

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.*

**BRIEF AND APPENDIX OF APPELLANT MARYLAND CASUALTY  
COMPANY, D/B/A ZURICH NORTH AMERICA**

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## ISSUES PRESENTED

**I. What Is 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?**

The Court of Appeals reversed the trial court’s conclusion that the appropriate end date is the date on which the insured is placed on notice of a potential claim, and held that the allocation period should extend to the date on which the damage is repaired.

*Northern States Power Co. v. Fidelity & Cas. Co. of New York*, 523 N.W.2d 657 (Minn. 1994).

*Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997)

*Hooper v. Zurich American Ins. Co.*, 552 N.W.2d 31 (Minn. App. 1996), *pet. for rev. denied* (Minn. Sept. 20, 1996).

**II. Should Defense Costs Be Shared Equally among Insurers in Cases in Which the Pro-rata by Time on the Risk Allocation Method Is Applied to Payment of Damages?**

Reversing the trial court on this issue as well, the Court of Appeals held that defense costs should also be allocated pro-rata by time on the risk.

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

*Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997)

*Franklin v. Western Nat’l Mut. Ins. Co.*, 574 N.W.2d 405 (Minn. 1998), *rehearing denied* (Minn. Mar. 3, 1998).

*Reinsurance Ass’n of Minnesota v. Timmer*, 641 N.W.2d 302 (Minn. App. 2002), *pet. for rev. denied* (Minn. May 14, 2002).

## STATEMENT OF THE CASE

Appellant Maryland Casualty Company seeks review of a Minnesota Court of Appeals' decision filed May 3, 2005. The underlying litigation was a declaratory judgment action to determine insurance coverage and the allocation of responsibility among multiple insurers for defense costs and indemnity payments for claims of property damage caused by water infiltration in homes constructed by the mutual insured, Appellant Wooddale Builders, Inc. Ruling on the parties' cross-motions for summary judgment, the trial court, the Honorable Robert A. Blaeser presiding, concluded that, due to the continuous and indivisible nature of the damages alleged, the appropriate method of allocating damages between the insurers was pro-rata based on each insurer's time on the risk. App. 80. The trial court further concluded that the starting date for allocation purposes should be the date of closing on the original purchase of each home, with each end date being the date on which Wooddale was put on notice of the claim for damages. *Id.* With respect to defense costs, the trial court concluded that the costs should be shared equally between all insurers whose policies were triggered. App. 81.

West Bend Mutual Insurance Company appealed from the decision of the trial court.<sup>1</sup>

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<sup>1</sup> American Economy Insurance Company ("Safeco") also appealed, but did not challenge the trial court's conclusions regarding the allocation end-date or the allocation of defense costs. Instead, it merely requested clarification as to whether each triggered policy should provide a full year of coverage regardless of the number of months, weeks or even days the insurer was on the risk. In other words, Safeco sought clarification as to whether allocations should be based on the number of years each insurer was on the risk, or some lesser increment. Safeco's appeal, however, was dismissed by the Court of Appeals in its May 3, 2005 decision.

The Court of Appeals, in a published decision released on May 3, 2005, reversed the trial court on both issues, holding that the appropriate ending date when allocating liability among consecutive insurers according to the pro-rata by time on the risk method is the date of remediation, and that defense costs should be allocated according to the same method used to apportion indemnity costs. *See Wooddale Builders, Inc. v. Maryland Casualty Co.*, 695 N.W.2d 399 (Minn. App. 2005). This Court granted the various Appellants' Petitions for Review on July 19, 2005.

## STATEMENT OF FACTS

Wooddale Builders, a general contractor, constructed a number of stucco covered homes during the 1990's. App. 9. Beginning in late 2000, Wooddale began receiving complaints of defective construction or faulty workmanship from homeowners who were experiencing water infiltration problems. App. 10. Wooddale ultimately received over 60 claims for water infiltration and mold growth in homes it constructed. App. 36, 37, 78.

Wooddale initially commenced this declaratory judgment action against Appellant Maryland Casualty Company, d/b/a Zurich North America ("Maryland"), seeking a declaration that Maryland was obligated to indemnify it against the homeowners' claims. App. 9-18. Maryland, in turn, filed a Third-Party Complaint against Appellant American Family Insurance, Appellant Western National Insurance Group, Respondent West Bend Mutual Insurance Company and Respondent SafeCo, each of whom insured Wooddale under an occurrence-based commercial general liability policy during the following policy periods:

<u>Insurer</u>	<u>Policy Period</u>	<u>Years of Coverage</u>
American Family	November 13, 1990 - November 13, 1995	5
West Bend	November 13, 1995 - November 13, 1996	1
SafeCo	November 13, 1996 - November 13, 1997	1
Zurich	November 13, 1997 - November 13, 2000	3

App. 20-22, 78. Western National was the last insurer joined in the lawsuit because it was the insurer on the risk when Wooddale began receiving complaints from homeowners. No party, least of all Wooddale, sought to join any insurers which came on the risk after Wooddale was on notice of the construction defect claims.

The Insuring Agreement to the Maryland policy is typical of all policies and provides, in pertinent part, as follows:

We will pay those sums that the insured becomes legally obligated to pay as damages because of . . . “property damage” to which this insurance applies. We will have the right and duty to defend any “suit” seeking those damages. . .

\* \* \* \*

This insurance applies to . . . “property damage” only if:

- (1) The “property damage” is caused by an “occurrence” that takes place in the “coverage territory;” and
- (2) The . . . “property damage” occurs during the policy period.

App. 56, 73. Each policy further defines an occurrence to mean “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.”

App. 67, 76. The most recently acquired policy, obtained from Western National in 2001, however, includes a “Known Injury or Damage” endorsement not found in the earlier policies that specifically addresses coverage for claims involving continuous injury. App. 51. This endorsement essentially precludes coverage under the policy if the insured receives a

demand or claim for damages or is aware that property damage has occurred or has begun to occur prior to the start of the policy period. *Id.*

None of the parties have disputed that the damages for which Wooddale seeks coverage arise from water intrusion. Nor has there been any dispute that the damages have resulted from a continuous process involving numerous water intrusion events occurring over the life of the residences. App. 79-80. Uncontroverted affidavits from three experts have established that the deterioration, decay and mold conditions present at the Wooddale homes were the product of a series of events and conditions over time and that the damage occurred as a continuous process that is indivisible over time from initial water intrusion until the conditions causing that intrusion are abated and the houses dry out. *See* Pashina, Pearce and Lstiburek Affidavits at App. 23-46. Based on these affidavits, the parties essentially agree 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 original purchase of each home. *See* 695 N.W.2d at 403. The parties, however, disagree on the appropriate end date for allocation and on how to allocate defense costs.

## STANDARD OF REVIEW

On appeal from a grant of summary judgment, the reviewing court must determine whether there are genuine issues of material fact presented by the parties and whether the trial court erred in its application of the law. *Offerdahl v. University of Minnesota Hospitals & Clinics*, 426 N.W.2d 425, 427 (Minn. 1988). When, as in this case, the material facts are not in dispute, a reviewing court need not defer to the trial court's application of the law. *Hubred v. Control Data Corp.*, 442 N.W.2d 308, 310 (Minn. 1989).

The interpretation and construction of an insurance policy is a matter of law that the trial court can properly determine on summary judgment and is reviewable *de novo* on appeal. *Iowa Kemper Ins. Co. v. Stone*, 269 N.W.2d 885, 886-87 (Minn. 1978). Likewise, the allocation of defense costs among insurers also presents a question of law subject to *de novo* review. *State Farm Ins. Co. v. Seefeld*, 481 N.W.2d 62, 64 (Minn. 1992). The trial court's allocation decisions, however, are reviewed under an abuse of discretion standard. *See In re Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405, 417 (Minn. 2003).

## ARGUMENT

Each of the trial court's rulings in this case gives effect to a fundamental and important principle of insurance law. The trial court's conclusion that damages should be borne by each insurer whose policy is triggered in proportion to the time that each insurer was on the risk recognizes that, under an occurrence-based insurance policy, the insurer should be liable only for those damages that occur during its policy period. *See Northern State Power Co. v. Fidelity & Cas. Co. of New York*, 523 N.W.2d 657, 662 (Minn. 1994). Likewise, the trial court's selection of the date on which Wooddale received notice of each claim as the end date for allocation purposes was the most logical and practical, providing a bright-line test to identify the last triggered policy, minimizing the potential for manipulation by insurer, insured or claimant, and giving effect to the basic notion, conceded by Wooddale itself, that insurance is purchased not to cover loss, but to cover the risk of loss. *See Waseca Mut. Ins. Co. v. Noska*, 331 N.W.2d 917, 924-25 n. 6 (Minn. 1983). Finally, the trial court's conclusion that, notwithstanding the pro-rata allocation of damages, the defense costs should be borne equally by all insurers whose policies are triggered advances the well-established principle that the duty to defend is distinct from the duty to indemnify, is indivisible, and arises if any part of the claim against the insured is arguably within the scope of coverage. *See Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 167 (Minn. 1986); *Reinsurance Ass'n of Minnesota v. Timmer*, 641 N.W.2d 641 N.W.2d 302 (Minn. App. 2002), *pet. for rev. denied* (Minn. May 14, 2002).

In contrast, the Court of Appeals' conclusion that the allocation period extends until the damages are repaired is problematic and impractical. Choosing remediation as the end date raises several questions as to the proper application of "known loss" principles, whether they arise under the common law or through contractual provisions such as the Known Injury or Damage endorsement to the Western National policy, and increases the likelihood of uninsured exposure that must be absorbed by the insured or, in some cases, the injured claimant. This inevitably creates a conflict between insurers and the insured regarding the conduct of the insured's defense, and the speed and scope of repair efforts. This conflict and confusion is further compounded by the Court of Appeals' error in adopting a time on the risk method of allocating defense costs that is at odds with longstanding law regarding the duty to defend.

**I. The Date on Which Wooddale Received Notice of a Claim is the Most Practical End-Date For Allocation and is Most Consistent With Public Policy.**

**A. Minnesota Applies the Time on the Risk Method of Allocating Damages In Cases Involving Continuous and Indivisible Property Damage.**

In order to provide the Court with a context for the present dispute, it is helpful to again summarize the Court's treatment of the time on the risk method of allocating damages that are continuous and indivisible.

The starting point for any allocation analysis is the language of the insurance policy at issue. In this case, each insurer's policy states, in the Insuring Agreement, that the insurance applies to property damage only if the property damage (physical injury or loss of use) "occurs during the policy period." *See, e.g.* App. 56, 73. Consistent with this language,

common to most occurrence-based CGL policies, Minnesota has adopted the “actual injury” or “injury in fact” trigger rule under which policies in effect when the complaining party actually sustains damage are “triggered” and required to respond to a loss. See *In re Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405, 415 (Minn. 2003). “The essence of the actual injury trigger theory is that each insurer is held liable only for those damages which occurred during its policy period; no insurer is held liable for damages outside its policy period.” *Northern States Power Co. v. Fidelity & Cas. Co. of New York*, 523 N.W.2d 657, 662 (Minn. 1994).

Questions concerning allocation typically have arisen in cases involving continuous injuries arising from environmental and biological contamination. *In re Silicone*, 667 N.W.2d at 417 (citing *NSP, supra*; *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305 (Minn. 1995); and *Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997)). From these cases has evolved a general principal that when injury is “continuous and indivisible,” costs should be allocated evenly between all policies on the risk from the first point at which damages occur to the time of discovery or clean up. *Domtar*, 563 N.W.2d at 732; *NSP*, 523 N.W.2d at 663. This is based on the assumption that damages are “evenly distributed (or continuous) through each policy period from the first point at which damages occurred to the time of discovery, clean up or whenever the last triggered policy period ended.” *NSP*, 523 N.W.2d at 663. However, in cases in which a continuous injury arises from a discrete and identifiable event, those policies on the risk at the point of initial

contamination may be liable for all property damage that flows from that event. *In re Silicone*, 667 N.W.2d at 420-21; *SCSC*, 536 N.W.2d at 318.

More recently, this Court, articulated an “analytical progression” for determining whether allocation among successive insurers is appropriate in a given case. *In re Silicone*, 667 N.W.2d at 421. Under this “analytical progression,” the court must make a preliminary determination whether the claimed injuries are continuous. *Id.* When the injuries are continuous, the next step in the analytical progression asks whether that continuous injury arose from some discrete and identifiable event. *Id.* If not, allocation may be appropriate.

The trial court’s decision in this case addressed both steps of the “analytical progression.” It determined that the damages claimed were indeed continuous. App. 79, 80. And properly so, given the un rebutted expert opinions that the damages occurred as a continuous process. Those un rebutted affidavits also established that the damages claimed by the homeowners resulted from numerous and ongoing instances of water intrusion and “cannot be determined to have occurred at a specific time or times or as the result of discrete and identifiable events.” *See* App. at 39 (Pearce Aff., ¶ 3. A.). *See also* Pashina Report, pp. 3-4 at App. 27-28; Lstiburek Aff. at App. 44-46. In light of the continuous and progressive nature of the claimed damages and the absence of any single discrete and readily identifiable event, the trial court properly determined that the time on the risk allocation method applied in this case.

**B. The Court Should Adopt the Notice End Date.**

Although this Court permits allocation in cases involving a continuous and indivisible injury, Minnesota case law provides little guidance for determining the proper end date in cases in which allocation is appropriate. In *NSP*, for instance, the Court referenced both “clean up” and time or point of discovery. *NSP*, 523 N.W.2d at 663, 664. *NSP* also references “whenever the last triggered policy period ended,” but does nothing further to identify the “last triggered policy.” *Id.* But as the Minnesota Court of Appeals later commented in *In re Silicone*, the length of the allocation period was not at issue in *NSP*. *In re Silicone Implant Ins. Coverage Litigation*, 652 N.W.2d 46, 61 (Minn. App. 2002). Nor, ultimately, was the length of the allocation period an issue in *In re Silicone* given this Court’s conclusion that allocation was improper in that case.<sup>2</sup> Likewise, the Court in *Domtar*, was concerned primarily with the question of whether damages should be allocated to years in which *Domtar* lacked coverage and did not engage in any discussion concerning the appropriate end date for allocation purposes or how that date should be determined. *See Domtar, generally*, 563 N.W.2d 724.

Although the appellate courts have not specifically addressed the appropriate end date for allocation purposes, this Court has nevertheless emphasized that flexibility is required and that allocation decisions must be guided by basic insurance principles:

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<sup>2</sup> The court of appeals in *In re Silicone*, however, had set the end date at the **earlier** of the date each underlying plaintiff filed her lawsuit or died. *In re Silicone*, 652 N.W.2d at 61-62.

[W]e are not faced with the question of whether these claims are “damages” but with how to allocate liability between insurers. This is a very different issue, one which may require a more flexible approach. As with all insurance contract-related issues, courts must consider many factors when deciding this issue, including the policy language, parties’ intent or reasonable expectations, canons of construction and public policy.

*NSP*, 523 N.W.2d at 661. See also *In re Silicone*, 667 N.W.2d at 417 (“We have stated, however, that damages are very fact-dependant, so ‘trial courts must be given the flexibility to apportion them in a manner befitting each case.’”) (quoting *NSP*, 523 N.W.2d at 663). And, significantly, the Court has emphasized the need for practical and manageable solutions to questions concerning allocation. See *Domtar*, 563 N.W.2d at 733-34; *NSP*, 523 N.W.2d at 663, 665.

In this case, and all others involving continuous and indivisible damages, the allocation end date that most advances the guiding considerations articulated by the *NSP* court is the date on which the insured receives notice of a claim. The notification end date selected by the trial court without question is the most practical and manageable. It is relatively easy to identify and is fixed, making it easier for insurers and insureds to calculate their respective potential liabilities early in a case, and to proceed based on that assessment of their respective risks. With a notice end date the risk of manipulation by an insurer, insured or claimant is minimized. And, equally significant, the adoption of a notification end date avoids any application, rejection or even consideration of “known loss” or fortuity principles, thereby affording the greatest protection to the insured, claimants and subsequent insurers consistent with their reasonable expectations, policy language and public policy.

The Court of Appeals, in adopting the remediation end date, recognized that its selection of that particular date would create a gap (between the time the insured received notice and repair) for which liability would need to be assigned to either the insured or one or more of its insurers. Yet its decision fails to provide a clear answer to this question, and further fails to consider the impact of a remediation end date on this case, and in future cases involving continuous injury. Consistent, however, with this Court's holdings in *NSP* and *Domtar*, the reasonable expectations of the parties, and the language of more recent CGL policies, liability for the share of damages occurring between notice and remediation will be assigned to the insured.

Neither Wooddale, nor any of its insurers, expected that Wooddale would have insurance coverage for the period between the end of the Western National policy (the policy providing coverage when Wooddale was placed on notice of a claim) and remediation or repair. Indeed, this point was vigorously argued by Wooddale to the Court of Appeals in support of Wooddale's position that the end date for allocation should be the date it receives notice of a claim:

[I]t would be fundamentally unfair to require an Insurer that issued a policy after Wooddale knew of a claim to indemnify Wooddale for that particular claim. Wooddale did not contract, and certainly the insurer did not intend, for indemnification of claims known when the policy was purchased and issued.

*See* Wooddale Court of Appeals Brief at p. 12.

No other insurers were joined, because no one, Wooddale included, reasonably expected that any subsequent insurers would be obligated to provide coverage for the claims.

This reasonable expectation was based on “known loss” considerations that have long been recognized by the appellate courts of this state. This Court most recently addressed the “known loss” doctrine in *Domtar*, explaining the doctrine as follows:

Insurance cannot be issued for a known loss. *Oster v. Riley*, 276 Minn. 274, 287, 150 N.W.2d 43, 52 (1967) (Otis, J., dissenting). Once the loss has occurred there is no longer any “risk.” Hence, where the loss has occurred prior to the application for insurance, the relevant question is . . . whether the parties, particularly the insured, knew of the loss at the time of the application, since the knowledge would be nearly conclusive evidence of bad faith.

*Domtar*, 563 N.W.2d at 737 (quoting *Waseca Mut. Ins. Co. v. Noska*, 331 N.W.2d 917, 924-25, n. 6 (Minn. 1983)). Based on this language, the Court commented that “known loss” is essentially a fraud-based defense requiring “proof that the insured withheld material information concerning the existence of property damage, . . ., for which the insured subsequently obtained insurance.” *Id.* The insured need not know the exact nature or extent of the damage as long as there is evidence that the insured knew of the property damage when it purchased insurance that would otherwise have covered the loss. *Id.*<sup>3</sup> Under *Domtar*, once the insured is placed on notice of a claim, the loss is known and, as Wooddale acknowledges, cannot thereafter be insured on subsequently purchased policies.

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<sup>3</sup> While recognizing the “known loss” doctrine, the *Domtar* court rejected its application to the particular facts in that case because there was no evidence in the record that the insured knew prior to its purchase of the policy in 1965 that an actual loss, as opposed to a potential for loss, had occurred. *Domtar*, 563 N.W.2d at 737. The Court of Appeals in this case acknowledged the distinction between knowledge of a potential for loss and knowledge that an insurable loss has occurred. *See* 695 N.W.2d at 405.

Application of the “known loss” doctrine to insurers who come on the risk after the insured has actual notice of a claim was specifically addressed by the court of appeals in *Hooper v. Zurich American Ins. Co.*, 552 N.W.2d 31 (Minn. App. 1996), *pet. for rev. denied* (Minn. Sept. 20, 1996). In that case, Hooper was insured by Zurich when he was sued in 1994. In 1995, coverage was switched to Western National, which was on the risk when an Amended Complaint was served upon Hooper. Citing *Noska* and *Oster*, the court of appeals noted that insurance is procured not to cover loss, but to cover the risk of loss. *Hooper*, 552 N.W.2d at 34-35. Because Hooper acquired the Western National policy not when it risked being sued, but after it had been sued, the loss was in progress and Hooper could not at that point insure against it. *Id.*

The parties’ reasonable expectation that Wooddale would not have insurance coverage for the gap between notice and remediation is further supported by a consideration of policy language. As the Western National policy demonstrates, “known loss” is no longer a common law or doctrinal defense to coverage, but is instead a contractual defense. Under the Known Injury or Damage endorsement, the language of which is increasingly being incorporated into CGL policies, the insurance applies to bodily injury and property damage only if the injury occurs during the policy period and:

- (3) Prior to the policy period, no insured . . . and no “employee” authorized by you to give or receive notice of an “occurrence” or claim, knew that the “bodily injury” or “property damage” had occurred, in whole or in part. If such a listed insured or authorized “employee” knew, prior to the policy period, that the “bodily injury” or “property damage” occurred, then any continuation, change or resumption of such “bodily injury” or

“property damage” during or after the policy period will be deemed to have been known prior to the policy period.

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- d. “Bodily injury” or “property damage” will be deemed to have been known to have occurred at the earliest time when any insured . . . or any “employee” authorized by you to give or receive notice of an “occurrence” or claim:
- (1) Reports all, or any part, of the “bodily injury” or “property damage” to us or any other insurer;
  - (2) Receives a written or verbal demand or claim for damages because of the “bodily injury” or “property damage”; or
  - (3) Becomes aware by any other means that “bodily injury” or “property damage” has occurred or has begun to occur.

App. 51. Unlike the “known loss” doctrine as interpreted by the Court in *Domtar*, there is no fraud element to the contractual defense. Coverage is not available under the policy if, prior to the start of the policy period, the insured or any of its representatives receives a demand or claim for property damage or is otherwise aware that property damage has begun to occur. This policy language, and its absence of any requirement that the insured act with improper motives, would be controlling because, as this Court recently held, in the absence of an ambiguity the extent of an insurer’s liability is governed by the contract entered into, and not by general principles or doctrines. *See Thommes v. Milwaukee Ins. Co.*, 641 N.W.2d 877, 882 (Minn. 2002).

Likewise, the fundamental policy requirement that property damage during the policy period be caused by an occurrence prevents the triggering of policies providing coverage

subsequent to the date the insured is put on notice of the claim. The term “occurrence” is defined in the various policies to mean “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” *See, e.g.*, App. 67, 76. An “accident” for purposes of an occurrence-based liability policy means “an unexpected, unforeseen, or undesigned happening or consequence.” *See American Fam. Ins. Co. v. Walser*, 628 N.W.2d 605, 611 (Minn. 2001). Once an insured is placed on notice of property damage resulting from construction defects, any continuation of that damage is foreseeable or expected and can no longer be considered accidental. *See, e.g., Domtar, Inc. Niagra Fire Ins. Co.*, 552 N.W.2d 738, 747 (Minn. App. 1996) (“Just as Minnesota law recognizes that an accident occurs when damage is done, a loss is accidental when insurance is purchased before the insured knows that a loss has occurred.”), *rev’d in part on other grounds by Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997). This absence of an occurrence prevents the triggering of any policies that come on the risk after the insured is placed on notice of a claim.

Related to both the known loss rule and the requirement of an occurrence in particular is the concept of fortuity. Specifically, insurance is designed to protect against fortuitous losses. *See Bituminous Cas. Corp. v. Bartlett*, 307 Minn. 72, 78, 240 N.W.2d 310, 313 (1976), *overruled on other grounds, Prahm v. Rupp Constr. Co.*, 277 N.W.2d 389, 391 (Minn. 1979). *See also Sentinel Management Co. v. New Hampshire Ins. Co.*, 563 N.W.2d 296, 299 (Minn. App. 1997). An occurrence is fortuitous if the outcome of the event is not known in advance by the insured. *Bituminous Cas. Corp.*, 307 Minn. at 78, 240 N.W.2d at

313 n. 8 (citing Herbert S. Denenberg, et. al., *Risk and Insurance* 146). The requirement that a loss be fortuitous is central to the basic principle that insurance is purchased to cover risk of loss:

. . . [T]he insurer is in the business of distributing losses due to such property damage among a large number of policyholders. It is able to properly set premiums and supply coverage only if those losses are uncertain from the standpoint of any single policyholder.

*Bituminous*, 307 Minn. at 78, 240 N.W.2d at 313. See also *Sentinel*, 563 N.W.2d at 299.

One simply cannot insure against a certainty. *Bituminous*, 307 Minn. at 78, 240 N.W.2d at 313 n. 8.

The interrelationship between the fortuity requirement, known loss principles and the liability policy's occurrence requirement was noted by the court of appeals in *Domtar*:

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*, 552 N.W.2d at 746. Considering the insurer's fortuity argument as a part of its known loss defense, the court of appeals found no factual basis for application of the doctrine because there was no evidence to suggest that *Domtar* knew of its loss when it purchased its policies. *Id.*, 552 N.W.2d at 747. This Court affirmed on similar grounds, noting there was no specific reference to fortuity as a requirement for coverage, but nevertheless suggesting that the defense is reflected in a liability policy's requirement that damage be unexpected. *Domtar*, 563 N.W.2d at 737.

Finally, in addition to the known loss limitation, and occurrence and fortuity requirements there may be other contractual defenses to coverage. As the Minnesota Attorney General noted in his *amicus* request, certain types of property damage exposures – water intrusion, gradual pollution and asbestos, for example – are increasingly subject to exclusions and limitations increasing the likelihood that some of the years between notice and remediation will be uninsured.

The practical effect of the Court of Appeals' ruling is that the insured inevitably will bear responsibility for the period between the end of the last triggered policy and remediation, as even Wooddale itself has acknowledged. *See Domtar*, 563 N.W.2d at 727 (syllabus) and 732-33 (insured is responsible for pro-rata share of damages for the periods it lacks coverage). This result gives rise to a separate set of policy concerns that also were inadequately addressed by the Court of Appeals. Most notably, the adoption of a remediation end date creates a very real conflict between insurers and the insured regarding the speed and scope of repair efforts. On the one hand, the Insuring Agreement found in most CGL policies does not simply impose upon the insurer a duty to defend the insured, but also gives the insurer the right to defend and, in furtherance of that right and duty, authorizes the insurer to investigate and settle the claim as it sees fit. *See, e.g.*, CGL Forms at App. 56, 73. In other words, the insurer has the right to contest and possibly minimize the insured's liability and damages by defending the case regardless of how long that might take. On the other hand, faced with the possibility of personal exposure, the insured's interest will be to settle the claims or repair the property damage as quickly as possible, ideally before the end of the last

triggered policy period. An insured who does so, however, risks voiding coverage as CGL policies typically contain a cooperation clause prohibiting the insured, except at its own expense, from voluntarily making any payment, assuming any obligations, or incurring any expense without the insurer's consent. *See App. 64, 74.*

The Court of Appeals' suggestion that neither the insured nor the insurer has an incentive to delay repair efforts because such a delay will result in additional decay and expense for the insured and the insurer on the risk, assuming added expenses to be true, is overly simplistic and fails to recognize the far-reaching impact of its allocation decision and the very real conflicts that decision creates. The fact that repair efforts may cost slightly more in subsequent years hardly provides an incentive for the insurer to cave in and settle what might be a defensible or even overinflated claim. Unlike a remediation end date, the notice end date permits insurers to investigate claims against the insured and provide a defense without conflict or the appearance of prejudice to the insured. In this regard, as well, the date on which the insured is placed on notice of a claim is the most practical and manageable end date for allocation purposes.

**II. The Court of Appeals' Decision Allocating Defense Costs Pro-Rata by Time on the Risk Must Be Reversed as Well Because it is Contrary to the Longstanding Rule in Minnesota that an Insurer's Obligation to Defend its Insured is an Indivisible One.**

The Court of Appeals' decision to allocate defense costs using the same methodology applied to the allocation of indemnity costs, *i.e.* pro-rata by time on the risk, conflicts with well-settled insurance principles and fails to fully appreciate the distinction between an

insurer's duty to defend and its duty to indemnify. And like its decision regarding the end date for allocation purposes, indeed because of that decision, the Court of Appeals in pro-rating defense costs, has chosen a solution that is neither practical nor manageable.

The principles that govern an insurer's duty to defend its insured are by now well established. Notably, an insurer's duty to defend is distinct from and broader than its duty to indemnify the insured. *See, e.g., Franklin v. Western Nat'l Mut. Ins. Co.*, 574 N.W.2d 405, 405 (Minn. 1998); *Brown v. State Auto. & Cas. Underwriters*, 293 N.W.2d 822, 825-26 (Minn. 1980). The duty arises if any part of the cause of action against the insured even arguably falls within the scope of coverage. *Inland Const. Corp. v. Continental Cas. Co.*, 258 N.W.2d 881, 883 (Minn. 1977). And significantly, the duty is an indivisible one – if any part of the claim against the insured is arguably within the policy's scope, the insurer must provide a defense to the entire lawsuit, including claims for which there is no coverage. *Franklin*, 574 N.W.2d at 406-07. *See also U.S. Fidelity & Guar. Co. v. Louis A. Roser Co.*, 585 F.2d 932, 936 (8<sup>th</sup> Cir. 1978) (applying Minnesota law) and *Reinsurance Association of Minnesota v. Timmer*, 641 N.W.2d 302, 307 (Minn. App. 2002), *pet. for rev. denied* (May 14, 2002). Under these principles, each insurer in this case has an independent obligation to defend Wooddale against an entire lawsuit, including that portion of a suit seeking damages that are not covered because they occurred outside the policy period.

Consistent with these basic principles, this Court previously has held that when it can legitimately be argued that more than one insurer has primary coverage for a claim, each has a duty to defend that claim. *Jostens v. Mission Ins Co.*, 387 N.W.2d 161, 167 (Minn. 1986).

The *Jostens* court further held, again consistent with these principles, that when it is established that multiple insurers have coverage, those insurers “shall be **equally** liable for the insured’s defense costs.” *Id.* (emphasis added). More recently, this Court recognized *Jostens* as holding that “when two or more insurers arguably have primary coverage for a claim, each should share equally in the insured’s defense costs.” *See Domtar*, 563 N.W.2d at 739.

The Court of Appeals offered two bases for distinguishing *Jostens*, neither of which justifies a departure from the Court’s pronouncement in that case. First, the Court of Appeals suggests that the result should be different because the insurers in this case are consecutively, as opposed to concurrently, liable for the damages alleged against Wooddale. *See* 695 N.W.2d at 406. But the Court’s holding in *Jostens* was based not on the insurers’ concurrent liability, but instead on their **primary** liability. *Jostens*, 387 N.W.2d at 168-69. None of the insurers in this case dispute that their policies apply on a primary basis. Second, the Court of Appeals found significance in that portion of the remand order in which the *Jostens* court stated that the defense could be equally divided if the defense costs for the two claims were so inextricably intertwined they could not be sorted out. 695 N.W.2d at 406. This “inextricably intertwined” limitation, however, arose because defense was being allocated between an underlying insurer and an umbrella carrier who do, in fact, contract for different defense obligations. *See Jostens*, 387 N.W.2d at 165 (describing difference in defense obligations between primary and umbrella insurers). This distinction was expressly noted by the court: “[I]f Wausau and Mission were ordinary primary-excess carriers, they would

share Jostens defense costs **equally**; however, Wausau is an underlying carrier and Mission is an umbrella carrier.” *Id.* at 168 (emphasis added). As none of the insurers in this case is an umbrella carrier, *Jostens*’ “equal obligation” rule should apply.

The Court of Appeals also cited fairness concerns as justification for its pro-rating of defense costs, noting it would be unfair to compel an insurer who provided only one year of coverage out of 20 (or who was on the risk for 5% of the period) to share equally with an insurer who covered the remaining 19 years. *See* 695 N.W.2d at 407. Although this fairness argument has superficial appeal, it simply overlooks the fact that every one of the insurers in this case contracted to provide Wooddale with a primary and complete defense to all allegations in any complaint alleging an arguably covered claim, including claims for which there is no coverage. *Jostens*, 387 N.W.2d at 165-66. Because each insurer has, by contract, a defense obligation that is primary and complete, any claim that equal allocation of defense costs is unfair simply rings hollow.

Noting that the majority of jurisdictions addressing the issue have allocated defense costs according to the same methodology as indemnity costs, the Court of Appeals, with no analysis whatsoever, concluded that the majority jurisdictions have the “better-reasoned approach.” But a review of the case cited by the court, *Ins. Co. of N. America v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1225 (6<sup>th</sup> Cir. 1980), reveals little reasoning on the part of the Sixth Circuit. The only rationale offered by the court in *Forty-Eight Insulations* was its observation that there was no reason why the same theory used to allocate indemnity costs should not apply to defense costs. *Forty-Eight Insulations*, 633 F.2d at 1225. That rationale

has no force when applied in the context of Minnesota law and its clear, repeated pronouncement that the duties to defend and indemnify are distinct, with the duty to defend being the broader of the two.

Equally significant, if not more so, the real issue in *Forty-Eight Insulations* was whether the insured should have to bear a portion of the defense costs based on the number of years it was uninsured. The Sixth Circuit did indeed allocate defense costs to the insured. *Forty-Eight Insulations*, 633 F.2d at 1225.<sup>4</sup> This is not the “better-reasoned” approach. Minnesota does not require an insured to fund any portion of its defense unless all arguably covered claims have been dismissed with finality. *See, e.g., Meadowbrook, Inc. v. Tower Ins. Co.*, 559 N.W.2d 411 (Minn. 1997) (discussing duration of duty to defend and circumstances under which insurer can withdraw defense). Indeed, in *Domtar* this Court upheld an award of all defense costs incurred by the insured despite there being only 15 years of insurance coverage over a 64-year period. *Domtar*, 563 N.W.2d at 739. Clearly, the “majority approach” is not Minnesota’s.

The Court of Appeals’ error in allocating defense costs pro-rata by time on the risk is further compounded by its error in setting repair as the end date for allocation. These two decisions, read together, undercut the policy goal, articulated in *Jostens*, of discouraging insurers with arguable coverage from adopting a “wait and see” attitude while leaving the

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<sup>4</sup> The Sixth Circuit’s reasoning appears to have been that an insurer contracts to pay the entire cost of defending only that portion of a claim that arises within the policy period. *See id.* at 1224.

insured to defend itself. *Jostens*, 387 N.W.2d at 167. Indeed, the adoption of a pro-rata allocation method for defense costs with a fluid, or moving target, as an end date does nothing but create uncertainty regarding the parties' ultimate obligations. Under this allocation method, must the insured contribute to its defense? If not, how is the uninsured portion to be allocated? And, are defense costs to be subject to repeated reallocation as each year, or even month, passes?

A very recent decision by the court of appeals highlights another problem with the court's method of allocating defense costs. Specifically, in *Westfield Ins. Co. v. Kroiss*, 694 N.W.2d 102 (Minn. App. 2005), *pet. for rev. denied* (Minn. June 28, 2005), an insurer (Westfield) that was on the risk during and shortly after construction of certain residences that later experienced moisture intrusion problems denied the insured's tender on the basis that no evidence had been presented to suggest the damage had begun to occur while its policies were in effect. In the subsequent declaratory judgment action, the court of appeals noted that since faulty construction allegedly allowed water to seep into the homes, damage could have started during Westfield's policy period; and because there was a question of fact as to when the damage actually occurred, property damage arguably took place while Westfield provided coverage. *Kroiss*, 694 N.W.2d at 106-07. Accordingly, Westfield was found in breach of its duty to defend. *Id.* Under *Kroiss*, an insurer must contribute to the insured's defense if there is an issue of fact as to whether injury occurred during its policy period; and under the court of appeals' reasoning in this case, that contribution should be pro-rated based on the insurer's time on the risk. But what happens if that "fact issue"

ultimately is resolved in the insurer's favor. Are defense costs still pro-rated based on the period of time of arguable property damage? Does the insurer get a refund?

Again, this Court has stressed the need for practical and manageable solutions to allocation issues. *Domtar*, 563 N.W.2d at 733-34; *NSP*, 523 N.W.2d at 663, 665. Equal allocation of defense costs among all insurers with arguable coverage not only is consistent with Minnesota law, as articulated in *Jostens*, in *Domtar*, and in the countless cases addressing the duty to defend, but unquestionably is the most practical and manageable allocation method.

**CONCLUSION**

The trial court's conclusions regarding both the duration of the allocation period and allocation of defense costs are not only consistent with Minnesota law, but are also the simplest to apply in practice. For all of the reasons discussed above, Appellant Maryland Casualty Company respectfully requests that the decision of the Court of Appeals be reversed in all respects, and the decisions of the trial court reinstated.

Respectfully submitted,

COUSINEAU, McGUIRE & ANDERSON,  
CHARTERED

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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).