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Drawing the Lines More Brightly: The Minnesota Supreme Court Clarifies Past Insurance Coverage Precedent

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DRAWING THE LINES MORE BRIGHTLY: THE MINNESOTA SUPREME COURT CLARIFIES PAST INSURANCE COVERAGE PRECEDENT

Robert P. Thavis†

I. INTRODUCTION................................................................. 451
II. TRIGGER AND ALLOCATION ............................................. 452
   A. Northern States Power Co. v. Fidelity & Casualty Co. of New York.......................................................... 453
   B. SCSC Corp. v. Allied Mutual Insurance Co.................. 457
   C. Domtar, Inc. v. Niagara Fire Insurance Co................. 459
   D. In re Silicone Implant Insurance Coverage Litigation........................................................................ 461
III. ATTORNEY FEES............................................................... 464
IV. ELECTRONIC DATA AS TANGIBLE PROPERTY ................. 466
   A. Minnesota Tax Law Cases ........................................... 467
   B. Minnesota Insurance Coverage Cases.......................... 470
   C. Insurance Coverage Cases From Other Jurisdictions...... 472
   D. Sprint Spectrum, L.P. v. Commissioner of Revenue.... 474

I. INTRODUCTION

This article reports on two cases decided by the Minnesota Supreme Court during its 2003-04 term. The first is a major insurance coverage “trigger-and-allocation” case; the second is a tax case with implications for insurance coverage of electronic property.

In 2003, the supreme court decided In re Silicone Implant

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Insurance Coverage Litigation ("In re Silicone"), a decision which clarified the effect of prior rulings in two areas. First and most significantly, the court re-addressed the trilogy of “allocation” decisions authored by then-Chief Justice Keith during the mid-1990s. Second, the supreme court declined an opportunity to expand the circumstances in which a policyholder successful in a coverage action may collect attorney fees incurred in that coverage action.

In the 2004 tax case *Sprint Spectrum, L.P. v. Commissioner of Revenue*, the supreme court clarified some, and modified other, prior rulings as to whether electronic data constitutes “tangible personal property” under Minnesota sales tax statutes. The *Sprint Spectrum* court concluded that electronic telephone transmissions constituted “tangible personal property,” adding to Minnesota’s body of case law supporting coverage for damage or loss to computer and other electronic data and programs.

II. TRIGGER AND ALLOCATION

The Minnesota Supreme Court’s decision in *In re Silicone* arose out of coverage litigation between 3M and a number of its insurers. 3M sought coverage, in relevant part, for sums paid to settle lawsuits brought against it by women who claimed to have been injured by the implantation of silicone-filled breast implants manufactured by 3M or its predecessors-in-interest. The supreme court used *In re Silicone* to clarify the “trigger and allocation” rules it adopted and applied in a series of earlier decisions that determined coverage under consecutively issued comprehensive general liability (“CGL”) policies.

The “trigger” concept addresses what sort of event activates, or triggers, the insurer’s coverage obligation under any single CGL policy. The issue of “allocation,” in turn, relates to the methodology used to prioritize coverage obligations when more

1. 667 N.W.2d 405 (Minn. 2003).
2. Id. at 417-22.
3. Id. at 422-25.
4. 676 N.W.2d 656 (Minn. 2004).
5. Id. at 665.
6. Id. at 666.
7. *In re Silicone*, 667 N.W.2d at 408.
8. Id. at 410.
9. Id. at 413-22.
10. Id. at 414.
then one CGL coverage period has been “triggered” by an insured event, or series of insured events, resulting in one loss. Thus, “trigger and allocation” might be viewed as the Abbott and Costello of the coverage world: just as Lou Costello’s punch line needed Bud Abbott’s straight man set-up, the punch line question of “allocation” requires the set-up of a “trigger” determination. A handful of different competing trigger rules and competing allocation methodologies have been adopted by the courts of various states.

During the 1990s the Minnesota Supreme Court decided three cases in which it adopted and applied rules to govern the allocation of coverage obligations between consecutively-issued CGL policies: *Northern States Power Co. v. Fidelity & Casualty Co. of New York* (“NSP”);12 *SCSC Corp. v. Allied Mutual Insurance Co.* (“SCSC”);13 and *Domtar, Inc. v. Niagara Fire Insurance Co.* (“Domtar”).14 All three decisions were authored by then-Chief Justice Sandy Keith.15 Although each was a clear decision, the three proved difficult to integrate into a cohesive rule, with the result that the practitioner was sometimes left wondering “Who’s on first?” With benefit of hindsight, it becomes clear that the primary reason for the confusion was that the decisions clearly enunciated Minnesota’s allocation rule, but did not adequately address the difficulties of applying the state’s trigger rule.

A. Northern States Power Co. v. Fidelity & Casualty Co. of New York

In NSP, the first of Minnesota’s allocation cases, NSP sought coverage, under policies with no pollution exclusion, for damages and clean-up costs resulting from long-term environmental contamination.16 NSP’s coverage dispute raised questions of both trigger and allocation.17 The *NSP* court first noted four competing approaches to the trigger question, but engaged in no debate among them, declaring that Minnesota’s rule was already settled:

12. 523 N.W.2d 657 (Minn. 1994).
13. 536 N.W.2d 305 (Minn. 1995).
14. 563 N.W.2d 724 (Minn. 1997).
15. *Domtar, Inc.*, 563 N.W.2d at 728; *SCSC Corp.*, 536 N.W.2d at 308; *N. States Power Co.*, 523 N.W.2d at 658.
17. Id. at 659-60.
Courts tend to follow one of four “trigger” theories to determine which policies were “on the risk:” the “exposure” rule, whereby only those policies in effect when the claimant or property was exposed to hazardous materials are triggered; the “manifestation” rule, whereby only those policies in effect when the injury or damage was discovered are triggered; the “continuous trigger” where the policies in effect at the time of exposure, the time of manifestation, and all the time in between are triggered; and the “actual injury” or “injury-in-fact” trigger, whereby only those policies in effect when damage occurred are triggered... Minnesota follows the “actual injury” or “injury-in-fact” theory to determine which policies have been triggered by an occurrence causing damages for which an insured is liable.

The NSP court then explained Minnesota’s “actual injury” rule in (somewhat) greater detail:

The essence of the actual injury trigger theory is that each insurer is held liable for only those damages which occurred during its policy period; no insurer is held liable for damages outside its policy period. Where the policy periods do not overlap, therefore, the insurers are consecutively, not concurrently liable.

With that, the NSP court promptly moved on to determine what rule of allocation would fit best with Minnesota’s “actual injury” trigger rule. The court first brushed aside the majority “all sums” approach, not on the merits, but on the ground that NSP was no longer advocating the “all sums” approach on appeal after its rejection by the trial court below. Instead, the supreme court noted that on appeal NSP urged a “pro rata by limits” allocation,”

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18. Id. at 662.
19. Id.
20. Id.
21. In an “all sums” approach, all triggered policies are jointly and severally obligated to provide coverage, and the policyholder may select which policies to exhaust. See Tod Zuckerman et al., 2 Environment Insurance Litigation: Law and Practice § 10:11 (2004). An insurer’s remedy to claimed overpayment, if any, would be a contribution action against the other insurers. See N. States Power Co., 523 N.W.2d at 660 n.4.
23. In a “pro rata by limits” approach, each triggered year of coverage is assessed its “share” based on the amount, or limits, of coverage purchased in that year. See Zuckerman, supra note 21. Thus, a year in which $10 million of coverage was purchased would make twice the indemnity payment of a year in which only $5 million in coverage was purchased.
The court rejected that as well, as “inconsistent with the actual injury trigger theory.”

The Minnesota Court of Appeals had applied an allocation scheme that apportioned damages “as proven; in other words, each policy would cover only those damages that are allocable to harm which occurred during the policy period.” The NSP court noted that the “as proven” rule would be consistent with an actual injury trigger. However, the supreme court further acknowledged that the “as proven” rule, being a fact-based test, would be more likely to foster costly litigation to determine what harm resulted in what policy year and less likely to foster early settlements. The supreme court also noted the resulting unfairness of requiring a policyholder to shoulder the burden of proving not just a right to coverage and the policyholder’s total damages, but also the amount of its damages which occurred in each policy period. Thus, the supreme court declared the “as proven” rule to be “unattractive given the scientific complexity of the issues involved, the extended period of time over which damages may have occurred before discovery, and the number of parties potentially involved.”

Instead, the NSP court adopted a “pro rata by time on the risk” allocation rule. The NSP court explained that its “time on the risk” rule would provide “the same result [as the court of appeals’ ‘as proven’ methodology] when, as may be the case here, the damages are continuous over all policy periods.” However, the “time on the risk” rule also had the perceived advantage of being “attractive for its simplicity,” given that it would be less fact-dependent in application.

That is because under the “pro rata by time on the risk” rule, a policyholder need show only (i) that “damage began on a particular date, X, and ended on, or was discovered at, a later date, Y . . . and [(ii)] the total amount of damages for which coverage may exist,” but need not show how much damage fell into each

25. Id.
26. Id. at 663.
27. Id.
28. Id.
29. Id.
30. Id.
31. Id. at 662-63.
32. Id. at 663.
33. Id. at 663-64.
policy period. Rather, the trial court presumes that the damages in a contamination case like NSP fall evenly from the first point at which damages occurred to the time of discovery, cleanup[,] or whenever the last triggered policy period ended. Each triggered policy therefore bears a share of the total damages proportionate to the number of years it was on the risk relative to the total number of years of coverage triggered.\textsuperscript{34}

This presumption that “damages were continuous from the point of the first damage to the point of discovery or clean up [sic]” is sufficient to shift the burden to the insurer(s) to establish how much damage actually occurred in a given policy year.\textsuperscript{35} Absent such a showing, coverage is apportioned equally to each year of triggered coverage.

Notwithstanding its adoption of this new rule, the NSP court took pains not to set the rule in stone. First, the NSP decision noted that trial courts must have leeway to apply differing allocation rules based on the facts in each particular case: “Damages are by nature fact dependent and the trial courts must be given the flexibility to apportion them in a manner befitting each case.”\textsuperscript{36} Second, the NSP court volunteered that its allocation rule could change as insurance coverage law continued to develop.\textsuperscript{37} These comments were viewed as clear indications that the door was not closed to alternative arguments in future cases, and may help explain why NSP was only the first in a series of decisions respecting allocation.

What sometimes has been overlooked in subsequent analyses of the NSP rule, however, were the limits imposed on that rule by the context within which it was announced. In NSP, the entire analysis described above began with the supreme court describing the particular type of loss giving rise to NSP’s claim for insurance coverage as an “environmental liability” claim.\textsuperscript{38} The NSP decision then noted that

environmental liability insurance cases raise a variety of issues, such as: what “trigger theory” should a court apply

\textsuperscript{34} Id. at 663.
\textsuperscript{35} Id. at 664.
\textsuperscript{36} Id. at 663.
\textsuperscript{37} Id. at 665.
\textsuperscript{38} Id. at 660-61.
to determine which policies are at issue; are the damages excluded by various provisions in the policies, such as the "owned property" and pollution exclusions; how should a court determine the number of "occurrences" under the policies; what method of allocation between successive insurers is most appropriate . . . .

A few paragraphs later, the NSP court’s entire discussion of the four competing trigger rules, which set the stage for its analysis of allocation, began with the words “[i]n these cases,” meaning “environmental liability insurance cases.”

Thus, while perhaps not initially clear, the conclusion is inescapable when viewed in hindsight. The allocation rules debated in NSP were being debated with respect to, and NSP’s “time on the risk” rule was intended to apply to, only those situations such as long-term environmental contamination coverage cases, in which coverage from multiple CGL policy periods was triggered. Certainly, NSP made clear that its “time on the risk” rule was never intended to apply if only one year’s coverage was triggered, since there would be no need to allocate at all. What was missing, however, was clarity as to when Minnesota’s “actual injury” trigger rule triggered consecutive policies, and when it triggered only one.

B. SCSC Corp. v. Allied Mutual Insurance Co.

That issue became a bit clearer the year after NSP when the supreme court issued its decision in SCSC. In SCSC, the damage was again environmental, but the insurers and SCSC disputed whether the environmental damage was the result of one sudden and accidental spill of contaminants in 1977, which would have been covered, or was the result of long-term gradual contamination, for which coverage would likely have been excluded under the policies’ “sudden and accidental” pollution exclusions. That fact question was resolved at trial, with the jury

39. Id. at 661.
40. Id. at 662.
41. Id. at 663.
42. SCSC Corp. v. Allied Mut. Ins. Co., 536 N.W.2d 305 (Minn. 1995).
43. Id. at 310. The "sudden and accidental" pollution exclusion, typically in use during the period from 1973-1986, purported to exclude coverage for pollution losses other than those resulting from a "sudden and accidental" occurrence. Irene A. Sullivan and Timothy G. Reynolds, Hazardous Waste Litigation: Comprehensive General Liability Insurance Coverage Issues, PRCTISING L.
agreeing with SCSC that at least some damage stemmed from one
“sudden and accidental” spill in 1977. It further found that
damage from that one spill continued for years thereafter, and that
that continuing damage from the 1977 spill was indistinguishable
from any damage that might have resulted from any gradual
contamination. The trial court therefore found NSP’s “time on
the risk” allocation rule inapplicable.

However, under Minnesota law, if any cause of an indivisible
loss is covered, then the entire loss is covered, absent proof by the
insurer that an uncovered cause was the “overriding” cause of loss. Since the insurers in SCSC failed to establish any “overriding” cause
of loss at trial, SCSC was entitled to full coverage for its entire loss. In deciding which insurers owed what portion of that coverage, the trial court applied a “vertical exhaustion” allocation formula, in
which all coverage in place during 1977, the first year of covered
loss, would be exhausted, followed by the 1978 policies, and then
those from 1979, 1980, and so on.

The supreme court accepted the finding that the one event of
contamination in 1977 triggered the coverage in place in 1977, and
that since no insurer established any other “overriding” cause of
loss, the entire loss was covered. The supreme court further
accepted that the contaminants spilled in 1977 continued to cause
additional damage to the environment, including by working their
way into the groundwater, for years thereafter. The SCSC court
therefore agreed that NSP was distinguishable as involving
continuing insurable event(s), while all of SCSC’s covered damage
was traceable solely to the 1977 spill. Thus, the supreme court
affirmed the trial court’s ruling that NSP’s “time on the risk” rule
was inapplicable.

However, the SCSC court rejected the trial court’s substitute
“vertical” allocation approach, concluding that if an insurable event

INST. 279, 331 (1997).
44. SCSC Corp., 536 N.W.2d at 310.
45. Id.
N.W.2d 645, 653 (Minn. 1986); Campbell v. Ins. Serv. Agency, 424 N.W.2d 785,
47. SCSC Corp., 536 N.W.2d at 310.
48. Id. at 317.
49. Id. at 318.
50. Id.
51. Id.
52. Id. at 317-18.
occurred only in 1977, then only that one year of insurance covered loss from that insured event.\textsuperscript{53} It did not matter if damage from that insured event continued beyond 1977, or whether damage from post-1977 uninsured events was covered by virtue of Minnesota’s “contributing loss” rule; any such damage did not trigger any additional policies’ coverage.\textsuperscript{54} If the limits of that 1977 coverage were insufficient to cover the policyholder’s full covered loss, then that loss was simply under-insured.

Thus, in \textit{NSP} the supreme court had articulated a rule under which repeated long-term insured events of environmental contamination triggered policies during the entire period of contamination and, absent evidence to the contrary, the injury was presumed to be equal in each year of contamination, resulting in a loss spread equally over the number of years of coverage during the period of contamination. In \textit{SCSC}, however, the supreme court had articulated the flip-side of that rule: when the insurable event was not a continuing one, then only insurance from the year of the insurable event was triggered, regardless of whether that insurable event resulted in covered loss or damage in later years. In short, after \textit{SCSC}, the \textit{NSP} decision appeared to be limited to only those cases in which repeated insurable events (such as gradual, long-term contamination or exposure) triggered multiple years of coverage.

\textbf{C. Domtar, Inc. v. Niagara Fire Insurance Co.}

Apparently believing that its rule of \textit{NSP} and \textit{SCSC} was less than crystal clear, however, the supreme court sought to “clarify” the rule of \textit{NSP} and \textit{SCSC} in \textit{Domtar} just two years later. \textit{Domtar}, like \textit{NSP}, involved long-term, gradual contamination, and the result in \textit{Domtar} was therefore the application of \textit{NSP}’s rule of “time on the risk” allocation.\textsuperscript{55} However, the supreme court introduced a twist unfavorable to policyholders. In \textit{Domtar}, the court determined that the period of contamination ran for sixty-four years following the first damage.\textsuperscript{56} However, because some older policies were lost and some insurers that had issued more recent policies (with “sudden and accidental” pollution exclusions)

\textsuperscript{53}. Id. at 318.
\textsuperscript{54}. Id.
\textsuperscript{56}. Id. at 732.
had settled, Domtar sought coverage for only fifteen of those sixty-four years. Domtar argued that under NSP’s “time on the risk” rule, its covered loss should be allocated equally among the fifteen years of triggered coverage. The supreme court, however, held that the denominator used to establish each insurer’s fractional liability was sixty-four years, even if insurance coverage had been available in only fifteen of those years. That had the effect of leaving the policyholder uninsured as to 49/64ths of its loss. 

More importantly for the later interpretation of the NSP/SCSC rule, the Domtar court distinguished between NSP and SCSC not in the abstract, but once again in the context of long-term environmental contamination. As a result, the Domtar opinion placed a greater emphasis on the NSP decision than on SCSC. Indeed, following almost two pages of discussion of the NSP decision, the Domtar court dismissed SCSC in a single paragraph:

The proper scope of coverage will also depend on the facts of the case. When environmental contamination arises from discrete and identifiable events, then the actual-injury trigger theory allows those policies on the risk at the point of initial contamination to pay for all property damage that follows. See SCSC Corp. v. Allied Mut. Ins. Co., 536 N.W.2d 305, 318 (Minn. 1995) (despite continuing damage from leaching of chemicals into the groundwater after the policy period, only the primary and excess policies on the risk at the time of the discharge were triggered, but those policies responded to the entire loss).

Then, in a passage with implications for In re Silicone, the Domtar court went on to describe the limits on NSP’s “time on the risk” allocation rule: “It is only in those difficult cases in which property damage is both continuous and so intermingled as to be

57. Id. at 731.
58. Id.
59. Id. at 732-33.
60. The Domtar court asserted that NSP was already clear on this issue and did not acknowledge Domtar as constituting a change to the rule of NSP. Id. at 733-36. However, the NSP decision had actually declared that “[e]ach triggered policy therefore bears a share of the total damages proportionate to the number of years it was on the risk relative to the total number of years of coverage triggered.” 523 N.W.2d at 663 (emphasis added).
62. Id. at 733.
practically indivisible that NSP properly applies.”

The problem with that pronouncement was that the Domtar court apparently did not mean that NSP applied in all “cases in which property damage is . . . continuous.” Rather, it meant only that NSP applied to those cases in which continuous property damage is the result of continuing insured events.

D. In re Silicone Implant Insurance Coverage Litigation

In In re Silicone, the supreme court undertook its first post-Keith analysis and application of NSP, SCSC, and Domtar. As in these three cases, the main question presented in In re Silicone was again one of “allocation.” However, in In re Silicone, it becomes clear that, as in stand-up comedy, timing is everything in “trigger and allocation,” and it is the “trigger” issue which really steals the show.

While the trilogy of NSP, SCSC and Domtar set the stage for the supreme court’s decision in In re Silicone, that stage also went through numerous “set changes” in proceedings below. For while the supreme court issued its decision in In re Silicone in 2003, the action was first filed in 1994, prior even to the court’s decision in NSP.

As such, the In re Silicone trial court was required to absorb and apply all three prior supreme court pronouncements on allocation. Not surprisingly, this resulted in some changes in the allocation rulings by the trial court.

Moreover, a key fact issue in In re Silicone, the identification of the triggering event, was not only disputed but was also complicated by the fact that both 3M and its insurers took the position that silicone breast implants caused no injury. While it is not unusual for a policyholder to settle underlying litigation without an admission of liability, in this case one of the keys to determining whether one, or more than one, coverage year was triggered was whether the injury to the underlying implant recipients was caused by one, or more than one, insurable event.

The trial court conducted a “medical trigger bench trial” in 1996 to determine trigger, but ultimately found itself required to

63. Id.
64. Id.
66. Id.
67. Id. at 410-11.
determine whether an injury, which all of the experts agreed did not happen, happened in the way described by 3M’s experts, or in the manner described by the insurers’ experts.

The trial court’s first allocation ruling, coming after its “medical trigger bench trial,” was issued in July 1996, after the supreme court’s ruling in SCSC but before Domtar. Based on the medical expert testimony, the trial court determined that for purposes of the case, “[a]ctual-injury” occurred at or shortly after time of implantation, and that “[c]overage is triggered continuously for all policies in effect at the time of implant, at the time of manifestation of systemic disease symptoms, and at all times in between those events.” Thus, the trial court found the NSP allocation rule applicable. That ruling was then clarified by an order changing “the end date of damages from ‘the time of manifestation of systemic disease symptoms’ to ‘the earlier of the implant recipient’s death, or the date on which the recipient files a lawsuit for damages.’”

However, the district court sua sponte vacated its July 1997 decision in light of Domtar. At that point, the district court reasoned that the continuously occurring injuries were all the consequence of one discrete occurrence (the implantation), and that under Domtar, where “a single, discrete occurrence can be identified, the continuous trigger has no applicability.”

In 1997, the district court, upon full briefing by the parties, reinstated its original 1996 ruling by applying the NSP rule. This determination was based upon the trial court’s conclusion that “the injury at issue is not one injury with continuous leakage, but a consistently recurring injury that takes place each time silicone comes in contact with new cells, creating a new bioreaction.” In other words, the trial court concluded that “injury” began at or near the time of implantation, and both injury and damage continued thereafter.

In reviewing the district court’s allocation decision, the supreme court concluded that in finding that this “recurring
injury” triggered coverage in multiple policy periods, the district court “appears to have equated a ‘continuous trigger’ with a ‘continuous injury,’ which is inaccurate.” Instead, the supreme court concluded that “injury” was the result of an insurable event, not the insurable event itself, and thus injury in multiple years was irrelevant to trigger. After affirming the district court’s finding that the insurable event occurred shortly after the time of implantation, the supreme court then concluded that under the “actual injury” trigger rule, “the policies were triggered at or about the time of implantation.” Hence, for each implant recipient’s claim, only one policy owed coverage.

The In re Silicone court then concluded that the trial court’s incorrect conclusion that an implantation triggered multiple policies had resulted in the trial court incorrectly applying a “time on the risk” allocation. In addressing this aspect of the trial court’s conclusion, the In re Silicone court once again analyzed NSP, SCSC, and Domtar at some length, but this time with a somewhat different emphasis than in Domtar. The supreme court concluded:

*Domtar* established guidelines for allocating losses from a continuing injury, like the immune diseases at issue here, using an injury-in-fact approach. The first, and most obvious, is that only insurance policies that are appropriately “triggered” are on the risk. Therefore, before an allocation discussion can occur, the district court needs to identify the triggered policies among which to allocate. The second, and most helpful guideline in this case, is that when there is a continuing injury that “arises from discrete and identifiable events, then the actual injury trigger theory allows those policies on the risk at the point of initial contamination to pay for all property damage that follows.” In other words, the issue of allocation should be raised only if the triggering injury does not “arise [ ] from discrete and identifiable events.”

In applying the rule of *Domtar*, the In re Silicone court then

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76. *Id.*
77. *Id.*
78. *Id.* at 414-15.
79. *Id.* at 417.
80. *Id.* at 417-22.
81. *Id.*
82. *Id.* at 420 (citation omitted).
articulated a two-step approach to claims of injury which do “not arise [ ] from discrete and identifiable events.”

First, we determine whether the plaintiffs’ injuries are continuous. If they are not, under the actual-injury trigger theory, the policies on the risk at the time of the injury would pay all losses arising from that injury. Here, the court found that the injuries are continuous, so we move to the next determination: whether the continuous injury arose from some discrete and identifiable event. If it does, the policies on the risk at the time of that event are liable for all sums arising from the event. If not, allocation may be appropriate.

The In re Silicone decision then concludes:
In our actual-injury trigger framework, allocation is meant to be the exception and not the rule because “[i]t is only in those difficult cases” that allocation is appropriate. Domtar, 563 N.W.2d at 733. If we can identify a discrete originating event that allows us to avoid allocation, we should do so.

Thus, notwithstanding Domtar’s suggestion that NSP was the correct rule and SCSC the exception, In re Silicone clarifies that SCSC, and now In re Silicone, are the rule. NSP and Domtar are the exceptions. The court suggests that NSP and Domtar are applicable only in cases, like gradual environmental contamination cases, in which an insurable event or events recurring over multiple years gives rise to a continuing injury.

Viewed in the context of NSP, SCSC, Domtar, and In re Silicone, it is now clear that the “time on the risk” allocation rule was not the focus of dispute in any case since NSP. Rather, what courts have struggled with is how to apply Minnesota’s “actual injury” trigger rule. The punch line of allocation flows from the straight man’s set-up. If policies from multiple years are triggered, “time on the risk” allocation will apply (absent contrary evidence assigning loss to particular periods). However, if only one policy year is triggered, there is nothing to allocate.

III. ATTORNEY FEES

In re Silicone also addressed the issue of attorney fees, less
confusing but nonetheless significant. 3M sought to recover its attorney fees incurred in defending against its insurer’s declaratory judgment action and prosecuting its counterclaims.86 Existing Minnesota law provides that a successful policyholder may recover attorney fees incurred in a coverage battle if the insurer has refused to provide a defense, or seeks a declaration of no duty to defend, whether it was the policyholder or the insurer that first brought the coverage suit.87 Here, however, 3M sought fees under policies that did not obligate 3M’s insurers to defend 3M, but instead required them to reimburse 3M’s defense costs.88 The supreme court refused to extend the attorney fees rule to that situation, explaining:

3M asserts that in both cases the insured contracts to avoid the burdensome expense of litigation only to have litigation thrust upon it by the insurer in a coverage action. We disagree . . . . As the insurers argue, if an insurer breaches its duty to defend, the insured must do twice what it contracted to avoid: hire attorneys and manage a lawsuit for both the underlying case and the declaratory judgment proceeding.

In contrast, the agreement to reimburse the insured for defense costs by its high-level, excess insurance providers does not involve the promise to relieve the insured from the burdens of litigation . . . . An agreement to reimburse the insured’s defense costs is simply an agreement for the payment of money. Attorney fees are not recoverable in declaratory judgment actions to establish that the insurer must pay the insured money.89

In terms of precedent, the supreme court’s decision is unremarkable. The court’s reasoning, however, is subject to challenge on the ground that there is no articulated basis for treating a breach of a contractual obligation to do something other than pay money differently from a breach of a contractual obligation to pay money. This is particularly true because insurers that owe a defense are not deemed in breach of that duty if they

86. Id. at 422.
87. Id.; see also Morrison v. Swenson, 142 N.W.2d 640 (Minn. 1966) (holding that where an insurer denies liability and a declaratory action is brought, the alleged insured, if successful, is entitled to recover legal fees caused by the insurer’s breach of contract).
88. In re Silicone, 667 N.W.2d at 424.
89. Id. at 425.
reserve their right to disclaim coverage and allow or require the policyholder to defend herself, while reimbursing the policyholder for her costs incurred in doing so.\textsuperscript{90}

However, the most fundamental problem with the court’s holding regarding attorney fees is that the court missed an opportunity to reconcile two competing views of an insurer’s obligations to its policyholder. While \textit{In re Silicone} treated 3M’s insurers’ obligations as merely contractual (and treated a contractual obligation to defend as different in kind from a contractual obligation to pay defense costs), other Minnesota decisions have previously acknowledged that an insurer’s policy obligations are not merely contractual.\textsuperscript{91} Rather, once coverage is triggered, the insurer becomes a fiduciary and will be held responsible for acting in the best interests of its insured.\textsuperscript{92}

United States District Court Judge Ann Montgomery of the District of Minnesota has recently sought to reconcile that dichotomy by concluding that an insurer’s fiduciary duties and good faith obligations arise only once an insurer accepts control of the settlement of claims, which, in turn, arises only upon that insurer’s acceptance of its duty to defend.\textsuperscript{93} Thus, under \textit{Miller}, 3M’s duty to reimburse defense costs, rather than defend directly, would not likely give rise to any fiduciary or good faith duties by the insurer.\textsuperscript{94} However, an insurer may owe duties to settle, or to contribute toward a settlement, even absent a duty to defend, especially under a “defense cost reimbursement” policy. In any event, it is an issue that would have benefited from clarification by the Minnesota Supreme Court.

\section*{IV. ELECTRONIC DATA AS TANGIBLE PROPERTY}

In \textit{Sprint Spectrum}, the supreme court decided a fairly narrow sales tax case.\textsuperscript{95} In doing so, however, it affirmed and strengthened

\begin{itemize}
\item \textsuperscript{90} Prahm v. Rupp Constr. Co., 277 N.W.2d 589 (Minn. 1979).
\item \textsuperscript{92} \textit{Short}, 334 N.W.2d at 387.
\item \textsuperscript{93} Miller v. ACE USA, 261 F. Supp. 2d 1130, 1140-41, 91 Fair Empl. Prac. Cas. (BNA) 1521 (D. Minn. 2003).
\item \textsuperscript{94} Indeed, under one reading of \textit{Miller}, an insurer could avoid its fiduciary responsibility by breaching its duty to defend, giving the insurer a significant incentive to breach its defense obligations. See \textit{id}.
\item \textsuperscript{95} Sprint Spectrum, L.P. v. Comm’r of Revenue, 676 N.W.2d 656, 658
\end{itemize}
a growing body of Minnesota law recognizing electronic data as (insured) tangible property. Some background is useful in interpreting *Sprint Spectrum.* While numerous courts have recently addressed whether electronic data is tangible property, including under CGL and property policies, Minnesota has addressed the issue, as the saying goes, “early and often.” As such, it has one of the most developed bodies of law on the issue. That law breaks down into tax cases and coverage cases.

A. Minnesota Tax Law Cases

One line of “tangible property” cases has arisen under Minnesota’s tax statute, which itself has been amended over time. The line begins in 1977, when the supreme court decided *Fingerhut Products Co. v. Commissioner of Revenue.* In that case, Fingerhut sought to avoid taxation by claiming that its mailing lists were not “tangible personal property” under section 297A.14 of the Minnesota Statutes. The supreme court found that the use of the names and addresses on the lists was not a taxable use of tangible property, since what was being used was the information on the list, and the form of the communication of the data was irrelevant or incidental to Fingerhut’s use. However, the supreme court further found that when Fingerhut purchased mailing labels with preprinted names and addresses, the use of mailing labels was use of tangible property, since the physical form of the information was a part of its value.

Legislative changes set the stage for subsequent cases. In 1984, the Minnesota Legislature exempted purchases of “capital equipment” from a portion of Minnesota’s sales tax, and in 1989 this became a full exemption. Section 297A.01, subdivision 16(a) originally defined capital equipment as “machinery and equipment . . . used by the purchaser or lessee for manufacturing, fabricating,
mining, quarrying, or refining a product to be sold at retail."102 In 1993, the statute was amended.103 One change was to replace "a product" in the text quoted above with "tangible personal property."104

In Minnesota RSA 10 Ltd. Partnership v. Commissioner of Revenue,105 the pre-1993 version of the statute was found applicable to the purchase of cellular telephone system equipment, which "does not merely deliver communications, but also 'creates the signal required to transmit voice or data.'"106 As such, RSA 10’s telephone equipment was deemed to have been used to manufacture, fabricate or refine a "product."107 However, in an earlier decision in that case (the decision in which the 1993 "tangible personal property" version of the statute was deemed inapplicable), the tax court concluded that "[t]he words 'product' and 'tangible personal property' are not synonymous . . . . RSA 10 . . . agrees that the [e]quipment is not used to manufacture tangible personal property."108 The tax court was affirmed without opinion by an equally divided supreme court.109

However, in 1997, the supreme court itself analyzed the 1993 legislative changes in Northern States Power Co. v. Commissioner of Revenue.110 NSP was seeking to avoid sales taxation on transformers, which the Commissioner of Revenue contended were used to produce electricity, an "intangible" product.111 The supreme court disagreed, noting that it had ruled electricity a "product" under the pre-1993 statute and determining by reference to legislative history that no narrowing of the prior 1993 exception was intended by the 1993 amendments.

Also in 1997, the supreme court decided Zip Sort, Inc. v.

102. MINN. STAT. § 297A.01, subd. 16(a) (1992).
103. Sprint Spectrum, L.P., 676 N.W.2d at 659.
104. Act of May 24, 1993, ch. 375, art. 9, § 25, subd. 16, 1993 Minn. Laws 2728, 2897 (codified as amended at MINN. STAT. § 297A.01, subd. 16(a) (Supp. 1993)).
105. No. 6481, 1997 WL 410997 (Minn. T.C. July 18, 1997), aff'd by an equally divided court, 581 N.W.2d 36 (Minn. 1998).
106. Sprint Spectrum, L.P., 676 N.W.2d at 661 (quoting RSA 10, 1997 WL 410997, at *3).
110. 571 N.W.2d 573 (Minn. 1997).
111. Id. at 575.
112. Id. at 575-76.
Commissioner of Revenue, another sales tax case. In this case, the supreme court concluded that bar codes added to mail constituted tangible property under the amended version of Minnesota Statutes section 297A.01, subdivision 16(a). In addressing whether the bar codes constituted tangible property, this time the supreme court did not rely on legislative history but instead conducted an analysis of the nature of tangible property. First, it noted the statutory definition of “tangible personal property” as “corporeal personal property of any kind.” The court also noted that Black’s Law Dictionary “defines ‘corporeal property’ as ‘all things which may be perceived by any of the bodily senses . . . although a common definition of the word includes merely that which can be touched and seen.’” The court concluded, however, that “the statutory language is not all that helpful,” and instead turned to its 1977 Fingerhut decision for guidance. Ultimately, the Zip Sort court concluded that the bar code was tangible personal property because the consumer was buying “more than the information contained in the bar code, it [was] paying for a particular ‘form’ of this information.”

Then, in 2001, the tax court decided Quest Corp. v. Commissioner of Revenue. In Quest, the tax court concluded that the 1993 amendment to Minnesota Statutes section 287A.01, subdivision 16(a) did narrow the exemption, based on the court’s reading of the meaning of “product” as contrasted with “tangible personal property” (and citing the first tax court order in RSA 10). “Tangible personal property,” in turn, was defined in Minnesota Statutes section 297A.01, subdivision 11, as “corporeal personal property of any kind.” The Quest tax court therefore turned to Black’s Law Dictionary for a definition of “corporeal:”

Such as affects the senses, and may be seen and handled, as opposed to incorporeal property, which cannot be seen
or handled . . . . In modern law, all things which may be perceived by any of the bodily senses are termed corporeal, although a common definition of the word includes merely that which can be touched and seen.

It also cited Black’s definition of tangible property: “property that has physical form and substance and is not intangible. That which may be felt or touched and is necessarily corporeal, although it may be real or personal.” Declaring that Minnesota Statutes section 645.08, subdivision 1, requires one to assign “common and approved” usage to statutory language, the *Qwest* tax court adopted the “common definition” of corporeal and concluded that telephone service was not “tangible personal property.”

The supreme court review involved only four justices, who split 2-2, resulting in an affirmance, without opinion, by an equally divided court.

B. Minnesota Insurance Coverage Cases

Minnesota’s foray into the physical nature of electronic data for purposes of insurance coverage arguably began with *Magnetic Data, Inc. v. St. Paul Fire & Marine Insurance Co.* Although the Minnesota Supreme Court in *Magnetic Data* technically declined to address the issue of whether the erasure of data constituted damage to “tangible” property, that case has been read by some as suggesting that data constitutes intangible, uninsured, property. In *Magnetic Data*, the insured mistakenly erased data on computer disk cartridges it had been asked to inspect. In determining that there was no coverage, the Minnesota Supreme Court stated in dicta: “[W]e find that the intent to limit coverage to loss of use of tangible property remains. Therefore, absent clear language to the contrary, we decline to interpret this CGL policy to

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122. *Id.* at *2-3* (quoting BLACK’S, *supra* note 116).
123. *Id.* (quoting BLACK’S, *supra* note 116, at 1456).
124. *Id.*
125. *Qwest Corp. v. Comm’r of Revenue*, 640 N.W.2d 351 (Minn. 2002).
126. 442 N.W.2d 153 (Minn. 1989).
127. *Id.* at 156.
129. *Id.* at 154.
extend coverage to loss of use of intangible property.”  The court then proceeded, however, to specifically decline to decide whether data constituted tangible or intangible property. Rather, the court reasoned it did not have to decide the issue because (i) if the data was intangible, there was no “property damage” and so the loss was not covered; and (ii) if it the data was tangible property, then the claim was excluded under the “care, custody and control” exclusion.

Two years later, the Minnesota Court of Appeals addressed the issue in Retail Systems, Inc. v. CNA Insurance Cos. and found that both computer tape, and the data on that tape, were tangible property. In doing so, it noted that Magnetic Data did not reach the issue and also distinguished Fingerhut on the grounds that “it is inappropriate to apply tax law to the interpretation of an insurance policy. Moreover, Fingerhut did not consider the tangibility of computer tapes or data. Finally . . . sales tax law . . . has since been amended to state that this material is tangible property for tax purposes.”

Finally, the Retail Systems court found that other jurisdictions were split on whether “recorded material is tangible property for tax purposes.” After noting that Minnesota’s statute appeared to parallel the smaller number of decisions from states finding that recorded material was tangible property, the court nonetheless declared that “we have considered whether these tax precedents should govern an insurance case and conclude that they should not.” While undoubtedly correct, this statement did not appear to end citation of tax cases by coverage counsel.

However, shortly thereafter, the Minnesota Court of Appeals held that misappropriation of proprietary information did not constitute “property damage” under a CGL policy because the information was not deemed “tangible.” In that case, the court
relied on the American Heritage Dictionary definition of “tangible” as: “1.a. Discernible by the touch; capable of being touched; palpable. b. Capable of being treated as fact; real; concrete; tangible evidence.” The court concluded that the proprietary information was not tangible because it was not capable of being touched.

Although less than directly on point, it is worth noting that the Minnesota Court of Appeals, in Sentinel Management Co. v. New Hampshire Insurance Co., found “direct physical loss” from the presence of asbestos in a building because its presence affected the building’s function. In 2001, the Minnesota Court of Appeals, relying heavily on Sentinel Management, decided General Mills, Inc. v. Gold Medal Insurance Co. In General Mills, food was sprayed with a cheaper, unapproved version of a substance chemically indistinguishable from the name-brand product that the FDA required be used. Even if food was chemically identical to what it was supposed to be and is “not dangerous for human consumption,” the “FDA treats the presence of an unapproved chemical as an illegal adulteration of food products” and deems the food unusable. The court of appeals concluded that the unusable food was “physically damaged” by virtue of its inability to be used for its intended purpose.

C. Insurance Coverage Cases From Other Jurisdictions

While a few other states addressed the insurable nature of electronic data prior to 2000, it is primarily since that date that courts have begun to directly address whether damage to such data constitutes “direct physical damage or loss.” In American Guarantee & Liability Insurance Co. v. Ingram Micro, Inc. the federal district court in Arizona concluded that data loss, including loss of use, did constitute “direct physical damage or loss,” but did so primarily on a public policy basis, rather than an interpretation of existing law.

141. Id. at 631 (emphasis in original) (quoting AM. HERITAGE DICTIONARY 1242 (2d Coll. Ed. 1982)).
142. Id.
143. 563 N.W.2d 296 (Minn. Ct. App. 1997).
144. Id. at 300-01.
146. Id. at 150.
147. Id.
148. Id. at 152.
The next major decision, America Online, Inc. v. St. Paul Mercury Insurance Co., rejected Ingram Micro, albeit in deciding coverage under a CGL policy, which references “physical damage to tangible property,” not “direct physical loss or damage.” Notwithstanding America Online, the Court of Appeals of New Mexico found coverage under a CGL policy for loss of data destroyed on a computer hard drive. Then, in Lambrecht & Associates, Inc. v. State Farm Lloyds, the Texas Court of Appeals found that the physical loss from the corporate policyholder’s computer system malfunction, the result of a hacker’s virus, required the replacement of the entire system.

In Cincinnati Insurance Co. v. Professional Data Services, Inc., the policyholder’s customer filed suit, alleging loss of use of software and lost or corrupted patient account data incorporated therein. The Cincinnati Insurance court concluded that such data was not tangible property and that therefore, there was no coverage for the policyholder defendant under the property damage clause of its CGL policy.

In Ward General Insurance Services, Inc. v. Employers Fire Insurance Co., the policyholder’s data was deleted during an upgrade to the policyholder’s computer systems. The policyholder sought first-party coverage for the cost of recovering the data and for the business interruption loss. The California Court of Appeals, citing Seagate Technology, Inc. v. St. Paul Fire & Marine Insurance Co. and America Online, held that because the operative terms “physical loss” and “tangible property” were undefined in the policy, the normal meaning of those words should be examined and that

150.  Id. at *2-4.
152.  Id. at 462.
156.  Id. at 27.
158.  Id. at *8.
159.  Id. at *18-22.
160.  7 Cal. Rptr. 3d 844 (Cal. Ct. App. 2003).
161.  Id. at 846.
162.  Id.
163.  11 F. Supp. 2d 1150 (N.D. Cal. 1998).
“physical” meant having a material existence perceptible to the senses and that “tangible” meant capable of being perceived, especially by the sense of touch. \(^{164}\) Utilizing those definitions, the Court concluded that a database was not physical since it did not have a material existence. \(^{165}\)

### D. Sprint Spectrum, L.P. v. Commissioner of Revenue

These developments helped add significance to the Minnesota Supreme Court’s 2004 *Sprint Spectrum* decision. \(^{166}\) In *Sprint Spectrum*, the question before the court was whether sales tax was due on capital equipment purchased by Sprint, which provides telephone service. \(^{167}\) Sprint argued that its purchase of equipment for its telephone service, like the purchase of equipment in *Zip Sort*, qualified for the tax exemption for capital used in manufacturing “tangible personal property.” \(^{168}\) The government contended that Sprint provided a telephone service, and thus did not manufacture tangible personal property. \(^{169}\) In a lengthy opinion, with an equally lengthy dissent, the court concluded that “[i]f the medium in which the information resides is merely incidental to the reason for the purchase, the transferred information is intangible property. But if the medium in which the information resides is essential or necessary to the reason for the purchase, then the transferred information is tangible property.” \(^{170}\) On that basis, the court determined that the telecommunications equipment qualified for the tax break. \(^{171}\)

The facts of *Sprint Spectrum* were established by stipulation. \(^{172}\) The three appellants (collectively “relators”) provided different aspects of telephone services, including local, wireless, and long-distance telephone service. \(^{173}\) All three appellants purchased equipment for their businesses and challenged the applicability of

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\(^{164}\) Ward, 7 Cal. Rptr. 3d at 851-52.

\(^{165}\) Id.

\(^{166}\) Sprint Spectrum, L.P. v. Comm’r of Revenue, 676 N.W.2d 656 (Minn. 2004).

\(^{167}\) Id. at 657.

\(^{168}\) Id.

\(^{169}\) Id. at 658.

\(^{170}\) Id. at 663 (citing Zip Sort, Inc. v. Comm’r of Revenue, 567 N.W.2d 34, 40 (Minn. 1997)).

\(^{171}\) Id.

\(^{172}\) Id. at 657.

\(^{173}\) Id.
sales tax on those purchases. The relators argued that they were eligible for a sales tax exemption on the equipment because the purchased equipment was “capital equipment” used in manufacturing “tangible personal property.” “Tangible personal property,” in turn, is defined as “corporeal personal property of any kind whatsoever, including property which is to become real property as a result of incorporation, attachment, or installation following its acquisition.”

The supreme court concluded that equipment used in providing telephone communications services to customers constituted capital equipment under the statutory definition, which included the definition of “tangible personal property.” In doing so, it relied heavily on its 1997 decisions in *Zip Sort* and *NSP*, in which it had ruled that bar codes and electricity were tangible personal property, and hence mail coding machines and electrical transformers were capital equipment that qualified for the sales tax exemption. As the *Sprint Spectrum* Court concluded in its discussion of *NSP*:

> As with electricity, telecommunications is corporeal personal property “of any kind whatsoever” and includes all things which may be perceived by any of the bodily senses, including, but not limited to, touch, sight, hearing and, in this case, can be precisely measured, directed and delivered for use by a retail customer. Our traditional analysis and precedent would categorize this telecommunications equipment as refining or manufacturing a product “to be sold ultimately at retail.”

The *Sprint Spectrum* court buttressed its statutory interpretation argument by again examining the legislative history of the statute in question and reaffirming that the 1993 legislative amendment to the statute, substituting “tangible personal property” in place of the earlier language “a product,” intended no narrowing of the tax exemption.

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174. *Id*.
175. *Id*.; see also MINN. STAT. § 297A.01, subd. 16(a) (2000).
176. *Sprint Spectrum, L.P.*, 676 N.W.2d at 659 (citing MINN. STAT. § 297A.01, subd. 11 (2000) (current version at MINN. STAT. § 297A.61, subd. 10 (2002))).
177. *Id* at 665.
178. *Id* at 664.
179. *Id* at 664; see also N. States Power Co. v. Comm’r of Revenue, 571 N.W.2d 573, 576 (Minn. 1997).
Finally, the *Sprint Spectrum* court abrogated *Qwest*, the earlier tax court decision that provided the basis for much of the tax court decision in *Sprint Spectrum*. “Relying on a previous tax court decision, [*Qwest*], the tax court noted that ‘the common definition of ‘corporeal’ ‘does not include a product that can only be heard and not touched or seen.’” In particular, the supreme court concluded that the tax court holding in *Qwest* “directly contradicted our holding in *NSP*” that the legislature intended no narrowing of the exception by its amendment.

The *Qwest* tax court decision was itself based in large part on Black’s Law Dictionary 1990 edition’s definition of “tangible property” as “that which may be felt or touched[,] and is necessarily corporeal.” Thus, the *Sprint Spectrum* court also reviewed, but rejected, the argument advanced by the tax court (and by Justice Anderson in his dissent) that the requirement that the personal property be “corporeal” “does not include a product that can only be heard and not touched or seen . . . .” Indeed, Justice Anderson nonetheless argued that the supreme court improperly rejected Black’s 1994 definition of “corporeal property,” which provides:

Such as affects the senses, and may been seen and handled, as opposed to incorporeal property, which cannot be seen or handled, and exists only in contemplation . . . . In Roman law, the distinction between things corporeal and incorporeal rested on the sense of touch; tangible objects only were considered corporeal. In modern law, all things which may be perceived by any of the bodily senses are termed corporeal, although a common definition of the word includes merely that which can be touched and seen.

In response, the supreme court entered into an extended discussion of various dictionary definitions of “corporeal” and

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182. *Id.* at 661 (citing *N. States Power Co.*, 571 N.W.2d at 575).
183. *Id.* at 660-61.
“tangible property.” It noted, for example, that the Black’s Law Dictionary definition had changed since the 1994 edition: “the 1999 [Seventh] edition of Black’s revised the definition of ‘corporeal property’ to ‘property that can be perceived.’” The Sprint Spectrum court then concluded: “While dictionary definitions are sometimes helpful in statutory interpretations, it would expand the power of a dictionary’s author for this court to rely solely on a portion of a specific dictionary text, or to overemphasize single words or examples within a specific dictionary entry.” Finally, the Sprint Spectrum Court noted while it referenced Black’s in Zip Sort, it did not rely on it but instead relied on Fingerhut in reaching its decision.

In short, the supreme court has wisely chosen not to bind itself to particular dictionary definitions but rather has clarified, albeit in a tax context, that “tangible property” will typically include electronic property such as telephone and electrical transmissions. That is good news for policyholders seeking coverage for electronic data loss.

186. Id. at 662.
187. Id.
188. Id. at 663. Of course, the one area in which tax law and insurance law do differ is that while the courts have looked to the “common” definition of a term in construing statutory language in insurance coverage, law terms undefined in the policy should be construed narrowly in favor of coverage. Compare Nadeau v. Austin Mut. Ins. Co., 350 N.W.2d 368, 373 (Minn. 1984) (“[T]he terms of a statute generally should be construed according to their plain and ordinary meaning.”) with Minn. Mining & Mfg. Co. v. Travelers Indem. Co., 457 N.W.2d 175, 179 (Minn. 1990) (“If the terms of an insurance policy are not specifically defined, they must be given their plain, ordinary and popular meaning . . . [but] ambiguous terms in an insurance policy are to be resolved against the insurer and in accordance with the reasonable expectations of the insured.”).
189. Sprint Spectrum, L.P., 676 N.W.2d at 663.