

**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MINNESOTA**

In re: )  
)  
SRC Holding Corp. ) Chapter 7 Case  
f/k/a Miller & Schroeder, Inc. ) BKY Case Nos. 02-40284 to 02-40286  
and its subsidiaries, ) Jointly Administered  
)  
Debtor. )

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Brian F. Leonard, Trustee, )  
)  
Plaintiff, ) ADV Case No. 03-4284  
)  
vs. ) **NON-CORE PROCEEDING**  
)  
Executive Risk Indemnity Inc., )  
)  
Defendant. )

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The Marshall Group, Inc., Jerome A. )  
Tabolich, James E. Iverson, Edward J. )  
Hentges, Kenneth R. Larsen, Steven W. ) **ORAL ARGUMENT REQUESTED**  
Erickson, Paul R. Eckholm, and Mary Jo )  
Brenden, )  
)  
Intervenors. )

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**NOTICE OF HEARING AND MOTION**

TO: Debtor SRC Holding Corporation, f/k/a Miller & Schroeder, Inc. and its subsidiaries, and its attorney, Thomas C. Atmore, LEONARD, O'BRIEN, SPENCER, GALE & SAYRE, LTD., 55 East 5th Street, Suite 800, St. Paul, MN 55101; and Brian F. Leonard, Trustee, LEONARD, O'BRIEN, SPENCER, GALE & SAYRE, LTD., 55 East 5th Street, Suite 800, St. Paul, MN 55101;

1. Defendant Executive Risk Indemnity Inc. moves the Court for the relief requested below and gives notice of hearing.

2. The Court will hold a hearing on this motion at 10:30am on December 16, 2004 in Courtroom 7 West, at the United States Courthouse, at 300 South Fourth Street, Minneapolis, Minnesota.

3. Pursuant to the Third Amended Scheduling Order and Order for Trial entered by Judge Dreher on September 30, 2004, any response to this motion must be filed on or before November 12, 2004. UNLESS A RESPONSE OPPOSING THIS MOTION IS TIMELY FILED, THE COURT MAY GRANT THE MOTION WITHOUT A HEARING.

4. As this case does not arise under Title 11 of the United States Code or fit within one of the categories listed in 28 U.S.C. § 157(b)(2), this is a non-core proceeding over which this Court has jurisdiction under 28 U.S.C. § 157(c)(1). *See In re Yukon Energy Corp.*, 138 F.3d 1254, 1259-60 (8th Cir. 1998) (holding that a state law fraud claim was a non-core proceeding); *Rosen-Novak Auto Co. v. Honz*, 783 F.2d 739, 742 (8th Cir. 1986) (holding that a coverage action by a debtor against its insurer was a non-core proceeding). The petition commencing this Chapter 7 case was filed on January 22, 2002. The case is now pending in this Court.

5. This motion is based on Fed.R.Civ.P. 56, made applicable in bankruptcy by Fed.R.Bankr.P. 7056, the attached Memorandum of Law, affidavit, exhibits, and all records and proceedings herein. Specifically, Executive Risk requests that the Court hold that the Securities Exclusion and General E&O Exclusion contained in Endorsement Nos. 3 and 9 in the insurance policy at issue in this case preclude the coverage sought by the Trustee and the Intervenors and, on that basis, enter judgment for Executive Risk.

WHEREFORE, Defendant Executive Risk Indemnity Inc. moves the Court for an Order granting its motion for Summary Judgment and directing that judgment be entered in favor of Defendant, and such other relief as may be just and equitable.

Dated: October 29, 2004

Respectfully submitted,

By: s/Susan E. Gustad  
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FAX: 202.719.7049

*Attorneys for Defendant Executive Risk  
Indemnity Inc.*

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	)	
Intervenors.	)	

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**DECLARATION OF DAVID H. TOPOL**

I, DAVID H. TOPOL, pursuant to 28 U.S.C. § 1746, hereby certify as follows:

1. I am a partner with the law firm of Wiley Rein & Fielding, counsel for Executive Risk Indemnity Inc. in the above-captioned adversary proceeding. I am a member in good standing of the bars of the State of Maryland and the District of Columbia and am admitted *pro hac vice* to the bar of this Court for the above-captioned adversary proceeding.

2. Exhibit 1 is a true and accurate copy of relevant excerpts from the deposition of James F. Dlugosch in this matter.

3. Exhibit 2 is a true and accurate copy of relevant excerpts from the deposition of Mary Marshall in this matter.

4. Exhibit 3 is a true and accurate copy of a facsimile from M. Marshall to R. Fierstein, dated 7/10/97 Bates numbered HAYS 00598.

5. Exhibit 4 is a true and accurate copy of M&S's Application for the 1997 Policy, Bates numbers ERII 006616-24.

6. Exhibit 5 is a true and accurate copy of an application that M&S completed for an American International Companies "Directors and Officers Liability and Private Company Reimbursement Insurance Policy, Bates numbers ERII 006609-15.

7. Exhibit 6 is a true and accurate copy of ERII Policy No. 751-075440-97, Bates numbers SRC1536-60.

8. Exhibit 7 is a true and accurate copy of a letter from M. Marshall to B. Mehlhaff with attached E&O Application, dated 3/10/97, Bates numbers HAYS 2028-36.

9. Exhibit 8 is a true and accurate copy of a letter from M. Marshall to B. Mehlhaff with attached Application, dated 10/31/97, Bates number HAYS 2007-08.

10. Exhibit 9 is a true and accurate copy of a Hays Group Meeting Agenda, dated 10/22/97, Bates number HAYS 002004.

11. Exhibit 10 is a true and accurate copy of a Hays Group Meeting Agenda, dated December 1997, Bates number HAYS 002002.

12. Exhibit 11 is a true and accurate copy of a Hays Group Meeting Agenda, dated January 1998, Bates numbers HAYS 001999-002001.

13. Exhibit 12 is a true and accurate copy of relevant excerpts from the deposition of Tom Nelson in this matter.

14. Exhibit 13 is a true and accurate copy of relevant excerpts from the deposition of Kenneth R. Larsen in this matter.

15. Exhibit 14 is a true and accurate copy of a letter from N. Franzese to K. Larsen, dated 5/8/00, Bates number SRC0029.

16. Exhibit 15 is a true and accurate copy of a facsimile from D. Hobot to K. Larsen, dated 7/25/00, Bates numbers SRC1532-35.

17. Exhibit 16 is a true and accurate copy of M&S's Application for the 2000 Policy, Bates numbers ER11 006530-33.

18. Exhibit 17 is a true and accurate copy of a letter from D. Hobot to K. Larsen dated 10/9/00 with ER11 Policy No. 8166-6027 attached, Bates numbers SRC0035-64.

19. Exhibit 18 is a true and accurate copy of the Trustee's Complaint in this matter.

20. Exhibit 19 is a true and accurate copy of the Complaint in Intervention of The Marshall Group, Inc., Jerome A. Tabolich, James E. Iverson, Edward J. Hentges, Kenneth R. Larsen, Steven W. Erickson, Paul R. Eckholm, and Mary Jo Brenden in this matter.

21. Exhibit 20 is a true and accurate copy of the Fourth Amended Consolidated Class Action Complaint in *In Re Heritage Bond Litigation*, Case No. 02-382 DT (RCx) (C.D. Cal.) (filed 9/17/03).

22. Exhibit 21 is a true and accurate copy of the complaint in *SEC v. Robert Kasirer, et al.*, Case No. 04-C-4340 (N.D. Ill., filed 6/29/04).

23. Exhibit 22 is a true and accurate copy of the Partial Stipulation of Settlement in *In Re Heritage Bond Litigation*, Case No. 02-382 DT (RCx) (C.D. Cal.).

24. Exhibit 23 is a true and accurate copy of an M&S Memorandum RE: Credit Committee Meeting, dated 12/1/97, Bates number MG023639.

25. Exhibit 24 is a true and accurate copy of an M&S Memorandum RE: Credit Committee Meeting, dated 6/23/98, Bates number MG023640.
26. Exhibit 25 is a true and accurate copy of an M&S Memorandum RE: Credit Committee Meeting, dated 9/10/98, Bates number MG023641.
27. Exhibit 26 is a true and accurate copy of an M&S Memorandum RE: Credit Committee Meeting, dated 10/5/98, Bates number MG023642.
28. Exhibit 27 is a true and accurate copy of an M&S Memorandum RE: Credit Committee Meeting, dated 3/3/99, Bates number MG023643.
29. Exhibit 28 is a true and accurate copy of the Second Amended Statement of Claim in *Salley v. Miller & Schroeder Financial, Inc., et al.*, NASD Case No. 01-03445.
30. Exhibit 29 is a true and accurate copy of the Second Amended Statement of Claim in *Onderwyzer, et al., v. Miller & Schroeder Financial, Inc., et al.*, NASD Case No. 01-05301, Bates numbers MG014217-37.
31. Exhibit 30 is a true and accurate copy of the Statement of Claim in *Moreland v. Miller & Schroeder Financial, et al.*, NASD Case No. 01-04161, Bates numbers ERII 002608-38.
32. Exhibit 31 is a true and accurate copy of Respondent Bruce Talley's Third Party Claim in *M.B. Timmerman, et al. v. Miller & Schroeder Financial, Inc., et al.*, NASD Case No. 01-06518, Bates numbers 000379-93.
33. Exhibit 32 is a true and accurate copy of Respondent Mark Augusta's Cross Claim in *Lenser, et. al. v. Mark Augusta, et al.* NASD Case No. 01-0113, Bates numbers ERII 002128-63.

34. Exhibit 33 is a true and accurate copy of Scott Penwarden's Third Party Claim in *Edge, et al. v. Penwarden, et al.*, NASD Case No. 01-03099, Bates numbers ERII 000076-103.

35. Exhibit 34 is a true and accurate copy of a letter from C. Campi to D. Reinhart, dated 2/8/02, Bates numbers SRC0070-73.

36. Exhibit 35 is a true and accurate copy of a letter from C. Campi to B. Huft, dated 5/14/02, Bates numbers ERII 002707-10.

37. Exhibit 36 is a true and accurate copy of a letter from C. Campi to M. Brennan, dated 6/13/02, Bates numbers ERII 002704-06.

38. Exhibit 37 is a true and accurate copy of a letter from S. McKelvey to E. Shermoen, dated 2/14/03, Bates numbers ERII 003074-79.

39. Pursuant to Local Rule 9013-2(e), this Declaration is provided as a summary of the exhibits supporting Executive Risk's Motion for Summary Judgment, which exceed 50 pages in length. A true and accurate copy of each of the exhibits described above is included, in PDF format, on the CD-ROM filed with the Court and served upon the each party to this proceeding.

40. I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on October 28, 2004

  
\_\_\_\_\_  
David H. Topol

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Intervenors.	)	
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**EXECUTIVE RISK INDEMNITY INC.'S MEMORANDUM IN SUPPORT OF ITS  
MOTION FOR SUMMARY JUDGMENT**

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## INTRODUCTION

This case involves the application of two unambiguous exclusions in a directors and officers (“D&O”) insurance policy (the “2000 Policy”) that Executive Risk Indemnity Inc. (“ERII”) issued to Miller and Schroeder, Inc. (“M&S”). Each exclusion independently precludes coverage for the lawsuits and arbitrations that M&S tendered to ERII, which allege a “Ponzi” scheme involving \$130 million in municipal bond issues, ostensibly designed to fund acquisition and renovation of health care facilities for Alzheimers patients, whereby funds from later bond issues were illegally shifted to cover shortfalls in earlier projects (the “Heritage Bond Litigation”). The plaintiffs in the Heritage Bond Litigation contend that the directors and officers of M&S – a company with approximately 100 employees – played a central role in the fraudulent scheme by, for example, serving on the credit committee that approved the bond offerings and failing to perform the necessary due diligence. The underlying plaintiffs therefore allege that the M&S directors and officers are liable for violations of federal, state and common law provisions in connection with the underwriting and sale of the Heritage Bonds. Indeed, the United States Securities and Exchange Commission has filed criminal charges against two of the M&S principals, including Plaintiff/Intervenor James Iverson, based on M&S’s central role as an architect in the Heritage Bond fraud.

Endorsement No. 3 to the 2000 Policy is a “Securities Exclusion,” which precludes coverage for any Claim “based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged violation of” any state or federal securities statute or regulation or any provision of the common law imposing liability in connection with the sale or purchase of securities. The underlying plaintiffs in the Heritage Bond Litigation allege that M&S and its officers and directors violated various securities laws, including the Securities Act of 1933, the Securities Exchange Act of 1934 and the California

Corporations Code, in connection with the underwriting and sale of the Heritage Bonds. The Securities Exclusion precludes coverage for precisely these types of allegations. Accordingly, the Securities Exclusion provides one basis for the Court to grant ERII's motion for summary judgment.

Endorsement No. 9 provides a second, independent basis for summary judgment. The Errors and Omissions ("E&O") Exclusion of Endorsement No. 9 precludes coverage for any claim "based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving" the provision of, or failure to provide, securities underwriting or securities broker/dealer services. The Heritage Bond Litigation centers on securities underwriting and securities broker/dealer services of M&S and its directors and officers. The E&O Exclusion therefore precludes coverage as well.

Both the Securities Exclusion and the E&O Exclusion are unambiguous and subject to only one reasonable interpretation, which precludes coverage. Plaintiffs have attempted in discovery to develop some extrinsic evidence in an effort to manufacture ambiguity; however, such evidence has no relevance. *See Pedersen v. United Services Auto Ass'n*, 383 N.W.2d 427, 430 (Minn. Ct. App. 1986) (extrinsic evidence is inadmissible to construe an insurance policy absent ambiguity in the policy language). Minnesota courts have consistently held that extrinsic evidence should not be considered by a court in making the legal determination whether a contract is ambiguous. *See Noran Neurological Clinic, P.A. v. Travelers Indem. Co.*, 229 F.3d 707, 710 (8th Cir. 2000); *In re Hennepin County 1986 Recycling Bond Litig.*, 540 N.W.2d 494, 498 (Minn. 1995).

Even if the Court were to consider extrinsic evidence, however, that evidence simply confirms the validity of ERII's position, because that evidence shows that M&S did not intend to

purchase, and ERII did not intend to offer E&O coverage for customer suits. M&S's insurance broker recommended that M&S purchase E&O coverage, and provided M&S with an E&O policy application that requested detailed information about the company's underwriting and broker/dealer activities. M&S elected not to purchase E&O coverage.

M&S did apply for D&O coverage. The detailed applications that M&S submitted to ERII provide information concerning stock ownership and board of directors activities, but none of the information about M&S's business operations or customers that would have been relevant to an insurer deciding whether, and on what terms, to provide E&O coverage for customer suits.

Although aware of the distinction between E&O and D&O coverage, M&S never applied for E&O coverage. Furthermore, when M&S applied for the 2000 Policy, the company never looked into changing the terms of its D&O coverage. Indeed, M&S's CFO, who was responsible for procuring insurance coverage, never even read the 2000 Policy, which plaintiffs now contend they expected to provide coverage for the Heritage Bond Litigation. M&S should not be permitted, after the fact, to transform its D&O Policy into an E&O Policy in order to obtain the insurance coverage it declined to purchase.

## **I. SUMMARY OF UNDISPUTED FACTS**

### **A. THE 1997 POLICY**

In 1997, MI Acquisition Corporation acquired Miller and Schroeder, Inc. and its subsidiaries ("M&S"). Dlugosch Dep. at 18-19, attached hereto as Exhibit 1. MI Acquisition Corporation accomplished this acquisition through a private placement of M&S stock.<sup>1</sup> *Id.* The acquisition became effective on July 31, 1997. *Id.*

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<sup>1</sup> Although the company's name was MI Acquisition Corporation, it did business as Miller & Schroeder, Inc. Ex. 1, Dlugosch Dep. at 20.

With the assistance of a retail insurance broker (Mary Marshall of the Hays Group) and a wholesale insurance broker (Richard Fierstein of ARC Excess & Surplus, Inc.), M&S sought to procure D&O insurance coverage to be effective at its inception. Marshall Dep. at 16-23 attached hereto as Exhibit 2; Facsimile from M. Marshall to R. Fierstein, dated 7/10/97, attached hereto as Exhibit 3. M&S dealt with Marshall who dealt with Fierstein, who dealt with ERII. Ex. 2, Marshall Dep. at 17-18.

M&S submitted to ERII an “Application for Directors and Officers Liability Insurance Policy Including Employment Practices Liability Coverage.” Attached hereto as Exhibit 4. James Dlugosch, the President of M&S, signed the application on August 7, 1997. *Id.* The D&O application requested, and M&S provided, information about M&S’s current D&O, commercial general liability, umbrella and employment practices liability policies. It did not ask whether M&S currently carried E&O coverage. The D&O application also contained detailed requests for information about shareholders, M&S’s board of directors and officers, auditors, sales of M&S’s own securities and human resource practices. The D&O application did not however, inquire into M&S’s business operations by asking, for example, how many customers M&S had, what securities it sold, or in what states it operated.

M&S also completed a second application for D&O coverage, which it provided to ERII. On July 25, 1997, Dlugosch signed an application for an American International Companies “Directors and Officers Liability and Private Company Reimbursement Insurance Policy.” Attached hereto as Exhibit 5. Like the ERII application, it requested information about stock ownership, activities of the board of directors and human resources practices. Like the ERII application, this application did not ask questions about M&S’s business operations or customers.

On September 16, 1997, ERII issued to M&S Policy No. 751-075540-97 (the “1997 Policy”). Attached hereto as Exhibit 6. The 1997 Policy is titled: “*The Power<sup>SM</sup>: Directors and Officers Liability Insurance Policy Including Employment Practices Liability Coverage.*” *Id.* at 1.

The insuring agreement of the 1997 Policy states:

The Underwriter will pay on behalf of the **Insured Persons Loss** from **Claims** first made against them during the **Policy Period** for **Wrongful Acts**, including **Employment Practices Wrongful Acts**, unless the **Company** pays such loss to or on behalf of the **Insured Persons** as indemnification.

*Id.*, § I(A). The 1997 Policy also provided that:

The Underwriter shall pay on behalf of the **Company . . . Loss** from **Claims** first made against the **Insured Persons** during the **Policy Period** for **Wrongful Acts**, including **Employment Practices Wrongful Acts**, if the **Company** pays such loss to or on behalf of the **Insured Persons** as indemnification; and . . . **Loss** from **Claims** first made against the **Company** during the **Policy Period** for **Wrongful Acts**, including **Employment Practices Wrongful Acts**.

*Id.*, § I(B). The 1997 Policy defined “**Claim**” as a “written notice received by an **Insured** that any person or entity intends to hold any **Insured** responsible for a **Wrongful Act.**” *Id.*, § II(B).

It defined “**Wrongful Act**” in pertinent part as any “actual or alleged act, error, omission, misstatement, misleading statement, or breach of duty by an **Insured Person** in his or her capacity as a director or officer of the **Company**” and “any matter asserted against an **Insured Person** solely by reason of his or her status as a director or officer of the **Company.**” *Id.*, §

II(M). The 1997 Policy defined “**Insured**” is defined as “the **Company** and any **Insured Person.**” *Id.*, § II(F). “**Company**” is defined as MI Acquisition Corporation doing business as Miller & Schroeder, Inc. and certain of its subsidiaries. *Id.*, §§ II(C) & (I) and Declarations, Item

1. The term “**Insured Person**” is defined, in relevant part, as “any past, present or future director or officer of the **Company** . . . .” *Id.*, § II(G)(1).

The grant of coverage in the 1997 Policy was, however, subject to a number of exclusions, including the Securities Exclusion set forth in Endorsement No. 3 and the E&O Exclusion set forth in Endorsement No. 9.

The Securities Exclusion set forth in Endorsement No. 3 states in its entirety:

In consideration of the premium charged, this Policy does not apply to any Claim based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged violation of:

- (1) the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, any other federal law, rule or regulation with respect to the regulation of securities, any rules or regulations of the United States Securities and Exchange Commission, or any amendment of such laws, rules or regulations; or
- (2) any state securities or “Blue Sky” laws or rules or regulations or any amendment of such laws, rules or regulations; or
- (3) any provision of the common law imposing liability in connection with the offer, sale or purchase of securities.

All other terms, conditions and limitations of this Policy shall remain unchanged.

*Id.*, Endorsement No. 3.

The 1997 Policy limited the application of the Securities Exclusion by expressly exempting the 1997 private placement of M&S stock from its scope. Endorsement No. 6, which is entitled “Limited Securities Coverage Endorsement,” states that “Endorsement No. 3 will not apply to any claim made against an Insured Person arising out of the offering, sale or purchase of

Common Stock as described more fully in the Private Placement dated as of May 20, 1997.” *Id.*,  
Endorsement No. 6.

In its entirety, the E&O Exclusion set forth in Endorsement No. 9 provides:

In consideration of the premium charged:

- (1) No coverage will be available under the Policy for Loss including Defense Expenses for any Claim made against any Insured based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving an insured’s actual or alleged rendering or failure to render the following services:

Investment Banking Services  
Security Broker/Dealer Services  
Securities Underwriting

- (2) Paragraph (1) above is not intended, however, nor shall it be construed, to apply to Loss, including Defense Expenses, in connection with any Claim against an Insured to the extent that such Claim is for a Wrongful Act by Insured Person in connection with the management or supervision of any division, Subsidiary or group of the Parent Corporation offering any of the aforementioned services.

*Id.*, Endorsement No. 9.

**B. The Unsubmitted E&O Application**

When procuring coverage, M&S chose to purchase a D&O policy. As *Couch on Insurance* explains, this is only one type of insurance that M&S could have purchased:

Within professional liability insurance, several different coverages are available. Under modern practice, two of the more common are (1) errors and omissions (E&O) coverage protecting against liability based on the failure of the insured, in his or her professional status, to comply with what can be considered in simplistic terms to be the standard of care for that profession; and (2) directors and officers (D&O) liability coverage, which has several variations, the most common of which appears to protect against both liability based on official actions of corporate officers and directors, and the expense of defending actions that seek to establish liability.

Lee R. Russ & Thomas F. Segalla 1 *Couch on Insurance* § 1:35 (3d ed. 2000).

Both before and after M&S purchased the 1997 Policy, its insurance broker recommended that it purchase E&O coverage. In a letter sent to Brad Mehlhaff of M&S in March of 1997, Mary Marshall of the Hays Group explained that “Miller and Schroeder currently *does not insure the professional exposure*” and enclosed a “Securities Broker/Dealer Errors and Omissions Liability Insurance Application” from American International Surplus Lines Insurance Company. Letter from M. Marshall to B. Mehlhaff with attached Application, dated 3/10/97, attached hereto as Exhibit 7 (emphasis added).

In stark contrast to the D&O applications, the E&O application requested detailed information regarding M&S’s provision of professional securities broker/dealer services, M&S’s customer base and past/pending claims by customers against M&S or its registered representatives. For example, the application asked:

- Give number of notices, letters and complaints received in the past three years by the Compliance Department.
- Does the Securities Broker/Dealer’s formal written procedures for supervising activities of Registered Representatives specifically address the handling of . . . [c]ustomer [c]omplaints [?]
- Describe measures the Securities Broker/Dealer has instituted for verifying customer orders and determining that confirmations are accurate and received on time.
- What percentage of client agreements contain arbitration clauses?
- Have any Professional Liability (E&O) (whether or not covered by insurance) claims been made during the past five years against the Securities Broker/Dealer or any Registered Representative?

*Id.* at 4-5.

After the 1997 Policy incepted, Marshall and the Hays Group continued to recommend to M&S that it procure E&O coverage. In a letter dated October 31, 1997, Ms. Marshall wrote to M&S recommending that, for E&O coverage, M&S “obtain[] a quote through the NASD

program, in addition to working with [the Hays Group] to review the balance of the market.”

Letter from M. Marshall to B. Mehlhaff, dated 10/31/97, attached hereto as Exhibit 8.

Ms. Marshall also prepared meeting agendas in October 1997, December 1997 and January 1998 for meetings with M&S that continued to raise E&O coverage as a topic for discussion.

Attached hereto as Exhibits 9-11.

### **C. THE 2000 POLICY RENEWAL**

ERII issued the 1997 Policy for a three-year period, so it was scheduled to expire on July 31, 2000. Ex. 6, 1997 Policy, Declarations, Item 2. At that point in time, M&S’s new Chief Financial Officer, Thomas Nelson, had assumed responsibility for handling insurance coverage issues. Nelson Dep. at 23, attached hereto as Exhibit 12. Kenneth Larsen – the Controller of M&S at the time of the renewal – assisted Nelson with matters relating to insurance procurement. Ex. 12, Nelson Dep. at 40-41; Larsen Dep. at 19-20, attached hereto as Exhibit 13.

Prior to the expiration of the 1997 Policy, M&S received a renewal application for D&O coverage from its new insurance broker, Marsh USA, Inc. (“Marsh”). Letter from N. Franzese to K. Larsen, dated 5/8/00, attached hereto as Exhibit 14. By facsimile dated July 25, 2000, Dan Hobot of Marsh provided a renewal proposal to Larsen of M&S, recommending that “given the current claims activity, the most advisable option would be to renew coverage with Chubb Executive Risk for either a one or three-year period.” Facsimile from D. Hobot to K. Larsen, dated 7/25/00, attached hereto as Exhibit 15. On June 22, 2000, James F. Dlugosch signed the application (the “2000 Application”), which M&S then submitted to ERII without requesting any change in coverage. 2000 Application, attached hereto as Exhibit 16.

Nelson and Larsen testified that they spent little time reviewing the renewal proposal, and never considered the renewal anything other than a straightforward continuation of the 1997 Policy. Ex. 12, Nelson Dep. at 48-52; Ex. 13, Larsen Dep. at 41-42. Indeed, Nelson expressly

testified that he never even read the 1997 Policy during the renewal process and that he did not request that Larsen do so. Ex. 12, Nelson Dep. at 48.

ERII issued a three-year D&O policy renewal to M&S, Policy No. 8166-6027 (the “2000 Policy”) a copy of which is attached hereto as Exhibit 17. The 2000 Policy and the 1997 Policy contain virtually identical language. Of particular note for this case, Endorsements Nos. 3, 6 and 9 are identical in both policies.

#### **D. THE UNDERLYING LITIGATION**

Plaintiffs’ complaints in this matter seek coverage for the “Heritage Bond Litigation.” See Trustee’s Complaint, ¶¶ 9-10, attached hereto as Exhibit 18; Intervenor’s Complaint, ¶ 21, attached hereto as Exhibit 19. The underlying plaintiffs in the Heritage Bond Litigation filed lawsuits and initiated arbitrations alleging that M&S and certain of its directors and officers violated federal, state and/or common law in connection with the underwriting and sale of municipal bonds used to finance the construction and/or renovation of Alzheimer’s treatment facilities in various states.<sup>2</sup> The underlying plaintiffs brought these actions in the United States District Court for the Central District of California, which has been assigned to handle the lawsuits arising out of the Heritage Bond Litigation, and the National Association of Securities Dealers arbitration program.

##### **1. Overview of the Heritage Bond Scheme**

The Heritage Bond offerings raised over \$130,000,000 between December 1996 and March 1999 to acquire, renovate and reopen former hospitals in four states as facilities designed to assist elderly persons. Complaint, *SEC v. Robert Kasirer, et al.*, Case No. 04-C-4340 (N.D.

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<sup>2</sup> Although every one of the underlying actions implicates M&S, some of the actions do not name it as a defendant because of the operation of the automatic stay following its bankruptcy filing. See, e.g., *In Re Heritage Bond Litigation*, Case No. 02-382 DT (RCx) (C.D. Cal.), Fourth Amended Consolidated Class Action Complaint (hereinafter “FAC”) ¶ 30 (filed 9/17/03), attached hereto as Exhibit 20.

Ill., filed 6/29/04) (hereinafter “SEC Complaint”), attached hereto as Exhibit 21. The Heritage Bonds were designed to be unrated, however, “they were to be marketed as ‘municipally approved’ and fulfilling an important ‘charitable’ purpose” – the creation and operation of geriatric Alzheimer’s healthcare facilities. Ex. 20, FAC, ¶ 144. Specific targets for the marketing of these bonds were “[a]ging ‘baby boomers,’ and donors to Alzheimer’s disease research and other geriatric causes.” *Id.*

As was set forth at length by the SEC in a securities fraud action filed against numerous individuals involved in the scheme, instead of using the funds raised by the Heritage Bond offerings to fully fund the facilities, certain individuals inflated the price of developing the facilities to their own financial advantage. Ex. 21, SEC Complaint, ¶ 3. The parties involved attempted to cover “the resulting cash shortfalls by operating a type of Ponzi scheme, commingling bond proceeds and diverting bond proceeds from more recent offerings to pay the expenses of earlier projects.” *Id.* ¶¶ 4-5; Ex. 20, FAC, ¶ 2. Eventually, however, all of the facilities went into receivership or bankruptcy. Ex. 21, SEC Complaint, ¶ 4; ; Ex. 20, FAC, ¶ 19. Each of the Heritage facilities is currently in default on its bond obligations. Ex. 21, SEC Complaint, ¶ 5. As set forth in more detail below, the FAC alleges that M&S, a relatively small company, was deeply involved in this scheme beyond simply the actions of the M&S-related defendants in the SEC criminal action.

## 2. The Heritage Bond Lawsuits

Between November 30, 2001 and October 28, 2002, purchasers of the Heritage Bonds filed four class action lawsuits, seeking relief against, among others, certain of the plaintiffs in this action for their alleged involvement in the sale of Heritage Bonds.<sup>3</sup> These actions were

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<sup>3</sup> See *In Re Heritage Bond Litigation*, Case No. 02-382 DT (RCx) (C.D. Cal.), Stipulation of Partial Settlement at 1-2, attached hereto as Exhibit 22.

eventually consolidated before Judge Dickran Tevrizian of the United States District Court for the Central District of California. Ex. 22, at 1. The court-appointed lead plaintiffs (the “Class Plaintiffs”) filed a series of Consolidated Class Action Complaints, culminating in the currently operative Fourth Amended Complaint. *Id.*

The FAC generally alleges that M&S both underwrote all of the \$130 million in Heritage Bonds and resold them to its clients. Ex. 20, FAC, ¶ 143. It further alleges that M&S and its officers, directors and employees widely distributed false official statements and aggressively marketed the Heritage Bonds. *Id.* ¶¶ 154-55.

The FAC names as defendants, among others, eight of the individuals who are plaintiffs/intervenors in this coverage action and were officers and/or directors of M&S: James E. Iverson, John M. Clarey, Edward J. Hentges, Kenneth R. Larsen, Jerome A. Tabolich, Paul R. Eckholm, Steven W. Erickson and Kenneth E. Dawkins (the “M&S Defendants”).<sup>4</sup> Ex. 20, FAC, ¶¶ 84-94. The FAC alleges that the individual M&S Defendants were directly involved in the purportedly unlawful activities giving rise to liability. For example, the FAC alleges that Iverson “was involved in performing due diligence and preparation of the Official Statements.” *Id.* ¶ 84. The FAC also alleges that “[c]orrespondence to him also show[s] that Iverson ratified the concealment of problems related to the Heritage offerings, including problems brought to his attention through dealings with Kasirer and through his supervision of Dhooge.” *Id.* ¶ 446(a).

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<sup>4</sup> The FAC also names John M. Clarey and Kenneth E. Dawkins as defendants. Dawkins and Clarey, along with Joseph K. Halloran, asked ERII and the other parties to this action to consent to their intervention in this adversary proceeding. Although each of these parties provided consent in September, Clarey, Dawkins and Halloran only recently filed that stipulation with the Court, which granted intervention on October 27, 2004. Clarey, Dawkins and Halloran have yet to file and serve their complaint in intervention. Notwithstanding this fact, the substance of this motion applies equally to them based on the allegations against them in the underlying litigation. *See, e.g.*, Ex. 20, FAC ¶¶ 86, 446(c) (alleging that Clarey was co-chair of the M&S credit committee.). The FAC does not name Mary Jo Brenden as a defendant. Internal M&S memoranda regarding credit committee meetings, which included in the documents produced by the Marshall Group in this action, confirm that Dawkins, Clarey, Halloran and Brenden were active members of the credit committee. *See* M&S Memoranda RE: Credit Committee Meetings dated 12/1/97, 6/23/98, 9/10/98, 10/5/98 and 3/3/99, attached hereto as Exhibits 23-27.

The FAC alleges that Mr. Clarey “was at all relevant times . . . co-chairman of Miller & Schroeder’s credit committee, with gate-keeper responsibility for approving the offer and sale of Heritage bonds to the public after reviewing the Heritage Bond due diligence documentation and the Official Statements.” *Id.* ¶ 86; *see also id.* ¶ 446(c). The FAC alleges that Tabolich, Erickson and Ekholm were “member[s] of Miller & Schroeder’s credit committee, with gate-keeper responsibility for approving the offer and sale of Heritage bonds to the public after reviewing the Heritage Bond due diligence documentation and the Official Statements.” *Id.* ¶¶ 90-92; *see also id.* ¶¶ 446(g)-(i).<sup>5</sup> The FAC further notes that “[t]he approval of the Heritage bond offerings required the unanimous consent of the credit committee.” *Id.* ¶ 86. The FAC alleges that Hentges was M&S’s Chief Compliance Officer and “was responsible for ensuring Miller & Schroeder’s compliance with securities laws, including its compliance in connection with the Heritage offerings.” *Id.* ¶ 446(e). In addition, the FAC states that M&S itself would be a defendant in the consolidated class action but for its bankruptcy filing. *Id.* ¶ 30.

The FAC asserts five causes of action against the M&S Defendants. First, the FAC asserts a cause of action for control person liability under § 20(a) of the Securities Exchange Act of 1934 against the M&S Defendants based on purported violation of Section 10(b) of the Securities Act of 1933. *Id.* ¶¶ 441-42, 445-47. Second, the FAC alleges a cause of action for control person liability under California Corporations Code § 25504 for purported violations of California securities laws. *Id.* ¶¶ 448-49, 451.

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<sup>5</sup> James Dlugosch, the former President and CEO of M&S, testified in his deposition that “[t]he credit committee’s responsibility was to review and determine that the credit that was being offered was acceptable for distribution in the way in which the underwriter was proposing to distribute it.” Ex. 1, Dlugosch Dep. at 66. Thomas Nelson similarly testified in his deposition that “Any new issuance of those bonds or any of the new issues that the company did had to be approved by the Credit Committee. So the public finance banker would present a package of information to the Credit Committee in advance to review. That would have included financials and a description of the financing. We would have met to ask questions, had discussions, and the financing would have been approved or not approved based on that.” Ex. 12, Nelson Dep. at 38.

In the third cause of action, the Class Plaintiffs plead negligence. *Id.* ¶¶ 461-63. The FAC alleges that

Defendants knew that prospective investors would rely upon the Official Statements. Thus, these Defendants owed a duty to Plaintiffs and the Class to exercise due care, in accordance with the standards utilized by reasonable prudent professionals, with respect to the investigations for and the drafting of the Official Statements, including but not limited to, the appraisals and the market feasibility studies.

*Id.* ¶ 462. As to the directors and officers of M&S, the Class Plaintiffs contend that “[a]s the underwriter [of the Heritage Bonds], . . . , the Principals of Miller & Schroeder and the Attorney Defendants had a duty to investigate to ensure that all material information concerning the Heritage Entities and the management companies were clearly and concisely disclosed in the Official Statements,” and that they failed to do so. *Id.* ¶ 463.

In the fourth count, Class Plaintiffs allege breach of fiduciary duties vis-à-vis the Class. *Id.* ¶¶ 474-81. The Class Plaintiffs contend that “[t]he Miller [&] Schroeder Principals had the ability to refuse to do bond offerings, and to dictate the disclosures in the Official Statements, yet never informed investors about their loans to Heritage.” *Id.*

Finally, the FAC asserts a cause of action for aiding and abetting breach of fiduciary duties against the M&S Defendants. *Id.* at ¶¶ 482-88. Specifically, the Class Plaintiffs contend that the M&S Defendants “had access to all of the financial information regarding the Heritage Facilities” and “knew of the false and misleading nature of the Official Statements and moreover, knew that the Facility renovations were not being adequately supervised, were going over budget and were delayed.” *Id.* ¶ 484. Furthermore, the FAC alleges that the M&S Defendants “knew of the primary wrong and assisted in order to retain their jobs and continue receiving monies.” *Id.* ¶ 485.

### 3. The NASD Arbitrations

Former customers of M&S have also initiated arbitration proceedings against M&S and its directors, officers and employees in connection with the Heritage Bonds. These arbitrations generally allege that M&S, its directors, officers and brokers are responsible for misrepresentations concerning whether the Heritage Bonds were sound investments, and that they lost significant sums of money when the alleged “Ponzi Scheme” that was the Heritage Bond system collapsed and the Heritage Bonds went into default. In some of the arbitration proceedings, M&S brokers brought third-party claims against M&S and its directors and officers alleging that the brokers were also victims because they unwittingly participated in the purportedly unlawful scheme perpetrated by the directors and officers. The following paragraphs discuss a representative sample of the NASD arbitrations filed against M&S, its directors and officers.

The Second Amended Statement of Claim in *Salley v. Miller & Schroeder Financial, Inc., et al.*, NASD Case No. 01-03445, attached hereto as Exhibit 28, contends that the sale of Heritage Bonds “violated state and federal laws regulating underwriters, the rules, regulations, standards of conduct imposed on licensed brokers and agents by the SEC, the California Department of Corporations, the Municipal Securities Rulemaking Board and the NASD.” Ex. 28, *Salley*, ¶ 32. The Statement of Claim in *Salley* names, among others Iverson, Tabolich, Hentges, Larsen, Erickson, Ekholm, Halloran, Dawkins Clarey and Brenden as respondents. *Id.* ¶¶ 18-19. The *Salley* claimants allege that the individuals “were at all relevant times herein key officers, underwriters, directors, members of the credit committee, and supervisors at Miller & Schroeder Financial, Inc.” *Id.* ¶ 18. The *Salley* claimants further allege that these individuals had “responsibility for the due diligence for the Heritage Health Care Bonds . . . , which were

sold to the public including the claimants, causing the substantial losses to the claimants because of the actions of the ‘CONTROL PERSONS.’” *Id.* ¶ 19.

The *Salley* claimants specifically allege violations of numerous state and federal securities laws, as well as common law violations, in connection with the sale of Heritage Bonds and other securities. *Id.* ¶¶ 39-101. The statement of claim asserts causes of action against the individual respondents for breach of fiduciary duty, control person liability for violation of federal securities laws and SEC rules, constructive fraud and control person liability under California Corporations Code § 25501 et seq. for violations of California securities laws.<sup>6</sup> *Id.* ¶¶ 39-41, 47-55, 78-80.

The claimants in *Moreland v. Miller & Schroeder Financial, et al.*, NASD Case No. 01-04161, attached hereto as Exhibit 30, are a couple who allege that respondents invested their savings in highly speculative and unsuitable bonds. The *Moreland* claimants allege that they “were deceived and defrauded and sustained severe financial loss . . . due to Respondents’ misconduct, which was in violation of the anti-fraud provisions of the Federal Securities Act, various state and federal statutes and violations of the common law including common law fraud, breach of fiduciary obligation, Illinois State Securities Act, and the Illinois Uniform Deceptive Trade Practices Act.” Ex. 30, *Moreland*, ¶ 14. The claimants contend that “[M&S] failed to adequately or properly supervise the activities of Respondents and aided and abetted the fraud perpetrated by Respondents.” *Id.* ¶ 21. The claimants allege six causes of action, including violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, common law fraud,

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<sup>6</sup> The foregoing description of the *Salley* arbitration also applies to *Onderwyzer, et al., v. Miller & Schroeder Financial, Inc., et al.*, NASD Case No. 01-05301, in which the underlying claimants filed a virtually identical statement of claim. *Onderwyzer* Second Amended Statement of Claim, attached hereto as Exhibit 29.

negligence, breach of fiduciary duty and violation of Section 15(b)(4)(E) of the Exchange Act. *Id.* ¶¶ 27-37.

In addition, some of M&S's former brokers filed third-party statements of claims against M&S and its director and officers, alleging that those individuals deceived the brokers. For example, in *M.B. Timmerman, et al. v. Miller & Schroeder Financial, Inc., et al.*, NASD Case No. 01-06518 former M&S broker Bruce Talley filed a third party claim against, among others, Iverson, Tabolich, Hentges, Larsen, Erickson, Ekholm and Brenden.<sup>7</sup> Attached hereto as Exhibit 31. Talley alleges that, “[c]ommencing in or during 1996 . . . third party respondents, entered into agreements and scheme[s] to defraud investors by effecting transactions in Heritage . . . bonds through the use of negligent due diligence, improper underwriting, false and misleading statements of material facts,” and that “[Talley] had no knowledge of this scheme to defraud investors at any time.” Ex. 31, *Talley*, ¶ 9. Talley contends that these individuals “were at all relevant times, officers, underwriters, directors, members of the credit committee, and supervisors at Miller & Schroeder Financial, Inc.” *Id.* ¶ 5. Talley further alleges that Iverson, Tabolich, Hentges, Larsen, Erickson, Ekholm, and Brenden had “responsibility for the due diligence for the Heritage Health Care Bonds . . . , which were sold to the public including the claimants, causing the substantial losses to the claimants because of the actions of the ‘CONTROL PERSON THIRD PARTY RESPONDENTS.’” *Id.* ¶ 19.

Talley also set forth specific allegations as to the active role of each respondent in connection with the underwriting and/or sale of the Heritage Bonds. He alleges, for example, that Iverson “agreed to participate with full knowledge of the conspiracy by . . . [i]nstructing investment bankers under his supervision to ignore material information regarding the Heritage

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<sup>7</sup> As with the FAC, *see supra* n. 4, the *Talley* Third-Party Claim names Halloran, Dawkins and Clarey as defendants and alleges that they knowingly participated in the scheme alleged by Talley. Ex. 31, *Talley*, ¶¶ 5-6, 23, 30.

Bonds.” *Id.* ¶¶ 22(f). Talley alleges that Tabolich, Erickson, Eckholm, and Brenden “agreed to participate with full knowledge of the conspiracy by . . . [a]cting as a member of the credit committee at Miller & Schroeder with responsibility for reviewing the proposed various Bond underwritings and documentation including the Official Statements.” *Id.* ¶¶ 24(a), 27(a), 28(a), 30(a). Based on the foregoing allegations, Talley asserts causes of action for implied indemnity, comparative indemnity, declaratory relief, equitable indemnity and contribution. *Id.* ¶¶ 33-49.<sup>8</sup>

**E. ERII’S DENIAL OF COVERAGE**

Beginning in 2001, M&S and certain of its directors and officers tendered the underlying NASD statements of claims and lawsuits to ERII. Ex. 18, Trustee’s Complaint, ¶ 16; Ex. 19, Intervenors’ Complaint ¶ 22. Based on its review of these materials and the Policy, ERII denied coverage for the various matters comprising the Heritage Bond Litigation. *See, e.g.*, Letter from C. Campi to D. Reinhart, dated 2/8/02, attached hereto as Exhibit 34; Letter from C. Campi to B. Huft, dated 5/14/02, attached hereto as Exhibit 35; Letter from C. Campi to M. Brennan, dated 6/13/02, attached hereto as Exhibit 36; Letter from S. McKelvey to E. Shermoen, dated 2/14/03, attached hereto as Exhibit 37.

ERII based its denial of coverage on two independent grounds. First, ERII denied coverage because the Heritage Bond Litigation is based on, arises out of or in any way involves alleged violations of federal, state and common law provisions governing the sale of securities, and the Securities Exclusion of Endorsement No. 3 bars coverage for such matters. Exs. 34-37. ERII also denied coverage based on Endorsement No. 9, the E&O exclusion because the

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<sup>8</sup> At least two other M&S brokers brought similar third party claims against M&S asserting nearly identical allegations regarding systematic and deliberate fraud on the part of the named M&S principals in connection with the Heritage Bonds, of which they were also allegedly victims. *See Lenser, et al. v. Mark Augusta, et al.* NASD Case No. 01-0113, Respondent Mark Augusta’s Cross Claim, attached hereto as Exhibit 32 and *Edge, et al. v. Penwarden, et al.*, NASD Case No. 01-03099, Scott Penwarden’s Third Party Claim, attached hereto as Exhibit 33.

Heritage Bond Litigation involves the provision of securities broker/dealer and securities underwriting services. *Id.*

## II. APPLICABLE LEGAL STANDARDS

### A. Summary Judgment Standards

Under Federal Rule of Civil Procedure 56(c), summary judgment is proper “if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Fed. R. Civ. P. 56(c).<sup>9</sup> The moving party “bears the initial responsibility of informing the district court of the basis for its motion,” and must identify “those portions of [the record] which it believes demonstrate the absence of a genuine issue of material fact.” *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). If the moving party satisfies its burden, Rule 56(e) requires the party opposing the motion to respond by submitting evidentiary materials that designate “specific facts showing that there is a genuine issue for trial.” *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

In opposing a properly supported motion for summary judgment, the nonmoving party may not “rest on mere allegations or denials, but must demonstrate on the record the existence of specific facts which create a genuine issue for trial.” *Krenik v. County of Le Sueur*, 47 F.3d 953, 957 (8th Cir.1995). Moreover, as the Eighth Circuit has emphasized, “the mere existence of a scintilla of evidence in favor of the nonmoving party’s position is insufficient to create a genuine

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<sup>9</sup> On November 14, 2003, ERIL filed a motion to dismiss the Trustee's complaint pursuant to Federal Rule of Civil Procedures 12(b)(6) for failure to state a claim upon which relief could be granted based on the Securities Exclusion set forth in Endorsement No. 3 of the Policy. On January 30, 2004, the Court denied the motion after the Trustee argued that discovery could demonstrate that he was entitled to relief. The Trustee has now had a full opportunity for discovery and for the reasons set forth in this memorandum, nothing generated in discovery precludes the Court from granting ERIL's motion for summary judgment based on Endorsement No. 3 of the Policy, as well as Endorsement No. 9 of the Policy.

issue of material fact” sufficient to defeat a summary judgment motion. *In re Temporomandibular Joint (TMJ) Implant Prods. Liab. Litig.*, 113 F.3d 1484, 1492 (8th Cir. 1997); *see also Matsushita*, 475 U.S. at 586 (indicating that a nonmovant “must do more than simply show that there is some metaphysical doubt as to the material facts” in order to prevent summary judgment).

**B. Interpretation of Insurance Policies**

Under Minnesota law, if an insurance “contract is clear and unambiguous, then the language is given its plain and ordinary meaning.” *Edgeley v. Lappe*, 342 F.3d 884, 889 (8th Cir. 2003) (citing *Lobeck v. State Farm Mut. Auto. Ins. Co.*, 582 N.W.2d 246, 249 (Minn. 1998), and *Am. Commerce Ins. Brokers, Inc. v. Minnesota Mut. Fire & Cas. Co.*, 551 N.W.2d 224, 227-28 (Minn. 1996)). Ambiguity is a question of law to be decided by the court. *ReliaStar Life Ins. Co. v. IOA Re, Inc.*, 303 F.3d 874, 880 (8th Cir. 2002) (“Under Minnesota law, construction of a contract, including deciding whether it is ambiguous, is a legal determination.”) (citing *Kauffman Stewart, Inc. v. Weinbrenner Shoe Co.*, 589 N.W.2d 499, 501 (Minn. Ct. App.1999)).

The Minnesota Supreme Court has warned of the duty to ““fastidiously guard against the invitation to create ambiguities where none exist.”” *Columbia Heights Motors, Inc. v. Allstate Ins. Co.*, 275 N.W.2d 32, 36 (Minn. 1979) (quoting *Farkas v. Hartford Acc. & Indem. Co.*, 173 N.W.2d 21 (Minn. 1969)); *accord Edgeley*, 342 F.3d at 889 (quoting *Columbia Heights*); *Noran Neurological Clinic, P.A. v. Travelers Indem. Co.*, 229 F.3d 707, 709 (8th Cir. 2000) (same).

“[W]hen a provision within an insurance policy is subject to both a reasonable and unreasonable interpretation, the reasonable construction controls, thereby eliminating any ambiguity.”

*Edgeley*, 342 F.3d at 889 (quoting *Mut. Serv. Cas. Ins. Co. v. Wilson Township*, 603 N.W.2d 151, 153 (Minn. Ct. App.1999)). Since determination of ambiguity is a legal matter, “[t]he court generally does not consider extrinsic evidence when determining contractual ambiguity.” *In re*

*Hennepin County 1986 Recycling Bond Litig.*, 540 N.W.2d 494, 498 (Minn. 1995); accord *Noran*, 229 F.3d at 710.

If, however, “a court finds that a policy is ambiguous, then extrinsic evidence is admissible to construe the policy.” *Pedersen v. United Serv. Auto. Ass’n*, 383 N.W.2d 427, 430 (Minn. Ct. App. 1986). In evaluating extrinsic evidence, “Minnesota courts have been quite clear that the initial existence of a contractual ambiguity does not ineluctably lead to the conclusion that the drafter is to lose.” *Piper Jaffray Cos., Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.*, 967 F. Supp. 1148, 1154 (D. Minn. 1997) (internal quotation marks omitted) (citing *Davis by Davis v. Outboard Marine Corp.*, 415 N.W.2d 719, 724 (Minn. Ct. App. 1987)). Rather, in considering extrinsic evidence, the court’s “task is to determine and give effect to the intent of the parties to the contract.” *Id.*

### C. **Burden of Proof**

In a dispute regarding insurance coverage under Minnesota law, the burden of proof initially rests with the insured to prove a prima facie case of coverage. *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 311 (Minn. 1995) (citing *Boedigheimer v. Taylor*, 178 N.W.2d 610, 614 (Minn. 1970)). In addition, “the insured bears the burden of proving the total amount of damages for which coverage may exist.” *N. States Power Co. v. Fid. & Cas. Co. of N.Y.*, 523 N.W.2d 657, 664 (Minn. 1994).

Once the policyholder carries its initial burden of making a prima facie showing of coverage, “[i]f the policy contains an exclusion clause, the burden then shifts to the insurer to prove the applicability of the exclusion as an affirmative defense.” *SCSC*, 536 N.W.2d at 313. If, however, an exclusion contains an exception, which an insured relies on for coverage, the burden of proof as to the exception rests with the insured, not the insurer. *Id.* at 314. An insurer may sustain its burden and thus force the insured to prove the applicability of any exception to

the exclusion by showing that the exclusion itself is unambiguous and applies to the facts of the case at bar. *See, e.g., Amos ex rel. Amos v. Campbell*, 593 N.W.2d 263, 266-270 (Minn. Ct. App. 1999) (holding that the insurer met its burden of proof because the unambiguous bodily injury and intentional acts exclusions applied to bar coverage).

## ARGUMENT

### **III. THE SECURITIES EXCLUSION PRECLUDES COVERAGE.**

#### **A. The Plain Language of the Securities Exclusion Precludes Coverage In This Case.**

The Securities Exclusion set forth in Endorsement No. 3 of the 2000 Policy precludes coverage for any claim “based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged violation of” any federal rule or regulation concerning securities, any state rule or regulation concerning securities or any common law obligation concerning the offer, sale or purchase of securities. Ex. 17, 2000 Policy, Endorsement No. 3. This language unambiguously applies to bar coverage for the Heritage Bond Litigation. As discussed above, each of the complaints and statements of claims in the Heritage Bond Litigation alleges violations of federal, state and common law provisions concerning the offer, sale or purchase of securities – precisely what Endorsement No. 3 excludes.

The M&S bond offerings that are the subject of the underlying litigation are unquestionably securities. In the Securities Act of 1933, Congress defined the term “securities” as follows:

The term “security” means any note, stock, treasury stock, security future, *bond*, . . . or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(a)(1) (emphasis added). Other federal securities statutes such as the Securities Exchange Act of 1934 and the Investment Company Act of 1940 contain virtually identical definitions of “securities.” *See* 15 U.S.C. § 77c(a)(10) (defining the term “security” to include “bond”); 15 U.S.C. § 80-a2(a)(36) (defining the term “security” to include “bond”). Minnesota statutes also define “security” to include bonds. *See* Minn. Stat. § 80A.14(18)(a). *See also Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 (1985) (stating that definition of “securities” is “quite broad . . . and includes both instruments whose names alone carry well-settled meaning, as well as instruments of ‘more variable character [that] were necessarily designated by more descriptive terms’, such as ‘investment contract’ and ‘instrument commonly known as a “security””) (quoting *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943)).

Here, there can be no question that the bonds at issue in the underlying complaints constitute “securities.” For example, in the FAC, the underlying plaintiffs allege that “Plaintiffs in this action have suffered approximately \$100,000,000 in damages as a result of eleven (11) municipal bond offerings, which raised over \$130,000,000 between December 1996 and March 1999.” Ex. 20, FAC, ¶ 4. In addition, the FAC sets forth, in detail, each of the twelve Heritage Bond offerings. *Id.*, ¶ 25. Similarly, as set forth above in the Statement of Undisputed Facts, the claimants in the NASD arbitrations uniformly allege that their claims arise out of the sale of the Heritage Bonds. *See supra* Part I.D.2.

The Heritage Bond Litigation also undisputably is “based on, aris[es] out of, directly or indirectly result[s] from, [is] in consequence of, or in any way involve[es] any actual or alleged violation of” any federal rule or regulation concerning securities, any state rule or regulation concerning securities or any common law obligation concerning the offer, sale or purchase of securities. Ex. 17, 2000 Policy, Endorsement No. 3. As discussed in Part I.D of the Summary of

Undisputed Facts, every complaint and statement of claim alleges specific violations of various federal securities laws (*e.g.*, The Securities Exchange Act of 1934), state securities laws (*e.g.*, California Corporations Code § 25504) and/or common law concerning securities (*e.g.*, breach of fiduciary duty). *See supra* Part I.D.

Minnesota courts interpreting such policy language have construed the term “arising out of” broadly. *See, e.g., Meadowbrook, Inc., v. Tower Ins. Co.*, 559 N.W.2d 411, 419 (Minn. 1997) (“Typically, this court has defined the words ‘arising out of’ in an insurance policy to mean ‘causally connected with’ and not ‘proximately caused by.’”). Indeed, in *Piper Jaffray*, Judge Tunheim expressly held that “[i]t is clear that proximate causation is not required for a loss to ‘arise out of’ some specified event or instrumentality.” *Piper Jaffray*, 967 F. Supp. at 1160.

Courts in three other jurisdictions have held that the language in a securities exclusion is unambiguous and provides a basis for an insurance company to deny coverage. Most recently, a New York appellate court held that a Securities Exclusion with similar wording in a policy also issued by Executive Risk unambiguously applied to the “transfer,” “foreclosure,” or sale of private as well as public securities. *Nat’l Rests. Mgmt., Inc. v. Executive Risk Indem. Inc.*, 758 N.Y.S.2d 624, 625 (N.Y. App. Div. 2003). Similarly, in a case involving a Securities Exclusion with almost identical language to Endorsement No. 3 of the 2000 Policy, the United States Court of Appeals for the Tenth Circuit held that the exclusion barred coverage for two common law tort claims alleging that the insured directors and officers of the policyholder company provided false and misleading information concerning the company in connection with a merger. *Bendis v. Fed. Ins. Co.*, 958 F.2d 960 (10th Cir. 1992). Additionally, the United States Court of Appeals for the Sixth Circuit applied a similarly worded exclusion to bar coverage for alleged breaches of fiduciary duty and the Exchange Act in connection with the sale of an interest in a privately held

company. *Isroff v. Fed. Ins. Co.*, 25 F.3d 1048 (6th Cir. 1994) (unpublished table decision), 1994 WL 253027 (holding exclusion to be unambiguous).

These cases confirm Executive Risk’s interpretation of the unambiguous policy language of Endorsement No. 3. Here, as in these other cases, the allegations in the complaint are based on, arise out of, or in any way involve alleged violations of federal and state securities laws and regulations or the common law in connection with securities. Accordingly, the Securities Exclusion should be applied as written to preclude coverage. Since plaintiffs’ assertions fail in the face of the plain policy language, the court should grant Executive Risk’s motion for summary judgment.

**B. The “Management Carveback” in Endorsement No. 9 Does Not Apply to Endorsement No. 3.**

In an effort to avoid the unambiguous language of the Securities Exclusion, plaintiffs have suggested that the management carveback in a different exclusion – the E&O Exclusion contained in Endorsement No. 9 of the 2000 Policy – can somehow be read to limit the application of Endorsement No. 3. In Part IV.B below, we demonstrate that plaintiffs are misreading the carveback even in the context of the E&O Exclusion. However, even assuming, for purposes of argument, that plaintiffs’ interpretation of the carveback to the E&O Exclusion were somehow correct, that carveback has no conceivable relevance to the Securities Exclusion.

Endorsement No. 9 of the 2000 Policy contains a “General E&O Exclusion (With Management Carveback).” Paragraph (1) of the E&O exclusion precludes coverage for Claims involving “an Insured’s actual or alleged rendering or failure to render the following services: Investment Banking Services, Security Broker/Dealer Services, [or] Securities Underwriting.” Ex. 17, 2000 Policy, Endorsement No. 9. Paragraph (2) of Endorsement No. 9 contains a “carveback” that unambiguously applies only to Paragraph (1) of that exclusion. Specifically,

Paragraph (2) states that: “**Paragraph (1) above** is not intended, however, nor shall it be construed to apply to Loss . . . .” *Id.* (emphasis added.)

In arguing that this “carveback” in the second paragraph of the E&O Exclusion somehow creates coverage excluded elsewhere in the Policy, plaintiffs ignore the fact that the carveback expressly states that it applies only to “**Paragraph (1) above.**” This limitation on the application of the carveback could not be more precise.<sup>10</sup>

The Minnesota Supreme Court has addressed the question of whether a carveback in one exclusion can apply to a second exclusion, and it has expressly rejected the arguments that plaintiffs now espouse. *See Moorhead Mach. & Boiler Co. v. Employers Commercial Union Ins. Co.*, 285 N.W.2d 465, 468 (Minn. 1979). In *Moorhead*, an insurer issued a general liability policy to a machinery company. The company later sought property damage coverage after two tanks it constructed collapsed. The insurance policy at issue contained two different exclusions potentially barring coverage for the property damage. One of the two exclusions contained a carveback applicable in the case. The machinery company, like plaintiffs here, argued that the exception in the first exclusion should be applied to the second exclusion as well. The court rejected that argument, explaining that “[t]he existence of an exception to an exclusion should only indicate that the exception is a grant of coverage if the policy as a whole is ambiguous.” *Id.* The court concluded that the second exclusion was not ambiguous and therefore precluded coverage, notwithstanding the exception in the first exclusion – precisely the situation before this Court. *See also Auto-Owners Ins. Co. v. Evergreen, Inc.*, 608 N.W.2d 900, 902 (Minn. App.

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<sup>10</sup> By contrast, Endorsement No. 6 of the Policy, which limits the scope of the Securities Exclusion by making the exclusion inapplicable to any claim arising out of the May 20, 1997 Private Placement of M&S stock, expressly states that “Endorsement No. 3 will not apply to any claim made against an Insured Person arising out of the offering, sale or purchase of Common Stock as described more fully in the Private Placement dated as of May 20, 1997.” Ex. 17, 2000 Policy, Endorsement No. 6.

2000) (relying on *Moorhead* and stating that “[r]ather than constituting a grant of coverage, exceptions to exclusions merely operate to narrow the scope of the exclusions”); 1 Allan D. Windt, *Insurance Claims and Disputes* § 6:2 (4th ed. 2003) (“If any exclusion applies, there should be no coverage regardless of the inferences that might be argued on the basis of exceptions or qualifications contained in other exclusions.”) (citing cases from multiple jurisdictions, including *Moorhead*).

No ambiguity exists in the Securities Exclusion at issue in this case such that the carveback of a different exclusion could be deemed relevant. More significantly, the language of the carveback in paragraph (2) of the E&O Exclusion, which expressly limits its application to Paragraph (1) of that Exclusion, eliminates any conceivable ambiguity on this point.

#### **IV. THE E&O EXCLUSION ALSO PRECLUDES COVERAGE.**

##### **A. Paragraph (1) of the Exclusion Is Applicable.**

As discussed in the previous section, Endorsement No. 9 of the Policy contains a General E&O Exclusion. Paragraph (1) of Endorsement No. 9 excludes coverage “for any Claim made against any Insured based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving an Insured’s actual or alleged rendering or failure to render the following services: Investment Banking Services, Security Broker/Dealer Services, [or] Securities Underwriting.” Ex. 17, 2000 Policy, Endorsement No. 9.

All of the allegations against the plaintiffs/intervenors in the underlying actions “aris[e] out of” or “in any way involv[e]” the provision of Security Broker/Dealer or Securities Underwriting services. Indeed, the allegations in all of the underlying complaints are predicated entirely on the plaintiffs’/intervenors’ alleged roles in the underwriting or sale of the Heritage Bonds. *See supra* Part I.D. Thus plaintiffs cannot dispute that paragraph (1) of the E&O Exclusion, standing alone, precludes coverage.

**B. Paragraph (2) of the E&O Exclusion Does Not Carve Back Coverage In This Case.**

Paragraph (2) of the E&O Exclusion contains a narrow carveback that limits the application of Paragraph (1) of the E&O Exclusion – and only that exclusion. The carveback clarifies that, since this is a D&O policy, the E&O Exclusion does not preclude coverage for directors and officers who are sued based on their actions as a manager of a “division, subsidiary or group,” rather than because of purported errors or omissions in providing investment banking, securities underwriting or securities broker/dealer services. For example, the carveback ensures that the E&O exclusion would not bar coverage if the CFO were sued for an alleged breach of fiduciary duties in reporting to shareholders the revenues of the company attributable to the underwriting division.

The carveback does not apply in this case because the allegations in the underlying litigation rest on purported errors and omissions in connection with the sales of particular securities to individual customers. The underlying plaintiffs in the Heritage Bond Litigation contend that the directors and officers actively participated in the approval of the Heritage Bond offerings as members of the M&S credit committee, which had the responsibility for conducting due diligence, reviewing the Official Statements and granting final approval for all M&S Bond Offerings, or otherwise. *See* Ex. 20, FAC, ¶¶ 86, 90-92, 446(g)-(i). The underlying plaintiffs contend that they are entitled to relief because of these specific failings, not because of actions taken as managers.

For example, the FAC alleges that Iverson “was involved in performing due diligence” for the Heritage Bond and “ratified the concealment of problems related to the Heritage Offerings, including problems brought to his attention through dealing with Kasirer.” *Id.* ¶¶ 84, 446(a). The FAC alleges that other directors and officers sat on the credit committee and in that

capacity “approved” the Heritage Bonds. *Id.* ¶¶ 90-92, 446(g)-(i). The FAC also alleges that the directors and officers “had a duty to investigate to ensure that all material information concerning the Heritage Entities and the management companies were clearly concisely disclosed in the Official Statements,” and failed to do so. *Id.* ¶ 463. Similarly, in the *Salley* arbitration, plaintiffs allege that the directors and officers had “responsibility for the due diligence for the Heritage Health Care Bonds . . . , which were sold to the public including the claimants, causing the substantial losses to the claimants because of the actions of the ‘CONTROL PERSONS.’” Ex. 28, *Salley*, ¶ 19.

Similarly, the third-party actions brought by M&S’s own brokers against the company and its directors and officers allege that M&S’s directors and officers “entered into agreements and scheme[s] to defraud investors by effecting transactions in Heritage . . . bonds through the use of negligent due diligence, improper underwriting, false and misleading statements of material facts.” Ex. 31, *Talley*, ¶ 9; *see also* Ex. 32, *Augusta* Cross Claim, ¶ 23 and Ex. 33, *Penwarden* Third-Party Claim, ¶ 9. These allegations also rest on the role of the directors and officers in the underwriting and brokering process, not their management of a division.

To be sure, a few of the underlying Statements of Claims contain counts that are titled “Failure to Supervise” and are based on purported violations of NASD Rule 3010 and/or alleged common law fiduciary duties of supervision. Rule 3010 provides that each NASD member company must implement a system for supervising its registered representatives in order to achieve compliance with all applicable securities laws and regulations. NASD Rule 3010.

Those “failure to supervise” counts have no relevance to this case. As an initial matter, some of the underlying actions – including the FAC in the Consolidated Class Action – do not contain such a count. Even in those arbitrations in which the statement of claim contains a

failure to supervise count, none of the counts allege that the directors or officers failed to supervise a “division, subsidiary or group,” as the carveback in the E&O Exclusion requires. Rather, the underlying plaintiffs allege that M&S and/or its directors and officers failed to supervise adequately *individual registered representatives* who were engaged in particular securities – the Heritage Bonds. *See, e.g.,* Ex. 28, *Salley*, ¶ 40(c) (“Respondents breached their fiduciary duty to claimants by . . . [f]ailing to implement a system of supervision and/or failing to supervise its employees and agents as set forth hereinafter”); Ex. 30, *Moreland*, ¶ 34 (“Respondents . . . have breached their duties in failing to adequately supervise Respondents (and any others in connection with Claimants’ accounts).” Allegations of failure to supervise individual registered representatives do not fall within the carveback to the E&O Exclusion.

V. **EXTRINSIC EVIDENCE CONFIRMS THAT ENDORSEMENT NOS. 3 AND 9 PRECLUDE COVERAGE.**

Parts III and IV demonstrate that the plain language of both the Securities Exclusion and the E&O Exclusion unambiguously preclude coverage. As a result, the Court has no reason to consider extrinsic evidence. In anticipation of plaintiffs’ likely attempt to use extrinsic evidence to manufacture ambiguity – notwithstanding Minnesota law barring them from doing so – ERII briefly notes that extrinsic evidence confirms the validity of its position.

Under Minnesota law, “[t]o infer the parties’ intent, the court should look to (1) circumstances surrounding the making of the contract and (2) the parties’ own subsequent interpretations of the contract.” *Outboard Marine Corp.*, 415 N.W.2d at 723-24. Apart from the plain language of the 2000 Policy, three factors confirm that neither party to the insurance contract at issue expected ERII to provide coverage for the Heritage Bond Litigation: (1) the D&O application; (2) the contemporaneous recommendation by M&S’s broker, which M&S declined, that it procure E&O coverage; and (3) the fact that the individuals responsible for

purchasing insurance when ERII issued the 2000 Policy never even read the Policy. By contrast, plaintiffs cannot point to a single contemporaneous document supporting its argument for coverage.

The 1997 and 2000 Policies provide D&O coverage, and the applications therefore asked many questions concerning the activities of the directors and officers in managing the company.<sup>11</sup> For example, the 1997 application asks:

- Have there been any changes in the Board of Directors or Senior Management of the **Applicant** within the past three (3) years for reasons other than death or retirement?
- Has the **Applicant** changed outside auditors in the last three (3) years?
- Have the outside auditors stated that there are no material weaknesses in the **Applicant's** system of internal controls?

Ex. 4, 1997 Application at 2.

The D&O application also requested, and M&S provided, information about M&S's current D&O, commercial general liability, umbrella and employment practices liability policies. *Id.* at 1. It did not ask whether M&S currently carried E&O coverage.

Similarly, the 1997 and 2000 Policies provide specified employment practices liability (“EPL”) coverage for “Employment Practices Wrongful Acts,” which the 1997 Policy defines as including “wrongful termination . . . demotion . . . failure or refusal to hire or promote . . . discrimination or sexual harassment . . . [or] retaliatory treatment against an employee . . . on account of such employee’s exercise . . . of his or her rights under law.” Ex. 6, 1997 Policy, § II(E). The 1997 Application therefore asks a number of questions central to the evaluation of the Applicant’s potential EPL exposure such as:

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<sup>11</sup> The 1997 and 2000 Applications are identical save except the deletion of Question 9 from the 2000 Application. *Cf.* Ex. 4 (1997 Application) and Ex. 16 (2000 Application).

- Does the **Applicant** anticipate any plant, facility, branch or office closing, consolidations, or layoffs within the next twenty-four (24) months?
- How many employees or officers have been terminated in the past two (2) years?
- What percentage of your employees has turned over in the past two (2) years?
- Does the **Applicant** . . . [h]ave a full-time human resources coordinator?
- Does the **Applicant** . . . [h]ave a written policy with respect to sexual harassment?
- Does the **Applicant** . . . [u]se outside counsel for employment advice?

Ex. 4, 1997 Application at 2. M&S also filled out a second D&O application from a second D&O carrier that contained virtually identical questions. Ex. 5.

Conspicuously absent from either the 1997 or 2000 Application, however, is any question concerning M&S's customers or the services or products M&S provided to those customers. This fact undermines plaintiffs' assertion that they expected coverage E&O claims by customers, about whom M&S had not disclosed anything to the underwriters. It defies logic to suggest that an insurer would provide coverage for litigation by customers against any of a company's directors or officers without obtaining information about those customers or the services the company provided to its customers, including the nature of the securities. M&S could not reasonably have expected such coverage when it never provided information to the insurer to evaluate that risk.

The E&O application located in the Hays Group's file of correspondence with M&S further undermines any argument by plaintiffs about an expectation of coverage for customer suits. That application, which the Hays Group sent to M&S *before* M&S completed the D&O application, contained numerous questions that would have provided information to an insurer evaluating whether to provide coverage against customer suits, including:

- Give number of notices, letters and complaints received in the past three years by the Compliance Department.

- Does the Securities Broker/Dealer's formal written procedures for supervising activities of Registered Representatives specifically address the handling of . . . [c]ustomer [c]omplaints [?]
- Describe measures the Securities Broker/Dealer has instituted for verifying customer orders and determining that confirmations are accurate and received on time.
- What percentage of client agreements contain arbitration clauses?
- Have any Professional Liability (E&O) (whether or not covered by insurance) claims been made during the past five years against the Securities Broker/Dealer or any Registered Representative?

Ex. 7 at 4-5.

M&S's retail insurance broker, Mary Marshall of the Hays Group, provided the E&O application to M&S with a note referencing the need to insure "professional exposure." Ex. 7. M&S nevertheless decided not to purchase such coverage. Indeed, Marshall repeatedly raised the need for E&O coverage with M&S over the next few months, and M&S refused to act. As noted above, Ms. Marshall wrote to M&S in October 1997 recommending that M&S and the Hays Group work together to gather quotes from various sources for E&O coverage. *See* Ex. 8. Marshall also prepared meeting agendas in October 1997, December 1997 and January 1998 for meetings with M&S that continued to raise E&O coverage as a topic for discussion. *See* Exs. 9-11.

By contrast, plaintiffs cannot point to a single document suggesting that the 2000 Policy, or the 1997 Policy for that matter, provided E&O coverage for the customer suits and NASD arbitrations that comprise the Heritage Bond Litigation. Indeed, Nelson and Larsen – the two individuals responsible for procuring and renewing M&S's insurance policies at the time M&S purchased the 2000 Policy – testified that they never even read the 1997 Policy that was up for renewal, let alone communicated with anyone about whether the 2000 Policy afforded coverage for customer suits. Ex. 12, Nelson Dep. at 48-52; Ex. 13, Larsen Dep. at 41-42. Nelson further

testified that he did not seek any advice on whether the terms of the 1997 Policy should be modified in his deposition:

Q. [ By Mr. Topol] Did you ask Marsh to look at changing any terms in the policy?

A. I did not.

Q. Did you ask Mr. Larsen to look at whether any terms in the policy should be changed?

A. I did not.

Q. Did you discuss renewal of this policy with Mr. Dlugash [sic]?

A. I don't recall if I did or not. I don't think so. I considered it a routine renewal.

Ex. 12, Nelson Dep. at 52. Similarly, Larsen testified as follows:

Q. [By Mr. Topol] Do you know whether you asked Marsh to try to negotiate any different terms in the insurance policy issued by Chubb for D&O coverage?

A. I don't recall.

Q. Do you know whether anybody else at Miller & Schroeder did so?

A. I don't believe so.

Ex. 13, Larsen Dep. at 41.

As to E&O coverage, Nelson testified that he never even considered the issue.

Q. [By Mr. Topol] Any point when you were at Miller & Schroeder, did you look into purchasing E&O coverage?

A. No.

Q. Did you instruct Mr. Larsen to look into purchasing E&O coverage?

A. Not that I recall.

Q. Do you know whether anybody at Miller & Schroeder looked into purchasing E&O coverage?

A. Not that I'm aware of.

Ex. 12, Nelson Dep. at 55. Similarly, Larsen testified as follows:

Q. [By Mr. Topol] While you were at Miller & Schroeder, was there any discussion about the company purchasing an additional policy to provide E&O coverage?

A. I don't recall any.

Ex. 13, Larsen Dep. at 48-49.

The only "evidence" purportedly supporting plaintiffs' position regarding their expectation of coverage for customer suits in documents produced or deposition testimony is the self-serving, uncorroborated deposition testimony of James Dlugosch, who now asserts that he expected coverage under the Policy for the type of litigation that comprises the Heritage Bond Litigation. Ex. 1, Dlugosch Dep. at 37-39. However, Dlugosch cannot provide any support for this after-the-fact effort to manufacture coverage. In his deposition, Mr. Dlugosch testified

Q. [By Mr. Topol] Did you at any point when the 1997 policy was being purchased, did you have any conversations with Executive Risk about the terms of coverage?

A. No, I don't believe I did. I'm sure that I did not.

Q. Did you at any point thereafter?

A. No.

Q. Did you have any conversations with anybody at any insurance company about the terms of D&O coverage?

A. Not that I recall, no.

Q. Did you instruct anybody who worked for you at Miller & Schroeder to -- well, I guess then MI Acquisition Corporation -- to speak with Executive Risk Indemnity about the terms of the insurance policy?

A. Not that I recall, no.

Q. At any point after 1997, did you ever instruct anybody to speak with Executive Risk about the terms of the insurance policy?

A. Not that I recall.

Q. Are you aware of any representation by Executive Risk Indemnity, Inc. as to whether this policy would provide coverage for suits by customers?

A. No, I don't.

....

Q. Do you know whether anybody at The Hays Group spoke with anyone at Executive Risk about insurance coverage?

A. No, I don't.

Q. Did you ever ask them to speak with anybody at Executive Risk?

A. No.

*Id.* at 50-52. Even if extrinsic evidence were relevant, such self-serving, unsupported, unilateral pronouncements cannot defeat a motion for summary judgment. *See Davenport v. Riverview Gardens Sch. Dist.*, 30 F.3d 940, 945 (8th Cir. 1994) (upholding grant of summary judgment for defendant-employer in a discrimination case where plaintiff's only evidence of differential treatment based on race was his own unsubstantiated statements in deposition); *Bridgmon v. Array Sys. Corp.*, 325 F.3d 572, 577 (5th Cir. 2003) ("Apart from his uncorroborated and conclusory testimony, George has offered no evidence to show that the software used by Array is the same software that was licensed to Array. Such unsubstantiated or conclusory assertions are incompetent summary judgment evidence and cannot defeat a motion for summary judgment."); *Larsen v. City of Beloit*, 130 F.3d 1278, 1285 (7th Cir. 1997) ("[A] plaintiff's own uncorroborated testimony is insufficient to defeat a motion for summary judgment.") (quoting *Weeks v. Samsung Heavy Indus. Co.*, 126 F.3d 926, 939 (7th Cir.1997)).

In the absence of any reliable evidence to rebut ERII's interpretation of Exclusion Nos. 3 and 9, M&S will inevitably reduced to arguing "that there is some metaphysical doubt as to the material facts" supporting this motion – a contention that the Supreme Court has unequivocally labeled insufficient to prevent entry of summary judgment. *Matsushita*, 475 U.S. at 586 (indicating that a nonmovant "must do more than simply show that there is some metaphysical doubt as to the material facts" in order to prevent summary judgment). Plaintiffs/Intervenors thus cannot show any dispute as to a material fact and this court should grant summary judgment on behalf of Executive Risk.

### CONCLUSION

For all of the foregoing reasons, Executive Risk hereby respectfully requests that this Court grant its motion for summary judgment and declare that Executive Risk has no duty to defend or indemnify plaintiffs or intervenors for the claims asserted against them in the underlying actions, on the grounds that the Endorsement No. 3 of the Policy precludes coverage for this matter, and Minnesota law prohibits equitable relief in this case.

Dated: October 29, 2004

Respectfully submitted,

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**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MINNESOTA**

In re:	)	
	)	
SRC Holding Corp.	)	Chapter 7 Case
f/k/a Miller & Schroeder, Inc.	)	BKY Case Nos. 02-40284 to 02-40286
and its subsidiaries,	)	Jointly Administered
	)	
Debtor.	)	

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Brian F. Leonard, Trustee,	)	
	)	
Plaintiff,	)	ADV Case No. 03-4284
	)	
vs.	)	<b>NON-CORE PROCEEDING</b>
	)	
Executive Risk Indemnity Inc.,	)	
	)	
Defendant.	)	

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The Marshall Group, Inc., Jerome A.	)	
Tabolich, James E. Iverson, Edward J.	)	
Hentges, Kenneth R. Larsen, Steven W.	)	
Erickson, Paul R. Eckholm, and Mary Jo	)	
Brenden,	)	
	)	
Intervenors.	)	

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**ORDER**

This matter having come before the Court upon Plaintiff Executive Risk Indemnity Inc.’s (“Executive Risk”) Motion for Summary Judgment, pursuant to Federal Rule of Bankruptcy Procedure 7056 and Federal Rule of Civil Procedure 56, and the Court having read and considered all papers submitted in connection with the motion and considered all the parties’ arguments and determined that Endorsement Nos. 3 and 9 to Executive Risk Policy No. 8166-6027 (the “Policy”) preclude the coverage sought by the Trustee and Intervenors in this proceeding;

IT IS ORDERED that Executive Risk's Motion for Summary Judgment is hereby granted and this case is dismissed with prejudice.

IT IS FURTHER ORDERED that the Policy does not afford coverage for any of the Heritage Bond lawsuits and arbitrations tendered to Executive Risk.

SO ORDERED THIS \_\_\_\_ DAY OF \_\_\_\_\_, 2004.

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Honorable Nancy C. Dreher