COURT OF APPEALS
DECISION
DATED AND RELEASED

June 5, 1997

NOTICE

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.

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No. 96-2625

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

WAYNE K. HERMANSON AND SANDRA HERMANSON,

PLAINTIFFS-APPELLANTS,

V.

HORACE MANN INSURANCE COMPANY,

DEFENDANT-RESPONDENT.

APPEAL from a judgment of the circuit court for La Crosse County: DENNIS G. MONTABON, Judge. *Reversed and cause remanded.*

Before Eich, C.J., Dykman, P.J., and Vergeront, J.

EICH, C.J. In this "insurer bad-faith"[1] case we are asked to hold that an insurer may properly decline to defend an action against its insured on the basis of its knowledge of "extraneous information" that does not appear within the four corners of the complaint in the action. We conclude that ***Grieb v. Citizens Casualty Co.,*** 33 Wis.2d 552, 148 N.W.2d 103 (1967), and ***Professional Office Buildings, Inc. v. Royal Indemnity Co.***, 145 Wis.2d 573, 427 N.W.2d 427 (Ct. App. 1988), preclude such a holding. We therefore reverse the trial court's judgment dismissing the action.

The facts are not in dispute. Wayne Hermanson,[2] a La Crosse police officer, was injured in an altercation with a young man named Wayne Reuter, and Reuter was convicted of felony battery to a peace officer. Hermanson sued Reuter for damages, claiming that his injuries resulted from Reuter's negligence, among other things. Reuter tendered the defense of Hermanson's action to Horace Mann Insurance Company as an insured under his father's homeowner's policy. While investigating Reuter's claim, Horace Mann learned of Reuter's conviction and refused the tender on the basis of a policy provision excluding coverage for intentionally caused injuries and for acts "constitut[ing] a violation of any criminal law."

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[1] The tort of bad faith results from a breach of the insurer's fiduciary duty arising out of the relationship established by the insurance contract. ***Anderson v. Continental Ins. Co.***, 85 Wis.2d 675, 688-89, 271 N.W.2d 368, 375 (1978). Specifically, when an insurer unreasonably and in bad faith declines to pay an insured's claim, it is subject to liability in tort. ***Id***. at 689, 271 N.W.2d at 375. To establish bad faith, a plaintiff must demonstrate "the absence of a reasonable basis for denying benefits" and the insurer's "knowledge or reckless disregard of the lack of a reasonable basis for denying the claim." ***Id.*** at 691, 271 N.W.2d at 376.

[2] Hermanson's wife, Sandra, is also a plaintiff in the action.

Reuter and Hermanson eventually settled the lawsuit, and Reuter assigned to Hermanson any possible "bad-faith" claim he had against Horace Mann for breach of its duty to defend him in the underlying lawsuit. Hermanson then brought this action, seeking to hold Horace Mann liable for his damages, claiming that it had unreasonably denied coverage and refused to defend the action. The trial court granted summary judgment dismissing Hermanson's complaint, concluding that Horace Mann's independent knowledge of Reuter's battery conviction was sufficient to trigger the exclusionary clause, which barred coverage as a matter of law.

Summary judgment is appropriate in cases in which there is no genuine issue of material fact and the moving party has established entitlement to judgment as a matter of law. ***Germanotta v. National Indem. Co.***, 119 Wis.2d 293, 296, 349 N.W.2d 733, 735 (Ct. App. 1984). Because no material facts are in dispute in this case, we consider the legal issue—whether Horace Mann had a duty to defend Reuter against Hermanson's action—*de novo*. ***Benjamin v. Dohm***, 189 Wis.2d 352, 359, 525 N.W.2d 371, 373-74 (Ct. App. 1994).

We have held that the duty to defend an insured is "dependent solely on the allegations of the complaint." ***Professional Office Bldgs.***, 145 Wis.2d at 581-82, 427 N.W.2d at 430. Amplifying upon that proposition, we said:

> Because the duty to defend is not based on extrinsic evidence, but is, as the supreme court has said, triggered by the allegations contained within the four corners of the complaint, it follows that the existence of the duty depends solely upon the nature of the claim being asserted against the insured and has nothing to do with the merits of the claim.

Kenefick v. Hitchcock, 187 Wis.2d 218, 232, 522 N.W.2d 261, 266 (Ct. App. 1994) (quotations and quoted sources omitted). The rule is unequivocal: "If there

are allegations in the complaint which, if proven, would be covered by the policy, the insurer has a duty to defend." ***Grube v. Daun***, 173 Wis.2d 30, 72, 496 N.W.2d 106, 122 (Ct. App. 1992). And in considering the complaint we resolve all doubts in favor of the insured. ***Sola Basic Indus., Inc. v. United States Fidelity & Guar. Co.***, 90 Wis.2d 641, 646-47, 280 N.W.2d 211, 214 (1979).

The parties agree that Hermanson's original complaint alleged that Reuter negligently caused Hermanson's injuries.[3] While Horace Mann points to its policy terms, which expressly exclude coverage for liability resulting from the insured's criminal or intentional acts, at this stage of the inquiry we are required to ignore "both the merits of the claim and any exclusionary or limiting terms and conditions of the policies." ***Kenefick***, 187 Wis.2d at 232, 522 N.W.2d at 266. Based on allegations of Reuter's negligence in Hermanson's complaint, we cannot say that Horace Mann had no duty to defend the action at least up to the point at which its policy defenses to coverage were resolved.

Horace Mann, acknowledging the rule that the duty to defend is determined by the four corners of the complaint, suggests that the supreme court's statement in ***Grieb***, 33 Wis.2d at 558, 148 N.W.2d at 106, that "[t]here are at least four exceptions to the general rule determining the extent of the insurer's duty to defend," signals the existence of the "exception" for which it argues here: that when the insurer has extrinsic or independent knowledge of an event or situation triggering a policy exclusion, no such duty exists. But the ***Grieb*** court never discussed any such "exceptions." All it said was: "There are at least four

[3] Hermanson's original complaint in the underlying action does not appear in the record. His complaint in the instant action states that "[a]mong the causes of action[] contained in the [original] complaint was [one] sounding in negligence against Wayne Reuter."

exceptions to the general rule determining the extent of the insurer's duty to defend and generally the insurer who declines to defend does so at his peril. These and allied problems are extensively covered in Anno. Liability Insurer—Duty to Defend, 50 A.L.R.2d 458." ***Id***.[4]

Horace Mann argues that despite the lack of any finite discussion of the point in ***Grieb***, the supreme court intended to recognize the existence of the "exception" for which it argues in this case. It points to a federal trial court decision, ***American Motorists Ins. Co. v. Trane Co.***, 544 F. Supp. 669 (W.D. Wis. 1982), *aff'd*, 718 F.2d 842 (7th Cir. 1983), as supporting the view that it may rely on evidence extrinsic to the underlying complaint to determine whether it has a duty to defend an action. In that case the court, while noting that the quoted language in ***Grieb*** was dictum because "none of the exceptions referred to in the opinion was the basis for that decision," went on to say that, in its opinion, "***Grieb*** suggests that under Wisconsin law an insurer may consider known or readily ascertainable facts when deciding whether to defend an insured." ***Id.*** at 677-78. The court thus concluded that "[i]n Wisconsin ... the court may consider facts known at the appropriate time by the insurer when determining whether the insurer has breached its duty to defend." ***Id.*** at 678.

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[4] The cited annotation sets forth what it terms "special situations" that "are not covered directly by the general rule" of a insurer's duty to defend. They arise when: (1) there is a conflict between allegations in the complaint and extrinsic facts known to or ascertainable by the insurer; (2) the complaint contains ambiguous or incomplete allegations; (3) the complaint alleges some facts that represent a covered risk and others that do not; and (4) the complaint states conclusions rather than alleging facts. C.T. Drechsler, Annotation, *Allegations in Third Person's Action Against Insured as Determining Liability Insurer's Duty to Defend*, 50 A.L.R.2d 458, 464 (1958). As we discuss below, courts are split as to whether the first situation still requires the insurer to base its defense on the allegations in the complaint or whether it can rely on other facts to determine its duty; in the other three situations, resolving doubts in the insured's favor, the insurer must still defend if the complaint contains any allegation that would bring the case within the terms of the policy coverage. ***Id.*** at 464-65.

We can only state here, as we did in ***Professional Office Buildings***, that despite our own agreement with the district court's reasoning in ***American Motorists***—reasoning we described as "persuasive"—we consider ourselves bound by the supreme court's ruling in ***Grieb***, and similar cases, that "the [insurer's] duty to defend is dependent solely on the allegations of the complaint." ***Professional Office Bldgs.***, 145 Wis.2d at 580-81, 427 N.W.2d at 430.

Horace Mann, recognizing our lack of enthusiasm for a blanket four-corners-of-the-complaint rule for determining the insurer's duty to defend—a rule that does not recognize even uncontested extraneous facts that would deny coverage as a matter of law—asks us to carve out a "narrow exception" to the ***Grieb*/*Professional Office Buildings*** rule in this case, and it points to decisions in at least two other states that have done so.[5] As the supreme court recently stated, however, the Wisconsin Court of Appeals is a "unitary court" and, as such, lacks the power to overrule, modify or withdraw language from a published opinion. ***Cook v. Cook***, 208 Wis.2d 166, 189-90, 560 N.W.2d 246, 256 (1997).[6]

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[5] Courts in Minnesota and Washington have held that an insurer has no duty to defend when "facts outside the complaint are such that any liability resulting from the cause of action would be excluded from coverage." ***Denike v. Western Nat'l Mut. Ins. Co.***, 473 N.W.2d 370, 373 (Minn. Ct. App. 1991); *see also* ***E-Z Loader Boat Trailers, Inc. v. Travelers Indem. Co.***, 726 P.2d 439, 444 (Wash. 1986). In the other cases Horace Mann cites as reaching a similar conclusion, the insurer—unlike Horace Mann in this case—litigated coverage before declining to defend the insured. Such a procedure, as we discuss below, has been recognized as a means of avoiding the very predicament in which Horace Mann finds itself here.

[6] Horace Mann also states that if we do not recognize an extrinsic-facts exception to the four-corners rule, "insurers will be forced to clog the already overcrowded court system with declaratory judgment lawsuits, or to delay pending litigation with motions ... in order to resolve nonexistent coverage issues." We disagree. In discussing the duty to defend in ***Grube v. Daun***, 173 Wis.2d 30, 75-76, 496 N.W.2d 106, 123-24 (Ct. App. 1992), we said that

> the policy of judicial economy is a reason behind requiring insurers either to provide a defense immediately or to use alternate methods to reduce the costs of providing a defense until the coverage issue is decided. If insurers have a duty to defend

(continued)

Finally, Horace Mann argues the merits of its position: that it cannot be held to have acted in bad faith in refusing the tender of Reuter's defense because the policy precluded coverage by reason of Reuter's intentional criminal acts. Hermanson responds that because Horace Mann did not follow "proper steps" in obtaining a judicial declaration of coverage prior to refusing to defend Reuter, it is estopped from now challenging coverage.

The supreme court has held that, in cases in which coverage is disputed, "the proper procedure for an insurance company to follow … is to request a bifurcated trial on the issues of coverage and liability and move to stay any proceedings on liability until the issue of coverage is resolved." ***Newhouse v. Citizens Sec. Mut. Ins. Co.***, 176 Wis.2d 824, 836, 501 N.W.2d 1, 6 (1993). "When this procedure is followed, the insurance company runs no risk of breaching its duty to defend." ***Id***. But when the case proceeds without a prior determination of coverage, "the insurer who declines to defend does so at [its] peril." ***Grieb***, 33 Wis.2d at 558, 148 N.W.2d at 106. And where, as here, an insurer improperly refuses to defend, it will be held to have waived any subsequent challenge to coverage. ***Professional Office Bldgs.***, 145 Wis.2d at 585, 427 N.W.2d at 431.

We thus conclude that, under ***Professional Office Buildings***, ***Grieb***, and similar cases, Horace Mann must be held to have breached its duty to defend Reuter in the underlying action and is now estopped from denying coverage for Hermanson's injuries. We therefore reverse the summary judgment dismissing

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from the time the suit is initiated, then these insurers will be inclined to settle; thus, the strain on the courts is reduced.

Hermanson's action and remand to the trial court for further proceedings consistent with this opinion.[7]

By the Court.—Judgment reversed and cause remanded.

Not recommended for publication in the official reports.

[7] As Hermanson notes in his brief, the trial court never determined what damages, if any, he may be entitled to recover from Horace Mann, and that issue is not before us.