COURT OF APPEALS
DECISION
DATED AND RELEASED

November 14, 1996

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. *See* § 808.10 and RULE 809.62, STATS.

NOTICE

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

No. 95-1763

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT IV

ECONOMY PREFERRED INSURANCE COMPANY,
a foreign insurance corporation,

Plaintiff-Respondent,

v.

EDWARD A. SOLNER and GEORGE D. SOLNER,
d/b/a Solner & Associates,

Defendants-Appellants,

SMITH PLUMBING & HEATING COMPANY,
and MATTHEW P. FLYNN,

Defemdants.

APPEAL from an order of the circuit court for Dane County: GERALD C. NICHOL, Judge. *Reversed*.

Before Dykman, P.J., Vergeront, J., and Robert D. Sundby, Reserve Judge.

SUNDBY, J. In this declaratory judgment action, Economy Preferred Insurance Company sought to establish that its liability insurance policy did not cover the possible liability of its insured Edward Solner[1] in ***Flynn v. Solner***, No. 90-CV-3567 (Dane Cty. Cir. Ct. 1992). This action was dismissed by the trial court May 9, 1995, on its own motion under § 805.03, STATS., because Economy failed to prosecute the action. However, the court denied Solner's motion for attorney fees because it concluded that ***Elliott v. Donahue***, 169 Wis.2d 310, 485 N.W.2d 403 (1992), did not permit the court to award such fees where the coverage issue was mooted by a judicial determination of the underlying action.

In ***Elliott***, the Wisconsin Supreme Court held that supplemental relief under § 806.04(8), STATS., of the declaratory judgment act included the award to the insured of his attorney fees where the insured successfully established coverage under an insurance policy. ***Id***. at 324, 485 N.W.2d at 409. The trial court concluded that ***Elliott*** did not permit it to deviate from the so-called American Rule that each party must bear his or her attorney fees because here the insured did not successfully establish coverage. We hold that where an insurer denies coverage and forces its insured to incur attorney fees and costs of litigation to defend the insurer's declaratory judgment action, it cannot avoid exercise of the trial court's discretion under § 806.04(8), STATS., by failing to prosecute the action. We therefore reverse the judgment insofar as it denied the insured's motion for attorney fees. We further conclude that had the trial court exercised its discretion under § 806.04(8), it would have erroneously exercised that discretion had it denied the insured's motion. We therefore remand the cause to the trial court to determine and award Solner his reasonable attorney fees and costs of litigation in this action.

Background

Economy undertook the defense of its insured Edward Solner in ***Flynn*** under a reservation of rights. When Dane County Circuit Court denied its motion for summary judgment, Economy began this action on December 10, 1991, in Milwaukee County Circuit Court to establish its coverage defenses.

[1] Although Economy brought this action against Edward A. Solner and George D. Solner, d/b/a/ Solner & Associates, the briefs concentrate on the coverage questions as to Edward.

However, when Dane County Circuit Court reversed itself and Flynn dropped his only remaining claim, Economy informed Milwaukee County Circuit Court that it would dismiss this action without prejudice. Economy would not dismiss the action with prejudice because it wished to reassert its coverage defenses if the circuit court's order was reversed on appeal.

However, Solner would not stipulate to dismiss this action without prejudice unless Economy agreed to pay its attorney fees and costs of litigation. Economy then informed Milwaukee County Circuit Court that it could not get a stipulation to dismiss this action without prejudice and therefore continued the action. It did agree to change venue to Dane County and an order for that purpose was entered November 13, 1992.

Economy did not thereafter pursue this action and Dane County Circuit Court placed the action on its dismissal calendar on March 31, 1994. The court's notice stated that it was proceeding pursuant to § 805.03, STATS., and it would hear the dismissal motion May 26, 1994. On April 1, 1994, Solner informed the circuit court by letter that he objected to dismissing this action without an award of attorney fees. On December 21, 1994, Solner's attorney informed Economy by letter that Solner would stipulate to dismissing this action upon payment of legal fees of $1,200.74. On December 27, 1994, Economy responded that it did not believe that Solner had a claim for attorney fees under § 805.04(2), STATS. That statute applies to voluntary dismissals and not dismissals for want of prosecution under § 805.03, STATS. In any event, Economy refused to pay any of Solner's attorney fees in this action.

Dane County Circuit Court again placed this case on its dismissal calendar and scheduled a hearing on the dismissal for February 21, 1995. On February 8, 1995, Solner moved the court for an order granting him "default" judgment dismissing this action and awarding him actual reasonable attorney fees, costs and disbursements pursuant to §§ 805.03, STATS., and 804.12(2)(a)3., STATS., or in the alternative, pursuant to § 806.04(8) or § 814.025, STATS. Solner has abandoned his claim for costs and attorney fees under § 814.025, STATS.

On April 20, 1995, the trial court entered its memorandum decision and order dismissing this action. However, the court denied Solner's

motion for attorney fees.[2] The trial court stated that the issue was: "Can Solner recover attorney fees from Economy under the reasoning in ***Elliott*** even though there will not be a court adjudication on the coverage issue?" The court held: "Solner is not entitled to recover attorney fees from Economy in ***Elliott*** since the issue of coverage was never determined before the case was dismissed against Solner and Economy."

Decision

In its memorandum decision, the trial court stated:

> The American Rule requires that the ***Elliott*** decision be read narrowly. Under a narrow interpretation, Solner could not recover attorney fees unless there is a court adjudication on the coverage issue indicating that Solner's policy with Economy included the roofing accident.

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[2] The Order for Dismissal, entered May 10, 1995, reads:

> WHEREAS, *this matter was scheduled for dismissal on the court's calendar,* and
>
> WHEREAS, the defendants Edward A. Solner and George D. Solner filed a motion to recover costs, disbursements, and actual attorney fees, and
>
> WHEREAS, the court heard oral arguments on the motion and considered the briefs and affidavits submitted by the parties,
>
> NOW, THEREFORE, IT IS HEREBY ORDERED:
>
> 1. Defendants' motion for costs, disbursements and actual attorney fees is denied.
>
> 2. This case is dismissed with prejudice.

(Emphasis added.)

The court also concluded that it would be inequitable to grant Solner attorney fees when Economy had not had an evidentiary hearing to determine whether Solner had given Economy adequate notice of its possible exposure. We conclude that ***Elliott*** did not preclude the trial court from awarding Solner attorney fees under § 806.04(8), STATS.

The circuit court was rightly concerned with the fairness of the proceedings. However, it overlooked the fact that a dismissal under § 805.03, STATS., is on the merits and that Economy was responsible for failing to obtain an evidentiary hearing on the merits of its late-notice defense.

Section 805.03, STATS., provides:

> For failure of any claimant to prosecute or for failure of any party to comply with the statutes governing procedure in civil actions or to obey any order of court, the court in which the action is pending may make such orders in regard to the failure as are just, including but not limited to orders authorized under s. 804.12(2)(a). *Any dismissal under this section operates as an adjudication on the merits unless the court in its order for dismissal otherwise specifies for good cause shown recited in the order.* A dismissal on the merits may be set aside by the court on the grounds specified in and in accordance with s. 806.07. A dismissal not on the merits may be set aside by the court for good cause shown and within a reasonable time.

(Emphasis added.)

The circuit court did not specify that its dismissal was not an adjudication on the merits. Therefore, its order precludes Economy in any other action from asserting the coverage defenses it asserted in this action.

The ***Elliott*** court concluded that § 806.04(8), STATS., permitted recovery of attorney fees in that case because "recovery is proper under the principles of equity." ***Elliott***, 169 Wis.2d at 324, 485 N.W.2d at 409. The

principles of equity identified by the ***Elliott*** court arise because a liability insurance policy "represents a *unique* type of legally enforceable contract." ***Id***. at 320, 485 N.W.2d at 407 (emphasis added). "An insurer has a special `fiduciary' relationship to its insured which derives from the great disparity in bargaining positions of the parties." ***DeChant v. Monarch Life Ins. Co.***, 200 Wis.2d 559, 570, 547 N.W.2d 592, 596 (1996). The ***Elliott*** court said that a reasonable person in the position of the insured would believe that he or she would have to pay nothing more than the periodic premium to obtain the benefits of indemnification and defense for claims described in the policy. ***Elliott***, 169 Wis.2d at 322, 485 N.W.2d at 408. The court stated:

> The insurer that denies coverage and forces the insured to retain counsel and expend additional money to establish coverage for a claim that falls within the ambit of the insurance policy deprives the insured the benefit that was bargained for and paid for with the periodic premium payments. Therefore, the principles of equity call for the insurer to be liable to the insured for expenses, including reasonable attorney fees, incurred by the insured in successfully establishing coverage.

Id. at 322, 485 N.W.2d at 408.

Although the ***Elliott*** court did not base its decision on the language of the insurance contract it did state:

> Courts in several other jurisdictions have held that attorney fees are recoverable by the insured in defending against an insurer's declaratory judgment action where the insurance policy provides reimbursement for all reasonable expenses incurred at the request of the insurance company.... Initiating an action which imposes an obligation on the part of the insured to successfully defend coverage is the equivalent of requesting the insured to incur reasonable expenses.

Id. at 319, 485 N.W.2d at 406-07.

Solner's policy with Economy provided reimbursement to the insured for "all reasonable expenses incurred by the insured at our request."

Economy argues, "This case provides a textbook example of how an insurance company should proceed when simultaneously faced with a coverage defense and liability claim." Not according to the supreme court. In ***Elliott***, the court relied on ***Mowry v. Badger State Mutual Casualty Co.***, 129 Wis.2d 496, 385 N.W.2d 171 (1986), to explain the proper procedure when the insurer denies coverage:

> Contrary to Heritage's assertion, however, it did not comply with the requirements of ***Mowry***. While a bifurcated trial was ordered in this case, the coverage and liability issues were litigated simultaneously, forcing Donahue to retain counsel to simultaneously defend him in both aspects of the case. To be entirely consistent with ***Mowry***, *the insurer should not only request a bifurcated trial on the issues of coverage and liability, but it should also move to stay any proceedings on liability until the issue of coverage is resolved*.

Elliott, 169 Wis.2d at 318, 485 N.W.2d at 406 (emphasis added).

We recognize that the insurer in ***Elliott*** failed to provide its insured with a defense, while Economy provided Solner with a defense, albeit under a reservation of rights. However, the most efficient and least costly procedure is to resolve any issue as to coverage before litigating the liability question. This is not merely a "chicken-or-egg" choice; even where the insurer provides a defense, the threat of no coverage cannot help but affect the cooperative spirit with which the insurer and insured should approach the liability defense. The insured is entitled to the most vigorous defense the insurer can make on the insured's behalf. We do not fault the defense Economy provided Solner, but we believe that the interests of justice will be best served if the coverage "decks" are cleared before the liability issue is faced. Further, we do not believe it is fair to require the insured to invest the economic and emotional resources that participating in the liability trial requires. Solner was forced to endure almost four years of uncertainty as to his possible ruinous

liability.[3] In short, we do not believe that Economy's "ace-in-the-hole" strategy is in the best interest of the parties or the civil justice system.

The trial court concluded that it was not equitable to require Economy to pay Solner's attorney fees because there were issues as to reasonableness of notice and prejudice which only a jury could resolve. However, the burden of advancing a case for trial remains with the party instituting the action. ***Gawin v. Redevelopment Auth. of City of Milwaukee***, 52 Wis.2d 380, 385, 190 N.W.2d 201, 204 (1971). The undisputed facts show that Economy made no effort to advance this case for trial for almost four years. We consider it inequitable to deny Solner an award of attorney fees because Economy, by its strategic procrastination, prevented its coverage defenses from being tested.

Even after the coverage issues became moot by reason of the favorable judicial determination of our court and the supreme court, Economy did not move to dismiss this action. Instead, it waited until the trial court placed this action on its dismissal calendar under § 805.03, STATS. This curious reluctance is explainable when the history of Economy's effort to have this action dismissed without prejudice is considered.

After the favorable determination by Dane County Circuit Court, Economy received an order from Milwaukee County Circuit Court setting a pretrial conference in this case for November 12, 1992. On September 17, 1992, Economy's counsel informed the company that he had received the scheduling order and suggested that Economy simply dismiss the action without prejudice. He stated: "We can always file the action again later on, if necessary." By letter of September 23, 1992, Economy's counsel informed the court that Economy would "voluntarily dismiss this case without prejudice and I am in the process of circulating a stipulation to that end." However, Solner informed Economy that he would argue to the court that Economy should pay his attorney fees to protect him if Economy recommenced this action and "inflict[ed] duplicate fees on the Solners at a future date." On October 26, 1992, Economy responded, "On

[3] Flynn began his action September 10, 1990, and on October 9, 1990, Economy undertook defense of the action under a reservation of rights. We affirmed the trial court's order dismissing Flynn's remaining causes of action, and the supreme court denied review August 24, 1994.

a dismissal without prejudice you are probably entitled to costs, disbursements *and the nominal statutory attorney fee*." (Emphasis added.)

On October 29, 1992, Solner replied, "On dismissal without prejudice, ... [t]he court can impose the actual reasonable attorneys' fees expended, as a condition of the dismissal." On November 3, 1992, Economy informed Solner, "I have checked the applicable authority and you are correct that a court may condition a voluntary dismissal on terms which the court deems proper, and these terms can include attorney fees as a discretionary matter." On November 9, 1992, Economy informed Milwaukee County Circuit Court, "I was unable to achieve a voluntary dismissal of this case by stipulation, since it will apparently proceed." By that letter, Economy enclosed an order for change of venue, which the court entered November 13, 1992. After the change of venue, Economy took no further action to advance this case for trial, nor did it move to dismiss the action without prejudice. Economy simply awaited what might be.

Economy now blames Solner's counsel for "eviscerat[ing] his client's claim for attorney fees as a condition of dismissal." It points to its dismissal-without-prejudice letter of November 3, 1992, in which it advised Solner's counsel: "I have no idea what amount of money you are seeking and would ask that you propose a number and brief rationale. I will then relay that to Economy in an effort to resolve this without court intervention."

Economy's effort to shift the blame for its procrastination to Solner is disingenuous. This action could not be disposed of without "court intervention." Either the action would be dismissed without prejudice or with prejudice. Most important, Economy did not allow Solner's counsel time to respond. Six days after its letter, Economy informed Milwaukee County Circuit Court that it had been unable to achieve a voluntary dismissal and asked that the case be transferred to Dane County.

The only inference permissible from Economy's actions after it realized that it would expose itself to the court's discretion under § 806.04(8), STATS., if it moved to voluntarily dismiss this action is that it decided to keep this action alive as a fallback defense if the ***Flynn*** appeal went against it. Even after this action became moot by a final judicial determination dismissing

Flynn's claims, Economy refused to expose itself to the circuit court's discretion under the voluntary dismissal statute, § 805.04, STATS.

Economy's effort to avoid exercise of the trial court's discretion is unavailing. We conclude that Economy, by failing to prosecute this action, could not prevent the trial court from exercising its discretion to grant Solner supplemental relief pursuant to § 806.04(8), STATS. Because we find ample discretion under the declaratory judgment act for the trial court to grant Solner's motion for attorney fees and costs, we do not decide whether the trial court could have granted his motion under § 805.03, STATS.

Because the trial erroneously assumed it did not have authority under § 806.04(8), STATS., to award Solner attorney fees, it did not exercise its discretion. See ***State v. Wyss***, 124 Wis.2d 681, 734, 370 N.W.2d 745, 770 (1985). We therefore review the record de novo to determine whether the trial court would have erroneously exercised its discretion if it had applied its discretion to deny Solner's request for attorney fees under § 806.04(8). We conclude that it would have. Economy forced Solner to retain counsel to defend its denial of coverage in a forum geographically favorable to it and to obtain an order changing venue to Dane County, where the principal action was being tried. Economy refused Solner's reasonable request that it pay his attorney fees as a condition of dismissal of the action without prejudice. Finally, it allowed this action to languish until the Dane County Circuit Court twice placed this case on its dismissal calendar under § 805.03, STATS. We conclude that principles of equity support Solner's claim for his attorney fees and costs in defending this action and appearing on the dismissal motions under § 805.03.

By the Court.—Order reversed.

Recommended for publication in the official reports.

No. 95-1763(D)

VERGERONT, J. (*dissenting*). I respectfully dissent. I would not extend ***Elliott v. Donahue***, 169 Wis.2d 310, 485 N.W.2d 403 (1992), to the circumstances of this case. I would affirm the trial court's decision.

In ***Elliott***, the insurance company did not provide a defense for the insured in the bifurcated liability litigation until coverage was determined and did not obtain a stay of the liability litigation until coverage was determined. For that reason, the court held, the insurance company was liable for the attorney fees incurred by the insured in defending against liability before coverage was determined. ***Elliott***, 169 Wis.2d at 318, 485 N.W.2d at 406. The court also concluded that because the insured had prevailed in the coverage dispute, the insurance company had to pay the reasonable attorney fees incurred by the insured in defending on this issue. ***Id***. at 325, 485 N.W.2d at 409. The court construed the insurance contract to provide that the insured had to pay nothing more than the premiums in order to obtain the benefits of indemnification and the defense for claims described in the policy. The court reasoned that if the insured had to expend money to establish coverage for a claim that fell within the policy, the insured was not receiving the benefit bargained and paid for under the policy. ***Id***. at 322, 485 N.W.2d at 408. The court concluded that "equity call[s] for the insurer to be liable to the insured for expenses, including reasonable attorney fees, incurred by the insured in successfully establishing coverage." ***Id***. The court determined that § 806.04(8), STATS., permitting further relief in a declaratory judgement action whenever just and proper, permitted a recovery of attorney fees in this situation, and it was therefore unnecessary to fashion an exception to the American Rule. ***Id***. at 324-25, 485 N.W.2d at 409.

In ***DeChant v. Monarch Life Ins. Co***., 200 Wis.2d 559, 547 N.W.2d 592 (1996), the Wisconsin Supreme Court declined to extend ***Elliott*** to provide a basis for recovery of attorney fees incurred by an insured in prosecuting a first-party action against an insurance company for breach of contract and bad faith. ***Id***. at 569, 547 N.W.2d at 595. Instead, the court held that the insured could recover those fees as part of the compensatory damages for the bad faith claim. ***Id***. at 577, 547 N.W.2d at 599. In discussing ***Elliott***, the court said:

> We agree ... that our decision in ***Elliott*** stands for the proposition that courts have the equitable power to award attorney's fees to insureds in limited

> circumstances. However, our result in ***Elliott*** was firmly grounded within the statutory authority found in Wis. Stat. § 806.04(8) (1993-94). ***Elliott*** involved a declaratory judgment action in which the insurer breached its duty to defend. Therefore, although some of the rationale expressed in ***Elliott*** is supportive, we decline to extend ***Elliott*** beyond its particular facts and circumstances.

Id. at 569, 547 N.W.2d at 595 (footnote omitted).

This case, like ***Elliott***, involves a declaratory judgment action. But the reason the ***Elliott*** court determined that equity warranted invoking the supplementary relief provisions of that statute was that the insured should not have to pay more than premiums when there was coverage. In the absence of a determination that there is coverage, I do not see how it is possible to determine whether equity requires payment of the insured's fees, as the majority opinion does. For example, the majority considers it unreasonable for Economy not to have paid the insured's attorney fees in the coverage dispute as a condition for dismissing without prejudice the coverage action, initially filed in Milwaukee County.[4] But Economy is not liable for those fees unless there *is* coverage.

The trial court concluded that Economy's position that there was no coverage was not without a reasonable basis.[5] The Solners do not contend

[4] Apparently after the Solners moved to change venue to Dane County, Economy proposed to dismiss the coverage action without prejudice instead. The Solners refused, demanding that dismissal be with prejudice, or without prejudice but with payment of attorney fees. Economy chose to change venue to Dane County.

[5] The trial court also concluded that it could not decide Economy's coverage defense--lack of notice--based on Solner's deposition and that an evidentiary hearing would be needed to resolve the merits of the defense.

that Economy acted in bad faith in contesting coverage or that the issue of coverage was not fairly debatable. *See* ***Anderson v. Continental Insurance Co.***, 85 Wis.2d 675, 687, 271 N.W.2d 368, 374 (1978). This is not a situation where the insurer dragged its feet in resolving the coverage issue, leaving the insured to defend itself in the liability action in the meantime. Unlike the insurer in ***Elliott***, Economy was providing a defense in the liability action before it began the declaratory judgment action to determine coverage, and it continued to do so until the liability action was resolved in the Solners' favor.

True, if Economy had raised the coverage issue in the liability action in Dane County rather than filing a separate action in Milwaukee County, the Solners would not have needed to file a motion to change venue.[6] But the Solners are not claiming that Economy's initial choice of venue did not meet the requirements of § 802.05(1), STATS.,[7] or that Economy did not have the right to file a separate action. The attorney fees the Solners incurred in answering the coverage complaint and defending when Solner was deposed in the coverage action would presumably be the same whether that action was separate or part of the liability case.

Although the Solners and the majority find it unreasonable that Economy did not vigorously prosecute the coverage action, I fail to see how that harmed the Solners, given that Economy was already providing their defense. Perhaps Economy did decide that the liability defense was stronger than its claim of no coverage and that it should concentrate on the liability action, leaving the coverage dispute until later. That does not indicate a lack of good faith. The most that can be said is that, had Economy prosecuted the coverage

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[6] See *supra* note 1.

[7] Section 802.05(1)(a), STATS., provides in relevant part that the signature of an attorney on every pleading motion or paper constitutes a certificate that the document is well grounded in fact and warranted by existing law or a good faith extension of existing law and not filed for an improper purpose.

dispute to conclusion immediately and had the Solners prevailed, the Solners would have been entitled under ***Elliott*** to the attorney fees they now seek, as well as the much larger amount of attorney fees they would have incurred in defending the coverage dispute to its conclusion. The Solners did not incur more attorney fees precisely because Economy did not move ahead with the coverage action after deposing Solner. Resolution of the coverage dispute was ultimately unnecessary given the favorable outcome on liability.

There may be cases in which equity would compel an extension of ***Elliott***. However, in the absence of an indication from the supreme court that ***Elliott*** is to be read broadly, I am not persuaded that we should extend ***Elliott*** to apply in this case.