

Commercial Associates argues that the trial court correctly refused to submit The Work Connection’s contract theory to the jury because the record did not contain clear and convincing evidence of a modification of the insurance proposal. But the insurance proposal was not a contract – it was unsigned by either party. There is no evidence in the

³⁴ CA Reply Brief p. 6.

³⁵ T. 528.

record that the written proposal alone was intended or accepted as a complete representation of Commercial Associates' undertaking.

On the contrary, the record contains ample and unrebutted evidence that Commercial Associates' Jerry Crandall made a presentation to The Work Connection for renewal of its workers compensation insurance that was a blend of the written proposal and Crandall's oral modifications and corrections to it. Crandall specifically told The Work Connection that the workers compensation policy he proposed to get would have a price discount – a “schedule credit” – of 19%. The jury agreed that Crandall had made this false representation.³⁶ The Work Connection accepted his proposal and instructed him to buy the policy he had described. That was the meeting of the minds. That was the contract.

Crandall then committed The Work Connection to paying for a policy that lacked the price discount he had promised. The Work Connection ended up paying \$304,647 more for this policy it would have paid for the policy Crandall had described and promised to buy. Commercial Associates contracted to buy for The Work Connection a policy with a favorable pricing structure, but bought something else instead.

If a principal contracts with an agent to buy a new Cadillac and gives the agent money for a new Cadillac, the agent must return with a new Cadillac. If the agent instead delivers a Ford Pinto, the agent has breached the contract. The damages are the

³⁶ Special Verdict Question 16 (A-11).

difference in value between what the agent promised to get and what the agent actually delivered.

A party is entitled to a specific instruction on its theory of the case if there is evidence to support the instruction and it is in accordance with applicable law.³⁷ A trial court's refusal to give a requested instruction setting forth a litigant's theory of the case, where there is evidence to support such a theory, constitutes reversible error unless the substance of the requested instruction was covered by a general charge to the jury.³⁸

As a practical matter, the breach of contract claim may turn out to be the most critical claim in the case. Insurance agents typically have professional malpractice insurance policies that cover them for their errors and omissions that result in the failure to procure insurance with the characteristics requested by the customer. This claim may therefore be the only one covered by insurance – it was not merely duplicative or redundant of other claims, as the trial court may have believed. The availability of insurance has become increasingly significant since Commercial Associates ceased its operations and sold its assets shortly after the judgment in this case was rendered against it last March.

CONCLUSION

For the reasons stated herein, the trial court's order that Commercial Associates must forfeit its fees should be affirmed; the trial court's denial of The Work Connection's motion for disgorgement of the commissions secretly taken by Commercial Associates

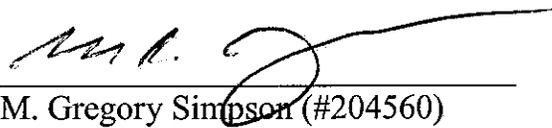
³⁷ *Sandhofer v. Abbott-Northwestern Hosp.*, 283 N.W.2d 362, 367 (Minn. 1979).

³⁸ *Oldendorf v. Eide*, 260 Minn. 458, 464, 110 N.W.2d 310, 314 (1961).

should be reversed; the trial court's denial of The Work Connection's motion for new trial on the contract claim should be reversed; and the case should be remanded for a retrial limited to The Work Connection's contract claims.

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