

Nos. A04-1442 and A04-1612

**STATE OF MINNESOTA  
IN THE SUPREME COURT**

Wooddale Builders, Inc.,

Appellant,

vs.

Maryland Casualty Company, d/b/a Zurich North America,

Appellant,

vs.

American Family Insurance, and  
Western National Insurance Group,

Appellants,

and

West Bend Mutual Insurance Company, and  
American Economy Insurance Company, (SafeCo),

Respondents.

**AMICUS CURIAE BRIEF OF THE MINNESOTA ATTORNEY GENERAL**

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## STATEMENT OF AMICUS CURIAE

The Attorney General's interest in this matter is public in nature and relates to the potential adverse impact of the decision below in future cases involving insurance coverage for the cost of cleaning up ground water contaminated by past commercial and industrial activities. In particular, application of the decision below in environmental coverage cases may significantly reduce the ability to recover money spent to remediate pollution of the State's ground water, both by the State and by those responsible for the contamination, thereby placing more of the financial burden of cleanup on the State and its taxpayers.

Although this case involves insurance claims by a private contractor, Wooddale Builders, Inc. (hereinafter "Wooddale"), for liability for property damage due to water intrusion, it shares a core legal issue with environmental coverage cases, namely: how to allocate liability resulting from continuous and indivisible occurrences of property damage to consecutive insurance policies in effect when the continuous injury occurred. Both property damage due to water intrusion and pollution of the State's ground water from sites such as old landfills, dumps, leaking petroleum tanks and other commercial and industrial contamination sources, involve continuous and indivisible property damage that occurs over a period of years. The decision as to how to allocate damages to the insurers in such cases may have a significant effect on whether an injured party is made whole or has to bear a significant portion of the damages. When the injured party is the public,

through damage to the State's ground water, those costs may fall on the public and on taxpayers of the State.

Insurance coverage historically purchased by parties who are legally responsible for ground water contamination plays a significant role in the ability of the State to recover its pollution cleanup costs. The Landfill Cleanup Act, Minn. Stat. § 115B.39 *et seq.*, (2004) specifically identifies insurance coverage as one of the primary means for the State to pay for the ongoing remediation of 106 closed municipal waste landfills. Minn. Stat. §§ 115B.40, subd. 7(b)(2)(i); and 115B.441-445 (2004). The Petroleum Tank Release Cleanup Act and the Dry Cleaner Environmental Response and Reimbursement Act also identify insurance coverage as a potential source of cleanup cost recovery. Minn. Stat. §§ 115C.04, subd. 3; and 115B.50, subd. 1(b) (2004). The State also obtains assignment of insurance claims from responsible parties as a result of settlements of cleanup liability under the principles of *Miller v. Shugart*, 316 N.W.2d 729 (Minn. 1982).

The Attorney General is authorized to bring legal actions to recover the State's environmental cleanup costs from responsible parties and their insurers. *See* Minn. Stat. §§ 115B.17, subd. 6; 115B.441-445; and 115C.04, subd. 3 (2004). This authority includes the right to bring a direct action against certain insurance carriers to recover environmental response costs incurred by the State to clean up closed landfills under the Landfill Cleanup Act. Minn. Stat. § 115B.444 (2004). The issue of the allocation end-date for multiple consecutive insurance policies has arisen in several cases brought by the Attorney General under this statute.

Because the case on appeal is not an environmental coverage case, this Court's decision on allocation in this case may not be directly controlling in pending or future environmental coverage cases. However, the Attorney General anticipates that, if remediation is approved as the end-date for allocation in this case, insurance carriers will aggressively seek to apply that decision in future environmental coverage cases. Unless the decision of the Court of Appeals in this case is reversed, the State faces the risk that its future recoveries of environmental cleanup costs incurred to protect public health and the environment could be substantially reduced, shifting more of the financial burden for cleanups to the State and its taxpayers.

## **LEGAL ISSUES**

### **I. REASONS FOR REVERSING THE DECISION OF THE COURT OF APPEALS**

The Attorney General respectfully submits that the Court of Appeals fundamentally erred in this case by adopting a per se rule that extends the period for allocating insurers' liability for continuous, indivisible property damage through the date when the damage is remedied or repaired. This Court has developed a substantial body of case-law to guide the trial courts in allocating damages in such cases. The trial court in this case found that liability should be allocated through the date when the policyholder was notified of the claims -- that is, the date of *discovery*. The trial court's decision followed the precedents established by this Court and should have been affirmed by Court of Appeals. The Attorney General respectfully requests that this Court reverse the Court

of Appeals and clarify the principles articulated in its previous coverage cases to provide greater certainty to trial courts in making future allocation decisions.

This Amicus Brief of the Attorney General focuses on three reasons why this Court should reverse the Court of Appeals. First, the Court of Appeals erred in its initial analysis of the trial court's allocation decision when it concluded that allocation through the time of discovery violated the actual injury rule announced by this Court in *Northern States Power Co. v. Fidelity & Cas. Co.*, 523 N.W.2d 657 (Minn. 1994) (hereinafter "*NSP*"), and reaffirmed in *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997) (hereinafter "*Domtar*"). The Court of Appeals' rejection of the trial court's allocation decision, and its consideration of an alternative allocation rule, was based on this erroneous conclusion. The trial court's allocation decision did not violate the actual injury rule and should be affirmed as consistent with this Court's holdings in *NSP* and *Domtar*.

Second, the Court of Appeals erroneously applied a *de novo* standard of review to the trial court's allocation decision instead of determining whether the decision was within the sound discretion of the trial court as an equitable matter, as required by the prior jurisprudence of this Court. This Court has consistently stated that allocation decisions in complex insurance coverage cases are heavily fact-specific and that the trial courts have wide flexibility to apportion damages in a matter befitting the facts of each case. *See NSP*, 523 N.W.2d, at 633, and *Domtar*, 563 N.W.2d, at 733-734 ("*NSP* does not establish hard-and-fast rules; it offers a practical solution in the face of uncertainty.")

(citation omitted). Furthermore, this Court has expressly held that abuse of discretion is the proper standard of review for such allocation decisions by the trial courts. *In re Silicone Implant Ins. Coverage Litigation*, 667 N.W.2d 405, 417 (Minn. 2003). Contrary to these principles, the Court of Appeals applied *de novo* review to the trial court's allocation decision and adopted a *per se* rule for allocating liability in continuous indivisible property damage cases that deprives trial courts of their authority to fashion allocation decisions in accordance with the unique facts of future cases.

Third, the Court of Appeals erred as a matter of law in adopting remediation as the end-date for allocating liability in this case because a remediation end-date conflicts with the principles set forth in past insurance coverage cases of this Court, including the principles underlying the "known loss" doctrine, and this Court's public policy to effectuate policyholders' reasonable expectations of coverage. If this Court determines that a *per se* rule is desirable to guide trial courts in setting the end-date for allocating damages in future cases, this Court should adopt discovery, rather than remediation, as the appropriate allocation end-date.

## **II. MINNESOTA CASE-LAW ON INSURANCE COVERAGE FOR CONTINUOUS, INDIVISIBLE INJURY: ACTUAL INJURY RULE; ALLOCATION BY TIME ON THE RISK**

Four decisions of this Court involving coverage for continuous environmental and personal injuries provide the framework against which the Court of Appeals' decision below must be evaluated. Those cases are: *NSP*, 523 N.W.2d 657 (Minn. 1994); *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305 (Minn. 1995) (hereinafter "SCSC");

*Domtar*, 563 N.W.2d 724 (Minn. 1997); and the *3M Breast Implant Case*, 667 N.W.2d 405 (Minn. 2003).

The *NSP* case involved liability for environmental cleanup costs resulting from a series of spills and leaks that occurred at an NSP facility over many years, causing contamination of the State's ground water. Several insurance carriers issued coverage for environmental liabilities to NSP during the period of the ongoing injury. The questions before this Court in *NSP* were: which of the insurance carriers were obligated to cover the environmental liability (the "trigger of coverage issue"), and how should that liability be assigned or allocated among those carriers (the "allocation" issue). The Court of Appeals had held that damages were to be allocated among NSP's insurance carriers in proportion to the injuries that occurred during each policy period based on proof of the quantum of injury occurring in each period, *NSP*, 523 N.W.2d at 662. NSP argued that the environmental liability should be allocated among its insurers in proportion to their policy limits. *Id.* at 660 and n.4. This Court ultimately rejected both of these methods of allocation and chose instead to allocate the losses to each insurance carrier by that carrier's "time on the risk." *Id.* at 664.

This Court began its analysis in *NSP* with the issue of the trigger of coverage -- that is, what must happen during the policy period in order for coverage to apply in the first place? *See Id.* at 659 n.3. This Court held that Minnesota follows the "actual injury" or "injury-in-fact" rule, under which only those policies in effect when injury or damage occurs are triggered. *Id.* at 662. The Court then explained how the actual injury trigger

rule affects allocation of liability among multiple carriers and why it was rejecting NSP's allocation by policy limits argument:

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. . . . A "pro rata by limits" allocation method effectively makes those insurers with higher limits liable for damages incurred outside their policy periods and is therefore inconsistent with the actual injury trigger theory.

The question therefore becomes, how may a court allocate damages consistent with the "actual injury" trigger theory? One option would be to apportion the damages as proven; in other words, each policy would cover only those damages that are allocable to harm which occurred during the policy period. This is the approach followed by the Court of Appeals in this case. . . . A second option would allocate damages pro rata by each insurer's "time on the risk."

*Id.* at 662-63.

After considering the serious difficulties of proof that would be faced by policyholders under an allocation by proven injury theory (the theory adopted by the Court of Appeals), this Court rejected that theory and instead held that pro rata allocation by time on the risk was the appropriate way to allocate the liability for damages under the facts of the *NSP* case. Under the pro rata by time on the risk theory, each triggered policy bears "a share of the total damages proportionate to the number of years it was on the risk relative to the number of years of coverage triggered." *Id.* at 663. In explaining its holding, this Court said that

[A] "pro-rata by time on the risk" allocation scheme could reduce the costs of litigation because it is more or less a per se rule. This method assumes that the damages in a contamination case are evenly distributed (or

continuous) through each policy period 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 of coverage triggered.

*Id.*

It is important to note that, despite the language used in *NSP* to explain how the actual injury trigger rule holds consecutive insurers liable “for only those damages which occurred during its policy period,” this Court has never adopted a literal interpretation of the actual injury rule in its coverage cases. Indeed, in *NSP* this Court rejected allocation by proof of damages, which was the only allocation theory that would strictly satisfy the actual injury rule. By adopting allocation by time on the risk, *NSP* tempered the actual injury rule by allowing damages to be “evenly distributed” throughout the triggered period. In addition, *NSP* made clear that it is the “total damage” arising from the continuous occurrence that is allocated over the triggered years. Thus, from the outset, this Court has never adhered to a literal or even strict application of the actual injury rule in allocating continuous damage.

The remaining issue that this Court addressed in *NSP* was the starting and ending dates of the triggered allocation period. On this issue, *NSP* left considerable discretion to trial courts. First, this Court emphasized that “damages are by nature fact-dependent and that trial courts must be given the flexibility to apportion them in a manner befitting each case.” *Id.* To assist the trial courts, the Court announced a set of “guidelines” to apply in

particular cases. *Id.* at 663-664 and n.8. One guideline, addressing the policyholder's burden of proof, stated that:

It is sufficient in these cases, however, if the insured shows damage began on a particular date, X, and ended on, or was discovered at, a later date, Y, which period of time includes the policy periods for the policies at issue

*Id.*, at 663-664. The Court then added the following:

Where, in this case, the damages occurred over multiple policy periods, the trial court should presume that the damages were continuous from the point of the first damage to the point of discovery or cleanup.

*Id.*, at 664. Finally, the Court emphasized in its concluding paragraph in *NSP* that “[w]e do not expect that this case will be the ‘last word’ in this area.” *Id.* at 665.

Just one year after *NSP*, this Court again addressed an environmental liability coverage dispute in *SCSC*. This case involved contamination of ground water that continued over a long period of time, but where the environmental injury resulted from an identifiable, discrete event. *Id.* at 318. This Court held that only the insurance policies in effect at the time of this single event were triggered and that these policies were responsible for all of the damages arising from the ongoing contamination. *Id.* This Court declared that the result in *SCSC*, though different from the allocation for indivisible continuous damage in *NSP*, was consistent with the actual injury rule. *Id.* The Court also clarified that its “decision in *NSP* was an equitable one based upon the complexity of proving in which policy periods covered property damage arose.” *Id.* (emphasis added).

Two years later, this Court decided *Domtar*, another case involving continuous, indivisible environmental property damage. In *Domtar*, this Court reaffirmed the key

holdings in *NSP* and reiterated its guidance to trial courts on how to allocate liability among insurers, stating that “if the insured proves when the contamination began and when it ended or was discovered, then the trial court should presume that property damage was continuous from its initiation until the time of clean-up or discovery.” *Id.* at 732.

*Domtar* also addressed one other question not directly considered in *NSP*: whether the policyholder must bear liability for damage that occurs in triggered years when the policyholder is uninsured. *Id.* at 731-732. *Domtar* had only been able to demonstrate that it had coverage during 15 of the 64 years in which continuous environmental injury had occurred. *Id.* at 731. *Domtar* argued that the total environmental damages arising from the injury should be allocated only to the 15 years of triggered policies. *Id.* at 731-732. This Court rejected *Domtar*’s argument, holding that, under the actual injury rule, “[e]ach insurer is liable for that period of time it was on the risk compared to the *entire* period during which the damages occurred.” *Id.* at 732 (emphasis in original). Thus, this Court concluded that “[I]t was not error for the trial court to limit the [insurer] defendants’ liability to damages occurring during their policy periods.” *Id.* at 732-33. By so limiting the carriers’ liability, the remaining liability fell on *Domtar* for the years in which it had not demonstrated that it was insured.

Although *Domtar* reaffirmed the actual injury rule, it also rejected the insurance carriers’ argument that the actual injury rule precluded courts from allocating liability to a carrier for damages occurring outside its policy period: “It should also be clear, however,

that the defendants' reading of *NSP* is too broad. It is inaccurate to conclude that a CGL insurer is *never* liable for damages occurring outside of the policy period." *Id.* at 733 (emphasis in the original).<sup>1</sup>

Six years later, in the *3M Breast Implant* case, this Court again addressed issues related to continuous, multi-year occurrence of injuries -- this time in a personal injury case. This Court held that the ongoing medical injury resulted from the single discrete event of surgically implanting the devices, and therefore an *NSP*-type allocation was not appropriate. However, on the issue of the trial court's discretion to apportion damages in complex coverage cases, this Court reiterated its statement in *NSP* that "trial courts must be given the flexibility to apportion them in a manner befitting each case." *Id.* at 417. This Court further concluded that "Such language indicates that allocation decisions should be reviewed under an abuse of discretion standard and that is the standard we apply here." *Id.*

## ARGUMENT

The case on appeal involves damages resulting from water intrusion in homes constructed by the policyholder, Wooddale. Evidence in the case showed that the damage caused by water intrusion was a continuous and indivisible injury. *Wooddale Builders, Inc. v. Maryland Casualty Co., et al.*, 695 N.W.2d 399, 402-403 (Minn. App. 2005, hereinafter "*Wooddale Builders*"). Applying the *NSP* principles to the facts of this case,

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<sup>1</sup> To support this statement the Court cited *SCSC*, explaining that "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." *Domtar*, 563 N.W.2d at 733.

the trial court allocated liability for the continuous injury among Wooddale's insurers based on their pro rata time on the risk. The trial court set the beginning date for allocation as the date when the homeowners closed on the purchase of their homes and the end-date when the builder was put on notice that a homeowner was making a claim for damages. *Id.* at 403. In effect, the allocation end-date selected by the trial court was the "discovery" of the property damage. On appeal, the Court of Appeals, reviewing the trial court's decision *de novo*, reversed and held that the end-date for allocation is the date when the damage caused by the water intrusion was repaired or remediated. *Id.* at 406. Wooddale and two of Wooddale's insurance carriers, Maryland Casualty and Western National, have appealed the Court of Appeals' remediation end-date decision to this Court.

**I. THE COURT OF APPEALS' RULING IS BASED ON INCORRECT APPLICATION OF THE ACTUAL INJURY RULE**

The Court of Appeals began its analysis of the trial court's allocation decision by considering the actual injury rule adopted in *NSP*. However, the Court of Appeals made a critical error in the first step of this analysis, which led to its erroneous reversal of the trial court's allocation decision. The Court of Appeals' error was to assume that, in adopting discovery as the end-date for allocation, the trial court either failed to allocate to any insurer that portion of the injury or loss which continued after discovery or, by allocating those losses to pre-discovery policies, the trial court's allocation decision violated the actual injury rule. In the words of the Court of Appeals, "either no insurer is liable for post-notification damages or each triggered insurer is potentially liable for post-

notification damages even if a separate insurer provided Wooddale coverage during that period.” *Wooddale*, 695 N.W.2d at 404-405.

The crux of the Court of Appeals’ error is its overly literal reading of this Court’s actual injury rule. As this Court cautioned the insurer defendants in *Domtar*, it is simply wrong to conclude from the actual injury rule “that a CGL insurer is *never* liable for damages occurring outside of the policy period.” 563 N.W.2d at 733 (emphasis in the original). To the contrary, this Court clearly stated in *NSP* and *Domtar* that, once the trial court determines the period of time that is triggered by an occurrence of property damage which is ongoing and continuous, the *total* damages or loss resulting from that occurrence is allocated among the policies in effect during that period (and to any uninsured portions of that period). *See, NSP*, 523 N.W.2d at 664 (“we have also held that the total amount of the property damage should be allocated to the various policies in proportion to the period of time each one was on the risk”), and *Domtar*, 563 N.W.2d at 733 (explaining that in the *SCSC* case, “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.*”) (emphasis added).

Thus, under *NSP* and *Domtar* the proper function of the actual injury rule is to define the trigger period in which allocation of liability for a continuous occurrence is to be made. The rule should not be applied, as the Court of Appeals did here, to limit the losses that may be allocated to the policies triggered during that period. Stated slightly

differently, the actual injury rule is used only to determine which policies must respond to liability from an occurrence that continues indivisibly over multiple policy periods. However, the actual injury rule does not limit the obligation of the triggered policies to answer for whatever liability arises out of such an occurrence. Rather, the scope of liability of triggered policies is based on the policies' language. Under the allocation by time on the risk rule, each triggered policy is liable for its proportion of the total liability arising from the occurrence, based on that policy's time on the risk. The fact that the liability for the occurrence may extend beyond the end-date of the allocation period does not violate the actual injury rule.

When these principles are applied in the case on appeal, it is clear that all liability for loss arising from the occurrence of water intrusion, including loss arising after discovery, was correctly allocated by the trial court to the policies that were triggered through the date of discovery. The actual injury rule was not violated by such an allocation and the Court of Appeals erred in thinking that it was necessary to extend the allocation period for that reason.

## **II. THE COURT OF APPEALS APPLIED THE WRONG STANDARD OF REVIEW**

The Court of Appeals also erred by conducting *de novo* review of the allocation decision of the trial court. This Court has repeatedly rejected the use of any hard and fast allocation end-date rule in continuous indivisible damage cases. *See NSP* and *Domtar, supra*. Rather, this Court has emphasized that "damages are very fact-dependent, so 'trial courts must be given the flexibility to apportion them in a manner befitting each case.'" *3M Breast Implant* case, 667 N.W.2d at 417 (quoting *NSP*, 523 N.W.2d at 633). For this

reason, this Court has stated that “allocation decisions should be reviewed under an abuse of discretion standard, and that is the standard we apply here.” *Id.*

The Court of Appeals in this case, however, expressly decided to review the trial court’s allocation decision under a *de novo* standard. In a footnote, the Court of Appeals stated:

The Supreme Court has stated that a trial court’s “allocation decisions should be reviewed under an abuse of discretion standard.” *In re Silicone Implant Ins. Coverage Litig.*, 667 N.W.2d 405, 417 (Minn. 2003). The issue before the *Silicone* court was the district court’s decision to *apply* the pro-rata-by-time on the risk method in allocating damages among multiple insurers. *Id.* Here, the issue is the district court’s application of this method to the facts presented and this Court reviews the district court’s conclusions *de novo*.

*Wooddale Builders*, 695 N.W.2d at 403, n.1. The Court of Appeal’s rationale for *de novo* review in this case is not well founded. The decision of how to apply allocation principles to a specific set of facts, as the trial court was called upon to do here, is exactly the kind of “fact-dependent” determination that warrants application of the abuse of discretion standard.

Under an abuse of discretion standard of review, the trial court’s allocation decision should have been affirmed. There is no dispute in this case about the continuous or indivisible character of the water intrusion damage giving rise to the liability. The trial court properly applied the precedents of this Court in concluding that the liability arising from the continuing occurrence of property damage should be allocated from the time when homeowners closed on their homes until the policyholder was put on notice of the claims due to the occurrence. By reviewing the trial court’s decision *de novo*, the Court of Appeals deprived the trial court of the

flexibility that this Court has consistently afforded in fashioning allocation decisions that are appropriate to the facts of each case.

### **III. THE COURT OF APPEALS' REMEDIATION END-DATE RULE CONFLICTS WITH THE PRINCIPLES AND POLICIES OF MINNESOTA INSURANCE COVERAGE CASES**

The Court of Appeals' remediation end-date decision in this case is inconsistent with longstanding Minnesota case-law on insurance coverage issues. First, by eliminating the option for the trial court to choose discovery as the end-date for allocation the Court of Appeals' per se allocation rule conflicts with this Court's holdings in *NSP* and *Domtar*. Second, a remediation end-date for allocation conflicts with the legal principles underlying the "known loss" doctrine as set forth in Minnesota case-law. And third, by significantly extending the allocation period, a remediation end-date rule severely diminishes recoveries that policyholders can expect to obtain from their insurers for continuous indivisible injuries and increases the share of liability that policyholders will have to bear. This is contrary to public policy expressed in Minnesota case-law favoring full effectuation of policyholders' reasonable expectations of coverage under their insurance contracts. Such an extension of the allocation period also raises the question of equity in imposing liability on policyholders for periods where coverage for a particular type of risk has become unavailable in the insurance market. For all of these reasons, a remediation end-date rule for allocation should be rejected. If this Court determines that a per se rule is needed to guide trial courts in setting the end-date for allocating damages in future cases, this Court should adopt discovery rather than remediation as the appropriate allocation end-date.

#### **A. A Per Se Remediation End-Date Rule Conflicts With *NSP* And Is Inconsistent With The "Known Loss" Doctrine**

This Court has repeatedly made clear, in its cases involving continuous injury, that an allocation period may run "to the time of *discovery*, cleanup, or whenever the last

triggered policy period ended.” *NSP*, 523 N.W.2d at 663 (emphasis added). “In these cases, the insured bears the burden of proving that a policy has been triggered, but if the insured proves when the contamination began and when it ended *or was discovered*, then the trial court should presume that property damage was continuous from its initiation until the time of clean-up *or discovery*.” *Domtar*, 563 N.W.2d at 732 (emphasis added). Neither *NSP* nor *Domtar* provided specific guidance on how a trial court might choose between discovery and clean-up in setting the end-date for the allocation period. But it is beyond dispute that those decisions allowed trial courts to choose either option.

In this case, the Court of Appeals imposed a remediation end-date as a per se rule that will apply in cases where remediation occurs after discovery. But remediation is likely to occur after discovery in virtually *all* cases of continuous damage. This is particularly true for environmental damage, which often requires years of investigation and study before a remedy can be selected and implemented. By holding that a remediation end-date is required in all such cases in order to be consistent with its overly literal interpretation of the actual injury rule, the Court of Appeals has rewritten *NSP* and *Domtar*, eliminating discovery as a basis for setting the allocation period. This alone should be sufficient to reverse the Court of Appeals’ remediation end-date rule.

Furthermore, contrary to the Court of Appeals’ reasoning in the decision below, the remediation end-date rule also conflicts with the “known loss” doctrine. The fundamental principle of this doctrine is that “[I]nsurance cannot be issued for a known loss.” *Waseca Mut. Ins. Co. v. Noska*, 331 N.W.2d 917, 924-925 n.6 (Minn. 1983) (citing

*Oster v. Riley*, 150 N.W.2d 43, 52 (Minn. 1967) (Otis, J., dissenting); *Gopher Oil Co. v. American Hardware Ins. Co.*, 588 N.W.2d 756, 759 (Minn. App. 1999). “Once the loss has occurred, there is no longer any “risk.” *Domtar*, 563 N.W.2d at 737 (quoting *Waseca*, 331 N.W.2d at 924-925 n.6.) The known loss doctrine is a fraud-based defense for insurers which bars a policyholder from claiming coverage under policies acquired with knowledge that a liability has already occurred. Its purpose is to prevent fraud and preserve “fortuity” as a central concept of insurance. As a practical matter, most policyholders find it impossible to purchase coverage for a liability problem after they have already learned about it.

In this case, the loss due to continuing water intrusion became known to the policyholder when Wooddale was notified of the damage claims by the affected homeowners. Under the “known loss” doctrine, the liability for property damage due to water intrusion became uninsurable once it was discovered. Thus, no liability attributable to this damage should have been allocated to policies acquired after discovery. Nevertheless, the Court of Appeals held that the “known loss” doctrine did not apply to policies acquired by Wooddale after discovery of the loss. The Court reached this conclusion for two reasons, both of which are erroneous.

First, the Court of Appeals held that the known loss doctrine did not apply in this case because “Wooddale purchased each triggered policy with knowledge of a potential for loss and without knowledge of an actual loss.” *Wooddale Builders*, 695 N.W.2d at 405. The Court of Appeals based this holding on its analysis of the known loss issue in

the *Domtar* case, in which the court found that “knowledge of a potential for loss did not have ‘the same legal significance as knowledge that an insurable loss has occurred.’” *Id.* at 405, citing *Domtar, Inc. v. Niagara Fire Ins. Co., et al.*, 552 N.W.2d 738, 747 (Minn. App. 1996) *rev’d in part on other grounds by Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997). However, a closer review of the holdings of both the Court of Appeals and of this Court in the *Domtar* case shows that the known loss issue in *Domtar* turned on the lack of any evidence in the record that Domtar knew its polluting activities had resulted in any specific loss at the time it purchased the policies in question. *Domtar, Inc. v. Niagara Fire Ins. Co.*, 552 N.W.2d at 747 (“Because no evidence in this case suggests that Domtar knew of its loss when it purchased its policies, there was no factual basis for application of the [known loss] doctrine . . . .”), and *Domtar*, 563 N.W.2d at 737 (“The insured need not know of the exact nature or extent of the contamination, but there must be evidence that the insured knew of the property damage when it purchased insurance that would otherwise cover the loss. There is no such evidence in the record before us.”)

Contrary to the situation in *Domtar*, Wooddale knew of its loss once it was notified by affected homeowners of specific claims due to water intrusion. This is not an example of a policyholder who only had knowledge of a “potential loss.” Wooddale had actual knowledge of specific claims of loss which were submitted by the homeowners whose homes were damaged by infiltrating water. The Court of Appeals’ reliance on

*Domtar* to conclude that the “known loss” doctrine did not apply to Wooddale is erroneous.

Second, the Court of Appeals rejected Appellant Maryland Casualty’s argument that “continuing insurance coverage beyond the date the insured is placed on notice of a loss is at odds with the basic principle that insurance is purchased to cover risk of loss, not an existing loss.” *Wooddale Builders*, at 405-406. In rejecting this argument, the Court of Appeals erroneously concluded that the actual injury rule required it to consider a continuing occurrence of property damage as a continuing “risk of loss,” which would remain subject to insurance coverage even if the loss became known to the policyholder. *Id.* at 406. Thus, in the Court of Appeals’ opinion, the water intrusion liability was still an insurable risk even after it was discovered. *Id.* (“the risk of loss remained the same because the occurrence was still continuing”). This reasoning is seriously flawed. While damage may continue to occur after the policyholder becomes aware of a claim, this is not the same as a continuing “risk” in the sense of an unknown or unexpected fortuity for which the policyholder could continue to buy liability insurance in the future. In effect, the reasoning of the Court of Appeals’ changes the rule for pro rata allocation from “time on the risk,” as required by *NSP*, to allocation by “time-on-the-loss.” This result is a distortion of *NSP* and is not required by the actual injury rule.

Thus, the remediation end-date rule for allocation adopted by the Court of Appeals should be rejected because it is at odds both with the holdings of *NSP* and *Domtar* and with the principles embodied in the “known loss” doctrine.

**B. A Per Se Remediation End-Date Rule Conflicts With Public Policy Favoring Full Effectuation Of Policyholders' Reasonable Coverage Expectations.**

The remediation end-date rule adopted by the Court of Appeals virtually ensures that policyholders facing claims based on continuous indivisible property damage will never obtain full insurance coverage for the losses they incur. Any property damage that takes years or decades to develop and manifest is unlikely to be remedied quickly or simply. Furthermore, in setting "remediation" as the allocation end-date, presumably the Court of Appeals meant "the start of remediation," not "the completion of remediation."<sup>2</sup> But even if the Court of Appeals meant to extend allocation only to the start of remediation, there will almost always be a significant gap between discovery of a continuous environmental injury and when it is remedied. Setting aside the inability of the policyholder to acquire further coverage under the "known loss" doctrine once the damage is discovered, the extended period between discovery and remediation is likely to severely diminish the ability of policyholders to recover the full losses from their insurers. Such a result clearly would frustrate policyholders' reasonable expectations of coverage under their insurance contracts.

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<sup>2</sup> A "completion of remediation" rule would be particularly draconian to policyholders. In many instances of ground water contamination, complex and time-consuming studies are required to determine the nature and extent of the contamination and to identify alternative remedies. After a remedy is selected and implemented, it may take decades to fully remediate the contamination.

Insurance coverage serves the important societal purpose of spreading losses across the risk pool so that losses are easier to bear. Insurance companies that pay large losses can raise their premiums, whereas policyholders who suffer large losses without full insurance must bear the loss directly. Accordingly, Minnesota embraces a strong public policy of extending coverage rather than allowing confusing or ambiguous language to restrict coverage. *See, e.g., Safeco Ins. Co. v. Lindberg*, 380 N.W.2d 219, 221-22 (Minn. App. 1986). Minnesota also follows the doctrine that a policyholder's objectively reasonable expectation of full coverage should be upheld. *See, e.g., NSP*, 523 N.W.2d at 661; *Minnesota Mining & Mfg. Co. v. Travelers Indemnity Co.*, 457 N.W.2d 175, 179 (Minn. 1990); *Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co.*, 366 N.W.2d 271 (Minn. 1985). The Court of Appeals' remediation end-date rule, by imposing a significantly greater share of the losses from continuous indivisible injuries on policyholders, conflicts with this Court's public policy in favor of upholding policyholders' reasonable coverage expectations. The effect on policyholder expectations will be particularly egregious in cases such as the one on appeal, where the policyholder bought liability coverage during every pertinent year through discovery of the injury and reasonably expected full coverage.

The extension of the allocation period resulting from a per se remediation end-date rule may significantly diminish policyholders' recovery for another reason. The insurance industry has sometimes responded to major loss experiences for certain types of liabilities by imposing industry-wide exclusions on all new policies. This practice is illustrated by

the absolute asbestos exclusions that became standard in 1985, *See, e.g., Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1203-04 (2d Cir. 1995); the qualified pollution exclusions that became standard in about 1973, precluding coverage for gradual pollution of ground water, *See, e.g., Sylvester Bros. Devel. Co. v. Great Central Ins. Co.*, 480 N.W.2d 368 (Minn. App. 1992); and the “absolute” pollution exclusions that became standard in the 1980s. Thus, imposing a remediation end-date may have particularly severe consequences when environmental damage is at issue, because a longer allocation period may shift liability to years when coverage for the risk at issue is no longer available for purchase.

The equity of allocating liability to policyholders in uninsured years requires a different analysis when lack of insurance results from market unavailability rather than from a voluntary choice of the policyholder to go without insurance. There are some legitimate reasons to require a policyholder to bear some liability for continuous property damage when the policyholder has voluntarily decided to self-insure for part of the period at risk. *See, e.g., Olin Corp. v. Insurance Co. of N. Am.*, 221 F.3d 307 (2d Cir. 2000) (allocation prevents policyholder “from benefiting from coverage for injuries that took place when it was paying no premiums”). In theory, such a rule should encourage the purchase of adequate amounts of insurance, which allows risk to be transferred and spread in an economically rational way. But allocation to the policyholder is not equitable when there is nothing more that the policyholder could reasonably do to obtain

coverage.<sup>3</sup> To the extent that the remediation end-date decision below permits or requires allocation to policyholders in situations where an uninsured policyholder could not reasonably have done anything more to obtain insurance coverage, the decision below is neither supported by precedent nor consistent with settled canons of Minnesota coverage law.

**C. If This Court Determines That A Per Se Allocation End-Date Rule Is Needed, This Court Should Adopt Discovery As The Appropriate End-Date.**

If this Court determines that a per se rule to define the end-date for insurance allocation in continuous indivisible damage cases is desirable in order to give clearer guidance to trial courts, the Attorney General urges the Court to adopt discovery as the appropriate end-date. The arguments for selecting discovery as the allocation end-date in these cases mirror the strong legal and policy arguments that weigh against a remediation rule. Discovery has been consistently put forward by this Court in previous continuous injury cases as an appropriate allocation end-date. Discovery as an end-date for insurance allocation is also consistent with the principles that underly the “known loss” doctrine, and reduces the risk that policyholders will be forced to pay for losses accruing after discovery because the liability is no longer insurable. A discovery end-date will generally

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<sup>3</sup> Leading cases in other jurisdictions with pro rata insurance allocation rules have made it clear that the allocation period must end at the point when insurance for the particular liability risk was no longer available. See, e.g., *Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1203-04 (2d Cir. 1995) (ending pro rata allocation for asbestos liabilities in 1985, the year in which asbestos liability coverage ceased to be available); *Owens-Illinois, Inc. v. United Insurance Co.*, 650 A.2d 974, 995 (N.J. 1994) (“When periods of no insurance reflect a decision by an actor to assume or retain a risk, as opposed to periods when coverage for a risk is not available, to expect the risk-bearer to share in the allocation is reasonable”).

shorten the allocation period, especially in environmental damage cases. If policyholders have been diligent in procuring available coverage, a discovery end-date will generally provide a greater chance of obtaining full coverage for the loss, thus effectuating policyholders' reasonable coverage expectations. Finally, an allocation period with a discovery end-date is less likely to extend into periods where coverage for the risk at issue has become unavailable in the insurance market. Thus, a discovery end-date is likely to produce a more equitable result for policyholders who did all that they reasonably could to obtain coverage for the risks involved in their activities.

### CONCLUSION

For all of the reasons set forth above, the Attorney General urges this Court to reverse the insurance allocation end-date decision of the Court of Appeals in the case on appeal, and to reaffirm and clarify its holdings in *NSP* and *Domtar* so that trial courts will have clear guidance on this important issue in future cases. If this Court determines that a per se rule for defining the end-date for allocation is desirable, the Attorney General urges this Court to adopt discovery as that end-date.

Dated: August 25, 2005

Respectfully submitted,

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A handwritten signature in cursive script, appearing to read "Alan C. Williams", is written over a horizontal line.

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## CERTIFICATION

I certify that this Brief conforms to RCAP 13.01 and was prepared as follows:

Proportional serif font- Microsoft Word 2002 - Times New Roman Font face, font size 13 pt. This Brief contains 6,963 words and is 26 pages.



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