SANDBERG PHOENIX

PROFESSIONAL LIABILITY BLOG

Insurance Applications Matter – Montana Supreme Court holds one attorney's failure to disclose potential malpractice claim precluded coverage for claim against entire law firm

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Background

A law firm was seeking Professional Liability ("PL") coverage through a new carrier. As such, each attorney had to fill out a form attesting to the fact they had no knowledge of any potential legal malpractice claims. One attorney who so attested had knowledge of two separate potential malpractice incidents involving the same client – discovery sanctions in one case and a default judgment in another – yet did not disclose either of these incidents on the form, which was part of the firm's application for PL coverage. After the policy went into effect, the attorney, along with his firm and two other attorneys, were sued for malpractice. No one at the firm other than the attorney who committed the malpractice knew of the potential claims prior to the issuance of the policy. When they did become aware, which was several months after the policy had gone into effect, the firm put its new PL carrier on notice. The insurer, however, denied coverage for the firm and all three attorneys and then filed a declaratory judgment action. Summary judgment was granted to the insurer in the declaratory judgment action, and the case made its way to the Supreme Court of Montana.

Court's Holding

The Montana Supreme Court did not base its ruling on misrepresentations made on the application of insurance, as may have been expected. Rather, the court noted that "claims-made" and "claims-made-and-reported" insurance policies were developed to limit an insurer's risk by placing a "temporal limitation on coverage," noting known loss provisions reinforce the common law principle that one may not insure a loss already in progress or for which the insured is already aware. *Id*. at 645. Specifically, the court relied on two separate provisions within the policy. First, the court held a provision in the insuring agreement stating coverage only exists if no insured knows or reasonably should have known or foreseen the claim is a condition precedent to coverage. Even though only the attorney who committed the acts knew of the potential claim prior to the issuance of the policy, the court held it applied to the entire firm and to the other two attorneys named as defendants because coverage is tied to the "claim" itself and cannot be divided based on which insured had – or did not have – knowledge. In its analysis, the court also rejected an argument the common law "innocent insured" doctrine should apply and provide coverage for the other two attorneys, as this doctrine cannot be used to displace clear and unambiguous provisions of an insurance policy. *Id*. at 645-646.

Because a condition precedent to coverage was not met, the court concluded the district court did not need to rule on the applicability of any exclusions. However, the court affirmed, if relevant, the exclusions also would have precluded coverage for the entire firm. The primary applicable exclusion applied if *any* insured failed to give notice to the insurer prior to the effective date of the policy of a claim or potential claim. *Id*. at 645. The court also rejected arguments the innocent insured provision within the policy applied – because it only applies to fraud or bad acts by an insured – and that the reasonable expectations doctrine applied, as "no reasonable attorney would expect an insurer to cover a malpractice claim that existed prior to the inception of the policy when the malpractice was known to an attorney in the firm." *Id*. at 648.

Takeaway

There are two important take-aways from this Montana Supreme Court opinion. First, insurance applications matter and are not just formalities. An honest assessment of not just claims, but potential claims, needs to be made, as the failure to do so cannot only preclude coverage for the attorney who committed the alleged malpractice, but for any other attorney against whom the claim has been made, even if the other attorneys had no knowledge of the claim or the potential for a claim. Second, this condition precedent to coverage in most PL policies applies not only to claims, but to potential claims. Therefore, it is better to err on the side of disclosure than to risk the preclusion of coverage for an attorney and his or her entire firm. In the *ALPS Casualty* case, the default judgment for which coverage was precluded for the subsequent malpractice claim was for $2.2 million, so the consequences of failure to disclose a claim or potential claim can be significant and have dire consequences.

Case Citation: *ALPS Property & Casualty Insurance Company v. Keller Reynolds, Drake, Johnson & Gillespie, P.C.*, 483 P.3d 638 (Mont. 2021)