DON’T WAIVE GOODBYE TO YOUR CONSTRUCTION LIEN RIGHTS

Wisconsin’s construction lien law provides contractors, subcontractors, suppliers, service providers, and design professionals with a valuable remedy to help them collect payment for their work. On privately owned projects, the law allows these parties to place a lien against the project property as security for payment. The economic fallout from the COVID-19 crisis has made construction lien rights more precious than ever to construction industry businesses. Yet, everyday contractors mishandle lien waivers and unwittingly forfeit their lien rights with the stroke of a pen.

Lien waivers are an integral and unavoidable part of the construction payment process in Wisconsin and throughout the country. Subcontractors and suppliers are typically required to provide a signed lien waiver along with each application for a progress payment. The prime contractor then delivers these lien waivers, together with its own lien waiver, to the owner along with the prime contractor’s progress payment application. A savvy owner will refuse to release payment unless it has received all the necessary lien waivers.

Lien waivers are governed by Wis. Stat. Sec. 779.05, which imposes strict rules that can become a trap for the unwary. The statute mandates a default rule that a lien waiver is deemed to waive “all lien rights” unless the lien waiver “specifically and expressly limits the waiver to a particular portion” of the work. The statute further provides that any ambiguity in the lien waiver shall be construed against the person signing it. Therefore, a contractor must ensure that the express language of each lien waiver specifically limits the scope of the waiver only to the specific work or dollar value for which payment is sought. Otherwise, the default rule will apply, and the lien waiver will be deemed a full waiver, even if only a partial waiver had been intended. Unfortunately, this happens with alarming frequency.

The industry practice is for lien waivers to be provided in advance of payment. Section 779.05 provides that a lien waiver is “valid and binding” regardless of whether or not any consideration was paid for it. That means that the lien waiver is valid and enforceable even if the lien claimant does not subsequently receive the anticipated payment for which the waiver was given. While there is always risk in providing the lien waiver in advance of payment, under normal circumstances the risk is tolerable, especially if the lien claimant is careful to use a properly worded partial lien waiver. But these are not normal circumstances. The economic impact of the coronavirus pandemic requires construction businesses to be extra careful. If a payment problem is anticipated, special measures should be taken to manage the risk of loss of lien rights through the lien waiver process. This can include the use of an escrow agreement, or a simultaneous exchange of the waiver for the payment.

In these extraordinary times, a construction lien may become a contractor’s only hope of

collecting payment on a problem project. Therefore, contractors must know how to manage the risks associated with lien waivers.

If you have any questions or need assistance, contact Steve Slawinski at 414-276-5000 or steve.slawinski@wilaw.com.

WISCONSIN CONSTRUCTION LIENS 101

Most Wisconsin construction contractors know that the construction lien law exists, but few know how it works or how to use it. With the economy reeling from the COVID-19 crisis, construction lien rights will become more vital than ever to businesses in the construction industry.

Wisconsin's construction lien law (provided in subchapter I of ch. 779, Wisconsin Statutes) creates a statutory payment remedy available only to construction contractors, subcontractors, suppliers, service providers, and design professionals engaged in the improvement of real property. Excluding public improvements, a construction contractor is entitled to place a lien against the construction site and the improvements being built as collateral to secure payment for the work it has performed. In case of nonpayment, the lien may be enforced through a legal action for foreclosure just like a mortgage. A construction lien claim puts pressure directly on the owner by placing the owner's title to the property at risk. It also allows non-prime claimants (those that did not contract with the owner) to seek payment directly from the owner, providing them with another deep pocket and another path to collect payment aside from the claimant's contract with a higher tier contractor.

To take advantage of the benefits of the construction lien law, a lien claimant must comply with the express requirements of the statute within the short time limits prescribed by law. These steps generally must be followed to the letter and the deadlines cannot be extended. The statutes prescribe in detail what must be done and how it must be done. A failure to comply with the statutory requirements will likely result in a loss of lien rights.

The process of creating a lien generally consists of the following steps. The lien is created by filing a claim for lien with the office of the clerk of circuit court in the county where the property is located. This must be done no later than six months after the claimant has last performed work or provided materials. At least 30 days before filing the lien, the lien claimant must serve the property owner with a written notice of intent to file a lien claim. Within 30 days after the lien claim is filed, the claimant must serve the owner with a copy of the claim for lien. Once the lien has been filed, the claimant has two years in which to enforce it through a foreclosure lawsuit.

Respecting small residential projects (up to four family living units), an additional first step may be required—an early notice of lien rights must also be served upon the owner, subject to certain exceptions. A prime contractor must include this notice in its written contract with the owner, or it must serve the owner with a separate written notice within 10 days of commencing work if there is no written contract. A non-prime claimant must serve the owner with two copies of a written notice within 60 days of commencing its work.

Contractors often wait until a payment problem has festered before scrambling to pursue their lien rights, but that may be too late. It is easy to make a mistake or to miss a deadline, but the Construction Lien Law has zero tolerance for either. With the economic impact of the COVID-19 crisis, construction contractors, suppliers, service providers, and design professionals must take extra care to preserve and to properly exercise their statutory construction lien rights. A failure to do so could mean the difference between getting paid and not getting paid.

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SHOULD A CONTRACTOR STOP WORK DUE TO NONPAYMENT?

As owners and contractors feel the bite of shrinking revenues due to the economic slowdown, contractors are bound to see payment problems arise on ongoing projects. Contractors may find themselves contemplating whether to stop work on-site in response to nonpayment.

At first blush, stopping work on-site may seem like a simple and obvious solution for nonpayment. But in reality, stopping work is fraught with risk, and almost always involves a difficult and complicated decision. If the contractor’s entitlement to payment is unclear or in dispute, a work stoppage by the contractor could amount to a breach of contract exposing the contractor to potential liability for substantial damages. For example, the owner may claim to have an arguable contractual right to withhold payment due to some prior alleged breach by the contractor, such as defective work, or a lien claim asserted by a sub-contractor. Particularly on large and complex projects, it may not be difficult for an owner to find some arguable basis justifying nonpayment. A contractor that stops work due to nonpayment faces the risk that a court may later hold that the owner was legally entitled to withhold payment and that the contractor was not entitled to stop work.

The contract documents may govern how, and under what circumstances, a contractor may

stop work due to nonpayment. Often, the contract imposes procedural requirements that a contractor may need to comply with before a work stoppage can be justified. For example, under Article 9.7 of the AIA A201-2017 General Conditions, a contractor is required to give the owner and the architect seven days' written notice before the contractor may stop work for nonpayment. Additionally, a contractor may be required to comply with Article 15, which contains a specific procedure for relevant claims and disputes. Similarly, under Article 9.5 of the ConcensusDocs 200, a contractor must give seven days' written notice to the owner before the contractor may stop work due to nonpayment.

A contractor should always consult legal counsel when considering whether to stop work due to nonpayment. The decision of whether or not to stop work usually requires analysis of the background facts, the contract documents, and the applicable law. The answer is seldom written in black or white, but rather in shades of gray. The contractor and its counsel must carefully identify, judge, and weigh all the risks. If you have questions or need assistance, contact Steve Slawinski at 414-276-5000 or steve.slawinski@wilaw.com.

CITY OF MILWAUKEE'S STAY AT HOME ORDER EXEMPTS CONSTRUCTION

On Tuesday, March 24, 2020, the City of Milwaukee's Health Department issued a written Stay at Home Order, which goes into effect on Wednesday, March 25, 2020. In general, the Order requires City of Milwaukee residents to stay at home, and requires all businesses located within the City to "cease all activities at facilities located within the City except Minimum Basic Operations," as defined in the Order. The Order includes a list of exceptions for "Essential Businesses and Operations," which does not prevent employees from working at facilities that are deemed to qualify.

Under paragraph 13h of the City's Stay at Home Order, construction and construction-related activities are defined as "Essential Businesses and Operations," which have been exempted from the mandate of the Stay at Home Order. The Order lists "Building and Construction Tradesman and Tradeswomen" along with "plumbers, electricians . . . operating engineers, HVAC, [and] painting" as "Critical Trades" that are exempt from the Order. "Construction" is also listed in the definition of "Essential Infrastructure," exempt from the Order under paragraph 10.

Suppliers of materials and equipment for construction activities are also exempt from the Stay at Home Order. Under paragraph 13u, "manufacturing companies, distributors, and supply chain companies producing and supplying essential products and services in and for

industries such as . . . Construction" are listed among exempt "Essential Businesses and Operations." Although the Order does not specifically mention architects, engineers or other design professionals, such professionals are arguably also exempt from the Stay at Home Order, as "other service providers who provide services that are necessary to . . . Essential Businesses and Operations" under paragraph 13h—the provision which exempts "critical trades," including construction.

At least for the time being, the construction industry in Milwaukee will remain open for business.

The full Order can be found here.

If you have questions contact Steve Slawinski at 414-276-5000 or steve.slawinski@wilaw.com.

WISCONSIN'S MASS GATHERING BAN DOES NOT APPLY TO CONSTRUCTION SITES

On Friday, March 20, 2020, the Evers administration issued Emergency Order #8 Updated Mass Gathering Ban. This Order updated and clarified Emergency Order #5, which had been issued three days earlier. Emergency Order #5 imposed "a statewide moratorium on mass gatherings of 10 people or more to mitigate the spread of Covid-19." Under Emergency Order #5, there were numerous exemptions to the "moratorium on mass gatherings," but it was unclear whether or not the mass gathering ban applied to construction work, particularly if being performed outdoors. Emergency Order #5 did not specifically address construction sites. Among other things, Emergency Order #8 clarifies and elaborates on the various exemptions to the statewide ban on mass gatherings. Emergency Order #8 adds a specific exemption for "construction sites and projects, including public works and remodeling projects." It clarifies that the mass gathering ban does not apply to on site construction work. The construction exemption would appear to apply not only to work done outdoors or in open air conditions, but also to construction work performed indoors. Emergency Order #8 therefore makes clear that the statewide mass gathering ban does not require construction work to be shut down.

If you have questions contact Steve Slawinski at 414-276-5000 or steve.slawinski@wilaw.com.

KEY WISCONSIN TITLE LITIGATION DECISIONS: RESTRICTIVE COVENANTS, ANTICIPATED PRIVATE NUISANCE, STATUTE OF LIMITATIONS APPLICABLE TO FORECLOSURES, AND STIPULATED DISMISSAL OF PRIOR FORECLOSURE

Recently, Wisconsin Courts have handed down several key decisions concerning title litigation that deal with the issues of restrictive covenants, anticipated private nuisance, the statute of limitations applicable to foreclosure actions, and stipulated dismissal of prior foreclosures.

Below is a brief summary of the most important of these court decisions.

Restrictive Covenants

The Wisconsin Supreme Court faced the question of whether the short-term rental of a residential property constitutes "commercial activity" under a restrictive covenant. In *Forshee v. Nueschwander*, a 4-3 majority of the court held that because the term "commercial activity" was ambiguous, the restrictive covenant in place did not prohibit the Nueschwanders from using their property for short-term rentals.

Lee and Mary Jo Nueschwander bought the property in question on Hayward Lake in Hayward, Wisconsin in 2014, renovated it, and began renting it out for short-term rentals to vacationers through the popular VRBO (Vacation Rental By Owner) website. The Nueschwanders' neighbors sued in Sawyer County Circuit Court to enforce the covenant, contending that the short-term rentals were "commercial activity" under a restrictive covenant that provided, "There shall be no commercial activity allowed on any of the lots."

The circuit court agreed with the neighbors and granted an injunction to stop the Nueschwanders' rental activity; the Court of Appeals reversed the circuit court's decision and lifted the injunction.

On appeal, writing for the majority, Chief Justice Patience Drake Roggensack reasoned that public policy favors the free and unrestricted use of property. Moreover, wrote Justice Roggensack, deed restrictions "must be expressed in clear, unambiguous, and preemptory terms" and strictly construed to favor free use.

Turning to the covenant at hand, the court found that “commercial activity” was undefined and ambiguous as written. Accordingly, the court ruled that the term should be construed in favor of free use and affirmed the appellate court’s decision to lift the injunction.

Justice Shirley Abrahamson concurred, writing that the term “commercial activity” was unambiguous and that it meant activity undertaken for profit. Justice Abrahamson focused on the occupants’ activities on the property and concluded that no “commercial activity” was conducted on the property.

Justice Daniel Kelly’s concurrence, which was joined by Justice Rebecca Bradley, also focused on the occupants’ activities on the property but found that the renters were not engaging in “commercial activity” on the property. Justice Kelly also wrote that the covenant does not preclude renting out the property.

In dissent, Justice Ann Walsh Bradley found that the term “commercial activity” was not ambiguous and that it means “of or relating to commerce.” Justice Bradley noted that the Nueschwanders made $56,000 renting out the property in 2015, which made it a lucrative enterprise and, therefore, a “commercial activity.” She openly questioned whether the numerous covenants that use the same term or a similar term will be enforceable in the burgeoning short-term rental industry.

Also in restrictive covenant news, the Wisconsin Court of Appeals held that a treehouse was a “structure” covered by a restrictive covenant that provided, “All structures to be place or constructed upon lots . . . shall, prior to construction, be approved in writing, by C&B Investments.”

In *C and B Investments v. Murphy*, James Murphy and Rebecca Richards-Bria were homeowners in a subdivision developed by C and B Investments. In June 2015, without the approval of C and B, Murphy began building a treehouse that would be 10 feet long by 8 feet wide by 7 feet high at its completion. C and B filed suit to enforce the covenant requiring its consent to construct “structures” on its property.

The Circuit Court of Juneau County ruled that the treehouse was not a “structure,” and C and B appealed the decision. The Court of Appeals, in a per curiam opinion, reversed the circuit court, finding that the term “structure” was unambiguous and means something that is built or constructed. As the covenant applied to “all structures,” it covered a treehouse, according to the appellate court.

Anticipated Private Nuisance

In *Krueger v. AllEnergy Hilton, LLC*, the Court of Appeals addressed whether Wisconsin recognizes a cause of action for anticipated private nuisance. The appellate court held that the state does recognize such a claim but that the complaint in the case before it was

deficient.

AllEnergy sought to construct a frac sand mine in the town of Hixton, but town landowners, including Greg Krueger the lead plaintiff, sought a permanent injunction to stop that from happening.

The group of landowners alleged that the proposed mine would operate 24 hours a day, 7 days a week, and would cause air, water, noise, and light pollution as well as vibration. Moreover, they alleged, the mine would deplete ground water, interfere with quiet, peaceful enjoyment, and also cause a drop in property values and an increase in traffic congestion and road damage.

The Circuit Court of Jackson County granted AllEnergy's motion to dismiss the case, and the Court of Appeals affirmed. The court held that Wisconsin does, indeed, recognize a cause of action for anticipated nuisance, and laid out the elements:

(1) Defendant's proposed conduct will "necessarily" or "certainly" create a nuisance; and

(2) The resulting nuisance will cause the claimant harm that is "inevitable and undoubted."

Turning to the case at hand, the Court of Appeals affirmed the circuit court and ruled that the complaint failed to state a claim because the allegations contained within it were "too sparse" and did not support the conclusion that the mine would necessarily create a nuisance and inevitably result in harm.

Statute of Limitations Applicable to Foreclosure Actions

In 2018 in *Bank of New York Mellon v. Klomsten*, the Court of Appeals faced the question of whether Wisconsin's six-year statute of limitations for contract actions bars a mortgage foreclosure action.

Gloria J. and Steven S. Klomsten executed a note and mortgage in 2003 and defaulted in 2005. A foreclosure action against them was not filed until 2016. The Klomstens moved to dismiss while the bank requested summary judgment. The Jefferson County Circuit Court sided with the bank, granted summary judgment, and denied the Klomstens' motion to dismiss. The Klomstens appealed.

The Court of Appeals affirmed the circuit court. The appellate court ruled that while action on the note was barred by the six-year statute of limitations in Wis. Stat. § 893.43, the 30-year limitations period under Wis. Stat. § 893.33 applies, allowing foreclosure of the mortgage.

Stipulated Dismissal of Prior Foreclosure

In *Deutsche Bank Nat'l Trust Co. v. Buboltz*, the Court of Appeals reversed the Milwaukee County Circuit Court and held that the stipulated dismissal of a prior foreclosure action did not bar a lender from filing a subsequent foreclosure action.

In 2006, Alexander Groysman purchased a residential property for which he secured a mortgage with Bank United, FSB. He then deeded the property to EAG Investments, LLC. Bank United assigned the note and mortgage to OneWest Bank, the predecessor of Deutsche Bank.

Payments on the mortgage stopped in 2008 and OneWest Bank filed a foreclosure action in June 2009. In April 2013, a foreclosure judgment was entered. Two years later, in April 2015, the foreclosure was reopened and dismissed without prejudice by stipulation, which stated that the stipulation and order was "due to payoff of the loan."

The loan had not been paid off, however, and OneWest assigned the mortgage to Deutsche in June 2016. In April 2016, Groysman/EAG sold the property, and the title company discovered the unsatisfied mortgage and requested from Groysman the loan number and contact information for the bank. In response, Groysman provided an old letter from the bank that said the load was paid off "contingent" on final audit of Groysman's check, but no payment had actually been made.

Deutsche filed a foreclosure action on May 12, 2017. The purchasers filed a summary judgment motion seeking dismissal of the action, arguing that the prior foreclosure was "dismissed due to payoff of loan," and therefore Deutsche's only option would have been to reopen the old dismissed case, but it was too late under Wis. Stat. § 806.07(2).

The bank countered that the prior case was dismissed without prejudice, allowing the bank to file a new case of its own.

Judge Rothstein in the circuit court dismissed the foreclosure action, and the bank appealed. The Court of Appeals reversed and remanded the case, concluding that a dismissal without prejudice is not final on the merits and "by definition" allows a plaintiff to sue again. The court therefore ruled that the bank was not barred by Wis. Stat. § 806.07 from filing a new foreclosure action.

If you have questions about these cases or title litigation in Wisconsin contact Steve Slawinski at 414-276-5000 or steve.slawinski@wilaw.com.

WISCONSIN ADOPTS LAW ALLOWING REMOTE ONLINE NOTARIZATION

Wisconsin has now joined a growing group of more than 20 states that allow electronic Remote Online Notarization (RON) of documents. On March 3, 2020, Wisconsin enacted 2019 Wisconsin Act 125, Wisconsin's New RON law. The Act takes effect on May 1, 2020 and requires the Wisconsin Department of Financial Institutions to promulgate new rules regarding the performance of a RON notarial act.

Under prior law, all documents that required notarized signatures had to be executed while in the physical presence of a notary public, who would witness or attest the signature. The new RON law updates document notarization requirements to meet the demands of modern 21st century business practices and technology.

With RON, a signatory no longer needs to be in the physical presence of the notary when the document is executed. In fact, a signatory can be in another city, state, or even another country. The notary may use approved online tools to perform the notarial act while the signatory executes the document at a remote location. The RON law requires the notary and the signatory to have an online audio and visual connection allowing them to communicate with each other in real time, and the notary must make an audio and visual recording of the notarial act.

The use of RON has its limits, however. It cannot be used to notarize certain types of documents, including wills and testamentary trusts, living trusts, powers of attorney, marital property agreements, authorizations for disclosure of health care information, and health care powers of attorney and living trusts. But the new RON law will help to simplify and facilitate the closing of real estate transactions and other business deals.

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.

NEW LAW CHANGES WISCONSIN SALES AND USE TAX RULES FOR CONSTRUCTION CONTRACTORS

A new Wisconsin law allows contractors to purchase materials tax-free for construction projects undertaken by certain tax-exempt government and non-profit entities. Under former law, such entities generally had to purchase the construction materials directly themselves in order to receive the Wisconsin sales and use tax exemption. Now, construction contractors may make tax-exempt purchases of construction materials for projects owned by exempt entities. These entities generally include the State of Wisconsin and its agencies, counties, municipalities, school districts and other units of local government, sewerage commissions and districts, water authorities, religious, charitable and non-profit entities, and Indian tribes. The new law took effect on January 1, 2016, and applies to construction contracts entered on or after that date.

To qualify for the tax exemption, the contractor must transfer the materials to the exempt entity, and the materials must become "a component of a facility in this state that is owned

by the entity." The new law defines "facility" as a "building, shelter, parking lot, parking garage, athletic field, athletic park, storm sewer, water supply system, or sewerage and waste water treatment facility." There is a notable express exception. A "facility" does not include a highway, street, or road. Consequently, the new rules will not apply to road and highway projects.

The purpose of the new law is to avoid inflation of the cost of public construction projects due to difficulties in realizing the sales and use tax exemption under prior law. The new law should help government and non-profit entities take full advantage of their tax-exempt status in connection with construction projects. It will also simplify the material purchasing process both for the tax-exempt owner and for the contractor.

If you have any questions, please contact Attorney Steve J. Slawinski at O'Neil Cannon at 414-276-5000.

SEVENTH CIRCUIT RULES THAT LENDER'S TITLE INSURANCE POLICY DOES NOT COVER RISK OF INADEQUATE CONSTRUCTION FUNDING

Does a Lender's title insurance policy cover construction liens filed by unpaid contractors where the lender has discontinued disbursing its construction loan mid-stream due to insufficient funds to complete the project? In *BB-Syndication Services, Inc. v. First American Title Insurance Co.*, 780 F.3d 825 (7th Cir. 2015), the United States Court of Appeals for the Seventh Circuit has emphatically answered "No."

The *BB-Syndication Services, Inc. v. First American Title Insurance Co.* litigation arose from the financial collapse of a major Kansas City mixed-use construction project. At the inception of construction, a dispute arose between the general contractor and the owner-borrower regarding the cost of construction. The contractor claimed that design changes made by the owner and its architect entitled the contractor to a price increase of over $22M. If the contractor's allegations were true, then the construction project would be underfunded by over $22M. The borrower disputed the price increase, and construction continued while the dispute between the contractor and the borrower progressed through arbitration.

With knowledge of the potential funding shortfall, the construction lender chose to proceed with financing the costs of construction as it progressed. The lender continued to fund the monthly construction draws for over one and one-half years, before it finally elected to cease

all further construction loan disbursements, citing the huge loan imbalance and other defaults by the borrower. By then, the lender had disbursed about $61M of its $86M construction loan. Construction stopped, unpaid contractors filed construction liens totaling millions of dollars against the property, and the borrower filed bankruptcy.

In response to the liens, which had priority under Missouri law, the lender made a claim against the title insurance policy that insured the priority of its mortgage. The lender demanded that First American pay off all of the liens under the loan policy's construction lien coverage. First American ultimately denied coverage on grounds that the lender's own conduct—ceasing all funding of construction and refusing to release undisbursed loan proceeds to pay the contractors—had caused the liens to be filed, triggering policy exclusion 3(a). Exclusion 3(a) bars coverage for liens and encumbrances that are "created, suffered, assumed, or agreed" to by the insured.

BB-Syndication ultimately filed suit against First American. The District Court granted summary judgment in favor of First American, holding that exclusion 3(a) barred all coverage for all of the construction liens. BB-Syndication appealed. In a pivotal opinion, the Seventh Circuit affirmed the District Court's decision, holding that the lender had "created" the liens.

Perhaps the most significant aspect of the Seventh Circuit's opinion is its reasoning. In the few court decisions in other prior cases facing this issue, the outcome has turned upon the following two factors: 1) the existence or nonexistence of a disbursement agreement between the construction lender and the title company; and 2) whether or not the lender had disbursed the entire loan amount. The Seventh Circuit expressly criticized the reasoning of those prior decisions, and charted its own course. The Court recognized that construction lenders typically possess the power to exercise significant control over the loan transaction and over the construction project, particularly with regard to the project's finances. The Seventh Circuit concluded that construction lenders have both the ability and the duty to investigate, monitor, and to ensure the construction project's economic viability, both at inception and throughout construction. The Court held that "[w]hen liens arise from insufficient funds, the insured lender has 'created' them by failing to discover and prevent cost overruns—either at the beginning of the project or later." Consequently, the Seventh Circuit adopted a simple rule that "exclusion 3(a) excludes coverage for liens that arise as a result of insufficient funds."

The lesson for construction lenders is clear. They can no longer rely upon title insurance as a safety net against construction liens that arise due to insufficient construction funding. Instead, they must rely upon their own due diligence and other financial instruments, such as third-party guarantees or performance bonds. On the other hand, title insurers can take comfort that they will not be left holding the bag when a construction lender decides to quit disbursing a construction loan due to insufficient funding.

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