THE BUSINESS RISK DOCTRINE IN MINNESOTA: THE EMPEROR HAS NO CLOTHES

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I. INTRODUCTION

Commercial General Liability (CGL) insurance, which allows parties to a construction project to manage the risks inherent in the construction process, is a mainstay of risk management in the construction industry.[1] The heart of the standard CGL policy is the "insuring agreement," which is the basic affirmative promise identifying the scope of coverage

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provided.[2] The insuring clause typically protects the insured against claims for "bodily injury" or "property damage" resulting from an "occurrence."[3] If there is an accidental "occurrence," then the policy obligates the insurer "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," unless the losses are otherwise expressly excluded elsewhere in the policy.[4]

While the CGL insuring clause is standard in CGL policies, its construction, and the construction and application of other language in the policy, have spawned considerable debate.[5] Foremost among the principles that traditionally have guided the Minnesota courts in their interpretation of CGL policies is the fundamental rule that the express language of the policy should define the limits of coverage.[6] The rationale behind this principle is obvious: contracting parties should be allowed to define the terms under which their contract will be performed. In the words of the Minnesota Supreme Court: "[p]arties to insurance contracts, as in other contracts, absent legal prohibition or restriction, are free to contract as they see fit, and the extent of liability of an insurer is governed by the contract they enter into."[7]

Notwithstanding this bedrock principle of contract construction, Minnesota courts have also incongruously invoked on occasion a different doctrine, the Business Risk Doctrine (BRD), which substantially undermines this settled rule of contract interpretation.[8] Courts that employ the BRD interpret the CGL policy based not on the actual language of the policy but on an implied "intention" presumed to underlie CGL insurance—namely, that CGL insurance should cover "tort liability for physical damages to others" but not "contractual liability" attributable to the cost of repairing or

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[2] *See* DONALD S. MALECKI & ARTHUR L. FLITNER, COMMERCIAL GENERAL LIABILITY 5 (8th ed. 2005).

[3] *See* DEUTSCH, KERRIGAN & STILES *supra* note 1, at 174–77.

[4] *See* MALECKI & FLITNER, *supra* note 2, at 5–11 (describing the key components of an insuring agreement).

[5] For a discussion of the varying interpretations of identical CGL policy terms among many state courts, see Dean B. Thomson & William D. Thomson, *A Modest Proposal: Conflicting Judicial Decisions Should Mandate Coverage for the Insured Under the Ambiguity Doctrine*, 3 J. AM. C. CONSTRUCTION LAW 1, 1–2 (2009).

[6] *See* Am. Family Mut. Ins. Co. v. Ryan, 330 N.W.2d 113, 115 (Minn. 1983); *see also* State Farm Ins. Cos. v. Seefeld, 481 N.W.2d 62, 64 (Minn. 1992) (terms in insurance policy should be given their plain and ordinary meaning); Minn. Mining & Mfg. Co. v. Travelers Indem. Co., 457 N.W.2d 175, 179 (Minn. 1990) (courts are to determine and effectuate the intent of the parties as it appears from the terms of the contract); Canadian Universal Ins. Co. v. Fire Watch, Inc., 258 N.W.2d 570, 572 (Minn. 1977) ("The provisions of an insurance policy are to be interpreted according to plain, ordinary sense so as to effectuate the intention of the parties."); Struble v. Occidental Life Ins. Co. of Cal., 120 N.W.2d 609, 616 (Minn. 1963) (requiring a construction that will effectuate the object and intent of the contract).

[7] Bobich v. Oja, 104 N.W.2d 19, 24 (Minn. 1960).

[8] *See infra* Part V.

replacing an insured's own work-product. As applied by the courts, the BRD operates essentially as a hidden exclusion that denies coverage to the insured for damages resulting from faulty workmanship—coverage that the insured might otherwise reasonably expect, based on the language of the policy.[9]

Over the last decade, Minnesota courts have moved to distance themselves from the BRD. They have, instead, begun to return to a jurisprudence anchored in the language of the CGL policy itself, rather than judicial presumptions about the "purpose" of CGL insurance.[10] In a 2008 case, *Integrity Mutual Insurance Co. v. Klampe*, however, the Minnesota Court of Appeals resurrected the BRD to deny a claim for coverage.[11]

As used in *Klampe*, and other recent Minnesota Court of Appeals cases, the BRD threatens to reemerge as a policy which frustrates the right of contracting parties to define the terms under which their negotiated relationship will be performed. It is long past time for Minnesota to join the modern nationwide trend and reject the BRD.[12] A faulty and indefensible

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[9] *See infra* Part III.

[10] *See infra* text accompanying notes 54–98 (discussing the Minnesota courts' adoption of and subsequent retreat from the BRD).

[11] *See* Integrity Mut. Ins. Co. v. Klampe, No. A08-0443, 2008 WL 5335690, at *4 (Minn. Ct. App. Dec. 23, 2008). While *Klampe* is an unpublished opinion, and thus, is not supposed to have precedential value, in practice such opinions are not inconsequential. Under Minnesota Statute section 480A.08, subdivision 3 (2010), unpublished decisions may be cited, if the decision is appended to a brief. Despite supreme court admonitions to the contrary, litigants frequently ask trial courts to consider unpublished opinions. Moreover, irrespective of their precedential value, unpublished opinions resolve rights of individual litigants. If wrongly decided, they do injustice to the parties involved.

[12] *See, e.g.*, Fireguard Sprinkler Sys., Inc. v. Scottsdale Ins. Co., 864 F.2d 648, 653–54 (9th Cir. 1988) (rejecting business risk policy analysis in *Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W.2d 229 (Minn. 1986) and *Bor-son Bldg. Corp. v. Emp'rs Commercial Union Ins. Co. of America*, 323 N.W.2d 58 (Minn. 1982) and holding that "we find unpersuasive the argument [in *Knutson*] that because the prime contractor's control makes the work of a subcontractor a contractual business risk, the prime contractor should not be able to obtain insurance against that risk"); Fejes v. Alaska Ins. Co., 984 P.2d 519, 523–24 (Alaska 1999) (argument based on alleged public policy considerations underlying CGL policy could not overcome actual language of policy); Vandenberg v. Superior Court, 982 P.2d 229, 243–46 (Cal. 1999) (rejecting the distinction between tort damage and contract damage at the heart of business risk doctrine and instead relying solely on language used by contracting parties); Md. Cas. Co. v. Reeder, 270 Cal. Rptr. 719, 726 (Ct. App. 1990) (following *Fireguard* in rejecting the Minnesota courts' analyses in both *Knutson* and *Bor-son* and noting that "[l]ike the Ninth Circuit, in the absence of unambiguous policy terms we are not inclined to restrict the risks for which businesses may obtain insurance and insurers may collect premiums"); Nitterhouse Concrete Prods. v. Pa. Mfrs'. Ass'n Ins. Co., No. 2002-2970, 2004 WL 2491763, at *232 (Pa. Com. Pl. June 30, 2004) (quoting Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co., 825 A.2d 641, 653 (Pa. Super. Ct. 2003), *rev'd*, 908 A.2d 888 (Pa. 2006) ("The [insurance] industry has now taken to arguing that whenever a claim of defective construction is alleged against an insured, the claim is automatically barred from coverage as not constituting an 'occurrence.' The position is nothing more than a rehash of the 'business risk' doctrine, [the success of which] depends entirely on courts ignoring the actual language of the [commercial general liability] policy."

doctrine should not be permitted to override the express language of a negotiated agreement as the basis of policy interpretation.

II. THE ORIGINS OF THE BUSINESS RISK DOCTRINE

The BRD's impact on CGL insurance law in Minnesota is surprising, given its obscure and precipitous origins in a 1971 law review article written by Roger C. Henderson, then an associate professor of law at the University of Nebraska.[13] Over the course of a lengthy article dealing with a wide variety of insurance law issues, Henderson included a single paragraph setting out his opinion as to what types of liability a CGL policy is meant to cover.[14] Without providing evidence from the insurance industry to support his claims, Henderson declared:

> The risk intended to be insured [by CGL insurance] is the possibility that the goods, products or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable. The insured, as a source of goods or services, may be liable as a matter of contract law to make good on products or work which is defective or otherwise unsuitable because it is lacking in some capacity. This may even extend to an obligation to completely replace or rebuild the deficient product or work. This liability, however, is not what the coverages in question are designed to protect against. The coverage is for tort liability for physical damages to others and not for contractual liability of the insured for economic

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(first alteration in original)); Am. Family Mut. Ins. Co. v. Am. Girl, Inc., 2004 WI 2, ¶ 47, 673 N.W.2d 65, 78 (implicitly rejecting public policy analysis underlying BRD in rejecting argument that losses actionable in contract may never be "occurrences" under CGL's initial coverage grant because if that were the case, the business risk exclusions included in the CGL policy would be unnecessary). Other states generally reject a public policy approach to construction of a CGL policy in favor of the established principle that contract interpretation should turn on the express language of policy. *See* Sheehan Constr. Co. v. Cont'l Cas. Co., 935 N.E.2d 160, 169 (Ind. 2010), *reh'g granted*, (Dec. 17, 2010), *opinion adhered to as modified on reh'g on other grounds*, 938 N.E.2d 685 (Ind. 2010) (business risk rule is not a per se bar to insurance coverage and courts must instead look to specific language of policy); Architex Ass'n v. Scottsdale Ins. Co., 2008-CA-01353-SCT (¶17) (Miss. 2010) ("We find the appropriate analysis should not be driven by policy justifications, but rather should be confined to the policy language. The policy either affords coverage or not, based upon application of the policy language to the facts presented.").

[13] *See* Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations—What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 441 (1971).

[14] *See id.*

> loss because the product or completed work is not that for which the damaged person bargained.[15]

Henderson's paragraph was seized upon by several state courts as a sufficient foundation for a new doctrine of insurance law jurisprudence.[16] Among these was the Minnesota Supreme Court, which in a 1982 case, *Bor-Son Building Corp. v. Employers Commercial Union Insurance Co. of America*, adopted Henderson's gloss.[17] In that case, Bor-Son designed and built two high-rise apartment complexes, which subsequently developed serious problems with water leakage due to faulty construction.[18] After settling with the property owner, Bor-Son commenced a declaratory judgment action seeking indemnification from its insurer.[19] The question at issue before the court was whether property damage to the buildings resulting from Bor-Son's faulty workmanship was covered by the contractor's CGL insurance policy.[20] In deciding the case, the supreme court chose to ignore, almost completely, the specific language of the policy.[21] Instead, the court simply concluded (relying primarily on Henderson for support) that CGL insurance was not "intended" to afford coverage to builders for the cost of repairing their own faulty work.[22] Rather, the court opined, the cost of repairing or replacing shoddy work was a "business risk" to be borne exclusively by the contractor.[23] Therefore, under this "business risk" doctrine, Bor-Son was not entitled to recover from its insurer.[24]

Bor-Son established the BRD in Minnesota, albeit specifically in the context of exclusions to the CGL policy. In a later decision, *Knutson Construction Co. v. St. Paul Fire & Marine Insurance Co.*, the Minnesota

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[15] *Id.*

[16] *See* Weedo v. Stone-E-Brick, Inc., 405 A.2d 788, 790–91 (N.J. 1979) (citing Henderson, *supra* note 13, at 441). *Weedo*, in turn, spawned its own progeny. *See, e.g.*, Wm. C. Vick Constr. Co. v. Pa. Nat'l Mut. Cas. Ins. Co., 52 F. Supp. 2d 569, 586 (E.D.N.C. 1999) (citing *Weedo*, 405 A.2d at 796); Vari Builders, Inc. v. U.S. Fid. & Guar. Co., 523 A.2d 549, 552 (Del. Super. Ct. 1986) (citing *Weedo*, 405 A.2d at 796); *see also* Hartford Accident & Indem. Co. v. Pac. Mut. Life Ins. Co., 861 F.2d 250, 253 (10th Cir. 1988) (citing Henderson, *supra* note 13, at 441); Blaylock & Brown Constr., Inc. v. AIU Ins. Co., 796 S.W.2d 146, 153 (Tenn. Ct. App. 1990) (citing Henderson, *supra* note 13, at 441).

[17] *See Bor-Son*, 323 N.W.2d at 63 (citing Henderson, *supra* note 13, at 441).

[18] *Id.* at 60.

[19] *Id.* at 61.

[20] *Id.* at 59.

[21] In commenting on the case, treatise authors Bruner and O'Connor state, "The *Bor-Son* decision provides very little analysis of the policy language in reaching its conclusion that coverage is not afforded to a general contractor for . . . poor work." 4 PHILIP L. BRUNER & PATRICK J. O'CONNOR, BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 11:28 n.20 (2002). In fact, the language of the policy is not directly quoted or examined at all in *Bor-Son*.

[22] *Bor-Son*, 323 N.W.2d at 63 (citing Henderson, *supra* note 13, at 441).

[23] *Id.* at 61.

[24] *Id.* at 64.

Supreme Court elaborated on the rationale behind the doctrine.[25] According to the court, the BRD was justified on public policy grounds to prevent contractors from receiving compensation for the repair or replacement of their own shoddy work.[26] As the court warned, "If insurance proceeds could be used to pay for the repairing and/or replacing of poorly constructed products, a contractor or subcontractor could receive initial payment for its work and then receive subsequent payment from the insurance company to repair and replace it."[27] Furthermore, the court feared that, without the BRD to protect it, the insurance industry would be exposed to claims that it supposedly could not safely underwrite, and thus, would be exposed to loss.[28] Without citation to authority for its conclusion, the court explained that the risk of damage from shoddy workmanship is "one which the insurer does not assume" because it "is one the general contractor effectively controls," and the insurer, therefore, "cannot establish predictable and affordable insurance rates."[29] That the insurer may, in fact, have intentionally underwritten and assumed that risk through its contract with the insured seems not to have seriously troubled the court. In the supposed interest of public policy, and in accordance with the purported intent of CGL insurance according to the BRD, the court ruled that Knutson could not recover from its insurer.[30]

III. BUILDING ON SAND: THE UNFOUNDED PUBLIC POLICY UNDERLYING THE BUSINESS RISK DOCTRINE

As exemplified by the *Knutson* decision, earlier Minnesota decisions primarily justified the BRD by arguing that it is in the public interest to prevent contractors from insuring themselves against their own negligence. The courts assumed that to permit insurance claims for a contractor's own faulty workmanship would encourage "substandard construction, or even fraud," resulting in loss to property owners.[31] Moreover, the courts,

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[25] *See* Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co., 396 N.W.2d 229, 232–33 (Minn. 1986).

[26] *See id.* at 234–35.

[27] *Id.* at 235 (quoting Centex Homes Corp. v. Prestressed Sys., 444 So. 2d 66, 66–67 (Fla. Dist. Ct. App. 1984)).

[28] *Id.* at 233–34.

[29] *Id*. at 234.

[30] *See id.* at 238–39. As in *Bor-Son*, the *Knutson* court did not analyze the actual language of the CGL policy at issue in detail. Knutson purchased a Broad Form Property Damage endorsement (BFPD), which, due to a recent change, exempted the work of subcontractors from the exclusion of coverage for damage arising out of the general contractor's work. *See Knutson*, 396 N.W.2d at 236–37. Since most of Knutson's work was done by subcontractors, the BFPD should have convinced the court that Knutson was entitled to indemnification for much of its repair costs. The court, however, ignored as insignificant the change in language creating the subcontractor exemption. *See* 4 BRUNER & O'CONNOR, *supra* note 21, § 11:28 n.20.

[31] *Knutson*, 396 N.W.2d at 233.

apparently motivated by the dire warnings of insurance industry counsel, have accepted without evidence that substantial losses to insurers and skyrocketing insurance costs would necessarily be the result of permitting insureds the full extent of their policy coverage.[32] Although these rationales are perhaps superficially plausible, close examination shows them to be unfounded. Certainly, neither supports a decision by the courts to jettison the actual language of the policy as the basis for determining the limits of coverage.

The contention that contractors will be unduly tempted to cheat their employers—or their insurers—if allowed coverage for poor workmanship is unjustified. In other fields, insurance coverage for negligent work is standard, or even required. Doctors, lawyers, and accountants, for example, are allowed without question to be insured against their own malpractice. There is no evidence that this has translated into greater negligence on the part of these professionals.[33] Nor is there a perception that it is somehow against the public interest for members of these professions to be able to pass along their liability—liability that they effectively "control"—to the insurance industry. Indeed, particularly in the case of doctors, it is felt necessary that they be permitted to do so.[34] If these professionals can be trusted to resist the temptation to be "less than optimally diligent"[35] when their negligence is covered by insurance, what principled reason can there be for denying the same right to contractors?[36] Given that "it cannot be conclusively demonstrated" that allowing what is essentially limited malpractice insurance for contractors would "promote shoddy workmanship and the lack of exercise of due care," the courts should not deny, on public policy grounds, insurance to builders that is permitted to doctors, lawyers, and a host of other professionals.[37]

A number of courts, including both the *Bor-Son* and *Knutson* courts, have defended the BRD by arguing that to allow insurance coverage for

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[32] *See id*.

[33] Indeed, available evidence suggests that physicians heighten their standard of care in part due to their desire to reduce their malpractice insurance premiums. *See, e.g.*, U.S. Cong., Office of Tech. Assessment, *Defensive Medicine and Medical Malpractice* 1, 3 (July 1994), http://biotech.law.lsu.edu/policy/9405.pdf ("[C]oncern about malpractice liability pushes physicians' tolerance for uncertainty about medical outcomes to very low levels."). In order to reduce risk, "New York State obstetricians who practice in hospitals with high malpractice claim frequency and premiums do more Caesarean deliveries than do obstetricians practicing in areas with low malpractice claim frequency and premiums." *Id.* at 8.

[34] *See* Michelle M. Mello, *Understanding Medical Malpractice Insurance: A Primer*, 1, 1 (January 2006), http://www.rwjf.org/pr/synthesis/reports_and_briefs/pdf/no10_primer.pdf.

[35] *Knutson*, 396 N.W.2d at 234.

[36] *See* James Duffy O'Connor, *What Every Construction Lawyer Should Know About CGL Coverage for Defective Construction*, CONSTRUCTION LAW., Nov. 1, 2001, at 15, 18.

[37] *Id.*

faulty workmanship would be, in effect, to transform CGL insurance into a performance bond.[38] In essence, these courts assert that if a contractor desires coverage for his own negligence, then the proper instrument is a performance bond, not insurance.[39] Much like the public policy-based defenses of the BRD, this argument is only superficially attractive. A performance bond and insurance are fundamentally different and serve two very different purposes.

Though performance bonds are often products sold by insurance companies, they are not insurance.[40] When a contractor secures a performance bond (usually at the behest of the property owner), he is simply providing a guarantee from his surety that he will be able to perform his contractual obligations—the surety agrees to become answerable for the debt of the contractor to the property owner.[41] Unlike insurance companies, however, sureties invariably require the contractor to sign what is known in the industry as a "general agreement of indemnity," promising to indemnify the surety in the case of a claim or loss on the bond.[42] Thus, performance bonds do not provide real insurance protection for the contractor because they do not transfer risk from the contractor to the surety.[43] Instead,

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[38] *See Knutson*, 396 N.W.2d at 234; Bor-Son Bldg. Corp. v. Emp'rs Commercial Union Ins. Co. of Am., 323 N.W.2d 58, 62 (Minn. 1982); *see also* Reliance Ins. Co. v. Mogavero, 640 F. Supp. 84, 85 (D. Md. 1986) ("[T]his case turns upon one overriding principle: that Reliance issued a general liability policy, not a performance bond, to Mogavero."); Solcar Equip. Leasing Corp. v. Pa. Mfrs.' Ass'n Ins. Co., 606 A.2d 522, 527 (Pa. Super. Ct. 1992) ("The insurance contract at issue is not a performance bond . . . ."); Erie Ins. Prop. & Cas. Co. v. Pioneer Home Improvement, Inc., 526 S.E.2d 28, 33 (W. Va. 1999).

[39] 4 BRUNER & O'CONNOR, *supra* note 21, § 11:29.

[40] CONSTRUCTION INSURANCE 13 (Stephen D. Palley et al. eds., 2011) ("Although insurance carriers and sureties often cover what appear to be similar risks (and many companies offer both products), in reality those risks are distinct." (citations omitted)).

[41] *See* U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So. 2d 871, 887–88 (Fla. 2007) ("The purpose of a performance bond is to guarantee the completion of the contract upon default by the contractor. Thus, unlike an insurance policy, a performance bond benefits the owner of a project rather than the contractor. Further, a surety, unlike a liability insurer, is entitled to indemnification from the contractor." (citations omitted) (internal quotation marks omitted)); *see also* Lamar Homes, Inc. v. Mid–Cont'l Cas. Co., 242 S.W.3d 1, 10 (Tex. 2007) ("Any similarities between CGL insurance and a performance bond . . . are irrelevant, however. The CGL policy covers what it covers. No rule of construction operates to eliminate coverage simply because similar protection may be available through another insurance product. Moreover, the protection afforded by a performance bond is, in fact, different from that provided by the CGL insurance policy here.").

[42] *See* Armen Shahinian, *The General Agreement of Indemnity*, *in* THE LAW OF SURETYSHIP 487 (Edward G. Gallagher ed., 2d ed. 2000).

[43] CONSTRUCTION INSURANCE, *supra* note 40, at 13 ("Bonds do not necessarily transfer risk themselves. The bond is provided by the contractor-principal in favor of the owner-obligee and if a loss occurs under a bond, the surety is able to respond to that loss. Nevertheless, the principal-contractor has not transferred risk to the surety; rather, the principal remains liable for the loss at issue, typically through an indemnity agreement with the surety. By contrast, insurers pay covered losses with no right of recourse against the insureds beyond deductible obligations.").

performance bonds are best thought of as "a form of credit enhancement rather than a type of risk financing, e.g., insurance."[44]

The courts' contention that CGL insurance should not be construed to cover faulty workmanship because that function is better served by a performance bond in the construction setting represents a fundamental misconception of what the two instruments are designed to accomplish.[45] Defending the BRD on grounds that insurance protection against faulty workmanship is already available to contractors through a performance bond is, accordingly, wrong. Only insurance offers a contractor protection against risk through risk transference; unlike a surety, the insurance company has the obligation to pay with no recourse against the insured.[46]

Equally faulty as a justification for the BRD is the contention, promoted by the insurance industry, that to grant coverage for faulty workmanship would expose the industry to claims it never intended to cover and could not effectively underwrite. The argument commonly put forward in this context is that insurers cannot adequately assess the risk they assume when providing contractors with negligence insurance because the "risk is one the general contractor effectively controls."[47] Courts, however, should not be overly concerned about the ability of insurers to protect themselves from loss when faced with claims arising out of the insured's negligence. Sophisticated actuaries with advanced degrees should be quite comfortable—indeed it is their chosen business—assessing and pricing the cost of insuring contractors against their own careless acts. In other circumstances, they do it all the time: besides the professional malpractice insurance mentioned above, insurers provide millions of Americans with no-fault car insurance that indemnifies drivers regardless of their own negligence.[48] In these cases,

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[44] 4 BRUNER & O'CONNOR, *supra* note 21, § 11:4 (citation omitted); *see also* THE BUSINESS INSURANCE HANDBOOK 312 (Gray Castle et al. eds., 1981) ("Surety bonding is often misunderstood for a Surety Bond is not an insurance policy—it is merely an extension of credit—more akin to an irrevocable bank line of credit than an insurance policy.").

[45] 4 BRUNER & O'CONNOR, *supra* note 21, § 11:29.

[46] *See* Edward G. Gallagher, *Introduction*, *in* THE LAW OF SURETYSHIP, *supra* note 42, at 1–2.

[47] Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co., 396 N.W.2d 229, 234 (Minn. 1986).

[48] For instance, Minnesota requires no-fault insurance, which compensates those involved in automobile accidents, irrespective of negligence. *See* MINN. STAT. § 65B.42(1) (2010) (adopting no-fault insurance "without regard to whose fault caused the accident"). *See generally* 7 AM. JUR. 2D Automobile Insurance § 31 (2007) ("No-fault acts have transferred victim compensation from a fault-based common-law tort recovery to a compulsory no-fault insurance fund . . . . [B]y, among other things, requiring all owners of motor vehicles to carry no-fault insurance, requiring payments to be made immediately on accrual of loss, eliminating a determination of liability based on fault as a requirement for recovering certain [damages], and seeking to [require] each automobile insurer [to] pay the medical expenses of its own insureds, no-fault statutes are intended to remove the bulk of motor vehicle accidents from the constraints of the tort system, and thus provide direct and rapid compensation to automobile accident victims through an insurance fund without regard to fault." (citations omitted)).

actuaries simply use the insured losses to statistically determine the proper premium to be charged. There is no reason for the Minnesota courts to assume that insurers cannot, or have not, been able to devise an appropriate algorithm for underwriting the risk of contractors' fault.[49] As for the public policy concern, if the legislature has not found it to be against public policy to provide motorists with insurance if they are at fault, it cannot be against public policy for insurers to do the same for contractors.

Moreover, the nature of the insurance business provides a built-in disincentive that strongly discourages contractors from being careless and relying on insurance to relieve them from their negligence: premium price. A company that makes too many insurance claims based on its own negligence will either find itself unable to secure coverage in the future, or its premiums will increase to such an extent that it will become uncompetitive and go out of business. As an example, contractors have workers compensation insurance, but they still institute and carefully monitor worker safety programs; they know that workers compensation claims will increase their premiums, and in order to remain competitive, they have implemented admirable programs to avoid claims. There are, thus, market incentives created by the underwriting process that will cause contractors to exercise care, even though they have insurance covering their negligence precisely because they want to retain a competitive premium rate.[50]

Ultimately, though, if the insurance industry truly does not wish to insure contractors for faulty workmanship, it has a simple solution: rewrite the terms of the CGL policy to clearly and completely exclude coverage for claims arising out of an insured's own negligence. This approach has worked

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[49] Carriers are able to calculate risks using actuarial projections and charge premiums to reflect the total amount of risk across the entire pool of insureds. *See* ALAN I. WIDISS, INSURANCE: MATERIALS ON FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES AND REGULATORY ACTS §1.2 (1989); *see also* Ruth E. Kim & Kimball R. McMullin, *AIDS and the Insurance Industry: An Evolving Resolution of Conflicting Interests and Rights*, 7 ST. LOUIS U. PUB. L. REV. 155, 155–56 (1988) ("Insurance is the business of risk allocation. For monetary consideration, the insurer contracts to assume certain risks of the insured. Using actuarial projections, as well as morbidity and mortality statistics, insurance companies determine the cost and the extent of coverage for assumed risks." (citations omitted)).

[50] In public contracting, whether a contractor's bid is the lowest usually determines whether it is awarded the contract. *See, e.g.*, MINN. STAT. § 16C.28 subd. (a)(1) (2010). In a highly competitive market, even marginal differences in insurance premium costs can determine which contractor is the successful low bidder. *See, e.g.*, *A Guide to General Liability Insurance*, DUN & BRADSTREET CREDIBILITY CORP, http://www.dandb.com/credit-resources/business-finances/liability-insurance-for-businesses/ (last visited Jan. 4, 2012) ("To keep liability and other insurance rates down, business owners should take precautions to prevent accidents."); *Experience Modification Rates,* SAFETY MANAGEMENT GROUP, http://www.safetymanagementgroup.com/emr-experience-modification-rate.aspx (last visited Jan. 4, 2012) ("An [Experience Modification Rate] of 1.2 would mean that insurance premiums could be as high as 20% more than a company with an EMR of 1.0. That 20% difference must be passed on to clients in the form of increased bids for work. A company with a lower EMR has a competitive advantage because they pay less for insurance.").

well for insurers in the past when faced with judicial decisions that threatened to expand coverage beyond what the industry intended to provide.[51] The fact that insurers have not taken this step despite scores of decisions finding coverage for what the industry claims it did not mean to grant suggests that all these allegedly unfavorable decisions have not been contrary to the industry's underwriting expectations. Indeed, the insurance industry, after arguing successfully in *Knutson* that a finding of coverage would raise the cost of CGL insurance to a "prohibitive" level, actually moved within the year "to a new coverage form which would expressly provide the very coverage that the insurers claimed in *Knutson* would make insurance" too expensive.[52] This is hardly an indication that insurers are troubled by the prospect of insuring contractors against their own negligence.

Thus, ultimately, neither the public nor the insurance industry needs the protection that the BRD provides. There is no reason for the courts to assume that contractors, if given insurance for faulty workmanship, will be encouraged to cheat their employers any more than doctors or lawyers will be encouraged to commit malpractice; and in any event, the premiums that the insurance market will charge to careless contractors will drive them either to be careful or out of business. And certainly the trillion-dollar insurance industry is not in need of the special protection of the courts.[53] Armed with remarkable actuarial skills, the industry is more than capable of protecting itself against allegedly unsustainable loss, especially when it is in control of the language of the CGL policy, and thus, can easily write-out any coverage it does not wish to provide. In employing the BRD, then, the courts are not serving any necessary public policy goals. Instead, they are simply shielding insurers from the full extent of their contractual obligations and

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[51] See, for example, the insurance industry's reaction to the adverse decisions in *Hauenstein v. Saint Paul-Mercury Indem. Co.*, 65 N.W.2d 122, 125 (Minn. 1954) and *Western Cas. & Sur. Co. v. Polar Panel Co.*, 457 F.2d 957, 959–60 (8th Cir. 1972) holding that diminution in value constituted "property damage" as defined by the then-current CGL policy. In response to these decisions, the insurance industry amended the CGL policy to define property damage as being limited to "*physical* injury to or destruction of tangible property." Federated Mut. Ins. Co. v. Concrete Units, Inc., 363 N.W.2d 751, 756 (Minn. 1985). In the leading case of *Federated Mut.*, this simple change in policy language was held to effectively bar coverage for diminution in value. *Id.* at 757. See generally James Duffy O'Connor, *Construction Defects: "Property Damage" and the Commercial General Liability Policy*, CONSTRUCTION LAW., Nov. 2, 2004, at 11, 11–18, for a more thorough discussion of efforts to amend the CGL policy in order to eliminate unintended coverage.

[52] 4 BRUNER & O'CONNOR, *supra* note 21, § 11:28 n.20; *see also* O'Shaughnessy v. Smuckler Corp., 543 N.W.2d 99, 104–05 (Minn. Ct. App. 1996), *abrogated on other grounds by* Gordon v. Microsoft Corp., 645 N.W.2d 393 (Minn. 2002).

[53] *See, e.g.*, ANDREW TOBIAS, THE INVISIBLE BANKERS 14–15, 72 (1982) (illustrating just how lucrative the insurance industry is by noting that for every dollar received in premiums, insurance companies pay out on average only sixty-five cents in claims, and some sectors of the industry, such as title insurance, pay out as little as fifteen cents).

unfairly denying insureds coverage to which they might otherwise be entitled under the express terms of their policy.

IV. THE BUSINESS RISK DOCTRINE IN DECLINE

The BRD's lack of basis in the language of the policy and its failure to advance any legitimate public policy interest have led to a reappraisal of the doctrine, both in Minnesota and elsewhere. In Minnesota, the trend away from the BRD began with a 1996 court of appeals case, *O'Shaughnessy v. Smuckler Corp*.[54] In *O'Shaughnessy*, Smuckler built a home entirely through subcontractors, and it was later found to have numerous defects as a result of faulty workmanship.[55] Smuckler looked to its insurer for indemnification but was refused coverage on the grounds that "the costs of repairing design and construction defects involve a business risk . . . for which there is no coverage under Minnesota's Business Risk Doctrine."[56] The O'Shaughnessys countered that a 1986 change to the CGL policy expressly provided coverage for damage arising out of a subcontractor's faulty workmanship during completed operations coverage.[57] The court of appeals agreed.[58] Although accepting that the BRD as expressed in *Bor-Son* and *Knutson* precluded coverage, generally, for negligent property damage occurring during construction, the court concluded that the plain language of the policy must nevertheless control and that the language of the policy plainly intended coverage for the defective work of subcontractors that occurred during completed operations:[59]

> This result is contrary to both *Bor-Son* and *Knutson*, which indicate that the basic risk to be protected against by the CGL policy is the risk of damage to property other than the completed work itself. However, given the nature of exclusion *(l*), which explicitly addresses "'property damage' to 'your work,'" we must conclude that the exception restores coverage to a subcategory of "your work."[60]

The court rejected the insurer's contention that the change in policy language should not prevent the court from applying the BRD: "[i]t would be willful and perverse for this court simply to ignore the exception that has now been added to the exclusion."[61] The court of appeals' decision in *O'Shaughnessy* thus represents a return to the salutary principle that the

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54 *See O'Shaughnessy*, 543 N.W.2d at 100.
55 *Id.* at 100–01.
56 *Id.* at 101.
57 *See id.*
58 *Id.* at 100.
59 *See id.* at 104.
60 *O'Shaughnessy*, 543 N.W.2d at 104 (citation omitted).
61 *Id*.

extent of coverage should be determined by the express language of the policy.

In a 2002 case, *Thommes v. Milwaukee Insurance Co.*, the Minnesota Supreme Court went further, largely rejecting the concept of a BRD that exists independently of the language of the contract.[62] In considering the court of appeals' application of the BRD to find coverage for the insured contractor, the supreme court emphasized that the BRD did not "operat[e] to override the express language of [the] policy"[63] and made clear that "if parties to an insurance contract demonstrate their intent, using clear and unambiguous language, . . . then there is no need to look to business risk principles to ascertain [what risks] the policy was intended to cover."[64] As the court explained, "[p]arties are free to contract as they desire, and so long as coverage required by law is not omitted and policy provisions do not contravene applicable statutes, the extent of the insurer's liability is governed by the contract entered into."[65] In *Thommes*, the court characterized its early treatment of the BRD in *Knutson* and *Bor-Son* as follows:

> In both cases, we used business risk principles as a means of illuminating the underlying purpose of CGL insurance. *Notably absent from* Bor-Son *and* Knutson *is any indication that these principles serve as a foundation for a separate "business risk doctrine" that operates to override the express language of policy exclusions*.[66]

The *Thommes* court concluded its analysis of *Knutson* and *Bor-Son* by stating:

> While the distinction set out in *Knutson* and *Bor-Son* is useful for exploring the fundamental purpose of CGL insurance, it is not dispositive because the parties to an insurance contract may agree to coverage that is different in scope. . . . Thus, if parties to an insurance contract demonstrate their intent, using clear and unambiguous language . . . then there is no need to look to business risk principles to ascertain whether the policy was intended to cover such risks. See *Nathe Bros.*, 615 N.W.2d at 344 (stating we will avoid an interpretation of an insurance contract that forfeits the rights of the insured unless such an intent is manifest in clear and unambiguous language) . . . .[67]

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62 *See* Thommes v. Milwaukee Ins. Co., 641 N.W.2d 877, 884 (Minn. 2002).

63 *Id.* at 880.

64 *Id.* at 882.

65 *Id.* (quoting *Am. Family Mut. Ins. Co. v. Ryan*, 330 N.W.2d 113, 115 (Minn. 1983) (internal quotation marks omitted)).

66 *Id.* at 880 (emphasis added).

67 *Id.* at 882.

Consistent with this recitation of Minnesota law, the *Thommes* court stated, "The first step, therefore, in determining whether Thommes's CGL policy covers damage to the Krajewskis' property is to examine the policy language."[68]

The supreme court reiterated its rejection of the BRD as an independent and extra-contractual basis for denying CGL coverage two years later in *Wanzek Construction, Inc. v. Employers Insurance of Wausau*.[69] In *Wanzek*, the court explicitly found that the determination of whether coverage exists under a CGL policy must be based upon the specific terms of the policy at issue, not upon the BRD.[70] There, the court declared that:

> [T]he suggestion . . . that the principles of *Bor-Son* and *Knutson*, in combination with the general principles of the business-risk doctrine, should drive the interpretation of words of the [policy], is incorrect. We conclude that *the extent to which [the] CGL policy covers [the insured's] business risk . . . must be determined by the specific terms of the insurance contract*.[71]

The idea of a BRD that acts as an independent limitation on the extent of coverage has thus been replaced in Minnesota by a jurisprudence once again centered on the language of the CGL policy.[72] This development has been mirrored nationally. Recent supreme court decisions in Florida, Kansas, Tennessee, Texas, and Wisconsin have all rejected the principles behind the BRD, and have confirmed that the proper determiner of coverage

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[68] *Thommes*, 641 N.W.2d at 882.

[69] *See* Wanzek Constr., Inc. v. Emp'rs Ins. of Wausau, 679 N.W.2d 322, 329–30 (Minn. 2004).

[70] *See id.* at 327.

[71] *Id.* (emphasis added).

[72] Dicta in *Thommes* suggests the BRD retains vitality as an interpretive aid at least where the contract is ambiguous: "[h]owever, in the absence of clear and unambiguous language demonstrating the parties' intent to exclude the risk of liability to third parties, application of the principles set out in *Bor-Son* and *Knutson* to determine the scope of coverage provided by the policy is appropriate." *Thommes*, 641 N.W.2d at 882. This justification for continuing the BRD cannot withstand scrutiny because it conflicts with the well-established rule of contract interpretation known as contra proferentem. This long-settled doctrine, applied with near unanimity by courts, posits that, where two valid interpretations of a term or provision in a contract are possible, the one most favorable to the non-drafting party is to be adopted. *See* Nathe Bros. v. Am. Nat'l Fire Ins. Co., 615 N.W.2d 341, 344 (Minn. 2000) ("[A]mbiguities in a policy are generally resolved in favor of the insured."). Fortunately, in *Wanzek* the Minnesota Supreme Court denied the BRD even this last misguided foothold. There the court wrote:

> [T]he suggestion by Wausau that the principles of *Bor-Son* and *Knutson*, in combination with the general principles of the business-risk doctrine, should drive the interpretation of the words of the 1986 standard-form exclusion, is incorrect. We conclude that the extent to which Wausau's CGL policy covers the business risk of Wanzek *must be determined by the specific terms of the insurance contract*.

Wanzek, 679 N.W.2d at 327.

is the CGL policy itself.[73] One of the justifications of the BRD is its declaration that the purpose of CGL insurance is to cover the "tort liability" for physical damages to others but not the "contractual liability" attributable to the cost of repairing or replacing an insured's own work product.[74] In the case of *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, however, the Texas Supreme Court wrote that "the CGL policy makes no distinction between tort and contract damages . . . . Therefore, any preconceived notion that a CGL policy is only for tort liability must yield to the policy's actual language."[75] Similarly, the Wisconsin Supreme Court declared in *American Family Mutual Insurance Co. v. American Girl, Inc.* that "there is nothing in the basic coverage language of the current CGL policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the CGL[] [policy]."[76] Just as in Minnesota, these courts are rebelling against a doctrine that excludes a whole class of claims without any direct basis in the language of the policy. Throughout the nation, then, the BRD and its notions of the "purpose" of CGL insurance has given way to a jurisprudence that, quite sensibly, looks to the specific terms of the contract to decide what the obligations of the contracting parties should be.

V. ATTEMPTS TO RESUSCITATE THE BRD IN MINNESOTA: THE MINNESOTA COURT OF APPEALS' DECISION IN *KLAMPE*

Given the Minnesota Supreme Court's pronouncement against a BRD that exists independent of the language of the contract, and given the clear national trend away from the BRD, one might reasonably assume that the BRD has breathed its last. The BRD, however, is resilient. Insurance industry counsel, having experienced success in using the doctrine to excuse insurers from their express contractual obligations, continue to employ it whenever they think it has a chance of succeeding.[77] Unfortunately, this approach occasionally still works, as judges continue to accept the BRD as a substitute for the plain language of the policy itself. The result is injustice to

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[73] *See* U.S. Fire Ins. Co. v. J.S.U.B., Inc., 979 So. 2d 871, 891 (Fla. 2007); Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co., 137 P.3d 486, 489–90 (Kan. 2006); Travelers Indem. Co. of Am. v. Moore & Assocs., 216 S.W.3d 302, 310–11 (Tenn. 2007); Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 14 (Tex. 2007); Am. Family Mut. Ins. Co. v. Am. Girl, Inc., 2004 WI 2, ¶ 63, 673 N.W.2d 65, 82–83.

[74] *See supra* Part II.

[75] *Lamar Homes, Inc.*, 242 S.W.3d at 13.

[76] *Am. Family Mut. Ins. Co.*, 2004 WI ¶ 41, 673 N.W.2d at 77.

[77] As an example, although the Minnesota Court of Appeals decided the case on grounds other than the BRD, insurance industry counsel at the trial and appellate level continued to rely in their briefs on BRD arguments as if the doctrine were still valid. *See* Grinnell Mut. Reinsurance Co. v. Ripley, No. A09-179, 2009 WL 5088774, at *3–4 (Minn. Ct. App. Dec. 29, 2009).

the insured. A recent example—one that threatens to resurrect the BRD in Minnesota—is the Minnesota Court of Appeals' decision in *Integrity Mutual Insurance Co. v. Klampe*.[78]

The facts underlying *Klampe* are straightforward. Homeowners Terry and Jennifer Klampe entered into a contract with a builder, Hruska Builders LLC (Hruska), to build an addition onto their existing house.[79] At the time the construction agreement was signed, Hruska was insured by Integrity Mutual Insurance Company (Integrity) under a CGL policy.[80] Hruska's faulty workmanship resulted in more than twenty separate construction defects and damage to the Klampe's home, including a burst pipe and ensuing water leaks.[81] Hruska sought coverage under its CGL policy; Integrity denied coverage, and Hruska sued.[82]

The district court sided with the insurer by holding that it owed no duty to defend or indemnify Hruska.[83] Specifically, it determined that there was no "occurrence" within the terms of Hruska's CGL policy.[84] Alternatively, the court held that even if there was an "occurrence," policy exclusions applied to prevent coverage.[85] Relying on the BRD, the Minnesota Court of Appeals affirmed.[86]

The court of appeals began by acknowledging that to establish coverage under the CGL policy at issue, the insured was "required to show that there was an 'occurrence' resulting in 'property damage' within the particular policy period."[87] Turning to the policy language, the court noted that "occurrence" was defined for purposes of the policy as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions."[88] Rather than focus on whether "occurrence" or "accident" as defined in the CGL policy could reasonably be construed to encompass faulty workmanship, the court turned instead to the business risk doctrine, finding that the doctrine—rather than the express language of the policy—defeated Hruska's claim for coverage.[89]

Referencing *Bor-Son*, a case decided on an earlier version of a CGL policy materially different from the one at issue, the court noted that "CGL policies are designed to insure tort liability, not contractual liability."[90]

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78 *See* Integrity Mut. Ins. Co. v. Klampe, No. A08-0443, 2008 WL 5335690, at *5–6 (Minn. Ct. App. Dec. 23, 2008).
79 *Id.* at *1.
80 *Id.*
81 *See id.* at *2.
82 *See id.* at *1.
83 *See id.*
84 *Klampe*, 2008 WL 5335690, at *1.
85 *Id.*
86 *See id.* at *6.
87 *Id*. at *1.
88 *Id.* at *1.
89 *See id.* at *3–4.
90 *Klampe*, 2008 WL 5335690, at *3.

Specifically, the court reiterated: *"*[*t*]*he coverage [under a CGL policy] is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained*."[91] The court added that to the extent a third-party owner seeks damages for building and structural damage, the CGL policy provides no coverage because "[a] comprehensive general liability policy is intended to protect third parties who suffer damage to person or property. It is not intended to guarantee the insured's workmanship."[92]

To justify the difference between business risks and those risks covered by a CGL policy, the court again turned to *Bor-Son* and the BRD. With respect to business risks, the court noted:

> [T]he "insured-contractor can take pains to control the quality of goods and services supplied. At the same time he undertakes the risk that he may fail in this endeavor and thereby incur contractual liability whether express or implied." Thus, the "consequence of not performing well is part of every business venture; the replacement or repair of faulty goods is a business expense, to be borne by the insured-contractor in order to satisfy customers" and not an expense to be borne by the insurer.[93]

The court contrasted "business risks" with another form of risk, which it characterized as "injury to people and damage to property caused by faulty workmanship."[94] Again, quoting from *Bor-Son*, the court found that:

> *Unlike business risks of the sort described above, where the tradesman commonly absorbs the costs attendant upon the repair of his faulty work, the accidental injury to property or persons substantially caused by his unworkmanlike performance exposes the contractor to almost limitless liabilities.* While it may be true that the same neglectful craftsmanship can be the cause of both a business expense of repair and a loss represented by damage to persons and property, the two consequences are vastly different in relation to sharing the cost of such risks as a matter of insurance underwriting.[95]

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[91] *Id.* (quoting Sphere Drake Ins. Co. v. Tremco, Inc., 513 N.W.2d 473, 478 (Minn. Ct. App. 1994) (quoting Bor-Son Bldg. Corp. v. Emp'rs Commercial Union Ins. Co., 323 N.W.2d 58, 63 (Minn. 1982))).

[92] *Id.* (quoting *Sphere Drake Ins. Co.*, 513 N.W.2d at 478) (internal quotation marks omitted).

[93] *Id.* (citations omitted) (quoting *Bor-Son,* 323 N.W.2d at 64).

[94] *Id.*

[95] *Id.* (quoting *Bor-Son*, 323 N.W.2d at 64).

Applying the *Bor-Son* test, the court of appeals agreed with the district court that the Klampes' complaints about the quality of Hruska's work "mirror[ed] the business risks described in *Bor-Son*, not the risks of accidental injury that a CGL policy is intended to protect against."[96] With the exception of a burst pipe, which occurred when a pre-existing pipe was exposed to sub-zero temperatures as a result of Hruska's removal of an exterior wall, the court concluded that the complaints alleged were complaints about the quality of work "consciously and intentionally provided by appellant, not claims of accidental injury to property substantially caused by appellant's unworkmanlike performance."[97] Furthermore, the court added:

> [A] "contractor who knowingly violates contract specifications [as the district court found Hruska to have done] is consciously *controlling his risk of loss and has not suffered an occurrence"* . . . . And where the result is a highly predictable outcome of the insured's business decision, it will not qualify as an occurrence under the CGL policy.[98]

VI. THE FALLACY OF THE COURT OF APPEALS' ANALYSIS IN *KLAMPE*

In starting its analysis of the matter before it with the BRD, instead of looking to the language of the CGL policy and Minnesota precedent construing that language, the *Klampe* court embarked down the wrong analytical path. *Klampe* ultimately turns on a contorted interpretation of "occurrence" driven by the BRD and the policy considerations that underlie it, which contravene the express language of the CGL policy itself, as construed by the courts of this state.[99] There is clear Minnesota precedent on what constitutes an "occurrence," with which the decision in *Klampe* cannot be reconciled.

The standard CGL policy at issue in *Klampe* defines '"occurrence' as an 'accident, including continuous or repeated exposure to substantially the same general harmful conditions.'"[100] For the purpose of determining whether there has been an occurrence under a CGL policy, it is well-settled that it is not the act that must be accidental, but the result. As the Minnesota Supreme Court declared in distinguishing between an accidental "occurrence" and an intentional act, "where there is no intent to injure, the

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[96] *Klampe*, 2008 WL 5335690, at *4.

[97] *See id.*

[98] *Id.* (citations omitted) (quoting Bituminous Cas. Corp. v. Bartlett, 240 N.W.2d 310, 314 (Minn. 1976), *overruled on other grounds by* Prahm v. Rupp Constr. Co., 277 N.W.2d 389 (Minn. 1979)).

[99] *See id.* at *2–3.

[100] *Id*. at *1.

incident is an accident, even if the conduct itself was intentional."[101] As summarized by treatise authors Bruner and O'Connor:

> [F]or two reasons the occurrence element should be met in most defective construction cases. First, in order for the policy to provide any meaningful coverage, the focus of the inquiry regarding what should be deemed "accidental" is upon the injuries resulting from the act rather than the act itself. Second, in focusing upon the loss or injury instead of the act itself, the question of whether the resulting loss was unexpected or unforeseeable is generally viewed subjectively (i.e., from the insured's standpoint).[102]

Minnesota courts have routinely recognized that unintended defects due to faulty construction may constitute "occurrences" in standard CGL policies. In *O'Shaughnessy v. Smuckler Corp.*, for example, the court had no problem finding that construction defects attributable to faulty workmanship were covered occurrences.[103] In so doing, the court stated in part:

> The above example involved damages caused by defective workmanship. [The insurer] appears to distinguish damage as a result of defective workmanship from "accidental" damage. We see no reason, however, to treat defective wiring that causes a fire any differently from defective structural supports which cause collapsing of portions of a floor and cracking in both the floors and walls of a house. The damage in both cases is real and substantial as well as being the accidental result of defective workmanship.[104]

The Minnesota Supreme Court's decision in *Ohio Casualty Insurance Co. v. Terrace Enterprises, Inc.* is also on point.[105] In that case, the construction contractor performed work in the winter despite a warning from

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[101] Am. Family Ins. Co. v. Walser, 628 N.W.2d 605, 612 (Minn. 2001); *see also* Voorhees v. Preferred Mut. Ins. Co., 607 A.2d 1255, 1264 (N.J. 1992) ("[T]he accidental nature of an occurrence is determined by analyzing whether the alleged wrongdoer intended or expected to cause an injury. If not, then the resulting injury is 'accidental,' even if the act that caused the injury was intentional.").

[102] 4 BRUNER & O'CONNOR, *supra* note 21, § 11:26 (citations omitted).

[103] *See* O'Shaughnessy v. Smuckler Corp., 543 N.W.2d 99, 100 (Minn. Ct. App. 1996), *abrogated on other grounds by* Gordon v. Microsoft Corp., 645 N.W.2d 393 (Minn. 2002).

[104] *Id.* at 105; *see also* Bituminous Cas. Corp. v. Bartlett, 240 N.W.2d 310, 313 (Minn. 1976), *overruled on other grounds by* Prahm v. Rupp Constr. Co., 277 N.W.2d 389 (Minn. 1979) ("If property damage occurs because of mistake or carelessness on the part of the contractor or his employees, he reasonably expects that damage to be covered."); Hauenstein v. Saint Paul-Mercury Indem. Co., 65 N.W.2d 122, 125 (Minn. 1954) (shrinking and cracking of plaster was an "occurrence").

[105] *See* Ohio Cas. Ins. Co. v. Terrace Enters., Inc., 260 N.W.2d 450, 456 (Minn. 1977).

a consulting engineer about the damage of construction defects due to freezing weather.[106] The contractor's precautions to protect the work from freezing were unsuccessful.[107]

The property owners sued the contractor for the construction defects, and the contractor tendered the lawsuit to its insurer.[108] The insurer denied coverage and argued that there was no "occurrence."[109] The Minnesota Supreme Court rejected this argument, noting:

> [The contractor] was aware, from its own knowledge and the soil report, of the dangers of freezing conditions. The company took precautions that failed to adequately protect the soil and concrete. Such conduct was perhaps negligent, but not reckless or intentional. Hence, the settling of the building was an "occurrence" within the terms of the policy.[110]

The contractor in *Terrace Enterprises* intended to work in the winter, but it did not intend for the building to be damaged by working in winter. The damage that resulted in the building was thus an accident and, therefore, an "occurrence" within the meaning of the CGL policy.

As in *Terrace Enterprises*, the evidence in *Klampe* might well have established that Hruska, while perhaps negligent or intending to skip steps required by the specifications, nonetheless did not intend the damage caused by its actions.[111] At the very least, consistent with *Terrace Enterprises*, Hruska should have been permitted to prove that the damage caused was "accidental" and, therefore, the result of an "occurrence."[112]

The court of appeals did take exception to one of the district court's conclusions by disagreeing with the district court's finding that the damage to the Klampe's home from the burst pipe was not an occurrence within the CGL policy.[113] Instead, the appellate court found that "[b]ecause the

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[106] *Id.* at 452.

[107] *Id.*

[108] *Id.*

[109] *See id.*

[110] *Id.* at 452–53.

[111] *See supra* text accompanying notes 79–87.

[112] That the proper focus is on the damage resulting from the act, rather than the act itself, was underscored as well by the Eighth Circuit Court of Appeals in *Koch Engineering Co. v. Gibralter Casualty Co.*, 78 F.3d 1291, 1293 (8th Cir. 1996), in which the insured, Koch, engaged in defective design and construction of a distillation tower, which caused the pipes in the distribution system to become clogged. The Eighth Circuit, construing Missouri law, concluded that "the plugging of the distribution system constituted an occurrence and triggered the policies' coverage." 78 F.3d at 1294. In doing so, the court stated, "[T]here is simply no evidence in the record that Koch intended for the holes to become plugged with debris. As such, the district court's finding of recklessness alone does not support the inference of intent." *Id.* at 1294.

[113] *See* Integrity Mut. Ins. Co. v. Klampe, No. 08-0443, 2008 WL 5335690, at *5 (Minn. Ct. App. Dec. 23, 2008).

dramatic temperature drop, the bursting of the pipe, and the subsequent damages were unexpected, unforeseen, and undesigned happenings or consequences, we conclude that the bursting of the pipe was an occurrence."[114] But the court went on to reject coverage under the CGL policy for this damage under an exclusion to the policy (exclusion j(5)), which precluded coverage for "property damage" to "[t]hat particular part of real property on which you or any contractor or subcontractor working directly or indirectly on your behalf is performing operations, if the 'property damage' arises out of these operations."[115] Although the court acknowledged that Hruska's work on the Klampe's home was limited to tearing down the west wall, it concluded that, because the west wall formed a part of the Klampe's "existing 'real property,'" the "particular part of real property on which" Hruska had been performing operations was, "for purposes of the CGL policy's damage to property exclusion," the entire home.[116] Thus, the court determined that Hruska was excluded from CGL coverage for damage to all parts of the home, regardless of whether the contractor had worked on that *particular* part or not.[117] By adopting this type of "knee-bone is connected to the shin-bone" analysis, in which work on one part of a home is held to constitute work on the entire home, the *Klampe* court so broadened the scope of exclusion j(5) as to make Hruska's insurance essentially illusory.

In so doing, the court ignored extensive precedent holding that exclusion j(5) should be interpreted narrowly in light of the language limiting it only to "that *particular* part of real property"[118] on which the insured is working.[119] By ignoring decisions that would have found coverage based on

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[114] *Id.* at *5.

[115] *Id.* (alteration in original).

[116] *See id.* at *6.

[117] *See id.*

[118] *Id.* (emphasis added).

[119] *See, e.g.*, Essex Ins. Co. v. Hines, No. 09-40374, 2010 WL 10941, at *3 (5th Cir. Jan. 4, 2010) ("Our precedent makes plain that the 'that particular part' language of exclusion limits the scope of the exclusion to damage to parts of the property that were actually worked on by the insured. If work on any part of a property would leave an insured exposed for damages to the entire property, the exclusion should state: Property damage to property that must be restored, repaired or replaced because your work was incorrectly performed on any part of it." (citation omitted) (internal quotation marks omitted)); W.E. O'Neil Constr. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 721 F. Supp. 984, 996 (N.D. Ill. 1989) (holding that the literal meaning of "particular part" of property limited exclusion to specific property on which insured was performing work and not remainder of property); Hathaway Develop. Co. v. Am. Empire Supplies Lines Ins. Co., 686 S.E.2d 855, 863 (Ga. Ct. App. 2009) (holding that exclusion j(5) did not preclude coverage for damages to other property caused by insured's work on plumbing); Transp. Ins. Co. v. Piedmont Constr. Group LLC., 686 S.E.2d 824, 827 (Ga. Ct. App. 2009) (holding that exclusion j(5) applied only to the room and the plumbing on which subcontractor was working prior to fire starting, rather than the entire building that was being renovated at the time of the fire, holding otherwise consistent with BRD would render insurance coverage illusory); Frankel v. J.

a literal reading of the exclusion, the court of appeals fell victim to the BRD's declaration of the supposed intent of coverage rather than the coverage actually created by the precise terms of the policy.

Perhaps the *Klampe* case would not be so troubling if it were only an aberration, but other cases have ignored or miscited *Thommes* and *Wanzek* and improperly relied on the BRD as foundation. For example, the federal district court in Minnesota in *Aten v. Scottsdale Insurance Co.*, citing *Bor-Son* and reciting the purpose of the BRD, ruled as a matter of law that water damage caused by faulty construction could not be a covered "occurrence" under the terms of the CGL policy.[120] Applying Minnesota law, the Eighth Circuit Court of Appeals rejected the District Court's use of the BRD and instead appropriately engaged in a conventional analysis of the language of the CGL policy.[121] Referencing *O'Shaughnessy v. Smuckler Corp.*, the court found that "Aten's water damage to other property resulting from an improperly poured and graded basement floor which caused water to flow away from a floor drain" was a covered occurrence.[122] Having found an occurrence with resulting property damage, the Eighth Circuit then considered whether the resulting claim was otherwise excluded by an express policy exclusion.[123] Finding in the record before it facts that, if believed, could support coverage under the exception to the "Your Work" exclusion, the court of appeals reversed the district court's decision granting dismissal and remanded to allow for "limited discovery regarding whether subcontractors poured or leveled the basement floor or performed the work which suffered water damage as a result of the improperly graded basement floor."[124]

More recently, the Minnesota Court of Appeals recited the rule of *Bor-Son* and *Knutson* in *Remodeling Dimensions, Inc. v. Integrity Mutual*

Watson Co., 484 N.E.2d 104, 106 (Mass. App. Ct. 1986) (distinguishing "between damage to the work product of the insured and damage to larger units of which the insured's work product is but a component"); Columbia Mut. Ins. Co. v. Schauf, 967 S.W.2d 74, 81 (Mo. 1998) ("[E]xclusion applies to the 'property *on* which [the insured] is performing operations,' not to the entire area in which the insured is performing operations." (second alteration in original)); ACUITY v. Burd & Smith Constr., Inc., 721 N.W.2d 39, 41 (N.D. 2006) (j(5) exclusion construed narrowly to exclude coverage for damages for repair or replacement of roof on which general contractor was working but not damage to interior of apartment building); *cf.* Ohio Cas. Ins. Co. v. Terrace Enters., Inc., 260 N.W.2d 450, 454–55 (Minn. 1977) (exclusion (m) applicable to "property damage to work performed by or on behalf of the named insured" did not extend to entire building as building as whole was not the work performed by the insured).

[120] See Aten v. Scottsdale Ins. Co., No. 06-2931, 2006 WL 2990476, at *4 (D. Minn. Oct. 19, 2006), *rev'd and remanded*, 511 F.3d 818 (8th Cir. 2008).

[121] *See Aten*, 511 F.3d at 821.

[122] *See id.* at 820.

[123] *See id.*

[124] *See id.* at 821.

Insurance Co.[125] Ironically, after its incantation of the BRD, the court proceeded appropriately to analyze the express language of the policy.[126] If policy language was the basis of its decision, however, there was no reason to cite *Bor-Son* and *Knutson* as the predicate for its analysis, nor was it appropriate for the court to conclude that the two exclusions at issue "collectively reflect the business-risk doctrine."[127] The court's invocation of the BRD is a reminder of the doctrine's continued threat to proper contract interpretation.

VII. CONCLUSION

In relying on the BRD instead of looking to Minnesota precedent on what constitutes an "occurrence," the Minnesota Court of Appeals in *Klampe* wrongly treated the BRD as an independent, extra-contractual basis for denying CGL coverage without regard to the express terms of the policy.

This approach is contrary to Minnesota law concerning insurance contract interpretation. Indeed, a careful reading of Minnesota Supreme Court precedent subsequent to *Bor-Son* and *Knutson* suggests that the BRD is at most a statement of the reasons for certain policy exclusions and not a substitute for such exclusions. In any insurance coverage analysis, consistent with well-settled law, the court must look to the language of the policy to determine whether coverage exists.

The basic problem with the Minnesota Court of Appeals' opinion in *Klampe* is that it short-circuits the process long used by courts to interpret and implement the intent of the contracting parties. In place of the settled and familiar rules that have historically guided contract interpretation, the Minnesota Court of Appeals instead substituted a purported public policy of dubious validity. As set forth in Williston on Contracts: "[i]f the language [of a contract] clearly conveys the parties' lawful intentions, then, subject to overriding principles of legality and public policy, the court has no choice but to enforce the agreement according to its terms."[128] The BRD serves no "overriding principle" of public interest, and as such, it presents no public policy justification for replacing the intent of the contracting parties. There simply is no evidence and no reason to believe that the existence of insurance coverage to cover construction errors committed by contractors would encourage shoddy construction practice or devastate the industry to the extent necessary to invoke "public policy" to rewrite the policy. Indeed, the only apparent result of the BRD to date has been to prevent insured parties

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[125] *See* Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co., No. A10-1992, 2011 WL 2519203, at *7 (Minn. Ct. App. June 21, 2011).

[126] *See id.* at *7–8.

[127] *See id.* at *8.

[128] 11 SAMUEL WILLISTON, WILLISTON ON CONTRACTS § 32.2 (Richard Lord ed., 4th ed. 1999) (citation omitted).

from obtaining coverage for which they have paid and to which they should, in many cases, be entitled under the terms of their policy. Indeed, to the extent it defeats coverage arguably found in the policy, the BRD clearly conflicts with another long-established doctrine of insurance contract interpretation: contra proferentem. Under this doctrine, if two reasonable interpretations of a term or provision in an insurance contract are possible, the one most favorable to the non-drafting party (here, the insured) is to be adopted.[129] Given that the BRD protects and furthers the interests of the insurer at the expense of contract language that supports the claim of the insured, it is fundamentally at odds with the presumption underlying contra proferentem. Faced with a choice of one or the other, the courts should abandon the unfounded and increasingly-rejected BRD in favor of a universally recognized rule of contract interpretation that has historically guided the courts in addressing ambiguity in contracts.

In the wake of *Wanzek* and *Thommes*, the BRD should no longer have any independent extra-contractual role in contract interpretation in Minnesota. As it has no validity as a matter of policy and conflicts with long-established legal precedent governing contract interpretation, the Business Risk Doctrine is truly the legal equivalent of the fabled emperor who had no clothes.

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[129] *See* Dean Thomson & William Thomson, *supra* note 5, at 8; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981).