
THE RESTATEMENT OF THE LAW OF LIABILITY INSURANCE HAS BEEN APPROVED: NOW WHAT?

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INTRODUCTION

In May 2018, The American Law Institute ("ALI") membership approved the final draft of the Restatement of the Law of Liability Insurance (the "RLLI"), paving the way for it to be published and injected into liability insurance debates nationwide. If you defend policyholders or represent insurance carriers, you have no doubt heard about the RLLI and considered how it might impact your practice or the clients you represent. You are maybe even one of the hundreds of people who have written law review articles, white papers, blog posts, and other commentary about the RLLI, its controversial history, and the impact it will have on the law of liability insurance. A substantial amount has been written in recent years about some of the more controversial sections of the RLLI, including sections that address policy interpretation and insurer liability for the conduct of defense counsel. And even though several significant changes were made to these and other sections of the RLLI in the lead up to its final approval, the influence of the RLLI in Minnesota and elsewhere will remain a hotly debated issue given how the law of liability insurance varies, in some ways sharply, from state to state.

So now that the RLLI has been approved, it is time to look forward and ask, "now what?" Or more specifically, what does the approval of the RLLI mean for attorneys representing policyholders and insurance carriers in

Minnesota? After briefly introducing and discussing the history of the RLLI, we quickly shift our attention to these pertinent questions. One thing is certain: the rules adopted by the RLLI are not the law in Minnesota and will not become the law unless and until they are adopted by the Minnesota Supreme Court. The first part of this article will therefore focus on how the Minnesota Supreme Court has approached Restatements in the past, as well as how a limited number of courts around the country have already begun to grapple with the RLLI, in an attempt to illustrate circumstances under which a rule adopted by the RLLI would not be adopted as law in Minnesota. This discussion will hopefully provide defense and insurance attorneys in Minnesota with a roadmap to follow as the RLLI inevitably comes up in future cases.

This article then briefly touches on a few of the provisions adopted by the RLLI in the context of Minnesota law. This discussion not only recognizes the extent to which the law of liability insurance is already well established in Minnesota such that resort to RLLI concepts is unnecessary, but also underscores that various RLLI provisions and the rationale for them are frankly contrary to Minnesota law. By examining just a few sections of the RLLI in the context of a single state's law, this article will hopefully demonstrate not only why there has been so much controversy surrounding

Restatement of the Law continued on page 14



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the ALI's attempt to "restate" the law in an area that varies so widely from state to state, but also why the RLLI is not a persuasive document to be cited in future Minnesota insurance coverage litigation.

THE RLLI'S LONG ROAD TO FINAL APPROVAL

The ALI, which today is comprised of 3,000 elected judges, lawyers, and law professors (including 29 from Minnesota) as well as life, honorary, and ex-officio members, was founded in the 1920s to seek to improve the law and its administration. The ALI mainly seeks to accomplish these goals through its Restatements, which the ALI describes as follows:

Restatements are primarily addressed to courts and aim at clear formulations of common law and its statutory elements, and reflect the law as it presently stands or might appropriately be stated by a court.

If you are an attorney, you are likely familiar with the ALI and its Restatements of the Law. At a minimum, you probably recall learning about and memorizing provisions from the Restatement of the Law (Second) of Contracts, the Restatement of the Law (Second) of Torts, and perhaps other venerable "old school" Restatements in law school. But, in addition to these venerable Restatements, the ALI also has recently published and is in the process of developing additional "modern" Restatements; the ALI also publishes Principles of the Law, which are much less well-known, as well as Model Codes and Studies.

Unlike Restatements, Principles are primarily addressed to legislatures, administrative agencies, and private actors with the aim of reforming or changing the law in a particular area. In other words, Restatements were originally intended to be restrained and simply restate the common law, whereas Principles were designed to have more freedom to advocate for what the ALI believes the law should be. For this reason, the ALI has traditionally not developed Restatements in areas of the law that are unsettled or that are governed by statute or administrative rules in addition to common law.

Given the distinction between the two types of publications, it is not surprising that the RLLI has had such a controversial history. Work on the RLLI first began in 2010 not as a Restatement but as the "Principles of the Law of Liability Insurance," which makes sense given the liability insurance is an area of the law that varies widely from state to state and is at least partially regulated by statute in each state. But in 2014, after the first two chapters of the Principles project had been completed and approved by the ALI's membership, the ALI changed the project to a Restatement. In the years that followed, the first two chapters were revised, and two additional chapters were added to create the four-chapter RLLI that was ultimately approved for publication in May 2018.

As the RLLI Project became more and more a reality, a greater number of insurance, defense, and business groups became sharp critics of the Project as a whole, and challenged many of its more aspirational provisions in particular. The controversy surrounding the RLLI Project ultimately reached a crescendo in May 2017 as the ALI was set to vote on a final draft of the RLLI at its annual meeting. The Defense Research Institute ("DRI"), insurance groups such as the American Insurance Association, the National Association of Mutual Insurance Companies and the National Conference of Insurance Legislators, and business leaders including the general counsels of nine major corporations, submitted letters to the ALI criticizing the RLLI and urging the ALI to defer its vote on the RLLI to allow time for further debate. The focused input ultimately led the ALI to delay its final vote until its next annual meeting in May 2018.

During the year that followed, the ALI made a few significant changes to the black letter rules of the RLLI and also made changes and additions to the fine print of the rules—the Comments and Reporters' Notes—in an attempt to address some of the criticism being directed at the RLLI from inside and outside its ranks. The revised final draft of the RLLI was ultimately presented to and approved by the ALI membership at the ALI's May 2018 annual meeting.

Now that the RLLI has been approved for publication, a book could be written about the evolution of the RLLI from the Principles project that began in 2010 to the final product that is being published this year. Some of the more contentious or aspirational legal principles that initially survived the change to a Restatement and appeared in initial drafts of the RLLI have either been removed or revised. But the final version of the RLLI is not devoid of controversy. As discussed below, the RLLI remains a "modern" Restatement in an area of the law that is not amenable to restating, and will thus be hotly debated in the courts for years to come.

AS THE RLLI HITS THE STREETS, WHEN WILL WE SEE IT IN MINNESOTA?

It should go without saying, but the ALI's final approval and ultimate publication of the RLLI does not mean that the RLLI now governs the handling of liability insurance claims and disputes in Minnesota. While Restatements are directed to courts and have historically been considered and cited by state and federal courts when presented with unresolved issues of law, Restatements are not law and do not become law until adopted by the courts of a particular state. See *Williamson v. Guentzel*, 584 N.W.2d 20, 24–25 (Minn. Ct. App. 1998) "Restatements of the law are persuasive authority only and are not binding unless specifically adopted in Minnesota by statute or case law." (citing *Mahowald v. Minnesota Gas Co.*, 344 N.W.2d 856, 860 [Minn. 1984]), *review denied* (Minn. Nov. 24, 1998). Accordingly, unless and until

the rules set forth in the RLLI are adopted by Minnesota's appellate courts or the Minnesota Legislature, they will not be binding in Minnesota.

This simple fact did not stop the Ohio Legislature from proactively trying to block the RLLI from being applied in Ohio. Shortly after the RLLI was approved, the Ohio Legislature passed a statute that provides, "The 'Restatement of the Law, Liability Insurance' that was approved at the 2018 annual meeting of the American Law Institute does not constitute the public policy of this state and is not an appropriate subject of notice." Ohio Rev. Code § 3901.82. While the statute sends a strong signal that two branches of Ohio's government do not think very highly of the RLLI, it may well be that the statute will not actually prevent Ohio's appellate courts from looking to or adopting rules set forth in the RLLI as the common law of Ohio.

If the political branches of government in a particular state seek to prevent sections of the RLLI from becoming part of the law in their state, they will need to go further than general statements about the credibility of RLLI and legislate insurance law as Minnesota has done with first-party bad faith, see Minn. Stat. § 604.18, and as California has done with its Insurance Code, see Cal. Ins. Code §§ 1 to 16032. At least one state has already responded to the RLLI in this way, as Tennessee amended Tenn. Code Ann. § 56-7-102 to add additional language regarding the interpretation of insurance policies in order to counteract the RLLI's handling of policy interpretation. Similar efforts are underway in Minnesota to preempt the Restatement of the Law (Third) of Torts' novel handling of trespasser liability by codifying existing common law. See e.g., H.F. 35, 91st Leg. (Minn. 2019-2010); H.F. 985, 90th Leg. (Minn. 2017-2018). Statutes rejecting the Restatement Third of Torts' novel "flagrant trespasser" rule have already been enacted in at least 16 states. See U.S. Chamber Institute for Legal Reform, American Law Institute Projects Quietly Reshape Civil Litigation, Lawsuit Ecosystem II: New Trends, Targets and Players (Dec. 2014) at 111 & n. 623, available at <https://www.instituteforlegalreform.com/uploads/sites/1/evolving.pdf>.

In the absence of preemptive legislation, Minnesota's appellate courts could look to the RLLI when resolving questions of law relating to liability insurance, but that does not mean they should or will. While the Minnesota Supreme Court has historically cited ALI Restatements in its decisions, it may not consider "modern" Restatements such as the RLLI and the Restatement Third of Torts to be persuasive as compared to the ALI's earlier, less-controversial Restatements. As Justice Scalia famously observed in 2015, "modern Restatements... are of questionable value, and must be used with caution." *Kansas v. Nebraska*, 135 S. Ct. 1042, 1064 (2015) (Scalia, J., concurring in part and dissenting in part). Justice Scalia went on to explain:

The object of the original Restatements was "to present an orderly statement of the general common law." Restatement of Conflict of Laws, Introduction, p. viii (1934). Over time, the Restatements' authors have abandoned the mission of describing the law, and have chosen instead to set forth their aspirations for what the law ought to be. Keyes, *The Restatement (Second): Its Misleading Quality and a Proposal for Its Amelioration*, 13 Pepp. L.Rev. 23, 24-25 (1985). Section 39 of the Third Restatement of Restitution and Unjust Enrichment is illustrative; as Justice THOMAS notes, *post*, at 1068 (opinion concurring in part and dissenting in part), it constitutes a "novel extension" of the law that finds little if any support in case law. Restatement sections such as that should be given no weight whatever as to the current state of the law, and no more weight regarding what the law ought to be than the recommendations of any respected lawyer or scholar. And it cannot safely be assumed, without further inquiry, that a Restatement provision describes rather than revises current law.

Id. As the ALI ventures into new areas of the law that were not traditionally viewed as appropriate for a Restatement and revisits its traditional Restatements with an eye toward moving the law forward, Minnesota courts should heed Justice Scalia's advice and approach such modern Restatements with caution.

Minnesota Supreme Court precedent suggests the Court will do just that. For instance, the Minnesota Supreme Court has recognized the limitations of the Restatements when there is already precedent to the contrary, stating "[w]e will not adopt a provision of a Restatement of the Law if our precedent is to the contrary and we believe that our precedent still reflects the proper rule of law." *Traventine Corp. v. Lexington-Silverwood*, 683 N.W.2d 267, 271-72 (Minn. 2004) (citing *Coyle v. Richardson-Merrell, Inc.*, 526 Pa. 208, 584 A.2d 1383, 1385 (1991) "Where the facts of a case demonstrate that the [Restatement] rule outruns the reason, the court has the power, indeed the obligation, to refuse to apply the rule, a power for the most part unavailable where the rule is legislatively ordained. Were it otherwise, our recognition of the work of the American Law Institute would approach an improper conferral of legislative authority."). These observations implicitly acknowledge the doctrine of *stare decisis*, which, in the absence of a "compelling reason" to overrule its precedent, requires the court to adhere to its former decisions "in order to promote the stability of the law and the integrity of the judicial process." *Walsh v. U.S. Bank, N.A.*, 851 N.W.2d 598, 604 (Minn. 2014) (citations omitted). The court further demonstrated this adherence to precedent and the "proper rule of law" in *Zutz v. Nelson*, when it declined to abandon what the dissent contended had become a minority position in favor of the modern

majority position proposed by the Restatement Second of Torts. 788 N.W.2d 58, 68 (Minn. 2010) (Anderson, J. Paul, dissenting).

The Minnesota Supreme Court has also recognized that even if a Restatement section is “persuasive,” the Court’s decision in a particular case “must be limited to the legal questions presented by the facts of [the] case and made within the context of [Minnesota’s] own common law.” *Moreno v. Crookston Times Printing Co.*, 610 N.W.2d 321, 332 (Minn. 2000); see also *Zutz*, 788 N.W.2d at 63 (limiting its decision to the limited issue before it and considering whether the Restatement rule is consistent with Minnesota law and public policy). In other words, the Minnesota Supreme Court will not adopt a Restatement section unless it is harmonious with Minnesota precedent and reflects sound public policy; even then, the Court will only go so far in adopting a Restatement section as the present case requires. Finally, and importantly considering the controversy surrounding the RLLI, the Minnesota Supreme Court has made clear that it will look to how a Restatement section has been received by other courts when considering whether to adopt it. See e.g., *Domagala v. Rolland*, 805 N.W.2d 14, 24 (Minn. 2011) (citing heavy criticism from multiple jurisdictions and significant public policy concerns in declining to adopt Section 321 of the Restatement Second of Torts).

Minnesota’s appellate courts have not yet been asked to adopt sections of the RLLI, but several courts nationally have. Early case law referencing the RLLI has, for the most part, taken the type of restrained approach hoped for and even expected based on the particular court’s precedent — a methodology similar to what would be employed by Minnesota’s appellate courts. In one of the first decisions addressing the RLLI after its adoption, the Superior Court of Delaware, applying Tennessee law, held that an insurer was entitled to reimbursement of defense costs based on a 10-year-old Tennessee federal district court decision rather than following the purported “trend” toward not allowing reimbursement of defense costs reflected in Section 21 of the RLLI. *Catlin Specialty Ins. Co. v. CBL & Assocs. Properties, Inc.*, 2018 WL 3805868, at *3-5 (Del. Super. Ct. Aug. 9, 2018). See also *Outdoor Venture Corp. v. Philadelphia Indem. Ins. Co.*, 2018 WL 4656400, at *18 (E.D. Ky. Sept. 27, 2018) (rejecting the RLLI’s rule as to independent counsel as contrary to Kentucky law); *Progressive Nw. Ins. Co. v. Gant*, 2018 WL 4600716, at *6 (D. Kan. Sept. 24, 2018) (refusing to use the a RLLI provision that had not been relied upon or adopted by Kansas courts “as a means to overturn or expand Kansas law”), appeal filed (Oct. 24, 2018). In another decision, even though the Nevada Supreme Court ultimately followed the RLLI’s rule with respect to consequential damages, it first analyzed related Nevada law and the majority and minority rules as to consequential damages independently to reach its decision before citing the RLLI as additional support. See *Century Sur. Co. v. Andrew*, 134 Nev. Adv. Op. 100, 432 P.3d 180, 186 (2018). In a footnote in the same decision, however, the Nevada Supreme Court took the

opposite approach and cited the RLLI’s four-corners rule rather than its own precedent for the proposition that “as a general rule, facts outside of the complaint cannot justify an insurer’s refusal to defend its insured.” *Id.* at 184 n. 4.

Given the way Minnesota courts are likely to approach the RLLI and the ongoing controversy surrounding its persuasiveness as a Restatement in general, there are few if any valid reasons to cite it in Minnesota. Admittedly, there are provisions in the RLLI that might inure to a party’s benefit if cited to complement a particular position in a particular case, but the citation of one RLLI section arguably provides credibility to the RLLI as a whole, including to its more controversial provisions. Critically, and as noted above, Minnesota courts should not be persuaded by the RLLI’s provisions unless the provision is harmonious with Minnesota law and reflects the better rule of law for a particular situation. Accordingly, it is much more persuasive to cite to controlling Minnesota precedent, even if it is not directly on point or to argue that a particular rule should be adopted based on decisions from other jurisdictions, since this is the methodology the Court will utilize to evaluate the merits of a party’s arguments before looking to the RLLI.

THE TIP OF THE ICEBERG: A CURSORY LOOK AT A FEW SECTIONS OF THE RLLI IN THE CONTEXT OF MINNESOTA LAW

Several sections of the final draft of the RLLI that was approved for publication remain quite controversial, and it therefore makes sense to examine at a few of these sections in the context of Minnesota law. Given the brevity of this article, it is impossible to fully analyze each of the following RLLI sections, much less all 50 sections of the Restatement. The observations that follow, however, do raise questions, consistent with the above discussion, about whether the RLLI is an appropriate secondary source upon which a Minnesota practitioner should rely when litigating coverage issues.

We begin with the RLLI’s scaled-back but still unique approach to “The Plain-Meaning Rule” in Section 3. We next discuss Section 12 “Liability of Insurer for Conduct of Defense,” which is probably the most controversial section of the RLLI. We then discuss three defense sections—Section 13 “Conditions Under Which the Insurer Must Defend,” Section 15 “Reserving the Right to Contest Coverage,” and Section 16 “The Obligation to Provide Independent Defense”—given that they address issues that arise in nearly every coverage case. Finally, we conclude with the insurer’s “Duty to Make Reasonable Settlement Decisions” set forth in Section 24, focusing on the RLLI’s use of “reasonableness” as a standard and the interplay between Section 24 and Section 11, which governs “Confidentiality.”

THE PLAIN-MEANING RULE WITH A TWIST

Section 3 of the RLLI was one of the few rules that was scaled back between the ALI's 2017 and 2018 annual meetings. In the version of the RLLI that was to be presented for a final vote in May 2017, Section 3 made "plain meaning" a presumption that could be overcome by extrinsic evidence. See RLLI Council Draft No. 4 (December 4, 2017), § 3(2) "An insurance policy term is interpreted according to its plain meaning, if any, unless extrinsic evidence shows that a reasonable person in the policyholder's position would give the term a different meaning. That different meaning must be more reasonable than the plain meaning in light of the extrinsic evidence, and it must be a meaning to which the language of the term is reasonably susceptible." The RLLI Reporters argued that, although novel, their presumption approach was supported by and consistent with the contextual approach to policy interpretation used in some jurisdictions, including California, as well as the Restatement of the Law (Second) of Contract's approach to contractual interpretation.

Ultimately, the Reporters scaled back the presumption rule to adopt the strict plain-meaning rule that is "generally" considered to be the rule in the vast majority of states, including Minnesota. Compare RLLI Final Draft No. 2 – Revised (2018), § 3(2) ("If an insurance policy term has a plain meaning when applied to the facts of the claim at issue, the term is interpreted according to that meaning.") with *Commerce Bank v. W. Bend Mut. Ins. Co.*, 870 N.W.2d 770, 773 (Minn. 2015) ("An insurance policy must be read as a whole, and unambiguous language must be given its plain and ordinary meaning."); *Eng'g & Constr. Innovations, Inc. v. L.H. Bolduc Co.*, 825 N.W.2d 695, 704 (Minn. 2013) ("Where the language of an insurance policy is clear and unambiguous, we effectuate the intent of the parties by interpreting the policy according to plain, ordinary sense." [quotations omitted]). Based on this comparison, it would be easy to presume Section 3 presents the same standard as that utilized in Minnesota to interpret policy language. However, when the content in Section 3's Comments and Reporters Notes is considered, it becomes clear the "rule" enunciated in Section 3 does not fully track with Minnesota law.

The Comments to Section 3 provide that courts that follow a plain-meaning rule may consider generally accepted sources of plain meaning such as dictionaries and court decisions. See RLLI § 3, cmt. b. This portion of the "generally accepted sources" comment is not necessarily controversial given that Minnesota courts have long cited such sources in analyzing the plain meaning of insurance policy terms. See, e.g., *Russell v. Sentinel Ins. Co., Ltd.*, 906 N.W.2d 543, 546 (Minn. Ct. App. 2018) "We apply the ordinary meaning of terms not defined in an insurance policy, as well as the interpretations adopted in prior cases. And we may rely on dictionary definitions in determining the ordinary meaning of insurance-policy terms" (quotations omitted). *But see*

Sylvester Bros. Dev. Co. v. Great Cent. Ins. Co., 480 N.W.2d 368, 375 (Minn. Ct. App. 1992) "The existence of multiple dictionary definitions of [a] word... does not prove the word is ambiguous. Dictionaries are helpful insofar as they set forth the ordinary, usual meaning of the words. However, dictionaries are 'imperfect yardsticks of ambiguity.' We must determine whether the word... is ambiguous in the context of the specific insurance policies at issue." (citations omitted).

But the Section 3 comments go on to then state that generally-accepted sources of plain meaning can also include matters such as custom, practice, and usage in the insurance market. See RLLI § 3, cmt. c. This "custom, practice, and usage" comment appears to be a vestige of the analysis the Reporters utilized in justifying the "plain meaning presumption" rule that ultimately was not adopted by the ALI membership. See RLLI § 3, Notes a (reciting case law and other authority favoring a contextual approach to analyzing whether a policy term is ambiguous), c (reciting case law and authority for the consideration of extrinsic evidence such as custom, practice, and usage in determining whether a term has plain meaning). "Custom, practice, and usage" implies an ability to provide a court with a contextual interpretation of policy language beyond the simple application of the facts of the claim to the language in the policy in light of pertinent state law. Such an approach invites the submission of true extrinsic evidence to determine whether a term is plain and unambiguous. As well, should such materials be considered, there is a likelihood that identical terms of a liability policy could have different meanings depending on the industry to which the insurance applies. The submission of extrinsic evidence and a real potential of a "duplication" of a term's meaning is contrary to Minnesota case law, which strives to consistently interpret clear and unambiguous insurance policy language as a matter of law.

The RLLI Landmine: Liability of Insurer for Conduct of Defense

Section 12 is probably the most controversial provision in the RLLI. In the end, the RLLI did not adopt a vicarious liability rule as proposed in earlier drafts which would have held an insurer vicariously liable for the appointed defense counsel's professional obligation breaches. See RLLI Council Draft No. 4 (December 4, 2017), § 12(1). Such a rule has been rejected in the majority of jurisdictions, but not yet addressed in Minnesota, see *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602, 616 (Minn. 2012) (declining to determine whether an attorney appointed by an insurance company to represent an insured can be an agent of the insurance company so as to make the insurance company vicariously liable for the conduct of the attorney).

Instead, the RLLI proposes two situations in which an insurer might be directly liable for the conduct of counsel

appointed to defend the insured, regardless of whether a reservation of rights letter is involved in the extension of the defense. Despite the rollback in the Section 12 rule, there is even less support for the final version of the rule set forth in Section 12 than the widely rejected vicarious liability rule. As the ALI readily admits in the Notes to Section 12, there is a “dearth” of case law holding liability insurers liable in either of the proposed situations. Rather than established case law, the proposed final Section 12 rule appears to be derived entirely from other ALI Restatements, a law review article, and implicit statements in four cases. It is thus not hard to understand the controversy the final version of Section 12 has generated.

Section 12 first proposes that an insurer should be tortiously liable for its failure to reasonably determine whether defense counsel is competent if the purported incompetency later results in the insured personally incurring liability in the action (usually through an excess verdict). In support of this proposition, Section 12’s Comments discuss situations in which defense counsel may have some infirmity known to the insurer that compromises the defense of the action or may fail to maintain “adequate” malpractice coverage with regard to the assigned matter as examples of the heavily fact-dependent circumstances that may impose such liability on an insurer. See RLLI § 12, cmts. b (addressing insurer liability for negligent selection of defense counsel in general) and c (addressing insurer liability for retaining defense counsel with inadequate professional liability insurance but then stating the “Restatement takes no position on this issue, because no court has yet addressed it”). But, again, the ALI readily admits in the Notes to Section 12 that there is a dearth of reported cases holding liability insurers directly liable in such situations. And we are not aware of any in Minnesota.

Second, Section 12 would hold an insurer tortiously liable if the insurer directs defense counsel to override counsel’s independent professional judgment and commit a negligent act or omission which is later determined to be to the personal financial detriment of the insured. Section 12’s Comments appear to justify this rule by implying that since traditional theories of liability such as agency, vicarious liability, apparent authority, and negligent supervision may not apply in a tripartite relationship situation, a separate insurer liability model with regard to counsel selection and defense handling needed to be articulated. But given the lack of case law holding insurers liable under such circumstances, it is unclear why the ALI believed such a rule was needed. After all, Restatements are meant to “reflect the law as it presently stands or might appropriately be stated by a court” rather than create the law, as the ALI appears to be trying to do in Section 12.

A detailed substantive analysis of Section 12’s rules and shortcomings — including the extent to which Section 12 attempts to create rules of law instead of restating rules of law — is beyond the scope of this article. But, given the controversial nature of Section 12, see *Domagala*, 805

N.W.2d at 24 (refusing to consider a controversial section of the Restatement Second of Torts), and how the Minnesota Supreme Court has analyzed legal issues involved with the tripartite relationship in the past, see *Pine Island Farmers Coop v. Erstad & Riemer, PA*, 649 N.W.2d 444, 449 (Minn. 2002) (recognizing “that defense counsel hired by an insurer to defend a claim against its insured represents the insured” and “owes a duty of undivided loyalty to the insured and must faithfully represent the insured’s interests”), it seems unlikely that the court would find the rules created in Section 12 to be persuasive, much less adopt them as the law in Minnesota.

EVERYDAY TASKS: DETERMINING DUTY TO DEFEND, RESERVING RIGHTS, AND APPOINTING DEFENSE COUNSEL

While the most polarizing sections of the RLLI receive the vast majority of the attention, the RLLI covers all aspects of liability insurance and therefore has the potential to impact even the most basic tenets of liability insurance — an insurer’s determination as to whether it has a duty to defend, potentially reserving rights once the determination has been made, and appointing defense counsel. The RLLI’s handling of these everyday tasks is significant.

SECTION 13 – CONDITIONS UNDER WHICH THE INSURER MUST DEFEND:

The complaint-allegation rule (more commonly referred to as the four-corners or eight-corners rule) adopted in Section 13(1) of the RLLI is not the rule in Minnesota. Even more so, the extension of this Section 13(1) rule in Section 13(2)(b) to permit the insured to also rely on additional allegations not contained in the pleading to invoke a duty to defend is also not the rule in Minnesota. Quite to the contrary, Minnesota allows consideration of not only the pleading’s allegations, but also facts extrinsic to the pleading, to allow both an insured and an insurer to determine if an insurer’s duty to defend is invoked.

“[T]he general rule in Minnesota is that ‘[t]he obligation to defend is contractual in nature and is generally determined by the allegations of the complaint against the insured and the indemnity coverage afforded by the policy.’” *AMCO Ins. Co. v. Inspired Techs., Inc.*, 648 F.3d 875, 880–81 (8th Cir. 2011) (quoting *Farmers & Merchs. State Bank of Pierz v. St. Paul Fire & Marine Ins. Co.*, 309 Minn. 14, 242 N.W.2d 840, 842 [1976]). But “the complaint is not controlling when actual facts clearly establish the existence or nonexistence of an obligation to defend.” *Id.* (quoting *Farmers & Merchs. State Bank*, 242 N.W.2d at 842 [quotation and citation omitted]). See also *Meadowbrook, Inc. v. Tower Ins. Co.*, 559 N.W.2d 411, 419 (Minn. 1997) (“[T]his court typically will determine a duty to defend by comparing only those allegations in the complaint with the appropriate language in the policy. Only when actual facts within the insurer’s

Restatement of the Law continued from page 18

knowledge clearly establish the existence or nonexistence of an obligation to defend, will this court hold that the complaint is not controlling.” [quotations omitted]). In other words, Minnesota law permits an insurer to properly decline to defend an insured when facts extrinsic to the pleadings establish there is no duty to defend. Minnesota’s “extrinsic facts” rule permits an insurer to properly decline to defend the insured in all circumstances and not just the limited exceptions set forth in RLLI Section 13(3). Therefore, citation to Section 13 to support a claim that a defense is owed is simply contrary to Minnesota law.

SECTION 15 – RESERVING THE RIGHT TO CONTEST COVERAGE:

Section 15 of the RLLI governs reservation of rights letters, and while the rule is relatively straightforward, it is worth mentioning as it likely imposes greater obligations and liabilities on insurers than does Minnesota coverage law.

For instance, Section 15 requires that an insured provide “detailed notice” of any ground for contesting coverage that it knows or should know. While the Minnesota Supreme Court has not specifically articulated the level of detail required for a reservation of rights letter to be effective, case law suggests that it may not require the level of detail contemplated by Section 15. *See e.g., Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602, 616 (Minn. 2012) (“When an insurer has a duty to defend a liability claim for which it questions coverage, the insurer must expressly inform its insured that it accepts defense of the claim subject to its right to later contest coverage of the claim based on facts developed at trial.”); *Nw. Airlines, Inc. v. Fed. Ins. Co.*, 32 F.3d 349, 356 (8th Cir. 1994) (applying Minnesota law and holding that although insurer could have been far more specific in its reservation of rights letter, the insurer adequately reserved its right to deny coverage). Section 15 also imposes a heavy burden on an insurer — to timely update its reservation of rights as it learns of new information — that may go beyond what is required under Minnesota law.

The RLLI’s endorsement of the doctrines of waiver and estoppel in the reservation of rights context in the Comments to Section 15 as well as Sections 5 and 6, which specifically deal with waiver and estoppel, also goes well beyond Minnesota law. In Minnesota, waiver and estoppel generally cannot be used to expand or create insurance coverage where it does not otherwise exist. *Shannon v. Great Am. Ins. Co.*, 276 N.W.2d 77, 78 (Minn. 1979) “The policy considerations in support of this principle are well founded, for it would be wholly improper to impose coverage liability upon an insurer for a risk not specifically undertaken and for which no consideration has been paid.” A limited exception to this rule estops an insurer from relying on coverage defenses, up to the policy limits, when the insurer, with full knowledge of the relevant facts, defends the insured without issuing a reservation of rights, and the insured is substantively prejudiced by the failure to issue the letter. *Faber v. Roelofs*, 311 Minn. 428, 431-32, 250 N.W.2d 817, 820 (1977); *see also*

NewMech Cos., Inc. v. Transp. Ins. Co., 2006 WL 2632096, at *10 (D. Minn. 2006) “The doctrine of estoppel operates in such a circumstance to prevent an insured from being left in the untenable position of having no voice in the litigation where the insurer is defending its own interests, not those of the insured.” (citing *Patterson v. Adan*, 119 Minn. 308, 138 N.W. 281, 283 [1912]). “Assumption-of-defense estoppel is narrowly applied, however, and is not applicable where the insurer has refused the defense of the insured, where the insurer gives a notice of a reservation of rights, or where the insurer does not conduct the defense with knowledge of the relevant facts.” *Minn. Commercial Ry. Co. v. Gen. Star Indem. Co.*, 408 F.3d 1061, 1063-64 (8th Cir. 2005) (internal citations omitted). In *Minn. Comm. Ry. Co.*, the court further recognized that under Minnesota law, “[a]bsent prejudice to the insured, a late reservation of rights will not result in a waiver of the insured’s right to assert a policy exclusion.” *Id.* at 1028 (quoting *Nw. Airlines*, 32 F.3d at 356) (citing *St. Paul School District v. Columbia Transit Corp.*, 321 N.W.2d 41 [Minn. 1982]), *aff’d*, 408 F.3d 1061 (8th Cir. 2005).

Under Minnesota law, an insurer may also be estopped from claiming that the insured has the burden of allocating an arbitration award between covered and uncovered amounts where 1) the insurer fails to notify the insured in its reservation of rights letter of the insured’s interest in obtaining a written explanation of the arbitration award that identifies the claims or theories of recovery actually proven and the portions of the award attributable to each, and 2) the insured shows the required conditions, including prejudice to the insured, were satisfied. *See Remodeling Dimensions*, 819 N.W.2d at 618. But even if estoppel is found in this limited situation, the remedy is simply that the burden shifts to the insurer to prove by a preponderance of the evidence that some part of the award is attributable to a noncovered claim. *Id.*

Unlike Minnesota law, the RLLI does not mention prejudice in the context of Section 15 or Sections 5 and 6 and endorses a much broader application of waiver and estoppel in the reservation of rights context. Therefore, it is questionable whether these Restatement provisions are persuasive for a court considering the issues raised in these Sections.

SECTION 16 – THE OBLIGATION TO PROVIDE AN INDEPENDENT DEFENSE:

The independent counsel rule adopted in Section 16 of the RLLI facially appears to be consistent with Minnesota law. As such, there does not appear to be any reason a Minnesota practitioner would need to cite to Section 16 over well-settled Minnesota caselaw.

In Minnesota, an insurer retains the right to appoint counsel even after the issuance of a reservation of rights absent the showing of “actual conflict.” *Mut. Serv. Cas. Ins. Co. v. Luetmer*, 474 N.W.2d 365, 368 (Minn. Ct. App. 1991); *see also Hawkins, Inc. v. Am. Int’l. Specialty Lines Ins. Co.*, 2008 WL 4552683

Restatement of the Law continued on page 20

at *7 (Minn. Ct. App. Oct. 14, 2008). But, where a conflict is shown to exist, an insurer must pay for independent defense counsel selected by the insured if the insured opts to hire its own counsel. *Select Comfort Corp. v. Arrowood Indem. Co.*, No. CIV. 13-2975 JNE/FLN, 2014 WL 4232334, at *5 (D. Minn. Aug. 26, 2014) (citing *Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 [Minn. 1979]). A conflict exists when the underlying action will involve trial of a fact issue on which the insured and insurer would be on opposing sides in a coverage dispute that the insurer reserved its right to raise. *Id.* (citing *Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 167 n. 6 (Minn. 1986), noting that “in cases where the parties agree and the main action can be tried without having to try a fact issue that also creates a conflict of interest, the reservation of rights device can be a useful, simple, and inexpensive method of handling the litigation”).

These concepts are similar to Section 16. Under Section 16, if a reservation of rights is issued, an independent defense would be owed when “there are facts at issue that are common to the legal action for which the defense is due and to the coverage dispute, such that the action could be defended in a manner that would benefit the insurer at the expense of the insured” Section 16’s Comments show that a right to an independent defense is not automatically activated by a demand in excess of limits (Comment c.), or by the mere assertion of a claim for punitive damages unless more dynamics are in play (Comment d.). It also appears the mere issuance of a reservation of rights letter does not activate a right to an independent defense.

THE DUTY TO MAKE REASONABLE SETTLEMENT DECISIONS

Section 24 conceptualizes an insurer’s “duty to settle” as an obligation to make “reasonable settlement decisions.” An insurer is obligated to make “reasonable settlement decisions” when the insurer has authority to “settle a legal action brought against the insured, or the insurer’s prior consent is required for any settlement by the insured to be payable by the insurer” and the insured is faced with an exposure in excess of its coverage limits. A “reasonable settlement decision” is one that would be made by a “reasonable insurer” that would have “sole financial responsibility for the full amount of the potential judgment,” including making the policy limits “available to the insured for the settlement of a covered legal action that exceeds those policy limits if a reasonable insurer would do so in the circumstances.”

There are several concerns about whether Section 24 reflects a general black letter rule, the least of which is that it potentially converts every unsuccessful insurer negotiation resulting in an excess verdict into a *post hoc* jury trial over what a “reasonable insurer” would have “reasonably” done. As well, the rule fails to take into consideration what an insurer is entitled to consider when some of the lawsuit’s claims are not covered in light of Section 11’s

confidentiality rule — a rule which could be manipulated by an insured to avoid disclosure to an insurer of information that is needed to accurately determine what amount of the damages comprising the potential excess verdict would or would not be covered. See RLLI § 11(2) (“An insurer does not have the right to receive any information of the insured that is protected by attorney-client privilege, work-product immunity, or a defense lawyer’s duty of confidentiality under rules of professional conduct, if that information could be used to benefit the insurer at the expense of the insured.”). This is a concern despite the RLLI’s attempt to address this issue in Section 25 (discussing effects a reservation of rights letter may have on the duty to make reasonable settlement decisions).

But what is certain about Section 24 is that while the RLLI casts this duty as a breach of contract, Minnesota need not recast the duty as such because Minnesota case law generally addresses this subject. For example, in *Short v. Dairyland Ins. Co.*, 334 N.W.2d 384, 387-88 (Minn. 1983), the Minnesota Supreme Court defined when an insurer may be liable in excess of its policy limits for failing to settle a case it defends (and therefore has authority to settle). *Short* held the insurer is in breach of its duty of good faith and therefore liable:

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.

In these situations, *Short* cited longstanding Minnesota caselaw recognizing an insurer’s obligations to consider offers to compromise an action within the applicable policy limits and to “view the situation as if there were no policy limits applicable to the claim, and to give equal consideration to the financial exposure of the insured.” *Id.* at 388 (citation omitted).

Given *Short* considered the insurer’s failure to keep the insured apprised of settlement demands and offers to be potential evidence of the insurer’s bad faith, it appears *Short* and the jurisprudence upon which it relied is more than sufficient to provide the framework to analyze the issues raised in RLLI Section 24. Therefore, it makes little sense to cite to Section 24, especially when *Short* and the principles it cites have ongoing vitality under Minnesota law. See e.g. *Kissoondath v. U.S. Fire Ins. Co.*, 620 N.W.2d 909 (Minn. Ct. App. 2001). Moreover, recent caselaw clarifying the breadth of the principles discussed in *Short* shows there is no basis to advocate the Restatement rule over Minnesota law. See e.g. *St. Paul Fire and Marine Ins. Co. v. A.P.I., Inc.*, 738 N.W.2d 401 (Minn. Ct. App. 2007) (declining to extend an insurer’s obligations where the insurer did not have authority to “settle a legal action brought against the insured” because the insurer did not defend the insured), *review denied* (Minn. Dec. 11, 2007). Because Minnesota case law already adequately

addresses the main issues discussed within Section 24, there is no need to look to Section 24 as persuasive authority in cases analyzing an insurer's obligations with regard to settlement negotiations.

CONCLUSION

After an eight-year journey from a principles project to a Restatement, the RLLI is now a reality. But that does not mean the RLLI is the law in Minnesota, or that it ever

will be. The RLLI remains highly controversial and will be debated section by section for years to come in courts around the country, including in Minnesota. As the debate over the RLLI heads to the courts, this article provides some helpful context regarding not only the RLLI and its more controversial sections, but also how the Minnesota Supreme Court has approached the ALI's other Restatements and thus illustrates why the RLLI is likely not a secondary source for citation in Minnesota coverage litigation.



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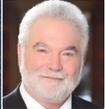
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Su	Mo	Tu	We	Th	Fr	Sa
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28		

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