NO. A04-1330

State of Minnesota

In Court of Appeals

Westfield Insurance Company,

Appellant,

vs.

Stephen J. Kroiss and Stephen R. Kroiss
d/b/a S. Kroiss Homes,

Respondents.

BRIEF OF *AMICUS CURIAE* BUILDERS' ASSOCIATION OF MINNESOTA AS UMBRELLA ORGANIZATION FOR TWIN CITY BUILDERS' ASSOCIATION AND MINNESOTA OUTSTATE BUILDERS' ASSOCIATIONS IN SUPPORT OF RESPONDENTS

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ISSUE PRESENTED

In this brief, *Amicus Curiae* addresses the primary issue before this Court: Did the District Court properly determine that Westfield Insurance Company owes Kroiss a duty to defend seven underlying actions, all of which allege damage caused by defective construction techniques?

INTEREST OF *AMICUS CURIAE*

The Builders Association of Minnesota ("BAM") is the umbrella organization for the Builders Association of the Twin Cities ("BATC") and for out state builders associations. BAM, BATC, and the out state associations are nonprofit, nonpartisan, voluntary trade associations established to represent the interests of building contractors, manufacturers, suppliers, and related business enterprises throughout the State of Minnesota. BAM's membership includes BATC's members and the out state association members. BAM's membership includes more than 4,000 members, most of whom are BATC members. Collectively BAM, BATC, and the out state associations will be referred to in this *Amicus Curiae* brief as the "Builders Associations."[1]

The Builders Associations' membership are engaged in building and remodeling homes throughout Minnesota. In total, the membership employs more than 500,000 Minnesotans. The Builders Associations serve their membership by developing and promoting programs and services to enhance their ability to conduct individual businesses successfully, with integrity and competence, and to promote quality construction techniques thereby benefiting the home-buying public.

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[1] Other than the Builders Associations and their members, no party or entity made any monetary contribution to the preparation or submission of this brief. Respondents are BAM and BATC members, but they did not make any direct financial contribution to this brief. This brief was authored solely by the Builders Associations' attorneys, Fabyanske, Westra & Hart, P.A. These certifications are provided in accordance with the requirements of Minn. R. Civ. App. 129.03.

Under Minnesota law, all licensed residential contractors are required to purchase commercial general liability ("CGL") insurance policies to protect themselves and the home-buying public against, among other things, property damage claims caused by inadvertent construction defects. The Builders Associations are vitally interested in the outcome of this case in order to ensure that its members and the home-buying public receive the protections paid for by their members, relied upon by the home-buying public, and afforded by CGL insurance coverage. If Minnesota courts permit an insurer to refuse to defend an insured because the complaint alleges construction defects generally, but does not expressly state that the damage occurred within an insurer's policy period or afterwards, the effect will be that, before an insurer must defend its insured against such claims, the insured must prove to the insurer that it did in fact perform defective work which, in turn, damaged the plaintiff's property during the insurer's policy period. This consequence means builders have to admit they performed defective work and they caused damage during their insurer's policy period before the insurer has any obligation to defend the builder against the plaintiff's claims.

In other words, if Westfield's proposed rule is adopted by this Court, in cases where the complaint's allegations are pleaded generally, an insurer's duty to defend would never arise until the fact finder determines when the damage occurred or the insured admits liability and the date(s) resulting damage occurred. Westfield's proposed rule is at odds with well-settled Minnesota law and would render the defense benefit in CGL policies illusory. Equally as important, the home-buying public would be harmed by the adoption of Westfield's proposed rule because few, if any, CGL insurers would offer money to resolve a homeowner's claim against a builder until after trial established: (1) liability, and (2) date(s) of damage.

SUMMARY OF ARGUMENT

This case threatens to replace the predictability of an insurer's duty to defend its insured when allegations in a complaint assert damages that bring the case potentially within the policy's risk coverage. The significance of and potential harm caused by any narrowing of an insurer's obligation to defend its insured cannot be overstated. If Westfield's approach to an insurer's defense duty is adopted by this Court whether an insured defendant is entitled to a defense will be dependent on whether *plaintiff's* counsel pleads specific date(s) the alleged damage occurred. Thus, if the plaintiff's complaint is pleaded generally or silent regarding date(s) when the alleged damage occurred, as most defective construction complaints are plead, then no insurer will owe a defense obligation to its insureds. Such a ruling would render an insurance policy's defense obligation illusive, at least until the insured established its own negligence through judicial admissions and showed that damage occurred and that the damage occurred during an insurer's policy period. By that time, the defendant insured has been deprived of any meaningful defense by its insurer against a plaintiff's claim.

In order for the insured to gain any meaningful value from the defense benefit it paid for when it purchased CGL insurance, the insurer must defend immediately and entirely. Otherwise, the fight over when the damage or injury occurred and which insurance company owes a duty to defend can deprive the insured of being defended at all. Equally as important, under Westfield's proposed rule, plaintiff's counsel will have the power to determine whether defendant builders have the benefit of a defense from insurers simply by omitting any allegation in the complaint regarding date(s) of damage.

ARGUMENT

This insurance coverage dispute presents a discrete, but important, issue pertaining to an insurer's obligation to defend its insured against third party claims that may ultimately be covered under CGL policies issued by the insurer.

A. An Insurer's Duty to Defend Its Insured Is Created By the Insurer's CGL Policy and Is an Important Benefit Paid for By the Insured.

At issue in this case are two identical CGL policy forms sold by Westfield to Stephen J. Kroiss and Stephen R. Kroiss, d/b/a Kroiss Homes (collectively "Kroiss"). A CGL policy's function is to protect the insured against claims asserted by third parties. Protection is afforded by imposing two principal duties on an insurer—first, a duty to defend lawsuits, and second, a duty to indemnify or pay claims in the event that the insured's liability is established. Both duties are based upon the contractual language of the CGL policies so-called "insuring agreement," which provides:

> 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. **We will have the right and duty to defend <u>any</u> 'suit' seeking those damages.** We may at our discretion investigate any 'occurrence' and settle any claim or 'suit that may result. But:
>
> (1) The amount we will pay for damages is limited as described in LIMITS OF INSURANCE (SECTION III); and
>
> (2) Our right and duty to defend end when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A or B or medical expenses under Coverage C.
>
> No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under SUPPLEMENTARY PAYMENTS—COVERAGES A AND B.
>
> 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;' and

(2) The 'bodily injury' or 'property damage' occurs during the policy period.

c. Damages because of 'bodily injury' include damages claimed by any person or organization for care, loss of services or death resulting at any time from the 'bodily injury.

(Westfield's Brief and Appendix, p. A016, bold emphasis added.) Thus, an insurer's duty to defend an insured is contractual and is based upon the language of the policy that the insurer drafted. *Republic Vanguard Ins. Co. v. Buehl*, 204 N.W.2d 426, 429 (Minn. 1973).

The duty to defend operates as a form of "litigation insurance" protecting the insured from having to find and fund its own defense when sued by a third party on potentially covered claims. The importance of defense coverage for the construction industry cannot be overlooked. Recent industry reports show that the cost of defense on an average general liability claim is approximately 50 percent of the amount paid to resolve liability. In complex commercial litigation, such as construction defect cases where multiple parties and experts are commonplace, some industry reports place the cost of defense as high as 77¢ for nearly every 23¢ paid to claimants. S.C. Turner, INSURANCE COVERAGE OF CONSTRUCTION DISPUTES, § 7.1 (2nd Ed. West Group 2004 supplement). As one commentator noted, "from a purely economic standpoint, defense coverage represents more than half of the benefit of liability insurance to the construction litigant." *Id.*

Many, if not most, of Minnesota's home builders are small, family-owned businesses. When faced with a lawsuit, the defense benefit in builders' CGL policies ensures there are adequate funds available to investigate and defend plaintiffs' claims. The insured contractor is not forced to incur high costs of litigation that could be financially catastrophic, especially for small builders like Kroiss. Currently, Minnesota's residential construction industry is dealing

with a deluge of construction defect claims. Because most claimants are individual homeowners, they are interested in resolving their claims quickly and they often initiate early settlement negotiations to avoid the expenses and delays of litigation. Early settlement is often achieved only because the contractor's insurer is on board and funding the settlement. When an insurer denies its defense obligation, as Westfield did here, it has no duty to indemnify. *See generally Garvis v. Employer's Mut. Cas. Co.*, 497 N.W.2d 254 (Minn. 1993). Without participation from insurers early on, settlement in the early stages of litigation would clearly be hindered.

If insurers are permitted to sit on the sidelines until their insureds admit their own liability and prove property damage occurred during an insurers' policy period, then the insured contractor is deprived of its defense benefit. Further, early, fair settlements will not be achieved and the catastrophic costs to the home-buying public and contractors to resolve these claims may be ruinous. Moreover, if the fact finder ultimately determines that the contractor is responsible for property damage and the damage occurred during an insurer's policy period, the insurer will eventually have to respond to the contractor's request for indemnification against resulting damages caused by covered property damage. Accordingly, defense coverage and insurers' early involvement in these claims is to everyone's benefit, including insurers'.

B. Minnesota Courts Broadly Interpret an Insurer's Defense Duty.

Minnesota courts have long held that the duty to defend is distinct from and broader than the duty to indemnify. *See SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 316 (Minn. 1995); *Brown v. State Auto & Casualty Underwriters*, 293 N.W.2d 822, 825 (Minn. 1980); *Inland Constr. v. Continental Ins. Co.*, 258 N.W.2d 881, 884 (Minn. 1977) (*citing Christian v. Royal Ins. Co.*, 240 N.W. 365 (1932)). Because an insurer's defense obligation is broader than indemnity obligations, if any claim is arguably covered under a CGL policy the insurer must defend and protect its insured even if the insurer issues a reservation of rights letter to defer

coverage disputes. *Brown*, 293 N.W.2d at 825. An insurer's duty to defend arises when the underlying complaint against the insured alleges any facts that *might* fall within the coverage of the policy. *Prahm v. Rupp*, 277 N.W.2d 389, 390 (Minn. 1979). Importantly, "[a]ny ambiguity is resolved in favor of the insured, and the burden is on the insurer to prove that the claim clearly falls outside the coverage afforded by the policy. If the claim is not clearly outside coverage, the insurer has a duty to defend." *Id.* Thus, under clearly established Minnesota law, to avoid any obligation to defend its insured, the insurer--not the insured--must demonstrate that undisputed facts conclusively eliminate any possibility of coverage.

C. If an Insurer's Defense Duty Depends on Whether *Plaintiff's* Counsel Pleads Specific Dates In a Complaint, An Insured Could Be Totally Deprived of its Defense Benefit.

If an insurer's duty to defend its insured is dependent on whether a plaintiff's complaint clearly alleges the precise date(s) when the damage complained of occurred, an insured served with a complaint that contains specific allegations of when the alleged damage occurred is fortunate because at least one of its insurer's defense duties is triggered. But, if the complaint is silent as to dates of damage, then the insured's luck turns from bad to worse because its insurer can deny any duties to defend or indemnify, leaving the insured as a defendant in a lawsuit with no defense benefit.[2] Indeed, applying Westfield's proposed rule to continuous damage claims, an insured could be totally deprived of any defense benefit from any of its insurers because the plaintiff would seldom, perhaps never, limit its damages to a particular year. The following hypothetical illustrates this risk:

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[2] Because some insurance policies expire at times other than the end or start of a calendar year, the plaintiff's complaint would have to plead the precise date(s), i.e., year, month, and date, of damage or injury under Westfield's proposed rule in order for the insured to have a defense. Otherwise, the insurers who issued policies to the insured during a particular year could reject the insured's tender of defense on the ground that while there is an allegation that the damage or injury occurred in the year the policies were issued, there is no allegation that the damage or injury occurred during the exact period the policy(ies) were in effect. Westfield's proposed rule would, therefore, encourage every insurer in Minnesota to issue policies so that they do not coincide with the calendar year as a further means to avoid defense and indemnity obligations.

> On June 1, 2004, an insured builder was sued by a homeowner. In her complaint, the homeowner claimed the house was completed by the builder in 2000. The homeowner vaguely alleges in her complaint that she "recently" discovered that the house was defectively constructed, which allowed water to enter the home's wall cavities and damage the house's structural components.
>
> The homeowner's complaint is devoid of any date(s) when the alleged damage occurred.
>
> The insured builder purchased insurance for the years 2000-2004; but at the end of every annual policy period, the builder switched insurers. Thus, for the years 2000-2004, the builder was insured by a different insurer each year.
>
> Upon receiving the plaintiff's complaint, the builder requested that all five insurers who insured the builder during the 2000-2004 period defend and indemnify the builder against the plaintiff's claims.
>
> All of the builder's insurers, however, reject the builder's requests for defense on the ground that the plaintiff's complaint has no allegation of when the alleged damage occurred. Thus, although the builder complied with Minnesota law and was fully insured during the period when the alleged damage could have occurred, under Westfield's rule, none of the builder's insurers would be required to defend the builder against the homeowner's claims.

An insured's right to a defense should not be dependent on whether plaintiff's counsel chooses to plead the precise date(s) when the alleged damage occurred.[3] Such a result would shift the burden to the insured receiving a generally pleaded complaint to establish that:

(1) damage occurred, (2) the insured was responsible for the damage and

(3) the damage or injury occurred during the policy period before the insurer would be required to protect the insured against the claim. Insurance coverage is not intended for the lucky; it exists to protect the unlucky from their unintended misfortunes. It is for this reason that "a

[3] In many cases, at the time the complaint is prepared plaintiff's counsel does not have the necessary facts to specifically plead the date(s) when the alleged damages or injuries occurred, especially when the complaint is being prepared and served to avoid an impending statute of limitations. Further, diverse and complex construction claims adhere to the notice pleading doctrine and are usually broadly pleaded; as a result, plaintiffs seldom specifically identify the years their alleged damages occurred.

policy protects against poorly or incompletely pleaded cases as well as those artfully drafted." *Ruder & Finn, Inc. v. Seaboard Surety Co.*, 422 N.E.2d 518, 519 (N.Y. 1981).

D. Other Jurisdictions Which Broadly Construe an Insurer's Defense Duty Have Rejected Narrowing the Defense Duty Based On Plaintiff's Failure to Allege Precise Date(s) Of Damage or Injury in the Complaint.

Although *Amicus Curiae* was unable to find any Minnesota appellate decision addressing an insurer's argument advocating narrowing an insured's defense benefit based upon a plaintiff's failure to specifically allege in the complaint when the damage occurred, the Rhode Island Supreme Court and the Eleventh Circuit Court of Appeals (applying Florida law) have addressed and dismissed identical arguments raised by insurers.

1. *Flori v. Allstate Ins. Co.*, 388 A.2d 25 (R.I. 1978).

In *Flori v. Allstate Ins. Co.*, 388 A.2d 25, 27 (R.I. 1978), the Rhode Island Supreme Court held that the insurer had a duty to defend its insured, even though the allegations in the plaintiff's complaint failed to specify whether the insured's alleged negligence occurred before or after the insured's operations would be deemed completed under the policy to trigger the insured's completed operations exclusion. *Id.* at 26. The policy at issue excluded coverage for any liability that occurred after the insured completed its work. *Id.* at 25.

Flori, a concrete subcontractor, performed foundation and concrete work for a general contractor who, in turn, was hired by the homeowner to remodel the homeowner's basement. *Id.* Subsequent to Flori commencing his work, the basement flooded. *Id.* The homeowner commenced a lawsuit against Flori and the general contractor, alleging that Flori and the general contractor negligently performed their work and seeking to recover resulting damages. *Id.*

Allstate Insurance Company ("Allstate") insured Flori under a general liability policy that covered Flori against liability for property damage and bodily injury while Flori was on the premises and engaged in work as a concrete and foundation contractor. *Id.* Excluded from

coverage was liability arising from "completed operations." *Id.* at 26. The policy defined operations to be completed when "all operations to be performed by or on behalf of the insured under the contract had been completed, even if those operations required further service or repair because of defect or deficiency." *Id.*

Allstate denied coverage and refused to defend Flori against the homeowner's claims. *Id.* Flori responded by commencing a declaratory judgment action against Allstate, seeking a declaration of his and Allstate's respective rights and obligations under the general liability policy. *Id.* The trial court found that Allstate had a duty to defend Flori. *Id.* Allstate appealed the trial court's decision to the Rhode Island Supreme Court. *Id.*

On appeal, the Rhode Island Supreme Court, citing to previous decisions, articulated Rhode Island's rule regarding an insurer's defense duty to its insured. "[I]f the complaint discloses a statement of facts bringing the case potentially within the risk of coverage of the policy the insurer will be duty-bound to defend irrespective of whether the plaintiffs in the tort action can or will ultimately prevail." *Id.* The *Flori* court then examined the plaintiff's complaint, which included the following general allegations:

> 3. The Defendant Peter Flori was negligent in the performance of his work, labor, undertakings, and acts in connection with the foundation walls of the aforesaid project.
>
> 4. As a direct and proximate result of the concurrent negligence of the Defendant Peter Flori with the negligence of the aforesaid Defendant Delmar R. Levesque and the Defendant Arctic Home Improvement Company . . . the Plaintiffs and each of them suffered damages referred to in Count I. . . . *Id.*

Based upon the complaint's allegations, the *Flori* court concluded that:

> [t]hese allegations fail to specify whether Flori's alleged negligence occurred before or after his operations would be deemed completed under the policy. The pleadings, therefore, leave in doubt whether a state of facts exists that will render inapplicable the completed operations exclusion. *Id.* at 27.

Applying Rhode Island's duty to defend rule, the Rhode Island Supreme Court held that "[u]nder our rule that doubt must be resolved against Allstate." *Id.* (citation omitted). Rhode Island's duty to defend rule is identical to Minnesota's duty to defend rule.

2. Trizec Properties v. Biltmore Constr. Co., 767 F.2d 810 (11th Cir. 1985).

Likewise, in *Trizec Properties v. Biltmore Constr. Co.*, 767 F.2d 810, 813 (11th Cir. 1985), the Eleventh Circuit Court of Appeals held that the plaintiff's complaint was broad enough to trigger the insurer's duty to defend because the language of the complaint "at least marginally and by reasonable implication [citation omitted] could be construed to allege that the damage (cracking and leaking of roof deck with resultant rusting) may have begun to occur immediately after installation . . . and continued gradually thereafter over a period of time." *Id.* Thus, the *Trizec* court concluded that the complaint's allegations were broad enough to allow the plaintiff to prove that at least some of the damages occurred during the insurer's policy periods so the insured was entitled to a defense from its insurer. *Id.*

E. Minnesota's Actual Injury Rule and the Defense Duty.

In its brief, Westfield states that because Minnesota follows the actual injury rule "[a]n occurrence-based policy is triggered for the purposes of the duty to defend by an allegation of damage that occurred during the policy period." (Westfield's Brief and Appendix, p. 7.) The actual injury rule, however, applies to determine which insurers have indemnity obligations, not defense obligations. *See generally In re Silicone Implant Litigation*, 667 N.W.2d 405 (Minn. 2003).

Westfield's reliance upon the actual injury rule reflects an improper commingling of the analysis of defense and indemnity obligations. Moreover, even if Westfield could establish that the actual injury rule applies to determine when an insurer's defense duty is triggered, a recent

Minnesota Federal District Court decision applied Minnesota's actual injury rule against Westfield in a water intrusion/construction defect case involving a different insured contractor. The federal district court found that the damages were continuous since construction was complete in 1997 and arose from a discrete and identifiable event—defective design and construction techniques. Specifically, in *Westfield Insurance Company v. Weis Builders, Inc.*, 2004 U.S. Dist. LEXIS 13658, **10-14 (D. Minn. July 1, 2004), the Honorable Joan Ericksen concluded that Westfield's policy, the policy on the risk when the project was completed in 1997, was the only policy triggered by the plaintiff's claims. Consequently, the actual injury rule does not support Westfield in this case.

Like some of the plaintiff homeowners who asserted claims against Kroiss, there was evidence of water intrusion during Westfield's policy period in the *Weis Builders, Inc.* case. *Id.* In *Weis Builders, Inc.*, Westfield argued that water intrusion problems were not attributable to any of the design and construction defects in existence at the time the project was completed, but instead were caused by multiple events, including severe rains and repair work performed by the general contractor, Weis Builders, Inc., after Westfield's policy expired. *Id.* at *13. Westfield offered no evidence to support its assertions that the damages or water intrusion were not derivatives of earlier damage or were caused by defective construction completed during Westfield's policy period. *Id.* Thus, Judge Ericksen found Westfield's arguments unpersuasive and concluded that Westfield's policy (and only Westfield's policy) was triggered by an occurrence during the relevant policy period—the time of the construction project's completion in 1997.[4] *Id.* at **13-14.

[4] Notably, in *Weis Builders, Inc.*, Valley Forge Insurance Company ("Valley Forge") acknowledged its duty to defend Weis Builders, Inc. ("Weis"). Valley Forge insured Weis after Westfield's policy expired. Ultimately, Valley Forge had no indemnity obligation to Weis, but its acceptance of its defense duties highlights the separateness of the two duties. Valley Forge accepted that there was at least the potential that a court might find that property damage and water intrusion were continuous so the loss could be allocated between Valley Forge and

Accordingly, even if the actual injury rule applies to determine when an insurer's defense obligation is triggered, the only reported Minnesota decision applying the actual injury rule to a construction defect/water intrusion case found that the policy on the risk at the time of substantial completion of the project was the only policy triggered. It is conceivable under Judge Ericksen's decision in *Weis Builders, Inc.* that, depending upon the facts of the case, an insurer insuring a construction defect/water intrusion claim where the damages are continuous might not be entitled to share any indemnity obligation it owes the insured contractor with the contractor's subsequent insurers. In other words, the insurer on the risk when construction was completed may not be limited to defending the insured with other insurers which have policies during the entire period damages allegedly occurred, it may be the only insurer with an indemnity obligation.

CONCLUSION

For the reasons discussed in this brief, and the reasons set forth in Respondents' brief, the Builders Associations respectfully request that this Court affirm the District Court's October 23, 2003, Order (1) denying Westfield's Motion for Summary Judgment, (2) granting Kroiss' Motion for Partial Summary Judgment, and (3) declaring that Westfield defend and/or indemnify Kroiss against the homeowners' claims.

Dated: September 27, 2004

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Westfield. Accordingly, Valley Forge accepted its defense obligation and contributed to Weis' defense against the plaintiff's claims.

CERTIFICATION OF BRIEF LENGTH

I certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subds. 1 and 3, for a brief produced with a proportional font. The length of the brief is 4,719 words. The brief was prepared using Microsoft Word 2002.

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