STATE OF MINNESOTA
IN COURT OF APPEALS
A08-0996

Royal Indemnity Company, successor in interest
to Royal Insurance Company of America,
Appellant,

vs.

C. H. Robinson Worldwide, Inc.,
Respondent

Filed July 21, 2009
Affirmed in part, reversed in part, and remanded
Peterson, Judge

Hennepin County District Court
File No. 27-CV-06-19200

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Considered and decided by Peterson, Presiding Judge; Connolly, Judge; and Johnson, Judge.

U N P U B L I S H E D O P I N I O N

PETERSON, Judge

This appeal is from a grant of summary judgment in favor of a second excess insurer, appellant Royal Indemnity Company, in an insurance-coverage declaratory-judgment action against its insured, respondent C. H. Robinson Worldwide, Inc.

(CHRW). CHRW filed a notice of review. We affirm in part, reverse in part, and remand.

FACTS

CHRW had a primary policy for employment-practices liability insurance from Gulf Underwriters Insurance Co. that contains a $10 million limit of liability and a duty to defend. CHRW also had excess-liability coverage. The first layer of CHRW's excess-liability coverage was provided by a Nutmeg Insurance Co. policy with a $10 million limit of liability, which follows form to the underlying Gulf policy, except as to the duty to defend. The second layer of excess-liability coverage was provided by Royal's policy, which has a $10 million limit of liability and also follows form to the underlying policies.

In 2002, current and former CHRW employees brought a nationwide class-action lawsuit against CHRW in federal district court (*Carlson* Litigation), alleging gender-discrimination, hostile-work-environment, compensation, and promotion claims. CHRW tendered defense and indemnification to Gulf, Nutmeg, and Royal. The insurers accepted, subject to reservations of their rights.

In 2005, the federal district court granted class certification for the compensation and promotion claims, but denied certification for other claims. Following this order, individuals with claims outside the scope of the certified classes filed administrative charges with the Equal Employment Opportunity Commission (EEOC), and some of these individuals commenced lawsuits (EEOC lawsuits).

As litigation progressed, Gulf, Nutmeg, and Royal questioned the necessity and reasonableness of the defense costs submitted, as well as the sufficiency of defense

counsel's billing practices, but the billing disputes were not resolved. Defense costs exhausted the $10 million liability limit of Gulf's primary policy.

One week before trial was scheduled to begin, CHRW demanded authorization for a settlement offer of up to $15 million, which was within its remaining insurance limits with Nutmeg and Royal. CHRW threatened to sue for excess/uninsured exposure if the insurers refused to pursue the settlement in good faith. Nutmeg and Royal consented to the settlement offer, but Royal expressly reserved its rights to continue to dispute coverage and to seek reimbursement for uncovered claims included in the settlement and to recoup improperly paid defense costs. CHRW settled for $15 million. Nutmeg paid $8.5 million toward the settlement, with the remainder of its $10 million limit going toward defense costs, and Royal contributed $6.5 million. The settlement agreement included the creation of a Qualified Settlement Fund to be administered by trustees for the purpose of distributing the settlement funds.

Royal then commenced this declaratory-judgment action against CHRW to pursue its coverage and defense-costs challenges. In several orders, the district court granted summary judgment in favor of CHRW, concluding that (1) Royal had no independent cause of action against CHRW to challenge whether the underlying insurers paid for noncovered claims that did not properly exhaust their respective liability limits; (2) taxes and severance payments were covered losses under the policy; and (3) the EEOC lawsuits were sufficiently related to the class-action lawsuit to be covered, except as to one plaintiff. The district court referred the defense-costs issue to a special master, and the

parties ultimately stipulated to accept the findings by the special master as to the reasonableness of the defense costs.

After judgment was entered, Royal filed this appeal. CHRW filed a notice of review.

D E C I S I O N

On appeal from summary judgment, a reviewing court must determine whether there are any genuine issues of material fact and whether the district court erred in its application of the law. *State by Cooper v. French*, 460 N.W.2d 2, 4 (Minn. 1990). The reviewing court views the evidence in the light most favorable to the nonmovant. *Fabio v. Bellomo*, 504 N.W.2d 758, 761 (Minn. 1993). "Insurance coverage issues and the interpretation of insurance contract language are questions of law," which will be reviewed de novo. *Jenoff, Inc. v. N.H. Ins. Co.*, 558 N.W.2d 260, 262 (Minn. 1997).

A court will interpret insurance policies pursuant to the general principles of contract law. *Thommes v. Milwaukee Ins. Co.*, 641 N.W.2d 877, 879 (Minn. 2002). "In interpreting insurance contracts, we must ascertain and give effect to the intentions of the parties as reflected in the terms of the insuring contract." *Jenoff*, 558 N.W.2d at 262. The insured bears the burden of demonstrating coverage under an insurance policy *Travelers Indem. Co. v. Bloomington Steel & Supply Co.*, 718 N.W.2d 888, 894 (Minn. 2006). If this burden is met, the insurer must then establish the applicability of exclusions, which will be "construed narrowly and strictly against the insurer." *Id.*

I.

The district court concluded that Royal "has no independent cause of action as against [CHRW] to challenge amounts paid to exhaust the policy limits of the underlying insurers Gulf and Nutmeg, or for recoupment of defense costs paid under CHRW's policies with the two prior insurers." In its memorandum, the court explained:

> Royal's right to challenge amounts paid or owing only applies to amounts owed by Royal, through its contribution to the settlement and defense costs submitted to Royal by CHRW. Royal has no right, through contract or subrogation, to an *ex post facto* challenge of amounts paid by Gulf or Nutmeg after exhaustion of those underlying policies.

The court further explained that "Royal can cite to no Minnesota authority that allows an excess carrier to challenge the amounts paid by other carriers, not paid under the terms of the excess carrier's own contract, let alone recoup amounts that may have been wrongfully paid out by others."

It appears that in reaching its conclusion, the district court misunderstood Royal's claim. As we understand the claim, Royal is challenging the amounts that it paid through its contribution to the settlement, alleging that under the terms of its own policy, it was not obligated to pay the full amount that it contributed. Royal's argument is based on provisions in its policy that state that Royal's "[l]iability for any covered Loss . . . shall attach . . . only after the insurers of the Underlying Policies shall have paid in legal currency the full amount of the Underlying Limit" and that "[i]n the event . . . of the . . . exhaustion of the Underlying Limit *by reason of* the insurers of the Underlying Policies paying in legal currency Loss, this policy shall . . . continue in force as primary

insurance." (Emphasis added.) In other words, Royal's liability as an excess insurer attaches when the liability limits of the underlying policies have been exhausted because the underlying insurers have made payments for loss. Royal claims that because the underlying Gulf policy specifically defines "Loss," it is not sufficient under Royal's policy for CHRW to show only that the underlying insurers made payments in the amount of the underlying liability limits; it is also necessary for CHRW to show that the payments that were made fit within the policy definition of "Loss." Therefore, if Gulf and Nutmeg made payments that did not fit within the policy definition of "Loss," CHRW cannot rely on those payments to establish that the underlying policies have been exhausted.

The primary Gulf policy, to which the Royal policy follows form, defines "Loss" to mean,

> 1. any amount which an Insured becomes legally obligated to pay as the result of a covered Claim or Claims . . . for Wrongful Employment Acts, including but not limited to damages (including back pay and front pay), judgments (including an award of pre-judgment and post-judgment interest) and settlements; and
>
> 2. Defense Costs.

The policy defines "Defense Costs" to mean "that part of Loss consisting of the reasonable costs, charges and expenses (including but not limited to attorney fees) incurred in defending or investigating Claims, including appeals therefrom." Royal's claim is that CHRW cannot rely on payments for claims that are not covered or defense costs that are not reasonable to establish that the underlying policies have been exhausted.

We disagree with the district court that Royal cannot assert this claim against CHRW. The claim may appear to be an ex post facto challenge to the amounts that Gulf and Nutmeg paid under their policies because the district court considered it after the settlement occurred and the insurers made their contributions to the settlement. But Royal's policy was in effect when the payments were made, and Royal had previously asserted to CHRW that its coverage did not include certain claims. And in response to CHRW's settlement demand, Royal stated that to the extent the settlement included uncovered claims, it would require—and it received—CHRW's written acknowledgement that Royal "reserved its right to continue to dispute coverage for the uncovered claims, and to seek reimbursement for any amounts attributable to such claims." Royal also reserved its right to be reimbursed by CHRW "for any defense costs paid by the insurance tower, including all underlying insurers, which were not covered or which were otherwise not reasonable and/or necessary to the defense of coverage litigation and claims."

Furthermore, an insurer "owes its insured a duty of good faith in deciding whether to accept or reject a settlement." *Cont'l Cas. Co. v. Reserve Ins. Co.*, 307 Minn. 5, 8, 238 N.W.2d 862, 864 (1976). If the settlement offer had collapsed because Royal wanted to resolve whether its liability attached because the underlying coverage was properly exhausted, Royal could be liable for a bad-faith, failure-to-settle claim, which CHRW in fact threatened. *See, e.g.*, 1 Allan A. Windt, *Insurance Claims & Disputes*, § 2:1, at 55-56 (4th ed. 2001) (discussing similar situation).

Consequently, we conclude that Royal may assert its claim that under the terms of the Royal policy, if Gulf and Nutmeg made payments that did not fit within the policy definition of "Loss," CHRW cannot rely on those payments to establish that the underlying policies have been exhausted. This policy-interpretation issue is properly raised in a declaratory-judgment action,

II.

As we have already discussed, the Gulf policy defines "Loss." In addition to the portion of the definition quoted above, the policy states that "Loss does not, however, include . . . taxes or fines or penalties imposed by law." Based on this exclusion from the definition of "Loss," Royal sought a declaration that it is entitled to reimbursement or credit for the amounts paid into the settlement that are designated for taxes. The district court ruled that the policy provision is ambiguous with regard to the question of the person upon whom a tax obligation must be imposed to be excluded from the definition of "Loss" and, construing the exclusion narrowly against the drafter, the district court found that amounts paid into the settlement and designated for taxes were not excluded from coverage.

Royal argues that the district court erred because the policy contains no language that suggests that coverage for taxes depends upon a determination that the taxes were imposed on the insured. We disagree. An insurance "policy must be construed as a whole, and unambiguous language must be given its plain and ordinary meaning." *Henning Nelson Constr. Co. v. Fireman's Fund Am. Life Ins. Co.*, 383 N.W.2d 645, 652 (Minn. 1986). Language in a policy is ambiguous if it is susceptible to two or more

reasonable interpretations. *Medica, Inc. v. Atl. Mut. Ins. Co.*, 566 N.W.2d 74, 77 (Minn. 1997).

The Gulf policy defines "Loss" as "any amount which an Insured becomes legally obligated to pay as the result of a covered Claim or Claims . . . for Wrongful Employment Acts." The policy defines "Claim" to include, among other things, "a civil proceeding commenced by the service of a complaint or similar pleading" and "a formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar document" if either of these proceedings "is brought and maintained by or on behalf of any past, present or prospective Employee of the Insured Company."

Reading the exclusion for taxes imposed by law in light of the definition of claim, the exclusion refers only to taxes imposed on the insured company because taxes, fines, or penalties would be a possible outcome of a formal administrative or regulatory proceeding against the company but the imposition of taxes, fines, or penalties would not ordinarily be expected to be the outcome of a civil proceeding commenced by an employee. Also, a tax, fine, or penalty imposed on a party other than the insured company would not ordinarily be paid by the company, and there would be no reason to exclude from coverage amounts that the company would not pay.

In this case, amounts paid into the Qualified Settlement Fund will be used, in part, to pay taxes that are imposed on employees due to payments that the employees receive from the fund. The taxes are not imposed on CHRW, and the payments from the fund produce the same net result as making larger payments to employees and having them

pay their own taxes. The district court did not err in interpreting the taxes exclusion as not applying to taxes owed by settling employees in the underlying litigation.

III.

Royal asserts that because certain "severance payments" made to three named plaintiffs do not qualify as "Loss" under the policy, it is entitled to reimbursement and/or credit from CHRW for the amounts used to make the payments.

The Gulf policy defines "Loss" as "any amount which an Insured becomes legally obligated to pay as the result of a covered Claim or Claims . . . for Wrongful Employment Acts." The policy defines "Wrongful Employment Act" as "any act, error or omission committed or attempted, or allegedly committed or attempted . . . in connection with any actual or alleged wrongful dismissal, discharge or termination of employment, . . . [or] violation of employment discrimination laws." Royal argues that the severance payments were not a covered loss because the payments were made solely in exchange for the employees' voluntary agreements to sever their employment and were not amounts that CHRW became legally obligated to pay as the result of a claim for a wrongful employment act.

The three named plaintiffs had class claims and asserted individual non-class claims for hostile work environment. When approving the settlement agreement, the federal district court stated:

> Named Plaintiffs will be treated the same as other class members with respect to the settlement of the Class Claims. To the extent that they are entitled to receive additional settlement monies outside of the claims process, they are required to give additional consideration – that is, a broader

> release of claims than the release to be signed by other class members, including the relinquishment of their individual appellate rights, and, in three instances, the voluntary termination of their employment with [CHRW].

Even though a severance agreement, by itself, would not necessarily be a wrongful employment act under the policy, the three severance agreements at issue here are part of the settlement agreement. The settlement agreement is the result of covered claims for wrongful employment acts, and CHRW became legally obligated to make the severance payments when it entered into the settlement agreement. It is simply implausible to suggest that the severance agreements are not the result of the covered claims that were settled in the settlement agreement. The district court was correct in ruling that the severance payments are covered losses.

IV.

The next issue concerns the district court ruling that claims for the EEOC lawsuits, which were denied class certification and were filed after the expiration of the Royal policy period, were covered under the Royal policy as "related claims."

The Gulf policy provides wrongful-employment-act coverage for "any Claim first made against the Insureds during the Policy Period." The policy states:

> All Loss based upon or arising out of the same Wrongful Employment Act or Related Wrongful Employment Acts of one or more of the Insureds shall be considered a single Loss incurred as a result of a single Claim, which Claim shall be deemed to have been made on the date the first Claim for such Wrongful Employment Act or for one or more of such Related Wrongful Employment Acts is made against any of the Insureds, whether such date is before or after the Policy Inception Date. The retention shall apply only once to each such Claim.

"Related Wrongful Employment Act" is defined as "Wrongful Employment Acts that arise out of, are based on, relate to or are in consequence of the same facts, circumstances or situations."

Royal contends that because the federal district court concluded that the EEOC claims did not satisfy the commonality test under Fed. R. Civ. P. 23(a)(2), they cannot satisfy the "related claims" provisions of the policy. We disagree, because class certification is separate and distinct from the policy language governing whether claims are "related" for coverage purposes. As the district court ruled, the policy definition of "Related Wrongful Employment Act" is broader than the commonality test.

"[T]he common understanding of the word 'related' covers a very broad range of connections, both logical and causal." *Am. Commerce Ins. Brokers, Inc. v. Minn. Mut. Fire & Cas. Co.*, 551 N.W.2d 224, 228 (Minn. 1996) (addressing whether employee's acts of embezzlement were related for coverage purposes). Under the policy, related wrongful acts are those "that arise out of, are based on, relate to or are in consequence of the same facts, circumstances or situations." As the district court determined, each of the EEOC lawsuits arose out of the wrongful employment acts alleged in the class action, were specific in number and readily identifiable, and were filed as a direct result of being excluded from the class action. As the district court further explained, but for these plaintiffs being dismissed from the class-action suit, no individual claims would have been filed. Under the related-wrongful-acts provision of its policy, Royal must indemnify for the EEOC lawsuits.

CHRW contends in its notice of review that the district court erred in ruling that another individual lawsuit was not a related case. Because this suit raised age-discrimination and retaliation claims, was not originally contemplated to be part of the class action, and was a "subsequently filed" case, it is not a related wrongful act. As stated by the district court, to hold that this claim is covered under the Royal policy would impermissibly extend the Royal coverage beyond the reasonable expectations of the parties when they negotiated and drafted the policy.

V.

CHRW challenges the district court's adoption of the special master's finding that, as a matter of law, Royal cannot be liable for the portions of the defense-cost invoices that were not paid by the underlying carriers. CHRW contends that the special master did not have authority to make this legal conclusion. But we need not reach this issue, because we are reviewing the district court's decision, not the special master's decision.

The district court ruled that Royal had no obligation to pay the remaining balances of the defense-cost invoices that Gulf and Nutmeg did not pay, explicitly applying the same logic that it applied in its ruling that Royal could not challenge whether the underlying policies were prematurely exhausted. As Royal concedes, because we reverse the district court's decision as to Royal, we reverse its decision as to CHRW and hold that just as Royal may assert claims that Gulf and Nutmeg paid defense costs that were not reasonable, CHRW may assert claims that Gulf and Nutmeg refused to pay defense costs that were reasonable.

Under Royal's excess policy, liability for covered losses, which include covered claims and defense costs, attaches when the liability limits of the underlying policies have been exhausted. Royal asserts that it only has an obligation to pay reasonable defense costs and that it should have the opportunity to review the unpaid invoices for a determination of reasonableness. Royal asserts that it has a right to a jury trial as to all fact questions, including reasonableness. Because the district court ruled that Royal could not assert its claim regarding the reasonableness of defense costs, it has not considered whether Royal has a right to a jury trial. We will not consider the issue for the first time on appeal. *See Thiele v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988) (reviewing court will not consider issue not decided by district court).

VI.

CHRW argues that the district court erred in adopting the special master's determination of the reasonableness of defense fees. CHRW contends that the special master's analysis of the reasonableness of attorney fees is not consistent with Minnesota law. But the judgment for attorney fees was entered in accordance with the parties' stipulation and order for entry of final judgment, in which the parties agreed "to accept as the findings of the fact finder in this action the Special Master's findings and recommendations as to the reasonableness of defense costs incurred by CHRW in the *Carlson* Litigation and for those EEOC claims determined by this Court to be covered under the Royal Excess Policy." CHRW has not addressed why this stipulation is not valid and binding. Consequently, we will not review its claim that the special master did not apply the correct legal analysis.

VII.

Finally, CHRW argues that the district court erred when it ruled that the Royal policy was merely a "defense reimbursement policy" and did not impose a duty to defend CHRW. The district court ruled that because the Royal policy followed form to the Nutmeg policy, which specifically excluded a duty to defend, Royal did not have a duty to defend.

CHRW argues that because Royal's "follow form" policy fails to distinguish its coverage of defense costs from the primary layer's "duty to defend," Royal's policy should also provide "duty to defend within its limits" coverage. CHRW cites *In re Silicone Implant Ins. Coverage Litig.*, 652 N.W.2d 46, 64-68 (Minn. App. 2002), *rev'd in part on other grounds*, 667 N.W.2d 405 (Minn. 2003). In that case, excess insurers sought to be relieved of any obligation to pay defense costs in excess of their policy limits. *Silicone Implant Ins. Coverage Litig.*, 652 N.W.2d at 63. This court held "that unless there is a specific exclusion, policies that follow form to the underlying policy and do not limit defense costs . . . obligate the insurer to pay defense costs in addition to policy limits." *Id.* at 66-67. CHRW argues that because the excess policies do not expressly limit the defense obligation to "defense reimbursement coverage," Royal is obligated to provide duty-to-defend coverage to CHRW. Because the Nutmeg policy repeatedly and explicitly excludes the duty to defend, we disagree. The district court correctly ruled that Royal had no duty to defend.

Affirmed in part, reversed in part, and remanded.