Nos. 03-35033 & 03-35133

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

DARBY LUMBER, INC., ROBERT E. RUSSELL, AND PEGGY L. RUSSELL,

Plaintiffs – Appellees,

v.

INDIANA LUMBERMENS MUTUAL INSURANCE COMPANY,

Defendant – Appellant.

On Appeal From
The United States District Court
For The District Of Montana

BRIEF FOR APPELLANT

Mark S. Williams
WILLIAMS LAW FIRM, P.C.
235 East Pine
P.O. Box 9440
Missoula, Montana 59807
(406) 745-4350

Alan E. Untereiner
ROBBINS, RUSSELL, ENGLERT, ORSECK & UNTEREINER LLP
1801 K Street, N.W., Suite 411
Washington, D.C. 20006
(202) 775-4500

Lawrence W. Schmits
KRIEG DEVAULT LLP
One Indiana Square, Suite 2800
Indianapolis, Indiana 46204
(317) 636-4341

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Appellant Indiana Lumbermens Mutual Insurance Company states that it has no parent corporation and that no publicly held corporation owns 10% or more of its stock.

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STATEMENT OF JURISDICTION

The district court had subject-matter jurisdiction under 28 U.S.C. § 1332(a)(1) over this action brought by a Montana corporation, with its principal place of business in Montana, and by two Montana citizens, against an Indiana corporation, with its principal place of business in Indiana, and involving an amount in controversy exceeding $75,000.00. The judgment being appealed in No. 03-35033 is final under Federal Rule of Civil Procedure 54(b). The order awarding attorney's fees being appealed in No. 03-35133 followed the entry of judgment.

This Court has jurisdiction over the appeals pursuant to 28 U.S.C. § 1291. The judgment being appealed in No. 03-35033 was entered on December 3, 2002. A notice of appeal was timely filed under Federal Rule of Appellate Procedure 4(a)(1)(A) on December 31, 2002. The order awarding attorney's fees being appealed in No. 03-35133 was entered on January 17, 2003. A notice of appeal was timely filed under Federal Rule of Appellate Procedure 4(a)(1)(A) on February 14, 2003.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

At issue in this case is the meaning of an insurance policy that covers claims stemming from an insured's "negligen[ce]" in the "administration" of an employee benefits program. The policy specifically defines "Administration" as consisting of certain ministerial acts: "[g]iving counsel" to employees about a benefit program; "[i]nterpreting" a program; "handling [program] records"; and, most important for

present purposes, "*[e]ffecting enrollment*, termination or cancellation" of employees in a benefit program. The issues presented are:

1. Whether the district court erred in holding that this policy language encompassed – and thus gave rise to a duty to defend – claims brought against an insured for breach of fiduciary duties under the Employee Retirement Income Security Act (ERISA), arising out of the insureds' actions both in funding a company Employee Stock Ownership Plan and in making investment decisions about the plan's assets.

2. Whether the award of attorney's fees to the plaintiffs should be reversed if the judgment in their favor is reversed.

STATEMENT OF THE CASE

This is an appeal from a final judgment on one claim in a diversity action brought by plaintiffs Darby Lumber, Inc., Robert E. Russell, and Peggy L. Russell against Indiana Lumbermens Mutual Insurance Co. (ILMI), consolidated with an appeal from an award of attorney's fees. The plaintiffs sued seeking a declaration that ILMI was obligated under an insurance policy it issued both to defend them in a suit brought against them alleging violations of ERISA and to indemnify them for any losses in that action. On August 28, 2002, the district court granted summary judgment on the plaintiffs' claim that ILMI had a duty to defend and denied summary judgment on the plaintiffs' claim that ILMI had a duty to indemnify. On

November 26, the court granted ILMI's motion under Federal Rule of Civil Procedure 54(b) for entry of final judgment on the duty-to-defend claim. The clerk entered the judgment on December 3; ILMI timely appealed on December 31. On January 17, 2003, the district court awarded the plaintiffs attorney's fees; ILMI timely appealed on February 14. On March 18, 2003, this Court consolidated the two appeals.

STATEMENT OF FACTS

This case arises from what the district court called "the implosion of Darby Lumber, Inc." (ER 55), which ceased operations on December 31, 1998. Four years earlier, on August 26, 1994, Darby created the Darby Lumber Employee Stock Ownership Plan (ESOP) and the Employee Stock Ownership Trust (ESOT). ER 56. On the same day, the ESOT borrowed $6.5 million from the company and used the proceeds to buy 565,217 shares (of one million outstanding) of Darby's common stock from Robert and Peggy Russell. The Russells were officers, directors, and employees of Darby, as well as members of the committee appointed to control and manage the operation and administration of the ESOP. ER 56-57. Robert Russell was also a trustee of the ESOT.

1. *The* Behling *Suit for Breaches of ERISA Fiduciary Duties.* On December 1, 1999, after Darby had failed, participants in the ESOP sued Darby and the Russells in the United States District Court for the District of Montana, in a case styled *Behling* v. *Russell*, No. CV 99-165-M-LBE. ER 8-20. The *Behling* plaintiffs, suing

derivatively on behalf of the ESOP (see ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2)), sought to recoup losses to the plan that allegedly resulted from a breach of ERISA's fiduciary duties by Darby and the Russells. The complaint alleged violations of the general fiduciary duties set forth in Section 404 of ERISA, 29 U.S.C. § 1104 (see *Behling* Cplt. ¶¶ 1.3, 2.23-2.25, 4.5, and 5.1-5.8, ER 9, 13-14, 15, 16-17), as well as prohibited transactions in violation of Section 406, 29 U.S.C. § 1106 (see *Behling* Cplt. ¶¶ 2.23-2.25, 5.6-5.7, and 5.9-5.11, ER 13-14, 17, 17-19).[1] The factual underpinning of these violations, the complaint alleged, was the stock sale by Darby and the Russells to the ESOT. ER 14-15. In essence, plaintiffs alleged that the stock was worth less than the price that the ESOT paid – that is, that Darby and the Russells

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[1] More specifically, the *Behling* complaint alleged that, "[a]s ERISA fiduciaries," Darby and the Russells "were required to discharge their duties: '[W]ith respect to the . . . [ESOP and ESOT] solely in the interest of the participants and beneficiaries . . . for the exclusive purpose of providing benefits to participants and their beneficiaries . . . with the care, skill, prudence, and diligence under the circumstances [then] prevailing that a prudent man acting in a like capacity and familiarity with such matters would use in the conduct of an enterprise of like character and with like aims . . . .'" *Behling* Cplt. ¶ 5.3, ER 16 (quoting ERISA § 404, 29 U.S.C. § 1104). Echoing this general fiduciary duty provision, the complaint further alleged that Darby and the Russells "breached their fiduciary duty by failing to act in the interest of the Plan participants and their beneficiaries for the exclusive purpose of providing benefits to such participants and their beneficiaries" and "failed to act with the care, skill, prudence, and diligence" of a "prudent man." *Id.* ¶ 5.8, ER 17. The complaint also alleged a breach of fiduciary duty as a consequence of Darby's and the Russells' causing or permitting the ESOT to engage in a prohibited transaction on August 26, 1994. *Id.* ¶ 5.9, ER 17-18.

had overvalued the stock and thus pocketed more than they should have. ER 16-18. The *Behling* case is still pending.

2. *The Employee Benefits Liability Endorsement Issued by ILMI to Darby.* On January 6, 2000, in the wake of the filing of the *Behling* action, Darby and the Russells asked ILMI to provide a defense and indemnity pursuant to a Commercial General Liability (CGL) insurance policy that ILMI had issued on January 1, 1995 (more than four months after the August 26, 1994 transaction) and had renewed annually on January 1 of each of the following four years. ER 2. Among other provisions, the policy included an Employee Benefits Liability Endorsement (EBL Endorsement), a two-page rider that Darby and the Russells said covered the suit against them. The EBL Endorsement defined its scope of "coverage" as follows:

> The Company will pay on behalf of the "Insured" all sums which the "Insured" shall become legally obligated to pay as damages on account of any claim made against the "Insured" by any present or former "employee", or the beneficiaries or legal representative thereof, because of injury caused by any negligent act, error or omission of the "Insured" or of any other person for whose acts, errors, or omissions the "Insured" is legally liable, in the *administration* of the "Insured's Employee Benefit Programs."

EBL Endorsement ¶ 1, ER 43 (emphasis added).

The Endorsement went on to define the terms "Administration," "Employee Benefit Programs," and "Policy Period." *Id.* ¶ 3, ER 43. The term "Employee Benefit Programs" was broadly defined as "group life insurance, group accident or health insurance, profit sharing plans, pension plans, employee stock subscription plans,

workers compensation insurance, unemployment insurance, social security, disability benefits insurance, and payroll deduction plans." *Id.* ¶ 3(b), ER 43.

Finally, and critically, the EBL Endorsement defined "administration" as follows:

> "Administration" means:
>
> (1) Giving counsel to "Employees" with respect to the "Employee Benefit Programs";
>
> (2) Interpreting the "Employee Benefit Programs" for employees;
>
> (3) The handling of records in connection with the "Employee Benefit Programs";
>
> (4) Effecting enrollment, termination or cancellation of "Employees" under the "Employee Benefit Programs";
>
> provided all such acts are authorized by the Insurance.

EBL Endorsement ¶ 3(c), ER 43.

3. *The Denial of Coverage and Darby's and the Russells' Suit Against ILMI.* On April 10, 2000, ILMI denied the requests for a defense and indemnity. ER 45-55. As an initial matter, ILMI noted that "[i]f the wrongful act or acts which ultimately caused the loss occurred in 1994 when the company adopted the ESOP and ESOT and authorized the ESOT to borrow $6,500,000.00 to purchase stock from the Russells . . . , then arguably the loss arose before [ILMI] first issued coverage for Darby Lumber, Inc. in 1995." ER 50. Next, ILMI explained that "[e]mployee benefits liability coverage" – *i.e.*, the EBL Endorsement – "was designed to protect employers

from claims arising from error and negligence in administering employee benefit plans." ER 53. The Endorsement "does not provide for benefits due from employers, nor for liabilities arising under ERISA, which imposes fiduciary liability in connection with the management of benefit plan assets and prohibits certain transactions in the investment and disbursement of plan funds." *Ibid.* Coverage for breaches of fiduciary duty, ILMI explained, is "[i]nstead . . . provided under a Fiduciary Liability Endorsement" or policy (*ibid.*) – which the CGL policy issued to Darby and the Russells did not include.

On June 15, 2001, Darby and the Russells sued ILMI in the United States District Court for the District of Montana for a declaratory judgment that ILMI had a duty to defend and indemnify them. The parties then cross-moved for summary judgment.

Darby and the Russells argued, first, that by accusing them of overvaluing the stock, the *Behling* complaint had alleged the type of "negligent act, error or omission" (EBL Endorsement ¶ 1, ER 43) that the policy covered. Next, they argued, the negligent acts or errors – the overvaluation of the stock sold to the ESOT – had occurred in the "administration" (EBL Endorsement ¶ 3(c), ER 43) of the ESOP. The word "administration," they maintained, should *not* be defined by reference to the specific definition of that term included in the EBL Endorsement. Rather, it should be understood as defined in *Webster's College Dictionary*: "to direct or manage," or

to "bring into use or operation." Under that dictionary definition, Darby and the Russells argued, the word "administer" covered the malfeasance alleged in the *Behling* complaint – malfeasance in "managing or directing" the affairs of the ESOP or "bringing [the ESOP] into use or operation." The policy definition was inapplicable, Darby and the Russells maintained, because the word "administration" was not in quotation marks in the EBL Endorsement. To support that claim, they pointed to a statement on the first page of the CGL policy form – 22 pages earlier, before any of the various endorsements – indicating that words and phrases that "appear in quotation marks have special meaning" and referring the reader to a later provision of the form that contained some defined terms.

ILMI argued that the acts or errors were not in the "administration" of the ESOP. As for the proper definition of "administration," ILMI maintained that the term was specifically and carefully defined in the EBL Endorsement itself, and there was no basis for ignoring that definition merely because the Endorsement did not put quotation marks around the word. The earlier language in the CGL policy form, ILMI explained, did not apply to the EBL Endorsement (which, like the other endorsements, came later and included its own defined terms); and, in any event, the earlier language meant only that words in quotations have special meanings, not that definitions cannot be applied if quotation marks are lacking.

Under the EBL Endorsement's definition of "administration," ILMI further argued, the acts or errors alleged in the *Behling* complaint were not covered by the policy, and, accordingly, ILMI had no obligation to either indemnify or defend. Moreover, ILMI explained, the relatively sparse case law on EBL endorsements such as the one here supported ILMI's position. ILMI pointed to *Maryland Casualty Co.* v. *Economy Bookbinding Corp. Pension Plan & Trust*, 621 F. Supp. 410, 413 (D.N.J. 1985), where, interpreting virtually identical policy language, the court stated that "[i]t is clear that the policy limits coverage to liability incurred in relatively routine, ministerial acts . . . and avoids coverage of liability involved in managing [a pension plan's] investments."

4. *The District Court's Decisions.* On August 28, 2002, the district court granted the plaintiffs' motion for summary judgment on the duty-to-defend claim and denied ILMI's. (The court denied both cross-motions on the duty-to-indemnify claim, holding that because *Behling* had not been resolved yet, a decision on that claim was premature.)

Applying Montana law (which the parties agreed applies), the court first held that the *Behling* complaint had in fact alleged negligence on the part of Darby and the Russells – "at least in part." ER 61.

Next, the district court turned to the question whether the acts or errors occurred within the ESOP's "administration." It agreed with ILMI that despite the absence of

quotation marks around the word administration, the carefully crafted definition in the Endorsement – not a definition plucked from a dictionary – applied. The district court rejected plaintiffs' contrary argument as "not consistent with Montana's rules of insurance policy interpretation." ER 63. The court explained:

> Reading the insurance policy as a whole, the term "administration" is not reasonably subject to two definitions. While administration does not appear in quotation marks, the term is used only three times in the Endorsement, including once in the definition itself, and the definition begins three paragraphs after the first use of the word. A consumer of average intelligence would not be confused as to whether to apply the Endorsement's definition or the normal, everyday definition of administration.

ER 63; see also ER 62 ("The definition[] appears in a two-page endorsement, however, the definition and all uses of administration fall on the first page of the Endorsement."). Moreover, the district court reasoned, "[f]ollowing Darby Lumber's line of reasoning would nullify the definition of administration in the Endorsement." ER 63. And "it would change the [CGL] policy [form] to state that *only* words in quotations have special meaning." *Ibid.* (emphasis in original). Finally, the plaintiffs' position failed as a matter of common sense because it required a court to conclude that "a consumer of average intelligence would ignore the definition of administration set forth immediately after the first use of the word," and would instead "search[] for and apply[] the provision about words in quotation marks." ER 63-64.

The district court then considered whether, under the Endorsement's definition, the *Behling* complaint had alleged acts occurring within the "administration" of the

ESOP. Because the question had not been addressed in Montana, the court looked for guidance to *Maryland Casualty*, which involved an EBL endorsement "with language nearly identical to the language in the Endorsement issued to Darby Lumber." ER 65. In *Maryland Casualty*, the district court explained, "the underlying action alleged that the trustees violated their fiduciary duties and ERISA by investing too large of a percentage of pension plan funds" in a company's own securities. *Ibid.* That allegation, the *Maryland Casualty* court had held, fell outside of the policy coverage, which was "limited . . . to liability incurred in *relatively routine, ministerial acts*, and excluded from coverage actions taken in the 'decisionmaking and monitoring involved in managing the Plan's investments.'" *Ibid.* (quoting 621 F. Supp. at 413) (emphasis added).

Nevertheless, the district court purported to find support for the position of Darby and the Russells in *Maryland Casualty*'s observation that "miscalculation of the percentage of funds invested in [the company's] own securities *may have* fallen under the policy's definition of administration." ER 65 (emphasis added). Although the district court acknowledged that this statement was *dictum* – because the *Maryland Casualty* court had concluded that the plaintiffs there were "complaining of the 'investment itself'" rather than any miscalculation – it nevertheless stated that "[t]he facts in the case before this Court are similar to those in *Maryland Casualty*." ER 66-67. The district court explained:

> Darby Lumber and the Russells are accused, in part, of overvaluing Darby Lumber stock that they sold to the Trust to be invested in the ESOP. However, a potential finding in [*Behling*] is that Darby Lumber negligently accepted an incorrect appraisal. Following this reasoning, Darby Lumber then miscalculated the value of its stock based on its negligent act of accepting the appraisal. *These actions were taken in setting up the ESOP, which effected enrollment of the employees.*

ER 66 (emphasis added). Because "a miscalculation of the value of the stock *may* fall within the definition of administration" (*ibid.* (emphasis in original)), whether that miscalculation "actually occurred within the administration of the ESOP" did not matter – ILMI had a duty to defend (*ibid.*). As to the duty to indemnify, the district court held, that depended on findings to be made in *Behling*; the court thus stayed the duty-to-indemnify claim pending *Behling*'s final resolution. *Ibid.*

On November 26, 2002, the district court granted ILMI's motion under Rule 54(b) for entry of final judgment on the duty-to-defend claim. ER 68-73. The court also granted the plaintiffs' motion for attorney's fees. Under Montana law, the court held, the plaintiffs did not have to show that ILMI acted in bad faith in denying coverage; rather, the plaintiffs were entitled to fees simply because ILMI's denial was wrong. ER 69-72. The clerk entered judgment on December 3. ER 74. On January 17, 2003, the district court ordered the payment of fees. ER 77-78.

SUMMARY OF ARGUMENT

The district court correctly recognized that this case turns on a pure question of law – the proper interpretation of the EBL Endorsement. The district court also correctly rejected the plaintiffs' contention that "administration" should be interpreted by resort to dictionaries rather than to the definition specifically included in the Endorsement itself. The court erred, however, in holding that the Endorsement – which covers damages caused by "negligent acts[s], error[s], and omission[s]" in the "administration" of a wide range of employee benefit plans – also covers a claim for breaches of fiduciary duties under ERISA in the initial funding of a plan or the investment of plan assets. In so holding, the district court misunderstood the definition in the Endorsement of the word "administration," misunderstood the mechanics of employee benefit plans, and misread the relevant case law. The decision also ignores the basic distinction between the relatively inexpensive, garden-variety EBL coverage involved here and the distinct, and vastly more expensive, form of insurance covering breaches of ERISA fiduciary duties. And it overlooks the fact that the stock purchase that lies at the heart of the *Behling* complaint occurred more than four months before ILMI's policy was issued.

Given, finally, that ILMI was not obligated under the Endorsement to defend Darby and the Russells, this Court should vacate the district court's award of attorney's fees.

ARGUMENT

I. THIS COURT REVIEWS THE DISTRICT COURT'S JUDGMENT AND ORDER AWARDING ATTORNEY'S FEES *DE NOVO*

This Court reviews the grant of summary judgment under Rule 56 *de novo*. *E.g.*, *American Consumer Publishing Ass'n, Inc.* v. *Margosian*, ___ F.3d ___, 2003 WL 22705492, at *2 (9th Cir. Nov. 18, 2003). These appeals involve the interpretation of a contract, a pure question of law also reviewed *de novo*. *E.g.*, *Flores* v. *American Seafoods Co.,* 335 F.3d 904, 910 (9th Cir. 2003). The award of attorney's fees depends solely on the legal question whether ILMI had a duty to defend and is likewise subject to *de novo* review. All of the issues were raised and ruled on in the course of the cross-motions for summary judgment and the motion for fees (Circuit Rule 28-2.5).

II. THERE IS NO DUTY TO DEFEND BECAUSE THE EBL ENDORSEMENT DOES NOT COVER THE CLAIMS ASSERTED IN THE *BEHLING* COMPLAINT

In holding that ILMI had a duty to defend its insureds in *Behling*, the district court rested its decision on an interpretation of the language of the EBL Endorsement. As the district court noted, an insurer has a duty to defend its insured when the acts alleged in an action against the insured would, if proved, require indemnification (ER 59-60); conversely, "where the complaint alleges events *not* within the coverage of the policy, and the insurer would *not* be obligated to indemnify the insured if the complaining party recovered, then the insurer has *no* duty to defend." *Graber* v. *State*

Farm Fire & Casualty Co., 797 P.2d 214, 217 (Mont. 1990) (emphases added). Specifically, the court concluded that the allegations made in the *Behling* litigation fell within the EBL Endorsement because those allegations targeted one or more "negligent act[s], error[s] or omission[s] of" Darby and the Russells "in the *administration* of [Darby's] 'Employee Benefit Programs'" – including acts, errors and omissions in "*[e]ffecting enrollment*, termination or cancellation of 'Employees' under the 'Employee Benefit Programs.'"[2] EBL Endorsement ¶ 3(c) (emphasis added), ER 43. As we next explain, the district court's conclusion is wrong, and the court's analysis is flawed at all but one turn.

---

[2] In determining that the *Behling* complaint alleged negligence, the district court agreed with Darby and the Russells that the pivotal paragraph was 5.8. ER 59. Paragraph 5.8, however, alleges not that Darby and the Russells failed to act as *reasonable* men would have – which is the standard of care that defines *negligence*, see RESTATEMENT (SECOND) OF TORTS § 298 (1965 & Supp. 2003). Rather, the *Behling* complaint alleges that Darby and the Russells "failed to act with the care, skill, prudence, and diligence [of] a *prudent* man" – which is the standard of care required of ERISA *fiduciaries*, see 29 U.S.C. § 1104. The fiduciary standard of care – that of a prudent man – is far more demanding than the negligence standard required of a reasonable man. As Chief Judge Cardozo famously wrote, "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." *Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928); see *Pegram* v. *Herdrich*, 530 U.S. 211, 224-25 (2000) (describing the high standards of care required of ERISA fiduciaries).

A. The District Court Misinterpreted And Misapplied The EBL Policy's Definition Of "Administration"

By its clear terms, the EBL Endorsement excludes the breach-of-fiduciary duty claim asserted in the *Behling* complaint. As we have noted, the scope of "coverage" of the EBL Endorsement is carefully defined as follows:

> The Company will pay on behalf of the "Insured" all sums which the "Insured" shall become legally obligated to pay as damages on account of any claim made against the "Insured" by any present or former "employee", or the beneficiaries or legal representative thereof, because of injury caused by any negligent act, error or omission of the "Insured" or of any other person for whose acts, errors, or omissions the "Insured" is legally liable, in the *administration* of the "Insured's Employee Benefit Programs."

The critical issue, then, as the district court recognized, is what "administration" means. The EBL Endorsement includes a detailed, four-part definition of that term, which bears repeating:

> "Administration" means:
>
> (1) Giving counsel to "Employees" with respect to the "Employee Benefit Programs";
>
> (2) Interpreting the "Employee Benefit Programs" for employees;
>
> (3) The handling of records in connection with the "Employee Benefit Programs";
>
> (4) Effecting enrollment, termination or cancellation of "Employees" under the "Employee Benefit Programs";
>
> provided all such acts are authorized by the Insurance.

EBL Endorsement ¶ 3(c), ER 43.

1. The District Court Properly Applied The Policy Definition Of "Administration" Rather Than The Dictionary Definitions Urged By The Plaintiffs

As an initial matter, the district court correctly held that the definition contained in the EBL Endorsement applies to the use of the word "administration" elsewhere in the short, two-page Endorsement – including in the provision defining the scope of coverage. In reaching that conclusion, the district court rejected the plaintiffs' argument that the highly specific policy definition should be ignored in favor of the "ordinary meaning" of the word "administration" as set forth in their chosen dictionary definition.

This aspect of the district court's decision is unassailable. As the court correctly pointed out, the EBL Endorsement is exceedingly short, and it uses the term "administration" only twice apart from the definitional section (¶ 3(c)). ER 62. Both of those other uses of the term (including the key provision defining the scope of coverage) obviously have the same meaning; the plaintiffs have never suggested otherwise. And both uses obviously draw on the carefully defined definition set forth in the EBL Endorsement itself. To hold that the Endorsement's definition is inapplicable accordingly would render that definition superfluous, in contravention of how insurance policies – indeed, contracts generally – are interpreted. As the Montana Supreme Court has written, "we will read the insurance policy as a whole, and will if possible, reconcile its various parts to *give each meaning and effect.*"

Farmers Alliance Mutual Ins. Co. v. *Holeman*, 961 P.2d 114, 119 (Mont. 1998) (emphasis added); accord, *e.g.*, *Mitchell* v. *State Farm Ins. Co.*, 68 P.3d 703, 708 (Mont. 2003); see MONT. CODE ANN. § 28-3-202 (2003) (contracts must be interpreted "so as to give effect to every part if reasonably practicable"). An average consumer plainly would not be confused about what "administration" means in the Endorsement. See *Maryland Casualty*, 621 F. Supp. at 413 (refusing to apply dictionary rather than policy definition to "administration" in almost identical EBL policy).

The district court rightly rejected plaintiffs' argument based on the provision on the first page of the CGL policy form – 22 pages earlier, before any of the various endorsements – which states: "[W]ords and phrases that appear in quotation marks have a special meaning. Refer to DEFINITIONS (Section V)." ER 21. That provision merely says that quotation marks around a word signifies a special meaning, not that the *absence* of quotation marks *precludes* the reader from resorting to a definition included in the policy (here, included only a few lines below the references to "administration"). In any event, the reference to "Section V" – which contains no definition of "administration" – demonstrates that the drafters did not have in mind the EBL Endorsement, which came later. And the EBL Endorsement is a separate, free-standing document with its own definition of coverage, defined terms, and exclusions; it does not depend on the CGL policy for its terms or coverage. Nor is this

unusual. Several of the endorsements to the CGL policy form include their own definitions of key terms.

2. The District Court Misinterpreted The Policy's Definition Of "Administration" And Relied On A Misunderstanding Of How And When Enrollment Occurs Under ESOPs And Other ERISA Employee Pension Benefit Plans

Unfortunately, in taking its next step the district court went astray. In interpreting and applying the definition of "administration" set forth in the EBL Endorsement, the district court erroneously concluded that this language encompassed the allegations of the *Behling* complaint. As we explain, that error involved a misunderstanding not only of the language of the Endorsement but also of the nature of an ESOP.

The district court reasoned that "a potential finding" at trial in *Behling* was that plaintiffs "miscalculated the value of [Darby] stock based on [the] negligent act of accepting" an "incorrect appraisal" that had overestimated the stock's true value. ER 66. Such a "potential finding," the court continued, would fall within the meaning of "administration" because "[t]hese actions were taken *in setting up the ESOP*, which *effected* enrollment of the employees." *Ibid.* (emphases added). In reaching this conclusion, the court relied on the EBL Endorsement's definition of "administration" as including the "[e]ffecting" of "enrollment, termination or cancellation of 'Employees' under the 'Employee Benefit Programs.'" EBL Endorsement ¶ 3(c)(4), ER 43. The district court also apparently credited the plaintiffs' argument that

coverage exists "because the ESOP could not exist, and no employees could be enrolled, without a purchase of Darby Lumber stock." ER 64; see also *ibid.* (also referring to the plaintiffs' argument that "[b]ecause the purchase of stock *effects* enrollment, the allegations of wrongdoing related to the *valuing and purchase* of stock fall within the administration of the ESOP and the Trust") (emphases added).

a. The Interpretive Error

To begin with, the district court appears to have made a common error of usage by confusing the words "effect" and "affect." See THE AMERICAN HERITAGE BOOK OF ENGLISH USAGE: A PRACTICAL AND AUTHORITATIVE GUIDE TO CONTEMPORARY ENGLISH (1996) ("*Affect* and *effect* are sometimes confused.") (available at http://www.bartleby.com/64/C003/015.html). When used as a verb, to "effect" means to "bring about," "accomplish," or "execute." WEBSTER'S THIRD NEW WORLD INTERNATIONAL DICTIONARY 724 (3d ed. 1986). In contrast, to "affect" means to "influence," "act upon," or "make an impression on." *Id.* at 35. "*Effecting* enrollment, termination or cancellation" of employees under "Employee Benefit Programs" thus means bringing about the employees' enrollment in the plans (or cancelling or terminating their status as plan participants). It does not mean any action that "affects" an "Employee Benefit Program" or the "enrollment, termination, or termination" of employees under it. The latter is obviously far broader than the former, and would include acts in running the business that "affect" whether the

business remains solvent and can therefore continue to offer a plan to its employees. That is not what the provision means.

The meaning of the phrase "effecting enrollment" is, moreover, confirmed by the surrounding language in the EBL Endorsement. See MONT. CODE ANN. § 28-3-202 (2003) ("The whole of a contract is to be taken together so as to give effect to every part if reasonably practicable, *each clause helping to interpret the other.*") (emphasis added). As noted above, the policy definition of "administration" includes four components, each of which concerns "Employee Benefit Programs." In addition to the "effecting enrollment" provision, those components include (1) "[g]iving counsel to "Employees"; (2) "[i]nterpreting" the programs for employees; and (3) "handling of records in connection with" the programs.

Plainly, all three of these components involve relatively routine activities involving the provision of information, the handling of paperwork, and other ministerial tasks – nothing even remotely resembling the complex financial decisions involved in making investments of ESOP plan assets.[3] It would be strange indeed for the fourth category, "effecting enrollment," to include far more complex functions

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[3] Underscoring the narrow scope of its coverage, the EBL Endorsement expressly excludes claims based on the "failure of stock shares to perform as represented by an 'Insured'" as well as on "advice given by an 'insured' to an 'Employee' to participate or not to participate in stock subscription plans." EBL Endorsement ¶ 7(f), ER 44. Thus, the "counsel[ing]" covered by the Endorsement is quite limited.

than the first three. Moreover, it is notable that the first two components of the definition of administration involve providing basic information whereas the last two components involve routine tasks associated with the handling of plan records and with adding or omitting participants. Thus, "effecting enrollment" closely resembles the "handling of records" provision in its narrow, ministerial scope.

Nor is this all. The "effecting enrollment" provision covers "[e]ffecting enrollment, termination, or cancellation of 'Employees' *under* the 'Employment Benefit Programs.'" EBL Endorsement ¶ 3(c)(4) (emphasis added), ER 43. As that language suggests, "effecting enrollment" is something that occurs only *after* a program or plan is in place. Contrary to the district court's conclusion, "effecting enrollment" cannot happen in the process of "setting up" (ER 66) or creating the plan. Put differently, an insured company cannot "effect" or "bring about" the enrollment of employees in a benefit plan unless and until the plan has been legally established.

This limitation is also confirmed by the last clause of Paragraph 3(c), which makes clear that the counseling of employees about programs, interpretation of those programs, handling of records, and "[e]ffecting enrollment, termination or cancellation" of employees with respect to the programs all qualify as "administration" only if "*such acts are authorized by the Insurance*." EBL Endorsement ¶ 3(c) (emphasis added), ER 43. That too suggests that there must be "Insurance" already in place that authorizes "enrollment, termination or cancellation"

before "administration" of any kind can occur. Until a benefit plan exists, there is nothing to "administer."

Moreover, "effecting" covers not only "enrollment" but also "termination" and "cancellation." Like "enrollment," "termination" and "cancellation" are discrete, one-time events that alter the legal status of an "Employee" as a plan participant. "Effecting" those changes in participant status is thus a distinct occurrence that takes place at a particular point in time – not (as the district court concluded) preparatory conduct that both is remote in time and has nothing to do with any change in participant status (such as an ERISA fiduciary's acceptance of an appraisal in connection with a particular decision concerning how to invest plan assets).

Finally, it is significant that the "effecting enrollment" provision (and the other defined components of "administration") apply not just to ESOP plans but also to a wide array of "Employment Benefit Programs." As noted above, those include "group life insurance, group accident or health insurance, profit sharing plans, pension plans, employee stock subscription plans, workers compensation insurance, unemployment insurance, social security, disability benefits insurance, and payroll deduction plans." EBL Endorsement ¶ 3(b), ER 43. Whatever "effecting enrollment" means, it obviously applies to *all* of these various benefit programs. In all of these benefit programs, a participant must first become enrolled before he or she can obtain the

benefits offered. And that is precisely what is meant by "effecting enrollment" – the purely ministerial act of making someone a participant in an employee benefit plan.

As the foregoing examination of the language of the EBL Endorsement shows, the district court was wrong to conclude that the alleged acceptance of a faulty appraisal that was used by ERISA fiduciaries in determining how much should be paid for investments by the ESOP was an act that fell within the term "administration." Under the clear language of the policy, "actions . . . taken *in setting up*" (ER 66 (emphasis added)) an Employee Benefit Plan in the first place do not fit within the definition of "administration"; they are simply not the same as "effecting enrollment" of plan participants.

b. The Misunderstanding Of How And When Participants Are Enrolled In An ESOP Or Other ERISA Employee Pension Benefit Plan

In ruling that ILMI had a duty to defend Darby and the Russells in the *Behling* litigation, the district court observed that "actions . . . taken in setting up" the ESOP and in making initial investments are covered under "administration" because those actions "*effected* enrollment of the employees." ER 66 (emphasis added). As explained above, the district court may have simply been confusing "effect" with "affect." At the same time, though, the district court may have been relying on a mistaken conception of how ESOPs are created and how and when new participants are enrolled in them. In other words, the district court may have believed that the

investment decisions made by ERISA fiduciaries such as the Russells in connection with the loan and stock purchase are inextricably connected with, and perhaps a necessary precondition to, the *enrollment* of new participants in the pension benefit plan. If so, the district court misunderstood how enrollment works in this setting.

Although ESOPs are a type of plan "*designed* to invest primarily in *qualifying employer securities*" (29 U.S.C. § 1107(d)(6)(A) (emphases added)), there is no legal requirement that they *make* such investments *before* enrollment of participants occurs – or that they eventually purchase the company's *common stock* (as opposed to other types of "qualifying employer securities"). Put differently, neither ERISA nor the Internal Revenue Code provides for a nexus between the funding of a plan and the enrollment of plan participants. Indeed, as we discuss below in more detail, federal law authorizes the enrollment of participants in an ESOP (and in other types of plans) *months and even years before the ESOP is actually funded* (which, of course, is a prerequisite to investment of the plan's assets). See pages 29-31, *infra*; 29 U.S.C. § 1052(a)(4); I.R. Code 410(a)(4), 26 U.S.C. § 410(a)(4); I.R. Code 404(a)(6), 26 U.S.C. § 404(a)(6).

In addition, an ESOP is nothing more than a *regulatory category* of ERISA employee pension benefit plans. If for some reason an employee pension benefit plan ceases to qualify as an ESOP, the plan does not cease to exist or become defunct. Instead, it merely becomes another *type* of employee pension benefit plan. But this

regulatory "cross-over" does not terminate the enrollment of plan participants. Nor does an employee pension benefit plan have to qualify for ESOP status before it may enroll participants. Enrollment and ESOP status are unconnected and independent. In multiple respects, then, the essential premise of the district court's analysis was wrong.

To see why that is so, it is necessary to examine how ERISA defines and regulates ESOPs as well as other categories of employee pension benefit plans. Section 3(2)(A) of ERISA, 29 U.S.C. § 1002(2)(A), defines an "employee pension benefit plan" as

> any plan, fund, or program . . . established or maintained by an employer . . . to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program (i) provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.

As this definition makes clear, the defining feature of an employee pension benefit plan is not the manner in which plan assets are invested. Instead, it is the fact that it provides retirement income or deferred income to employees who participate in the plan. Nor does this definition make the enrollment of participants dependent in any way upon how the employee pension benefits plan's assets are invested, either before or after such enrollment.

ERISA also goes on, in Section 407(d)(6), 29 U.S.C. § 1107(d)(6), to define an ESOP as follows:

> The term 'employee stock ownership plan' means an individual account plan –
>
> (A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase plan both of which are qualified, under section 401 [of the Internal Revenue Code], and which is designed to invest primarily in qualifying employer securities, and
>
> (B) which meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

Thus, an ESOP is not a single, undifferentiated type of employee pension benefit plan. Rather, it is "an individual account plan" that is *either* a "stock bonus plan" *or* a combination "stock bonus plan" and "money purchase plan." Under Section 407(d)(3)(A) of ERISA, 29 U.S.C. § 1107(d)(3)(A), an "individual account plan" is further defined, among other things, as (i) a profit sharing, stock bonus, thrift, or savings plan, (ii) an ESOP, or (iii) a money purchase plan in existence on the date of enactment of ERISA. The statute does not define a "stock bonus plan" or a "money purchase plan" but those terms are defined in Treasury regulations issued under Section 401(a) of the Internal Revenue Code of 1986.[4]

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[4] See, *e.g.*, 26 C.F.R. § 1.401-1(b)(1)(iii) ("A *stock bonus plan* is a plan established and maintained by an employer to provide benefits similar to those of a profit sharing plan, except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer company. For the purpose of allocating and distributing the stock of the employer which is to be shared among his employees or their beneficiaries, such a plan is

Thus, an ESOP is fundamentally either a stock bonus plan or a combination stock bonus and money purchase plan, both of which qualify as employee pension benefit plans under ERISA. An ESOP that falls short of the requirement that its assets be "primarily invested in qualifying employer securities" does not cease to exist as an employee pension benefit plan. Rather, it continues to exist as either a stock bonus plan or a combination stock bonus and money purchase plan. In either case, eligible employees may continue as participants in the plan, new participants may be enrolled, and participants who lose their eligibility may have their participation terminated.[5] By the same token, participants may be "enrolled" in an employee pension benefit plan even though it is not as yet an ESOP (because its assets are not yet primarily

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subject to the same requirements as a profit-sharing plan.") (emphasis added). A "money purchase pension plan," in contrast, is essentially a "pension plan" with a non-actuarially determined employer contribution: "A pension plan within the meaning of [Internal Revenue Code] section 401(a) is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement." *Id.* § 1.401-1(b)(1)(i). "A plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for purposes of section 401(a), be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits, or, as in the case of money purchase pension plans, such contributions are fixed without being geared to profits." *Ibid.*

[5] For this reason, an ESOP that once was primarily invested in qualifying employer securities but ceases to do so because of (for example) a tender offer ceases to be an ESOP but it does not automatically cease to be an employee pension benefit plan under ERISA. It may continue its existence as a stock bonus plan, a combination stock bonus and money purchase plan, or, if properly amended, as some other type of individual account plan such as a profit sharing plan. Disenrollment of the ESOP participants is not triggered by such events.

invested, or at all invested, in "qualifying employer securities").[6] Enrollment, in short, does not hinge on the plan's investments or status as an ESOP.

Even if an ESOP could *not* exist unless it acquired "qualifying employer securities" of the sponsoring employer, there is no legal requirement that such acquisition occur *before* participants are enrolled. In the case of a leveraged ESOP (which has borrowed the funds necessary to acquire "qualifying employer securities"), such as the Darby plan, there is no legal obligation that the proceeds of the acquisition loan be used immediately to purchase qualifying employer securities – and certainly no requirement that such purchases occur before eligible employees are enrolled. In fact, the Department of Labor's regulations require only that the proceeds of such a loan be used "within a reasonable time after their receipt" by the borrowing ESOP to acquire qualifying employer securities. See 29 C.F.R. § 2550.408b-3(d) (regulation governing ESOP loans that are exempt from ERISA's prohibited transactions provisions). Thus, the purchase of the common stock of the sponsoring employer of the ESOP is not a condition precedent to the establishment of an ESOP, is not a condition or other requirement for "effecting enrollment" of the employees eligible

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[6] See ERISA Section 407(d)(5), 29 U.S.C. § 1107(d)(5) (defining a "qualifying employer security," in pertinent part, as "an employer security which is (A) stock, (B) a marketable obligation (as defined in subsection (e) . . .), or (C) an interest in a publicly traded partnership"); *id.* § 1107(e) (defining "marketable obligation" as including bonds, debentures, notes, certificates, or other evidence of indebtedness, of the sponsoring employer).

to participate in the ESOP, and is not a prerequisite for the existence of an employee pension benefit plan as defined by ERISA.

The independence of (a) enrollment of eligible employees as participants in ESOPs and in other employee pension benefit plans and (b) specific decisions about how plan assets are invested is further confirmed by the provisions of the Internal Revenue Code applicable to the *creation and funding* of plans (including ESOPs) that are intended to qualify for favorable federal income tax treatment (so-called "qualified plans"). Pursuant to I.R. Code Section 401(b), 26 U.S.C. § 401(b), an employer may adopt a qualified plan as of any date, even if retroactive, in the taxable year of the employer in which the plan is created. Thus, for example, if a company's taxable year is the calendar year, it may adopt an ESOP on December 31, 2003 and make the plan effective retroactively a full year earlier – on January 1, 2003. As of January 1, 2003, all employees who at that time satisfied the ESOP's eligibility requirements for enrollment (participation) in the plan would have become participants. This is required by I.R. Code Section 410(a)(4), 26 U.S.C. § 410(a)(4), which mandates, as a matter of plan qualification, that an otherwise eligible employee *must* commence participation in the plan no later than the first day of the first plan year beginning after the date on which the employee has satisfied the ESOP's eligibility requirements for enrollment.

Moreover, I.R. Code Section 404(a)(6), 26 U.S.C. § 404(a)(6), allows a taxpayer until the due date of its corporate income tax return, plus extensions thereof, to make its initial contribution to the ESOP – and deems such initial contribution to have been made as of the last day of the *preceding* calendar year. See also Rev. Rul. 81-114, 1981-1 CB 207 ("[D]eductions are allowable under section 404(a) of the Code for contributions paid after the close of the taxable year, but within the time prescribed for filing the employer's income tax return for the preceding year, even though the employees' trust did not have a corpus at the close of the preceding year."). This means that, under the hypothetical just given, the employer would have until *March 15, 2004* – or, if the due date of its 2003 corporate income tax return were automatically extended, *until September 15, 2004* – to make its initial contribution to the ESOP for the 2003 plan year. Thus, under this scenario, federal law permits *a delay of 20½ months* from the date (January 1, 2003) that the ESOP first enrolled participants and the date (September 15, 2004) that the ESOP *first had any plan assets*. Since the existence of plan assets is obviously a necessary prerequisite to investing those assets, these I.R. Code provisions conclusively demonstrate the complete independence – functionally and temporally – of enrollment and investment decisions.[7]

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[7] Under I.R. Code Section 410(a)(4)(B), 26 U.S.C. § 410(a)(4)(B), a qualified plan is required, at a minimum, to have dual entry dates each year that are no more than six months apart. Thus, under the hypothetical given in text, there would be *at*

Because the funding of the ESOP and the purchase of Darby's common stock were not necessary preconditions to "[e]ffecting enrollment" of plan participants, it follows that neither was the prior acceptance of an appraisal of the value of that stock from a qualified professional appraiser (and the same holds true for any other actions that were undertaken in preparation for the stock purchase). Yet this is precisely the rationale adopted by the district court. Acceptance (even negligent acceptance) of an appraisal of assets that are purchased by an ESOP plan bears no relationship to "effecting" the enrollment of a participant (or participants) in the plan itself.

Finally, even if the August 26, 1994 purchase of the Darby common stock *was* a necessary precondition to enrolling ESOP participants, and the acceptance of the appraisal *was* a necessary precondition to the purchase, the plaintiffs' argument would still prove too much. In essence, their position is that "effecting enrollment" includes all conduct that is a "but for" cause of enrollment. Because enrollment may never occur "but for" an initial purchase of employer stock, the argument goes, the stock purchase (and the appraisal that necessarily precedes it) counts as bringing about the enrollment. Under that logic, however, the same can be said for the legal work undertaken to create the ESOP and the ESOT – since without that work, "an ESOP cannot exist, and no employee can be enrolled." Darby Reply in Support of Motion

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least four enrollment dates for newly eligible employees during the 20½ month period between the creation of the ESOP (and initial enrollment of participants) and the date on which the ESOP was first funded.

for Summary Judgment at 8. The legal work undertaken to create the ESOP and ESOT, however, obviously does not qualify as "effecting enrollment" of new participants or "administration" of the ESOP. The plaintiffs' argument is thus far too broad. For that reason as well, it should have been rejected.

B. The District Court's Ruling Finds No Support In The Case Law

In holding that "effecting enrollment" under the EBL Endorsement covered the allegations of the *Behling* complaint, the district court purported to draw support from *Maryland Casualty Co.* v. *Economy Bookbinding Corp. Pension Plan & Trust*, 621 F. Supp. 410 (D.N.J. 1985). That reliance was misplaced. *Maryland Casualty*, as well as the other cases in the sparse body of law relating to EBL policies, *favors* ILMI's position that there was no coverage here – and thus no duty to defend.

In *Maryland Casualty*, the court considered an EBL policy that was (as the court here correctly recognized) "nearly identical" (ER 65) to ILMI's policy (including the use of the same four-part definition of "administration"). "It is clear" that this language, the *Maryland Casualty* court explained, "limits coverage to liability incurred in *relatively routine, ministerial acts* performed in relation to the Pension Plan, and avoids coverage of liability incurred *in the decision-making and monitoring involved in managing the Plan's investments.*" 621 F. Supp. at 413 (emphases added). For that reason, the court explained, the insurer deserved summary judgment on the claim that various individuals who were administrators or trustees of an ERISA plan

"violated their fiduciary and statutory (ERISA) duties" by their actions in investing plan funds in the company's own securities. *Id.* at 412. The *Maryland Casualty* court reasoned:

> ERISA allows such purchases [of the company's own stock] of up to 10% of a plan's funds; here, 16% was purchased. Defendant Davanzo claims the purchase was a result of an innocent error in calculating the Plan's assets, and therefore was "negligent" and should be covered. This is clearly a question of fact.
>
> But "investment" is not "administration" under the contract. Although the miscalculation may have been "administration" *under the second or third clause in the definition "interpreting the . . . programs" – "handling of records"* – the investment itself is what is complained of, and *this does not fall within the definition.* In fact, it is just this sort of loss through bad investments that the definition of the word administration is intended to exclude.

Id. at 413-14 (emphases added). For largely the same reason, the court held that the policy did not cover a separate claim alleging that the trustees or administrators failed to collect accounts receivable for the ERISA plan (specifically, certain interest on real estate purchase money which was returned). See *id.* at 414 ("The collection of such accounts is a task associated with the *management* of investment funds, not with the *administration* of the Plan." (emphasis added)).

In this case, the district court thought it significant that the *Maryland Casualty* court "noted that miscalculation of the percentage of funds invested in Economy Bookbinding's own securities *may* have fallen under the policy's definition of administration." ER 65 (emphasis added). At the same time, however, the court

acknowledged that *Maryland Casualty* court had "determined that the underlying plaintiff's [sic] were complaining of the 'investment itself,' which did not fall within the policy's definition of administration." *Ibid*. Nevertheless, the court here wrote:

> Darby Lumber and the Russells are accused, in part, of overvaluing Darby Lumber stock that they sold to the Trust to be invested in the ESOP. However, a potential finding in the underlying suit based on the allegations of negligence in the Complaint is that Darby Lumber negligently accepted an incorrect appraisal. Following this reasoning, Darby Lumber then miscalculated the value of its stock based on its negligent act of accepting the appraisal. These actions were taken in setting up the ESOP, which effected enrollment of the employees. As the *Maryland Casualty* court recognized, a miscalculation of the value of the stock *may* fall within the definition of administration.

Id. at 12 (emphasis in original).

The district court's reliance on *Maryland Casualty* is flawed in at least four ways. *First*, the tentative observation made in *Maryland Casualty* was *dictum*. *Second*, the *dictum* had nothing to do with the meaning of "effecting enrollment" under the policy's definition of "administration." As the passage quoted above makes clear, the *Maryland Casualty* court offered the view that a miscalculation of the kind alleged in that case might qualify under the "program interpretation" or "records handling" components of administration – *not* as an example of "effecting enrollment." *Third*, there is no comparison between the simple, mathematical error posited in *Maryland Casualty* – which *is* a "relatively routine, ministerial act[] performed in relation to the Pension Plan" (621 F. Supp. at 413) – and the allegation that the Russells "negligently accepted an incorrect appraisal" (ER 66), which is

hardly a ministerial or routine act, and which instead implicates the very "decision-making and monitoring involved in managing the Plan's investments" that the *Maryland Casualty* court *held* does *not* qualify as "administration." 621 F. Supp. at 413. *Fourth*, and relatedly, the district court seized on this irrelevant *dictum* while at the same time ignoring the central holding of *Maryland Casualty*, which is that policy language of the kind involved here does *not* cover the type of investment decisions by ERISA fiduciaries that are at the heart of the allegations underlying the *Behling* suit.

Contrary to the district court's analysis, then, *Maryland Casualty* strongly supports ILMI's position and demonstrates that there is no coverage (and thus no duty to defend) here. And other decisions involving the interpretation of EBL policies are consistent with the holding of *Maryland Casualty* that such policies "limit[] coverage to liability incurred in relatively routine, ministerial acts performed in relation to the Pension Plan" and accordingly exclude "the decision-making and monitoring involved in managing the Plan's investments." 621 F. Supp. at 413.

For example, in *Bendis* v. *Hartford Accident & Indemnity Co.*, 1993 WL 463617 (D. Kan. Sept. 16, 1993), the court held that there was no coverage and thus no duty to defend under an EBL policy that also defined "administration" as including the "handling of records" and the "effecting or terminating [of] enrollment" of participants in the company benefit programs. That language, the court explained, does not encompass allegations that several company officials conspired to defraud

a participant of bonus and stock option rights under a benefit plan, or breached and made misrepresentations concerning a stock option contract to which the participant was a party. *Id.* at *1. The *Bendis* court's analysis obviously reflects a far narrower conception of "effecting enrollment" than was applied by the district court here. The *Bendis* court was not willing to read the policy language as covering everything that might "*a*ffect" the enrollment or termination of plan participants. See also *Lapeka* v. *Security National Ins. Co.*, 814 F. Supp. 1540, 1550-51 (D. Kan. 1993) (refusing, among other things, to hold that an EBL policy's reference to "effecting or terminating" participation of employees as part of definition of "administration" covered the termination of employees from their jobs in order to cut costs); *Arbella Protection Ins. Co.* v. *Tark Eng'g Corp.*, 2001 WL 1349654, at *3 (Mass. Super. Ct. Oct. 19, 2001) (agreeing with the insurer's position that under an EBL policy paralleling ILMI's, liability arising out of errors or omission in the "administration" of an employee benefits plan is "limited to clerical or ministerial mistakes in administering the plan" and does not include claims for wrongful termination) (citing *Maryland Casualty* and *Lapeka* with approval).[8]

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[8] In the district court, the plaintiffs relied on *Wyman-Gordon* v. *Liberty Mutual Fire Ins. Co.*, No. 962208A (Mass. Super. Ct. 2000). That case is distinguishable. Most obviously, the EBL policy at issue was broader in scope than the policy language in *Maryland Casualty*, *Bendis*, and *Lapeka* (as the Massachusetts trial court expressly recognized). See also *Arbella Protection*, 2001 WL 1349654, at *3. It was also broader than the EBL language involved here. The policy in *Wyman-Gordon* defined "administration" as including "the determination of the eligibility of

Indeed, in virtually *all* of these cases the courts have rejected attempts by insureds to expand the extremely limited scope of EBL policies to cover claims that are markedly different (and, typically, as here, the subject of an entirely different kind of insurance coverage). Thus, in *Arbella Protection* and *Lapeka*, litigants sought to invoke EBL policies to cover wrongful termination and associated claims arising out of the loss of employment (and the accompanying loss of benefits). Similarly, in *Bendis*, an insured claimed that a dispute over whether an employee had been defrauded out of benefits by the employer was covered by an EBL policy. And in *Maryland Casualty & New Hampshire Insurance Co.* v. *Westlake Hardware, Inc.*, 11 F. Supp. 2d 1298 (D. Kan. 1998), aff'd, 1999 WL 1066836 (10th Cir. 1999), the insureds sought, unsuccessfully, to invoke coverage under an EBL policy for claims of intentional wrongdoing and breach of fiduciary duties under ERISA with respect to discretionary decisions made concerning employee benefits.

In this case as well, the plaintiffs are essentially seeking to convert a standard EBL rider into a vastly different – and vastly more expensive – form of insurance: insurance for breach of fiduciary duties under ERISA. As commentators have pointed out:

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employees to participate in the employee benefits program" and the underlying lawsuit challenged the company's decision to require retired workers who were participants to contribute to the benefit program in order to continue to receive benefits.

> The exposure insured by the Employee Benefits Liability endorsement is liability arising out of errors or omissions in the administration of an employee benefits plan. The covered administrative functions are usually defined as giving advice to employees about the covered benefits program, interpreting the covered program's regulations for an employee, keeping records in connection with the covered program, and enrolling or cancelling participation in the covered program.
>
> This endorsement does not provide coverage for benefits due from employers, nor for liabilities arising under ERISA, which imposes fiduciary liability in connection with the management of benefit plan assets and prohibits certain transactions in the investment and disbursement of plan funds. Instead, this coverage is provided under the Fiduciary Liability policy.

Paul E.B. Glad and Richard V. Rupp, *Employment-Related Liability Claims and Insurance*, 716 PLI/Comm. 721, 728 (1996); see also Douglas Richmond, *Insurance Coverage for Employee Benefits Liability*, 22 INSURANCE LITIG. RPTR. 335, 339 (July 1, 2000) ("EBL endorsements are often misunderstood. . . . [They] insure against negligence in the performance of routine ministerial acts. Broader coverage must come in the form of employment practices liability insurance and fiduciary liability policies.").

C. The District Court's Analysis Also Ignores – And Effectively Extinguishes – The Crucial Distinction Between EBL Insurance And Pension Fiduciary Liability Insurance

Although the district court's decision should be reversed because it rested on a misreading of the EBL Endorsement and of the relevant case law, as well as a misunderstanding of how ESOPs work, this Court should also be concerned about the broader ramifications of these errors. At bottom, the district court's holding ignores

the clear distinction – long reflected in the practice of the insurance industry – between (a) garden-variety EBL insurance of the type involved here, which is a relatively inexpensive add-on to general commercial liability insurance, and (b) pension fiduciary liability insurance, a highly specialized, far more expensive, and typically freestanding, form of insurance coverage (which may, but sometimes does not, encompass EBL negligence claims as well).

The distinction between these two types of insurance is well established and widely recognized in the industry. See generally EMMETT VAUGHN & THERESE VAUGHN, FUNDAMENTALS OF RISK AND INSURANCE 593 (9th ed. 2003) (noting distinction between (i) "[p]ension fiduciary liability insurance," which is designed to protect against exposure for violations of the responsibilities imposed under ERISA "on employers and fiduciaries supervising pension plans and group life and health insurance programs," including violations of "the prudent man rule in the supervision of such a plan," and (ii) "employee benefit errors and omissions coverage, which protects against liability arising from errors in advising employees and from other types of mistakes related to a fringe benefit plan"); INTERNATIONAL RISK MANAGEMENT INSTITUTE, FIDUCIARY LIABILITY POLICY COVERAGE ANALYSIS § XII.C.8 (Mar. 2002) ("*Fiduciary liability insurance* covers claims alleging breach of discretionary duties specified by the 1974 ERISA law (e.g., failure to invest plan assets prudently); *Employee benefits liability* policies cover claims involving

nondiscretionary, administrative errors pertaining to pension and benefit plans (e.g., failing to name an intended beneficiary on a life insurance policy).") (emphases in original); John L. Bayley, *A General Overview of Fiduciary Liability Insurance Coverage*, ELC Glass CLE 619, 630 (1998) (calling EBL coverage "much more limited in scope" than fiduciary liability policies).

As a commentator has explained:

> EBL coverage is not a panacea for employers who fear liability attending employee benefit decisions. . . . [I]t is limited in its scope. EBL coverage is intended only to provide coverage for negligent acts, errors and omissions in the administration of employee benefit plans or programs. This includes routine ministerial tasks, such as adding new employees to coverage, explaining benefits to employees, implementing beneficiary changes, and the like. ERISA liability is excluded, as is liability for bodily injury, and damage to and the loss of use of tangible personal property. An EBL endorsement does not insure against liability flowing from an employer's discretionary acts or business judgment in the administration of its employee benefits programs. EBL coverage is thus much narrower than coverage under "fiduciary liability" policies. Fiduciary liability policies are designed specifically to respond to ERISA liability, including liability flowing from plan administrators' discretionary judgment, in addition to insuring against negligence in employee benefits administration.

Douglas Richmond, *supra*, 22 INSURANCE LITIGATION RPTR. at 335 (footnotes omitted); see also *ibid*. (noting that "fiduciary liability coverage is significantly more expensive than EBL coverage" because of the "catastrophic liability" that fiduciary conduct may trigger). Thus, pension "fiduciary liability" insurance is a "specialized liability coverage[]" that is "designed to meet [a] specific exposure[]." EMMETT VAUGHN & THERESE VAUGHN, *supra*, at 592-93. In contrast, the Commercial General

Liability policy is, as its name suggests, "designed to insure those *general liability exposures* that are *common to most organizations*: premises and operations, products and completed operations, liability arising out of independent contractors, and contractual assumptions of liability." *Id.* at 585 (emphasis added); see also *id*. at 583-84 (explaining each of these categories of general liability exposure).

The EBL policy in this case is entirely consistent with the generalized nature of the CGL policy to which it was added – and singularly ill-suited to address the specific exposure of ERISA fiduciary liability. Thus, the EBL Endorsement covered "injur[ies] caused by any negligent act, error or omission of the 'Insured' or of any other person for whose acts, errors, or omissions the 'Insured' is legally liable, in the administration of the 'Insured's Employee Benefit Programs[]'" (EBL Endorsement ¶ 1, ER 43), and it defined the covered "Employee Benefit Programs" broadly to include those programs that are common to most organizations: "group life insurance, group accident or health insurance, profit sharing plans, pension plans, employee stock subscription plans, workers compensation insurance, unemployment insurance, social security, disability benefits insurance, and payroll deduction plans" (*id*. ¶ 3(b), ER 43). This language plainly extends far beyond ERISA plans. The EBL Endorsement's relationship to the CGL policy provides further insight into the proper interpretation of the Endorsement's coverage – and further illustrates the error of the district court's analysis. See MONT. CODE ANN. § 28-3-402 (2003) ("A contract may

be explained by reference to the circumstances under which it was made and the matter to which it relates.").

The fact that EBL coverage is *not* intended to cover potentially expensive claims for breach of fiduciary duties under ERISA is further confirmed by the Endorsement's limitation to damages caused by "*negligent* act[s], error[s], or omission[s] . . . in the administration of the [policy]." EBL Endorsement ¶ 1, ER 43 (emphasis added). The ordinary negligence standard, of course, differs greatly from the specialized standard of care imposed on plan fiduciaries by ERISA. See note 2, *supra*. The district court concluded, however, that this language *also* stated a claim for negligence. Under that logic, almost any EBL policy covering negligent "errors and omissions" would obligate the insurer to defend ERISA fiduciary litigation, if the alleged breach could in some way be tied (if only by allegation) to the "setting up" of the plan. Indeed, *any* claim for breach of ERISA fiduciary duties arising out of the purchase of qualifying employer securities for an ESOP could, under the district court's reasoning, be brought within an EBL endorsement such as the one here through the simple expedient of identifying some ministerial act attendant to an investment decision (such as the acceptance of an appraisal) and claiming that it was done negligently. That cannot possibly be right.

As the foregoing makes clear, the definition of "administration" is critically important to maintaining the proper boundary between EBL coverage and pension

fiduciary liability insurance. The district court erred by expanding the concept of administration beyond recognition so that it could cover a host of discretionary judgments by plan fiduciaries.

At the end of the day, Darby and the Russells are seeking in this litigation to get much more than they actually, and knowingly, paid for. They did not purchase the more expensive pension fiduciary liability insurance from ILMI. Instead, they opted for a simple EBL Endorsement to their general CGL coverage. Yet "[b]uying only an EBL endorsement under a CGL policy and not purchasing a fiduciary liability form leaves the organization uncovered for fiduciary liability claims. *This is because employee benefits liability policies do not cover fiduciary liability exposures*." INTERNATIONAL RISK MANAGEMENT INSTITUTE, *supra*, at § XII.C.35 (emphasis in original).

D. The Department Of Labor's Interpretation Of ERISA Confirms The Narrow Scope Of Plan "Administration"

For the reasons just given, it is no accident that the definition of "administration" in the EBL Endorsement includes only ministerial conduct that cannot give rise to ERISA fiduciary liability. The Labor Department's regulatory guidance confirms that "administration" of employee pension benefit plans does not include conduct that triggers the exercise of fiduciary duties. On June 25, 1975, shortly after ERISA's enactment, the Department issued an interpretive bulletin, ERISA IB 75-8 (29 C.F.R. § 2509.75-8), which gave general guidance related to

fiduciary responsibility. The bulletin included the following questions and answers concerning whether "administrative" acts can constitute fiduciary conduct under ERISA:

> Q: Are persons who have no power to make any decisions as to plan policy, interpretations, practices or procedures, but who perform the following administrative functions for an employee benefit plan, within a framework of policies, interpretations, rules, practices and procedures made by other persons, fiduciaries with respect to the plan:
>
> (1) Application of rules determining eligibility for participation or benefits;
>
> (2) Calculation of services and compensation credits for benefits;
>
> (3) Preparation of employee communications material;
>
> (4) Maintenance of participants' service and employment records;
>
> (5) Preparation of reports required by government agencies;
>
> (6) Calculation of benefits;
>
> (7) Orientation of new participants and advising participants of their rights and options under the plan;
>
> (8) Collection of contributions and application of contributions as provided in the plan;
>
> (9) Preparation of reports concerning participants' benefits;
>
> (10) Processing of claims; and
>
> (11) Making recommendations to others for decisions with respect to plan administration?
>
> A: No. Only persons who perform one or more of the functions described in section 3(21)(A) of the Act with respect to an employee

> benefit plan are fiduciaries. Therefore, a person who performs *purely ministerial functions* such as the types described above for an employee benefit plan within a framework of policies, interpretations, rules, practices and procedures made by other persons is not a fiduciary because such person does not have discretionary authority or discretionary control respecting management of the plan, *does not exercise any authority or control respecting management or disposition of the assets of the plan*, and does not render investment advice with respect to any money or other property of the plan and has no authority or responsibility to do so.

29 C.F.R. § 2509.75-8 (emphases added).

Comparing the non-fiduciary acts identified in the DOL guidance with the acts covered under the EBL endorsement in this case shows striking parallels. Thus, for example, the "handling of records in connection with the 'Employee Benefit Programs'" (EBL Endorsement ¶ 3(c), ER 43) is similar to the "[m]aintenance of participants' service and employment records," the "[p]reparation of reports required by government agencies," and the "[p]reparation of reports concerning participants' benefits" mentioned in the Labor Department regulation. Similarly, "[e]ffecting enrollment, termination or cancellation of 'Employees' under the 'Employee Benefit Programs'" (EBL Endorsement ¶ 3(c), ER 43) is akin to the "[o]rientation of new participants" and the "[a]pplication of rules determining eligibility for participation or benefits" – both mentioned in the Labor Department's guidance. This confirms that the insured acts under the EBL endorsement are "purely ministerial functions" that do not qualify as fiduciary functions. For that reason, the insured acts are not fiduciary acts that would violate Section 404 of ERISA, 29 U.S.C. § 1104. And the acts of

Darby and the Russells alleged in the *Behling* complaint as constituting violations of ERISA accordingly do not fall within the definition of "administration" contained in the EBL Endorsement.

E. In Any Event, Plaintiffs Failed To Show That The August 26, 1994 Loan And Stock-Purchase Transactions Fell Within The Policy Period

The district court also erred because the allegations of the *Behling* complaint fall largely outside of the policy period covered by the EBL Endorsement. For that reason as well, the coverage issue should have been resolved in ILMI's favor, and the district court should have ruled as a matter of law that ILMI had no duty to defend its insureds.

The Endorsement defines the "policy period" as "the period of time beginning with the date this endorsement becomes a part of an existing policy and ending with the expiration of the policy or cancellation date of the endorsement or policy, whichever date is earlier." EBL Endorsement ¶ 3(e), ER 43. ILMI's coverage for the Russells and Darby began on January 1, 1995. The EBL Endorsement contains a policy period and territory coverage provision, which states:

> This insurance applies only to claims made against the "Insured" within the United States of America, its territories or possessions, Puerto Rico or Canada:
>
> (a) During the "Policy Period", provided that the "Insured" had no knowledge of any circumstances which could reasonably result in a claim prior to the effective date of this Endorsement, and

(b) After the "Policy Period" has ended, if and only if the negligent act, error or omission from which the claim results occurred during the "Policy Period".

EBL Endorsement ¶ 5, ER 44.

ILMI's coverage for the Russells and Darby ended on October 1, 1999. The first notice of claim appears to have been the filing and subsequent service of the *Behling* complaint in December 1999. Accordingly, pursuant to Paragraph 5(b), coverage under the EBL Endorsement would not extend to events that occurred prior to January 1, 1995, and, as a consequence, would afford no coverage for the alleged fiduciary breaches and prohibited transactions relating to the ESOP loan and ESOP purchase of employer securities that occurred on August 26, 1994. By the same token, the EBL Endorsement would not extend to any actions by the Russells or Darby in negligently accepting a faulty appraisal of the value of the Darby stock – since such actions necessarily predated the August 1994 transactions themselves.[9]

Because ILMI does not owe coverage to the Russells or Darby for the events in August 1994 that are the heart of the *Behling* plaintiffs' claims, summary judgment

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[9] Even if a claim had been made against Darby or the Russells during the "Policy Period" it is undeniable that Darby and the Russells had knowledge of the circumstances which resulted in the claims prior to January 1, 1995, the effective date of the Endorsement. For that reason, even under Paragraph 5(a), there is no coverage for Darby or the Russells for acts, errors and omissions which occurred prior to January 1, 1995.

should have been granted to ILMI on the coverage issue (and thus on the duty to defend).

III. THE AWARD OF ATTORNEY'S FEES SHOULD BE VACATED

The district court awarded Darby and the Russells attorney's fees because, under Montana law, it is enough that an insurer is wrong in denying coverage – even if an insurer acts in good faith. If this Court concludes that ILMI was *right* in denying coverage, then it follows *a fortiori* that the Court should vacate the award of fees. See, *e.g.*, *Weiss* v. *St. Paul Fire & Marine Ins. Co.*, 283 F.3d 790, 798 (6th Cir.) ("[B]ecause we have held that St. Paul had no duty to defend, we will reverse the district court's judgment awarding attorney's fees and costs."), cert. denied, 537 U.S. 883 (2002); *Employers Mutual Casualty Co.* v. *Key Pharmaceuticals*, 75 F.3d 815, 824 (2d Cir. 1996).

CONCLUSION

The judgment should be reversed, and the order awarding attorney's fees should be vacated.

Dated: December 12, 2003

Respectfully submitted,

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Alan E. Untereiner
ROBBINS, RUSSELL, ENGLERT, ORSECK & UNTEREINER LLP
1801 K Street, N.W., Suite 411
Washington, D.C. 20006
(202) 775-4500

Lawrence W. Schmits
KRIEG DEVAULT LLP
One Indiana Square, Suite 2800
Indianapolis, Indiana 46204
(317) 636-4341

Mark S. Williams
WILLIAMS LAW FIRM, P.C.
235 East Pine
P.O. Box 9440
Missoula, Montana 59807
(406) 745-4350

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitations of Federal Rule of Appellate Procedure 32(a)(7)(B) because it contains 12,321 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii). This brief complies with the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6) because it has been prepared in a proportionally spaced typeface using the WordPerfect 10 word processing system in 14 point Times New Roman.

STATEMENT OF RELATED CASES

There are no related cases pending in this Court.

CERTIFICATE OF SERVICE

I hereby certify that on December 12, 2003, I caused to be served copies of the foregoing Brief for Appellant and an accompanying Excerpts of Record on the following by overnight delivery service:

W. Arthur Graham
Graham Law Firm
1008 South Avenue West
Missoula, Montana 59801

Richard A. Reep
Reep & Bell
2687 Palmer
Missoula, Montana 59808

Don Torgenrud
Torgenrud Law Office
109 First Avenue
St. Ignatius, Montana 59865

____