STATE OF MINNESOTA
IN COURT OF APPEALS
A10-698

Kraus-Anderson Construction Co.,
Respondent,

vs.

Transportation Insurance Co., et al.,
Respondents,

Evanston Insurance Co.,
Appellant,

RLI Insurance Co.,
Respondent

NewMech Companies, Inc.,
Respondent.

Filed April 12, 2011
Affirmed in part, reversed in part
Toussaint, Judge

Hennepin County District Court
File No. 27-CV-05-5575

John M. Anderson, Steven P. Aggergaard, Bassford Remele, Minneapolis, Minnesota (for respondent Kraus-Anderson Construction Co.)

Robert E. Salmon, Meagher & Geer, P.L.L.P., Minneapolis, Minnesota (for respondent Transportation Insurance Co., et al.)

Katherine L. MacKinnon, St. Louis Park, Minnesota; and

Tory M. Bishop (pro hac vice), Omaha, Nebraska (for appellant Evanston Insurance Co.)

Patricia St. Peter, Christopher R. Paar, Kathryn M. Hoffman, Zelle Hofmann Voelbel & Mason LLP, Minneapolis, Minnesota (for respondent RLI Insurance Co.)

Gerald S. Duffy, Siegel, Brill, Greupner, Duffy & Foster, P.A., Minneapolis, Minnesota (for respondent NewMech Companies, Inc.)

Considered and decided by Peterson, Presiding Judge; Toussaint, Judge; and Hudson, Judge.

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

TOUSSAINT, Judge

Appellant Evanston Insurance Co. challenges the district court's entry of judgment against it and in favor of respondent Kraus-Anderson Construction Co., arguing that it did not breach its duty to defend Kraus-Anderson and, in the alternative, that fees, costs, and prejudgment interest were miscalculated. By notice of related appeal, respondent RLI Insurance Co. also challenges the judgment of the district court, arguing that it did not breach its duty to defend and that Evanston is solely liable for defense costs, and alternatively, that the district court erred in calculating and allocating declaratory-judgment fees and costs. Finally, by notice of related appeal, Kraus-Anderson also challenges the judgment of the district court, arguing that the district court erred by failing to award it costs incurred defending respondents Transportation Insurance Co. and NewMech Companies, Inc., and by miscalculating prejudgment interest.

We conclude that RLI did not owe a duty to defend Kraus-Anderson until all scheduled underlying insurance—including the Evanston policy—was exhausted. Because the limits of the Evanston policy remain available, RLI did not breach its duty to

defend. We therefore reverse the judgment against RLI. We affirm in all other respects.

FACTS

Kraus-Anderson was the general contractor for several riverfront construction projects in Minneapolis, including the Stone Arch Lofts and Washburn Lofts projects. Kraus-Anderson contracted with the Stone Arch Lofts developer, Brighton Development Corporation, in 1999. Kraus-Anderson subcontracted with NewMech to provide the heating, ventilating, and air-conditioning systems on the Stone Arch Lofts project.

In August 2001, Stone Arch Lofts unit owners began experiencing excessive humidity and related problems such as mold growth and damage to the wood floors. Brighton contacted Kraus-Anderson for repairs, which in turn contacted NewMech. Litigation ensued between unit owners, Brighton, Kraus-Anderson, and NewMech in 2002. Brighton, Kraus-Anderson, and NewMech reached agreements among themselves to make repairs; the agreement between Brighton and Kraus-Anderson included an arbitration clause.

In December 2002, Brighton filed for arbitration, seeking damages from Kraus-Anderson for work done on the Stone Arch Lofts. Kraus-Anderson made a third-party indemnification claim against and arbitration demand on NewMech. Brighton's December 17, 2002 arbitration demand stated a claim seeking "[i]n excess of $2,000,000.00." In January 2003, Kraus-Anderson filed for arbitration against Brighton in a separate matter, seeking money owed from the Washburn Lofts project, and Brighton filed a counterclaim for damages. Because there were some witnesses and discovery issues common to the Stone Arch Lofts and Washburn Lofts arbitrations, the arbitrator

consolidated the two arbitration actions.

Following extensive arbitration that included 48 days of testimony and over 30,000 pages of documents, the arbitrator issued an interim award of the following: $1,603,914 plus interest in favor of Brighton against Kraus-Anderson, all but $100,000 of which Kraus-Anderson received in indemnification from NewMech; $3,255,378 plus interest in separate damages to Kraus-Anderson from NewMech; and $550,000 in attorney fees to Kraus-Anderson from NewMech. A district court confirmed this award in November 2005.

At all relevant times, Kraus-Anderson had several layers of insurance. Kraus-Anderson had two underlying policies: first, a comprehensive-general-liability (CGL) policy from St. Paul Insurance Company, and second, an architects-and-engineers-professional-liability policy from Evanston. Each had a $1 million liability limit. Kraus-Anderson was also an additional insured under NewMech's CGL policy, which was issued by Transportation. Kraus-Anderson also had an umbrella insurance policy issued by RLI. The RLI umbrella policy followed form to the Evanston policy, but separate terms and exclusions were drafted into the RLI umbrella policy in regard to its coverage in excess of the St. Paul policy.

St. Paul defended Kraus-Anderson in the arbitration subject to a reservation of rights. St. Paul and Kraus-Anderson reached a settlement in October 2003, with St. Paul paying Kraus-Anderson $750,000 for all claims under its policy and $55,000 in defense costs. Pursuant to the settlement, St. Paul then stopped defending Kraus-Anderson.

In July 2003, Kraus-Anderson sued Transportation, seeking a declaratory judgment that Transportation was obligated to defend and indemnify Kraus-Anderson as the primary liability insurer and seeking attorney fees and costs. In November 2005, Kraus-Anderson amended its complaint to add claims against NewMech, RLI, and Evanston. Kraus-Anderson also sought declaratory relief "concerning the respective obligations of [Krause-Anderson], NewMech, and the defendant insurers and the proper apportionment of liability."

In November 2006, Kraus-Anderson, Transportation, and NewMech reached a settlement of all their claims against each other; they stipulated to dismissal with prejudice of their claims against each other, with Kraus-Anderson to defend and indemnify Transportation and NewMech against any cross-claims of the non-settling parties. The district court accepted the stipulation and ordered dismissal with prejudice of Kraus-Anderson's claims against Transportation and NewMech and of NewMech's cross-claim against Transportation and entry of judgment pursuant to Minn. R. Civ. P. 54.02. The settlement provided for payment of $4,580,783.63 plus interest to Kraus-Anderson, $650,000 of which was allocated to defense costs.

In May 2007, Kraus-Anderson and RLI brought cross-motions for partial summary judgment. RLI sought a declaration that it had no duty to defend Kraus-Anderson in the arbitration. Kraus-Anderson sought declarations that RLI breached its duty to defend in the arbitration and that RLI had to reimburse Kraus-Anderson for its unpaid attorney fees and costs incurred in the underlying arbitration and for its attorney fees and costs in the instant suit to compel RLI to acknowledge its defense obligation.

In September 2007, the district court granted Kraus-Anderson's motion for partial summary judgment, denied RLI's motion for partial summary judgment, and granted Kraus-Anderson attorney fees and costs incurred in the underlying arbitration and in this litigation. The court concluded that RLI breached its duty to defend Kraus-Anderson under its follow-form umbrella policy over the Evanston policy; after the St. Paul policy was exhausted through settlement and St. Paul ceased its defense, RLI also breached its duty to defend under that umbrella policy.

A bifurcated bench trial was set to follow; after what was scheduled to be Phase I, the district court issued an order on June 30, 2008. The court found that, although Kraus-Anderson relied on St. Paul for its initial defense, it put both RLI and Evanston on notice of the potential claims on those policies in regard to only the Stone Arch Lofts project. The court found that Kraus-Anderson tendered defense of the arbitration to RLI in December 2002 and to Evanston in January 2003 but that it never formally tendered defense of the Washburn Lofts matter to St. Paul, RLI, or Evanston.

The district court awarded Kraus-Anderson $196,008.11 in unpaid defense costs from the Stone Arch Lofts arbitration; it rejected Kraus-Anderson's request for an additional $90,000, which was based on the Washburn Lofts arbitration. The court also awarded attorney fees and costs incurred in the instant declaratory-judgment action ($321,265.88 through January 1, 2008, plus reasonable amounts incurred through the date the order was filed). The court concluded that Evanston and RLI were jointly and severally liable, but ordered Evanston to pay these amounts first, up to its policy limit, with RLI liable for any remaining amount.

After Phase I of the trial, the parties brought cross-motions for summary judgment, which they agreed could resolve the remaining issues.[1] In September 2009, the district court issued an order granting Kraus-Anderson's motion for summary judgment and denying Evanston's motions for summary judgment on its counterclaims against Transportation and NewMech. The court concluded that Transportation and Evanston both were primary insurers of Kraus-Anderson and had a duty to defend. The court also concluded that Kraus-Anderson's settlement with Transportation was reasonable and fulfilled Transportation's obligation to defend and indemnify. The court also concluded that Evanston's contribution claim failed because of the lack of a loan-receipt agreement, that Evanston's subrogation claim failed because Evanston breached its duty to defend and because of the settlement with Kraus-Anderson, and that Evanston was liable for attorney fees incurred in the instant action because Transportation settled with Kraus-Anderson before a judicial finding of breach of contract.

On February 10, 2010, the district court issued an order for judgment that incorporated the earlier orders. The court granted Kraus-Anderson unpaid defense costs relating to the Stone Arch Lofts arbitration and attorney fees and costs relating to this declaratory-judgment action, as well as prejudgment interest on both. These judgments totaling $853,137.71 ($661,061.57 in defense costs and attorney fees, $192,076.14 in prejudgment interest) were to be paid first by Evanston, up to its policy limits, and any remainder by RLI. Attorney fees and costs incurred by Kraus-Anderson in defense of

[1] Phase II was to deal with the various indemnity claims and obligations, as well as Evanston's cross-claims against NewMech and Transportation.

NewMech and Transportation were not granted. Final judgment was entered on February 18.

D E C I S I O N

1. Evanston's Liability

Evanston challenges the district court's conclusion that it breached its duty to defend Kraus-Anderson and the amount of liability imposed, both of which the district court determined following a bench trial. We will not set aside the district court's findings of fact unless they are clearly erroneous. Minn. R. Civ. P. 52.01. We do not defer to the district court on questions of law, however. *Marchio v. W. Nat'l Mut. Ins. Co.*, 747 N.W.2d 376, 379 (Minn. App. 2008). The application and interpretation of an insurance policy presents a question of law. *Id.*

An insurer's duty to defend is contractual and is broader than its duty to indemnify its insured. *Cargill, Inc. v. Ace Am. Ins. Co.*, 784 N.W.2d 341, 349 (Minn. 2010). Whether a duty to defend exists is a question of law. *Rechtzigel v. Fidelity Nat'l Title Ins. Co. of N.Y.*, 748 N.W.2d 312, 320 (Minn. App. 2008), *review denied* (Minn. July 15, 2008).

> The duty to defend is broader than the duty to indemnify in three ways: (1) the duty to defend extends to every claim that "arguably" falls within the scope of coverage; (2) the duty to defend one claim creates a duty to defend all claims; and (3) the duty to defend exists regardless of the merits of the underlying claims.

Wooddale Builders, Inc. v. Md. Cas. Co., 722 N.W.2d 283, 302 (Minn. 2006). Because the insurer's duty to defend arises if any part of the claim against the insured is arguably within the scope of the protection afforded by the policy, the insurer "bears the burden of

establishing that all parts of a cause of action clearly fall outside the scope of coverage." *Franklin v. W. Nat'l Mut. Ins. Co.*, 574 N.W.2d 405, 407 (Minn. 1998).

A. Tender of Defense

Evanston argues that the district court erred by concluding that Kraus-Anderson tendered defense to Evanston through its January 31, 2003 letter.

"Before an insurer's duty to defend is triggered, 'the formal tender of a defense request is a condition precedent to the recovery of attorney fees that a party incurs defending claims that a third party is contractually obligated to pay.'" *Home Ins. Co. v. Nat'l Union Fire Ins. of Pitt.*, 658 N.W.2d 522, 531 (Minn. 2003) (quoting *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 316 (Minn. 1995)). Defense is properly tendered "once an insured provides its primary or umbrella insurer with notice of a suit and opportunity to defend." *Id.* at 534.

In *Home Insurance*, the supreme court rejected, on public policy grounds, "a rule that requires insureds to expressly request a defense in order to trigger the duty to defend." *Id.* at 532. The court cited three reasons for defining "tender" as notice and the opportunity to defend: "first, it clarifies the duties of the parties early in the litigation; second, it acknowledges the greater knowledge and sophistication of the insurer; and third, it places no significant burden on insurers." *Id.* The court explained that "[t]he relationship of an insured to its insurer is not one of equals," even when the insured is a company (i.e., a "sophisticated" insured) rather than an individual. *Id.* at 533.

Once an insurer is given notice of the suit, "it is responsible for defending the insured unless the insured *explicitly* refuses the insurer an opportunity to defend." *Id.*

(emphasis added). The insurer "must begin defending the suit or bring a declaratory action if it believes the policy does not cover the claim." *Id.* Even when the insured does not expressly request a defense, the insurer bears the burden "to contact the insured to determine whether the insurer's assistance in the suit is required." *Id.* This burden is "not onerous," as the insurer "can simply ask the insured if the insurer's involvement is desired, thus eliminating any uncertainty on the question." *Id.* (quotation omitted). Although insurers should not be "saddled with defense costs over which they had no control," the notice-and-opportunity-to-defend rule "ensures insurers will not be surprised when defense costs are foisted on them." *Id.* at 533-34.

Evanston argues that, contrary to the district court's finding, Kraus-Anderson did not tender its defense on January 31, 2003. Evanston argues that Kraus-Anderson is a sophisticated insured who knew its rights and whose "course of conduct was wholly inconsistent with providing Evanston an opportunity to defend as required to invoke Evanston's defense obligations under Minnesota law."

On January 31, 2003, counsel for Kraus-Anderson sent a letter to Evanston identifying the policy whose benefits were claimed. The letter states that Brighton served Kraus-Anderson with a demand for arbitration and that the arbitration demand was pending; a copy of Brighton's arbitration demand was provided to Evanston. The letter states: "[Kraus-Anderson] hereby tenders defense of the case to its insurer, and requests the benefits of the policy." It then goes on to state: "For your information, [Kraus-Anderson] also tendered defense of its CGL carrier, St. Paul Mercury. That insurer has stated that it will defend, but the precise arrangements are yet to be worked out."

It is undisputed that this letter provides Evanston with notice of the arbitration. Evanston's claim is that it was never given an opportunity to defend because defense was also tendered to St. Paul, and Kraus-Anderson noted that St. Paul had stated its intention to defend. Despite Evanston's suggestion to the contrary, the letter does not state that St. Paul would have exclusive control of the defense and that a defense by Evanston was in fact not sought. Common sense dictates that Evanston should have at that time sought to cooperate with St. Paul if it in fact was concerned with control of the defense. Insureds are frequently insured by multiple insurers, and a prudent insured will tender defense to each insurer that may have a duty to defend. *Wooddale Builders*, 722 N.W.2d at 303 (recognizing desirability of cooperative arrangements between multiple insurers to whom defense has been tendered). Indeed, recent caselaw establishes that insurers with duties to defend and whose policies have been triggered for defense purposes have an equitable right to seek contribution from other insurers who also have a duty to defend and whose policies have been triggered for defense purposes. *Cargill*, 784 N.W.2d at 354. It is clear that an insured may not avoid its duty to defend by the mere fact that defense has also been tendered to another insurer.

During the underlying arbitration, Steven Champlin, counsel for Kraus-Anderson, had ongoing communications by letters and telephone calls with Tory Bishop, counsel for Evanston. Champlin testified to this fact at trial, and the letters were introduced as exhibits. After the January 2003 letter purportedly tendering the defense to Evanston, Champlin provided status updates in the form of letters to Bishop in April 2003, September 2003, and March 2004. In the September 2003 letter, Champlin informed

Evanston that St. Paul was currently providing a defense and indicated that Kraus-Anderson continued to request the benefits of its policy with Evanston. Champlin informed Evanston of the St. Paul settlement terminating St. Paul's defense of Kraus-Anderson in March 2004; he also informed Evanston of the declaratory judgment action against Transportation at this time. Champlin testified that neither Bishop nor anyone else on behalf of Evanston ever expressed interest in intervening in the declaratory judgment action against Transportation. Champlin's communications with Bishop were focused on reporting the status of these matters; both parties indicated that they continued to reserve their rights under the Evanston policy. Kraus-Anderson settled with St. Paul in October 2003, and it first informed Evanston of the settlement in March 2004. These facts are not disputed by Kraus-Anderson or Evanston—they merely disagree about what these facts mean.

In its reply brief, Evanston analogizes this case to *Fed. Ins. Co. v. Arthur Andersen LLP*, 522 F.3d 740 (7th Cir. 2008). In that case, the Seventh Circuit held that, under Illinois law, Arthur Andersen did not tender its defense to Federal Insurance. 522 F.3d at 745. In reaching that conclusion, the court emphasized that "Arthur Andersen retained [the law firm] Mayer Brown directly, and, though it wanted its insurers to pay as much of the bill as possible, Arthur Andersen made it clear that it would control both the defense and the law firm conducting that defense." *Id.* *Arthur Andersen* involved two underlying suits; in neither case did Arthur Andersen's notice letter to Federal Insurance request a defense. *Id.* at 742. Rather, Arthur Andersen specifically informed Federal Insurance that it had retained Mayer Brown to represent it and asked Federal Insurance to chip in

toward that cost. *Id.* Additionally, Arthur Andersen was unresponsive to follow-up requests for additional information. *Id.* at 742, 744. Although a federal court's decision applying Illinois law is not binding on Minnesota courts applying Minnesota law, *Arthur Andersen* is, in any event, readily distinguishable on its facts. Here, Kraus-Anderson did request a defense and did communicate with Evanston and keep it informed through status reports, and its initial notice-and-tender letter did not state that defense arrangements not including Evanston had been arranged and finalized.

Finally, although there is no precedent elaborating on the tender requirements set forth in *Home Insurance*, the thrust of that opinion is clear: the burden of communicating whether an insured who provides notice of an arguably covered claim in fact seeks assistance with its defense is to be borne by the insurer rather than the insured. *See Home Ins. Co.*, 658 N.W.2d at 532-34. Kraus-Anderson's letter requesting policy benefits, stating that defense is tendered, and requesting a response was adequate to place the burden on Evanston to ask if its involvement was desired; at that time, unless Kraus-Anderson explicitly refused Evanston an opportunity to defend, Evanston's duty to defend was effectively triggered. *See id.* at 533. Evanston does not cite, and we do not find, any record evidence of an explicit refusal of an offered defense in this regard; instead, Evanston argues that tender to other insurers was more clear, which impliedly shows that Kraus-Anderson did not initially want a defense from Evanston.

The heart of Evanston's argument is that it was not given an opportunity to defend Kraus-Anderson despite Kraus-Anderson's use of the word "tender." We need not conclude that "tender" is a magic word that is always effective to tender defense. The

district court found that Kraus-Anderson tendered defense to Evanston on a record including the January 2003 letter purportedly tendering defense, the subsequent communication between Champlin and Bishop, Kraus-Anderson's repeated requests to receive the benefits of its policy, no evidence that Evanston ever specifically asked Kraus-Anderson whether it wanted a defense, and no evidence that Kraus-Anderson ever denied Evanston an opportunity to defend it. On this record, we cannot conclude that the district court's finding that Evanston was given an opportunity to defend Kraus-Anderson was clearly erroneous.

B. Equitable Estoppel

Evanston argues that equitable estoppel bars Kraus-Anderson's breach-of-contract claim against it.

"A party seeking to invoke the doctrine of equitable estoppel has the burden of proving three elements: (1) that promises or inducements were made; (2) that it reasonably relied upon the promises; and, (3) that it will be harmed if estoppel is not applied." *Hydra-Mac, Inc. v. Onan Corp.*, 450 N.W.2d 913, 919 (Minn. 1990).

> Estoppel is an equitable doctrine which is intended to prevent a party from taking an unconscionable advantage of his own wrong while at the same time asserting his strict legal rights. The substance of estoppel is the reasonable reliance by one party upon the representation of another which will injure the first party if that other is permitted to assert the existence of a state of facts at variance with those represented.

Lundberg v. Nw. Nat'l Bank of Minneapolis, 299 Minn. 46, 50, 216 N.W.2d 121, 124 (1974) (quotation omitted).

"It is a well-established principle that one who comes into equity must come with clean hands." *Home Ins. Co.*, 658 N.W.2d at 535 (quotation omitted). An insurer's "breach of a duty to defend precludes application of an equitable right to contribution." *Cargill*, 784 N.W.2d at 354. The doctrine of equitable estoppel has apparently never been applied by any Minnesota appellate court to let an insurer off the hook for its breach of the duty to defend its insured. Further, all of the above reasons why Kraus-Anderson tendered the defense to Evanston weigh against applying this doctrine to benefit Evanston. Under Minnesota law, when an insured provides notice to its insurer of claims arguably falling within the policy's defense requirement, absent explicit refusal of a defense by the insured, the insurer must provide a defense. *Home Ins. Co.*, 658 N.W.2d at 533. At bottom, Evanston's argument is that it was induced not to defend Kraus-Anderson by Kraus-Anderson's silence and lack of an express request for a defense; applying the doctrine of equitable estoppel to bar Kraus-Anderson's breach-of-contract claim on these facts would undermine the supreme court's decision in *Home Insurance*. We conclude that Evanston's breach of its duty to defend Kraus-Anderson precludes application of the doctrine of equitable estoppel in Evanston's favor.

C. Exhaustion of the St. Paul Policy

Evanston argues that its defense obligation was not triggered because St. Paul settled with Kraus-Anderson for less than the full $1 million policy limit. RLI makes several similar and related arguments.

As discussed above, St. Paul issued Kraus-Anderson a $1 million underlying CGL policy, and it settled with Kraus-Anderson for $750,000 plus defense costs. Evanston's

policy contained a provision for erosion of the policy limit through claims expenses; it also contained an excess clause stating that it provided only excess coverage. RLI's policy contained a provision stating that it would assume Kraus-Anderson's defense and pay those costs only if the underlying insurers' obligations ceased through exhaustion of all underlying limits, and it specifically identified the Evanston policy as scheduled underlying insurance.

Evanston argues that the district court misapplied *Drake v. Ryan*, 514 N.W.2d 785 (Minn. 1994), and *Cincinnati Ins. Co. v. Franck*, 644 N.W.2d 471 (Minn. App. 2002), in concluding that the St. Paul settlement exhausted that policy. In *Drake*, the supreme court held that Minnesota public policy permits enforcement of a settlement in which the plaintiff fully releases the insured defendant and his primary liability insurer up to the limits of the primary liability coverage but expressly retains the right to pursue a claim for additional damages from the excess liability carrier. 514 N.W.2d at 789. The court rejected the argument that the plaintiff could not proceed against the excess insurer until the limits of the primary policy were exhausted because the plaintiff agreed to "swallow the gap" between the amount of settlement and the primary policy limits, which reduced the risk that the primary insurer would make "token settlements." *Id.*

In *Cincinnati Insurance*, this court extended *Drake*, holding that the same public-policy considerations apply when umbrella carriers are involved; thus, "coverage under an umbrella policy becomes available when the injured party, the insured, and the primary insurer reach a settlement for less than the primary policy limits and the injured party agrees to absorb the gap between the settlement amount and the primary policy

limits." 644 N.W.2d at 476. The *Cincinnati Insurance* court rejected the umbrella carrier's argument that the settlement required it "to 'drop down' and provide coverage at lower limits, thus forcing an increase in premiums for umbrella policies" because the umbrella insurer's "duty to indemnify will be only for amounts over and above the primary policy limit." *Id.* at 474. The court noted that the umbrella insurer had already assumed the duty to defend and did not seek to recover defense costs. *Id.*

Neither *Drake* nor *Cincinnati Insurance* is squarely on point. The district court reasoned that *Cincinnati Insurance* allows a settlement agreement for less than the policy limits to effectively exhaust a policy as long as the excess insurer is credited the full amount of the policy limit because the insured absorbs the gap between the settlement amount and the liability, which was the case here. The district court's reasoning is not inconsistent with precedent, and we find no error in this regard. "Minnesota courts sometimes consider questions of public policy in interpreting insurance policies." *Seaway Port Auth. v. Midland Ins. Co.*, 430 N.W.2d 242, 249 (Minn. App. 1988). Strict enforcement of policy-exhaustion clauses would force an insured to litigate the claim to final judgment to exhaust the policy claim limits, which could decrease the insured's net recovery and delay payment. *Drake*, 514 N.W.2d at 789. Further, there has been no showing that the St. Paul settlement was anything other than a good-faith settlement. *Cf. id.* (expressing concern about "token settlements"). We agree with the district court that the St. Paul settlement, with Kraus-Anderson absorbing the gap, effectively exhausted that policy and left Evanston with a duty to defend.

D. Evanston's Cross-Claims

Evanston argues that the district court erred by dismissing its cross-claim against Transportation because, even without a loan-receipt agreement, Evanston had a right to equitable contribution from Transportation for an equal share of Kraus-Anderson's unreimbursed defense costs.

Evanston relies on the supreme court's holding in *Cargill* that "a primary insurer that has a duty to defend, and whose policy is triggered for defense purposes, has an equitable right to seek contribution for defense costs from any other insurer who also has a duty to defend the insured, and whose policy has been triggered for defense purposes." 784 N.W.2d at 354. When an insurer has a right to equitable contribution from other insurers, defense costs should be divided equally. *Id.*

Even assuming that Transportation had a duty to defend Kraus-Anderson, we reject Evanston's argument. Transportation's settlement with Kraus-Anderson included $650,000 allocated for defense costs. Public policy favors the settlement of claims. *Voicestream Minneapolis, Inc. v. RPC Props., Inc.*, 743 N.W.2d 267, 271 (Minn. 2008). As the district court observed, at the time Kraus-Anderson reached this settlement, no insurer had stepped forward to provide it with a defense, and permitting Evanston to pursue a claim against Transportation—which would be indemnified by Kraus-Anderson—would negate the settlement. Further, *Cargill* is crystal clear that "breach of a duty to defend precludes application of an equitable right to contribution." 784 N.W.2d at 354. Because Evanston breached its own duty to defend Kraus-Anderson, it may not rely on *Cargill* in support of an equitable right to seek contribution from Transportation.

Evanston also contends that Transportation, NewMech, and RLI are all equally liable with Evanston for the award of declaratory-judgment fees if the Transportation settlement is a *Pierringer* release, and that if it is not a *Pierringer* release, the settlement extinguished any claim Kraus-Anderson may have had for declaratory-judgment fees from Evanston and RLI. This court has explained that, "under a *Pierringer* release, the plaintiff releases one or more joint tortfeasors while retaining a claim against the tortfeasors not a party to the agreement." *Drake v. Ryan*, 498 N.W.2d 29, 32 (Minn. App. 1993), *aff'd* 514 N.W.2d 785. So-called *Pierringer* releases arise in the context of comparative negligence in tort actions. *Frey by Frey v. Snelgrove*, 269 N.W.2d 918, 921 (Minn. 1978). Evanston has not shown that the Transportation settlement is a *Pierringer* release; because this is a contract action, we think it is not.

At bottom, Transportation reached a reasonable settlement with Kraus-Anderson even as Evanston breached its own duty to defend Kraus-Anderson. We find no authority permitting Evanston to recover from Transportation on the facts of this case, and we conclude that the district court did not err by granting summary judgment dismissing Evanston's cross-claims.

2. RLI's Liability

RLI argues that the district court erred by concluding that RLI breached its duty to defend Kraus-Anderson because the scheduled underlying insurance was not exhausted, which was required to create a duty to defend under the terms of RLI's excess policy. Both Kraus-Anderson and Evanston argue that RLI is liable for breaching its duty to defend Kraus-Anderson; Evanston additionally contends that RLI must equally share any

liability for Kraus-Anderson's defense costs.

Because RLI's breach was determined in the district court's grant of partial summary judgment in favor of Kraus-Anderson, we review de novo whether there are any genuine issues of material fact and whether the district court erred in its application of law. *Dealers Mfg. Co. v. Cnty. of Anoka*, 615 N.W.2d 76, 79 (Minn. 2000); *Driscoll v. Standard Hardware, Inc.*, 785 N.W.2d 805, 809-10 (Minn. App. 2010), *review denied* (Minn. Sept. 29, 2010).

An insurer's duty to defend its insured is contractual. *Cargill*, 784 N.W.2d at 349. Interpretation of the terms of an insurance contract is a question of law. *Jenoff, Inc. v. N.H. Ins. Co.*, 558 N.W.2d 260, 262 (Minn. 1997). "When interpreting an insurance contract, words are to be given their natural and ordinary meaning and any ambiguity regarding coverage is construed in favor of the insured." *Am. Family Ins. Co. v. Walser*, 628 N.W.2d 605, 609 (Minn. 2001). Whether a contract is ambiguous is a question of law. *Carlson v. Allstate Ins. Co.*, 749 N.W.2d 41, 45 (Minn. 2008).

In this case, the RLI policy provides two exclusive triggers for its duty to defend:

> 1. In the event a claim or suit alleges damages covered by underlying policies and the obligation of all underlying insurers either to investigate and defend the insured or to pay the costs of such investigation and defense ceases solely through exhaustion of all underlying limits of liability through payments of any combination of covered expenses, settlements or judgments for occurrences taking place during our policy period, then we shall assume the investigation and defense of the insured against suits seeking damages.
>
> 2. Except for the retained limit, we will also pay for, investigate and defend any suit brought against an insured for a claim or suit that alleges damages arising out of an occurrence which is not covered, in whole or in part, under scheduled underlying insurance and unscheduled

> underlying insurance, but which seeks damages arising out of an occurrence otherwise covered by this policy.

The RLI policy followed form to the Evanston policy, which was expressly designated as scheduled underlying insurance. The St. Paul CGL policy was also scheduled underlying insurance.

Because RLI issued a follow-form umbrella policy, there are no occurrences otherwise covered by RLI's policy that are not covered, at least in part, by Evanston's professional-liability policy. Thus, RLI had a duty to defend Kraus-Anderson only if all scheduled underlying insurance was exhausted. But the underlying limits of the Evanston policy were never exhausted and have at all times remained available—the district court had not yet considered Evanston's breach and liability at the time it granted partial summary judgment against RLI, and the final entry of judgment was for less than the Evanston policy's $1 million limit.

Kraus-Anderson relies on the Eighth Circuit's statement that "Minnesota law generally requires an umbrella insurance carrier to defend a party when the party's underlying carrier refuses to do so." *Hawkins Chem., Inc. v. Westchester Fire Ins. Co.*, 159 F.3d 348, 354 (8th Cir. 1998). But the holding in *Hawkins Chemical* that the underlying insurer breached its duty to defend rested on the settled principle that "an insurer's duty to defend arises whenever a claim against the insured is *arguably* within the scope of the policy." *Id.* at 354-55. In that case, the umbrella policy disclaimed a duty to defend when the underlying insurer breached its own duty to defend, and the underlying insurer refused to defend based upon an exclusion whose validity had not

been litigated; because the underlying insurer would not have breached its duty to defend if the exclusion had been effective, it was arguable that the underlying insurer did not breach and that the umbrella carrier therefore owed a duty to defend the insured. *Id.* at 355. Unlike *Hawkins Chemical*, arguable coverage does not come into play in this case because RLI's policy followed form to Evanston's underlying policy and RLI's coverage and duty to defend was never arguably triggered.

More on point is the supreme court's decision in *Jostens*, in which the court held that both insurers have a duty to defend a claim when it can legitimately and in good faith be argued that either insurer has primary coverage for that claim. *Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 167 (Minn. 1986). As *Jostens* makes clear, both insurers may be equally liable for the insured's defense costs as between themselves when they both arguably have primary coverage; however, "as between the underlying insurer and the umbrella insurer, the underlying insurer shall be liable for the entire defense costs except as to those costs that the underlying insurer can show were for defending claims covered only under the umbrella insurer's 'broader' or primary coverage." *Id.* In this case, the RLI excess policy provides follow-form coverage and is no broader than Evanston's underlying, primary policy.

Consistent with caselaw and the plain language of the RLI excess policy, we conclude that RLI's duty to defend Kraus-Anderson was never triggered because, by its plain terms, the excess policy required RLI to defend Kraus-Anderson only when the policy limits of Evanston's primary policy were exhausted. Thus, the district court erred by concluding that RLI breached its duty to defend Kraus-Anderson, and we reverse the

judgment against RLI.

3. Amount of Judgment

A. Costs of Litigating Cross-Claims

Kraus-Anderson seeks recovery of an additional $9,000 that it incurred in litigating Evanston's cross-claims against Transportation and NewMech. The district court reasoned that Kraus-Anderson was "not entitled to attorney fees and costs incurred in defense of NewMech and Transportation" because Kraus-Anderson voluntarily agreed to assume the defense.

Kraus-Anderson argues that these damages arise directly from Evanston's breach of its duty to defend because, "[h]ad Evanston defended its insured, its cross-claims never would have been asserted." We disagree. Contrary to Kraus-Anderson's assertion, it is possible that Evanston would have sought indemnity and subrogation from Transportation and NewMech even if it had defended Kraus-Anderson. Further, Kraus-Anderson's costs incurred in defending Transportation and NewMech more directly arise as the result of the intervening settlement. Kraus-Anderson agreed to defend those claims through its settlement with Transportation and NewMech, and we are not convinced that the district court abused its discretion by declining to award those defense fees and costs to Kraus-Anderson.

B. Declaratory-Judgment Fees

Evanston challenges the district court's calculation and allocation of its award of defense costs. For the reasons stated above, Evanston's arguments that it is jointly liable with Transportation, NewMech, and RLI fail. We now consider Evanston's arguments

that Kraus-Anderson may not recover fees paid to Champlin and his law firm, Dorsey & Whitney LLP, and may not recover fees incurred during pursuit of claims against RLI during the declaratory-judgment action.

We review an award of attorney fees and costs incurred in a successful declaratory-judgment action to establish an insurer's obligations for an abuse of discretion. *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724, 740 (Minn. 1997). We also review the reasonableness of an award of attorney fees for an abuse of discretion. *Id.* at 741.

The district court awarded Kraus-Anderson $465,053.46 in attorney fees, costs, and expenses related to this declaratory-judgment action. The district court rejected Evanston's argument that attorney fees ceased to be allowed once Evanston was found to have breached its duty to defend. As the district court reasoned, "Evanston continued to dispute its obligation" through the September 2009 order, and Kraus-Anderson "had an interest in the proceedings and required action by counsel until the case was closed." Caselaw establishes that an insured may not be required to segregate damages. *Id.* at 740. Even when it is reasonably possible to segregate billing activity by defendant, an insured is not necessarily required to do so, especially when there are "common legal issues and considerations." *Id.* at 740-41.

Here, the district court found that Kraus-Anderson's attorney fees and costs incurred in pursuing coverage were not segregated as to each defendant insurer. The insurance policies were themselves interconnected, and the litigation necessarily involved common issues of fact and law. Like the *Domtar* court, we "decline [the] invitation to

retroactively impose upon [the insured] an obligation to segregate its billing for attorney fees in a manner that is not typical in such litigation." Id. at 740. We find no abuse of discretion with respect to this issue in the record before us.

With respect to attorney fees paid to Dorsey & Whitney, the district court found that the fees charged for Champlin's participation in the declaratory-judgment action were "reasonable and necessary based on his expertise in general construction litigation and his familiarity with this particular project." Champlin testified that he was "involved in one way or another with the Stone Arch Lofts project and the disputes arising out of it since August of 2001." Based on this, the court reasoned, his involvement "was essential to the best [litigation] of the declaratory action, as he was in the best position to understand the complexity of the arbitrations and the coverage disputes."

Evanston characterizes Champlin as a fact witness, arguing that attorney fees for his work were therefore not recoverable. But Evanston acknowledges that "Champlin may otherwise be entitled to compensation as an expert or fact witness." Evanston cites no law standing for the proposition that compensation of an expert or fact witness is not recoverable in a declaratory-judgment action for an insurer's breach of its duty to defend. Minnesota caselaw has long established that legal fees incurred in a declaratory-judgment action against an insurer that breached its duty to defend are recoverable because those are "damages arising directly as the result of the breach." *Morrison v. Swenson*, 274 Minn. 127, 138, 142 N.W.2d 640, 647 (1966). That is, "the injured party in an action of this kind ought to be permitted to recover whatever expenses he has been compelled to incur in asserting his rights, as a direct loss incident to the breach of contract." *Id.* The

same logic applies with equal force in this case. The district court found that fees paid to Champlin were reasonable expenses that enabled Kraus-Anderson to successfully sue Evanston for its breach of its duty to defend. We conclude that Evanston has not met its burden of showing that the district court abused its discretion in this regard.

C. Prejudgment Interest

Evanston and RLI argue that Kraus-Anderson is not entitled to prejudgment interest under either Minn. Stat. § 60A.0811 (2010) or Minn. Stat. § 549.09 (2010) for the attorney fees incurred in this declaratory-judgment action. Meanwhile, Kraus-Anderson argues that the district court erred in its calculation of prejudgment interest.

Section 549.09 authorizes prejudgment interest in some circumstances, but it does not permit an award of prejudgment interest for "that portion of any verdict, award, or report which is founded upon interest, or costs, disbursements, attorney fees, or other similar items added by the court or arbitrator." Minn. Stat. § 549.09, subd. 1(b)(5). Caselaw establishes that this provision "applies only to costs and attorney fees *added* to a judgment by a court." *Seaway Port Auth.*, 430 N.W.2d at 252. Thus, it permits "adding prejudgment interest to a judgment for attorney fees when the fees are the subject matter of the lawsuit." *Gaughan v. Gaughan*, 450 N.W.2d 338, 344 (Minn. App. 1990), *review denied* (Minn. Mar. 16, 1990). Declaratory-judgment attorney fees arise directly as a result of an insurer's breach of its duty to defend and are recoverable as contract damages of that breach. *Morrison*, 274 Minn. at 138, 142 N.W.2d at 647. We agree with Kraus-Anderson that the district court did not err by awarding prejudgment interest on the

declaratory-judgment fees.[2]

Kraus-Anderson also argues that the district court erred in calculating prejudgment interest. We review an award of prejudgment interest, including determination of the dates during which it is calculated, for an abuse of discretion. *McKay's Family Dodge v. Hardrives, Inc.*, 480 N.W.2d 141, 148 (Minn. App. 1992), *review denied* (Minn. Mar. 26, 1992); *In re Estate of Renczykowski*, 409 N.W.2d 888, 892 (Minn. App. 1987). Kraus-Anderson submitted an affidavit stating that the total prejudgment interest to which it was entitled was $192,076.14, which was the amount ultimately awarded by the district court. Kraus-Anderson now contends that the calculation of prejudgment interest in its affidavit was based on an estimate of when judgment would be entered, which ultimately proved incorrect. Kraus-Anderson does not cite and we do not find any authority holding that a district court abuses its discretion by relying on a party's affidavit which later proves incorrect and unfavorable to that party. *See White v. Minn. Dep't of Natural Res.*, 567 N.W.2d 724, 734 (Minn. 1997) (holding that error is never presumed on appeal and must be shown by the party claiming it). We conclude that the district court did not err by awarding prejudgment interest and that Kraus-Anderson has not shown that the district court's calculation is an abuse of discretion.

Affirmed in part and reversed in part.

[2] Because the prejudgment interest awarded for Kraus-Anderson's declaratory-judgment attorney fees is authorized by section 549.09, we need not address section 60A.0811 as an alternative ground for the same prejudgment-interest award.