NAVIGATING THE CHANGES TO THE RULES GOVERNING MILLER-SHUGART SETTLEMENT AGREEMENTS IN MINNESOTA

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When it comes to liability insurance, the insurer is generally in control of settlement decisions. Liability insurance policies typically grant the insurer the right to settle a claim or suit against its insured and contain cooperation and voluntary payment clauses that preclude an insured from making settlement decisions on their own. For 40 years, however, the Minnesota Supreme Court has recognized a narrow exception to this general rule. In *Miller v. Shugart*, the supreme court approved a settlement method that protects an insured defendant when an insurer disputes the existence of any insurance coverage for the claims or suit against its insured. 316 N.W.2d 729, 733-34 (Minn. 1982). In these cases, a claimant and an insured can stipulate to a judgment against the insured on the condition that the insured be released from any personal liability and the judgment be collected only from the insurer.

Since being approved in Minnesota, *Miller-Shugart* settlements have been scrutinized under a unique set of rules. In general, to be enforceable against an insurer, a *Miller-Shugart* settlement not only has be covered under the insurer's policy, but it also has to be reasonable and not the product of fraud or collusion. In addition, it has long been understood that to be enforceable such settlements must allocate damages by defendant when multiple defendants are involved, see *Bob Useldinger & Sons, Inc. v. Hangsleben*, 505 N.W.2d 323, 331 (Minn. 1993), and allocate by damage item in cases of a single defendant when covered and uncovered damages are involved, see *Corn Plus Co-op. v. Cont'l Cas. Co.*, 516 F.3d 674, 681 (8th Cir. 2008). With the Minnesota Supreme Court's recent decision in *King's Cove Marina, LLC v. Lambert Com. Constr. LLC*, 958 N.W.2d 310 (Minn. 2021), however, allocation between covered and uncovered claims when there is a single defendant is no longer required.

In this article, we discuss the purpose and logistics of *Miller-Shugart* settlements, the facts that led to the Minnesota Supreme Court's decision in *King's Cove*, the supreme court's new two-step inquiry for determining the reasonableness of an unallocated *Miller-Shugart* settlement, and what the change means for using these settlements going forward.

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THE PURPOSE AND LOGISTICS OF *MILLER-SHUGART* SETTLEMENTS

Miller-Shugart settlements are only permitted when an insurer denies coverage of all claims—or reserves its rights on all claims alleged against the insured. If an insurer denies coverage, an insured can enter a *Miller-Shugart* settlement without providing any notice to the insurer. If an insurer defends while reserving rights on coverage for all claims, however, an insured must provide notice to the insurer before entering into a *Miller-Shugart*.

Under a *Miller-Shugart* settlement, an insured defendant admits liability and stipulates to the entry of a judgment for a specific amount on condition that the judgment is collectible only from the insurer. Liability is then established, and the plaintiff can pursue collection from the insured defendant's insurer by garnishment or in a separate declaratory judgment action. In either proceeding, the insurer may challenge not only the scope of coverage under the insurance policy, but also the validity and reasonableness of the settlement. See *Alton M. Johnson Co. v. M.A.I. Co.*, 463 N.W.2d 277, 279 (Minn. 1990). A *Miller-Shugart* settlement is only enforceable against the insurer to the extent it is covered, reasonable, and not the product of fraud or collusion. See Miller, 316 N.W.2d at 733-35.

A plaintiff seeking to enforce a *Miller-Shugart* settlement must first establish that it is a settlement of covered claims. "[I]f there is found to be no coverage for the *Miller-Shugart* judgment, that ends the matter; there is no recovery against the insurer and the reasonableness of the settlement becomes a moot issue." Alton M. Johnson, 463 N.W.2d at 279. To establish coverage, the plaintiff must do more than cite the allegations in the underlying complaint or the stipulated facts recited in the *Miller-Shugart* settlement. There must be actual facts that establish coverage for some or all of the claims—and only those claims are covered. *Nelson v. Amer. Home Assur. Co.*, 824 F. Supp. 2d 909 (D. Minn. 2011), aff'd, 702 F.3d 1038 (8th Cir. 2012).

A plaintiff seeking to enforce a *Miller-Shugart* settlement also has the burden to prove the settlement was reasonable and prudent. Miller, 316 N.W.2d at 735. Reasonableness is a question of fact for the district court. Alton M. Johnson Co., 463 N.W.2d at 279. Reasonableness is not linked directly to what a jury would have decided, but rather to "whether the [tortfeasor] could have been liable for" the amount of the settlement considering liability risks and damage uncertainty. *Osgood v. Medical, Inc.*, 415 N.W.2d 896, 903 (Minn. App. 1987). The rough guide is whether a settlement figure is "what a reasonably prudent person in the position of the defendant would have settled for on the merits of plaintiff's claim." Miller, 316 N.W.2d at 735.

A *Miller-Shugart* settlement is not binding on the insurer if obtained through fraud or collusion. See Miller, 316 N.W2d at 734. In Miller, the Minnesota Supreme Court recognized the possible collusion that can occur in a *Miller-Shugart* settlement because there is no incentive for the insured to negotiate any terms favorable to the insurer, and the adversity between the plaintiff and insured in a sense disappears in the face of the mutual goal of shifting all exposure to a liability insurer. See id. at 735. The "dynamics of *Miller-Shugart* settlements make [the] settlement amount more suspect than in other consent settlements because a defendant with little to lose may agree to an inflated judgment amount in order to avoid personal liability." *Indep. Sch. Dist. No. 197 v. Accident & Cas. Ins. of Winterthur*, 525 N.W.2d 600, 607 (Minn. App. 1995), rev. denied (Minn. April 27, 1995).

If coverage does not exist, the plaintiff recovers nothing. If coverage exists but the stipulated judgment amount is invalid or unreasonable, then the settlement is unenforceable and the plaintiff's initial tort action against the insured is reinstated. Alton M. Johnson Co., 463 N.W.2d at 279-280. That is, unless the plaintiff waives reinstatement of its claims against the insured defendant as part of the *Miller-Shugart* settlement. See *Corn Plus*, 516 F.3d at 681 (declining to reinstate litigation underlying unreasonable *Miller-Shugart* settlement based on plaintiff's express waiver of reinstatement as part of the settlement).

Historically, in cases with multiple defendants and/or multiple claims, courts have held that a *Miller-Shugart* settlement must allocate stipulated damages among multiple defendants and/or between covered and non-covered claims to be reasonable. See e.g., *Bob Useldinger & Sons*, 505 N.W.2d at 331 (requiring allocation among multiple defendants); *Corn Plus*, 516 F.3d at 681 (requiring allocation between covered and uncovered claims); *Ebenezer Soc. v. Dryvit Systems, Inc.*, 453 N.W.2d 545, 549 (Minn. App. 1990) (finding no probable cause to hold insurers liable for potentially covered damages because there was no allocation in *Miller-Shugart* settlement for covered and non-covered items of damages).

Until the Minnesota Supreme Court's recent decision in King's Cove, the Eighth Circuit's decision in *Corn Plus* was the leading allocation case in Minnesota. In *Corn Plus*, a cooperative alleged a contractor performed faulty welding work on the cooperative's ethanol facility, resulting in decreased ethanol production, the need to repair the defective welds, and loss of use while the welds were being repaired. 516 F.3d at 676. After the contractor's insurers denied coverage, the cooperative and contractor entered into a *Miller-Shugart* settlement that did not itemize/allocate the damages being settled. *Id.* at 677. The district court and Eighth Circuit held the *Miller-Shugart* settlement was unreasonable and thus unenforceable because it failed to allocate damages. *Id.* at 678, 681. In so holding, the court noted "[a]bsent such allocation, a judicial determination into the reasonableness of the *Miller-Shugart* settlement is

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impractical since the parties are naturally in a better position to calculate the damages." *Id.* at 681. "Moreover, parties would also be tempted to inflate their covered claims post hoc if they were permitted to designate a settlement amount without damage allocation." *Id.*

In *King's Cove*, the Minnesota Supreme Court rejected the *Corn Plus* allocation rule and instead held that a *Miller-Shugart* settlement agreement with a single insured defendant is not per se unreasonable if it fails to allocate between covered and uncovered claims. The supreme court instead established a detailed two-step inquiry for courts to follow when scrutinizing the reasonableness of unallocated *Miller-Shugart* settlements.

KING'S COVE

In *King's Cove*, the King's Cove Marina hired Lambert Commercial Construction LLC to expand and remodel the main building of the marina. Lambert performed certain work itself and hired Roehl Construction, Inc. to perform certain other work. During the course of the construction project, a number of issues arose with the work of Lambert and Roehl, including water intrusion issues that led to damage to interior finishes that were not part of the work. King's Cove ultimately sued Lambert and others for breach of contract and negligence.

Lambert tendered the defense of the lawsuit to its liability insurer United Fire & Casualty Company, who denied coverage for the claims but defended Lambert under a reservation of rights. United Fire also started a separate declaratory judgment action. After notifying United Fire, King's Cove and Lambert settled pursuant to a *Miller-Shugart* settlement agreement, whereby Lambert stipulated to a judgment against it for the sum of $2 million, plus interest and costs, and King's Cove agreed to enforce the judgment against only United Fire. The agreement reserved any claims and damages that King's Cove had for the work of others, including the work of Roehl Construction.

The district court approved the *Miller-Shugart* settlement and allowed King's Cove to proceed against United Fire. In defense of the garnishment proceeding, United Fire denied coverage and asserted the *Miller-Shugart* settlement was unreasonable both overall and because it failed to allocate damages between covered and uncovered claims. The district court ruled in favor of King's Cove, concluding that there was insurance coverage under the United Fire policies for the entire settlement and that the settlement was reasonable in light of Lambert's potential exposure.

Both sides appealed, and the court of appeals reversed and remanded. See generally *King's Cove Marina, LLC v. Lambert Com. Constr. LLC*, 937 N.W.2d 458 (Minn. App. 2019). The court of appeals initially concluded that the district court erred in its coverage determination by failing to distinguish between damages associated with repairing or replacing Lambert's faulty work, which were barred from coverage by the "your work" exclusion, and damages to other property, which, if proven, would be covered. *Id.* at 468-69. Because King's Cove's claims and damages were at best only partially covered, the court of appeals further concluded the *Miller-Shugart* agreement was "unreasonable as a matter of law and unenforceable" against United Fire because it did not allocate between covered and uncovered damages. *Id.* at 470.

King's Cove again appealed, and the Minnesota Supreme Court affirmed in part, reversed in part, and remanded the case to the court of appeals for further proceedings. 958 N.W.2d at 313.

The Minnesota Supreme Court first affirmed the court of appeals' application of the "your work" exclusion to bar coverage for damages associated with repairing or replacing Lambert's own work. *Id.* at 320. The exclusion applied to exclude coverage for "'property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard.'" *Id.* While not the most-talked about part of the King's Cove decision, the supreme court's clear application of the "your work" exclusion to bar coverage for a large portion of the claimed damages is an important part of the decision. The court characterized the exclusion as a "business-risk exclusion" designed to "exclude coverage for property damage caused by the insured's faulty workmanship where the damages claimed are the cost of correcting the work itself." *Id.* at 316-17 (quotations omitted). Consistent with its purpose, the court expressly held that the language of the exclusion was clear and unambiguous and that it plainly barred coverage for the claimed property damage to Lambert's own work, notwithstanding the products-completed operations hazard. *Id.* at 318.

All of the claims involving Lambert's work were included in the "products-completed operations hazard" ("PCOH") definition because the property damage occurred away from Lambert's premises and arose out of Lambert's work after the work was completed. *Id.* In seeking to collect on the judgment, King's Cove argued that all of the claims settled in the *Miller-Shugart* settlement were covered claims. King's Cove referenced the separate "Products Completed Operations Aggregate Limit" in the Declarations Page and argued that the limit was separate coverage not subject to any of the exclusions within the CGL Policy. *Id.* at 318-19. In other words, King's Cove argued that because the damages for Lambert's work fell within the definition of "products-completed operations hazard," there was up to $2 million in coverage for those claims and the exclusions to Coverage A did not apply. *Id.*

The Minnesota Supreme Court rejected King's Cove's argument. It concluded that the PCOH limit is merely a

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"different applicable limit" of coverage and remains subject to exclusions in the Policy. *Id.* at 319-20. Further, application of exclusion l. to work within the definition of "products completed operations hazard" did not make the policy ambiguous or render coverage illusory. *Id.* at 320. The court concluded that application of the "your work" exclusion "is consistent with the general purpose of a commercial general liability policy, which is intended to protect the insured when its work damages someone else's property and is not intended to be a performance bond covering an insured's own work." *Id.* (quotations omitted).

Once it determined that damage to Lambert's roof and siding work was not covered but that damage to existing property adjacent to the work would, if proven, be covered, the Minnesota Supreme Court proceeded to consider the reasonableness of the unallocated *Miller-Shugart* settlement between King's Cove and Lambert. As a threshold matter, the court rejected a per-se rule that *Miller-Shugart* settlements involving a single defendant are unreasonable and unenforceable if they fail to allocate between covered and uncovered claims. *Id.* at 320, 322. The court reasoned that the test for reasonableness should instead be a "flexible one, grounded in principles of equity." *Id.* at 322.

The Minnesota Supreme Court also recognized that "[t]he issue of how much of the settlement is covered is distinct from the issue of whether a settlement is reasonable." *Id.* at 323 (quoting *Jostens, Inc. v. CNA Ins./Cont'l Cas. Co.*, 403 N.W.2d 625, 629 (Minn. 1987), overruled on other grounds by *N. States Power Co. v. Fid. & Cas. Co. of N.Y.*, 523 N.W.2d 657 (Minn. 1994)). The supreme court thus held that the reasonableness of unallocated *Miller-Shugart* settlements should be determined post-hoc under the following two-step inquiry:

The district court first considers the overall reasonableness of the settlement. If the settlement is reasonable, the district court then considers how a reasonable person in the position of the insured would have valued and allocated the covered and uncovered claims at the time of the settlement.

958 N.W.2d at 323. Despite calling the approach a two-step inquiry, the court acknowledged: "[b]ecause the relevant evidence on reasonableness and allocation overlaps, we contemplate that the district court typically will consider the reasonableness and allocation issues at the same time. If the district court finds that the unallocated settlement is reasonable, the district court then makes an allocation ruling in light of the ultimate coverage determination." *Id.* at 324.

The plaintiff judgment creditor bears the burden of showing that "the settlement is reasonable and prudent"—i.e., "what a reasonably prudent person in the position of the defendant would have settled for on the merits" of the plaintiff's claims at the time of the settlement. Miller, 316 N.W.2d at 735. This is a multi-factor objective test, which requires the district court to consider "the customary evidence on liability and damages," as well as the risks of going to trial, "the likelihood of favorable or unfavorable rulings on legal defenses and evidentiary issues if the tort action had been tried," expert legal opinions, and "other factors of forensic significance." Alton M. Johnson, 463 N.W.2d at 279. The reasonableness inquiry must consider the value of both the covered and uncovered claims.

If the overall settlement is reasonable, the district court must then consider allocation—i.e., how a reasonable person in the position of the insured would have valued and allocated the covered and uncovered claims at the time of the settlement—as it does in other contexts. *King's Cove*, 958 N.W.2d at 323-24 (citing *UnitedHealth Grp. Inc. v. Exec. Risk Specialty Ins. Co.*, 870 F.3d 856, 863 (8th Cir. 2017)). Following *King's Cove*, allocation in the *Miller-Shugart* settlement context will now be handled similarly to how it is handled in the context of arbitration awards, jury verdicts, and non-*Miller-Shugart* settlements. See *id.* (citing *Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co.*, 819 N.W.2d 602, 618 (Minn. 2012) (allocating arbitration award); *RSUI Indem. Co. v. New Horizon Kids Quest, Inc.*, 933 F.3d 960, 966 (8th Cir. 2019) (applying allocation analysis in *Remodeling Dimensions* to an unallocated jury award); *UnitedHealth Grp.*, 870 F.3d at 863 (adopting a similar allocation test in a dispute over coverage for settlements under professional liability excess insurance policies).

As with the overall reasonableness inquiry, the Minnesota Supreme Court recognized the plaintiff judgment creditor bears the burden of proof on allocation, in part because they are in the better position to know how the settling parties valued the claims and to shape the record on that issue. *Id.* at 325. "The allocation issue relates to the relative value of covered and uncovered claims. 'An allocation is, by its very nature, a determination of the relative value—not the absolute value—of the items being assessed.'" *Id.* at 323 (quoting *UnitedHealth Grp. Inc. v. Columbia Cas. Co.*, 47 F. Supp. 3d 863, 877 (D. Minn. 2014) (italics in original)). "The relevant evidence regarding allocation may include (1) information that was available to the parties at the time of the settlement regarding the underlying facts, (2) materials produced in discovery and any court rulings in the underlying litigation, (3) evidence of how the parties and their attorneys evaluated the claims at the time of the settlement, and (4) expert testimony about the value of the settled claims." *Id.* at 324.

On remand, the court of appeals declined to consider the reasonableness of the unallocated *Miller-Shugart* settlement and instead remanded the case to the district court for further analysis in light of the supreme court's new, two-step reasonableness inquiry. *King's Cove Marina, LLC v. Lambert Com. Constr. LLC*, 2021 WL 4259025, at *4 (Minn.

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Ct. App. Sept. 20, 2021). As of this writing, no further proceedings have taken place since the court of appeals' remand decision.

MILLER-SHUGART SETTLEMENT DYNAMICS AFTER *KING'S COVE*

The Minnesota Supreme Court's rejection of a bright-line rule requiring contemporaneous allocation will likely lead to increased costs, litigation, and uncertainty over the reasonableness of *Miller-Shugart* settlements involving covered and uncovered damages. If the parties to a *Miller-Shugart* settlement define and allocate the claims and damages being settled and a court subsequently determines that some claims and damages are covered while others are not, the court can efficiently and without further litigation apply its coverage determination to the settlement and bring the case to a close. On the other hand, under the new rule that allows and even encourages lump-sum settlements and post-settlement allocation, the potential for increased litigation is obvious. Following a district court's coverage determination, additional and potentially extensive proceedings—often requiring the need for expert opinions—will be necessary to allocate the lump-sum, unallocated settlement.

To avoid protracted after-the-fact litigation, the parties to a *Miller-Shugart* settlement may still want to specify and allocate the damages being settled up front instead of fully deferring the issue of allocation for post-settlement proceedings. In addition to streamlining the collection process, contemporaneous allocation may put the plaintiff judgment creditor in a better position to establish and collect the covered portion of a *Miller-Shugart* settlement. The plaintiff judgment creditor will ultimately bear the burden of proof on allocation, and what better evidence could there be of "how the parties and their attorneys evaluated the claims at the time of the settlement" than a contemporaneous allocation of the claims and damages being settled and for what amount? See *King's Cove*, 958 N.W.2d at 324 ("Events and circumstances happening after settlement are relevant only insofar as they inform how a reasonable party would have valued and allocated the claims at the time of settlement."); In re *RFC & ResCap Liquidating Tr. Action*, 399 F. Supp. 3d 804, 813 (D. Minn. 2019) ("An objective analysis of good faith and reasonableness, in turn, requires an analysis of what the parties knew or could have known at the time of the settlement; knowledge obtained years later, of new facts or new law, cannot inform the reasonableness of the settlement at the time it was made.") (citing Miller, 316 N.W.2d at 735).

This is not to say the parties to a *Miller-Shugart* settlement need to delve into what claims and damages might or might not be covered. In rejecting a per-se allocation rule, the Minnesota Supreme Court suggested "requiring allocation between covered and uncovered claims may unfairly burden the settling parties with predicting how the court in the garnishment action may resolve complex coverage issues." *King's Cove*, 958 N.W.2d at 322 (quotation omitted). But no such prediction is necessary. The purpose of a *Miller-Shugart* settlement is to fully resolve the liability claims against the insured and preserve any issues of coverage for subsequent resolution. Just as with an arbitration award, jury verdict, or non-*Miller-Shugart* settlement, however, the parties to a *Miller-Shugart* settlement may still be well-served to include a breakdown of the claims and damages being settled to which the court can then apply its coverage determinations.

The two-step reasonableness inquiry adopted in King's Cove also makes clear that in a case with covered and uncovered claims, the overall *Miller-Shugart* settlement amount must be for all of the claims, not just the covered ones. In *King's Cove*, King's Cove argued it was entitled to recover the entire $2 million stipulation judgment (which just happened to be equal to the combined limits of the United Fire Policies) from United Fire regardless of whether certain of its claimed damages were not covered. It urged the court to evaluate the reasonableness of the settlement "in light of the value of the covered damages claims" and enforce the settlement "if the value of the covered claim exceeds the value of the settlement." See *King's Cove*, 958 N.W.2d at 323. But, as explained by the Minnesota Supreme Court, "the issue of how much of the settlement is covered is distinct from the issue of whether a settlement is reasonable." *Id.* (quoting Jostens, 403 N.W.2d at 629). In a post-King's Cove world, the judgment creditor may have increased control over allocating damages to only the covered claims and minimizing damages for the non-covered claims. However, since a *Miller-Shugart* settlement resolves all claims against an insured defendant irrespective of coverage, a plaintiff judgment creditor should still only be able to recover the entire settlement amount if a court concludes all claims are fully covered.

The supreme court's analysis in *King's Cov*e also suggests allocation will still be required in multiple defendant cases. See *id.* at 322. In fact, in rejecting a per-se rule in single defendant cases involving covered and uncovered claims, the court expressly distinguished its prior holding in *Bob Useldinger & Sons* that a *Miller-Shugart* agreement that did not allocate damages among multiple defendants was unenforceable as a matter of law. *Id.*

The multiple-defendant rule was recently raised, in the only known *Miller-Shugart* appeal since the *King's Cove* decision, but not ultimately addressed by the court of appeals due to the facts and procedural history of the case. See *Bella Vista Condo. Ass'n v. Western Nat'l Mut. Ins. Co*., 2021 WL 4145005 (Minn. App. Sept. 13, 2021). In Bella Vista, the plaintiff executed an "Assignment of Claim under *Miller v. Shugart*"

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with a defendant contractor after the plaintiff obtained a default judgment against the settling defendant and others jointly and severally. *Id.* at *1. The district court concluded the agreement's failure to properly allocate rendered it per se unreasonable and unenforceable, but the court of appeals reversed. *Id.* at *2-3. The court of appeals held the agreement was not a true *Miller-Shugart* settlement because it involved a default judgment instead of a stipulated judgment. *Id.* at *3. The court of appeals added, however, that even if the agreement had been a valid *Miller-Shugart*, the court of appeals still would have had to remand the case for application of the new two-step reasonableness inquiry created in *King's Cove*. *Id.* at *3 n. 4.

CONCLUSION

The Minnesota Supreme Court's decision in *King's Cov*e changed the rules governing *Miller-Shugart* settlement agreements in cases involving a single defendant. Upfront allocation between covered and uncovered claims is no longer required for such agreements to be enforceable. This change may give plaintiff judgment creditors an increased ability to maximize coverage for *Miller-Shugart* settlements. But that does not mean lump-sum settlements in cases involving covered and uncovered damages will or should become the norm. Considering the increased costs, litigation, and uncertainty they may face, the parties to a *Miller-Shugart* settlement may still want to specify and allocate the damages being settled up front instead of fully deferring the issue of allocation for post-settlement proceedings. Only time will tell how settling parties handle *Miller-Shugart* settlements under the relaxed rules.

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