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***Tidyman's Management Services, Inc. v. Davis: The Duty to Defend Is Irrevocable in Montana***

**Carrie Gibadlo**

I. INTRODUCTION

In *Tidyman's Management Services, Inc. v. Davis*,<sup>1</sup> (*Tidyman's*) the Montana Supreme Court neglected to address the underlying issue: whether an insurer's duty to defend is revocable. Although the Court did not directly address revocability, the holding requires an insurer to provide defense after it acknowledges a duty to defend even if the insurer knows of information that undisputedly negates coverage. Therefore, the Court indirectly held the duty to defend is irrevocable. The holding is consistent with legislative intent.

II. *TIDYMAN'S MANAGEMENT SERVICES, INC. V. DAVIS*

A. *Facts*

The plaintiff employees filed a complaint in federal court against the officers and directors of Tidyman's, including Michael Davis (Davis) and John Maxwell (Maxwell).<sup>2</sup> The complaint alleged breach of corporate and fiduciary duties for misrepresenting the merit of a merger between Tidyman's and SuperValu.<sup>3</sup> The other Tidyman's officers and directors settled their claims.<sup>4</sup> National Union Fire Insurance Company (National Union) provided defense to Davis and Maxwell in federal court until the case was dismissed without prejudice.<sup>5</sup> The plaintiffs then filed a complaint in state district court against Maxwell and Davis alleging the same claims previously filed in federal court.<sup>6</sup> When the plaintiffs filed the state court claim, Tidyman's was added as a plaintiff.<sup>7</sup>

After the state court litigation commenced, Chartis Claims, Inc. (Chartis), which managed claims on behalf of National Union, sent Maxwell's and Davis's counsel a letter stating National Union would not cover their defense because the insurance policy's "insured v. insured"

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<sup>1</sup> *Tidyman's Mgt. Servs. Inc. v. Davis*, 330 P.3d 1139 (Mont. 2014). This Case Note will not address the Montana Supreme Court's order to the district court to consider the substantive reasonableness of the stipulated settlement nor the Court's third ruling on the resolution of conflict of law issues where an insurance contract does not contain a choice-of-law provision.

<sup>2</sup> *Id.* at 1143.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Tidyman's Mgt. Servs.*, 330 P.3d at 1143.

<sup>7</sup> *Id.*

exclusion allowed National Union to deny coverage where one party insured under a policy sued another party insured under the same policy.<sup>8</sup> Maxwell, Davis, and Tidyman's were insured by National Union, implicating the exclusion.<sup>9</sup> Davis's and Maxwell's counsel wrote Chartis on three occasions to inquire whether National Union would continue to provide coverage.<sup>10</sup> After the third letter, counsel for Chartis replied and denied coverage.<sup>11</sup> While waiting for a response, Davis's counsel filed a stipulation agreement alleging National Union wrongfully denied defense.<sup>12</sup> Before judgment on the stipulation, a National Union representative wrote to Maxwell and Davis and advised them that National Union would advance defense costs subject to a full reservation of rights.<sup>13</sup> After receiving the letter from National Union, Maxwell and the plaintiffs filed an identical stipulation to the one Davis had moved to approve and the plaintiffs moved for summary judgment alleging National Union breached its duty to defend.<sup>14</sup> The district court held that National Union breached its duty to defend and granted the plaintiffs' motion for summary judgment and motions to approve stipulations for entry of judgment.<sup>15</sup>

### *B. Majority Holding*

In a four-to-one majority opinion authored by Justice Mike Wheat, the Montana Supreme Court affirmed the district court's finding that National Union breached its duty to defend.<sup>16</sup> The Court held that National Union's duty to defend was triggered by the federal complaint because the plaintiffs alleged facts which were clearly covered under the policy.<sup>17</sup> The Court noted that National Union acknowledged the policy was implicated in federal court by defending the claim.<sup>18</sup> Therefore, the district court was correct to refuse to analyze coverage under the state court complaint.<sup>19</sup> The Court held that "all that matters is that National Union was on notice that the Policy was potentially implicated."<sup>20</sup> The Court reiterated that insurers should defend under a reservation of rights and seek a determination of coverage through a declaratory judgment.<sup>21</sup>

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<sup>8</sup> *Id.* at 1143–1144.

<sup>9</sup> Appellant's Br., *Tidyman's Mgt. Servs. Inc. v. Davis*, 2013 WL 6048695 at \*33 (Mont. Aug. 1, 2014) (No. DA 13-0228).

<sup>10</sup> *Tidyman's Mgt. Servs.*, 330 P.3d at 1144.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 1144–1145.

<sup>15</sup> *Id.* at 1146.

<sup>16</sup> *Tidyman's Mgt. Servs.*, 330 P.3d at 1150–1151.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 1150.

<sup>21</sup> *Id.* at 1151.

### C. Dissenting Opinion

Justice Laurie McKinnon argued that the Majority contradicted precedent by refusing to consider whether the facts alleged in the state complaint implicated policy coverage.<sup>22</sup> She contended that an insurer has a right to deny defense due to policy exclusions and the Court must consider the policy before imposing a duty to defend.<sup>23</sup> In her opinion, by holding the duty to defend hinges on notice rather than the content of the notice, the Majority's analysis expands the duty to defend.<sup>24</sup>

### III. ANALYSIS

*Tidyman's* is a case of first impression in the Court with two factors distinguishable from precedent: (1) the insurer was notified about the allegations of a claim in two complaints, in contrast to one, which provided the insurer with additional information; and (2) the insurer acknowledged a duty to defend in the federal action but attempted to revoke defense prior to litigation in state court. The opinion is significant for what the Court indirectly decided: in Montana, the duty to defend is irrevocable. The holding expands Montana's duty to defend and confirms the Legislature's intent to define the duty to defend broadly to protect the insured.

#### A. Tidyman's Qualifies Precedent in Montana

Under Montana law, the duty to defend arises when the insurer receives notice of a risk covered under a policy by looking at allegations of a claim in the complaint.<sup>25</sup> In *Farmers Union Mutual Insurance v. Staples*,<sup>26</sup> the plaintiff alleged that the defendant co-owned horses and as a result was covered under a third-party's insurance policy.<sup>27</sup> The insurer denied defense after deciding the defendant was not a co-owner.<sup>28</sup> The Court found that the insurer erred in denying defense because ownership was a disputed fact and therefore must be resolved in favor of coverage.<sup>29</sup> If policy coverage is invoked in the complaint, the Court does not analyze disputed facts, but rather it confines the duty to defend analysis to the complaint.<sup>30</sup> An insurer has a duty to defend

<sup>22</sup> *Id.* at 1158–1159 (McKinnon, J., concurring in part and dissenting in part).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 1160.

<sup>25</sup> *Grindheim v. Safeco Ins. Co. of Am.*, 908 F.Supp 794, 798 (D. Mont. 1995).

<sup>26</sup> 90 P.3d 381 (Mont. 2004).

<sup>27</sup> *Farmers Union Mut. Ins. Co. v. Staples*, 90 P.3d 381, 383 (Mont. 2004).

<sup>28</sup> *Id.* at 384.

<sup>29</sup> *Id.* at 385.

<sup>30</sup> *Id.* at 386.

when facts alleged in the complaint clearly come within coverage of the insurance policy.<sup>31</sup>

In *Tidyman's*, the facts in the federal complaint clearly invoked policy coverage, but the insurer had knowledge of undisputed facts that negated coverage. Unlike the insurer in *Staples* that denied defense based on factual disputes, National Union denied defense because Tidyman's was added as a plaintiff and invoked the "insured v. insured" exclusion. The Court did not find that the facts were disputed.<sup>32</sup> Instead, the Court referred to the facts as irrelevant, because the complaint implicated coverage.<sup>33</sup> Without evaluating the facts, the Court relied upon *Staples* to confine its analysis to the facts alleged in the federal complaint.<sup>34</sup> However, the Court failed to acknowledge that factual disputes are significantly different than undisputed facts when determining whether an insurer has a duty to defend.

Under Montana law, when the insurer learns of additional, undisputed facts, the insurer can use the information to negate or invoke coverage.<sup>35</sup> If the insurer considers facts outside of the complaint, and incorrectly denies coverage, the insurer is estopped from denying coverage and becomes liable for costs and judgments.<sup>36</sup> Thus, an insurer considers facts outside of a complaint at its own risk.<sup>37</sup>

In *Burns v. Underwriters Adjusting Co.*,<sup>38</sup> the insured was charged with aggravated assault.<sup>39</sup> The complaint alleged negligence, which implicated the policy; however, the insured recorded a statement causing the insurer to believe the altercation was intentional and not self-defense.<sup>40</sup> Because the acts were not actually negligent, the insured was not covered under the policy.<sup>41</sup> As a result, the insurer refused defense.<sup>42</sup> The Court upheld the insurer's refusal to defend, despite the complaint's implication of the policy, because the undisputed facts in the case clearly showed that the policy excluded coverage.<sup>43</sup>

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<sup>31</sup> *Id.*

<sup>32</sup> *Tidyman's Mgt. Servs.*, 330 P.3d at 1150.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *E.g., Burns v. Underwriters Adjusting Co.*, 765 P.2d 712 (Mont. 1988); *Revelation Indus v. St. Paul Fire & Marine Ins. Co.*, 206 P.3d 919 (Mont. 2009).

<sup>36</sup> *Tidyman's Mgt. Servs.*, 330 P.3d at 1149.

<sup>37</sup> *Id.*

<sup>38</sup> 765 P.2d 712 (Mont. 1988).

<sup>39</sup> *Id.* at 712.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 713.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

Conversely, in *Revelation Industry v. St. Paul Fire and Marine Insurance Company*,<sup>44</sup> the plaintiff alleged that damages were caused by the insured manufacturing defective merchandise; however, a subcontractor actually produced the products.<sup>45</sup> The insurance policy covered subcontractors who produced defective products, but not the insured.<sup>46</sup> The insurer knew the subcontractor actually manufactured the products, yet denied defense.<sup>47</sup> The Court held the insurer had a duty to defend because, based on the undisputed facts, the policy was clearly implicated.<sup>48</sup> An insurer cannot ignore known facts which compel coverage even if the factual allegations in the complaint do not fall under the policy.<sup>49</sup>

In *Tidyman's*, the majority failed to consider that undisputed facts outside of the complaint can be considered to determine coverage,<sup>50</sup> and therefore undisputed facts are relevant. Under Montana Law, the Court only confines its analysis to the complaint when additional facts are disputed.<sup>51</sup> In *Tidyman's*, like in *Burns*, the insurer learned of undisputed facts which negated policy coverage. Like in *Revelations*, the new information learned by the insurer invoked a policy exclusion. However, because National Union learned of the information after acknowledging a duty to defend, the Court should have recognized that *Tidyman's* presented a case of first impression.

*Tidyman's* asked the Court if an insurer could rely on additional information to deny coverage after already acknowledging a duty to defend. The Court failed to directly address this issue. However, by holding that National Union had a duty to defend, the Majority requires insurers to provide defense even when known facts clearly negate coverage if the insurer has previously acknowledged coverage. The holding implies that once a duty to defend is acknowledged, additional information becomes irrelevant—the duty to defend is irrevocable.

#### B. *Tidyman's* is Consistent with Legislative Intent

An irrevocable duty to defend in Montana is consistent with the legislative intent, which distinguishes an insurer's duty to defend from its obligation to indemnify the insured.<sup>52</sup> Under Montana law,

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<sup>44</sup> 206 P.3d 919 (Mont. 2009).

<sup>45</sup> *Id.* at 921.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 925–926.

<sup>50</sup> *E.g. Burns*, 765 P.2d 712; *Revelations Indus.*, 206 P.3d 919.

<sup>51</sup> *E.g. Burns*, 765 P.2d 712; *Revelations Indus.*, 206 P.3d 919; *Staples*, 90 P.3d 381.

<sup>52</sup> Mont. Code Ann. § 28–11–316.

“[t]he person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the person indemnified in respect to the matters embraced by the indemnity[.] If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the person indemnified suffered by the person indemnified in good faith is conclusive in favor of the person indemnified against the person indemnifying.”<sup>53</sup>

The Court has consistently interpreted the duty to defend as being “distinct from, different from, independent of, and broader than the insurer’s promise to pay on behalf the insured all sums which the insured shall become obligated to pay[.]”<sup>54</sup> The duty to defend seeks to preserve “the fundamental protective purpose of an insurance policy and the obligation of the insurer to provide a defense.”<sup>55</sup> Had National Union provided defense in state court, the insurer could have sought a declaratory action to relieve them from liability from the cost of judgment. They were not estopped from denying liability until revoking defense, consistent with the policy interpretation that the duty to defend is broader than an insurer’s obligation to pay. Likewise, by holding the duty to defend irrevocable, the Court reiterated the message that insurers should be prudent before denying coverage and instead seek a declaratory action.

#### IV. CONCLUSION

After *Tidyman’s*, an insurer in Montana can deny coverage only if the insurer has not previously acknowledged a duty to defend. The *Tidyman’s* holding qualifies prior caselaw by holding that an insurer loses its ability to use outside knowledge if it has already agreed to provide defense. Although the Majority failed to distinguish *Tidyman’s* from precedent and as a result, artificially confined their analysis, the holding is consistent with the legislative intent to interpret the duty to defend broadly and protect the insured.

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<sup>53</sup> *Id.*

<sup>54</sup> *McAlear v. St. Paul Ins. Cos.*, 493 P.2d 331, 335 (Mont. 1972).

<sup>55</sup> *Id.*