

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, and
Western National Insurance Group,

Appellants,

and

West Bend Mutual Insurance Company,

Respondent,

American Economy Insurance Co. (SafeCo),

Respondent.

BRIEF OF APPELLANT AMERICAN FAMILY INSURANCE

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STATEMENT OF ISSUES

Should defense costs be borne equally by insurers equally obligated to defend when indemnity is allocated pro rata by time on the risk?

The Court of Appeals held: In the negative.

Apposite Authorities:

Jostens, Inc. v. Mission Ins. Co. 387 N.W.2d 161 (Minn. 1986).

STATEMENT OF THE CASE

These consolidated appeals result from a trial court judgment entered on June 29, 2004, pursuant to an Order filed on June 15, 2004, in a declaratory judgment action. The declaratory judgment action was initiated to determine insurance coverage for water intrusion claims against a general contractor, Wooddale Builders, Inc., and had been broadened to include all of Wooddale's liability insurers from 1990 to 2002.

On cross-motions for summary judgment the trial court, the Honorable Robert A. Blaeser presiding, held on undisputed facts that the indemnity obligations of the insurers should be allocated pro rata by time on the risk, that the start date for allocation of indemnity costs is the date of closing on the purchase of the home at issue in a given claim, and that the end date for allocation purposes is the date on which the insured is put on notice of a homeowner's claim for damages resulting from alleged water intrusion. The trial court also held that the costs of defense should be borne equally by these insurers.

Appeals were taken by two of the insurers regarding the end date for allocation of indemnity obligations and the division of defense costs. The Court of Appeals reversed the trial court on both issues, holding that the end date for purposes of allocating indemnity obligations is the date of remediation and that defense costs are to be allocated among the insurers according to the pro-rata-by-

time-on-the-risk method. Wooddale Builders, Inc. v. Maryland Cas. Co., 695 N.W.2d 399 (Minn. Ct. App. 2005).

This Court has granted Petitions for Review by Wooddale, American Family, Maryland Casualty and Western National. Wooddale challenges the Court of Appeals' decision regarding the end date for indemnity allocation. Maryland Casualty and Western National challenge both the indemnity allocation end date and the allocation of responsibility for defense costs. American Family appeals only the defense cost issue.

STATEMENT OF FACTS

Wooddale Builders, Inc., is a general contractor engaged primarily in the business of constructing single family homes. App. 16. Beginning in late 2000, Wooddale began receiving complaints from the owners of sixty of these homes alleging water intrusion as a result of defective construction and/or faulty workmanship by Wooddale or its subcontractors. *Id.* Ultimately, Wooddale tendered the defense of, and demanded indemnity with respect to, the homeowners' claims to and from each of its insurers. App. 16. The insurers and their respective policy periods are:

American Family:	November 13, 1990-- November 13, 1995
West Bend:	November 13, 1995-- November 13, 1996
Safeco:	November 13, 1996-- November 13, 1997
Maryland Casualty:	November 13, 1997-- November 13, 2000
Western National:	November 13, 2000-- November 13, 2002

App. 16. Each of the policies provides occurrence-based coverage for a term or consecutive terms of one-year.

Dissatisfied with the insurers' responses to these claims, Wooddale brought a declaratory judgment action against Maryland Casualty Company and Maryland, in turn, joined the other insurers seeking contribution or indemnity with respect to indemnity payments and defense costs. App. 1 *et seq.*, 12 *et seq.*

The parties filed cross-motions for summary judgment regarding the allocation of indemnity among the insurers and their respective responsibilities for defense costs. App. 16-17. Uncontroverted affidavits from three experts established that the damages at issue were the product of a continuous process that starts during or after construction and continues until the conditions causing water intrusion are abated and the houses dry out. App. 17-18. The parties agreed that the obligation to indemnify Wooddale should be allocated among the insurers pro rata by time on the risk and that the starting point for allocation should be the closing date on the purchase of the homes. App. 18. They disagreed, however, on the end date for indemnity allocation and on the division of responsibility for defense costs. App. 18.

The district court granted summary judgment applying the accepted formula for allocation of indemnity obligations among the insurers pro rata by time on the risk; holding that the starting date for allocation was the date of original purchase of the house and that the end date for allocation was the date on which Wooddale was notified of each claim; and holding that all insurers on the risk were equally responsible for defense costs. App. 18-19.

On consolidated appeals by West Bend and Safeco, the Court of Appeals reversed the trial court's decisions on the end date for allocating indemnity and the division of defense costs, holding that the end date for indemnity allocation is the

date of remediation and that defense costs should be apportioned among the insurers based upon their time on the risk. Wooddale Builders, Inc., v. Maryland Cas. Co., 695 N.W.2d 399 (Minn. Ct. App. 2005).

STANDARD OF REVIEW

Allocation of defense obligations among insurers is a question of law subject to de novo review. State Farm Ins. Co. v. Seefeld, 481 N.W.2d 62, 64 (Minn. 1992).

ARGUMENT

DEFENSE COSTS MUST BE BORNE EQUALLY BY INSURERS OBLIGATED TO INDEMNIFY PRO RATA BY TIME ON THE RISK WHEN THEY HAVE THE SAME DUTY TO DEFEND AND THE CLAIMS THEY ARE DEFENDING ARE “SO INEXTRICABLY INTERTWINED THEY CANNOT BE FAIRLY SORTED OUT.”

INTRODUCTION

In reversing the trial court’s decision on allocation of defense costs, the Court of Appeals departed from settled precedent, blurred the distinction between insurers’ obligations of defense and indemnity, and adopted a rule that inevitably will increase litigation and frustrate public policy. As the trial court recognized, the same rule that governs the defense obligations of concurrently liable insurers ought to apply to consecutively liable insurers with identical, unlimited duties of defense.¹ By restoring the trial court’s decision to hold consecutive insurers on the same risk equally obligated to defend, this Court will restore predictability, efficiency and fairness to an area of insurance law implicated in cases ranging from “wet houses” to pollution to toxic torts.

¹ “Concurrently” and “consecutively” liable are terms used to discuss insurers’ duties to indemnify. These are misleading labels when it comes to the duty to defend, because in both situations each insurer’s primary defense obligation is triggered at the same time.

LAW AND APPLICATION

The duty to defend is separate and distinct from, and broader than, the duty to indemnify. Brown v. State Auto. & Cas. Underwriters, 283 N.W.2d 822, 825 (Minn. 1980). The duty to defend is indivisible; if any part of a claim is covered, the insurer is obligated to defend the whole claim, including those parts outside of the coverage. Bituminous Cas. Corp. v. Bartlett, 307 Minn. 72, 76, 240 N.W.2d 310, 312 (1976), *overruled on other grounds*, Prahm v. Rupp, 277 N.W.2d 389, 391 (Minn. 1979). This is true regardless of any time limits on coverage. *See*, Domtar, Inc. v. Niagara Fire Ins. Co., 563 N.W.2d 724 (Minn. 1997).² In fact, the duty to defend the whole claim may exist even where it is later determined that there is no obligation to indemnify the insured for any part of the claim. *See*, Economy Fire & Cas. Co. v. Iverson, 445 N.W.2d 824, 827 (Minn. 1989).

Every one of Wooddale's insurers has an unlimited, independent, and primary defense obligation regardless of the timing of "actual injury." Any one of them could have been called on to defend Wooddale. In fact, Wooddale initially tendered its defense to Maryland Casualty alone. Wooddale had a perfect right to do so because each and every one of these insurers contracted to be the primary provider of a defense in the event that Wooddale faced claims arguably within the

² Despite a number of years with "actual injury" but no coverage, this Court affirmed an award of all of the insured's defense costs. Domtar, *supra* 563 N.W.2d at 739.

insurer's coverage. When Maryland Casualty joined Wooddale's other insurers with the same primary defense duties, a question arose as to how to divide the defense costs among them. That question already had been answered.

Almost twenty years ago, this Court held that two insurers with "primary coverage for a claim both have [an equal duty] to defend that claim." Jostens, Inc. v. Mission Ins. Co. 387 N.W.2d 161, 165 (Minn. 1986). Where multiple insurers are found to have a primary defense duty, the next step is to apportion defense costs between them:

We remand, therefore, for the trial court to apportion the Wepler defense costs between Wausau and Mission. If defense costs for the two sets of claims are so inextricably intertwined they cannot be fairly sorted out, the costs may be equally divided.

Jostens, Inc., supra, 387 N.W.2d, at 168. (Emphasis added.)

The rule adopted in Jostens was grounded in practicality, public policy and, perhaps most importantly, in the parties' contracts. Both insurers had "bargained for primary coverage." Jostens, Inc., supra, 387 N.W.2d at 168. This Court believed that the insured was entitled to a defense and should not be left to its own devices while its insurers fought about their respective shares of the defense obligation. A rule was needed which would "encourage two insurers, when tendered a defense, to resolve promptly the duty to defend issue" rather than taking

a “wait and see” approach. Jostens, Inc., supra, 387 N.W.2d at 167. Jostens provided that rule.

After Jostens, the process is straightforward. If multiple insurers have primary defense duties we look to whether the claims for which each is responsible are sufficiently different so that the costs of defending those claims can be apportioned between the insurers. But if the “defense costs for the two sets of claims are so inextricably intertwined they cannot be sorted out,” then there is no alternative but to divide those costs equally between the insurers.

In our case, multiple insurers with identical defense obligations are confronted simultaneously with the same claim. The defense costs cannot be “sorted out” so, Jostens dictates, the defense costs have to be divided equally among the insurers. The trial court appreciated this but the Court of Appeals did not. The Court of Appeals took a wrong turn when it distinguished Jostens on false grounds:

Thus, equal division of the claims was a default only where allocation based on each insurer’s actual liability proved practically impossible.

Wooddale Builders, Inc., v. Maryland Cas. Co., 695 N.W.2d 399, 406 (Minn. App. 2005). [Emphasis added.] The “liability” the appeals court refers to is the Wooddale insurers’ liability for indemnity, which can be “sorted out” according to the timing of “actual injury” and apportioned pro rata by time on the risk.

Northern States Power Co. v. Fid. & Cas. Co. of New York, 523 N.W.2d 657

(Minn. 1994). But the cost of defense, not the obligation to indemnify, is the issue here. Because the insurers' obligations to defend are not limited to those claims based on damages occurring within their respective policy periods and are independent of the insurers' duties to indemnify their insured, the defense costs are "inextricably intertwined" and must be divided equally, as Jostens dictates.

There is no rationale for applying a different rule for allocating defense costs in this case than in Jostens. Whether or not the indemnity obligations of these insurers can be sorted out by time on the risk, they each have an identical duty to defend the same claim at the same time, with no limit as to dollar amount. So long as some damage is alleged to have occurred during their respective policy periods, each insurer has an obligation to defend all claims for damages occurring at any time. As the appeals court observed, it is beyond dispute that this case involves "one continuous occurrence." Wooddale, supra, 695 N.W.2d at 406. In this setting, and in reference to the duty to defend, the distinction between concurrent and consecutive indemnity duties is a distinction without a difference. The distinction is, as a matter of law, irrelevant. The only question is whether defense costs can or cannot be sorted out. If they cannot be, as they cannot be here, they must be divided equally.

The Court of Appeals calls equal division of defense costs among insurers with identical duties a “default” situation. Wooddale, supra, 695 N.W.2d at 406. In that respect, it is akin to the situation in which we find ourselves when multiple insurers have a duty to indemnify for “a continuous process in which the damage is evenly distributed over the period of time from the first contamination to the end of the last triggered policy (or self-insured) period.” Northern States Power, supra, 523 N.W.2d at 664. This Court approved allocation of indemnity pro rata as a “default” in that situation for exactly the same reason it approved equal division of defense costs in this situation: it is the only way to honor the parties’ contractual undertakings when insurers’ obligations cannot be sorted out.

The Court of Appeals was persuaded by West Bend’s argument that it is not “fair” to impose the same defense obligation on an insurer with just one-tenth of the coverage as on an insurer with half of it. Wooddale, supra, 695 N.W.2d at 407. But that argument overlooks the fact that West Bend, like every other one of these insurers, bargained for a primary defense obligation that is not limited contractually either by dollars or by time on the risk. West Bend could have been the only insurer Wooddale called on to defend, or the only solvent insurer left standing when suit was commenced, and West Bend would have been contractually obligated to defend the entire suit at its sole expense even if

ultimately it only had to indemnify for its time on the risk.³ By contract, West Bend's indemnity obligation is limited to occurrences causing "actual injury" during its time on the risk. But, by contract, West Bend's defense obligation is primary and unlimited. Requiring payment of an equal share of defense costs by insurers sharing an indivisible duty to defend is not an imposition on any insurer; it is merely a reflection of the obligation the insurer bargained to assume.

Jostens tells us that public policy and practicality compel an equal division of defense costs among these insurers. The supposedly "better reasoned approach" selected by the Court of Appeals, Wooddale, supra, 695 N.W.2d at 407, does not prove to be the better reasoned approach at all when we look at this problem in real world terms.⁴

Allocation of defense costs by time on the risk thwarts the public policy goal that motivated this Court in Jostens: prompt resolution of duty to defend issues and timely assumption of the duty to defend. Under the pro rata rule adopted by the Court of Appeals, insurers are motivated to dispute their time on the risk and to adopt exactly the "wait and see" attitude that this Court has found to be abhorrent.

³ This is the Domtar situation.

⁴ The foreign cases from which this rule derives are not well reasoned at all. The original formulation of the pro rata by time on the risk rule for defense cost allocation comes from Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc., 633 F.2d 1212, 1225 (6th Cir. 1980) where the only articulated rationale is: "There is no reason why this same theory [indemnity allocated by time on the risk] should not apply to defense costs." The cases that follow Forty-Eight Insulations do so with a similar lack of analysis.

What happens when the duty to defend is assessed by time on the risk? Do insurers defend provisionally, pursuant to a loan receipt, and then litigate their final shares later? Are defense costs subject to repeated reallocations as the case drags on? What happens when there has been actual injury during uninsured periods; is the insured allocated a share or are the insurers required to reallocate the uninsured share of defense costs among themselves when the time on the risk issue is resolved?

Consistent application of the Jostens rule avoids all of these problems. It imposes equal defense duties on all of the insurers which have bargained for sole responsibility for the defense of claims within their coverage and which, by law, have a duty to defend all claims in that case. When we focus properly, on the duty to defend rather than the duty to indemnify, there is no unfairness to an insurer on the risk for just one year, like West Bend. Holding that insurer equally responsible for the cost of defense is only holding that insurer to what it bargained to do: defend without limits on the cost of defense. The trade-off, of course, is an equal right of control over how the case is defended and resolved, no small opportunity in

circumstances where the indemnity costs are as substantial as they are in these wet house cases, or even higher in pollution cases or cases involving toxic torts.

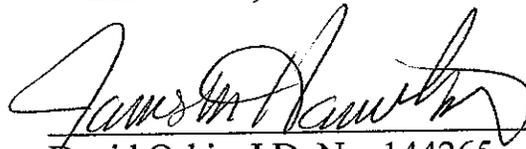
CONCLUSION

The Court of Appeals' decision to allocate defense costs pro rata by time on the risk must be reversed and the trial court's decision to impose defense costs equally on Wooddale's insurers must be restored.

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Respectfully submitted,

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).