COURT OF APPEALS
DECISION
DATED AND FILED

February 23, 2005

Cornelia G. Clark
Clerk of Court of Appeals

Appeal No. 04-1418 **Cir. Ct. No. 03-CV-46**

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

ADDISON INSURANCE COMPANY,

PLAINTIFF-APPELLANT,

V.

JAMES KORSMO, LAURIE KORSMO, STATE FARM INSURANCE COMPANY, DAVID PHILLIPS AND MONA PHILLIPS,

DEFENDANTS-RESPONDENTS.

APPEAL from a judgment of the circuit court for Sawyer County: NORMAN L. YACKEL, Judge. *Affirmed*.

Before Cane, C.J., Hoover, P.J., and Peterson, J.

¶1 CANE, C.J. Addison Insurance Company appeals a judgment declaring it has a duty to defend, under David and Mona Phillipses' commercial general liability policy, claims arising from the Phillipses' sale of a bat-infested

property to James and Laurie Korsmo. Addison first contends there is no coverage, and thus no duty to defend, because its policy with the Phillipses was cancelled before the sale of that property closed. Addison argues alternatively that, even if the policy was in force at the time of the sale, it does not cover any equitable claims for adjustment of the sales price, unjust enrichment, reformation of contract, or constructive trust; any claim for breach of contract or warranty; or the Korsmos' negligent misrepresentation claim.

¶2 We agree with the circuit court that the Phillipses' policy remained in force through the closing of the sale. We also conclude that the Phillipses' complaint establishes a sufficient nexus between the alleged misrepresentation claim and the alleged damages to establish coverage. Because the commercial general liability portion of the policy covers at least one claim, Addison has a duty to defend and we need not address whether coverage exists for the other claims. We therefore affirm the judgment.

Background

¶3 In May 2000, Addison issued an insurance policy to the Phillipses for the Crystal Beach Resort, a property they owned and managed.[1] Some time later, the Korsmos arranged to purchase that property from the Phillipses. On October 27, on her way to the closing, Mona Phillips visited her insurance agent to sign a cancellation request for the Phillipses' Crystal Beach Resort insurance and to pick up a binder for the new property they were about to purchase. According

[1] The policy consisted of a commercial property coverage section and a commercial general liability section, both of which applied to the property at issue in this appeal. The parties stipulated that the commercial property section of the Addison policy did not provide coverage for any of the Korsmos' claims.

to the request form signed by Mona, the Phillipses' old policy with Addison was cancelled at 12:01 a.m. on October 27.

¶4 In July 2002, the Korsmos and their insurer, State Farm, sued the Phillipses, alleging that (1) a mutual mistake of fact as to the condition of the property required adjusting the sale price and that the Phillipses (2) knew or should have known the property was infested, justifying contract reformation; (3) negligently, recklessly or intentionally failed to disclose the infestation; (4) were unjustly enriched because the infestation reduced the value of the property; (5) fraudulently failed to disclose the infestation; (6) profited to such an extent that a constructive trust should be imposed; and (7) breached a warranty of habitability. All of these claims arose from a single problem. According to the Korsmos, between six hundred and a thousand bats migrated regularly to the Crystal Beach Resort—and had apparently been doing so for many years.[2] As a result of this serial migration, massive amounts of guano had been deposited in the property impairing "its structural integrity," creating risk of disease and infection, and causing other damages. The Korsmos sought $148,930[3] in damages, costs and disbursements, and the imposition of a constructive trust.

¶5 In October 2002, the Phillipses sought indemnity for these claims under their old Addison policy. Addison immediately denied any duty to defend or indemnify and then brought the declaratory judgment action that is the subject of this appeal. The parties stipulated that only four issues remained for the circuit

[2] According to the Korsmos, the bats migrated to the property in the spring. They thus did not discover the infestation until some months after they moved in.

[3] State Farm paid that sum to the Korsmos before the underlying lawsuit in this case began.

court: (1) whether the policy was cancelled at 12:01 a.m. on October 27, 2000, and whether the comprehensive general liability portion of the Addison policy provided coverage for (2) equitable claims, (3) breaches of contract and warranty, and (4) negligent misrepresentation claims.[4] In March, the circuit court declared the Phillipses' policy had remained in effect through the closing. It also determined that the policy provided coverage for all the contested claims. Addison now appeals.

Standard of Review

¶6 Whether to grant a declaratory judgment is addressed to the circuit court's discretion. ***Bellile v. American Fam. Mut. Ins. Co.***, 2004 WI App 72, ¶6, 272 Wis. 2d 324, 679 N.W.2d 827. When the exercise of such discretion turns on a question of law, however, we review the question de novo, benefiting from the trial court's analysis. ***Id.*** The interpretation of an insurance policy is a question of law this court reviews without deference, applying the same rules of construction we apply to contracts generally. ***Wisconsin Label Corp. v. Northbrook Prop. & Cas. Ins. Co.***, 2000 WI 26, ¶¶22-23, 233 Wis. 2d 314, 607 N.W.2d 276. We interpret insurance policies as a reasonable person in the position of the insured would understand them. ***Kremers-Urban Co. v. American Employers Ins. Co.***, 119 Wis. 2d 722, 735, 351 N.W.2d 156 (1984). But we do not construe them to provide coverage for risks the insurer did not contemplate and for which it has not received a premium. ***American Family Mut. Ins. Co. v. American Girl, Inc.***, 2004 WI 2, ¶23, 268 Wis. 2d 16, 673 N.W.2d 65.

[4] Those issues were decided on stipulated facts.

¶7 Whether a duty to defend exists depends on the nature of the "claim alleged against the insured which is controlling even though the suit may be groundless, false or fraudulent." ***Grieb v. Citizens Cas. Co.***, 33 Wis. 2d 552, 558, 148 N.W.2d 103 (1967). The duty to defend is based solely on allegations contained within the "four corners of the complaint," without resort to extrinsic facts or evidence. *See* ***Atlantic Mut. Ins. Co. v. Badger Med. Supply Co.***, 191 Wis. 2d 229, 236, 528 N.W.2d 486 (Ct. App. 1995). The insurer's duty arises when the allegations in the complaint coincide with the policy's coverage. ***Smith v. Katz***, 226 Wis. 2d 798, 806-07, 595 N.W.2d 345 (1999). Those allegations are construed liberally[5] and all reasonable inferences are assumed. ***Id.*** at 815. A complaint may contain many theories of liability not covered by an insurance policy; but if just one theory appears to fall within the policy's coverage, the insurer is obligated to defend the entire action. *See, e.g.,* ***School Dist. of Shorewood v. Wausau Ins. Cos.***, 170 Wis. 2d 347, 366, 488 N.W.2d 82 (1992). To determine whether coverage exists under a particular policy, we examine the facts of the insured's claim to ascertain whether the insuring agreement makes an initial grant of coverage. ***American Girl***, 268 Wis. 2d 16, ¶24.

Discussion

¶8 The threshold question here is whether the circuit court erred when it determined, based on mutual mistake, that Addison's policy with the Phillipses

[5] Under WIS. STAT. § 802.06(6), pleadings are liberally construed with a view toward substantial justice to the parties. The same principle of liberal construction controls our examination of the allegations in a complaint in relation to the terms of a disputed insurance policy. ***Jares v. Ullrich***, 2003 WI App 156, ¶27, 266 Wis. 2d 322, 667 N.W.2d 843.

All references to the Wisconsin Statutes are to the 2003-04 version unless otherwise noted.

was still in force after 12:01 a.m. on October 27, 2000. Addison argues that there was no mutual mistake in this case—"any mistakes were solely on the part of Mrs. Phillips"—and therefore the court erred when reforming the contract to keep the policy in force until after the Phillipses and the Korsmos closed on the Crystal Beach Resort property. We disagree.

¶9 Contract reformation is an equitable remedy.[6] ***Jewell v. United Fire & Cas. Co.***, 25 Wis. 2d 509, 517, 131 N.W.2d 276 (1964). If the circuit court determines there is "clear and satisfactory evidence" that "through inadvertence, accident, or mistake" the terms of an insurance contract are not fully or accurately set forth, it may, at its discretion, reform the contract to express the parties' actual intent. ***Id.*** Less proof is required to establish mutual mistake with an insurance contract than with other written instruments. ***Id.***

¶10 It is unclear whether the circuit court treated the cancellation request as an exercise of a contractual right under the Phillipses' original insurance policy or as a separate contract between the parties. Under either theory, however, the court could have concluded that the policy remained in force.

¶11 The general rule is that a contract may be reformed when the "writing that evidences or embodies an agreement in whole or in part fails to express the agreement because of a mistake as to the contents or effect of the writing." ***Vandenberg v. Continental Ins. Co.***, 2001 WI 85, ¶50, 244 Wis. 2d

[6] Wisconsin applies the erroneous exercise of discretion standard to a range of decisions in equity including this one. ***Richards v. Land Star Group, Inc.***, 224 Wis. 2d 829, 847 n.8, 593 N.W.2d 103 (Ct. App. 1999) (citing ***Pouwels v. Cheese Makers Mut. Cas. Co.***, 225 Wis. 101, 106, 37 N.W.2d 869 (1949)).

802, 628 N.W.2d 876 (citing RESTATEMENT (SECOND) OF CONTRACTS § 155 (1979)).

¶12 According to the Common Policy Conditions section of the insurance contract the Phillipses signed in May 2000, the named insured may cancel "this policy by mailing or delivering to us advance written notice of" cancellation; the cancellation notice itself "will state the effective date of cancellation. ... the policy period will end on that day." The circuit court could have concluded that, under the May 2000 contract, the Phillipses and Addision intended to agree that a cancellation would not occur until *after* a cancellation form was signed and not *until* a date and time requested by the client.[7] This shared intent and a mistake as to the effect of the writing in the cancellation provision could thus have justified reformation.

¶13 The court could also, however, have found that the cancellation request was itself a contract by which the Phillipses sought to terminate the Crystal Beach Resort policy at a time specified by them to ensure there were no gaps in their insurance coverage. Based on the record,[8] the circuit court could have found the Phillipses intended to cancel the Crystal Beach Resort policy after the sale closing. In her deposition, Mona testified that she instructed the agency that she and her husband wanted coverage through closing. Addison does not

[7] The policy language suggests the intention that a cancellation request would precede and predate the actual cancellation rather than, as here, ratifying a cancellation that occurred before the request was signed.

[8] The parties stipulated that the circuit court's decision on the four issues should be based only on deposition transcripts and supplemental affidavits. Those transcripts were not submitted to this court as part of the appeal record. Neither party to the appeal objected to their absence nor did they object to any references or citations to individual depositions. Because the parties apparently accept each other's references and citations as authoritative, we do as well.

dispute her testimony nor did it offer any evidence that her instructions were otherwise.

¶14 The record also provides evidence of the agency's intention. One of the agents present on the day Mona signed the cancellation request testified that although the agency typically cancelled policies at 12:01 a.m. on the day of the request, when an insured requested coverage through a date, the cancellation was not noted until 12:01 a.m. the next day. Neither of the deposed agents remembered Mona's transaction, but both testified their job was to do what clients told them to do with regard to cancellation. The circuit court could thus have found that the insurer also intended to keep the Crystal Beach Resort policy in force until after the closing.

¶15 Addison argues that any common intent is irrelevant because the mistake at issue, not reading the cancellation agreement before signing it, was Mona Phillips' alone. In keeping with the general principles of fairness underlying the insurance contract reformation doctrine, Wisconsin courts have rejected that position, holding that an insured's failure to read or know the terms of a policy cannot defeat an action for reformation and that a unilateral mistake by an agent is sufficient grounds for reformation. ***Jewell***, 25 Wis. 2d at 516-17; ***Gilbert v. United States Fire Ins. Co.***, 49 Wis. 2d 193, 204, 181 N.W.2d 527 (1970). Under these facts, a shared intent and a mistake as to the contents of the writing could have justified reformation.

¶16 Based on the record and the applicable law, we thus cannot say the circuit court erred when it concluded that, due to the agent's mistake, the parties' intent to cancel the policy after the closing was frustrated and reformed either the policy or the cancellation notice to give effect to that intention.

¶17 We now turn to the question of whether, in light of our recent decision in another infestation case, the Korsmos' amended complaint establishes a sufficient nexus between the alleged misrepresentation and the alleged damages to create coverage under the commercial general liability section of the Addison policy. *See* ***Jares v. Ullrich***, 2003 WI App 156, ¶2, 266 Wis. 2d 322, 667 N.W.2d 843. If it does, we need not address any other coverage issues raised in this appeal.

¶18 The critical provisions of Addison's commercial general liability policy are familiar ones. Section I, Coverage A, Bodily Injury and Property Damage Liability, begins with an insuring agreement. "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." The insurance applies to property damage only if that damage is caused by an "occurrence." Section V of the policy defines "property damage" as either (1) "physical injury to tangible property, including all resulting loss of use of that property" or (2) "loss of use of tangible property that is not physically injured." That same section defines "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." To trigger an initial grant of coverage for the negligent misrepresentation claim, the Korsmos' complaint must thus allege "property damage" arising out of an "occurrence."

¶19 The majority rule in Wisconsin has been that misrepresentations and omissions cause economic damage rather than "property damage" as defined in insurance contracts. ***Smith***, 226 Wis. 2d at 816-17. The supreme court has recently made clear, however, that this general rule is not without exceptions, "particularly when 'property damage' can include 'loss of use of tangible property that is not physically injured.'" *See* ***id.*** at 816 (quoting ***Sola Basic Indus., Inc. v.***

United States Fid. & Guar. Co., 90 Wis. 2d 641, 654-55, 280 N.W.2d 211 (1979)). ***Smith*** concluded that a negligent misrepresentation claim must "contain some statement about physical injury to tangible property, some reference to loss of use, or some demand for relief beyond money damages if the complaint is to satisfy the requirement that 'property damage' be alleged within the four corners of the complaint." ***Id.*** at 817-18.

¶20 The Korsmos' complaint alleges that "the bats deposited large amounts of guano over their years of the infestation; the bats caused damage to the structural integrity of the home; and there were health risks associated with the bats." The complaint also alleges damages and expenses associated with remediating the bat infestation. Addison admits that damage to the structural integrity of the home is "arguably 'property damage' under the meaning of the Addison policy." Addison contends, however, that an allegation of loss of use is also required and none is alleged in the Korsmos' complaint. We are not persuaded.

¶21 Addison's argument appears to depend on a misreading of our decision in ***Jares***. The Jareses' complaint alleged that the residence they had purchased was so infested with raccoons, dead animal bodies, feces, urine and other matter in the walls and floors that they were unable to move in for several months. ***Jares***, 266 Wis. 2d 322, ¶13. Based on a definition of "property damage" almost identical to the Addison definition, the Jareses' insurers argued that allegations of loss of use, the second category of property damage, had to be accompanied by allegations of physical injury to, or destruction of, tangible property. ***Id.***, ¶15. We rejected that argument because the complaint referenced repair and restoration costs, which clearly implied that loss of use was accompanied by some injury to tangible property. The Korsmos' complaint, by

contrast, alleges damage to the structural integrity of a building.[9] This is a physical injury to tangible property, satisfying the first definition of "property damage" in the Addison policy.[10] We do not address whether the Korsmos' complaint seeks damages for economic loss that might be precluded in a tort action. At the declaratory judgment stage, we consider only whether Addison has a duty to defend. *See, e.g.,* ***id.***, ¶¶17-18.

¶22 In order for coverage to exist under the insuring agreement, however, the Korsmos must also establish a "causation nexus" between the Phillipses' alleged negligent misrepresentation and the damage claimed. *See* ***Smith***, 226 Wis. 2d at 823. Critical to that nexus is a single, uninterrupted cause resulting in all injuries and damages. ***Id.*** In ***Jares***, we determined that a causation nexus existed because the buyers discovered the property damage soon after the property changed hands. The sellers controlled the property up to the time of sale, the damage was to a residence in existence, and there were no intervening negligent acts by any third parties. ***Id.***, ¶23. In addition to this "unbroken chain" of events, we noted that the complaint expressly alleged the negligent misrepresentation induced, or caused, the purchasers to buy the property. ***Id.***, ¶25.

[9] We have said in the past that because the measure of damages awarded in a successfully litigated claim for negligent misrepresentation is the difference between the fair market value of the property at the time of the sale and the amount actually paid, the damages alleged are pecuniary in nature and do not constitute property damage. ***Qualman v. Bruckmoser***, 163 Wis. 2d 361, 366, 471 N.W.2d 282 (Ct. App 1991). We later clarified the grounds of that decision when we determined that when a complaint did not allege that the misrepresentation caused damage to property—only economic loss with regard to the value of the property—there was no property damage. ***Benjamin v. Dohm***, 189 Wis. 2d 352, 361, 525 N.W.2d 371 (Ct. App 1994). In the wake of ***Smith***'s causation nexus test, we have concluded that an express allegation that a misrepresentation caused the loss of use of damaged property can constitute property damage under a commercial general liability policy. *See* ***Jares***, 266 Wis. 2d 322, ¶25.

[10] Although not argued on appeal, some loss of use can be inferred from the complaint as well as based on allegations of health risks and repair and remediation costs.

¶23 Like the Jareses, the Korsmos bought an existing property that had been in control of the sellers until the time of the sale and subsequently discovered an ongoing infestation that had damaged their property. No third party was involved, nor was any outside negligence alleged. The chain of causation here is single and uninterrupted. The Korsmos' complaint does not specifically allege that the negligent misrepresentation induced them to buy the property. However, the complaint's references to the actual condition of the residence at the time of sale and the effect of the infestation on the property's value imply the Korsmos would not have entered into this contract except for the Phillipses' alleged misrepresentation. We therefore conclude that, under ***Smith*** and ***Jares***, the Korsmos' complaint sufficiently alleges a causation nexus to trigger an initial grant of coverage.

¶24 Because we conclude that the Phillipses' complaint establishes a sufficient nexus between the alleged misrepresentation claim and the alleged damages to create coverage, Addison has a duty to defend under the commercial general liability portion of the Phillipses' policy. We therefore affirm the judgment without addressing any other coverage claim raised by this appeal.

By the Court.—Judgment affirmed.

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