

NO. A05-0278

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State of Minnesota  
In Court of Appeals

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Kootenia Homes, Inc.,

*Respondent,*

vs.

Federated Mutual Insurance Company  
d/b/a Federated Insurance,

*Appellant,*

and

The Cincinnati Insurance Company,

*Respondent.*

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**BRIEF AND APPENDIX OF AMICUS CURIAE  
BUILDERS ASSOCIATION OF MINNESOTA**

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### Interest of Amicus Curiae

The Builders Association of Minnesota ("BAM") is a trade organization representing the interests of approximately 4,000 members who work in the residential building industry.<sup>1</sup> BAM members include home builders, remodelers, developers, subcontractors and suppliers who work in the residential building industry throughout the State of Minnesota.

Members of BAM also belong to local builder associations located throughout the state, the largest of which is the Builders Association of the Twin Cities ("BATC"), sponsor of the *Parade of Homes*<sup>SM</sup> events.

BAM members, especially its builder members, will be directly and significantly affected by the outcome of this case. Home builders in Minnesota are required by law to be licensed and, as a condition of licensure, to purchase commercial general liability ("CGL") insurance policies to protect themselves and the home buying public against, among other things, property damage claims such as those presented in this case. See Minn. Stat. § 326.94, subd. 2.

### Summary of Argument

The central issue in this case is whether the property damage sustained by the homes involved in this case is continuous damage and, if so, whether time on the risk allocation is appropriate.

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<sup>1</sup> **Rule 129.03 Certification.** This brief for *Amicus Curiae* BAM was authored solely by legal counsel for BAM. No other counsel for a party participated in or authored any portion of this brief. The Minnesota Developers and Builders Legal Action Fund (the "Fund") paid the legal fees and costs for this *Amicus Curiae* brief on behalf of BAM. The Fund consists of 67 member companies which raise funds to support the legal interests of the residential building industry. These 67 companies are also members of BAM. Respondent Kootenia Homes, Inc. is a member of the Fund and a member of BAM. Kootenia Homes did not participate in the decision by BAM to seek leave to file an *Amicus Curiae* brief in this case and did not participate in the decision by the Fund to pay the legal fees and costs for this *Amicus Curiae* brief.

Time on the risk allocation is a legal doctrine designed to address the special problems posed by environmental liability cases. *NSP v. Fidelity & Cas. Co. of New York*, 523 N.W.2d 657, 660 (Minn. 1994); *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305 (Minn. 1995); *Domtar, Inc. v. Niagara Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997).

The Minnesota Supreme Court made it clear that this type of allocation is the exception, not the rule, and is applied only after considering matters of public policy, the parties' intent or reasonable expectation, and canons of construction. *In Re Silicone Implant Insurance Cov. Litigation ("In Re Silicone")*, 667 N.W.2d 405, 418 (Minn. 2003). No insurance policy provision allows time on the risk allocation and Federated Mutual Insurance Company d/b/a Federated Insurance ("Federated") cites none.

Under the two-part test first formulated by the Supreme Court in *Domtar* and confirmed by the Court in *In Re Silicone*, 667 N.W.2d at 418, horizontal allocation is not appropriate here.

The property damage sustained by these homes is continuing damage, thereby satisfying the first test, but it arose out of a discrete and identifiable event, as the District Court correctly concluded, making such allocation improper here. *In Re Silicone*, 667 N.W.2d at 418.

It is clear that the improper installation of stucco on these homes, which Federated's own documents show is the cause of the property damage, is the discrete and identifiable event. Improper stucco installation exposed these homes to water damage. This damage began on or shortly after the homes were sold. The liability policy in effect at the time of the sale is the policy which is responsible for the property damage.

Time on the risk allocation, if adopted by this Court, will poison the liability insurance market for builders and encourage insurance companies to either refuse to

renew builder liability insurance policies or introduce endorsements designed to shield them from time on the risk allocation.

The facts of this case provide an apt example of why this detrimental impact occurs. Kootenia Homes, Inc. ("Kootenia") built more than 200 homes, including over 100 homes with stucco exteriors. See K. App. 446. This case concerns only 31 of the more than 100 stucco homes. There are 69 or more stucco homes built by Kootenia which may suffer from the same water intrusion damage as those homes damaged in this case and this damage has not yet been discovered.<sup>2</sup>

Adopting time on the risk allocation encourages current liability insurance carriers to cease renewing liability policies for builders because the longer they insure a builder, the greater their exposure to liability under time on the risk allocation.

It poisons the liability insurance market for builders because new insurance carriers are required to pay a pro rata share of property damage claims, even though the property damage occurred years before the inception date of their liability policies. To protect against this risk, insurance companies will either refuse to insure builders or add policy provisions to limit or eliminate this risk.

Indeed, Federated refused to renew Kootenia's policy effective April 1, 2002 and introduced in its final policy year an endorsement designed to shield Federated from the very type of allocation it encourages the Court to adopt here.<sup>3</sup> Federated argues in favor of

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<sup>2</sup> All 31 homes involved in this case were built between 1996 and August 4, 2000, K. App. 446-48, and yet no claims were made until April, 2002. The first two claims, the Woida and Long claims, were made in April, 2002—approximately five years after these homes were constructed. K. App. 003; K. App. 447. The time period between damage and discovery of damage can be significant.

<sup>3</sup> Endorsement CG-F-68 was added by Federated Insurance to Kootenia Homes' 2001-2002 CGL policy and provides: "This policy does not apply to, and the Company shall have no duty to defend, any claim seeking 'bodily injury' or 'property damage' that occurred before the policy period, regardless of whether that 'bodily injury' or 'property damage' is also deemed to have occurred during the policy period of this policy." K. App. 433-45. This endorsement is clearly designed to shield Federated from time on the risk allocation by excluding coverage for any property damage that occurs before the policy period.

time on the risk allocation while, at the same time, making sure to protect itself against its application.

The Cincinnati Insurance Company ("Cincinnati Insurance"), which insured Kootenia after Federated refused to renew its policy, cites additional endorsements or exclusions which it argues precludes coverage for these property damage claims.<sup>4</sup>

Federated and Cincinnati Insurance are not alone in their attempt to protect against liability from time on the risk allocation. Attached to this brief and summarized below are samples of other endorsements added to the CGL policies of BAM members:

1. A "Prior Completed Operations Exclusion" which excludes from coverage any property damage arising out of the builder's work which was completed prior to the policy period. BAM App-1.
2. An "Endorsement for Continuing or Progressive Bodily Injury, Personal Injury or Property Damage" which excludes from coverage continuing or progressive bodily injury or property damage by (i) treating such bodily injury or property damage as one "occurrence" and stating that it shall be deemed to occur only when the injury or damage first commenced and (ii) stating that the insurer has no duty to defend or investigate any such occurrence unless it first commenced during the policy period. See BAM App-2.
3. "Amendment of Limits for Moisture-Related Damage Including Expense" which puts a dollar limit on coverage for moisture related bodily injury and property damage claims. BAM App-4.

No policy provision permits time on the risk allocation and, as demonstrated above, there are many endorsements designed to limit or exclude its application.

Time on the risk allocation is bad public policy when applied to the residential construction industry. This case comes to this Court under facts which are not static, as in *NSP*, *SCSC* and *Domtar*, but where water intrusion damage on residential homes built by

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<sup>4</sup> Specifically, Cincinnati Insurance cites its "fungi or bacteria" endorsement, its "Exterior Insulation and Finish Systems and Direct Applied Exterior Finish Systems" exclusion and failure to provide immediate notice of loss as its bases for denying coverage. K. App. 486-93.

Kootenia and other builders may be ongoing and where insurers have every incentive to protect themselves from this allocation.

Time on the risk allocation will also spur litigation between insurers and their insureds as the validity and scope of the endorsements designed to limit exposure to allocation is tested. Still pending in this case are claims between Kootenia and Federated over the validity of the exclusion it introduced in the final policy year, and between Kootenia and Cincinnati Insurance over its mold and related exclusions.

Time on the risk allocation protects only the interests of those insurers that are liable for property damage which first occurred during their policy years and allows them to allocate their liability for property damage to present and future insurance carriers for builders, just as Federated is attempting to do in this case. The present and future insurance carriers will respond, as Federated and others have, by refusing to renew policies or by introducing endorsements designed to limit or exclude exposure to time on the risk allocation.

If this allocation is allowed, builders will be faced with substantial uninsured liability, even though the property damage first occurred during the time when there was coverage for the property damage. Ultimately, it will be homeowners who bear the brunt of this uninsured risk as many builders will be unable to withstand such substantial uninsured liability.<sup>5</sup>

#### Legal Issue

**Did the property damage sustained by the homes in this case on or shortly after closing result from a discrete and identifiable event, thereby making the policies on the risk at the time of that event liable for all sums arising from the event?**

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<sup>5</sup> Federated Insurance states it paid \$1,661,828.00 to address the first 12 of 31 stucco-related claims against Kootenia Homes. A. App. 454-456.

The District Court determined that the property damage from moisture intrusion in these homes resulted from the improper installation of stucco, which was a discrete and identifiable event and renders Appellant, whose policies were on the risk at the time of that event, liable for all sums arising from the event.

**APPOSITE AUTHORITY:** *In Re Silicone*, 667 N.W.2d 405 (Minn. 2003); *Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997).

### Legal Argument

1. Standard of Review.

The District Court granted Kootenia's Motion for Summary Judgment. In reviewing the grant of a summary judgment motion, the Appellate Court must determine whether any issues of material fact exist and whether the trial court erred in its application of the law. *DLH, Inc. v. Russ*, 566 N.W.2d 60, 71 (Minn. 1997), *reh'g denied* (Minn. Aug. 5, 1997). Where a non-moving party presents evidence which merely created metaphysical doubt as to a factual issue and which is not sufficiently probative with respect to essential elements of the non-moving party's case to permit reasonable persons to draw different conclusions, there is no genuine issue of material fact sufficient to preclude entry of summary judgment. *Id.*

An adverse party must present specific facts demonstrating a genuine issue for trial and may not rest upon mere averments or unsupported allegations. *Musicland Group, Inc. v. Ceridian Corp.*, 508 N.W.2d 524, 530-31 (Minn. App. 1993), *review denied* (Minn. Jan. 27, 1994).

2. Review of the Record.

Appellant claims that there is no evidence the damage occurred during its policy period and that the District Court wrongly adopted the completion of construction on each of these homes as the date when property damage occurred.

Respondents Kootenia and Cincinnati Insurance have thoroughly addressed this issue. Kootenia cites fourteen separate letters written by Federated to Kootenia in which Federated states that its evaluation of the claims results in a determination that the water infiltration/moisture damage to the home began shortly after the home was closed. See Respondent Kootenia's Brief, pp. 18-19.

Kootenia cites thirteen letters between Federated and homeowner claimants in which Federated states that the damage began to occur shortly after the home was closed. Kootenia cites communications between Federated and Cincinnati Insurance where Federated, once again, states that, based upon its investigation, property damage began shortly after the home was closed. Respondent Kootenia's Brief, pp. 21-22. Finally, Federated, in pursuing its subrogation claims against the stucco subcontractor, states that the property damage began at about the time of the closing of the home and makes similar factual statements in its District Court pleadings. Respondent Kootenia's Brief, pp. 23-24.

Cincinnati Insurance, in its brief, cites admissions by Federated representatives who state that Federated made payments because it believed them to be due under its policy and made payments under numerous claims with the understanding that no other insurer would be involved. Respondent Cincinnati Insurance's Brief, p. 10. Cincinnati Insurance also points out that the statements contained in Federated's subrogation pleadings ("that the damages described herein occurred from the time the stucco system was installed by Lusian Stucco Corporation until repairs were completed in approximately December of



2002") were made approximately three months after the filing of this declaratory judgment action. C. App. 501.

Contrary to Federated's claims, the trial court record contains substantial evidence that Federated, following its investigation of the property damage, concluded that the damage occurred on or shortly after the closing on the sale of the home and it repeated these admissions in letters to Kootenia, homeowners, the stucco subcontractor and, finally, the District Court in the subrogation actions.

This is a compelling factual record. Federated, based upon its own investigation, reached the conclusion that property damage occurred on or shortly after the closing on the sale of the home. The trial court correctly found that: "There is no issue of fact raised by Federated. The only evidence before this Court is that the property damage began shortly after completion of the homes, which is within the time frame of Federated's policies. Federated's policy was, therefore, triggered." See October 27, 2004 Amended Order and Memorandum at A. App. 017.

### 3. Time on the Risk Allocation.

The central issue here is whether the property damage sustained by the homes involved in this case is continuous damage and, if so, whether time on the risk allocation is appropriate.

However, before turning to this issue, it is important to highlight the fact that Federated's CGL policies are "occurrence" policies and that Federated's own investigation and admissions established that property damage first occurred on or shortly after the closing. Therefore, Federated is already liable for this property damage under the policies in effect at that time. The only question posed here is whether Federated should be allowed to allocate a portion of this damage to Cincinnati Insurance and other insurers

who follow Cincinnati Insurance. On its face, this allocation may appear equitable. Assuming the damage is continuous, allocating liability for this property damage over multiple policies is superficially appealing. However, when examined, this allocation is anything but equitable.

Time on the risk allocation exists nowhere in Federated's policy. It is a judicial doctrine applied to the unique problems posed by environmental liability cases. The doctrine was first applied by the Minnesota Supreme Court in *NSP v. Fidelity & Cas. Co. of New York*, 523 N.W.2d 657 (Minn. 1994).

In deciding the *NSP* case, the Supreme Court weighed issues of public policy, including the costs of litigation and the impact on the likelihood of settlement of cases, before applying time on the risk allocation to a ground water pollution case. The *NSP* Court was clearly concerned about both the practical and equitable issues posed by ground water pollution cases, and adopted the "pro rata by time on the risk" allocation, as a public policy matter. *NSP*, 523 N.W.2d at 663. The Court noted that this type of allocation would reduce the cost of litigation and eliminate impediments to settlement. *Id.*

The following year, however, the Court declined to apply time on the risk allocation in *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305 (Minn. 1995). In the *SCSC* case, the environmental damage was due to a 1977 spill of perchloroethylene, a dry cleaning chemical. The damage from this spill continued for years and the Court was urged to apply the time on the risk allocation, as in *NSP*. The Supreme Court rejected this argument, noting that, "our decision in *NSP* was an equitable decision based upon the complexity of proving in which policy periods covered property damage arose. In the present case, however, we have sufficient evidence indicating that the damage arose from a single event in 1977." 536 N.W.2d at 318. The Court concluded that only the policy in

effect at the time of this spill was triggered and that this result was consistent with the actual injury trigger or theory. *Id.*

In *Domtar, Inc. v. Niagra Fire Ins. Co.*, 563 N.W.2d 724 (Minn. 1997), the Court was faced, as in *NSP*, with a long-term ground water contamination case. This time, while applying time on the risk allocation, the Court defined the limits of this type of allocation. The Court stated that, "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." 563 N.W.2d at 733. Explaining its rationale in *NSP*, the Court states:

"*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."

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

Finally, the Court, in its first non-pollution related allocation case, confirmed the analytical framework necessary for determining when a time on the risk allocation is appropriate. The central issue in *In Re Silicone* was whether or not to allocate damages in the medical device implant setting. 3M was named in thousands of complaints alleging that its silicone gel breast implants caused symptoms consistent with systemic autoimmune disease.

The Court in *In Re Silicone* clarified that, to trigger an occurrence based policy, the insured must show some damage occurred during the policy period, even though the damage, "...is not 'diagnosable,' 'compensable,' or manifests during the policy period, as long as it can be determined, even retroactively, that some injury did occur during the policy period." 667 N.W.2d at 415 (citations omitted).

The insurers in *In Re Silicone* argued, as does Federated here, that the trial court dispensed with the actual-injury trigger rule when it held that the policies were triggered at about the time of implantation of the silicone gel implants. The trial court in *In Re Silicone*, after reviewing medical testimony, determined that the damage occurred at a cellular level at or about the time of implant and years before the plaintiffs began experiencing symptoms of systemic disease. 667 N.W.2d at 417. The Supreme Court concluded that the trial court had correctly applied the actual-injury trigger rule and that its findings that damage occurred at or about the time of implantation was not clearly erroneous. *Id.*

After reviewing its holdings in *NSP*, *SCSC*, and *Domtar*, the Court confirmed a two-part test for determining whether or not to allocate damages based upon time on the risk. First, it must be determined whether or not the plaintiffs' injuries are continuous. If not, the policies on the risk at the time of the injury pay all losses arising from that injury. Second, if the plaintiffs' injuries are continuous, it must be determined whether the continuous injury arose from a discrete and identifiable event. If so, "...the policies on the risk at the time of the event are liable for all sums arising from the event." 667 N.W.2d at 421.

The *In Re Silicone* Court stressed that:

"In our actual-injury trigger framework, allocation is meant to be the exception and not the rule because '[i]t is only in those difficult cases' that allocation is appropriate. *Domtar*, 563 N.W.2d at 733. If we can identify a discrete originating event that allows us to avoid allocation, we should do so. Here, the district court labeled the time of implant as the beginning of the continuing injury process. The implantation, therefore, is a readily identifiable discrete event from which all of the plaintiffs' alleged injuries arose. 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 cannot be apportioned among causes'."

067 WAV.Dd at 421-22. The *In Re Silicone* Court concluded that this was not one of those difficult cases and that, consistent with the actual-injury trigger rule, only those insurers on the risk at the time of implantation are liable up to the limits of their respective policies for the company's losses arising from that implantation. *Id.*

Here, it is clear that the improper application of the stucco exterior is the event from which all of the homeowner's damages arose. It is akin to the single spill that led to contaminating soil damage in *SCSC* and to the implantation of silicone gel implants in *In Re Silicone*.

Federated's own investigation clearly establishes that (1) improper application of stucco was the cause of the resulting water damage and (2) that the damage began on or shortly after the closing on the sale of the home. Federated clearly relied on its investigation and determination that damages occurred during its policy period by paying out \$1,061,828.00 to address the first twelve stucco related claims against Kootenia. Federated also consistently represented to its insured, to the homeowners, to the stucco subcontractor and to the District Court, in its subrogation actions, that damage began on or shortly after the home was closed. Therefore, time on the risk allocation is not appropriate here.

#### 4. Public Policy.

In addition, time on the risk allocation is bad public policy.

Imposing time on the risk allocation here will poison the CGL liability insurance market for builders because it will provide a strong incentive for existing insurers to drop their builder insureds. After all, the longer an insurer insures a builder, the greater its exposure to time on the risk allocation. In addition, insurance companies will be reluctant to insure a builder because of exposure to allocation for water intrusion damages, even

though the water intrusion began years before the inception date of their policies. Those insurers who do continue to insure builders will protect against time on the risk allocation by introducing endorsements designed to shield the insurance company from its application, thereby exposing the builder to an ever-growing uninsured risk.

Builders already bear lengthy liability exposure. Under Minn. Stat. § 541.051, subd. 4, the statute of repose for statutory warranty claims is up to twelve years. Insurers must take this fact into consideration before insuring a builder. If the builder has substantial stucco inventory, and time on the risk allocation is allowed, an insurer must consider the fact that, if it insures the builder, it faces time on the risk allocation for the builder's inventory of homes for a period of up to twelve years.

The facts of this case provide an apt example of this detrimental impact. Kootenia built more than 200 homes, including over 100 homes with stucco exteriors. K. App. 446. This case concerns only 31 of more than 100 stucco homes. There may be 69 or more stucco homes built by Kootenia suffering from the same water intrusion damage as those homes involved in this case. Any insurance company considering Kootenia as an insured must face the prospect of being exposed to time on the risk allocation, even though the inception date of its policy is years after the damage first occurred. To protect against this risk, the insurer will either decline to insure the builder or will introduce endorsements designed to prevent time on the risk allocation.

These outcomes are not speculative. Rather, the facts of this case demonstrate that such result will occur.

Federated refused to renew Kootenia's liability policy effective April 1, 2002. Federated also introduced, in its final policy year, an endorsement designed to shield Federated from the very type of allocation it encourages the Court to adopt here.

Federated introduced endorsement CG-F-68 in the 2001-2002 policy year. It provides: "This policy does not apply to, and the company shall have no duty to defend, any claim seeking 'bodily injury' or 'property damage' that occurred before the policy period, regardless of whether that 'bodily injury' or 'property damage' is also deemed to have occurred during the policy period of this policy." K. App. 433-45. Federated's endorsement is clearly designed to shield Federated from time on the risk allocation by excluding coverage from any property damage which first occurs before its policy period.

Cincinnati Insurance, which will have a strong incentive to cease insuring Kootenia if time on the risk allocation is adopted, has already cited endorsements which it argues precludes coverage for these property damage claims. It cites its "fungi or bacteria" endorsement, its "Exterior Installation and Finish Systems and Direct Applied Exterior Finish Systems" exclusion and Kootenia's alleged failure to provide immediate notice of loss as its bases for denying coverage for these claims. K. App. 486-93.

Federated and Cincinnati Insurance are not alone in their attempt to protect against liability from time on the risk allocation. Attached to this brief and summarized below are samples of other endorsements added to CGL policies of BAM members:

1. A "Prior Completed Operations Exclusion" which excludes from coverage any property damage arising out of the builder's work which was completed prior to the policy period. BAM App-1.
2. An "Endorsement for Continuing or Progressive Bodily Injury, Personal Injury or Property Damage" which excludes from coverage continuing or progressive bodily injury or property damage by (i) treating such bodily injury or property damage as one "occurrence" and stating that it shall be deemed to occur only when the injury or damage first commenced and (ii) stating that the insurer has no duty to defend or investigate any such occurrence unless it first commenced during the policy period. See BAM App-2.
3. "Amendment of Limits for Moisture-Related Damage Including Expense" which puts a dollar limit on coverage for moisture related bodily injury and property damage claims. BAM App-4.

Time on the risk allocation will also encourage litigation between insurers and their insureds, as the validity and scope of these endorsements, designed to shield against or limit exposure to allocation, are tested. Still pending in the Court below are the claims between Kootenia and Federated over the validity of the exclusion Federated introduced into its final policy year, and between Kootenia and Cincinnati Insurance over its mold and related exclusions.

Time on the risk allocation also discourages settlement. Insurers will resist contributing to the settlement of claims, citing the various endorsements and policy exclusions designed to limit or prevent time on the risk allocation. Insurers will argue, as Federated did here, that the builder is liable for its allocated share of damages, to the extent that policy provisions limit or bar application of time on the risk allocation. The builder, faced with the potential of uninsured risk, is given little choice but to challenge, as Kootenia did here, these endorsements and policy exclusions. Unlike *NSP* where the Court concluded time on the risk allocation would reduce the cost of litigation and encourage settlement, when applied to the residential construction industry, time on the risk allocation causes increased litigation and discourages settlement.

This case involves only one builder with approximately 200 homes. When applied to an industry, these problems multiply significantly and highlight why, under these circumstances, time on the risk allocation is bad public policy.

5. The Parties' Intent/Reasonable Expectations.

The Court must examine, as *NSP* and *In Re Silicone* require, the intent or reasonable expectation of the parties, as well as public policy. Kootenia has the right to expect that, where property damage occurs under its policy with Federated, the terms and conditions of that policy will determine coverage. Likewise, Federated has no reasonable



basis to expect that it will be allowed to allocate its liability exposure to others. Neither Kootenia nor Federated has any reason to believe that the circumstances of this case fit within the narrow confines of those cases where time on the risk allocation is allowed.

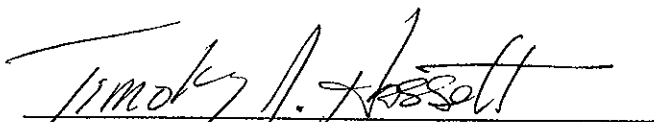
**Conclusion**

The Builders Association of Minnesota respectfully requests that this Court affirm the December 16, 2004 Judgment of the District Court granting summary judgment to Respondent Kootenia Homes, Inc. and denying summary judgment to Federated Mutual Insurance Company.

Dated: June 15, 2005.

Respectfully submitted,

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