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ALPS Property & Casualty Ins. Co. v. McLean & McLean, PLLP: **After Rescission, a Remedy for Third-Party Claimants and Innocent Insureds?**

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PRECAP; ALPS Property & Casualty Ins. Co. v. McLean & McLean, PLLP: After Rescission: A Remedy for Third-Party Claimants and Innocent Insureds?

Emily Gutierrez Caton

Oral Argument Scheduled for Friday, September 22, 2017, at 3:00 p.m. at Fairmont Hot Springs Resort, Anaconda, Montana, with an introduction to begin at 2:30 p.m.

I. INTRODUCTION

ALPS Property & Casualty Company (ALPS) rescinded McLean & McLean (M&M), David McLean, and Michael McLean's insurance policy after receiving notification of David McLean's theft of client money. ALPS rescinded the coverage based on the misrepresentations that David McClean made in the annual insurance renewal application. The rescission of the contract precluded coverage for third party claimants, including Joseph and Marilyn Micheletti (Michelettis), who allege David McLean negligently missed a filing deadline for their personal injury lawsuit resulting in professional malpractice. The district court granted summary judgment for ALPS, finding that the policy was void *ab initio*, resulting in a denial of coverage for M&M, Michael McLean, and the Michelettis.

II. FACTUAL AND PROCEDURAL BACKGROUND

David and Michael McLean, a father and son pair, practiced law at McLean & McLean, a law firm in Anaconda, Montana.¹ M&M maintained liability insurance through ALPS.² David McLean defrauded M&M's clients by misappropriating hundreds of thousands of dollars, a crime for which he was disbarred and is now spending 44 months in federal prison.³ David McLean signed applications annually to renew M&M's insurance policy through ALPS.⁴ Based on the application, ALPS issued Policy No. ALPS 7804-11 (Policy), effective January 1, 2014 to January 1, 2015.⁵ In these applications, David McLean indicated that neither he, nor anyone else in the firm, knew of facts that could be

¹ Joint Opening Brief of McLean & McLean, PLLP, and Michael McLean at 2, *ALPS Prop. & Cas. Ins. Co. v. McLean & McLean, PLLP*, <https://perma.cc/L7P4-U9PX>(Mont. Mar. 17, 2017) (No. DA 16-0739).

² *Id.* at 3.

³ Answer Brief of Appellee ALPS Property & Casualty Insurance Co. at 3, *ALPS Prop. & Cas. Ins. Co. v. McLean & McLean, PLLP*, <https://perma.cc/Z6G3-AHSL>(Mont. May 31, 2017) (No. DA 16-0739).

⁴ *Id.* at 4.

⁵ *Id.* at 1.

reasonably expected to be the basis of a claim against M&M, or David and Michael.⁶ M&M provided notice of the theft of client funds on July 24, 2014, the theft victims notified ALPS of their claims in August 2014, and the Michelettis notified ALPS of their claim on October 16, 2014.⁷

Several of the clients who made claims to ALPS were victims of David's theft, however, the Michelettis alleged malpractice and professional negligence due to David's mishandling of the Michelettis' personal injury suit against Costco.⁸ The Michelettis originally consulted David McLean about the representation in the personal injury lawsuit in early 2010.⁹ The Michelettis heard little from David McLean, but were reassured he was pursuing their claim.¹⁰ However, the Michelettis later learned that David failed to advise them that because the accident had happened in Colorado, the two-year statute of limitations proscribed by Colorado law applied to them to preclude their claim.¹¹

After ALPS received notice of David McLean's criminal and fraudulent actions, ALPS sent notification to M&M that the insurance policy was cancelled and included a check for \$231.41.¹² Thereafter, ALPS sent a Notice of Rescission of Coverage, which rescinded coverage retroactively to January 1, 2014, along with a check \$6,657.59 for the returned premium.¹³ The policy is a "claims made and reported" policy, meaning that no coverage existed under the policy for claims reported to ALPS before January 1, 2014 or after January 1, 2015.¹⁴ Montana statutory law allows rescission of an insurance policy when the insured makes misrepresentations that are fraudulent or material, or would cause the insurer to not have issued the policy.¹⁵ The procedure for a party to rescind a contract is also statutory.¹⁶

ALPS filed suit against M&M, David McLean, Michael McLean, and other third party claimants seeking a declaratory judgment and damages.¹⁷ The Michelettis moved to intervene because they had asserted claims of malpractice against David McLean.¹⁸ M&M counterclaimed and requested a declaratory judgment that the Policy remained in effect, that ALPS unlawfully cancelled and unlawfully rescinded the Policy, and that

⁶ *Id.* at 4.

⁷ *Id.* at 1.

⁸ Opening Brief of Joseph F. Micheletti and Marilyn C. Micheletti, Intervenors and Appellants at 4, *ALPS Prop. & Cas. Ins. Co. v. McLean & McLean, PLLP*, <https://perma.cc/U6FV-F8J5> (Mont. Mar. 31, 2017) (No. DA 16-0739).

⁹ *Id.* at 4.

¹⁰ *Id.* at 5.

¹¹ *Id.* at 5–6.

¹² Joint Opening Brief of McLean & McLean, *supra* note 1, at 10–11.

¹³ *Id.* at 10–11.

¹⁴ Answer Brief of Appellee, *supra* note 3, at 1.

¹⁵ MONT. CODE ANN. § 33–15–403 (2017).

¹⁶ § 28–2–713.

¹⁷ Opening Brief of Joseph F. Micheletti and Marilyn C. Micheletti, *supra* note 9, at 1.

¹⁸ *Id.* at 2.

ALPS is not entitled to damages or reimbursement.¹⁹ Michael McLean also answered and counterclaimed requesting that Michael remained an insured, that ALPS unlawfully cancelled and rescinded Michael's insurance coverage and that ALPS has a duty to defend Michael and is not entitled to reimbursement for costs of defense.²⁰ Michael also claimed breach of contract for ALPS failure to recognize Michael as an "innocent insured," along with other various claims against ALPS.²¹

The parties moved for summary judgment, and on September 19, 2016, the district court granted ALPS motion and declared that the Policy was rescinded and void *ab initio* as to all parties.²² M&M concedes that no coverage exists for the claims regarding David's thefts and David McLean has not appealed the district court's order.²³ Therefore, the scope of the appeal is limited to whether coverage exists for M&M, Michael McLean, and the Michelettis.

III. SUMMARY OF ARGUMENTS

A. *McLean & McLean, Michael McLean, and the Michelettis*

Michael McLean asserts that he is owed continuing coverage under the Policy as an innocent insured and under common-law doctrines.²⁴ M&M also asserts that it is covered under the common-law doctrine protecting innocent insureds.²⁵ M&M and Michael also point out the harshness of rescission and identify various alternatives including: rescinding the Policy only to David, or precluding coverage for David's illegal conduct, reforming the policy and increasing the premium, or providing M&M and Michael coverage as innocent insureds.²⁶

The Michelettis assert that David McLean's professional malpractice had nothing to do with David's intentional theft of client funds.²⁷ The district court determined that David McLean should have recognized and reported his malpractice in the Micheletti lawsuit and due to David's failure to report the potential claim, ALPS properly denied coverage to the Michelettis.²⁸ The Michelettis assert error with the district court's grant of summary judgment to ALPS based on the fact that David McLean should have known about his error in the Micheletti lawsuit and that it might result in claims against him.²⁹ However, the Michelettis argue

¹⁹ Joint Opening Brief of McLean & McLean, *supra* note 1, at 12–13.

²⁰ *Id.*

²¹ *Id.*

²² *Id.* at 14.

²³ Answer Brief of Appellee, *supra* note 3, at 3.

²⁴ Joint Opening Brief of McLean & McLean, *supra* note 1, at 17.

²⁵ *Id.* at 18.

²⁶ *Id.* at 32–33.

²⁷ Opening Brief of Joseph F. Micheletti and Marilyn C. Micheletti, *supra* note 9, at 11.

²⁸ *Id.* at 11–12.

²⁹ *Id.* at 15.

on appeal that the district court's conclusion was in error because it was not supported by evidence in the record.³⁰

B. ALPS

ALPS asserts on appeal that the district court properly upheld ALPS rescission of the Policy.³¹ ALPS asserts that David's misrepresentations were material, and that ALPS would not have issued the Policy had it not been for David's misrepresentations in the renewal application.³² Further, ALPS properly rescinded the Policy in accordance with 28-2-1713 and 33-15-403. ALPS denies that either the Policy or common-law doctrine provides M&M, Michael, or the Michelettis with innocent insured coverage.³³ Essentially, ALPS asserts that because the Policy was rescinded and void retroactively, the innocent insured coverage provision does not create coverage for Michael McLean. ALPS also argues that the Court has already rejected the innocent insured doctrine, and there is no support in precedent for its adoption in this case.³⁴

IV. ANALYSIS

The district court determined that neither the Policy's "Innocent Insured Coverage" provision, nor the common-law innocent insured doctrine prevented the rescission of the Policy nor provided coverage for M&M or Michael McLean.³⁵ Although the Policy's innocent insured coverage provision explicitly prevents M&M from retaining coverage under the exception, it is less clear whether Michael can retain coverage.³⁶ Allowing the innocent insured coverage provision in the Policy to only apply narrowly when an insurance company does not seek the statutory remedy of rescission seems to defeat the purpose of having an innocent insured policy exception. If an insured in a firm commits a fraudulent or criminal act, an insurance company who sought to rescind the contract could avoid providing coverage for other innocent members of the firm, whereas if the insurance company denied coverage for the claim under the policy provision which excludes coverage for fraudulent or criminal acts, the innocent insureds would remain covered. ALPS' narrow interpretation of the innocent insured coverage exception seems to leave an innocent insured policy provision with little or no application.

Although precedent in Montana may be on ALPS side to reject the innocent insured doctrine, the instant case provides a compelling reason to

³⁰ *Id.*

³¹ Answer Brief of Appellee, *supra* note 3, at 7.

³² *Id.* at 12–17.

³³ *Id.* at 20–21.

³⁴ *Id.* at 22–23.

³⁵ Joint Opening Brief of McLean & McLean, *supra* note 1, at 17–21.

³⁶ *Id.* at 6.

examine the interplay between the statutory remedy of rescission and coverage under both the common law and policy-based innocent insured exception. Providing liability insurance in a law firm may present a unique enough situation to warrant a closer look at the applicability of the innocent insured doctrine. The common-law doctrine of innocent insured has been rejected by the Court, at least in the context of denying fire insurance protection to a wife whose husband deliberately set their home on fire.³⁷ The Court noted the harsh result of denying coverage, but “the provision clearly and unequivocally states that loss caused by an intentional act of an insured party bars coverage.”³⁸ However, here, there is no provision that “clearly and unequivocally” bars coverage after an intentional act. In fact, section 4.3.1 of the Policy provides an exception for innocent insureds to remain covered.³⁹ The questions of coverage under the innocent insured provision in the Policy and under the common-law doctrine are both important and likely to be addressed by the Court. Another issue the Court will have to tackle is whether and what remedy is proper for the Michelettis. The Michelettis’ assertion that the district court’s grant of summary judgment is improper without further fact finding regarding whether David knew or should have known about the potential for a malpractice claim against him in the Michelettis’ lawsuit is compelling. Public policy concerns for Montanans and for insurers will play an important role in deciding whether the Michelettis have a remedy or retain coverage.

M&M and Michael McLean also assert that rescission of the policy was wrongful because it put the insurer in a much better position and did not restore the parties to their positions before the policy was in place because ALPS denied Michael extended coverage.⁴⁰ Amicus, Montana Trial Lawyers Association, asserts that reformation, rather than rescission is the appropriate remedy because Michael made no misrepresentations to ALPS.⁴¹ If the Court chooses to provide coverage to Michael, M&M, and/or the Michelettis, then they may choose the remedy of reformation, instead of finding coverage under the policy or common-law doctrine protecting innocent insureds.

The Court will face tough questions and policy implications as it navigates the path between maintaining the statutory right to rescission while also fulfilling Montana’s interest in the protective nature of insurance coverage.

³⁷ Woodhouse v. Farmers Union Mut. Ins. Co., 785 P.2d 192 (1990).

³⁸ *Id.* at 194.

³⁹ Answer Brief of Appellee, *supra* note 3, at 20–21.

⁴⁰ Joint Opening Brief of McLean & McLean, *supra* note 1, at 31.

⁴¹ Amicus Curiae Brief of the Montana Trial Lawyers Association at 13, *ALPS Prop. & Cas. Ins. Co. v. McLean & McLean, PLLP*, <https://perma.cc/4AAE-C8NC> (Mont. July 14, 2017) (No. DA 16-0739).