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HOLLMAN DEJONG & LAING S.C.

THE FOUR CORNERS RULE AND INSURERS' DUTY TO DEFEND IN WISCONSIN

One of the central purposes of liability insurance is to protect the insured by providing a defense in the event of a lawsuit. But what defines the limits of an insurer's duty to defend its insured under Wisconsin law? How is the insurer to decide whether or not to defend an insured in a given case? Has an insurer breached its duty if it refuses to do so? These are critical questions. If an insurer breaches its duty to defend, the insurer may face severe consequences under Wisconsin law, including potential bad faith liability, loss of coverage defenses, and liability beyond policy limits.

With so much at stake, how should an insurer determine its duty to defend? That question is not always easy to answer. Unfortunately, Courts in Wisconsin have made answering that question more difficult with a confusing series of inconsistent decisions over the decades.

The Four Corners Rule

To determine the insurers' obligation to defend a policyholder, states including Wisconsin have typically applied what's known as the "four corners rule"–review is limited to what's within the "four corners" of the documents' pages. No more, no less. In this case, that means that an insurer must decide whether or not to defend by comparing the language of the insurance policy to allegations made in the complaint. All other sources of information are deemed irrelevant.

As originally conceived, the rule was intended to protect the insured. It was to preclude insurers from denying a defense based upon the litigation's actual merits, and to prevent insurers from using facts they have learned to deny a defense.

In recent years, courts throughout the country have wrestled with the application of the four corners rule. The majority of states have carved out exceptions to it, while Wisconsin courts have struggled with these exceptions.

Amorphous Rulings For Amorphous Exceptions

In *Grieb v. Citizens Cas. Co.*, 33 Wis.2d 552, 558 (1967), the Wisconsin Supreme Court found that an insurer was not required to defend a policyholder. The Court saw no need to go

beyond the four corners of the complaint and the insurance policy in that case. But in dicta the Court appeared to recognize at least four situations in which it could be appropriate to look beyond the four corners of the documents:

1. Where there was a conflict between allegations made in the complaint and the known facts;
2. Where the allegations are ambiguous or incomplete;
3. Where the relevant facts fall both within and outside the policy coverage; or
4. Where the complaint states conclusions rather than facts.

The Wisconsin Supreme Court neither applied nor expressly adopted any of these exceptions in *Grieb*. Nevertheless, since then, both State and Federal courts in Wisconsin have used these exceptions.

For example, in *American Motorists Ins. Co. v. Trane Co.*, 544 F.Supp. 669 (W.D. Wis. 1982), a Federal District Court read *Grieb* to mean that an insurer could look at "known or readily ascertainable facts," but only if there was a conflict between the allegations and the facts or an ambiguity in the allegations.

In 1987, the Wisconsin Court of Appeals (District III) also looked to facts not included in the complaint, in *Berg v. Fall*, 138 Wis.2d 115 (Ct. App. 1987).

In *Berg v. Fall*, plaintiff Robin Berg alleged that he'd been punched by defendant James Fall. The Plaintiff's complaint alleged only intentional conduct, not negligence. Fall's insurer refused to defend Fall in the lawsuit, because its policy expressly excluded coverage for any intentional injury to another party. But Fall claimed that he had acted in self-defense, and therefore the policy's exclusion should not apply. The trial court decided that Fall had committed an intentional act (i.e., to strike Berg), and his reason for doing so was irrelevant. It granted summary judgment in favor of his insurer.

The Court of Appeals considered the same extrinsic facts but reversed, holding that the insurer had a duty to defend Fall. The policy was intended to exclude intentional torts. Citing *Grieb*, enough of the facts were there, accessible in the record, to support Fall's position, and, if proven, these facts would be a complete defense to the assault and battery claim. The appellate court also said that it wasn't surprising that Berg had omitted from his complaint facts that supported Fall's defense, and that Berg's omission should not determine Fall's insurance coverage.

However, a year later, the Court of Appeals (District IV) took the opposite view. In *Professional Office Bldgs. v. Royal Indem. Co.*, 145 Wis.2d 573, (Ct. App. 1988), the trial court considered extrinsic facts known to the insurer but not included in the complaint, and concluded the insurer had no duty to defend. But the Court of Appeals reversed, stating that the Federal Court's decision in *American Motorist* was persuasive, but ultimately, it did not

control in Wisconsin state courts. Grieb required the duty to defend to be determined solely by the allegations of the complaint, it held, without regard to extrinsic facts (contained in deposition testimony and so forth).

Later cases only further muddied the issue. In *Doyle v. Engleke*, 217 Wis. 2d 277 (1998), and in *Smith v. Katz*, 226 Wis. 2d 298 (1999), the Wisconsin Supreme Court signaled that under Wisconsin law an insurer's duty to defend is to be determined under the four corners rule, looking solely to the insurance policy and the allegations of the complaint. In both cases, the high court criticized the Court of Appeals' decision in *Berg* as being contrary to a long line of Wisconsin cases, yet did not overrule *Berg*.

Then, some twenty years after *Berg*, *Estate of Sustache v. Amer. Fam. Mut. Ins. Co*., 2007 WI App 144, 303 Wis.2d 714 (2007), came before the Wisconsin Court of Appeals.

Like *Berg, Sustache* involved a fistfight, and, once again, the complaint alleged only intentional battery, but the insured claimed he had acted in self-defense. The trial court based its decision solely upon the complaint and found no duty to defend. The Court of Appeals affirmed, citing *Doyle and Smith*, concluding that Wisconsin law "knows no exceptions" to the four corners rule. Yet, in dicta the Court noted that where the "true facts" call for coverage but the complaint fails to reveal those facts, the insured should be entitled to a defense. The Wisconsin Supreme Court had declined to hear the case on certification by the Court of Appeals. Hence, the Court of Appeals noted that "We think the issue warrants Supreme Court comment at some point in the future."

Given the mixed precedent, consideration of extrinsic facts by trial courts had become commonplace and inconsistent. Insurers had little clear guidance to help them resolve questions involving the duty to defend. And neither party could rely on trial courts to produce predictable results. In practice, cases often boiled down to insurers relying on extrinsic facts when denying a defense, while insured defendants asserted extrinsic facts as grounds for demanding a defense.

A New Clarity in the Duty to Defend?

To resolve the ongoing tension, in 2016, the Wisconsin Supreme Court decided a pair of companion cases: *Water Well Solutions Service Group Inc. v. Consolidated Ins. Co*. and *Marks v. Houston Cas. Co.* These two cases reestablished the supremacy of the strict application of the "four-corners" rule in Wisconsin.

In *Water Well Solutions Serv., Inc. v. Consolidated Ins. Co*., 2016 WI 54 (2016), Water Well Solutions Services, Inc. ("Water Well") had been hired by the Waukesha Water Utility in 2009 to replace a pump in an existing well. Two years later, Water Well's pump failed, and Waukesha sued for negligence. Water Well turned to its insurer, Consolidated Insurance

Company ("Consolidated"), for defense against the suit, under its Commercial General Liability Policy. Consolidated refused either to defend or to indemnify Water Well. Consolidated argued that it was not required to do so, because the complaint only alleged physical injury to Water Well's product, and the policy specifically excluded such claims.

Water Well hired its own counsel, and, eventually, it reached an out of court settlement with the Utility. Then, Water Well filed suit against Consolidated, alleging bad faith and breach of the duty to defend. The circuit court granted summary judgment in Consolidated's favor, finding no duty to defend, and the Wisconsin Court of Appeals affirmed.

Water Well appealed to the Wisconsin Supreme Court, arguing that the complaint did not include all of the physical damage at issue, claiming that other property besides the well had been damaged. If that was the case, Water Well continued, Consolidated would have been required to represent the firm. Therefore, Water Well argued that it should be allowed to present evidence establishing that additional damage. The insured urged the Court to adopt an exception to the four corners rule where an insurer refused to defend based upon a policy exclusion without seeking a coverage ruling and the complaint is factually incomplete or ambiguous.

The Court declined the invitation, instead clarifying adherence to the strict application of the four corners rule.

"We now unequivocally hold that there is no exception to the four-corners rule in duty to defend cases in Wisconsin," the Court wrote in *Water Well*. "We overrule any language in *Berg* suggesting that evidence may be considered beyond the four corners of the complaint in determining an insurer's duty to defend."

The Court did, though, address concerns about insurers who make a unilateral decision not to defend. While the Court did not require insurers to always seek a coverage determination, it "strongly encourage[d]" them to do so. Without one, insurers were acting "at [their] own peril" and opening themselves "up to a myriad of adverse consequences."

On that same day, the Court also issued its decision in a companion case, *Marks v. Houston Cas. Co.*, 2016 WI 53 (2016).

Marks, the insured, was the trustee of two trusts that owned a corporation, Titan Global Holdings, Inc. ("Titan"). Marks was an officer of Titan. Between 2007 and 2009, Marks and Titan became defendants in several lawsuits. Marks tendered his defense to Houston Cas. Co., with whom he had a policy for his work as trustee.

The lawsuits Marks faced, however, alleged only that Marks had committed misconduct as an officer of Titan, not as trustee. As a result, Houston refused to defend, because the policy contained an exclusion for Marks's activities as an officer for any entities other than the

trusts. Houston did not seek a coverage ruling when making this decision. At trial, the court found Houston had no duty to defend, and the appeals court affirmed.

The Supreme Court affirmed that, not just an initial grant of coverage, but the *entire* policy, including exclusions, must be considered when determining whether a duty to defend exists. The insurer may only be barred from asserting exclusions if it has *breached* the duty to defend. Because Houston's decision not to defend was correct, the Court explained, no breach occurred, and the exclusions were properly applied.

In *Marks*, the Court stated that the application of the exclusion could be determined from the allegations alone. The Court did note though, that it may not always be clear if an exclusion applies from the complaint, and often, extrinsic facts may be necessary for that determination. In such cases, the insurer would have a duty to defend.

What Now? Determining Duty to Defend in a Post-*Water Well and Marks World*

The *Water Well* Court couldn't have been more emphatic: the four corners rule applies, with no exceptions.

Accordingly, insurers should defend whenever the complaint alleges an arguably covered claim, even if the insurer knows certain facts that might negate coverage. Insurers cannot rely on policy exceptions or exclusions for protection, unless the complaint's allegations specifically trigger one of these clauses.

What if allegations in the complaint are arguably covered by the policy, but the insurer knows relevant extrinsic facts that negate coverage? *Newhouse v. Citizens Sec. Mut. Ins. Co.*, 176 Wis.2d 824 (1993) outlines the required procedure:

- Provide a defense under reservation of rights;
- Intervene and seek bifurcation and a stay of the underlying action;
- Seek a coverage determination while the underlying action is stayed or pending;
- Continue to provide defense as needed, pending a final ruling on coverage; and
- Withdraw defense only after a final ruling determines no coverage exists.

Although *Water Well* and *Marks* allow insurers to refuse to defend without first seeking a coverage ruling, the Court warned that doing so is risky. Skipping the process is best reserved for small-dollar cases or cases where the facts are clear and simple.

Must an insurer defend where known facts support coverage, but the complaint does not allege a covered claim? According to both *Water Well and Marks*, the answer is no. Extrinsic facts *cannot* be considered to create the duty to defend. And whether those facts would work to invoke coverage or to deny it is irrelevant.

But it is worth noting that neither *Water Well* nor *Marks* involved extrinsic facts known to the insurer that supported coverage (as did *Berg*).

There may be other business or strategic reasons to defend an insured, in such cases, even though no defense may be required under the four corners rule. As an example, if it is likely that an insurer may end up having to provide a defense down the road, it may wish to control the defense from the start, shaping litigation strategy. And if coverage will be litigated at some point, defending the insured may foster goodwill with a court that considers the coverage question.

Putting the Four-Corners Rule and Duty to Defend to Work

As stated at the beginning, if an insurer makes an incorrect decision regarding the duty to defend, there can be severe consequences. Thus, even with this newly clarified four corners rule, there are still issues insurers must consider, moving forward.

For instance, even if extrinsic evidence is no longer relevant to determine the duty to defend, it *is* admissible regarding the insurer's duty to *indemnify*. Therefore, insurers must still investigate facts relating to indemnification, and *Water Well* does nothing to change that.

We need to see how the Court handles other fact-patterns. And depending on those subsequent cases, there's always a possibility of legislative enactments in response to those rulings.

And insurers must be aware that Wisconsin's "no exceptions" rule puts it in the minority. In neighboring Illinois, extrinsic facts are relevant, and an insurer is responsible for investigating those facts. A strategy prevailing in Madison may be disaster in Chicago.

It will take time to figure out just how bright this bright-line rule truly is. Until then, insurers should proceed carefully.

For more information on this topic contact Steve Slawinski at 414-276-5000 or Steve.Slawinski@wilaw.com.