
RECENT DEVELOPMENTS IN INSURANCE COVERAGE LAW

Sarah E. Morris

LIND, JENSEN, SULLIVAN & PETERSON, P.A.



Both Minnesota's appellate courts and the U.S. District Court for the District of Minnesota have generated important insurance coverage decisions in the past year. The courts tackled topics ranging from the requisites of a defense tender to the business pursuits exclusion and insurance coverage for sexual abuse. One decision alone - *In re Silicone Implant*

Insurance Coverage Litigation, 652 N.W.2d 46 (Minn. App. 2002) - addresses 12 separate coverage questions. A summary of key recent cases follows.

TENDER OF DEFENSE

In *The Home Insurance Company v. National Union Fire Insurance*, 658 N.W.2d 522 (Minn. 2003), the Minnesota Supreme Court tackled a coverage issue of first impression - what constitutes a tender of defense. The court held that an insured successfully tenders the defense of a lawsuit to an insurer simply by providing the insurer with "notice of a suit and opportunity to defend." 658 N.W.2d at 534. The insured need not specifically request that the carrier defend the suit. In *Home Insurance Company*, an attorney for the insured, Cargill, Inc., sent a copy of a complaint in a patent infringement suit against the company to its umbrella carrier. After the carrier declined coverage and Cargill started a declaratory judgment action, the carrier asserted the defense that Cargill never gave a "formal tender of defense." *Id.* at 531. The court theorized that the notice and opportunity to defend rule would clarify the parties' obligations early in the action and acknowledge the insurer's greater sophistication, without burdening insurers. *Id.* at 533. The court's decision defied the prediction of the Eighth Circuit Court of Appeals in *C.J. Duffey Paper Company v. Liberty Mutual Insurance Company*, 76 F.3d 177, 178 (8th Cir. 1996), which had interpreted prior case law to imply a requirement that the insured specifically request a defense.

BUSINESS RISK DOCTRINE

Thomes v. Milwaukee Insurance Company, 641 N.W.2d 877 (Minn. 2002), the court's first business risk doctrine decision

in several years, demonstrates the great impact business risk principles have on the court's view of exclusions that appear designed to preclude coverage for third-party property damage. The insured in *Thomes* contracted to clear land for development. Pursuant to erroneous instructions from its client, the insured cleared land owned by third parties, who sued the insured for damages. 641 N.W.2d at 879. When the insured sought CGL coverage from Milwaukee, the trial court granted summary judgment for the insurer, relying in part on an exclusion for "property damage to . . . that particular part of real property on which you . . . are performing operations." *Id.* at 882.

The court of appeals held that the insured was entitled to coverage under the business risk doctrine and reversed. The Minnesota Supreme Court voted 4-3 to affirm. Although the court stated that the business risk doctrine did not provide a basis to disregard express policy exclusions, its extremely narrow reading of the exclusions in Milwaukee's policy appeared strongly influenced by its view that CGL policies are intended to insure against "risks arising from tort liability to third parties." 641 N.W.2d at 881. The court held the terms "that particular piece of real property" and "operations" were ambiguous and noted the insured's contention that the exclusion was intended to apply only to property identified in its contract, not to property owned by third parties. *Id.* at 883.

The court also rejected a second exclusion, which precluded coverage for "property damage to . . . that particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." 641 N.W.2d at 883. The court concluded that "incorrectly performed" could encompass work performed on the wrong property, but that it could also apply to work performed in a faulty manner. Accordingly, this exclusion was also ambiguous. *Id.* at 884.

In a strongly-worded dissent, Justice Stringer, joined by Justices Blatz and Paul Anderson, attacked the majority's construction of the policy exclusions as a "distortion," arguing "what could be more incorrect than performing the work on the wrong property?" 641 N.W.2d at 884-85.

DECLARATORY JUDGMENT FEE AWARD; TRIGGER AND ALLOCATION IN PRODUCTS LIABILITY ACTION

In late 2002, the Minnesota Court of Appeals issued its decision in *In re Silicone Implant Insurance Coverage Litigation*, 652 N.W.2d 46 (Minn. App. 2002), *rev. granted* (Minn. Dec. 17, 2002), the widely-watched complex coverage action arising

SARA E. MORRIS is an associate at the law firm of Lind, Jensen, Sullivan & Peterson, P.A. She is a cum laude graduate of the University of Minnesota Law School and has 100% of her practice devoted to litigation.

from breast implant claims against 3M. The court reversed the trial court's precedent-challenging decision that although the insurers had breached no duty of defense, they were obligated to pay 3M's attorney fees in the coverage action. 652 N.W.2d at 74. The trial court had based its fee award on its finding that the insurers breached the implied covenant of good faith and fair dealing.

The court of appeals noted that in the 36 years since the supreme court decided *Morrison v. Swenson*, 274 Minn. 127, 137-38, 142 N.W.2d 640, 647 (1966), the court had consistently refused to permit a fee award absent breach of a contractual duty to defend. 652 N.W.2d at 72. The court found the trial court's criticism of the *Morrison* rule as "baffling" and discouraging prompt performance of insurance obligations to be inapt, because neither the legislature nor the supreme court has sanctioned fee recovery without statutory authorization or breach of the duty to defend. *Id.* at 73 (quoting *Garrick v. Northland Ins. Co.*, 469 N.W.2d 709, 714 (Minn. 1991) ("[i]f the change in Minnesota's historical doctrine is to be made, it seems to us that this argument ought to be directed to the legislature.")).

The court of appeals also addressed trigger of coverage and allocation of damages. The parties disputed whether coverage was triggered at the time of implant, or when the medical records revealed disease symptoms. 3M's experts argued that disease might not manifest itself until years after the injury. The insurers' experts contended that injury occurred immediately before disease symptoms appeared. 652 N.W.2d at 58. The court noted that although neither party accepted the contention that silicone implants could cause autoimmune disease, the claimants had obtained settlements with 3M on that theory. It concluded that on the conflicting testimony, the trial court's finding that bodily injury occurred at the time of implant when leaked silicone contacted body tissues was not clearly erroneous. *Id.* at 59.

The court of appeals also affirmed the trial court's finding that the bodily injury was continuous, necessitating allocation of damages pro rata among the multiple carriers on the risk under *Northern States Power Company v. Fidelity & Casualty Company*, 523 N.W.2d 657 (Minn. 1994). 652 N.W.2d at 60. However, it concluded that the trial court erred by establishing an allocation period which ended on the last date the policies were in effect. The court applied the rule in *Domtar, Inc. v. Niagara Fire Insurance Company*, 563 N.W.2d 724 (Minn. 1997), which compared the period of time the insurer was on the risk to "the entire period during which

damages occurred." 652 N.W.2d at 61 (quoting *Domtar*, 563 N.W.2d at 732 (emphasis in original)). Under *Domtar*, the proper allocation period extended from the date of implant to the date the underlying plaintiffs' lawsuits were filed or the plaintiffs died. *Id.* at 62. *In Re Silicone Implant Insurance Litigation* is significant as the first decision to apply the allocation principles of NSP and *Domtar* in the mass tort context. The Minnesota Supreme Court accepted review of the trigger, allocation and fee award issues in *In Re Silicone Implant Insurance Litigation* and heard argument on June 3, 2003. Practitioners will want to review the high court's decision on these important questions.

KNOWLEDGE OF POTENTIAL CLAIM – LEGAL MALPRACTICE COVERAGE

The Minnesota Court of Appeals recently decided a legal malpractice insurance coverage case that highlights the impact of an insured's failure to disclose a potential malpractice claim to its malpractice carrier. In *Buller v. Minnesota Lawyers Mutual*, 648 N.W.2d 704 (Minn. App. 2002), the court of appeals considered whether a lawyer's failure to report the possibility of a malpractice claim against him to his insurer precluded him from obtaining coverage for the claim. The insured in *Buller* represented two silo purchasers in an action against a silo distributor. 648 N.W.2d at 706. After the case was tried, the purchasers sued the insured for malpractice, alleging that they were damaged by his failure to properly plead fraud and punitive damages. The trial court in the underlying case found on September 22, 1992 that the parties had not tried a fraud claim by consent. The Minnesota Supreme Court affirmed the decision on June 24, 1994. *Id.*

In June 1993, the insured had completed the application for his 1993-94 malpractice insurance policy. Although the application included a question regarding whether he was aware of "any incident which could reasonably result in a claim being made against [him]," the insured did not disclose the silo purchasers' potential claim against him. 648 N.W.2d at 706. When the former clients commenced a malpractice action, the carrier denied the insured's claim for coverage. The carrier cited the claims-made policy's insuring agreement, which provided that the policy covered prior errors and omissions, "if the insured had no knowledge of facts which could reasonably support a claim at the effective date of the first policy written and continuously renewed." *Id.* at 710.

The carrier had insured the attorney from 1987 through 1999. From 1987-1994, the policy was renewed on an annual basis. On September 15, 1994, after the firm with which the attorney practiced disbanded, the policy was cancelled. 648 N.W.2d at 711. The carrier issued a new policy on the same date insuring the attorney's new solo practice. The attorney argued that because he had been an insured under a policy issued by the carrier since 1987, the first policy written and continuously renewed was the 1987 policy. Because he did not have notice of the claim when the 1987 policy became effective, the claim fell within the insuring agreement, under the insured's interpretation of the insuring agreement. *Id.* at 710.

The court of appeals concluded that because the 1987 policy was cancelled and the insured purchased a new policy in 1994, the 1994 policy was the first policy written and continuously renewed. 648 N.W.2d at 711. The court reasoned that if the attorney had obtained a policy with another carrier in 1994, it would be clear the policy was a new policy and the same result should follow even though the insured chose to use his prior firm's carrier. Because the supreme court had affirmed the decision that the parties to the underlying action had not tried a fraud claim by consent several months before the new policy's effective date, the court affirmed the trial court's ruling that the attorney had knowledge of facts that could reasonably support a claim on the policy's effective date. *Id.*

COVERAGE FOR SEX ABUSE CLAIMS

In *B.M.B. v. State Farm Fire and Casualty Company*, No. C3-03-92, 2003 Minn. LEXIS 403 (Minn. July 10, 2003), the Minnesota Supreme Court, responding to a question certified by U.S. District Court Judge Richard Kyle, ruled that a trial court may not infer intent to injure as a matter of law from nonconsensual sexual conduct where there is a genuine issue as to whether the insured's actions were unintentional due to mental illness. The insured in *B.M.B.* sexually abused his niece, who obtained a \$1,595,000 judgment against him. Slip op. at 3. As assignee to the insured's policy rights, B.M.B. relied on expert testimony that the insured's sexual disorders prevented him from controlling his conduct and argued that his acts should be deemed unintentional under *State Farm Fire & Casualty Company v. Wicka*, 474 N.W.2d 324 (Minn. 1991). In *Wicka*, the supreme court held that an insured's actions are treated as unintentional for purposes of the intentional act exclusion when, because

of mental illness, the insured does not know the nature of the act, or cannot control his conduct. 474 N.W.2d at 331. Subsequent to *Wicka*, the supreme court ruled in several cases that an intent to injure is properly inferred as a matter of law from non-consensual sexual conduct. *See, e.g., R.W. v. T.F.*, 528 N.W.2d 869 (Minn. 1995); *Allstate Ins. Co. v. S.F.*, 518 N.W.2d 37 (Minn. 1994); *D.W.H. v. Steele*, 512 N.W.2d 586 (Minn. 1994).

The court rejected the insurer's argument that the *Wicka* holding does not apply to nonconsensual sexual contact. The court reasoned that the policy behind the intentional act exclusion – holding responsible those who choose to violate the law or intrude upon the rights of others – does not apply when the insured suffers from a mental illness. Slip op. at 9. The court noted the fact that “the insured-against conduct involves injury to members of the public” in support of its decision. *Id.*

When policyholders' counsel become aware of the limits *B.M.B.* imposes on the intentional act exclusion, coverage counsel relying solely on this exclusion will have difficulty obtaining summary judgment in a coverage action arising from sexual abuse or sexual assault. Because *B.M.B.* does not impact other exclusions explicitly directed at sexual abuse or other sexual conduct, insurers that have included these more specific policy exclusions should be able to obtain summary judgment in declaratory judgment actions seeking coverage for sexual abuse.

In another interesting sex abuse decision, *Capitol Indemnity Corporation v. Especially for Children, Inc.*, No. 01-2425, 2002 U.S. Dist. LEXIS 17121, (D. Minn. Aug. 29, 2002), the Honorable Ann Montgomery ruled that an endorsement issued to a day care center for damages “arising out of the rendering or failing to render professional services” covered negligence and strict liability claims asserted against the center when an aide purportedly molested a child enrolled there. *Id.* at 9. The court reasoned that the center provided professional services when it cared for children. Plaintiff's allegations that the center had failed to perform duties in hiring and supervising the aide and in caring for the child “[could] only be described as falling within the scope of failure to render professional services.” *Id.* at 11. In contrast, the court held that the endorsement did not cover battery and negligence claims against the aide, whose duties “did not include sexually abusing the children under his care.” *Id.* ▲