

2002

# Evolution or Revolution: Thommes' Role in the Development of the Business Risk Doctrine

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## Recommended Citation

Dotseth, Keith A.; Thurlow, Kari J.; and Daniel, Carrie A. (2002) "Evolution or Revolution: Thommes' Role in the Development of the Business Risk Doctrine," *William Mitchell Law Review*: Vol. 29: Iss. 2, Article 2.

Available at: <http://open.mitchellhamline.edu/wmlr/vol29/iss2/2>

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**EVOLUTION OR REVOLUTION:  
THOMMES' ROLE IN THE DEVELOPMENT OF THE  
BUSINESS RISK DOCTRINE**

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The views and opinions expressed herein are solely those of the authors and not necessarily the views of Larson • King or its clients. The authors wish to express their sincere gratitude to their colleagues at Larson • King, particularly Sarah Hornbrook, for their insight into this article.

## I. INTRODUCTION

The business risk exclusion was first introduced as a provision in standard form comprehensive general liability (CGL) policies in 1966. This provision in 1966 form policies was intended to exclude coverage for claims arising from inferior workmanship by the policyholder or its employees during the course of performing terms of a contract.<sup>1</sup> A workable construct of the provision, however, was not readily available until 1971 when Professor Roger C. Henderson clearly articulated the business risk doctrine—a doctrine that more fully explained the public policy purposes behind the business risk exclusion.<sup>2</sup> After Henderson's explanation, courts began to more consistently rely on the business risk exclusion to support insurer decisions to deny coverage for property damage or personal injury caused by faulty workmanship.<sup>3</sup>

With some exceptions, this trend towards reliance on the business risk doctrine to exclude most claims arising from faulty workmanship endured in Minnesota courtrooms until the recent Minnesota Supreme Court decision of *Thommes v. Milwaukee Mutual Insurance Co.*<sup>4</sup> The *Thommes* court appears to have concluded that business risk exclusions found in CGL policies do not preclude coverage for an insured in certain cases involving the infliction of damage on a third party. After *Thommes*, if an insured causes damage to a third party, or if the damage is caused by an action for which a party contracted, a policyholder's counsel will undoubtedly argue that there is support for a broad reading of the business risk exclusion. However, given the strength of the dissent in *Thommes*, it may yet become an anomalous decision that is ultimately distinguished by Minnesota courts in future opinions.

This article will first examine the role the *Thommes* decision plays in the development of the business risk doctrine in Minnesota. Second, this article will detail the origin of the business

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1. Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 438-46 (1971).

2. *Id.*

3. James Duffy O'Connor, *What Every Construction Lawyer Should Know About CGL Coverage for Defective Construction*, 21 CONSTR. L. 15, 16 (2001).

4. 641 N.W.2d 877 (Minn. 2002). Prior to *Thommes*, the Minnesota Court of Appeals appeared to signal some trend away from a broad application of the business risk doctrine by its decision in *O'Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99, 103-04 (Minn. Ct. App. 1996), *abrogated on other grounds by Gordon v. Microsoft Corp.*, 645 N.W.2d 393, 401-02 (Minn. 2002).

risk doctrine,<sup>5</sup> the development of the Minnesota courts' use of the business risk doctrine prior to *Thommes*,<sup>6</sup> and the procedural posture of *Thommes*.<sup>7</sup> This article will then offer an analysis of *Thommes*, discussing how *Thommes* signals an evolution in position by the Minnesota courts that, while recognizing the possibility this evolution will reach a quick end.<sup>8</sup> Finally, this article will offer considerations for insurance counsel regardless of whether *Thommes* is an evolution or a short-lived revolution.<sup>9</sup>

## II. HISTORY OF THE BUSINESS RISK DOCTRINE

CGL policies typically exclude coverage for defective performance of a contractual obligation.<sup>10</sup> The typical CGL policy accomplishes this intent through an exclusion known as a "business risk exclusion" or "own work" exclusion. The standard form policy provides that liability insurance does not cover:

That particular part of real property on which you or any contractors working directly or indirectly on your behalf are performing operations if the [third party's property damage claim] arises out of those operations or

That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it . . . .

"Property damage" to "your work" arising out of it or any part of it and included in the [complete operations hazard coverage] . . . .

[Property damage claims] arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work" or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other

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5. *See infra* Part II.

6. *See infra* Part III.

7. *See infra* Part IV.

8. *See infra* Part V.

9. *Id.*

10. A CGL policy "is a standardized liability policy promulgated by a group of organizations including the United States' leading insurance companies." Laurie Vasichek, Note, *Liability Coverage for "Damages Because of Property Damage" Under the Comprehensive General Liability Policy*, 68 MINN. L. REV. 795, 798 (1984).

property arising out of sudden and accidental physical injury to “your product” or “your work” after it has been put to its intended use.

Damages claimed for any loss, cost or expense insured by you or others for the loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of

- (1) “your product”
- (2) “your work” or
- (3) “impaired property”

if such product, work, or property is withdrawn or recalled from the market or from use by any person or organization because of a known or suspected defect, deficiency, inadequacy or dangerous condition in it.<sup>11</sup>

The business risk doctrine, which describes the public policy behind the business risk exclusions found in standard form CGL policies, is derived from the fundamental principle of insurance law that insurers should not be held liable for risks within the direct control of the insured.<sup>12</sup> Described in more detail:

The risk intended to be insured 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

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11. JEFFREY W. STEMPER, INTERPRETATION OF INSURANCE CONTRACTS § T4.2 (1994) [hereinafter STEMPER, INTERPRETATION OF INSURANCE CONTRACTS] (quoting INSURANCE SERVICE OFFICE, COMMERCIAL GENERAL LIABILITY FORM CG-00-01-11-88 (1988), *reprinted in* ALLIANCE OF AMERICAN INSURERS, POLICY KIT FOR STUDENTS OF INSURANCE 186-87 (1990) (paragraph labels omitted).

12. *See generally* Henderson, *supra* note 1. Indeed, the mention of the business risk doctrine was surprisingly absent from reported cases from the time it was introduced into products hazards and completed operations policies in 1966, until it was plainly articulated in a *Nebraska Law Review* article written by Professor Roger C. Henderson in 1971. *Id.* Professor Henderson is generally attributed with first articulating the business risk doctrine. JEFFREY W. STEMPER, LAW OF INSURANCE CONTRACT DISPUTES § 14.13 (2d ed. 2001) [hereinafter STEMPER, LAW OF INSURANCE CONTRACT DISPUTES].

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 loss because the product or completed work is not that for which the damaged person bargained.<sup>13</sup>

The business risk exclusion is crafted to “limit the CGL to providing coverage 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.’”<sup>14</sup> The “exclusion resists any policyholder tendency toward the moral hazard or adverse selection of shoddy work by forcing the policyholder to internalize the costs of unsatisfactory operations.”<sup>15</sup> Courts looking to apply the exclusion, as a result, must examine the nature of the complaint to determine whether it arose from tort or from contractual obligation.<sup>16</sup>

In 1979, the Supreme Court of New Jersey was one of the first courts to examine and openly endorse the business risk doctrine in *Weedo v. Stone-E-Brick, Inc.*<sup>17</sup> Facing a claim by a policyholder for coverage caused by faulty stucco, the court construed the business risk exclusion found in the CGL policy to unambiguously exclude coverage for faulty workmanship where the damages were limited to the cost of correcting the work itself (i.e., cracks and other signs of faulty workmanship in stucco masonry).<sup>18</sup> In so holding, the

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13. O'Connor, *supra* note 3, at 15 (quoting Roger C. Henderson, *Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know*, 50 NEB. L. REV. 415, 441 (1970)).

14. STEMPER, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 12, at § 14.13(a) (quoting Henderson, *supra* note 1, at 441).

15. STEMPER, INTERPRETATION OF INSURANCE CONTRACTS, *supra* note 11, at § T4.2.

16. *Id.*

17. 405 A.2d 788 (N.J. 1979). *Weedo* involved two consolidated claims against the same insured. Both claims involved the construction of the same comprehensive general liability provisions of a policy issued to a masonry contracting insured. *Id.* at 789.

18. *Id.* *Weedo* alleged, *inter alia*, that:

[A]s a result of the defective and unworkmanlike manner in which the defendants applied the said stucco, plaintiffs were compelled to and did cause the defects existing therein to be remedied, where possible, and the omissions to be supplied, and, in general, were compelled to and did furnish all the work, labor, services and materials necessary to complete the application of the said stucco . . . .

*Id.*

court found the risk of defective construction was not intended to be covered in a CGL policy.<sup>19</sup>

A number of jurisdictions have since joined the *Weedo* court, invoking the business risk doctrine and its theoretical underpinnings. Among the jurisdictions applying the business risk doctrine to exclude coverage include: Colorado,<sup>20</sup> Delaware,<sup>21</sup> Florida,<sup>22</sup> Indiana,<sup>23</sup> Maine,<sup>24</sup> North Carolina,<sup>25</sup> North Dakota,<sup>26</sup>

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The second claimants, the Gellas, sued their general contractor for alleged defects with roofing and gutter work performed by Stone-E-Brick pursuant to a subcontract. The general contractor sought indemnification from Stone-E-Brick, alleging that plaintiffs' damages were due to Stone-E-Brick's "faulty workmanship, materials, or construction." *Id.*

19. *Id.* at 791. The court stated:

Unlike business risks . . . where the tradesman commonly absorbs the cost 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.

*Id.*

The court further explained:

When a craftsman applies stucco to an exterior wall of a home in a faulty manner and discoloration, peeling and chipping result, the poorly-performed work will perforce have to be replaced or repaired by the tradesman or by a surety. On the other hand, should the stucco peel and fall from the wall, and thereby cause injury to the homeowner or his neighbor standing below or to a passing automobile, an occurrence of harm arises which is the proper subject of risk-sharing as provided by the type of policy before us in this case.

*Id.* at 791-92.

20. *Bangert Bros. Constr. Co. v. Americas Ins. Co.*, 888 F. Supp. 1069, 1073 (D.Colo. 1994) (applying Colorado law, the district court held that exclusions expressly precluded coverage for insured's faulty workmanship and defective performance).

21. *Vari Builders, Inc. v. United States Fid. & Guar. Co.*, 523 A.2d 549, 552 (Del. Super. Ct. 1986) (finding business policy exclusion unambiguous, and excluding coverage).

22. *Tucker Constr. Co. v. Mich. Mut. Ins. Co.*, 423 So.2d 525, 528 (Fla. Dist. Ct. App. 1982) (excluding coverage for property damage where the floor of a restaurant constructed by contractor settled).

23. *Ind. Ins. Co. v. DeZutti*, 408 N.E.2d 1275, 1279 (Ind. 1980) (excluding coverage for defective workmanship where policy language unambiguously excluded business risks).

24. *Peerless Ins. Co. v. Brennon*, 564 A.2d 383, 386 (Me. 1989) (holding that exclusions unambiguously precluded coverage for business risk that insured contractor's product or completed work was substandard).

25. *Wm. C. Vick Constr. Co. v. Penn. Nat'l Mut. Cas. Ins. Co.*, 52 F. Supp.2d

Oklahoma,<sup>27</sup> Tennessee,<sup>28</sup> and West Virginia.<sup>29</sup> For example, in holding that the insurer maintained no liability for the business risk exclusion precluding payment for damages due to workmanship, the North Dakota Supreme Court held that “the injury to products or work exclusion is intended to exclude insurance for damage to the insured’s product or work, but *not* for damage caused by the insured’s product or work.”<sup>30</sup> Thus, the exclusion does not apply where the product or work causes damage to other persons or property.

As more courts expressly endorsed the business risk doctrine, it became a more efficient and effective means by which an insurer could deny coverage of a claim.<sup>31</sup> Indeed, from the perspective of some policyholders, the business risk doctrine had grown so powerful for insurers that it supported a denial of coverage even when the doctrine’s application was contradicted by the policy’s express language.<sup>32</sup> For example, the policy provision at issue in *Baylock & Brown Construction, Inc. v. AIU Insurance Co.* expressly defined property damage as including:

- (1) physical injury to or destruction of tangible property that occurs during the policy period, including the loss of

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569, 592 (E.D.N.C. 1999) (finding that faulty workmanship did not constitute property damage under CGL policies). *See also* *W. World Ins. Co. v. Carrington*, 369 S.E.2d 128 (N.C. Ct. App. 1988); *Barbee v. Harford Mut. Ins. Co.*, 408 S.E.2d 840 (N.C. 1991).

26. *Fisher v. Am. Family Mut. Ins. Co.*, 579 N.W.2d 599, 605-06 (N.D. 1998) (finding that the injury to products or work exclusion precludes coverage for economic loss sustained by the insured due to repairing or replacing its own defective work or products).

27. *Hartford Accident & Indem. Co. v. Pac. Mut. Life Ins. Co.*, 861 F.2d 250, 253 (10th Cir. 1988) (applying Oklahoma law, the Tenth Circuit held that a CGL policy does not extend to ordinary business risks and excluding coverage for property damage to insured’s products and work).

28. *Vernon Williams & Son Constr., Inc. v. Cont’l Ins. Co.*, 591 S.W.2d 760, 763 (Tenn. 1979) (relying upon *Weedo* and holding that no coverage existed for a breach of contract action grounded upon faulty workmanship or materials).

29. *Erie Ins. Prop. & Cas. Co. v. Pioneer Home Improvement, Inc.*, 526 S.E.2d 28, 33-34 (W. Va. 1999) (finding policy language unambiguous and holding that policy precluded coverage for workmanship).

30. *Fisher*, 579 N.W.2d at 605 (emphasis added).

31. *See, e.g.*, *Hartford Accident & Indem. Co. v. Pac. Mut. Life Ins. Co.*, 861 F.2d 250, 253 (10th Cir. 1988); *Bangert Bros. Constr. Co. v. Americas Ins. Co.*, 888 F. Supp. 1069, 1073 (D.Colo. 1994); *Ind. Ins. Co. v. DeZutti*, 408 N.E.2d 1275, 1279 (Ind. 1980); *Peerless Ins. Co. v. Brennon*, 564 A.2d 383, 386 (Me. 1989); *Fisher*, 579 N.W.2d at 605; *Vernon Williams & Son Constr., Inc. v. Cont’l Ins. Co.*, 591 S.W.2d 760, 763 (Tenn. 1979).

32. O’Connor, *supra* note 3, at 15-16.

the use thereof at any time resulting therefrom, or (2) loss of the use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.<sup>33</sup>

Nonetheless, the court denied coverage, citing the business risk doctrine.<sup>34</sup>

### III. THE DEVELOPMENT OF THE BUSINESS RISK DOCTRINE IN MINNESOTA

The Minnesota Supreme Court first expressly endorsed the business risk doctrine in *Bor-Son Building Corp. v. Employers Commercial Union Insurance Co. of America*.<sup>35</sup> In doing so, the court turned to the *Weedo* opinion to support its broad finding that no insurance coverage existed for a general contractor whose liability arises from faulty workmanship and materials.<sup>36</sup> The court concluded, “[w]e are convinced that the standard comprehensive general liability policy does not provide coverage to an insured-contractor for a breach of contract action grounded upon faulty workmanship or materials, where the damages claimed are the cost of correcting the work itself.”<sup>37</sup> The court subsequently affirmed its *Bor-Son* holding in *Knutson Construction Co. v. St. Paul Fire & Marine Insurance Co.*<sup>38</sup>

A number of courts refused to follow the breadth of the *Bor-*

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33. 796 S.W.2d 146, 148 (Tenn. Ct. App. 1990).

34. *Id.* at 153. In an examination by the court of the conflicting positions of the plain language of the contract versus the business risk doctrine, the court found “coverage for property damage provided by the standard [CGL] policy [did] not extend coverage to an insured-contractor for a breach of contract action.” *Id.* See also *Vernon Williams & Son Constr., Inc. v. Cont’l Ins. Co.*, 591 S.W.2d 760, 763 (Tenn. 1979) (denying coverage on a similar basis).

35. 323 N.W.2d 58 (Minn. 1982). *Bor-Son* involved two suits that alleged that water leakage in newly constructed high-rise apartment complexes were due to defects caused by the use of faulty materials and workmanship. *Id.* at 60.

36. *Id.* at 63-64. The court found that all of the damages claimed by the building owner arose out of *Bor-Son*’s breach of contract, and it reasoned that the damages were a result of faulty workmanship in the performance of the contracts. *Id.* at 63. The court then concluded that “[t]his liability on the part of the contractor is not within the coverage of the contractor’s general liability policy.” *Id.*

37. *Id.* (quoting *Vernon Williams*, 591 S.W.2d at 765).

38. 396 N.W.2d 229, 235 (Minn. 1986). In *Knutson*, the court considered the *Weedo* decision but also relied upon the *Bor-Son* decision. *Id.* The court determined that building damage caused by a general contractor’s breach of contract duty due to faulty workmanship or use of defective materials was a business risk and was excluded from insurance coverage. *Id.*

*Son* opinion.<sup>39</sup> Some courts refused to follow *Bor-Son* without comment, whereas others expressly criticized the reasoning used by the Minnesota court.<sup>40</sup> In *Fireguard Sprinkler System Inc. v. Scottsdale Insurance Co.*, the court openly criticized the Minnesota court's logic, indicating that because "a general contractor may have little or no effective control over the manner in which subcontractors perform work, [therefore the court finds] unpersuasive the argument 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 the risk."<sup>41</sup> *Fireguard* acknowledged, however, that the *Bor-Son* analysis may be properly limited to general contractor-subcontractor relationships.<sup>42</sup>

Perhaps in response to the growing number of decisions critical of the *Bor-Son* analysis, the Minnesota Court of Appeals refused to follow *Bor-Son* in its 1996 decision of *O'Shaughnessy v. Smuckler Corp.*<sup>43</sup> In that case, the court limited the *Bor-Son* and *Knutson* rulings to CGL policies patterned after the unendorsed 1973 ISO CGL form.<sup>44</sup> The court stated that the post-1986 policy expressly covered insured contractors for defective construction property damage.<sup>45</sup> As a result, the court held that the business risk doctrine did not preclude coverage for damages arising out of the defective work of a subcontractor.<sup>46</sup> The Minnesota Supreme Court

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39. See, e.g., *Fireguard Sprinkler Sys. Inc. v. Scottsdale Ins. Co.* 864 F.2d 648 (9th Cir. 1988); *Md. Cas. Co. v. Reeder*, 221 Cal.App.3d 961, 973-74 (1990); *Southwest La. Grain, Inc. v. Howard A. Duncan, Inc.*, 438 So.2d 1224 (La. Ct. App. 1993); *Corner Constr. Co. v. United States Fid. & Guar. Co.*, 638 N.W.2d 887, 892-94 (S.D. 2002); *Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824 (Tex. Ct. App. 1988).

40. See, e.g., *Fireguard*, 864 F.2d at 653-54 (finding that *Bor-Son*'s explanation ignored the careful drafting of the policy); *Green Constr. Co. v. Nat'l Union Fire Ins. Co.*, 771 F. Supp. 1000, 1006 (W.D.Mo. 1991); *Harbor Ins. Co. v. Tishman Constr. Co.*, 578 N.E.2d 1197, 1201 (Ill. Ct. App. 1991).

41. 864 F.2d at 653-54.

42. *Id.* (citing *Bor-Son Bldg. Corp. v. Employers Commercial Union Ins.*, 323 N.W.2d 58, 63-64 (Minn. 1982)).

43. 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, 401-02 (Minn. 2002).

44. *Id.* at 103-05.

45. *Id.* at 104-05. The 1986 exception states, however, that the exclusion does not apply if the damaged work or the work out of which the damage arises was performed on 'your behalf' by a subcontractor. Thus, the plain language of the exception provides that damages to 'your work' is covered if the damage results from the work performed by a subcontractor." *Id.* at 104.

46. *Id.* at 104-05.

denied review.

As a result of these mixed decisions, the Minnesota Supreme Court's interpretation of the business risk doctrine was convoluted. The court broadly denied coverage for damage related to faulty workmanship and materials in the early Minnesota cases of *Bor-Son* and *Knutson Construction*.<sup>47</sup> Then, in an apparent progression towards coverage, the court of appeals in *O'Shaughnessy* held that the business risk doctrine did not preclude coverage for defective construction in policies dated after 1986.<sup>48</sup> In the midst of this uncertainty, *Thommes* presented an opportunity for Minnesota courts to further clarify their treatment of the business risk doctrine.

#### IV. THE THOMMES DECISION

Dean Morlock, Charles Vig, and HHA Development, Inc. owned a commercial development.<sup>49</sup> John Krajewski and Donna Krajewski (Morlock's sister) owned property directly adjacent to the development.<sup>50</sup> In September 1996, Thommes & Thomas Land Clearing ("Thommes") entered into a contract with Richard Knutson, Inc., to clear trees from the HHA development.<sup>51</sup> While describing the work that Thommes was to perform, Morlock pointed out a tree which marked the property line up to which Thommes was to clear.<sup>52</sup> He told Thommes not to worry about whether certain trees were on the development "because his sister owned the [adjacent] property."<sup>53</sup> Morlock mistakenly instructed Thommes to clear approximately one-half acre of the Krajewskis' land without obtaining the consent of the property owners.<sup>54</sup>

The Krajewskis filed an action against Thommes for damages.<sup>55</sup> Thommes tendered defense to its CGL insurer, Milwaukee Mutual

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47. *Bor-Son*, 323 N.W.2d at 63; *Knutson Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 396 N.W.2d 229, 235 (Minn. 1986).

48. *O'Shaughnessy*, 543 N.W.2d at 102-05.

49. *Thommes v. Milwaukee Ins. Co.*, 641 N.W.2d 877, 879 (Minn. 2002).

50. *Id.*

51. *Id.*

52. *Thommes v. Milwaukee Mut. Ins. Co.*, 622 N.W.2d 155, 157 (Minn. Ct. App. 2001).

53. *Id.*

54. *Thommes*, 641 N.W.2d at 879. Thommes first learned of his mistaken clearing of the Krajewskis' land upon their bringing of an action against Thommes. *Thommes*, 622 N.W.2d at 157.

55. *Thommes*, 622 N.W.2d at 157.

Insurance Company.<sup>56</sup> Milwaukee refused to defend and indemnify Thommes.<sup>57</sup> Milwaukee asserted that the damage on the Krajewski property was not covered due to the business risk exclusions contained in sections 2j(5) and 2j(6) of Thommes' CGL policy.<sup>58</sup> Thommes sought a declaratory judgment that Milwaukee had a duty to defend and indemnify Thommes under the policy.<sup>59</sup> Each party filed a motion for summary judgment, and the trial court granted Milwaukee's motion.<sup>60</sup>

The Minnesota Court of Appeals reversed the district court order and granted Thommes' motion for summary judgment.<sup>61</sup> In reversing the trial court's grant of summary judgment in favor of Milwaukee, the court of appeals began with the recognition that exclusions 2j(5) and 2j(6) are business risk exclusions, designed to exclude coverage for faulty workmanship within the insured's control.<sup>62</sup> Implying that the policy exclusions were unambiguous, the court found that "damage to third-party property caused by appellant's work is not excluded from coverage" by exclusions 2j(5)

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56. *Id.*

57. *Id.*

58. *Id.* The relevant portions of Thommes' CGL policy read:

I. Section I—Coverages

Coverage A. Bodily Injury and Property Damage Liability

1. Insuring Agreement

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

\* \* \* \*

2. Exclusions

This insurance does not apply to:

\* \* \* \*

j. Damage to property

"Property damage" to:

\* \* \* \*

(5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations; or

(6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

\* \* \* \*

19. "Your work" means:

Work or operations performed by you or on your behalf \* \* \* .

*Id.* 158.

59. *Thommes*, 641 N.W.2d at 879.

60. *Id.*

61. *Thommes*, 622 N.W.2d at 160.

62. *Id.*

and 2j(6).<sup>63</sup> Milwaukee appealed.<sup>64</sup>

The Minnesota Supreme Court affirmed the court of appeal's holding, finding that the Milwaukee policy provided coverage.<sup>65</sup> In so holding, the supreme court first turned to the basic rules of insurance policy construction.<sup>66</sup> The court examined the express policy language to determine whether the policy unambiguously covered damage to the Krajewskis' property.<sup>67</sup> As a threshold issue, if the policy language was unambiguous, the court concluded it had no need to invoke extrinsic evidence or public policy.<sup>68</sup>

Exclusion 2j(5) provided that coverage did not exist for "[p]roperty damage' to . . . [t]hat particular part of real property on which you [Thommes] or any contractors or subcontractors working directly or indirectly on your [Thommes's] behalf are performing operations, if the 'property damage' arises out of those operations."<sup>69</sup> The court held the policy language was ambiguous, finding that the phrase "that particular part of real property on which you . . . are performing operations" was susceptible to more than one meaning.<sup>70</sup> The court reasoned that because the phrase was not defined, and the express language did not clearly signify whether the land of a third party was covered, the exclusion was ambiguous.<sup>71</sup> With little explanation, the court appeared to further endorse this conclusion by indicating "the underlying purpose of CGL insurance" supported finding that the phrase was ambiguous.<sup>72</sup>

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63. *Id.*

64. *Thommes*, 641 N.W.2d at 879.

65. *Id.* at 884.

66. *Id.* at 880. The Minnesota Supreme Court criticized the court of appeals for its failure to properly apply the rules of construction. *Id.*

67. *Id.* at 882.

68. *Id.*

69. *Id.* (quoting the policy language).

70. *Id.* at 883.

71. *Id.*

72. *Id.* at 884. An insurer counsel might argue that this reasoning departs from Minnesota contract law because courts should only look to the language within the "four corners" of the contract in determining if there is an ambiguity. *See, e.g., In re Quinlan's Estate*, 233 Minn. 35, 35, 45 N.W.2d 807, 808 (1951) (stating that "[t]he primary rule of construction is that the intent of the testatrix, as expressed in the language of the will, is to be gathered from everything contained within its four corners, as read in the light of the surrounding circumstances"); *Hutchinson Gas Co. v. Phoenix Indem. Co.*, 206 Minn. 257, 261, 288 N.W. 847, 850 (1939) (finding no ambiguity in the contract and holding "such being the case, there is no room for construction even though the rule is that such a contract should be construed most favorably to the indemnitee"); *Oleson v.*

Exclusion 2j(6) provided that coverage did not exist for “‘property damage’ to . . . [t]hat particular part of any property that must be restored, repaired or replaced because ‘your [Thommes’s] work’ was incorrectly performed on it,” where “your [Thommes’s] work” includes “work or operations performed by you [Thommes] or on your [Thommes’s] behalf.”<sup>73</sup> The court concluded that this exclusion was ambiguous because it was unclear whether it applied only to work performed in a faulty or defective manner, and whether work was “incorrectly performed” if it was completed in the right manner but on the wrong property.<sup>74</sup> Invoking *contra proferentem*<sup>75</sup> the court reasoned that the exclusion applied only to work done in a faulty or defective manner; thus the property damage was covered because it was done in the right manner, just on the wrong property.<sup>76</sup>

After determining that the CGL exclusions were ambiguous, the court then turned to the business risk doctrine and recognized “that the underlying purpose of CGL insurance is to provide coverage for the risk of tort liability to third parties, as opposed to risks that arise as a matter of contract law.”<sup>77</sup> The court’s determination that the exclusions did not clearly demonstrate intent to exclude the risk of liability for damage to third parties’ property supported its decision to enforce the coverage provisions of the policy.<sup>78</sup>

Justice Stringer, joined by Chief Justice Blatz and Justice Paul Anderson, dissented, indicating disagreement with the characterization of the exclusions as ambiguous in nature; he believed the two provisions clearly and unambiguously excluded

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Bergwell, 204 Minn. 450, 454, 283 N.W. 770, 773 (1939) (“We are not permitted to so construe a contract as to avoid the chosen language used by the parties provided such language ‘is plain and unambiguous.’”). In *Thommes*, the court found two possible meanings of the policy exception, one derived from the plain meaning, and the other derived from the business risk doctrine. 641 N.W.2d at 879-80.

73. *Thommes*, 641 N.W.2d at 883.

74. *Id.*

75. *Contra proferentem* is a commonly used doctrine by which ambiguities in a document are to be construed unfavorably towards the drafter or in favor of coverage. *General Mills, Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147, 151 (Minn. Ct. App. 2001), *review denied* (Minn. Apr. 17, 2001) (citing BLACK’S LAW DICTIONARY 328 (7th ed. 1999)).

76. *Thommes*, 641 N.W.2d at 880.

77. *Id.* at 884.

78. *Id.*

the Krajewskis' property damage from coverage.<sup>79</sup> Justice Stringer suggested the majority distorted the policy language, and its conclusion was "absurd and inconsistent with our long-standing principle that we construe contracts to avoid absurd or unjust results, where reasonably possible."<sup>80</sup> Justice Stringer accused the majority of distorting the policy language in exclusion 2j(5) of the policy by limiting the definition of "real property on which you . . . are performing operations" to that on which Thommes contracted to work. He stated that such a distortion "does not support a conclusion of ambiguity that justifies ignoring the 2j(5) exclusion."<sup>81</sup> Justice Stringer would have also applied the 2j(6) exclusion, noting that "the insurance policy does not provide coverage for claims for work incorrectly performed—and what could be more incorrect than performing the work on the wrong property?"<sup>82</sup>

#### V. A CONTINUING EVOLUTION OR MERELY A REVOLUTION?

The final impact of *Thommes* on the status of the business risk doctrine in Minnesota remains unclear. Given the mixed history of the doctrine and the strength of the dissent, it is possible that *Thommes* may be viewed as an anomaly that is readily distinguished on its facts. On the other hand, *Thommes* could be viewed as a sign of a further evolution toward a more limited view of the business risk doctrine in Minnesota.

Most likely, the *Thommes* decision reflects a more balanced approach to judicial treatment of the business risk doctrine in Minnesota. Traditionally, courts have used the business risk doctrine to support a finding that CGL policies do not provide coverage for property damage or for personal injury caused by the

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79. *Id.* (Stringer, J., dissenting):

On the contrary, the plain meaning of the provisions clearly provide for an exclusion from coverage . . . . The plain meaning is nothing more or nothing less than what the words say—here the exclusion applies because Thommes was "performing operations" on the Krajewskis' property by cleaning and grubbing their land, and damage to the Krajewskis' trees, shrubs, and grass falls squarely within the reference to "property damage."

*Id.*

80. *Id.* at 884-85.

81. *Id.* at 884.

82. *Id.* at 885.

insured contractor's faulty workmanship.<sup>83</sup> The typical analysis asked whether the damage was caused by defective workmanship of the insured contractor.<sup>84</sup> If the damage was caused by faulty workmanship, coverage was excluded. If the damage was attributable to some other cause (i.e. the use of faulty materials), coverage might not have been excluded.

If *Thommes* is endorsed as an evolution of Minnesota law, Minnesota courts will now ask an additional preliminary question: was the damage incurred by a third party? If a court answers this question affirmatively, it appears that it will probably find that the CGL policy provides coverage, regardless of the cause of damage. This analysis would be, of course, a shift towards an interpretation of contracts to benefit those insureds who may have caused personal injury or property damage to a third party, notwithstanding the absence of a contractual relationship between the third party and the insured. This assumes that the insured's acts would otherwise be covered because the insured acted according to the conditions of the underlying contract.

Whether *Thommes* is ultimately judged to be an evolution or a revolution, it is undeniable that counsel facing a business risk issue must be prepared to address the impact of the decision. At a minimum, insurance counsel must continue to consider whether the damage resulted from the insured's faulty workmanship.<sup>85</sup> Under *Bor-Son*, if the court found that the damage was caused by faulty workmanship, it would most likely find that coverage was excluded under a standard CGL policy.<sup>86</sup> However, following *Thommes*, practitioners should also consider the language and purpose of the underlying contract between the insured and the third party.<sup>87</sup> If the purpose and scope of the underlying contract for work is narrowly and precisely defined, and damage occurs outside the scope of that contract, the insured may now be able to successfully argue that coverage for such damage exists.<sup>88</sup>

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83. See *supra* Part II. (describing the historical underpinnings of the business risk doctrine).

84. *Id.*

85. See, e.g., *id.* (noting that historically courts have been primarily concerned with whether damage was a result of faulty workmanship).

86. *Bor-Son Bldg. Corp. v. Employers Commercial Union Ins. Co.*, 323 N.W.2d 58, 63 (Minn. 1982).

87. For example, the purpose of the underlying contract in *Thommes* was to clear land. 641 N.W.2d at 879.

88. *Id.* at 884 ("Construing the exclusion narrowly against the insurer, as we must, we conclude that [the] exclusion . . . applies only to work performed in a

Insurance counsel should also be prepared to address the significance of who has incurred the damage. Indeed, *Thommes* might be interpreted by policyholder's counsel to support an argument that the business risk doctrine does not apply to any third party damage cases.<sup>89</sup>

## VI. CONCLUSION

The *Thommes* decision arrived at a time when Minnesota courts' application of the business risk exclusions found in standard CGL policies to claims arising from faulty workmanship seemed convoluted. At times, Minnesota courts had broadly applied the business risk exclusions, denying coverage for damage related to faulty workmanship. Later, Minnesota courts appeared to retreat from this position, indicating that its earlier holdings were limited. The *Thommes* decision may be considered an evolution of Minnesota's use of the business risk doctrine, an attempt to clarify how Minnesota courts will apply the doctrine to claims arising out of defective workmanship. On the other hand, *Thommes* may only be a short-lived revolution, which will be quickly distinguished by the Minnesota courts. Regardless of whether *Thommes* is an evolution or a revolution, *Thommes* clarifies the variables insurance counsel should consider when faced with a business risk exclusion issue.

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faulty or defective manner and thus, does not bar coverage of the damage to the Krajewskis' property.").

89. See *supra* Part V.