

**COURT OF APPEALS
DECISION
DATED AND FILED**

July 21, 2010

A. John Voelker
Acting Clerk of Court of Appeals

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Appeal No. 2009AP1428

Cir. Ct. No. 2007CV654

STATE OF WISCONSIN

**IN COURT OF APPEALS
DISTRICT II**

LAKESIDE FOODS, INC.,

PLAINTIFF-APPELLANT,

V.

LIBERTY MUTUAL FIRE INSURANCE CO.,

DEFENDANT-RESPONDENT.

APPEAL from a judgment of the circuit court for Manitowoc County: JEROME L. FOX, Judge. *Affirmed in part, reversed in part and cause remanded.*

Before Brown, C.J., Neubauer, P.J., and Snyder, J.

¶1 NEUBAUER, P.J. Lakeside Foods, Inc., (“Lakeside”) appeals from a summary judgment in favor of Liberty Mutual Fire Insurance Company (“Liberty”) on a duty to defend and bad faith claim. Lakeside alleges that Liberty

failed to provide it with an immediate and complete defense against a liability claim filed in California. Lakeside premises its contention primarily on Liberty's alleged failure to respond to its tender of defense for a three-month period after which Liberty reserved its rights and refused to pay reasonable attorney fees to Lakeside's choice of counsel. The trial court determined that Liberty and Lakeside reached an oral agreement regarding the reimbursement of attorney fees incurred in Lakeside's defense and, therefore, Liberty did not breach its duty to provide a full and complete defense. We reverse the trial court's judgment and remand for further proceedings because the facts surrounding the alleged oral agreement resolving all defense issues are disputed, as are the facts relating to Liberty's alleged bad faith. Additionally, the trial court erred in its determination that the California *Cumis* statute applies.¹ However, we affirm the trial court's ruling to the extent that the court found that there was no breach of the duty to defend based solely on Liberty's failure to respond to the tender of defense for three months.

¹ California's *Cumis* statute, CAL. CIVIL CODE § 2860 (2010), codified the holding in *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.*, (1984) 162 Cal. App. 3d 358 (1984). Under the *Cumis* statute, the insurer must provide independent counsel to the insured when there is a duty to defend and a conflict of interest arises. Sec. 2860(a). An insured has the right to select independent counsel, however, the insurer has the right to require that the selected counsel meets certain minimum requirements of competency. Sec. 2860(c). The *Cumis* statute also governs the amount an insurer must pay to defend an insured:

(c) ... The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended.... Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.

CAL. CIVIL CODE § 2860(c).

BACKGROUND

¶2 Lakeside is a food packaging company based in Manitowoc, Wisconsin, with facilities in Wisconsin, Minnesota, and Ohio. Lakeside purchased a commercial general liability insurance policy from Liberty for a coverage period of May 1, 2005, to May 1, 2006. Liberty is an insurance company whose Appleton, Wisconsin office issued the general liability insurance policy to Lakeside. The insurance policy covered, among other things, third-party claims of personal injury resulting from Lakeside's products or work.

¶3 Beginning in 2004, Lakeside entered into an agreement with a California firm, OnTech, to seal and process self-heating containers. OnTech is the owner of self-heating technology and another firm, Sonoco, is the manufacturer of the self-heating containers that utilizes OnTech's technology. From 2003 to 2005, Lakeside filled OnTech's orders. Beginning in 2005, in addition to filling OnTech's orders, Lakeside entered into a packaging agreement with one of OnTech's customers, WP Beverage Partners ("WP"), to directly fill WP's orders.

¶4 On February 22, 2006, OnTech filed a lawsuit in Orange County Superior Court against WP for nonpayment of invoices. On June 19, 2006, WP responded to OnTech's suit by filing a counterclaim and additional cross-claims against Lakeside and Sonoco, seeking damages in excess of \$20 million. WP alleged, among other things, that the self-heating containers caused personal injury and property damage to consumers.

¶5 Lakeside was notified of the action and served on June 26, 2006. The suit alleged that Lakeside should be responsible for damages resulting from defects in its self-heating containers. Four days later, on June 30, 2006, Lakeside

gave notice of the lawsuit to Liberty. Lakeside's counsel, David Krutz of Michael, Best & Friedrich (Michael Best), advised Liberty that it was "currently preparing the response pleading which is due on July 26, 2006" and "is providing notice of the Litigation and tendering it as a claim pursuant to the terms of Policy." Krutz requested that Liberty "advise us of your position as to coverage as soon as possible." On July 24, 2006, Lakeside retained Turner, Green, Afrasiabi & Arledge, LLP ("Turner Green"), as local counsel in California.

¶6 On July 25, 2006, Liberty responded to Lakeside's claim by informing Lakeside that it had initiated a coverage investigation. On September 14, 2006, approximately two and one-half months after the initial tender, Liberty informed Lakeside it had accepted its duty to defend because the cross-complaint alleged damages or injury to third parties caused by products. However, Liberty reserved its rights to withdraw from the defense, and to seek reimbursement and allocation of defense costs for uncovered claims.

¶7 On September 18, 2006, Liberty assigned Lakeside's case to panel counsel, the Los Angeles law firm of Yoka and Smith, and requested that Lakeside's current representation, Michael Best, be substituted out of the case. Michael Best responded on October 12, 2006, advising that Lakeside desired to maintain its chosen counsel. On November 9, 2006, Liberty informed Lakeside that it would continue seeking to replace Lakeside's existing defense team, advising that Yoka and Smith was "approved counsel" who will adhere to Liberty's "terms and conditions." At the same time, Liberty again asserted that it reserved its rights to withdraw from the defense if the pleadings were confined to claims for which there was no potential for coverage. Liberty advised if Lakeside continued with its choice of lead counsel, Michael Best, it would be at Lakeside's own cost.

¶8 Lakeside rejected the assignment in correspondence to Liberty dated November 28, 2006, in which Krutz explained:

[I]t is Lakeside's position that because Liberty has reserved rights in this matter, Lakeside has the right to control the defense....

Over 40,000 documents have been exchanged in discovery; numerous interviews of Lakeside's employees have taken place, numerous telephone conferences have taken place to discuss strategy with counsel for OnTech and Sonoco; discovery responses have been prepared. Lakeside would be significantly harmed if new counsel took the lead.

¶9 Responding on December 4, 2006, Liberty again asserted that it had the right to select counsel, and disagreed that Lakeside "has the right to control the defense." In an affidavit submitted on summary judgment, Lakeside's chief financial officer and vice president of administration, Denise Kitzerow, averred that Liberty's attempt to change counsel well into the litigation as well as its continued reservation to withdraw its defense caused Lakeside "great concern."

¶10 During this time, Lakeside continued to pay all of the costs and attorney fees in the underlying litigation. Russell Schmidt, Lakeside's chief financial officer and vice president of finance, testified that in order to obtain some participation from Liberty as to the cost of defense, the parties discussed a fee arrangement.

¶11 On December 8, 2006, Liberty and Lakeside attended mediation in the underlying litigation. Following the mediation, the parties discussed a fee arrangement whereby Liberty would pay \$135 per hour towards Turner Green's counsel fees, however, a final agreement was not reached that day.

¶12 Through subsequent phone conversations and voice messages between Schmidt and Liberty senior technical claims specialist, Michael Baker,

which were documented by Baker in Liberty's internal claim file notations, the parties purportedly reached an arrangement for Liberty to pay a portion of Lakeside's fees to Turner Green. The record reflects that on December 12, 2006, Liberty contacted Lakeside and discussed allowing Lakeside to retain Turner Green if they would agree to Liberty's panel counsel fee schedule. The next day, Liberty contacted Turner Green which rejected what would have been a large decrease in their normal fee schedule. The file notations indicate that Turner Green proposed to Liberty that Liberty pay \$135 per hour and Lakeside pay the difference. Then, on December 13, 2006, Liberty left Lakeside a message detailing Turner Green's proposal. Lakeside responded to Liberty's message on December 20, 2006, agreeing to the fee arrangement and reiterating that it would continue to retain Michael Best as lead counsel. Liberty then informed Turner Green of the discussions. The parties disagree whether this was an "understanding" or an "agreement," and whether it was final or temporary, but nonetheless, Liberty paid this hourly rate through the settlement of the case.

¶13 In Liberty's internal notations from December 21, 2006, Baker summarizes the agreement as follows:

We have finally, I believe, reached an agreement with the defense: The [insured] will continue to retain the Michael Best firm/David Krutz as lead counsel. They will do this at their cost. We have agreed to retain the Turner Green firm (who the [insured] would like to keep on) as local counsel. They will agree to split their billing, meaning we will pay fees and costs to \$135 per hour and [insured] will then be responsible for the difference.

However, Liberty's internal notations on December 20, 2006, also indicate that it was informed by Lakeside that it would "be getting something in writing from Mr. Krutz." Baker also noted that, "once confirmed," he would contact Turner Green to finalize details. The next day, on December 21, 2006, Baker sent an email to

another Liberty employee asking for approval of the retention of Turner Green. It is undisputed that no written agreement exists as to the payment of attorney fees.

¶14 On January 25, 2007, Krutz sent a letter to Liberty acknowledging that Liberty had agreed to pay a portion of Turner Green's fees but asserted that Liberty was obligated to pay the full cost of defense. On February 7, 2007, Liberty responded to Lakeside by sending a letter outlining the previous fee arrangement and stating their disagreement with Lakeside's position. Despite its assertion that the defense issue had been resolved, Liberty reiterated its reservation of rights to seek allocation or reimbursement of defense costs for uncovered claims.

¶15 On August 31, 2007, the parties to the underlying litigation, including Lakeside, reached a confidential settlement agreement as to all claims. Lakeside notified Liberty of the details of the settlement and requested contribution; Liberty declined based on the absence of evidence as to coverable damages. In total, Lakeside paid approximately \$1,070,000 for attorney fees to defend the underlying litigation, and Liberty contributed \$160,000 toward the fees.

¶16 On October 25, 2007, Lakeside filed a complaint against Liberty for breach of its duty to defend and bad faith. Lakeside asserts that Liberty's response after being notified of Lakeside's lawsuit was impermissibly slow, incomplete, and in bad faith. Additionally, Lakeside asserts that Liberty's failure to pay anything other than a small portion of the total cost of Lakeside's counsel was a violation of Liberty's duty to defend.

¶17 On November 7, 2007, Liberty filed its answer and affirmative defenses to Lakeside's complaint. Later, on February 21, 2008, Liberty filed an amended answer and affidavits. In its answer, Liberty denied any liability or

wrongdoing. Then, on November 4, 2008, Liberty filed a counterclaim against Lakeside requesting an allocation to determine what portion of defense costs incurred in the underlying litigation were for claims that were not potentially covered by Liberty's policy. Liberty also requested full reimbursement of all attorney fees and costs incurred during the underlying Lakeside litigation.

¶18 The trial court determined that the undisputed facts established that Liberty reserved rights to question coverage and allowed Lakeside to control its own defense. Additionally, the trial court found that Lakeside and Liberty agreed on a method of reimbursement which was memorialized in Baker's claim files. Further, the court stated that even if the agreement had not been reached, California law would require the dispute to be determined under California's *Cumis* statute. Liberty asserts that California law should apply while Lakeside argues that Wisconsin law should apply.² The court stated that the length of time it took Liberty to acknowledge its duty to defend could not support a breach of the duty to defend. Finally, the trial court determined that Lakeside's bad faith claim could not be supported by the facts.

¶19 On April 20, 2009, the trial court entered an order (1) denying Lakeside's motion for partial summary judgment, (2) granting Liberty's motion for summary judgment, (3) dismissing Lakeside's bad faith and breach of contract claims, and (4) dismissing Liberty's counterclaim. On June 8, 2009, the trial court entered judgment consistent with its April 20 order and also awarding costs to Liberty. Lakeside appeals.

² Liberty cites *Spic and Span, Inc. v. Continental Casualty Co.*, 203 Wis. 2d 118, 552 N.W.2d 435 (Ct. App. 1996), for the proposition that in a lawsuit filed in California, with a conflict between the insurer and insured, the *Cumis* statute will apply.

¶20 Additional facts relevant to the various legal issues are presented in the discussion of each issue below.

DISCUSSION

¶21 We review a grant or denial of summary judgment de novo, using the same methodology as the circuit court. *M & I First Nat'l Bank v. Episcopal Homes Mgmt., Inc.*, 195 Wis. 2d 485, 496-97, 536 N.W.2d 175 (Ct. App. 1995). We need not recite the details of the methodology here other than to point out that summary judgment methodology prohibits the circuit court from deciding questions of fact. *Preloznik v. City of Madison*, 113 Wis. 2d 112, 116, 334 N.W.2d 580 (Ct. App. 1983). The methodology is intended to prevent a trial on affidavits and depositions. *State Bank v. Elsen*, 128 Wis. 2d 508, 511, 383 N.W.2d 916 (Ct. App. 1986). Summary judgment is not to be used as a short cut to avoid a full trial where a factual dispute exists. *Id.* The moving party bears the burden of demonstrating the absence of a genuine issue as to any material fact with such clarity as to leave no room for controversy. *See Grams v. Boss*, 97 Wis. 2d 332, 338, 294 N.W.2d 473 (1980), *abrogated on other grounds by Olstad v. Microsoft Corp.*, 2005 WI 121, 284 Wis. 2d 224, 700 N.W.2d 139. The inferences to be drawn from the moving party's proofs should be viewed in the light most favorable to the party opposing the motion and doubts as to the existence of a genuine issue of material fact should be resolved against the party moving for summary judgment. *Id.* at 338-39.

Choice of Law

¶22 At the outset, we address Lakeside's contention that Wisconsin law governs its claims against Liberty based on breach of the duty to defend. Liberty contends that this is nothing more than an attorney fee dispute that is governed by

California law. However, the dispute regarding the payment of attorney fees stems from a disagreement regarding Liberty’s duty to defend—who was entitled to control Lakeside’s defense, choose counsel, and what Liberty owed as its duty to defend following its reservation of rights. We agree with Lakeside that this dispute is governed by Wisconsin law.

¶23 The CGL policy issued to Lakeside insures “all operations of the named insured.” The policy provides: “We will pay those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ to which this insurance applies. We will have the right and duty to defend the insured against any ‘suit’ seeking those damages.” The policy applies to “bodily injury” and “property damage” only if it is “caused by an ‘occurrence’ that takes place in the ‘coverage territory’[.]” The “coverage territory” is defined by the policy as “[t]he United States of America (including its territories and possessions), Puerto Rico and Canada,” and when the injury or damage arises out of products or goods made in the United States, the coverage extends throughout the world. Although the policy insures a broad coverage territory, the policy does not contain a “choice of law” provision.

¶24 A choice-of-law determination is a question of law subject to independent appellate review. *Drinkwater v. American Family Mut. Ins. Co.*, 2006 WI 56, ¶14, 290 Wis. 2d 642, 714 N.W.2d 568. When an insurance contract does not contain a choice of law provision, Wisconsin courts employ a “grouping of contacts” approach for resolving conflict of law questions.³ *Bradley Corp. v.*

³ Generally, when reviewing a conflict of laws issue, we first determine whether a genuine conflict exists. See *Burns v. Geres*, 140 Wis. 2d 197, 200, 409 N.W.2d 428 (Ct. App. 1987). Here, the parties do not dispute that a conflict exists.

Zurich Ins. Co., 984 F.Supp. 1193, 1197 (E.D. Wis. 1997) (addressing applicable law in a CGL policy dispute). “The approach includes looking at the place of contracting, negotiation, and performance of the contract, the location of the insured risk, and the domicile of the parties to the agreement.” *Id.* (citing *Utica Mut. Ins. Co. v. Klein & Son, Inc.*, 157 Wis. 2d 552, 556-58, 460 N.W.2d 763 (Ct. App. 1990)); see also *Sybron Transition Corp. v. Security Ins. Co.*, 107 F.3d 1250, 1255 (7th Cir. 1997).

¶25 The grouping of contacts rule was later explained and employed in *State Farm Mutual Automobile Insurance Co. v. Gillette*, 2002 WI 31, 251 Wis. 2d 561, 641 N.W.2d 662. There, the court instructed:

To determine which jurisdiction’s law applies to a contractual dispute, we look to Wisconsin contract choice of law rules. In contractual disputes, Wisconsin courts apply the “grouping of contacts” rule, that is, that contract rights must be “determined by the law of the [jurisdiction] with which the contract has the most significant relationship.”

Id., ¶26 (footnotes omitted). The *Gillette* court determined that because the insurance policy was issued in Wisconsin between an insurance company doing business in Wisconsin and a Wisconsin resident, and because the policy covered cars registered in Wisconsin, Wisconsin was the state with which the policy had its most significant relationship. *Id.*, ¶27. The court determined that Wisconsin law governed the interpretation of the insurance policy. *Id.*

¶26 We reach the same conclusion in this case. The facts demonstrate that the CGL policy at issue has its greatest contacts with Wisconsin. The record establishes that Liberty is incorporated in and does business in Wisconsin; Lakeside is a Wisconsin corporation with its principal place of business in this state; and the policy issued by Liberty was sold, negotiated, and delivered in

Wisconsin. This dispute involves the duties and obligations of Liberty to Lakeside under the CGL policy and the relationship between those parties has its greatest contacts in Wisconsin. *See Sybron*, 107 F.3d at 1256 (some of the insured occurrences and claims could arise from the insured’s activities and subsidiaries outside of the state, but the place of contracting is the state with the most significant relationship with the parties and the policy) (citing *Urhammer v. Olson*, 39 Wis. 2d 447, 159 N.W.2d 688 (1968) (the place of the accident is irrelevant factor in deciding which law governs insurance agreement)).

¶27 While the underlying products liability litigation happens to be in California, Lakeside’s product manufacturing activities related to the litigation occurred in Wisconsin. The policy insures all of the operations of Lakeside, a Wisconsin corporation with its principal place of business in Wisconsin, and the coverage territory for injury or damages arising out of goods or products sold extends throughout the world. The contract covers a group of risks with no particular location of insured risk. We agree with Lakeside that it would undermine predictability and uniformity to require the interpretation of the parties’ insurance contract to be governed by the law of the location of each and any particular lawsuit.

¶28 Liberty contends that this case is identical to *Spic and Span, Inc. v. Continental Casualty Co.*, 203 Wis. 2d 118, 552 N.W.2d 435 (Ct. App. 1996), and therefore California law applies. We disagree. In *Spic and Span*, the court expressly declined to address Spic and Span’s objection to the application of California law based on its concern that “California’s limitation on independent counsel selected by the insured would undermine Wisconsin policy and the intentions and expectations of the parties to insurance policies negotiated, sold and issued in Wisconsin.” *Id.* at 128. The court determined that Spic and Span had

tacitly accepted California law for the calculation of defense compensation and, therefore, waived its challenge to the application of California law. *Id.* at 128, 132. Liberty contends that Lakeside, like Spic and Span, also waived its objection.

¶29 In support of its argument, Liberty references correspondence to Lakeside dated December 4, 2006, in which it states, “It is our position that Lakeside’s ability to select their own counsel is dictated by the ‘*Cumis*’ statute-California Civil Code section 2860. Since we have agreed to defend our insured, we have the right to choose counsel.” However, in that same letter, as well as others, Liberty discusses its coverage obligations citing Wisconsin law. Moreover, while Liberty contends that Lakeside never objected to the application of California law, the parties’ correspondence indicates that this was an ongoing dispute. On November 28, 2006, prior to Liberty’s correspondence, Lakeside advised Liberty, “Lakeside objects to Liberty’s attempt to appoint counsel of its choice for Lakeside for numerous reasons. First, it is Lakeside’s position that because Liberty has reserved rights in this matter, Lakeside has the right to control the defense.” Then, after receiving Liberty’s December 6, 2006 correspondence, Lakeside again advised Liberty, “It is Lakeside Foods’ position that based on Liberty’s reservation of rights, Lakeside Foods has the right to control the defense and Liberty has the obligation to pay for that defense based on the CGL policy. I understand Liberty disagrees with that contention.” Moreover, the discussions reflect an ongoing dispute about Liberty’s desire to impose its panel counsel rates. No party indicated that the disagreement should be resolved by binding arbitration pursuant to the *Cumis* statute. *See* CAL. CIVIL CODE § 2860(c) (2010).

¶30 While not specifically referencing either California or Wisconsin state law, it is clear that Lakeside’s position is firmly based in the application of

Wisconsin law. Contrary to Liberty's assertions, the facts do not establish as a matter of law that Lakeside tacitly (much less intentionally) agreed to the application of California law such that it waived its objection under *Spic and Span*. Rather, the parties' dispute as to the duty to defend under the CGL policy and the resulting obligation to pay attorney fees was, and is, ongoing. We conclude that this contractual dispute is governed by Wisconsin law.⁴ See *Gillette*, 251 Wis. 2d 561, ¶27.

Breach of Duty to Defend

¶31 Contracts for insurance typically impose two main duties: the duty to indemnify the insured against damages or losses, and the duty to defend against claims for damages. *Johnson Controls, Inc. v. London Market*, 2010 WI 52, ¶28, No. 2007AP1868. These duties present separate contractual obligations. *Id.* "In Wisconsin, the duty of an insurer to provide a defense to its insured is determined by the complaint and not by extrinsic evidence. If there are allegations in the complaint which, if proven, would be covered, the insurer has a duty to defend." *Grube v. Daun*, 173 Wis. 2d 30, 72, 496 N.W.2d 106 (Ct. App. 1992) (citations omitted). When an insurance policy provides coverage for even one claim, the insurer is obligated to defend the entire lawsuit. *Fireman's Fund Ins. Co. v. Bradley Corp.*, 2003 WI 33, ¶21, 261 Wis. 2d 4, 660 N.W.2d 666.

An insurance company that disputes coverage, and thus the duty to defend, has several choices. The company may enter into a nonwaiver agreement with the insured wherein the insurer would agree to defend and the insured would

⁴ Based on our determination that the parties' dispute is governed by Wisconsin law, we need not address whether Liberty waived its right to seek dismissal of Lakeside's action in favor of binding arbitration under California's *Cumis* statute. See *Gross v. Hoffman*, 227 Wis. 296, 300, 277 N.W. 663 (1938) (only dispositive issue need be addressed).

acknowledge the right of the insurer to contest coverage. The company may seek to bifurcate the trial and obtain a declaratory judgment on coverage in advance of the determination of liability. The company may defend the insured under a reservation of rights, that is reserving its right not to pay a judgment if it is determined that coverage does not exist. Or, the company may decline to defend and risk the consequences.

Southeast Wisconsin Prof'l Baseball Park Dist. v. Mitsubishi Heavy Indus. Am., Inc., 2007 WI App 185, ¶42, 304 Wis. 2d 637, 738 N.W.2d 87 (citations omitted). When an insurer reserves rights the insured has the right to control the defense. See *Radke v. Fireman's Fund Ins. Co.*, 217 Wis. 2d 39, 45, 577 N.W.2d 366 (Ct. App. 1998); *Jacob v. West Bend Mut. Ins. Co.*, 203 Wis. 2d 524, 536, 553 N.W.2d 800 (Ct. App. 1996) (the insurer may give the insured notice of the insurer's intent to reserve its coverage rights, which allows the insured the opportunity to a defense not subject to the control of the insurer although the insurer remains liable for the legal fees incurred). Further, when an insurer determines to reserve its right to contest coverage, it must provide a defense "immediately" or use alternate methods to reduce costs until coverage is decided. See *Grube*, 173 Wis. 2d at 75-76.

¶32 The parties do not dispute that Liberty had a duty to defend Lakeside; Liberty acknowledged its duty, and reserved its rights. Liberty also acknowledges that generally, under Wisconsin law, based on a reservation of rights, an insured is entitled to control the defense, but contends that this is a nonissue because Liberty permitted Lakeside to proceed with its chosen counsel. However, Lakeside contends that Liberty breached its duty to defend Lakeside by "refusing to provide an immediate or complete defense and by attempting to force Lakeside into an agreement to accept less than the full defense to which it was contractually entitled." Lakeside's claims relate to both the timeliness of Liberty's

determination as to its duty to defend and also to its attempt to impose its choice of panel counsel on Lakeside, as well as paying only a portion of Lakeside's attorney fees. Liberty acknowledges the parties' disagreements, but responds that the parties arrived at an oral agreement which resolved the issues surrounding Lakeside's defense and provided for the payment of attorney fees from the time of tender through settlement.

1. *The Existence of an Oral Agreement*

¶33 Lakeside contends that Liberty breached its duty to defend by refusing to provide a complete defense subject to its control, including choice of counsel, at Liberty's expense. Because the facts demonstrate that Liberty ultimately conceded to the use of Lakeside's counsel, our initial inquiry involves the parties' oral fee arrangement and whether there exists a genuine issue of material fact as to whether the arrangement was intended to be final or whether the parties contemplated a temporary arrangement.

¶34 On summary judgment, Liberty asserted that it had come to a final agreement with Lakeside in December 2006 regarding fees, and that after Lakeside settled the litigation in August 2007, Lakeside reneged on the cost sharing agreement. In support of its contention that an oral agreement existed, Liberty cites to deposition testimony from Lakeside's representative Russell Schmidt who acknowledged that Liberty would pay Turner Green \$135 per hour and that this was never classified as "temporary." However, Schmidt testified that it was never classified as "permanent" either and he disputed its application to Michael Best, stating that Michael Best was not "on the table" during his discussions with Liberty's claims handler. Liberty also cites to the fact that, from

March 2007 forward until the conclusion of the litigation, Lakeside billed Liberty for Turner Green's services at a rate of \$135 per hour.

¶35 Lakeside contends that the undisputed evidence demonstrates that the parties had not reached a final agreement. We agree that there is a material issue of fact as to this issue. "Where the terms of an oral contract are to be gathered from conduct and conversations, or where they are in dispute, or are ambiguous or vague, the question as to what the understanding or agreement in fact was is a question for the jury." *James v. Carson*, 94 Wis. 632, 636-37, 69 N.W. 1004 (1897).

¶36 The record does not contain, and Liberty concedes that there does not exist, a written agreement as to the payment of attorney fees. The evidence Liberty relies on to support the existence of an oral agreement consists primarily of Baker's internal notations which memorialize his understanding of conversations with, and voice mails received from, the insured.⁵

¶37 In response, Lakeside points to an internal notation dated December 20, 2006, in which Baker indicates that Schmidt advised Baker that he would be receiving "something in writing from [] Krutz" which, Baker noted, would "hopefully" reflect Liberty's understanding with the insured.⁶ Liberty never

⁵ In response to submissions relating to Baker's subjective understanding that the parties had reached an agreement, Lakeside points to portions of Schmidt's testimony in which he testified that he believed the "arrangement" contemplated each party reserving their respective rights with regard to the allocation of defense costs, and specifically that either party could "come back" and seek reimbursement. Our focus on summary judgment is on the express communications between the relevant parties.

⁶ The internal claim file notation states:

(continued)

received a written agreement from Krutz. To the contrary, in correspondence to Liberty dated January 2007, Krutz identifies a continued dispute regarding the sufficiency of Liberty's actions in supporting Lakeside's defense, including the payment of attorney fees. Krutz requests a meeting to "review facts and issues concerning coverage and defense" and states that "[i]n the meantime, Lakeside Foods expects Liberty to pay the full cost of defense including Michael, Best & Friedrich's fees, Attorney Todd Green's full rate, and the disbursement costs" Thus, rather than document a final agreement, Krutz's correspondence clearly sets forth Lakeside's position that the parties had not reached a final agreement. Indeed, the only facts of record as to whether the parties intended to reach a final agreement orally or in writing are gleaned from the internal file notations of Baker on December 20, 2006, who was told by the insured that he would be receiving "something in writing," and who anticipated that the agreement would be confirmed in writing. Further, the next day, on December 21, 2006, Baker sent an email to another Liberty employee asking for approval of the retention of Turner Green.

¶38 In light of Krutz's January correspondence and the lack of a written agreement, we conclude that a genuine issue of material fact exists as to whether the parties had reached a final agreement as to the payment of attorney fees, either

Received voice message from Mr. Schmidt. He wanted to confirm that we have an understanding as to defense ... states I will be getting something in writing from Mr. Krutz. Will await written response from Krutz and hopefully, it will jive as to current understanding I have with [insured]. Once confirmed, will finalize details with Green firm and advise Yoka and Smith to close their file.

for Michael Best as lead counsel or Turner Green as local counsel, or whether they had simply reached a temporary fee arrangement. Moreover, at best, the evidence submitted is inconclusive as to whether the conversations between Schmidt and Baker resulted in an oral agreement or whether they were merely preliminary negotiations looking forward to the execution of a written document. *See Johann v. Milwaukee Elec. Tool Corp.*, 270 Wis. 573, 589, 72 N.W.2d 401 (1955). Further, even if we were to conclude that an agreement exists, and we do not, there are genuine issues of material fact as to the scope and terms of the agreement, for example, whether the agreement was intended to date back to the period between the date of tender by Lakeside and Liberty's reservation of rights or following the December negotiations.⁷

¶39 Depending on the fact finder's determination on remand, the issue of attorney fees may be resolved. However, if the fact finder determines that the rate schedule was only temporary, the court will have to determine Liberty's obligation for attorney fees from the time of tender until the resolution of litigation. Whether the requested compensation for attorney fees is reasonable is a question of fact to be addressed by the trial court following consideration of the factors in SCR 20:1.5 (2010), which includes the fees customarily charged in the locality for similar service, SCR 20:1.5(a)(3).⁸ *See Wright v. Mercy Hosp. of Janesville, Wis., Inc.*, 206 Wis. 2d 449, 470, 557 N.W.2d 846 (Ct. App. 1996); *Fireman's*

⁷ We reject Lakeside's contention that any oral agreement made by the parties would have been prohibited by the terms of the insurance policy. The policy issued by Liberty provides: "This policy's terms can be amended or waived only by endorsement issued by [Liberty] and made a part of this policy." However, an oral agreement as to the payment of attorney fees under a duty to defend would not constitute an agreement to change the terms of the policy.

⁸ We make no comment on the reasonableness of the fees or whether the retention of two law firms in this particular case was reasonable.

Fund Ins. Co. v. Bradley Corp., 261 Wis. 2d 4, ¶67; *see also HK Sys., Inc. v. Admiral Ins. Co.*, 2005 WL 1563340 at 18, 19 (E.D. Wis. 2005) (applying Wisconsin law, holding that an insurer’s responsibility for defense costs extends only to a reasonable charge and the market standard for attorney rates for a particular type of litigation in a particular geographic area is a question of fact preventing the grant of summary judgment); *see also* 14 Lee R. Russ & Thomas F. Segalia, *Couch on Insurance* § 202:35, at 202-87 (3d ed. 1999) (“An insurer’s obligation to reimburse independent counsel is limited to reasonable attorney’s fees and disbursements.”)

2. *Timeliness of Liberty’s Response*

¶40 We turn next to Lakeside’s claim that Liberty breached its duty to defend by failing to provide an immediate response to its tender of coverage. *See Grube*, 173 Wis. 2d at 75 (insurers must provide a defense “immediately” or use alternate methods to reduce costs until the coverage issue is decided). In doing so, we note that the viability of Lakeside’s claim as to timeliness could also depend on the fact finder’s ultimate determination as to the existence and scope of the oral agreement. However, because we find no explicit communications evidencing a meeting of the minds that a fee arrangement resolved all defense obligations from the date of tender, we address this issue as well.

¶41 Here, the undisputed facts establish that Lakeside tendered its defense to Liberty on June 30, 2006, four days after the filing of a cross-complaint against Lakeside in the underlying litigation. Lakeside’s tender included the cross-complaint and notified Liberty that its answer in that litigation was due on July 26, 2006. Liberty did not acknowledge Lakeside’s tender until July 25, 2006, when it notified Lakeside that it had “initiated a coverage investigation” and

requested a copy of the original complaint. Liberty did not inform Lakeside of its position as to coverage and its reservation of rights until September 14, 2006.

¶42 Lakeside contends that Liberty's investigation, which involves examining the complaint to determine whether it contains allegations that, if true, would trigger coverage, *see Liebovich v. Minnesota Ins. Co.*, 2008 WI 75, ¶16, 310 Wis. 2d 751, 751 N.W.2d 764, should have been brief, taking hours, not weeks, to decide. Lakeside asserts that "waiting nearly three months after tender of a \$26 million lawsuit to accept defense of the matter and waiting eight months after tender to actually begin to fund a minor portion of the defense is not defending an action 'immediately.'" Not surprisingly, Liberty contends it was not precluded from requesting more information or performing its own investigation before accepting the tender. Lakeside responds that Liberty's request for information and investigation should have occurred more quickly.

¶43 In briefing the issue of timeliness, neither party points to any case law indicating what length of time is acceptable for an insurer's response. It is undisputed that, by mid-September, Liberty had acknowledged its duty to defend Lakeside. Lakeside's initial correspondence with Liberty indicated that it had counsel, Krutz, who would be preparing a responsive pleading. Therefore, during the pendency of its coverage investigation, Liberty knew that Lakeside was represented by counsel, and presumably knew that it would be obligated to pay Lakeside's fees dating back to the tender of defense. While Lakeside understandably may have preferred a more prompt response from Liberty, Lakeside has not identified any prejudice or damages suffered as a result of the delay. Indeed, it was well represented by its counsel of choice. We cannot say that Lakeside has established a breach of Liberty's duty to defend as a matter of law based solely on the timeliness of Liberty's response to tender. However,

should the fact finder determine the absence of the oral agreement, timeliness may be considered as to whether Liberty's actions, when viewed as a whole, amounted to a bad faith handling of Lakeside's claim.

Bad Faith

¶44 Lakeside contends that the trial court additionally erred in granting summary judgment on the issue of bad faith. “To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim.” *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 691, 271 N.W.2d 368 (1978). “[B]ad faith conduct by one party to a contract toward another is a tort separate and apart from a breach of contract *per se* and ... separate damages may be recovered for the tort and for the contract breach.” *Id.* at 686. “[T]he tort of bad faith is not a tortious breach of contract. It is a separate intentional wrong, which results from a breach of duty imposed as a consequence of the relationship established by contract.” *Id.* at 687. Generally, in bad faith insurance actions, the tort of bad faith stems from a breach of the fiduciary duty the insurer owes its insured resulting from the relationship created by the insurance contract. *See Combined Investigative Servs., Inc. v. Scottsdale Ins. Co.*, 165 Wis. 2d 262, 270, 477 N.W.2d 82 (Ct. App. 1991).

¶45 Lakeside argues that there is “ample evidence from which a jury could conclude that Liberty lacked a reasonable basis for denying Lakeside the benefits of its policy—most significantly, a timely and full defense—and that Liberty knew that it lacked a reasonable basis for denying such benefits to Lakeside.” Liberty contends that Lakeside's bad faith claim is not recognized by Wisconsin courts because it does not fall within the three scenarios of insurer bad

faith previously addressed in case law and the Wisconsin Jury Instructions. However, Liberty's argument was recently rejected in *Roehl Transport, Inc. v. Liberty Mutual Insurance Co.*, 2010 WI 49, ¶36, No. 2008AP1303. There, the supreme court observed that the tort of bad faith is not "confined to the three fact patterns described in the existing case law." *Id.* We therefore turn to the possible merits of Lakeside's claim and the propriety of summary judgment.

¶46 Here, the record reflects that while denying Lakeside's right to continue with its chosen counsel, Liberty's internal correspondence indicates its understanding that Lakeside may have the right to control its defense.⁹ Liberty then informed Krutz that if Lakeside wished to continue with Michael Best as lead counsel it would be responsible for all Michael Best's fees and costs. Lakeside contends that bad faith on the part of Liberty is also evidenced by failing to respond to Lakeside's tender for eleven weeks, leaving Lakeside to fund the entirety of its defense; attempting to coerce Lakeside into relinquishing its right to control its defense by threatening to withhold financial assistance in paying legal fees; and by ultimately paying for only twenty percent of the legal fees incurred in defending the underlying action and refusing to contribute monies to the settlement. Lakeside submitted a detailed expert opinion documenting the manner in which Liberty "breached its insurance policy obligations and acted in bad faith" toward Lakeside.¹⁰

⁹ An internal email from Baker, Liberty's senior technical claims specialist, provides: "I have advised Mr. Krutz that Yoka and Smith should be lead counsel since they are approved on our panel. Mr. Krutz is asking if we would object to [Michael Best] taking the lead with local counsel (Yoka and Smith) also participating. I think we should object, though I realize [Michael Best] may have a right (?) to stay in the case based on our reservation of rights."

¹⁰ The expert's opinion was based in part on the following:

(continued)

¶47 Lakeside’s claims as to bad faith relate to both the timeliness of Liberty’s determination as to its duty to defend and also to its attempt to impose its choice of panel counsel on Lakeside, as well as paying only a portion of Lakeside’s attorney fees.¹¹ Liberty argues that Lakeside’s contentions are addressed, and were resolved, by an oral agreement purportedly reached by the parties in early December 2006. Liberty strenuously disputes that its actions amounted to a wrongful denial of its duties under the contract such that it acted in bad faith.

¶48 Bad faith has been described by our supreme court as follows:

Liberty did not respond to the June 30 tender until its September 14 letter agreeing to “provide a defense,” despite knowledge that Lakeside had a July 26 answer date and was expending money on a defense provided by Michael Best.

Liberty agreed that Michael Best should file the responsive pleading and otherwise defend the insured in its July 25 letter, but later would not pay the fees for such the pre-acceptance of tender work unless under certain conditions including the acceptance of lower hourly rates and/or a change of counsel.

Liberty insisted on a change of counsel mid-case despite knowledge that its panel counsel, Yoka & Smith, felt such a substitution “would be difficult.” Liberty “threatened to withhold all financial assistance” to Lakeside’s defense unless it agreed to use Liberty’s chosen counsel.

Liberty ultimately paid only twenty percent of the legal fees incurred in defending the underlying action.

¹¹ Presumably because Liberty ultimately conceded to Lakeside’s choice of counsel, the parties do not directly address or adequately brief whether Lakeside’s right to control its defense necessarily encompassed a right to select counsel under Wisconsin law. However, we note that, even in those jurisdictions where the insurer is permitted to select counsel, the appointed counsel must be truly independent and the insurer may not delay in disapproving the insured’s choice of counsel. See *HK Systems, Inc. v. Admiral Ins. Co.*, 2005 WL 1563340, at 10, 14, 16 (E.D. Wis. 2005) (citing 14 Lee R. Russ & Thomas F. Segalia, *Couch on Insurance* § 202:35, at 202-87 (3d ed. 1999) and discussing questions of fact that arise as to whether insurer-retained counsel is truly independent, i.e., the depth and extent of the attorney/client relationship between the insurer and appointed counsel).

“[B]ad faith is the absence of honest, intelligent action or consideration based upon a knowledge of the facts and circumstances upon which a decision in respect to liability is predicated.” There is a duty of ordinary care and reasonable diligence on the part of an insurer in handling claims, and it must exercise an honest and informed judgment.... “In short, it is proper when applying the bad faith test to determine whether a claim was properly investigated and whether the results of the investigation were subjected to a reasonable evaluation and review.”

Trinity Evangelical Lutheran Church v. Tower Ins. Co., 2003 WI 46, ¶34, 261 Wis. 2d 333, 661 N.W.2d 789 (citations omitted). “Bad faith is a determination to be made by the trier of fact.” *Mowry v. Badger State Mut. Cas. Co.*, 129 Wis. 2d 496, 517, 385 N.W.2d 171 (1986); *see also Baker v. Northwestern Nat’l Cas. Co.*, 26 Wis. 2d 306, 314-15, 132 N.W.2d 493 (1965) (explaining that the issue of bad faith is a matter for the jury), *overruled on other grounds by DeChant v. Monarch Life Ins. Co.*, 200 Wis. 2d 559, 547 N.W.2d 592 (1996).

¶49 Based on the disputed issues discussed earlier as to whether an oral agreement existed which comprehensively resolved the parties’ dispute regarding Liberty’s defense obligation, we agree with Lakeside that genuine issues of material fact could exist as to whether Liberty fulfilled its duty of ordinary care and diligence in handling Lakeside’s claim, and whether it exercised honest and informed judgment in doing so. As such, we reverse the trial court’s grant of summary judgment on this issue as well and remand for further proceedings.

CONCLUSION

¶50 The overarching issue in this case is whether summary judgment was appropriate. Because Liberty failed to demonstrate the absence of a genuine issue as to any material fact with such clarity as to leave no room for controversy, *see Grams v. Boss*, 97 Wis. 2d at 338, we conclude that it was not. Based on our

review of the summary judgment record, we conclude that there are genuine issues of material fact as to whether the parties arrived at a final oral agreement resolving all defense issues and, if so, what constituted the terms of that agreement. We further conclude that there are disputed issues of material fact as to whether Liberty acted in bad faith. As to choice of law, we conclude that the trial court erred in its determination that California law applies to this dispute. Finally, we uphold the trial court's determination that Liberty did not breach its duty to defend solely on the grounds that it took three months to respond to Lakeside's tender of defense. We therefore reverse the trial court's grant of summary judgment in favor of Liberty and remand for further proceedings consistent with these holdings.

By the Court.—Judgment affirmed in part, reversed in part and cause remanded.

Not recommended for publication in the official reports.

