



MINNESOTA'S RULES FOR DETERMINING THE OBLIGATION OF MULTIPLE CGL INSURERS FOR CONSTRUCTION DEFECT CLAIMS

By
Theodore J. Smetak
Robert W. Kettering
James F. Mewborn
Richard K. Besonen

Arthur, Chapman, Kettering, Smetak & Pikala, P.A. © 2006

500 Young Quinlan Building, 81 South Ninth Street, Minneapolis, MN 55402
Telephone (612) 339-3500 Fax (612) 339-7655
[www@arthurchapman.com](http://www.arthurchapman.com)

MINNESOTA'S RULES FOR DETERMINING THE OBLIGATION OF MULTIPLE CGL INSURERS FOR CONSTRUCTION DEFECT CLAIMS

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
II.	TRIGGERING CGL COVERAGE -- GENERAL RULE: <i>IN RE SILICONE</i>	5
	A. Policy Coverage is Triggered When Actual Injury Occurs, Not by an Event	5
	B. Allocation Among Insurers is Inappropriate When a Discrete, Identifiable Event Causes Injury	6
	C. The General Rule Applied to Wet Home Construction Coverage Cases -- <i>Kootenia Homes, Inc., v. Federated Mutual Ins. Co.</i>	9
III.	<i>WOODDALE BUILDERS: IS THE “EXCEPTION” THE “GENERAL RULE” FOR WATER INTRUSION CASES?</i>	10
	A. Insurer’s Time on the Risk -- Factor A	12
	B. Total Period Over Which Liability is Allocated -- Factor B	15
	C. Total Damages To Be Allocated -- Factor C	16
	D. Damages Allocated to Each Individual Insurer -- Result D	16
	E. Defense Obligations: Sharing and the Risk of Not Sharing?.....	17

MINNESOTA'S RULES FOR DETERMINING THE OBLIGATION OF MULTIPLE CGL INSURERS FOR CONSTRUCTION DEFECT CLAIMS

I. INTRODUCTION

Just what are the rules by which CGL insurers can determine their responsibility for water intrusion cases claims? With its decision in *Wooddale Builders* the Minnesota Supreme Court has literally provided a formula, a “simple” algebraic process which, when applied to the factors of any given case involving wet building cases, could easily and simply determine the allocated share of responsibility to be borne by any of several liability insurers on the risk from the time of construction until the damage is remediated. However understanding the impact of *Wooddale Builders* first requires recognition of the construction coverage landscape, the rules that apply in Minnesota to construction defect coverage claims. Only then can the lessons, and even the formula, of *Wooddale Builders* be meaningfully applied. Because pro-rata allocation and the *Wooddale* formula are not the general rule to be applied to determine insurance coverage obligations. *Wooddale Builders* is clearly and unequivocally the “exception to the general rule” for purposes of determining which insurer(s) has what coverage obligation. If in any given construction case it is possible to trace the damages to a single, discrete and identifiable event then (a) neither the *Wooddale Builders* formula nor any other method of allocation ought to be applied and (b) only the occurrence-based liability policy on the risk at that moment in time is exposed for damages and defense. The “general rule” with which construction defect coverage questions is to be answered is found in *In re: Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405 (Minn. 2003). And applied in an enlightening, if unpublished, decision of the court of appeals in *Kootenia Homes, Inc., v. Federated Mutual Ins. Co.*, 2006 WL 224162 (Minn. Ct. App. January 31, 2006).

The mechanical, but meaningful, step to take before applying the *Wooddale* formula is to determine first *whether* it is appropriate to apply a pro-rata allocation method at all. At the risk of over-simplifying, the initial questions are these:

1. Did damages occur during more than one policy period?
2. If so, are those continuing damages traceable to a single, discrete and identifiable event?

If the answer to the second question is “yes” then allocation, so as to involve multiple insurers, is not proper *despite* that damages occur over a several year period of time. Instead the occurrence-based insurer on the risk at the time the damages first occurred is the only liability insurer exposed. (And in the event there was no such insurer on the risk at that time, none of the subsequent insurers should have any responsibility for damages unless, of course, a subsequent insurer issued a claims made policy.)

Those awaiting *Wooddale Builders*, seeking a final, simple formula for determining insurance obligations for defense and indemnity for construction defect cases got precisely that: a formula ($\frac{A}{B} \times C = D$). And insofar as it sets out ground rules for allocation

– when the insurers all agree pro-rata-by-time-on-the-risk is their chosen method of sharing - *Wooddale Builders* refines that formula with careful, if sometimes artificial, precision. With the result that *Wooddale* provides very clear, if sometimes frustrating, guidance in terms of how to allocate shares. But the supreme court did not indicate that such allocation should be done as a matter of course. The court makes it abundantly clear:

The parties agreed that the appropriate method for apportionment of liability among the insurers is pro-rata-by-time-on-the-risk, and that the starting point for the liability allocation period for each claim is the closing date on the purchase of the home.

The supreme court has sent a clear caution to any builder, insurer or claimant that would rely on *Wooddale Builders* as dictating pro ration or other allocation as necessarily appropriate. The supreme court pointedly noted that the parties “agree that damage to the homes was not caused by a solitary, discrete, identifiable event; rather, the damage was caused by repeated water intrusion occurring over an extended period of time, with continual, progressive, and indivisible damage occurring to the homes.” By ruling out a “solitary, discrete, identifiable event” the *Wooddale* fact pattern is taken *out* of Minnesota’s general rule.

And, too, the supreme court emphasized again:

No party requested review of the propriety of the application of the pro-rata-by-time-on-the-risk method.

As to which the supreme court inserted this footnote 6:

Arguably, the damage to the homes is traceable to a discrete and identifiable event, such as installation of the windows, installation of the flashing, or the application of the building paper. Nevertheless, for purposes of this opinion, the applicability of the pro-rata-by-time-on-the-risk method is the law of the case. Accordingly, the issue whether the pro-rata-by-time-on-the-risk method is generally applicable to water intrusion damage cases is not before us.

In other words, the supreme court was answering questions as to *how* the “pro-rata-by-time-on-the-risk” method should be applied but the supreme court bluntly cautions that its opinion does not rule or hold that allocation is necessarily the rule to be applied. *Whether* any given water intrusion case results in allocation, so as to involve several insurers, might be logical and rational. After all, several insurers and coverage counsel stipulated such was the case, simply asking the court to clarify the application of that rule. But it is not the holding, it is not the rule, of *Wooddale Builders*.

It could be, however, that the supreme court’s clear caution (that *perhaps* allocation will not be applied to water intrusion coverage cases) is itself too cautious. Perhaps *Wooddale*’s allocation formula represents a common sense approach by which multiple liability insurers, faced with uncertainty as to how best to share exposure for an endless stream of water intrusion cases, may agree upon and apply a reasonably clear set of

guidelines by which each insurer can be more certain of its respective share of finite exposure. Or it could be that the formula and guidance of *Wooddale* is useful to the insurance industry for wet building cases generally because it might not be feasible, or economically sensible, to probe for the single, discrete and identifiable event which, once known, would designate a single liability insurer responsible for the entirety of damages and defense. Taken in that light, *Wooddale Builders* will be welcomed by many despite that perhaps some of the formula's provisions might seem a bit inconsistent with insurance principles.

General Rule

Before discussing how the *Wooddale Builders* case refines the “exception” to the “general rule” by which liability coverage obligations are established, it is helpful to summarize Minnesota law, both the general rule as well as how and why the exception arises.

So long as the policies provide occurrence-based liability coverage, and so long as the policies commit to pay for damage that occurs during the policy period, Minnesota applies the “actual injury” or “injury in fact” coverage trigger to determine whether an occurrence has activated insurance coverage. *In re: Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405, 415 (Minn. 2003). That is essentially how stock, occurrence-based commercial general liability policies are written. All of the policy language elements with which to apply the “general rule” are present in the usual liability policies applicable to builders, subcontractors and even product vendors.

The date of the occurrence is not the time the wrongful act is committed but is instead the time when the complaining party sustains bodily injury or property damage. *In re: Silicone*, 667 N.W.2d at 415. To trigger a policy the insured must show some damage during the policy period. *Id.* Property damage, like bodily injury, can occur even though not diagnosable, compensable nor manifest during a particular policy period. *Id.* It is enough if it can be determined, even retroactively, that some injury or damage did occur during a specific policy period. If the occurrence of damage (or injury) during a policy period can be established, even years after the policy period expired, then the standard liability coverage policy language applicable to that policy period would be *potentially* invoked to respond with defense and indemnity. Allocation or sharing of coverage concerns arises only if the damage or injury has occurred during multiple policy periods. But that is only the starting point, not the determinant that all policies are triggered.

Damage During Multiple Policy Periods Does Not Necessarily Trigger Multiple Policies

Property damage which continues, even spanning multiple policy periods, does not *necessarily* invoke multiple liability insurance policies simply because of continuing damages. Minnesota has rejected the continuous trigger rule under which “the policies in effect at the time of exposure, the time of manifestation, and all time in between are triggered.” *Northern States Power Co. v. Fidelity and Casualty Co. of N.Y.*, 523 N.W.2d 657, 662 (Minn. 1994) (*NSP*). By rejecting the continuous trigger rule as the general rule, Minnesota intentionally elected not to apply all of those policies as a matter of

course. One of the most common mistakes, then, is to conclude that all policies are necessarily invoked simply because damages continue over several policy periods.

Instead, if the property damage (like bodily injury) continued over multiple policy periods that only *potentially* triggers multiple liability policies. The next critical determination is whether the continuing injury/continuing damage arose from some discrete and identifiable event.

If the damage *can* be traced back to a single, discrete and identifiable event then the liability insurer with a policy in effect when the damage first began (occurred) is liable for all damage that results from that event, even though the damage may continue for many years. *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 724 (Minn. 1997). Subsequent liability insurers would not be liable for damages under the general rule, even though additional damage might occur during the subsequent policy periods, because all such damage was due to a single, discrete event. That is the impact of Minnesota's general rule.

If the continuing damage *cannot* be shown to be due to a discrete and identifiable event then depending upon policy language multiple insurers may each become liable under their several policies. Those are the "difficult" cases which led, for example, to certain of the environmental pollution coverage cases. However as will be discussed in this article, even the pollution cases begin with, and are subject to, Minnesota's general rule...to the extent the *facts* can be established. Where there is no single, discrete and identifiable event, but where the damages occur during several policy periods, then it can be said that each such separate policy has been triggered. (Property damage – or bodily injury – occurred during the occurrence-based policy. That is the standard, initial trigger of coverage.) Just how those multiple insurers share responsibility (or allocate coverage obligations) was the subject of *Wooddale Builders*. As was the question of at what point in time liability insurance should no longer be responsible for ongoing damages.

The general rule, then, is that the insurer on the risk when the damage first occurs as a result of a discrete and identifiable event is *solely* responsible for the damages owed by the insured, regardless how long the damages continue to be sustained. *In re: Silicone*, 667 N.W.2d 405 (Minn. 2003).

This framework, pursuant to which allocation is the *exception* rather than the *rule*, applies to coverage for construction defect cases. Nothing in *Wooddale Builders* alters that fundamental premise. Minnesota has applied the general rule to water intrusion cases. On the other hand, as evidenced by *Wooddale Builders*, insurers have sought to apply the exception, allocation. Whether any given case should be governed by the general rule (one liability insurer only) or the exception (meaning that multiple insurers – and possibly the insured – would share/allocate responsibility) has *not* been decided by the Minnesota Supreme Court. With that caveat, however, both Minnesota's "general rule" and Minnesota's "exception to the general rule" can be understood and applied meaningfully to a wide range of construction defect cases.

II. TRIGGERING CGL COVERAGE -- GENERAL RULE: *IN RE SILICONE*

In a decision that involved obvious “continuing injury” claims, the Supreme Court of Minnesota held that it is not appropriate to allocate losses among insurers pro-rata-by-time-on-the-risk in a case where the continuous injuries can be traced back to a discrete and identifiable event. In *In re: Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405 (Minn. 2003), the court held that the implantation of silicone gel breast implants was a discrete and identifiable event, that the injury occurred almost simultaneously with the implanting, and that the district court had erred in allocating losses among insurers pro-rata-by-time-on-the-risk. The court affirmed in part and reversed in part the decision of the court of appeals. *In re Silicone*, then, represents the supreme court’s most recent reconciliation and re-iteration of the dichotomy between the general rule and the exception.

In re Silicone involved a declaratory judgment action brought by several of 3M’s excess-layer, occurrence-based policy insurers (most contractor policies are occurrence based, covering accidents that cause injury during a given policy period, as opposed to claims-made policies that cover claims actually made during a policy period). These insurers sought to clarify their coverage obligations in 3M’s ongoing silicone gel breast implant mass tort litigation. The insurance policies at issue were in place from 1977 to 1985 and covered claims arising from injuries occurring during that time period. The implant claims for which 3M sought reimbursement were brought in the early 1990s, but were based largely on implantations that occurred during the policy periods, which implants allegedly caused various systemic autoimmune diseases.

The supreme court’s review included the following issues:

1. When and how policy coverage was triggered;
2. Whether allocation is appropriate and, if so, when the allocation period should end.

A. Policy Coverage is Triggered When Actual Injury Occurs, Not by an Event

The supreme court in *In re Silicone* observed that, as discussed in *NSP*, Minnesota follows an “injury-in-fact” or “actual-injury” rule and has explicitly rejected the continuous trigger rule. Under the actual-injury rule, the time of the occurrence is not the time the wrongful act was committed but the time the complaining party was actually damaged. Thus, under the actual-injury trigger rule, only those policies in effect when the *bodily injury or property damage* occurred are triggered. To trigger a policy, the insured must show that *some damage* occurred during the policy period. For purposes of the actual-injury trigger theory, an injury can occur even though the injury is not “diagnosable,” “compensable,” or manifest during the policy period as long as it can be determined, even retroactively, that some injury did occur during the policy period. *In re Silicone*, 667 N.W.2d at 415.

In holding that the insurance coverage was triggered shortly after implantation of 3M's silicone gel breast implants, the court noted that the district court, relying upon expert medical testimony, had made the factual determination that:

Leaked silicone is in contact with body tissues from the time of implant until the formation of the protective capsule, a period of several weeks. Silicone is bioreactive during that period and more likely than not that is the period during which cellular abnormality is produced. Thus, bodily injury within the purview of the trigger language occurs at or about the time of implant.

The greater weight of the evidence, in the context of the undisputed fact of systemic disease symptoms and the assumed fact of legal causation and the necessary inference of the occurrence of an abnormality, supports the conclusion that the leaking silicone gel is the cause, the cellular damage is the injury, and the disease symptoms are the effects. Such cellular damage is determinable, constitutes the underlying bodily harm without which there would be no manifestation in the form of disease symptoms, and satisfies the "actual injury" legal standard for trigger.

667 N.W.2d at 414. The supreme court held that this factual finding was not clearly erroneous and concluded that the policies were triggered at or about the time of implantation, because that is when the bodily injury first occurred.

B. Allocation Among Insurers is Inappropriate When a Discrete, Identifiable Event Causes Injury

Having concluded that the insurance policies were triggered at or about the time of implantation due to the fact that bodily injury occurred at that time, the supreme court then addressed whether to allocate 3M's losses from those injuries among the multiple insurers. Obviously the injuries continued for several years, potentially involving multiple liability insurers. The supreme court concluded allocation was not proper. It is useful to see how the district court and court of appeals initially felt liability insurance should be invoked because the same tendency exists on construction defect cases for many of the same reasons.

The district court had found that from the time of implantation, the damages were continuous and that "actual injury" continued to occur as silicone came in contact with new cells. That court therefore determined that 3M's losses should be allocated pro-rata-by-time-on-the-risk among all triggered policies, thus involving all of the insurers. The court of appeals affirmed the allocation ruling, concluding that the district court had made specific findings that "the injury causing event was the continuous leakage of silicone that comes into contact with the body's cells." Based on this continuous injury finding, the court of appeals affirmed the need for allocation.

The supreme court analyzed the issue by reviewing its three earlier decisions addressing environmental damage liability: *NSP*, 523 N.W.2d 657 (Minn. 1994); *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305 (Minn. 1995); and *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997). In those three cases, the court had discussed the pro-rata-by-time-on-the-risk allocation method, and how and whether it applies to continuous injuries arising from environmental contamination.

Because the contamination in *NSP* was viewed as a continuous process in which the property damage was evenly distributed over the period of time from the first contamination to the end of the last triggered policy (or self-insured) period, there was no period during which more or less damage occurred, so allocation according to time on the risk was appropriate, said the supreme court. In *NSP*, the court chose the time on the risk allocation method because it has the advantage of being a “more or less per se rule.” This method assumes that the damages in a contamination case are evenly distributed (or continuous) through each policy period from the first point at which damages occurred to the time of discovery, cleanup, or whenever the last triggered policy period ended.

One year later, in *SCSC*, the court revisited the issue of allocation. The jury in that case found that “property damage arose in August 1977, as the result of an unintended, unexpected, sudden and accidental event, and that the damage was neither divisible nor attributable to an overriding cause.” On appeal, the court held that the only covered “occurrence” was the 1977 chemical spill. The continual leaching of the chemicals from the soil into the groundwater did result in damages because of property damage, but that damage was held to be covered only by insurers that were on the risk in 1977, the year during which the only covered “occurrence” took place. The court refused to allocate any damages to insurers that were not on the risk in 1977. *SCSC*, then, is an iteration of the “general rule.”

Finally, in *Domtar*, the insured sought reimbursement for clean-up costs it incurred in association with its tar refining plant. In that case, the court summarized *NSP* as establishing that in “continuous and indivisible environmental contamination cases” (1) general liability policies are triggered when property damage occurs during the policy period; (2) insurer liability is consecutive, limited to property damage occurring during the insurer’s policy period; and (3) one way to allocate loss among consecutively liable insurers, in the absence of relevant policy language, is pro-rata-by-time-on-the-risk.

Accordingly, in *Domtar*, the supreme court affirmed the use of allocation pro-rata-by-time-on-the-risk, specifically rejecting appellant *Domtar*’s argument that this allocation method unfairly allocated losses to *Domtar* by allocating losses to periods during which *Domtar* was uninsured, self-insured, or underinsured. (*Wooddale Builders* has dealt again with periods of time during which the insured lacks insurance for one reason or another; that is discussed in the materials that follow.) The court also emphasized the limits of its holding, however, and attempted to clarify the discussion of allocation in *NSP* and *SCSC*:

The proper scope of coverage also will depend on the facts of the case. When environmental contamination arises from discrete and identifiable events, then the actual-injury trigger theory allows those policies on the risk at the point of initial contamination to pay for all property damage that follows. [citing *SCSC*] ... It is only in those difficult cases in which property damage is both continuous and so intermingled as to be practically indivisible that *NSP* properly applies. *NSP* provides a judicially manageable way for trial courts to adjudicate certain pollution-coverage disputes when it is difficult to determine when an “event” or “occurrence” or “damage” giving rise to legal liability has occurred. *NSP* does not establish hard-and-fast rules; it offers a practical solution in the face of uncertainty.

Domtar, 563 N.W.2d at 733-34.

In other words, even in the environmental pollution cases Minnesota follows the “general rule” for invoking occurrence-based liability coverage, reserving the exception to cases where it cannot be shown that the damages or injuries were due to a single, discrete and identifiable event.

In determining whether to allocate 3M’s losses from silicone gel injuries pro-rata by the insurers’ time on the risk, the supreme court followed the analytical progression provided in *Domtar*.

First, it determined whether the plaintiffs’ injuries were continuous. If they had not been continuing then under the actual-injury trigger theory the policies on the risk at the time of the injury would pay all losses arising from that injury. In *In re Silicone*, the district court had found that the injury was continuous and the “actual injury” continued to occur as silicone came in contact with new cells, so the court moved to the next determination: asking whether the continuous injury arose from a discrete and identifiable event. If it did, the policies on the risk at the time of that event covered all sums arising from the event. If not, allocation might be appropriate.

The court’s opinion in *In re Silicone* noted that in the actual-injury trigger framework, allocation is meant to be the exception and not the rule because it is only in those “difficult cases” that allocation is appropriate: the issue of allocation should be raised only if the triggering injury does not arise from discrete and identifiable events. If one can identify a discrete originating event that permits avoiding allocation, the court held that it should do so. Since the district court labeled the time of implant as the beginning of the continuing injury process, such implantation was viewed by the supreme court as a readily identifiable discrete event from which all of the plaintiffs’ alleged injuries arose, beginning at the moment of implant. Such implantation is more akin to the single spill that led to continuing soil damage in *SCSC* than it is to the situation in *NSP* or *Domtar* where contamination could not be apportioned among causes.

Thus, the court concluded that *In re Silicone* was not one of the “difficult cases” for which allocation is appropriate and, therefore, held that the lower courts erred in allocating the damages among the insurers. The supreme court explained that the lower courts had erroneously equated “continuous trigger” with “continuous injury.” “A trigger is the legal event that activates the insured’s policy, while a continuous injury is a factual finding that is based on medical testimony.” 667 N.W.2d at 414. Consistent with the actual-injury trigger theory, it held that those insurers on the risk at the time of implantation were liable up to the limits of their respective policies for 3M’s losses arising from that implantation.

C. The General Rule Applied to Wet Home Construction Coverage Cases --
Kootenia Homes, Inc., v. Federated Mutual Ins. Co.

Kootenia Homes, Inc., v. Federated Mutual Ins. Co., 2006 WL 224162 (Minn. Ct. App. January 31, 2006) (*review denied* April 18, 2006) is unpublished only because Chief Judge Toussaint recognized that the decision did not actually establish new law. However the case is an almost classic example of the actual injury rule applied to continuing injury/damage that can be shown due to a discrete and identifiable event, with blunt consequences, all as the result of application of the general rule to water intrusion damages. As such, *Kootenia* is a clear and explicit application of the “general rule” to a water intrusion case because the facts in *Kootenia* established that while the water intrusion damages continued over several years, as a matter of *fact* the damages were caused by a single, discrete and identifiable event, which meant that the general rule, not the exception applied. Only *Kootenia*’s insurer at the time the damages first began had liability coverage for the wet home claims.

The *Kootenia* case involved roughly 30 homes built by *Kootenia* between 1996 and 2000. Moisture intrusion was reported in a number of stucco homes. The investigation concluded that the primary cause was the use of improper materials and application of the stucco wall system. Of course the time of the negligent *act* (improper installation of stucco) is not the time of occurrence for purposes of triggering liability coverage. Rather it was determined that the *damage* began shortly after completion of the homes.

And at the time damage first occurred Federated was *Kootenia*’s insurer. Although the damage continued beyond the Federated policy period into policy terms of other subsequent liability insurers, the court of appeals did not hesitate to hold Federated, but only Federated, responsible for all of the home buyers’ damages. In doing so that court reiterated that allocation should be raised only if the triggering injury does not arise from discrete and identifiable events, citing to *In re Silicone Implant Insurance Coverage Litigation*, 667 N.W.2d 405 (Minn. 2003).

In re Silicone, as applied to water intrusion cases in *Kootenia*, stands for the proposition that if, even with the aid of hindsight, property damage can be traced to a discrete and identifiable event (such as improper flashing) then only the insurer(s) providing coverage at that distinct date ought be obligated to pay the

insured's damages. That is the general rule; under the general rule in Minnesota, multiple insurers do not allocate responsibility for continuing damages.

If *Kootenia* and *In re Silicone* set forth the general rule, what about water intrusion cases where, for one reason or another, damage spans several years/policy periods but there is (seemingly) no discrete and identifiable event? Or where it might be economically prohibitive to establish such a discrete cause? *Wooddale Builders* was submitted to the court as an *exception* to the general rule, a case where the parties wanted to apply allocation but could not agree upon the precise formula by which their allocated shares would be determined.

III. WOODDALE BUILDERS: IS THE “EXCEPTION” THE “GENERAL RULE” FOR WATER INTRUSION CASES?

In *Wooddale Builders* the Minnesota Supreme Court took great pains to emphasize that it was *not* ruling that allocation pro-rata-by-time-on-the-risk should apply to water intrusion cases, leaving open the potential that under the “general rule,” only one single insurer might be exposed for water intrusion damages. Aided by a partial list of examples of potential “single, discrete and identifiable events” the supreme court recognizes that perhaps, as in *Kootenia*, allocation should be rejected in favor of seeking the sole, solitary liability insurer whose coverage was invoked by injury or damage at a specific moment in time. That remains an intellectually sound unanswered question. However there are a number of reasons why the search for a single, discrete and identifiable event might not be as workable for water intrusion cases.

For example, the supreme court left open the possibility that all damages might be traced to installation of windows, to installation of the flashing or application of the building paper. Straightforward application of the “general rule” would seemingly be proper if the damage first began at or near to that moment in time. However stock insurance policy text provides that damage to property being worked upon, occurring before the work is completed or put to its intended use, is usually excluded as subject to the “business risk doctrine.” If the end result of the search for the single, discrete and identifiable event was to establish that damage occurred under circumstances for which there was no applicable liability coverage, will the court in the future apply the “general rule” if the result is to eliminate coverage?

An even more compelling argument in favor of applying *Wooddale Builders* as the “general rule” for water intrusion cases is that it might be more pragmatic to do so. How often is it economically viable to excavate the history of water intrusion damages, often due to multiple causes, in order to convincingly establish, as a fact, the date of a single, discrete and identifiable event?

The insurers in *Wooddale Builders* chose to apply the pro-rata-by-time-on-the-risk method in order to allocate, or share, liability for the damages sought in the water intrusion claims against Wooddale Builders. All they asked the court to do was to refine that method to a set of claims, refining the application of that sharing method. The same reasons why the Wooddale insurers opted for such an allocation method also apply to a great number, perhaps even the majority, of water intrusion cases.

For practical reasons, then, it just might be that *Wooddale Builders*, despite being an exception to the general rule, will become used as the usual, consensual or accepted method of responding to water intrusion cases.

Factual Background

The *Wooddale* case involved stucco homes constructed by Wooddale from 1991 to 1999. In late 2000 Wooddale began receiving claims of defective construction and/or faulty workmanship. There were several sources of water intrusion, including leaky windows, inadequate flashing, penetration through building paper and vents through which wind-driven water entered the homes. From 1990 through 2002, five separate insurers had provided occurrence-based insurance policies to Wooddale.

The insurers agreed that there was not a single, discrete, identifiable event which caused the damages to first occur. Rather they agreed the damage was caused by repeated water intrusion that occurred over an extended period of time with continual, progressive and indivisible damage occurring to the homes. Accordingly the insurers agreed to apply the pro-rata-by-time-on-the-risk liability allocation method in order to determine the proper sharing of indemnity exposure. And the parties agreed that the starting point for liability allocation for each claim should be the closing date on the purchase/sale of each separate home.

The parties could not agree upon the end date nor could they agree upon how defense obligations should be allocated.

And, too, Wooddale was without CGL coverage after November 13, 2002. That led to the question of whether, and on what basis, Wooddale should be allocated a share of the responsibility, either for payment of damages or defense costs.

The Key Issues Addressed by the Court

The supreme court's key conclusions, refinements as to the application of the pro-rata-by-time-on-the-risk method, were these:

1. The insurers on the risk for any particular claim were those that provided coverage at any time between the date of closing and, at the other end, the date the insured received notice of the claim. After the date the insured received notice of claim, subsequent insurers would not be required to share in the damages because after the date of notice ongoing damages were "expected" or similar to "known risk."
2. Any insurer with a policy within that time frame would be deemed on the risk for their entire policy period.
3. The total damages, of course, was the total damage figure the insured was legally obligated to pay. It is that total damage figure that was to be allocated.

4. With regard to the fact that Wooddale was uninsured for periods of time:
 - a. If insurance coverage was not available (if the insured was involuntarily uninsured) the allocation period ran from date of closing until the end of the policy year in which the insured received notice of claim or with the end of the last period of insurance coverage, whichever was *earlier*.
 - b. However if insurance coverage was available (if the insured was voluntarily uninsured) the allocation period would include the time period the insured was voluntarily uninsured and ends with the date of the policy year in which the insured received notice of claim or with the notice of claim, whichever was *later*.
 - c. Because the record did not establish why Wooddale had no insurance, the case was remanded so the district court could determine whether Wooddale was involuntarily uninsured or whether Wooddale was voluntarily self-insured before applying one rule or the other.

5. When multiple insurers are all exposed to the duty to defend under the pro-rata-by-time-on-the-risk method, and those insurers *participate* in providing a defense to a common insured, but recovery of defense costs is not barred by the *Iowa National* rule, defense costs should be apportioned equally among those insurers.

Allocation thus involves a sharing of the total sum of damages which the insured is legally obligated to pay due to a covered occurrence. Just how that sharing should be determined was the question for the court. The answer was returned in the form of a formula:

$$\frac{A}{B} \times C = D$$

Each element of that equation was discussed by the court. The allocation formula divides total damages the insured is to pay (C) into shares. The share (D) for each insurer is determined by comparing each insurer's time on the risk (A) with the total period of time over which liability is allocated (B.) This deceptively simple formula has both easy and difficult elements. Time on the risk has been somewhat artificially lumped into policy "years." The reason that is so apparently relates as much to rendering the formula simpler as anything else.

A. Insurer's Time on the Risk -- Factor A

Determining which insurers are on the risk asks initially whether any given policy was triggered. The answer depends upon whether there was damage during the policy period. The occurrence or event need not take place within the policy period under stock occurrence-based policy language; it is enough if there is damage during the policy period due to an occurrence. Here is the ISO CGL language:

1. Insuring Agreement
 - a. We will pay those sums that the insured becomes legally obligated to pay as damages because of “bodily injury” or “property damage” to which this insurance applies. ...
 - b. This insurance applies to “bodily injury” and “property damage” only if:
 - (1) The “bodily injury” or “property damage” is caused by an “occurrence” that takes place in the “coverage territory”
 - (2) The “bodily injury” and “property damage” occurs during the policy period; and ...

ISO CGL form CG 00 01 10 01.

The *Wooddale Builders* formula is true to the policy’s insuring agreement. If bodily injury/property damage occurs during the policy period, one element of coverage is met. But whether that damage is due to an “occurrence” also has to be met.

The parties to *Wooddale Builders* agreed that property damage began on the closing date of each separate home for purposes of triggering the coverage commitments of any insurer.

On the front end, then, the insurer on the risk at the moment of closing would be involved in sharing or allocating damages because property damage occurred during that policy period. Thereafter each occurrence-based liability insurer would seemingly be involved. Or would they? Or is there an end point, a date or event after which liability insurers would not be considered “on the risk” for allocation purposes?

Notice of Claim and Expected Damage: Not An “Occurrence” and Thus Not “On the Risk”

Even though property damage occurs during a policy period, that insurer is not “on the risk” unless the damages are due to a covered “occurrence.” Damages “expected or intended from the standpoint of the insured” are excluded and not due to a covered occurrence. The supreme court did not hesitate to state that:

[O]nce Wooddale receives notice of claim with respect to a particular home, any subsequent damage with respect to that claim is “expected,” and all subsequent insurance policies exclude coverage for damage to that claim.

Wooddale, at *6.

This is a bright line rule. Once an insured receives notice of claim with regard to damage to a specific home, that is the last occurrence-based policy to be invoked. Every subsequent insurer is no longer “on the risk.” Because, the court reasoned, the element of “risk” no longer exists so as to justify insurance. The rationale used by the supreme court resonates with terms used in other insurance contexts, such as “known loss doctrine” or “loss in progress.” Neither doctrine necessarily applies but the overall thrust of what should be insurable, what is “at risk,” justified the court’s decision that insurers “on the risk” *after* the insured received notice of claim of damage were not “on the risk” *for that specific property*.

The holding, as to this part of the formula, is that only the insurers providing coverage between the closing date of a particular home and Wooddale’s receipt of notice of claim are “on the risk” for that claim.

On the Risk: Policy Period Becomes the “Unit” for Measuring Policy Shares

This part of the *Wooddale* formula is most likely to cause some raised eyebrows, especially as it might apply to certain fact patterns. However it also appears that the supreme court’s opinion leaves room to apply the *Wooddale* rule rationally.

Some insurers had argued that the coverage obligation to pay damages ends when the insured receives notice of claim. However there is no language in stock insurance policies that either terminates coverage upon receipt of notice of claim or limits damages to that as an ending point. Instead the policies obligate the insurer to pay damage that “occurs during the policy period.” Accordingly the court held that an insurer whose policy was on the risk at the moment of receipt of notice of claim *remained* on the risk until the end of the policy period.

That much will not surprise insurers insofar as when its policy obligation ends. But when does it *begin*? This part of the court’s decision calls for careful reading to avoid absurd results. *Wooddale* leaves intact the fundamental proposition that an insurer contracts to pay damages which occur during the policy period. And the court uses the policy period, actually uses *years*, as the unit of measurement. But Safeco had asked whether that would obligate Safeco for an allocated share for damages occurring *before closing*. That issue had been dismissed by the court of appeals but the supreme court concluded that it must address the beginning date for purposes of setting forth a formula. The holding is that “the period of time on the risk for the first policy triggered by damage to a home begins on the beginning date of the policy period in which the closing on the home occurred.” *Wooddale*, at *7.

Does that mean an insurer whose policy expired a month after closing (the stipulated beginning date for covered damages) must pay a share so as to extend 11 months *before* the closing date? Some might observe that as to this particular element of the formula, such coverage niceties might have been overlooked in favor of an overall “simple” formula. Nonetheless this issue will likely grate on insurers if called upon to pay for damages during the policy period which are not “covered.” On the other hand, the *Wooddale* opinion strives to respect and

enforce the respective policy obligations and rights of the insurer and the insured. If damages are excluded (such as might be the impact of “Your Work” exclusion, for example) then perhaps there is less reason to worry about the possible over-reaching effect of *Wooddale*. And, too, those seeking to ensure *Wooddale* yields a result consistent with insurance policy language will seize upon the court’s statement when discussing the presumption that a proportionate share of damage falls under the policy:

Insurers that provided coverage to an insured during the liability allocation period [Factor B] are liable for a proportionate share of damages, unless the insurer can show that no appreciable damage occurred during its triggered policy period.

Wooddale, at *8.

B. Total Period Over Which Liability is Allocated -- Factor B

Factor A identifies all insurers whose policy periods apply. Factor B, in its simplest sense, would be the sum total of such policy periods. And using the court’s preferred unit (policy *years*) this factor might be easily determined. And often it will be easily calculated. But *Wooddale* dealt with some possibilities that could complicate the determination of the total time period covered by insurance policies.

One complication is that, for one or more “units” or policy periods the insured might *not* be covered by insurance policies. *Wooddale* was uninsured for the last years during which notice of claim had been first submitted for certain homes. After much analysis, the court concluded that an insured such as *Wooddale* that lacked insurance for one or more of the potential policy “years” would – if *voluntarily* uninsured – be responsible for those years much as if that insured was “self-insured.” On the other hand, if the insured was *involuntarily* uninsured (discussed later in this article) then the insured would not be punished, so to speak, by being made responsible as though the insured had intentionally self-insured during those time periods. If there were policy “years” during which the damages continued but for which the insured was *involuntarily* uninsured, those “years” would be taken out of the equation. Instead of 7 policy years, for example, this factor would become 5 if the insured was involuntarily insured for 2 of those years.

The effect of removing policy years when the insured was involuntarily self-insured is, of course, to shift a greater proportion to the insurers. The *Wooddale* court recognized that might be contrary to broad language by which, under the “actual injury rule,” an insurer was to be liable “only for those damages which occurred during its policy period.” *Wooddale*, at *11. However allocation is to be a “flexible approach.” Such facts, even if the allocation blurs the precise ratio for each insurer, justified a departure from the simpler “actual injury” fact pattern.

The result is that Factor B might be simple (nothing more than the sum of all policy years for triggered policies) or it might be complicated (by periods during which the insured is uninsured, for one reason or another.) The court remanded for determination of why Wooddale had no insurance. Not even in *Wooddale* was there a final determination as to Factor B.

C. Total Damages To Be Allocated -- Factor C

The ratio of each insurer's period of risk (Factor A) as a percentage of all policy periods (Factor B) must be applied, then, to the "total covered damages" (Factor C) in order to derive Factor D (which is each insurer's allocated share.)

This factor is refreshingly simple. All of the policies, as is typical, commit to pay:

...those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies

That is simple to determine under the "general rule." Under the general rule "the insurer whose policy was in effect at the time the discrete event occurred is liable for all damages that result from that event, even when the damage persists for many years." *Wooddale*, at *8. That is exemplified by *SCSC*; there the insurers on the risk at the time of the single chemical spill in 1977 were liable for the damages, the cost of remediation, which took until 1988. And it is consistent with *In re Silicone*: the insurer on the risk at the moment of implant and its contemporaneous bodily injury was liable for all damages, regardless how long those injuries or damages lasted.

But under the "exception" (such as the *Wooddale* water intrusion case with no discrete event) the focus, for some purposes, shifts toward the damages occurring during that specific policy period.

However, citing to *Domtar* and *NSP*, the *Wooddale* court concluded that under either approach total damages are the same. Thus Factor C, the total damages to be divided or allocated, consists of the "total damages Wooddale is legally obligated to pay with respect to that home, regardless of whether the damages occurred during the total period over which liability is allocated." *Wooddale*, at *12.

D. Damages Allocated to Each Individual Insurer -- Result D

Factors A, B, and to an extent, C involve some work to derive the precise number to be used in the *Wooddale* formula. Factor D is the simple result. Each insurer's respective share is determined by the formula.

To recap, only those insurers with policies in effect between (a) the date of sale/closing and (b) receipt of notice of claim are "on the risk." However each is "on the risk" for a unit amounting to a policy year.

Because some insurers may be on for one year while others may be on the risk for more years, Factor B is the sum of the policy years for all “on the risk” under Factor A.

Those two factors, $\frac{A}{B}$, provide a ratio appropriate for each insurer. That ratio is multiplied by the total damages (Factor C) to determine each insurer’s share, Result D.

The *Wooddale* court provided three scenarios applying the formula. The key dates for each were date of sale/closing and receipt of notice of claim. Insurers providing coverage to Wooddale Builders *after* the policy year in which notice of claim was received were not exposed; they are not “on the risk” because damages in any policy year after receipt of notice were “expected” and thus not covered. So long as those dates remained unchanged, the *ratio* among insurers did not change. That ratio would apply, then, whether the damages were remediated sooner or later; the ratio applied to all damages.

The third scenario introduces a variable: what if the notice of claim was not received until *after* Wooddale was no longer insured? If the date of sale/closing remained the same, then all of the insurers were “on the risk” under their respective policy years *until* the year after notice was received. Delaying the date of notice of claim could thus involve more insurers for their units or policy years. But what scenario 3 illustrates is the potential that the insured *could* possibly be required to absorb a share for years (units) when the insured was uninsured. If the insured was *voluntarily* uninsured, then the insured would be treated essentially as a self-insurer; with that came a share of the allocated damages. But if an insured is *involuntarily* uninsured, then the insured is excused from bearing a share of the damages.

Just what “involuntarily insured” means has not been established. Wooddale claimed coverage was not available. But the facts will have to be developed at trial before it will be know whether Wooddale (or one such as Wooddale) is obligated to share a portion of the damages.

E. Defense Obligations: Sharing and the Risk of Not Sharing?

The bulk of *Wooddale* dealt with refining a formula by which obligations for damages are to be shared between insurers, some of whom were on the risk for a greater or lesser period of time than the others. The other question was how the cost of defending the insured should be shared in the same setting. The court of appeals had approved a sharing by which each insurer should be responsible for a portion of the defense costs equal to the share each insurer absorbed as its percentage of covered damages. The supreme court rejected that approach and substituted its own reasoning and approach. Apportioning shares of defense costs according to the same methodology used for indemnity, said the supreme court, might be the case among concurrent insurers but is not necessarily the majority rule for consecutive insurers. The court further rejected the court of

appeals conclusion that sharing should be driven by considerations of equity and fairness, leading the court to lay out its reasoning as to how insurance obligations should be shared.

The risks associated with providing – or not providing – defense to an insured when other insurers would appear to share a duty to defend have been a complicating factor in water intrusion cases in particular. And there has been reason for the concern. After all, the rule before *Wooddale* (and the rule after *Wooddale*) is that *absent a loan receipt agreement* any insurer that undertakes to provide a defense to the insured “may not seek recovery of defense costs from the insured’s other insurers who also owed a duty to defend but failed to provide a defense.” *Wooddale*, at *15, citing *Iowa Nat’l Mut. Ins. Co. v. Universal Underwriters Ins. Co.*, 150 N.W.2d 233, at 236-37. This is the *Iowa National* rule. The *Iowa National* rule, then, could lead some insurers to decline, or simply ignore, a demand to defend an insured with the contemplation that one of the insurers would “blink” and provide a defense. And, as the rule provides, if the defending insurer failed to use a loan receipt then that insurer would essentially have to absorb the costs of that defense.

This has influenced insurers faced with that dilemma to consider using a loan receipt. Loan receipts are commonly considered to have developed between an insurer and its insured as a means of accomplishing subrogation, shifting the ultimate cost to a third party. The insurer would pay a certain sum to the insured as a “loan” repayable only in the event of recovery as contemplated in the “loan receipt” agreement. That concept has been extended to the troublesome area of shifting or sharing defense obligations by use of a loan pursuant to which an insurer “loans” to the insured such funds as are necessary for the *insured* to pay for *the insured’s defense and attorney fees costs*. The terms governing repayment of the loan provide in part that the insured agrees to seek recovery of the defense costs and attorney fees from the insurer that had refused to participate. That sort of loan receipt also typically provides that the insurer loaning the money is allowed to assert the *insured’s* rights over against the recalcitrant insurer. In the event of recovery, the loan is repaid out of funds the “insured” recovers from the other, non-participating insurer.

The threat of a loan receipt, when applied to funding of defense costs for an insured, is that *an insured* (at least where no insurer has paid for the defense) is entitled to recover *its* defense costs from an insurer. The potential, some have argued, is that the terms of the loan receipt just might result in shifting 100% of the defense costs to that insurer which was the target of the loan receipt agreement. And some would suggest that is not an inappropriate outcome because any insurer whose policy obligation is triggered is potentially obligated to provide the defense, and the existence of other insurance obligations is simply a fortuity that ought not dilute any insurer’s obligation.

Such a blunt outcome remained a possibility. The risks, one way or the other, could possibly provide incentive for some insurers to “wait and see” if another insurer, at its own risk, might step up and take over the defense.

The insurers participating in the *Wooddale* appeal had waived the *Iowa National* rule that otherwise barred recovery in the absence of a loan receipt agreement. Which means *Wooddale* does not explicitly rule on whether a loan receipt agreement indeed subjects the target insurer to the risk of paying 100% of the defense costs. What *Wooddale* holds is that when multiple insurers are all exposed to the duty to defend under the pro-rata-by-time-on-the-risk method, and those insurers *participate* in providing a defense to a common insured “but recovery of defense costs is not barred by the *Iowa National* rule,” defense costs should be apportioned equally among those insurers. *Wooddale*, at *17.

Which means that each of the insurers whose duty to indemnify was invoked had an equal *not a “pro-rata”* share of the defense costs.

In this case all of the insurers had “participated” in providing a defense. Presumably that means there was some sort of shared funding agreement, pending clarification of the precise obligation of each of the insurers ultimately held to owe *Wooddale* indemnity. And the idea that each insurer would ultimately be equally liable is not without some precedent in Minnesota. *Domtar* was a case where several insurers were ultimately determined liable for pollution damages under a pro-rata allocation method. There the supreme court stated that when no insurer has provided defense the *Jostens* rule applies such that the insured may recover all of its defense costs from any of the insurers with a duty to defend but that as between the insurers, each is equally liable for those costs. *Domtar*, 563 N.W.2d at 739; *citing Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 167 (Minn.1986).

If no insurer provides a defense, the insurers exposed on a pro-rata allocation basis end up with an equal share of the defense costs. And if all the insurers have “participated” in the defense, the same equal share results, leaving, perhaps, the impact of loan receipt recovery or shifting of defense costs for another day. Again referring back to *Jostens*, the *Wooddale* court emphasized that making insurers liable among themselves should encourage multiple insurers, to whom defense has been tendered, to address that duty to defend by some cooperative arrangement between them, by declaratory judgment or some other means. *Wooddale*, at *17.

Wooddale would seem to encourage defense funding agreements among insurers which are likely to be subject to pro-rata-by-time-on-the-risk allocation method. Of course not all insurers might be willing to conclude, on the front end, that the facts of any particular water intrusion case warrant the pro-rata allocation method as an “exception” to the general rule. In that case those insurers willing to participate would be wise to consider loan receipt terms as part of the defense funding agreement, thus preserving the insured’s right to invoke the non-participating insurer’s defense obligation, if that is how the facts play out.