

Nos. A04-1442 and A04-1612

State of Minnesota
In Supreme Court

WOODDALE BUILDERS, INC.,

Appellant,

vs.

MARYLAND CASUALTY COMPANY,
d/b/a ZURICH NORTH AMERICA,

Appellant,

vs

AMERICAN FAMILY INSURANCE GROUP, and
WESTERN NATIONAL INSURANCE GROUP,

Appellants,

and

WEST BEND MUTUAL INSURANCE COMPANY,

Respondent,

AMERICAN ECONOMY INSURANCE CO. (SAFECO),

Respondent.

**APPELLANT MARYLAND CASUALTY COMPANY,
D/B/A ZURICH NORTH AMERICA'S REPLY BRIEF**

COUSINEAU McGUIRE
CHARTERED
Peter G. Van Bergen (#112033)
Andrea E. Reisbord (#22411X)
Minard M. Halverson (#247030)
1550 Utica Avenue South, Suite 600
Minneapolis, Minnesota 55416-5318
(952) 546-8400

LEONARD, O'BRIEN, SPENCER,
GALE & SAYRE, LTD.
Ernest F. Peake (#212453)
Chad A. Kelsch (#0300794)
100 South Fifth Street
Suite 2500
Minneapolis, Minnesota 55402
(612) 332-1030

*Attorneys for Appellant Maryland Casualty
Company d/b/a Zurich North America*

*Attorneys for Appellant
Wooddale Builders, Inc.*

(Additional Counsel Listed on following page)

OSKIE, REUTER, HAMILTON
& SOFIO, P.A.

David Oskie (#144265)
James M. Hamilton (#167526)
970 Raymond Avenue
Suite 202
St. Paul, Minnesota 55114
(651) 644-8037

*Attorneys for Appellant American
Family Insurance Group*

GISLASON, MARTIN
& VARPNESS, P.A.

James T. Martin (#68044)
7600 Parklawn Avenue South
Suite 444
Edina, Minnesota 55435
(952) 831-5793

*Attorney for Appellant Western National
Insurance Group*

LIND, JENSEN, SULLIVAN
& PETERSON, P.A.

Ted E. Sullivan (#122452)
William L. Davidson (#201777)
150 South Fifth Street, Suite 1700
Minneapolis, Minnesota 55402
(612) 333-3637

*Attorneys for Respondent American Economy
Insurance Company (Safeco)*

HELLMUTH & JOHNSON, PLLC

Erik F. Hansen (#303410)
J. Robert Keena (#258817)
10400 Viking Drive, Suite 500
Eden Prairie, Minnesota 55344
(952) 941-4005

*Attorneys for Defective Construction
Homeowners of Minnesota (Amicus Curiae)*

JOHNSON • PROVO-PETERSON, LLP

Gregory J. Johnson (#202678)
Klay C. Ahrens (#236913)
First National Bank Building
332 Minnesota Street, Suite W-975
St. Paul, Minnesota 55101
(651) 227-2534

*Attorneys for Respondent
West Bend Mutual Insurance Company*

DORSEY & WHITNEY LLP

Jocelyn Knoll (#02298X)
Katie Pfeifer (#0309709)
50 South Sixth Street, Suite 1500
Minneapolis, Minnesota 55402-1498
(612) 340-2600

*Attorneys for Builders Association of Minnesota, as
Umbrella Organization for Builders Association of
the Twin Cities and Minnesota Out State Builders
Association (Amicus Curiae)*

WINTHROP & WEINSTINE, P.A.

Thomas H. Boyd (#200517)
Christianna L. Finnern (#310724)
Suite 3500
225 South Sixth Street
Minneapolis, Minnesota 55402
(612) 604-6400

*Attorneys for Minnesota Chamber of Commerce
(Amicus Curiae)*

Mike Hatch

Attorney General, State of Minnesota
Alan C. Williams (#117328)
Assistant Attorney General
445 Minnesota Street, Suite 900
St. Paul, Minnesota 55101-2127
(651) 296-7200

Amicus Curiae, State of Minnesota

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ARGUMENT

In accepting the parties' Petitions for Review, the Court agreed to consider two narrow issues. The first issue concerns the appropriate end date for purposes of determining which insurers and/or parties are "on the risk" in cases in which the "pro-rata by time on the risk" method of allocating insurance coverage for a continuous injury applies. Second, the Court is reviewing the Court of Appeals' decision that defense costs in such a case need not be shared equally among insurers, but should instead be allocated pro-rata by time on the risk. It is these two issues alone that are addressed in all but two of the briefs. Two of the *Amici*, however, the "Defective Construction Homeowners of Minnesota" and the Builders Association of Minnesota have used their briefs as a means to interject a third issue – whether allocation is appropriate in cases seeking damages for moisture intrusion due to alleged construction defects – that is not properly before the Court. For the reasons discussed below, the Court should decline the *Amici's* request to adopt a per se rule applicable to construction defect cases.

With respect to the first issue actually presented by this appeal, the Court has before it six briefs supporting the trial court's determination that liability should be allocated among all insurers who were on the risk from the time of closing on each affected property until Wooddale was placed on notice of a claim regarding that property. Each brief extensively discusses the concept of "trigger," the "actual injury" rule applied in Minnesota insurance coverage cases, and the various public policy and practical considerations that justified the trial court's conclusions under both an abuse of discretion and an error standard. In contrast,

Respondent West Bend, the lone dissenter, offers no argument in support of a remediation end-date beyond pointing out that courts in other states have extended the allocation period through repair. And although West Bend agrees with all parties, including Wooddale itself, that a remediation end date may implicate “known loss” principles, the lion’s share of its argument is devoted to convincing the Court that such an end date is not as problematic as the three Appellants and three *Amici* contend. In so doing, however, West Bend presents an argument that, taken to its logical conclusion, is really no different than that advocated by Appellants.

West Bend’s argument regarding allocation of attorney fees also draws heavily from cases decided in other jurisdictions. Such reliance likewise is misplaced as those cases are based on principles that conflict with Minnesota law.

I. Correction of the Record.

Given the number of years that have elapsed since the commencement of this action, and the number of briefs that have been filed with the Court, the presence of factual and procedural inaccuracies in those briefs was inevitable. Because some of the inaccuracies are significant, a correction of the record is necessary.

This action was commenced by Wooddale in or about August 2000. Maryland Appendix (“Maryland App.”) 18-19. Maryland Casualty Company was named as the sole defendant because, as alleged in the Complaint, it insured Wooddale in late 2000 when Wooddale first began receiving complaints related to the homes Wooddale constructed. *Id.* at 9-10. Wooddale asserts at page 5 of its brief that 60 claims had been tendered for coverage

as of June 2000, but in fact, Wooddale did not begin receiving claims until the latter half of that year, and many of the homeowners asserting the 60 claims Wooddale ultimately received did not discover their injury until 2001 and 2002, when Wooddale was insured by Western National. *Id.* at 10. *See also* Complaints at West Bend App. 10, 15, 24, 32, 37, 43, 54.

Maryland insured Wooddale between November 12, 1997 and November 12, 2000. Wooddale initially alleged that most of the homes had been constructed during the three years that Maryland provided coverage. *See* Complaint at Maryland App. 10. Investigation, however, revealed that the homes were constructed between 1991 and 1999, with at least 40 of those homes completed prior to 1997. *See* Maryland App. 31-37. Accordingly, Maryland brought a third-party action joining all insurers who insured Wooddale between 1990 and the commencement of this action in August 2002.¹

Contrary to the assertions made in a number of briefs, the parties did not stipulate that liability should be allocated among the insurers pro-rata by time on the risk. To the contrary, as reflected in the parties' summary judgment motions (Trial Court Docket Nos. 34, 36, 38, 39, 43), Western National took the position that the damages suffered in the homes were caused by single, discrete events, with the events being the construction and/or first instance

¹ The period of insurance coverage apparently extends through the expiration of the last Western National policy on November 13, 2002. Wooddale claims at page 12 of its Brief that after that date insurers ceased offering CGL policies providing coverage for water intrusion claims and cites as evidentiary support a footnote in West Bend's response to Wooddale's PFR wherein West Bend merely comments that Wooddale apparently was unable to obtain a policy after November 13, 2002. There is no evidence in the record to support either of these claims. Consequently, there is nothing in the record that explains the reasons why Wooddale lacked insurance coverage after November 13, 2002.

of water intrusion, making allocation inappropriate. As a result, West Bend, American Family, Wooddale and Maryland Casualty all moved for summary judgment on the allocation issue and supported their motions with expert reports concluding that the damage to the homes resulted from multiple water intrusion events and occurred as a continuous process that was indivisible over time. *See* Maryland App. 23-46. Unable to rebut the expert evidence offered by the moving parties, Western National “raised the white flag,” conceding that it could not support its “discrete event” argument. *See* Western National Memo. (Docket No. 43 at p. 2).² Thus, while it may be accurate to say that, by the time the motions were heard, the parties essentially agreed that allocation would be appropriate, they hardly stipulated to this approach. Consequently, the trial court considered the evidence presented and made conclusions of law concerning the appropriate method of allocating damages. Maryland App. 80.

II. The Trial Court Neither Abused Its Discretion Nor Erred in Concluding that Liability Should Be Allocated Through the Date When Wooddale Received Notice of a Claim.

A. The Appropriate Standard of Review is Abuse of Discretion.

The parties disagree on the appropriate standard of review. Drawing upon this Court’s pronouncements in *In re Silicone Implant Ins. Coverage Litigation*, 667 N.W.2d 405, 417 (Minn. 2003) and *Northern States Power Co. v. Fidelity & Cas. Co. of New York*, 523

² Western National, however, did maintain that Wooddale would be responsible for self-insured periods after November 15, 2002, an issue that was addressed by Wooddale in its Reply Brief. The parties **did not**, as Wooddale claims at page 13 of its Brief, stipulate that Wooddale would not bear any liability for damages.

N.W.2d 657 (Minn. 1994), Appellants, *Amici* and Respondent SafeCo all agree that the trial court's allocation decision is to be reviewed for an abuse of discretion. On the other hand, West Bend contends that the Court of Appeals was correct in concluding that only the initial decision whether to allocate is subject to the abuse of discretion standard and that any decisions concerning application of a particular allocation method are reviewable *de novo*. *Wooddale Builders, Inc. v. Maryland Casualty Co.*, 695 N.W.2d 399, 403 n. 1 (Minn. App. 2005). There is, however, no basis for this distinction between decisions concerning whether to allocate liability for damages among insurers and decisions concerning how to allocate.

This Court has emphasized that its decision in *NSP* was not intended to establish "hard and fast rules." *Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724, 733-34 (Minn. 1997). Rather, as the Court has stressed, because "damages are very fact dependent," "trial courts must be given the flexibility to apportion them in a manner befitting each case." *In re Silicone*, 667 N.W.2d at 417 (*quoting NSP*, 523 N.W.2d at 633). It is this need for flexibility that had led the Court to state "allocation decisions should be reviewed under an abuse of discretion standard." *In re Silicone*, 667 N.W.2d at 417.

In re Silicone broadly states that allocation decisions are within the trial court's discretion. It does not distinguish between decisions regarding whether to allocate and those regarding how to allocate. And in this case, the trial court's decisions regarding the duration of the allocation period were no less fact dependent and no less in need of flexibility than its initial decision that allocation was appropriate. The heightened abuse of discretion standard of review should be applied.

B. A Notice End Date Comports with the Record in this Case, the Contracting Parties' Reasonable Expectations, the Policies, the Common Law Concept of Fortuity, and the Court's Concerns for Practical and Judicially Manageable Solutions.

The record is clear that Wooddale did not seek insurance coverage and did not expect that later-acquired policies would provide coverage for damages that occurred after it received notice of a claim. Wooddale's expectation is consistent with the policy language and common law principles of fortuity. In light of these expectations, the trial court appropriately determined that all insurers providing coverage through the date Wooddale received notice of a claim were triggered. *See NSP*, 523 N.W.2d at 661 (courts must consider, among other things, policy language, the parties' reasonable expectations and public policy). Moreover, because the time on the risk method of allocating damages reflects an effort on the part of the courts to fashion a "practical solution" and provide a "judicially manageable" way to distribute ongoing losses over multiple insurance policy periods (*Domtar*, 563 N.W.2d at 733-34 (*citing NSP*, 523 N.W.2d at 663, 665)), practicality and manageability are important considerations that must not be overlooked in determining the duration of the allocation period.

As discussed in the opening briefs, allocating damage through the date on which the insured receives notice of a claim most advances these objectives because the date on which the insured receives notice 1) is static and easy to identify, thereby ensuring consistency and certainty; 2) is less susceptible to manipulation, also ensuring consistency and certainty while discouraging parties from taking a wait and see approach; 3) does not contradict policy

language or the actual injury trigger; and, 4) comports with the insured's expectations and affords the insured the greatest protection by avoiding any consideration or conflict with "known loss" or fortuity principles.

1. West Bend's Argument for a Remediation End Date, Which is Based on a Single Sentence in *Domtar*, Ignores the Practical Ramifications of Extending the Allocation Period.

West Bend's argument for a remediation end date is based on a single sentence taken from *Domtar*: "Each insurer is liable for that period of time it was on the risk compared to the *entire* period during which damages occurred." *Domtar*, 563 N.W.2d at 732 (emphasis in the original). From this single sentence, West Bend argues that it is somehow the law in Minnesota that as long as property damage in a given home continues (even after notice of damage to the insured) so must the allocation period. West Bend reads this particular sentence from *Domtar* too broadly. The *Domtar* court was never asked to address the duration of the allocation period, but instead was responding to the insured's claim that any years in which it lacked coverage should not be included in determining the total number of years over which damages would be allocated.

Beyond its citation to *Domtar*, West Bend offers little more in support of its position than its comment that courts in four other states (three of which were lower courts and two of which were reversed, albeit on different grounds) have extended the allocation period

through remediation. This hardly provides a basis for concluding that the trial court abused its discretion, or even erred, in this case.³

As discussed in the Appellants' opening briefs, and the *amicus* briefs, the notice end date most advances the parties' expectations and insuring principles, and presents the most manageable way to allocate damages and defense costs. It does so by avoiding the gap between the end of the policy providing coverage on the date the insured receives notice of the claim and the date of remediation, thereby avoiding questions regarding responsibility for that gap. Consistent with the concept of "fortuity" and the basic principle that insurance cannot be purchased to cover a known loss, Wooddale, the *amici*, and even West Bend apparently, agree that, with a remediation end date, the gap will be the insured's responsibility – a result that carries with it its own set of problems and raises the spectre of conflict between the insurer and its insured. Nevertheless, West Bend offers no argument regarding why a remediation end date would be advantageous or how it would provide a practical and workable solution.

³ One of the cases cited by West Bend, *Owens-Illinois, Inc. v. United Ins. Co.*, 625 A.2d 1 (N.J. Super. A.D. 1993) was later reviewed and reversed by New Jersey's high court. See *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974 (N.J. Dec. 22, 1994). In that case, the New Jersey Court concluded that the policies on the risk between exposure and manifestation of injury were triggered and then prorated based on policy limits multiplied by the number of years of coverage – trigger and allocation methods that were both rejected by the Minnesota Supreme Court in *NSP*. Likewise, *Mayor & City Council of Baltimore v. Utica Mut. Ins. Co.*, 802 A.2d 1070 (Md. Ct. App. 2002), the court rejected discovery by **the claimant** as an end date for allocation purposes, but remanded to the trial court for consideration of when the claims became known to the insured. *Id.* at 1099.

Instead, the vast majority of West Bend's argument is an effort to convince the Court that the remediation end date is not as problematic as virtually every other party and *amicus* contends. West Bend begins by taking issue with Maryland's argument that once an insured is placed on notice of property damage resulting from construction defects, any continuation of that damage is foreseeable or expected by the insured and can no longer be considered accidental for purposes of the occurrence requirement in policies that subsequently come on the risk. What West Bend loses sight of is that the policy requirement of an "occurrence" is intimately tied to the concept of "fortuity," which is the cornerstone of liability insurance:

Just as a liability policy typically states coverage for only an "accident" or "occurrence" during the term of the policy, the courts limit coverage, without additional policy language, by requiring that the claimed loss must be "accidental" or fortuitous, not one that is already known to the insured when the coverage is purchased.

Domtar, Inc. Niagra Fire Ins. Co., 552 N.W.2d 738, 746 (Minn. 1996), *rev'd in part on other grounds by Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997). Because liability insurance is procured to protect an insured against fortuitous losses that are beyond the insured's control, when the insured has knowledge of a claim prior to its procurement of a new policy, continuing damage can no longer be viewed as accidental or fortuitous from the insured's standpoint and coverage is precluded based on known risk principles. No party disputes this basic insuring principle.

2. The Remediation End Date Being Pursued by West Bend Does Not Provide a Practical or Judicially Manageable Solution.

West Bend appears to be in agreement with the fortuity principle. West Bend agrees with virtually every party and every *amicus*, Wooddale included, that, based on known loss or fortuity principles and policy provisions, any insurance policies that come into effect after an insured has been placed on notice of a claim for property damage will not provide coverage for the claim. However, it attempts to downplay the significance of the known loss and fortuity issues with argument that mischaracterizes Maryland's position and gives the false impression that Maryland is somehow seeking to avoid or minimize its liability for the property damage that occurred during its policy periods. In making these arguments, West Bend simply overlooks the negative far-ranging effect that remediation end date will have on future cases.

First, Maryland is not, as West Bend maintains at pages 15-17 of its brief, arguing for a "post-manifestation cut-off theory" or otherwise arguing that known loss principles should apply to a loss discovered during an insurer's policy period. As noted in its brief to the Court of Appeals, Maryland agrees, on the facts of this case and based on language in *NSP*, that if a policy is triggered, it may afford a full year of coverage. *See* Maryland Court App. Brief, p. 12, n. 4.⁴ It is, however, Maryland's position – one with which West Bend apparently agrees – that because of known loss principles embodied in the common law and in policy

⁴ The Court of Appeals, however, declined to address the issue on the basis that the issue had not been raised at the district court level. *Wooddale*, 695 N.W.2d at 407.

provisions, a policy coming into effect after an insured has knowledge of a claim may not afford coverage.

West Bend next maintains that “the fact an insured may be obligated to pay a pro rata share does not provide a basis for ignoring the progressive nature of damages and assigning an allocation end date which has no relationship to those damages or the language of the policy.” West Bend Brief, p. 20. As the Attorney General notes at page 8 of his brief, however, this Court has never adopted a literal interpretation of the actual injury rule in its coverage cases. The time on the risk allocation method was offered by the *NSP* court as a practical and judicially manageable solution, but it is based on assumptions regarding when to what degree property damage has occurred, and does not, therefore, strictly comport with actual injury. Under a time on the risk allocation theory, some insurers may end up paying more, some less, than the precise increment of damage occurring during their policy periods.

West Bend also notes the possibility that, even with a notice end date, Wooddale still may have to contribute a pro-rata share because there may be cases in which a claim is reported to Wooddale after the expiration of the last Western National policy. This is true. But the risk of an uninsured period is, with a notice end date, significantly less. Moreover, while Wooddale may risk exposure for the period of time between the expiration of the Western National policy and notice of a claim, that is not necessarily true of other insured contractors facing claims for construction defects.

West Bend’s next argument, one that is also raised by Wooddale, attempts to convince the Court that Maryland’s concerns over the gap created by a remediation end date are not

genuine or are unimportant because no insurer argued below that proration to Wooddale was appropriate and no insurer appealed the trial court's finding that damages were to be allocated "among the insurers." This is not accurate since Western National, in fact, did argue in its motion to the trial court that Wooddale would be responsible for self-insured periods, and Wooddale responded to that argument (*see* Docket Nos. 43, 47). In any event, proration to Wooddale was not an issue until the Court of Appeals extended the allocation period through remediation. With a notice end date, the vast majority of the claims against Wooddale were insured and, thus, there was no reason to argue that Wooddale would be responsible for a pro-rata share of the damages. More to the point, however, West Bend offers no explanation as to why this supposed failure to preserve issues favors a remediation end date; and its refusal to look beyond this case is puzzling given that the Court, in concluding that the parties had met the criteria of MRCAP 117 and accepting review, presumably intends to issue a ruling that will have an impact on future cases.

3. West Bend's Unavailability of Insurance Argument is Unsupported by the Record and the Law, and Does not Address the Gap in Coverage Created by its Remediation End Date Position.

Finally, West Bend attempts to downplay the parties' concerns regarding the gap between notice and remediation by suggesting that the insured would not be responsible for the gap if it were unable to obtain liability insurance in the marketplace. This argument, which again draws heavily from other jurisdictions, is contrary to *Domtar* and lacks evidentiary support in the record. More significant, however, if West Bend's analysis is

correct, then damages will be allocated among the insurers in the exact same proportion as if a notice end date were adopted in the first place.

The extrajurisdictional cases upon which West Bend relies are not helpful. In each of those cases, the decision whether to allocate losses to the insured turned on the insured's "assumption of risk" and whether the insured "choose to go bare." See, e.g., *Stonewall Ins. Co. v. Asbestos Claims Management Corp.*, 73 F.3d 1178, 1203-04 (2nd Cir. 1995); *Owens-Illinois, Inc.*, *supra*, 650 A.2d at 995. Thus, if an insured lacked coverage through no fault of its own, then allocation to the insured was deemed inappropriate. *Id.* Not all courts agree with this approach, however. See, e.g., *Mayor & City Council of Baltimore*, *supra*, 802 A.2d at 1101-02 (prorating to insured the period when it had no coverage because of policy exclusions); *Champion Dyeing & Finishing Co., Inc. v. Centennial Ins. Co.*, 810 A.2d 68, 73-74 (N.J. Ct. App. 2002) (insured need not choose to "go bare," if coverage was available but insured for some reason failed to obtain it, insured will be responsible on a pro-rata basis). In *Sybron Transition Corp. v. Security Ins. of Hartford*, 258 F.3d 595 (7th Cir. 2001), for instance, the insured was forced to "self insure" because the cost of obtaining insurance to cover asbestos liability was prohibitive. Although applying the law of New York (the same law predicted by the Second Circuit in *Stonewall*, *supra*), the Seventh Circuit refused to follow *Stonewall*, noting that the "whole idea of time-on-the-risk calculation is that any insurer's share reflects the ratio of its coverage . . . to the total risk" and that the full risk is not affected by whether the insurance later becomes unavailable or the insured chooses to go bare. *Id.* 258 F.3d at 600.

West Bend's (and Wooddale's) unavailability argument is not supported by Minnesota law. Notably, the insured's motivation was not determinative in *Domtar, supra*, wherein this court directly addressed how to allocate losses when the allocation period includes years in which the insured lacks coverage. Although referred to as "self-insured" for 49 of the 64 years in the allocation period, Domtar actually had insurance the entire time but could not prove coverage before 1954 because its policies were lost, or after 1970 when absolute pollution exclusions were incorporated into its policies. *Domtar*, 563 N.W.2d at 729 and n. 2. The court held the insured responsible for the periods of no coverage without considering the insured's state of mind or the reasons it lacked coverage. *Domtar*, 563 N.W.2d at 732-33.

Assuming, however, that the Court is willing to distinguish between insureds who "choose to go bare" and those who lack coverage for other reasons, there is nothing in the record supporting the claim that Wooddale was no longer able to obtain insurance after November 13, 2002 and, thus, nothing that explains the reasons for this claimed uninsurability. But again, West Bend's argument overlooks the big picture and the impact the Court's decision will have on future cases. If in a future case the insured has a policy but coverage is not provided because of an exclusion or because of known loss provisions, the concerns over a potential conflict that are addressed in the opening briefs clearly are presented. If, on the other hand, the insured lacks coverage due to the unavailability of insurance in the marketplace, then, according to West Bend, those years when coverage was

not available are not counted when calculating each insurer's pro-rata allocation.⁵ Yet what is the difference between an allocation period that ends on November 13, 2002 (the expiration of the Western National policy providing coverage when Wooddale receives notice) and one that ends on November 13, 2002 because the loss is now known and the insured cannot obtain coverage? Quite obviously, there is none.

In summary, Appellants and *Amici* have all presented compelling arguments supporting the district court's determination that the allocation period should extend through the date the insured is placed on notice of a claim. This is the most practical and manageable result, reflects the reasonable expectations of the parties and furthers public policy. The Court should reverse the Court of Appeals' decision and confirm that the appropriate end date for determining which policies and parties are on the risk is the date the insured receives notice of a claim.

III. Under Minnesota Law, Defense Costs Should Be Shared Equally By All Insurers Providing Coverage.

As expected, West Bend again looks outside Minnesota to support its claim that defense costs should be allocated pro-rata by time on the risk. There is, however, ample Minnesota authority supporting the equal shares method advocated by Appellants and adopted by the trial court. Those cases and the reasons why they compel a finding that each

⁵ The treatise cited at pages 23 and 24 in West Bend's Brief includes years in which the insurer has no obligation to pay by virtue of the known loss rule in the period of time that, under West Bend's analysis, would be ignored.

insurer must contribute equally to a mutual insured's defense are discussed at length in the parties' opening briefs and will not be repeated here.

West Bend's reliance on cases from other states is misplaced because the pro-rata allocation of defense costs in those cases was based on policy considerations that directly contradict Minnesota law. For instance, many of the decisions are based on equitable principles, as exemplified by *Centennial Ins. Co. v. United States Fire Ins. Co.*, 88 Cal. App. 4th 105, 113 n.3, 105 Cal. Rptr. 2d 559 (2001), the case discussed at pages 33-35 and 37 of West Bend's brief. Equity may be a consideration in California and elsewhere, but it isn't a consideration in Minnesota because, as this Court has repeatedly stated, absent a loan receipt agreement or some prior arrangement between the insurers, an insurer has an independent obligation to defend the insured and has no right of contribution. *See Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 166 (Minn. 1986); *Nordby v. Atlantic Mut. Ins. Co.*, 329 N.W.2d 820, 824 (Minn. 1983); *Iowa National Mut. Ins. Co. v. Universal Underwriters Ins. Co.*, 276 Minn. 362, 150 N.W.2d 233 (1967).

The Minnesota rule denying a right of contribution has as its rationale the fact "that there is no contractual relationship between the two insurers, and the insurer assuming the defense has no cause to complain because it is protecting its own interests and is only doing what it agreed and was paid a premium to do." *Jostens*, 387 N.W.2d at 166. And therein lies the second distinguishing feature between Minnesota law and the law followed in the cases cited by West Bend. The decision to pro-rate defense costs, and to allocate a portion of those costs to the insured, in cases such as *Insurance Co. of N. America v. Forty-Eight Insulations*,

Inc., 633 F.2d 1212 (6th Cir. 1980) is based on the belief that an insurer does not contract to pay defense costs for occurrences which take place outside the policy period. *Id.* at 1224-25. It is, however, well established in Minnesota that if any part of the claim against the insured is even arguably covered, the insurer must defend the entire action, including that portion of the claim that falls outside the scope of coverage because it is either excluded or fails to meet the policy's temporal or occurrence requirements. *Franklin v. Western Nat'l Mut. Ins. Co.*, 574 N.W.2d 405, 406-07 (Minn. 1998). This Minnesota authority compels the conclusion that defense costs must be shared equally by all insurers whose policies are triggered.

Finally, with respect to the allocation of defense costs, West Bend fails to even address the practical problems of allocating defense costs pro-rata by time on the risk while at the same time assigning a fluid, remediation end date for allocation. The impracticality and unworkability of having to constantly reallocate defense costs as the case progresses further supports the trial court's exercise of its discretion to allocate damages through the date of notice and its decision to allocate defense costs equally among all insurers whose policies are triggered.

IV. The Court Should Decline the Invitation to Adopt *In re Silicone's* Discrete Event Rule for Construction Defect Cases.

Finally, two *Amici*, the Defective Construction Homeowners of Minnesota [the "Homeowners"] and the Builders Association of Minnesota ["BAM"], ask the Court to reject outright the application of pro rata by time on the risk allocation in moisture intrusion cases.

See Homeowners' Brief, pp. 9-16; BAM Brief, p. 9 at n. 4. This invitation should be declined.

Whether the trial court abused its discretion in declaring that damages should be allocated by time on the risk is not an issue in this appeal. No party appealed from the trial court's decision to allocate and, thus, the issue was not subject to review by the Court of Appeals. No party raised the issue in a petition or conditional petition for review. Because the issue of whether allocation is appropriate in construction defect cases was not presented and, therefore, the Court does not have the benefit of full briefing by the parties, the issue should not be considered at this time.

However, even if the issue had been properly raised, there is absolutely no dispute in this case that the decision to allocate would be reviewed for an abuse of discretion. Yet, there is no basis for concluding that the trial court abused its discretion in this case. The parties did not, as BAM asserts, "stipulate" to allocation. They submitted unrebutted expert opinions regarding the continuous, progressive nature of the damages alleged and the absence of a single originating event. And although the trial court noted the parties were in agreement regarding allocation, it did not issue its ruling based on that agreement but instead reviewed the expert opinions and independently concluded that allocation was appropriate. Maryland App. 79-80. The trial court did not abuse its discretion.

Allocation decisions are reviewed under an abuse of discretion standard because damages in a continuous injury case are "highly fact-dependent" and the trial courts "must be given flexibility to apportion them in a manner befitting each case." *In re Silicone*, 667

N.W.2d at 417 (*quoting NSP*, 523 N.W.2d at 663). Thus, while the facts of the two cases appended to BAM's brief may not have supported allocation among insurers, the facts of this case do.⁶

The *per se* pronouncement the Homeowners and BAM seek would be inappropriate even if the standard of review were *de novo*. Citing *In re Silicone, supra*, the *Amici* (the Homeowners in particular) urge the Court to reject pro rata allocation in construction defect cases and instead proclaim that moisture intrusion arises out of a single, discrete and identifiable event – the construction itself – such that all damages should be allocated to the policy of insurance that was on the risk at the time construction was completed – the “discrete event.”⁷ This approach, however, does not comport with an actual injury trigger. Commercial general liability policies extend coverage for property damage that occurs during the policy period. Defective construction and poor workmanship, however, are not property damage; and it would be a mistake to equate defective construction with a chemical spill (as in *SCSC Corp. v. Allied Mutual Ins. Co.*, 536 N.W.2d 305 (Minn. 1995)) or a breast implant, both of which result in immediate injury that continues thereafter unabated and independent of any external influences. Poor workmanship may result in conditions that ultimately lead

⁶ For instance, one of the cases cited by BAM, *Westfield Ins. Co. v. Weis Builders, Inc.*, 2004 WL 1630871 (D.Minn. 2004) involved claims for continuous leaking that both began and was discovered during the same policy period in which the construction was completed. On these facts, all damages were allocated to this single policy period.

⁷ Alternatively, the Homeowners argue at pages 9-12 of their brief that the Court should adopt an “all sums” approach even though that analysis has been rejected in Minnesota. See *Domtar*, 563 N.W.2d at 733 n.5.

to physical injury to property one, two or ten years in the future, but it is not, of itself, property damage. Thus, to adopt a *per se* rule for construction defect cases that allocates all damages to the insurer on the risk when construction is completed without regard to whether damage actually occurred during the policy period would be to effectively replace the actual injury trigger with an exposure trigger that is not followed in Minnesota.

Finally, adoption of a single discrete event rule for moisture intrusion cases will not ensure full protection for the insured and injured homeowners, as the Homeowners believe. This is because insurance policies contain limits on the amount of coverage available for each occurrence and include an aggregate limit on the amount of damages the insurer will pay on all occurrences within the policy period. Under a discrete event approach, only one insurance policy is triggered, and once the limits of that policy are exhausted, the insured is personally liable for all further damages. *See SCSC*, 536 N.W.2d at 318. Under the terms of the policies, the duty to defend also ends when the limits are exhausted. *See Maryland App.* 56. The disadvantage to Wooddale of such an approach is highlighted by the year 1994, in which Wooddale constructed and/or closed on a minimum of 16 homes. *Id.* at 31-37. Although the limits of the American Family policy providing coverage for that year are not in the record, if they are assumed to be \$1 million those limits very easily could be exhausted under a discrete event approach, leaving Wooddale and late-filing homeowners to fend for themselves.

In short, the Court need not address, and should not adopt, a discrete event rule for construction defect cases.

CONCLUSION

For all of the reasons discussed above, and in Maryland's opening brief, Maryland Casualty respectfully requests that the court of appeals be reversed and the trial court's declaratory judgment reinstated.

Respectfully submitted,

COUSINEAU McGUIRE CHARTERED

Dated: November 2, 2005

By: Andrea Reisbord

PETER G. VAN BERGEN #112033

ANDREA E. REISBORD #22411X

MINARD M. HALVERSON #247030

Attorneys for Appellant Maryland Casualty
Company d/b/a Zurich North America
1550 Utica Avenue South, Suite 600
Minneapolis, Minnesota 55416-5318
(952) 546-8400

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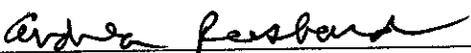
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FOR: Reply Brief of Appellant Maryland Casualty Company, d/b/a Zurich North America

RE: *Wooddale Builders, Inc. v. Maryland Casualty Company, d/b/a Zurich North America v. American Family Insurance Group and Western National Insurance Group and West Bend Mutual Insurance Company and American Economy Insurance Co. (SafeCo),*

State of Minnesota in Supreme Court Nos. A04-1442 and A04-1612

Dated: November 2, 2005



Andrea E. Reisbord #22411X