

Recent Developments in Construction Defect Litigation: Wooddale Builders/Kootenia

by **Matthew P. Bandt**

mbandt@jlolaw.com



**8519 Eagle Point Boulevard, Suite 100
Lake Elmo, Minnesota 55042-8624
(651) 290-6500**

Wooddale Builders, Inc. v. Maryland Casualty Co., 2006 WL 2828672 (Minn. Oct. 5, 2006); and Kootenia Homes, Inc. v. Federated Mutual Insurance Co., (Minn. App. 2006), review denied April 18, 2006.

Both *Wooddale* and *Kootenia* are water intrusion cases that involve multiple insurers potentially on the risk during various periods of coverage. The Minnesota Supreme Court in *Wooddale* applied a pro-rated time-on-the-risk formula to allocate liability among the multiple coverage periods. In contrast, due to a very unique set of facts, the Minnesota Court of Appeals in *Kootenia* did not allocate liability amongst the multiple insurers, and instead placed liability solely with the insurer on the risk at the time of construction.

A. WOODDALE

The Plaintiff in *Wooddale* was the general contractor of sixty stucco homes built between 1990 and 1996. Wooddale brought a declaratory action to establish insurance coverage for a series of water intrusion claims brought by the homeowners.

The parties agreed that the damage to the homes was caused by repeated water intrusion occurring over an extended period of time and not by a solitary, discrete, identifiable event. None of the parties argued that the damages could be traced to a discrete and identifiable event during the construction of the home. Therefore, the applicability of the pro-rata-by time-on-the risk method was not at issue. The parties also agreed the starting point for allocating damages was the closing date on the purchase of each home. The primary issue raised on appeal was the end date for allocating liability.

The district court held the end date for allocating damages was the date Wooddale received notice. The district court took a different approach to defense costs and apportioned them equally among the insurers on the risk.

The Minnesota Court of Appeals reversed the district court. The Court of Appeals used the date of remediation as the end date, rather than the date of notice. Furthermore, the Court of appeals apportioned defense costs in the same manner.

On October 5, 2006, the Supreme Court issued a decision reversing the Court of Appeals. Similar to the district court, the Supreme Court used the date of notice to allocate liability. Also, the Supreme Court held defense costs must be shared equally among the insurers on the risk. However, the Supreme Court did not simply reinstate the district court's ruling. The Supreme Court determined multiple sub-issues existed in allocating liability pursuant to the pro-rata-by-time-on-the-risk method. The Supreme Court broke down the appropriate calculation to a mathematical formula: $A / B \times C = D$.

$$\underline{A / B \times C = D}$$

In the Court's formula, A stands for each insurer's time on the risk, B stands for the total period over which liability is allocated, C is the total damages to be allocated, and D is the damages allocated to each individual insurer.

$$\underline{A = \text{Each Insurer's Time on the Risk}}$$

Each policy at issue in *Wooddale* is occurrence-based, which means they are triggered when property damage occurs during their respective coverage periods, regardless when the occurrence that causes property damage happens. According to

the “actual injury” rule adopted in Minnesota, a policy is triggered when a party is damaged, regardless when the negligent act occurred. See *N. States Power Co. & Fid. & Cas. Co. of N.Y.*, 523 N.W.2d 657, 662 (Minn. 1994).

However, pursuant to the language in the policies, as supported by the “known loss doctrine” in Minnesota, the insurers cannot be held liable for damages that Wooddale expected. Therefore, “once a specific notice of claim (was) received by Wooddale, no subsequent insurance policy (could) be on the risk with respect to the claim.” *Wooddale* at 6. Therefore, the insurers on the risk are those that provided coverage from closing through the date of notice of damages on each particular home.

The Court further reasoned that the entire policy period triggered by the closing should be used in allocating liability, as well as the entire policy period in effect when the Wooddale received notice.

It should be noted that part “A” in the formula only addresses the time frame for determining which insurers are on the risk. Part “B” determines the time period for allocating liability and part “C” addresses whether the insurers on the risk are responsible for damages that occur after the insured receives notice.

B = Total Period Over Which Liability is Allocated

As indicated above, the parties agreed that the closing date of each home is the beginning date for determining the time period over which liability is allocated, but they disagreed as to the end date. In deciding this issue, the Court first considered claims where the insured has continuous coverage through the date of notice and then considered claims, such as Wooddale’s case, involving uninsured periods.

In the case of continuous coverage, the Court held “that the total period over which liability is allocated (factor B) is the sum total of each individual insurer’s period of time on the risk, i.e., the sum total of the time periods identified under factor A.” *Wooddale* at 9. In cases involving periods of no insurance, the Court concluded that the total period over which liability is allocated must also include voluntary uninsured periods of damage.

C = Total Damages to be Allocated

The Court held “that the total damages to be allocated with respect to each affected home (factor C) are 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. In other words, the damages allocated between the parties include damages incurred after the insured received notice.

D = Damages Allocated to Each Individual Insurer

As the formula indicates, dividing “A” by “B” and then multiplying by “C” for each individual insurer will provide the exact amount of damages each insurer is liable for. The same applies in calculating the insured’s responsibility for voluntary uninsured periods of damage.

Defense Costs

The Court held when liability is allocated pursuant to the pro-rata-by-time-on-the-risk method that defense costs shall be apportioned equally among insurers whose policies are triggered, unless the Iowa National rule applies. Absent a loan receipt

agreement, the Iowa National rule bars an insurer from recovering defense costs from the insured's other insurers who also owed a duty to defend. *Iowa Nat'l Mut. Ins. Co.*, 150 N.W.2d 233, 236-37 (Minn. 1967). However, in *Wooddale* the insurers waived the Iowa National rule.

When accepting a tender of defense pursuant to a reservation of rights, the insurer should always ask the insured to sign a loan receipt agreement. Otherwise the Iowa National rule will bar the insurer from later seeking defense costs it is otherwise entitled to.

B. KOOTENIA

Similar to *Wooddale*, *Kootenia* was a water intrusion case involving multiple stucco homes. However, in *Kootenia*, the Minnesota Court of Appeals refused to allocate liability among the multiple insurers on the risk. *Kootenia* differed substantially from *Wooddale* in that the parties did not agree that the damage to the homes was caused by repeated water intrusion occurring over an extended period of time. Instead, the expert for the insurer on the risk at the time of construction opined the damage was due to improper stucco materials and application, which began shortly after completion of each home. The insurer proceeded to admit the opinions of its expert. Therefore, the other insurers potentially on the risk refused to apply the pro-rata-by- time-on-the-risk method.

Ultimately, based upon the admissions of the insurer on the risk at the time of construction, the Minnesota Court of Appeals held the damages arose from a discrete and identifiable event, and therefore, upheld the district court's refusal to allocate the

damages. It should be noted that *Kootenia* is unpublished and the Supreme Court denied review. Therefore, regardless its unique facts, *Kootenia* may have limited precedential value.

C. CONCLUSION

Neither *Wooddale*, nor *Kootenia*, provide much guidance regarding the ultimate issue as to whether moisture intrusion cases typically involve continuous damages giving rise to allocation, or whether allocation is typically barred by a discrete and ascertainable occurrence at the time of construction. In *Wooddale* the parties agreed to allocate damages, while in *Kootenia* the insurer on the risk admitted the damage occurred at the time of construction.

The Supreme Court in *Wooddale* concluded: “We note that our resolution of this case leaves questions unanswered ... our holdings here must be viewed through the lens of the facts presented to us. Therefore, we do not expect this to be the ‘last word’ in this area... and we continue to emphasize that the district courts must be flexible, as we have been here, in responding to different fact situations.” *Wooddale* at 14.

The Court in *Wooddale* repeatedly notes that the parties agreed the damage was continuous. In footnote 6 the Court acknowledged:

“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.”

Recent Developments in Construction Defect Litigation:
Wooddale Builders/Kootenia

In my opinion the argument raised by the Supreme Court is a clear violation of the actual injury rule, which provides a policy is triggered by the occurrence of damages, not the negligent act. Furthermore, most policies provide the same, including all those at issue in *Wooddale*.