IN THE SUPREME COURT OF THE STATE OF MONTANA

DA 20-0238

ALPS PROPERTY & CASUALTY INSURANCE COMPANY, d/b/a Attorneys Liability Protection Society, A Risk Retention Group,

Plaintiffs/Appellees,

vs.

KELLER, REYNOLDS, DRAKE, JOHNSON & GILLESPIE, P.C., RICHARD GILLESPIE, BRYAN SANDROCK, GG&ME, LLC, a Montana Limited Liability Company, and DRAES, INC., a Montana Close Corporation, CHARLES JOSEPH SEIFERT and THOMAS Q. JOHNSON,

Defendants/Appellants.

REPLY BRIEF OF APPELLANTS KELLER, REYNOLDS, DRAKE, JOHNSON & GILLESPIE, P.C., AND CHARLES J. SEIFERT AND THOMAS Q. JOHNSON

ON APPEAL FROM THE MONTANA FIRST JUDICIAL DISTRICT COURT, LEWIS & CLARK COUNTY
HON. MIKE MENAHAN, PRESIDING

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TABLE OF CONTENTS

TABLE OF CASES

TABLE OF CASES (continued)

TABLE OF STATUTES

INTRODUCTION

ALPS argues that attorney Richard Gillespie knew or should have known that the entry of default and/or sanctions order against Sandrock was sufficient to put him on notice that it may be the basis of a claim, and that the policy's "prior knowledge" provisions provide a blanket exclusion that applies to all claims against the Keller Firm and its other attorneys irrespective of whether they had knowledge of Gillespie's acts or omissions. ALPS claims that the exclusionary language extends to direct and separate negligent supervision claims against attorneys Seifert and Johnson even though they did not have knowledge of Gillespie's alleged acts or omissions before the policy's effective date, and they could not have had any reason to know that such claims could be asserted against them because they did not supervise Gillespie. The prior knowledge provisions only apply to the acts or omissions known by Gillespie and do not apply to the claims against the Firm's other attorneys, including the claims for negligent supervision.

ALPS seeks to distinguish *ALPS Property and Casualty Insurance Company v. McLean & McLean, LLP*, 2018 MT 190, 392 Mont. 236, 425 P.3d 651, by claiming that it involved a rescission issue and that it did not involve the denial of coverage based on a prior knowledge exclusion. But the *McLean* holding cannot be applied as narrowly as ALPS claims and the case did involve denial-of-

coverage issues. In *McLean*, the Court held that one partner's failure to make accurate disclosures on the insurance application presented a basis to deny coverage for that partner but that it had no bearing on the policy's application to the non-culpable partner.

Furthermore, the reasonable expectations doctrine provides a legitimate and separate basis to afford coverage for the Firm and its attorneys who had no prior knowledge of Gillespie's alleged acts or omissions and who paid premiums to obtain insurance coverage. Under ALPS' position, no attorney employed with a law firm in Montana could be reasonably assured that he or she would be adequately protected from claims or potential claims that relate to an act or omission of another attorney who was supposed to but did not disclose the information to an insurer before the policy's effective date. Under the facts of this case, the Firm and attorneys Johnson and Seifert are entitled to coverage under the ALPS' policy.

ARGUMENT

I. The Holding in *McLean* Supports a Finding of Coverage.

ALPS did not analyze the *McLean* case until near the end of its brief. ALPS stresses that the focus of this Court's ruling concerned the issue of whether the ALPS' policy could be rescinded. (Plaintiff's Brief, pp. 40-41) The case, however, also addressed the issue of whether claims against the culpable partner,

David McLean, and the firm could be denied. This Court held that M.C.A. § 33-15-403 created a remedy at law to "prevent a recovery" under an insurance policy if the specific elements of the statute were established. *Id.*, ¶25. One of the specific elements of the statute relates to "misrepresentations or "concealment of facts." § 33-15-403(2). As this Court stated: "ALPS may properly deny coverage under § 33-15-403, M.C.A., for claims made against David and M&M because of David's misrepresentations on the application, both in his individual capacity and as the representative of M&M . . . The prevention of recovery under the Policy as to David and M&M does not bear on the Policy's application to Michael [McLean] . . ." *Id*, ¶ 31. This Court held that David's "bad acts, and knowledge of the bad acts . . . is not imputed to Michael." *Id.*

One of the claims addressed in *McLean* was a third-party claim asserted by Mientae McConnell which was based on David's bad acts that occurred before the effective date of the policy. *Id.*, ¶ 9. The Court held that there was no coverage for that claim based on Exclusion 3.1.1 of the ALPS policy, which barred coverage for dishonest, fraudulent, criminal acts, etc. *Id.*, ¶ 41. A fair reading of the *McLean* decision indicates that the innocent partner, Michael, was entitled to continued coverage under the policy, including coverage for claims arising from his failure to supervise his partner.

Justice Rice recognized such coverage under the Court's holding in his dissent. *Id.* ¶ 62. ALPS, however, claims that Justice Rice did not opine that there was an entitlement to coverage in the event claims were asserted against the non-culpable attorney, and that he only indicated that a claim might be asserted against a non-culpable party in an effort to trigger coverage resulting in unfounded claims and increased liability for firms. (ALPS' brief, p. 43) To the contrary, what Justice Rice said is that Michael's counsel admitted that "negligent supervision" claims could be brought against Michael and that "mandating coverage could prompt such claims, for example, for negligently failing to sufficiently monitor the actions being taken by his sole partner . . ." *McLean*, ¶ 62. Justice Rice did not say or indicate that these claims were excluded from coverage under the Court's decision. Although the Court's majority opinion expressed its disagreement with the dissent in various respects, it did not express any disagreement regarding that issue.

ALPS states that it appears that Appellant Sandrock filed a claim against attorneys Seifert and Johnson for failure to "monitor and supervise" Gillespie's work in response to Justice Rice's dissent. (ALPS brief, p. 43) It may be true that Sandrock relied on the Court's decision in asserting the negligent supervision claims. And attorneys Johnson and Seifert are entitled to coverage for those claims based on the holding in *McLean* as well as the terms of the policy.

It is also noted that in *McLean*, this Court held that David's misrepresentations regarding his culpable conduct were not just attributable to him, but they were attributable to his firm because he was acting as the representative of the firm during the application process. That is not the case here. Mr. Gillespie was not an owner, director, or shareholder in the firm and he was not representing the firm during the application process.

ALPS addresses the Court's statement in *McLean* that "if one lawyer in a 100-person law firm lied on an insurance application, the other 99 premium paying lawyers would be excluded from coverage and exposed to potential liability notwithstanding a complete lack of culpability on their part." (Plaintiff's Brief, pp. 40-41) ALPS states that the representation issues in the case were "central only to the issue of rescission." (*Id.* at p. 41) ALPS argues that if one attorney in a large firm knew of omissions before the effective date of the policy, then all claims arising from the omission should not be covered, stating "that's just as it should be . . ." (*Id.*, p. 42)

It is submitted that the Court's hypothetical example has the same persuasiveness whether the issue relates to rescission of the policy or the denial of claims against other attorneys in the firm who did not have knowledge of the culpable attorney's omissions. Under either scenario, the non-culpable attorneys

would expect that they would be covered under their policy for unknown and unexpected claims against them.

II. The Prior Knowledge Exclusions Do Not Preclude Coverage for the Claims Against Attorneys Johnson and Seifert.

ALPS contends that the prior knowledge provision under Section 1.1.2 is a "condition precedent to coverage" and that the Firm and its attorneys have failed to meet their burden of establishing that the asserted claims fall within the general coverage provision of the policy. (*Id.*, pp. 17, 18 and 22) ALPS does not dispute that an insurer has the burden of proving the application of a policy exclusion. (*Id.* at p. 17)

However, ALPS' contention that the Firm and its attorneys have the burden of proving that the claims falls within the scope of coverage under Section 1.1.2 is not consistent with Montana law and is incorrect. Plaintiff cites *Bryan Bros. Inc. v. Cont'l Cas. Co.*, 660 F.3d 827, 830-31 (4th Cir. 2011), which held that a prior knowledge provision is a condition precedent to coverage. But under Montana law, "exclusions" and "words of limitation" in a policy "must be strictly construed against the insurer." *Leibrand v. National Farmers Union Property and Cas. Co.*, 272 Mont. 1, 6, 898 P.2d 120, 122-123 (1995). The language in Section 1.1.2 that states that there is coverage provided that no insured "knew or reasonably should have known" that the act, error or omission might be the basis of a claim, are

words of limitation, and are subject to the rule of strict construction to the same extent as an exclusionary provision. This is not disputed by ALPS.

Whether the prior knowledge language in Section 1.1.2 is placed in the coverage provision as opposed to the Exclusions section makes no difference. The limiting language must be strictly construed against ALPS and ALPS has the burden of establishing its applicability. In *Foster v. West Chester Fire Insurance Company*, 2012 WL 2402895 (W.D. Penn. 2012), the Court rejected the holding in *Bryan Bros*. that a prior knowledge provision contained in a policy's insuring provision was a condition precedent to coverage. The Court construed the provision as an exclusion and required the insurer to prove its applicability, stating "it is irrelevant under what heading in the policy the insurer chooses to place the exclusion." *Id*., *6 (quoting *Titan Indem. Co. v. Cameron*, 2002 WL 1774059, at *11 n. 12 (E.D. Pa. 2002). *See also Stonewall Ins. Co. v. Asbestos Claims Mgmt. Corp.*, 73 F.3d 1178, 1205 (2nd Cir. 1995) ("[U]nder New York law, the exclusionary effect of policy language, not its placement, controls the allocation of the burden of proof"). The holdings of these cases are consistent with Montana law. ALPS has the burden of proving the applicability of its policy exclusions regardless of where they are placed in the policy, and they must be strictly construed against ALPS.

ALPS contends that the firm and attorneys Johnson and Seifert are attempting to apply the policy's provisions to individual attorneys "rather than to a claim." (Plaintiff's Brief, p. 28) ALPS states that the policy does not allow a claim to be divided into parts based on the knowledge of each firm member and that claims-made policies are typically written to exclude coverage for claims the insured knew of prior to the inception of the policy. (*Id.*, citing *Capitol Specialty Ins. Co. v. Big Sky Diagnostic*, 2019 WL 1245642, *10) ALPS claims that because Gillespie had knowledge of a potential for a claim, the claim "in its entirety" falls outside the scope of coverage. (*Id.* at p. 30)

ALPS' argument is not persuasive and does not establish that the cited exclusionary provisions may bar coverage for claims other than those asserted against Gillespie. ALPS does not address the policy definition of "Claim" in its brief. The policy defines a "Claim" as a "demand for money or services . . ." (Policy, Definitions, Section 2.3, Policy, p. 4) The language at issue in Section 1.1.2 and Exclusion 3.1.5 concern prior knowledge of the "act, error, or omission" that may be the basis of a "Claim." The claim against Gillespie is not the same as the claims against Johnson and Seifert. The claim against Gillespie is based on his alleged failure to timely file an answer (and acts relating to the entry of a sanctions order on a discovery issue). The claims against Seifert and Johnson are based on their alleged negligent supervision of Gillespie's work. ALPS argues for a policy

interpretation that Gillespie's prior knowledge of his alleged omission is sufficient to bar coverage for negligent supervision claims against Johnson and Seifert. But a claim for negligent supervision is based on different acts or omissions, including a breach of alleged duties relating to what attorneys Johnson and Seifert allegedly did or did not do.

There is no evidence, nor has any allegation been made, that any member of the Firm had prior knowledge of any alleged acts or omissions with respect to the supervision of Gillespie's work. Gillespie has been in the practice of law for more than 40 years, and neither Johnson nor Seifert supervised his work. (See Affidavits of Charles J. Seifert and Thomas Johnson, App. 2 and 3)

ALPS cites no legal authority in support of its argument that the prior knowledge provisions bar separate negligent supervision claims against other attorneys in the firm. The prior knowledge provisions are subject to the rule of strict construction against ALPS and they may not be interpreted to bar coverage for the individual claims against Seifert and Johnson.

ALPS also seeks to distinguish *Wasik v. Allstate Ins. Co.*, 813 N.E.2d 1152 (Ill. App. 2004). ALPS claims that the case is distinguishable because it did not address prior knowledge provisions like those at issue here. (ALPS Brief, p. 33) However, *Wasik* addressed the similar issue of whether a misrepresentation made by one insured that was relevant to policy coverage was clear in barring coverage

for all other insureds who did not have knowledge of the misrepresentation. The Court found that the provision was ambiguous. In this case, there is a sufficient basis to conclude that the ALPS' policy provisions do not bar all attorneys from obtaining coverage, particularly with respect to claims for negligent supervision.

III. The Reasonable Expectations Doctrine Applies.

ALPS argues that the policy exclusions clearly exclude coverage for all claims asserted and that there is no basis to apply the reasonable expectations doctrine. Although the exclusions do not bar coverage against attorneys Johnson and Seifert, the reasonable expectations doctrine applies even if the policy language is unambiguous. *See Meadow Brook, LLP v. First Am. Title Ins. Co.*, 2014 MT 190, ¶ 14, 375 Mont. 509, 329 P.3d 608. The doctrine applies "even though painstaking study of policy provisions would have negated those expectations." *Id.*, ¶ 15.

ALPS argues that there should be no reasonable expectation of coverage for any of the insured attorneys citing the example of a homeowner who should not expect coverage for a house "that was already on fire." (*Id.*, at p. 31-32) ALPS further states that an insured should recognize an insurer's right to protect against a professional who "recognizing his past error or omission" rushes to purchase a claims-made policy before the error is discovered and a claim asserted against him. (*Id.*) ALPS also asserts that a "reasonable attorney" understands the importance of

providing accurate information when seeking coverage and that providing false or misleading information on an application constitutes the crime of insurance fraud. (*Id.*)

These arguments do in fact apply to the case where a particular attorney has prior knowledge of an error that would be the basis of a claim. But no other attorney in the firm, including Johnson and Seifert, had any knowledge of a potential for a claim before the policy was purchased. Moreover, M*cLean* rejected the argument that an attorney's misrepresentation on an application bars all other attorneys from recovering.

ALPS also states that "no attorney reasonably expects coverage for a claim which pre-exists the policy's inception when a firm member had prior knowledge of the acts giving rise to the claim." (*Id.* at 34) It is agreed that no attorney would expect coverage when that attorney has knowledge of the acts giving rise to a claim; however, ALPS is wrong in stating that if one firm member had such knowledge, then all other attorneys in the firm would expect that they would have no entitlement to coverage, particularly with respect to claims for negligent supervision. Attorney and law firms purchase professional liability coverage for a specific purpose, i.e., to protect them from liability for malpractice claims. Certainly, no attorney would expect coverage for any act or omission known by

that attorney; however, that is not what we are dealing with here with respect to the claims against the Firm and its other members.

IV. The Innocent Insured Doctrine Support Application of the Reasonable Expectations Doctrine.

ALPS argues that the Firm and its members are claiming that coverage exists under the policy's innocent insured exception. (ALPS Brief, pp. 35-36) That is not an accurate assessment of what the Firm and its members claim. What they have said is that in *McLean*, this Court relied on the policy's innocent insured exception because it supported the Court's conclusion that Michael McLean had a "reasonable expectation" that he would be entitled to maintain coverage under the policy regardless of David's misrepresentations. Michael was not culpable, and he did what he was required to do under the policy in notifying ALPS upon learning of David's bad acts. (See *McLean*, ¶¶ 35-38)[1]

The same type of situation exists here. Attorneys Seifert and Johnson were not involved in the representation of Sandrock, they did not supervise the work of attorney Gillespie, and they had no knowledge of the facts relating to his alleged negligence, including the entry of default. Gillespie was the only attorney in the Firm who had such knowledge. Once attorneys Seifert and Johnson learned of the

[1] The Firm (and attorneys Johnson and Seifert) acknowledged in their opening brief that the innocent insured exception under Section 4.3.1 does not provide an independent basis for coverage. (Opening Brief, p. 22) This Court in *McLean* relied on Section 4.3.1 in finding that coverage was afforded under the reasonable expectations doctrine. *McLean* did not state that the type of wrongful conduct excluded under Section 3.1.1 was necessary to invoke the reasonable expectations doctrine. But the Firm nevertheless noted that the alleged wrongful acts of Gillespie were deliberate which may be construed to rise to the level of acts excluded under Section 3.1.1. (*Id.*, p. 23)

entry of default that resulted from Gillespie's omission, the matter was immediately reported to ALPS. At the time the firm applied for malpractice insurance, no other member of the firm had knowledge of any information concerning potential claims that could be reported, and they had no information that could have been reported to the firm's prior malpractice insurer during the effective period of that policy.

V. The Common Law Innocent Insured Doctrine Should Be Adopted.

ALPS attempts to distinguish cases from other jurisdictions which afforded coverage to an innocent insured by stating that they either involved deliberate conduct by one insured, which is not present here, or the cases did not directly address the common law doctrine. ALPS' Brief, p. 38-39 (*citing Jensen v. Snellings*, 841 F.2d 600 (5th Cir. 1988), and *Perl v. St. Paul Fire and Marine Ins.*, 345 N.W.2d 209 (Minn. 1984)). Although ALPS seeks to distinguish this line of cases, ALPS does not dispute that there is ample authority from other jurisdictions that have endorsed coverage under the common law doctrine. The relevant cases also did not limit their holdings to cases involving deliberate conduct.

ALPS also claims that Montana law is settled based on *Woodhouse v. Farmers Union Fire Ins. Co.*, 241 Mont. 69, 785 P.2d 192 (1990), where the Court denied coverage for one insured whose former spouse intentionally set fire to their residence and committed suicide inside the burning dwelling. The case involved

an intentional act exclusion, which is not at issue here. The Court's adoption of the innocent insured doctrine would provide a separate basis to allow coverage for the Firm and attorneys Johnson and Seifert. *Woodhouse* would not prevent this Court from adopting the innocent insured doctrine in a case involving the different policy provisions that are at issue here.

VI. The Known Loss Doctrine Does Not Apply to the Claims Against Johnson and Seifert.

ALPS asserts that insurance "does not cover known losses," citing *Sapp v. Paul Revere Life Ins. Co*., 1994 WL 259328, 28 F.3d 108 (9th Cir. 1994). (ALPS Brief, p. 13) ALPS further states that claims-made policies are typically written to "exclude claims the insured knew of prior to the policy." (*Id.*, *citing Capitol Specialty*, 2019 WL 1245642 (D. Mont. 2019). Amicus Curiae, American Property and Casualty Company ("American Property"), raises the same argument in its brief. (See Brief, of American Property and Casualty, 10/19/2020)

It is not disputed that insurance does not cover "known" losses, and/or losses "in progress," and the examples cited by both ALPS and American Property concerning the purchase of insurance after the "house is burning" does not apply to the claims against Johnson and Seifert. There was no "known" loss at anytime before the effective date of ALPS' policy. In fact, no loss had occurred as a result of the entry of default in September 2015. A loss did not occur until a default

judgment was entered and that did not happen until well after the effective date of the policy.

Certainly, the exclusion of coverage for claims against Gillespie would be proper in the event the Court finds that that there is no issue of fact about whether his knowledge was sufficient to invoke the prior knowledge provisions. But the known loss argument does not apply to the claims against Johnson and Seifert because they lacked knowledge. ALPS' known loss argument adds nothing to their claim that there is no coverage for the claims against attorneys Seifert and Johnson.

It is important to note that a claims-made policy, including the one at issue here, does not bar coverage for acts that occurred prior to the effective date of the policy. It is only when the prior knowledge exclusion (or some other exclusion) applies to bar coverage. Those exclusions should not apply with respect to the claims against the Firm, and its members Seifert and Johnson, and affording coverage to them does not conflict with the known loss doctrine.

VII. The Firm and Attorneys Johnson and Seifert Complied with the Policy's Notice Requirement.

ALPS claims that coverage is not available due to late notice. (ALPS Brief, p. 23) ALPS cites policy provision 4.6.1 which states that an insured is required to give "immediate" notice to ALPS of the commission of any act, error, or omission.

(*Id.*) ALPS also alleges that Gillespie should have given notice to the prior insurer, Carolina Casualty, before the effective date of the ALPS policy. (*Id.*)

To the extent the notice provisions may provide a basis for denial of coverage, they could only apply to attorney Gillespie because he was the only attorney who had knowledge. ALPS does not contend that the notice provision under section 4.6.1 applies to an attorney who did not have knowledge of an act or omission, or knowledge of an actual or potential claim, including a claim for negligent supervision. The other members of the firm also had no information to report to the prior insurer. The cited exclusion, at Section 3.1.5, has already been addressed and may not be construed to bar coverage to attorneys who did not have knowledge of another attorney's act or omission that may be the basis of a claim.

CONCLUSION

The Court should hold that the Firm and its members, Joe Seifert and Tom Johnson, are entitled to coverage under the ALPS' malpractice policy. It is undisputed that attorney Gillespie is the only member of the Firm who had knowledge of his alleged acts or omissions at any time before the effective date of the policy. The Firm, including Johnson and Seifert, notified ALPS just as soon as they became aware of the circumstances of the entry of default against Sandrock. This Court should reject ALPS' expansive interpretation of its prior knowledge exclusions. These provisions must be strictly construed against ALPS and ALPS

has the burden to prove that they apply, which they cannot do with respect to the claims against the Firm and attorneys Johnson and Seifert.

RESPECTFULLY SUBMITTED this 16th day of November, 2020.

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 11 of the Montana Rules of Appellate Procedure, I certify that this brief is printed with a proportionately spaced Times New Roman text typeface of 14 points; is double spaced; and the word count calculated by Microsoft Word is 3,942 words**,** not averaging more than 280 words per page, excluding the Certificate of Service and Certificate of Compliance.

DATED this 16th day of November, 2020.

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