

# INSIDE FIRE



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## Minnesota's First-Party Bad Faith Statute: A Five-Year Review

By Stacy Kabele & Brad Ayers, Attorneys at Law

An insurer in Minnesota is liable to its insured for damages if the insurer does not act in good faith in its decision to deny the insured's claim for benefits under the insured's policy. The purpose of this article is to summarize many of the property damage decisions made by Minnesota's federal and state appellate and district courts during the last five years in order to provide direction to property claims adjusters as they continue to adjust similar kinds of claims.<sup>1</sup>

Courts have not, as a matter of course, allowed insureds to amend their Complaint to bring a claim for first-party bad faith. In two cases where an insured's claim for first-party bad faith proceeded to trial on the merits, the trial court held that the insurer did not act in bad faith. Both of those cases were personal injury cases, and are summarized in the endnote.<sup>2</sup>

### MINNESOTA: THE STATUTE

MINN. STAT. § 604.18 allows an insured to bring a claim for penalties (called "taxable costs") against her own insurer for an insurer's conduct that occurs on or after August 1, 2008. MINN. STAT. § 604.18 applies to policies of insurance that obligate an insurer to pay proceeds directly to the insured, such as claims for property damage, UM benefits, UIM benefits, and PIP benefits.<sup>3</sup>

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### PROPERTY DAMAGE CASES

#### FEDERAL COURT: THE UNITED STATES DISTRICT COURT (MINNESOTA)

##### *Hackbarth v. State Farm Fire and Cas. Co.*<sup>9</sup>

The insureds made a claim for a fire loss. The insurer paid damages for the loss. The insureds filed a lawsuit, claiming the home was a "total loss" and that they were entitled to the policy limits. The insurer counterclaimed, contending the insureds committed fraud. The jury agreed that the insureds committed fraud. The federal trial court did not make a decision about whether an insured could recover taxable costs even though the insurer prevailed in the underlying matter, deciding the insurer had a reasonable basis to conclude that a total loss did not occur. The insured was ordered to repay the insurer the amount that had been paid out on the claim.

##### *Friedberg v. Chubb and Son, Inc.*<sup>10</sup>

In December 2006, the insureds discovered extensive water damage to their home. After receiving its expert's opinion, the insurer denied the claim on August 7, 2007, based on the faulty workmanship exclusion, among others. The Magistrate Judge did not allow the insureds to amend their Complaint to bring a claim for first-party bad faith, holding that the insureds failed to show that the insurer's denial of the property damage claim was unreasonable. The Magistrate Judge noted that the insurer did not seek to "shield itself from the facts and otherwise [refuse] to learn the true nature of [the insureds'] claim. Instead, the record indicates that [the insurer] conducted a thorough inspection of [the insureds'] property." The Magistrate Judge held, "[B]ad-faith does not arise where the insurer is simply wrong about the factual basis for its denial of the claim. ... Nor can bad faith arise simply because the insurer's construction of the policy was subsequently found to be legally incorrect."

##### *Davis v. Grinnell Mut. Reinsurance Co.*<sup>11</sup>

The insured made a claim for hail damage to multiple buildings. The insurer's initial adjuster told the insured the roofs were totaled and that the insurer would replace the roofs. The

insurer's roofing expert later determined the roofs could be repaired and did not need replacement. Even though the insured was allowed to amend the Complaint to bring a claim for first-party bad faith, the federal trial court later granted the insurer's motion for summary judgment, deciding that evidence about the first adjuster's opinion does not mean that the offer to repair the roofs lacked a reasonable basis.

#### MINNESOTA STATE COURTS

#### MINNESOTA COURT OF APPEALS

##### *Homestead Hills Homeowner Ass'n v. American Family Mut. Ins. Co.*<sup>12</sup>

The insured sustained hail and wind damage to its condominium roofs in April 2009. The insurer determined that the shingle damage was caused by a manufacturing defect, not hail, and denied the claim. On appeal on a number of issues, the Minnesota Court of Appeals held that the insured failed to present sufficient prima facie evidence in support of its motion to amend for leave to bring a claim for first-party bad faith, holding that the trial court did not clearly abuse its discretion when it decided that the insured's hail damage claim was "fairly debatable."<sup>13</sup>

##### *N. Nat'l Bank v. N. Star Mut. Ins. Co.*<sup>14</sup>

A mortgagee claimed benefits under a homeowners' policy for a fire loss. The insurer paid the actual cash value loss at the time of the loss. The insurer denied the mortgagee's demand for an appraisal because the mortgagee was not a named insured. The mortgagee sued the insurer. During litigation, an appraisal was held. The trial court decided that the insurer acted in bad faith by not agreeing to the appraisal process and for the delay in making payment, but then concluded that taxable costs were not appropriate because the claim was resolved or confirmed by appraisal. The Minnesota Court of Appeals reversed the trial court's finding of

An insured's claim for first-party bad faith arises if the insured is able to show two things: (1) there existed no reasonable basis to deny benefits; *and* (2) the insurer knew of a lack of a reasonable basis for denying the benefits *or* acted in reckless disregard of the lack thereof.<sup>4</sup> An insurer's alleged failure to investigate arson and fraud in a timely manner is excepted from this law.<sup>5</sup>

A claim for first-party bad faith arises out of the underlying tort claim against the insurer. Accordingly, the insured cannot bring her claim for first-party bad faith until she files a Complaint for the underlying tort. Even then, the insured is not allowed to bring a claim for first-party bad faith as a matter of course. The insured must bring a motion seeking leave of Court to amend her Complaint in order to bring a claim for first-party bad faith. Neither no-fault arbitration findings nor Department of Commerce administrative rulings are admissible with respect to a MINN. STAT. § 604.18 claim.

If the Court allows the insured to make a claim for first-party bad faith, it is presumed that the parties would proceed with the litigation and trial of the underlying tort claim against the insurer before proceeding with the litigation and trial of the insured's claim for first-party bad faith.<sup>6</sup> As with the underlying tort claim, the insured bears the burden of proving first-party bad faith.

If the insured prevails upon her claim, then the Court may award to the insured taxable costs as follows: (1) either half the proceeds awarded that exceed the insurer's offer made 10 days or more before the start of trial or \$250,000, whichever is less; *and* (2) reasonable attorneys' fees up to \$100,000 attributable to efforts to establish the violation. Punitive damages are not awardable. Damages are not awarded in claims resolved or confirmed by arbitration or appraisal.<sup>7</sup>

Only an "insured" (as defined by the policy) may recover. Neither third-party beneficiaries nor assignees may make a claim for taxable costs pursuant to MINN. STAT. § 604.18.<sup>8</sup>

## Minnesota's First-Party Bad Faith Statute: A Five-Year Review (Continued from Page 2)

bad faith, noting that the insurer promptly adjusted the loss and tendered payment in a certain amount; that the mortgagee waited two years after the loss before it advised that it was disputing the amount paid; that there was a legitimate dispute about whether the mortgagee could appraise the loss; that the insurer paid the balance of the actual cash value loss into Court after the appraisal award; and that the delay was occasioned by matters "unquestionably" out of the insurer's control.

### MINNESOTA DISTRICT COURTS

#### *Auto-Owners Ins. Co. v. Second Chance Investments LLC*<sup>15</sup>

The insured's residence sustained a fire loss. The insured claimed a total loss to its insurer. The insurer eventually paid the mortgage amount, and later tendered to the insured an undisputed amount, but disputed the total amount of the loss and the forum to resolve the dispute. The trial court decided that it had the authority to determine whether there was a total loss, and ordered a jury trial. The trial court allowed the insured to amend its Complaint to bring a claim for first-party bad faith, noting that other courts outside Minnesota have found that a delay in payment is tantamount to a denial.

#### *King's Cove Marina, L.L.C. v. St. Paul Mercury Ins. Co., et al.*<sup>16</sup>

The insured suffered significant damage to its marina due to a windstorm. The insurer denied coverage for a large portion of the claim. First, the insured claimed that the insurer acted in bad faith by not paying the difference between the depreciated cost of replacing an overhead electrical system and the actual cost. The trial court held that there is no basis for a claim for first-party bad faith because the payment of the difference is not triggered until repairs are completed and actual costs are incurred. Second, the insured claimed that the insurer acted in bad faith by denying claims for the costs of demolition and debris removal. The insurer did not pay for these claims because it appeared that some items

may be covered and others were not, and the adjuster thought that the issues would be clarified "through the discovery process in this lawsuit." The trial court held, "The mere statement that the pending lawsuit may clarify coverage issues does not strike the Court as a reasonable basis for the [insurers] not paying a portion of those costs which are indeed covered and are not in dispute."

<sup>15</sup>Due to restrictions on the length of this article, the personal injury cases could not be included in this newsletter. Please feel free to contact Stacy Kabele ([skabele@morrisonsond.com](mailto:skabele@morrisonsond.com)) or Brad Ayers ([bayers@morrisonsond.com](mailto:bayers@morrisonsond.com)) for further information.

<sup>16</sup>In *Bernstrom v. American Family Mut. Automobile Ins. Co.*, a jury verdict was returned in favor of the insured, Kathleen Bernstrom, in the amount of \$453,703.71 after the trial of her UIM claim. (*Kathleen Bernstrom and Gordon Bernstrom v. American Family Mutual Automobile Insurance Company*, County of Kittson, Ninth Judicial District, State of Minnesota, Court File No. 35-CV-09-5 (The Hon. Donna K. Dixon, filed December 22, 2010).) The verdict was more than \$400,000 in excess of the UIM policy limits. Upon the subsequent court trial of the insured's first-party bad faith claim, the trial court found in favor of the insurer. In so holding, the trial court acknowledged a number of factors that supported its decision, including the presence of evidence of a pre-existing condition in the treating doctor's report and in the IME doctor's report; the conservative venue; and the necessity of a large verdict before any recovery (due to offsets). The trial court stated, "There were many good reasons to pay the full benefit amount, as [the insured] points out, and denying the benefits may have been a mistake in judgment, but MINN. STAT. § 604.18 does not force payment of benefits simply because good reasons exist, it prohibits very arbitrary or reckless denials." The trial court noted that the investigation could have been more thorough, but, "This was not a situation where the insurer willfully stalled or obstructed an investigation in order to avoid payment of benefits." Similarly, in another Minnesota state court trial to decide the insured's claim for first-party bad faith,

the trial court found in favor of the insurer, holding, "The failure of [the insurer] to conduct much investigation into the accident, while probably not prudent, does not, in this case, indicate a lack of reasonable basis to deny the policy limits demand in the UIM case." (*Sheila Greseth vs. North Star Mu. Ins. Co.*, County of Traverse, Eighth Judicial District, State of Minnesota, Court File No. 78-CV-08-268 (The Hon. Gerald J. Seibel, May 14, 2009 and October 20, 2009).) The trial court in the *Greseth* case also gave consideration to the significant question concerning liability and the fact that the insured had accepted a 25% discount from the liability carrier's policy limits.

<sup>3</sup>MINN. STAT. § 604.18 excepts workers' compensation and health insurance; self-insurance provided by political subdivisions; and coverage through the Minnesota Joint Underwriting Association.

<sup>4</sup>MINN. STAT. § 604.18, subd. 2.

<sup>5</sup>*Id.*

<sup>6</sup>MINN. STAT. § 604.18, subd. 4(b) provides that the insured's first-party bad faith claim will be decided by the Court "in a proceeding subsequent to any determination by a fact finder of the amount an insured is entitled to under the insurance policy ... ."

<sup>7</sup>See, generally, MINN. STAT. § 604.18, subd. 3.

<sup>8</sup>MINN. STAT. § 604.18, subd. 1(b).

<sup>9</sup>*Hackbarth v. State Farm Fire and Cas. Co.*, 2013 WL 375543 (D. Minn. 2013).

<sup>10</sup>*Friedberg v. Chubb and Son, Inc.*, 800 F.Supp.2d 1020 (D. Minn. 2011).

<sup>11</sup>*Davis v. Grinnell Mut. Reinsurance Co.*, 2010 WL 5464915 (D. Minn. 2010).

<sup>12</sup>*Homestead Hills Homeowner Ass'n v. American Family Mut. Ins. Co.*, 2012 WL 5896829 (Minn. Ct. App. 2012).

<sup>13</sup>The Minnesota Court of Appeals noted, "The majority of states with statutes similar to MINN. STAT. § 604.18 have adopted a "fairly debatable" standard when evaluating an insurer's denial of benefits."

**Minnesota’s First-Party Bad Faith Statute: A Five-Year Review** (Continued from Page 3)

<sup>14</sup>*N. Nat’l Bank v. N. Star Mut. Ins. Co.*, 2012 WL 4052835 (Minn. Ct. App. 2012), *review denied* (Minn. Nov. 27, 2012).

<sup>15</sup>*Auto-Owners Insurance Company v. Second Chance Investments LLC*, County of Hennepin, Fourth Judicial District, State of Minnesota, Court File No. 27CV10-15620 (The Hon. Robert A. Blaeser, filed April 11, 2011).

<sup>16</sup>*King’s Cove Marina, L.L.C. v. St. Paul Mercury Ins. Co., St. Paul Fire and Marine Ins. Co.*, both a.k.a. *St. Paul Travelers Companies*, County of Dakota, First Judicial District, State of Minnesota, Court File No. 19-HA-CV-09-2118 (The Hon. Richard G. Spicer, filed June 2, 2009).

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**Change Smoke Detector Batteries**



As we “Spring Forward” this is a reminder to everyone to check their smoke detector batteries. Approximately two-thirds of home deaths occur in homes without working smoke alarms. Take this time to test your smoke detectors and keep you and your family safe.

**News About Us—A Note from Robert Whitemore**



Do I dare even say it? Is Spring really about to make it’s debut in the frozen north? All I can say is that I am over Winter and the challenges that we face everyday trying to dig out frozen debris. And, based on the conversations that I have had with many of you, we all are of the same mindset. The 70’s are in the forecast, and for most of us, it is a welcome relief. This has been a busy year for all of us. In 2014, Minnesota has experienced the highest fire death rate in recent history not to mention all of the structure and vehicle fires. Some of these fires have been extremely large involving commercial buildings, here in Minnesota as well as Iowa, Nebraska, Wisconsin and the Dakotas. Was it the weather, only time will tell as we thankfully move on to warmer temperatures.

I’d like to take this opportunity to congratulate Brian Haag, CFI, President of the Minnesota Chapter of the International Association of Arson Investigators. This was the first year of Brian’s presidency of the MNIAAI, and by all accounts, the recent conference was a success. Brian and his board of directors have made excellent strides in implementing changes to the chapter business. Change is never easy, but these updates have improved the function and services of our chapter.

Congratulations to the Minnesota State Fire Marshal, Chief Investigator Rick Kleis on his recent retirement. Whitemore Fire Consultants, Inc. has always had a strong relationship with the Fire Marshal’s Office and its investigators, which was supported by Rick and his leadership. All of us that have worked closely with you will miss your leadership and commitment to the fire industry both public and private, but congratulate you on this next phase of your life. Best wishes!

Robert B. Whitemore, CFI  
President



# News About Us . . . .

## Whitemore Presents at Boat US & Seaworthy Insurance



Bob Whitemore was invited by Boat US and Seaworthy Insurance to provide a one-day program at their Alexandria, VA headquarters on investigating marine fires. Approximately 50 claims professionals and managers attended the program, either on-site or via webcam where case studies of boat fires were discussed.

A special thank you to the management of Boat US for inviting us and for the warm hospitality.

## NE-SD-ND-IA—State Farm Insurance Spring Meeting

Thank you to State Farm Insurance Company who invited Whitemore Fire Consultants to provide a program on fire investigation and subrogation at their spring claims meeting held in Sioux Falls, South Dakota.



Bob Whitemore provided an investigation overview and case studies to the claims professionals and management.

Approximately 50 representatives attended the program held on March 19th.

## Prior Lake Rotary Recognizes the Fire Department

Bob Whitemore of Whitemore Fire Consultants, Inc. served as keynote speaker at the recent Prior Lake Rotary at their Fire Department Recognition Dinner.

The Rotary recognized the public fire service and its members that protect the city's residents. Bob provided a short program on the fire service and investigating fires and how important private and public relationships are to the fire investigation community.

Congratulations to all the members of the Prior Lake Fire Department.



# MNIAAI News . . .

## MNIAAI—Conference Update



On March 26-28, 2014, over 175 attendees participated in the Minnesota Chapter International Association of Arson Investigator's Annual Conference & Seminar held in St. Cloud, Minnesota. Whitemore Fire Consultants, Inc. is proud to be a sponsor of the program and educational opportunities provided to Upper Midwest investigators, both private and public. Congratulations to Brian Haag, CFI, President of the Minnesota Chapter and the entire seminar planning committee for a "job well done."

We all look forward to the programs scheduled for the year to come!

For more information, check out the new website at: [www.mniaai.org](http://www.mniaai.org).

## MN IAAI Recognizes Years of Service

Congratulations to Robert B. Whitemore, CFI and President of Whitemore Fire Consultants, Inc. for his 32-years of membership with the Minnesota Chapter of the International Association of Arson Investigators. Bob was recognized, along with many of his colleagues, at the recent Annual Conference and Seminar held in St. Cloud, Minnesota. During his membership, Bob has served an many committees at the state level, and also represented Minnesota as a Board of Director and President at the international level.



Congratulations to Brian P. Haag, CFI and Senior Fire Consultant, of Whitemore Fire Consultants, for his recognition of 14-years with the Chapter. Brian has served the Minnesota Chapter as a Board of Director and currently as President.

The commitment of all of the Chapter's members and the strengths that each of them bring ensures the success in its programs and educational opportunities. Thanks to Bob and Brian for their continued leadership in the IAAI.

## Hussong Manufacturing Recalls Gas Fireplaces Due Fire Hazard

RECALLS



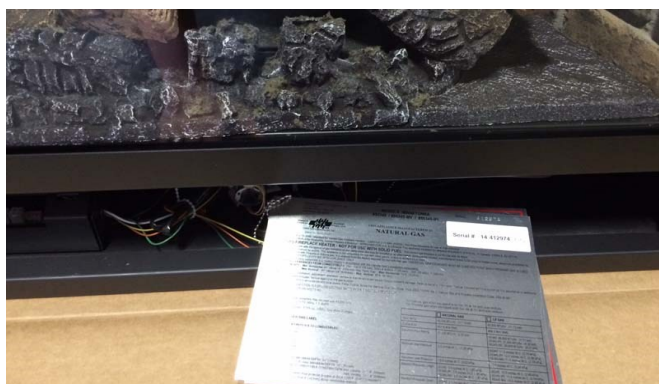
The Consumer Product Safety Commission in cooperation with Hussong Manufacturing Co. Inc., d/b/a Kozy Heat Fireplaces of Lakefield, Minnesota has voluntarily issued a recall of Kozy Heat, Ambiance and Steallar Hearth gas fireplaces and fireplace inserts. The main control module can allow gas to be released and buildup in the burner area, posing an explosion hazard.

Approximately 15,000 units were sold at fireplace dealers and distributors from October 2009 to April 2013 for between \$1,450 and \$3,325. Hussong Manufacturing received reports of nine incidents of gas being released prematurely and exploding resulting in minor property damage and two reports of abrasions.



This recall involves Hussong Manufacturing direct vent gas fireplaces and gas fireplace inserts that use American Flame brand main control modules. The recalled products are 22 models sold under the brand names Kozy Heat Fireplaces, Ambiance Fireplaces and Stellar Hearth Products. Recalled fireplaces and inserts were manufactured between October 2009 and April 2013. The fireplace name, model number, manufacture date and serial number are on a silver testing label attached by a chain and next to the gas valve of the fireplace or fireplace insert. For a complete list of the model and serial number ranges involved in this recall, please visit: [www.cpsc.gov](http://www.cpsc.gov), and click on "Hussong Manufacturing Recall."

Consumers should immediately stop using the recalled fireplaces and fireplace inserts. Turn off the gas to the units and contact the dealer where the unit was purchased or Hussong Manufacturing to have the ignition board on the fireplace main control module replaced free of charge. For more information, please visit the following company's websites: [www.kozyheat.com](http://www.kozyheat.com); [www.ambiancefireplace.com](http://www.ambiancefireplace.com); or [www.stellarhearth.com](http://www.stellarhearth.com), then click on "Recall Information."





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## Dyson Recalls Bladeless Portable Heaters Due Fire Hazard



The Consumer Product Safety Commission in cooperation with Dyson Inc. of Chicago, Illinois, has voluntarily issued a recall of the Dyson portable electric heaters. The heaters can develop an electrical short and overheat, posing a fire hazard to consumers. Approximately 400,000 units were sold in the United States and Canada at Bed Bath & Beyond, Best Buy, Costco, Fry's, Kohl's, Macy's, Lowes, Sears, Target and other retailers nationwide and online at Abt.com, Amazon.com, Dyson.com, Groupon.com, HSN.com, and Walmart.com from September 2011 to March 2014 for about \$399.00.

This recall is for all Dyson Hot heaters and Dyson Hot+Cool heaters having model number AM04 and all Dyson Hot+Cool heaters with model number AM05. The heaters are 23 inches tall with a round base and an upper body shaped like an elongated ring. The heaters have no external fan blades. They are made of plastic and were available in the colors silver, black and silver, blue and gray, gray and silver, pink and gray, purple and gray, and white and gray. Each heater came with a remote control. The model number is found above the Dyson logo on the product information sticker on the underside of the heater's base.

Dyson is aware of 82 incidents of the recalled heaters short-circuiting and overheating, including four reports of heaters with burned or melted internal parts. No injuries or property damage have been reported. Consumers should immediately stop using and unplug the recalled heater and contact Dyson for a free repair. For more information, please visit: [www.dyson.com](http://www.dyson.com) and click on Safety Recall at the bottom of the page.

## Lenovo Recalls Battery Packs for ThinkPad Notebook



The Consumer Product Safety Commission in cooperation with Lenovo, Inc. of Morrisville, NC has voluntarily issued a recall of the ThinkPad notebook computer battery packs. The battery packs can overheat, posing a fire hazard. Approximately 40,000 units were sold in the United State and Canada at computer and electronics stores, authorized dealers and online at [www.lenovo.com](http://www.lenovo.com) nationwide from October 2010 through April 2011 for between \$350 and \$3000 when sold as part of the Thinkpad notebook computers. The battery packs were also sold separately for between \$80 and \$150. Lenovo has received two reports of the battery packs overheating, resulting in damage to the computer, battery pack and nearby property. No injuries have been reported.

This recall involves Lenovo battery packs sold with the following ThinkPad notebook computers: the Edge 11, 13 and 14 series, the T410, T420, T510 and W510 series, and the X100e, X120e, X200, X201 and X201s series. The battery packs were also sold separately. The black battery packs measure between 8 to 11 inches long, 1 to 3 inches wide and about 1 inch high. Recalled battery packs have one of the following part numbers starting with the fourth digit in a long series of numbers and letters printed on a white sticker below the bar code on the battery pack: 42T4695, 42T4711, 42T4798, 42T4804, 42T4812, 42T4822, 42T4828, 42T4834, 42T4840 and 42T4890.

Consumers should immediately turn off their ThinkPad notebook computer, remove the battery pack and contact Lenovo at [www.lenovo.com](http://www.lenovo.com) for a free replacement.

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Click on "registration", complete the form and press "submit". It's easy and you won't miss a thing!



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**[www.whitemorefire.com](http://www.whitemorefire.com)**

Click on "Submit a Loss" tab . . . .

Complete the online form and press "submit" and you will receive an electronic confirmation of our receipt of your loss request. You will also receive a response from our on-call representative as well as a follow-up all during the next business day.

**Submit Your Loss Online**