STATE OF MINNESOTA
IN COURT OF APPEALS
A11-680

Alerus Financial National Association, et al.,
Appellants,

vs.

St. Paul Mercury Insurance Company, et al.,
Respondents,

Federal Insurance Company,
Respondent,

Kansas Bankers Surety Company,
Respondent.

Filed January 30, 2012
Affirmed
Hudson, Judge

Hennepin County District Court
File No. 27-CV-09-3344

Christopher H. Yetka, Daniel N. Sacco, Bryan R. Freeman, Lindquist & Vennum PLLP, Minneapolis, Minnesota (for appellants)

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Michael Keeley (pro hac vice), Strasburger & Price, LLP, Dallas, Texas (for respondents St. Paul Mercury Insurance Company, et al.)

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Scott L. Schmookler (pro hac vice), Clausen Miller, P.C., Chicago, Illinois (for respondent Federal Insurance Company)

Robert W. Vaccaro, Gaskins, Bennett, Birrell, Schupp, L.L.P., Minneapolis, Minnesota; and

Rebecca Yocum (pro hac vice), Bottaro, Morefield, Kubin & Yocum, Kansas City, Missouri (for respondent Kansas Bankers Surety Company)

Considered and decided by Hudson, Presiding Judge; Peterson, Judge; and Stoneburner, Judge.

U N P U B L I S H E D O P I N I O N

HUDSON, Judge

This case involves an insurance-coverage dispute in which appellant banks challenge the district court's summary-judgment determination that their loan losses arising out of a financial-misrepresentation scheme were not covered by financial-institution bonds purchased from respondent insurers. Because we agree that there are no genuine issues of material fact and that judgment is appropriate as a matter of law, we affirm.

FACTS

At the center of this bond-coverage dispute are five loans obtained between December 2004 and March 2006 by businessman Louis J. Pearlman, who has since pleaded guilty to various financial crimes, including a case involving a bank-fraud scheme that related to misrepresentations about the financial condition of Pearlman and his businesses. Pearlman retained North American Capital Markets (NACM), a Minneapolis-based investment broker, to place the loans. NACM in turn retained Minneapolis attorney James Dierking, of Winthrop and Weinstine, P.A., to assist with closing the loans. Each of the loans was structured to have one lead, or servicing, bank

that loaned the money and later serviced the loan, with numerous other banks ("participating banks") buying various percentages or "participations" in the loans. As collateral for the five loans, Pearlman offered guarantees from one of his business entities, Trans Continental Airlines (TCA), as well as TCA stock. Pearlman represented TCA as a successful charter airline company, but he later admitted that the corporation existed only on paper and had no business or assets.

Pearlman eventually defaulted on the loans, and each of the appellants, as participating banks, made claims against financial-institution bonds purchased from one of the three respondents. Respondents denied coverage, and the appellants initiated this breach-of-contract and declaratory-judgment action. Respondents moved for summary judgment, arguing that appellants' losses did not fall within the bonds' coverage for losses resulting directly from employee dishonesty or forgery. The district court granted the motion, and this appeal follows.

D E C I S I O N

On appeal from summary judgment, this court reviews de novo whether there are genuine issues of material fact and whether judgment is appropriate as a matter of law. *STAR Centers, Inc. v. Faegre & Benson, L.L.P.*, 644 N.W.2d 72, 76-77 (Minn. 2002). The court views the evidence in the light most favorable to the nonmoving parties and draws all reasonable inferences in their favor. *Id.* "A material fact is one of such a nature as will affect the result or outcome of the case depending on its resolution." *Zappa v. Fahey*, 310 Minn. 555, 556, 245 N.W.2d 258, 259-60 (1976). "[T]here is no genuine issue of material fact for trial when the nonmoving party presents evidence which merely

creates a metaphysical doubt as to a factual issue and which is not sufficiently probative with respect to an essential element of the nonmoving party's case to permit reasonable persons to draw different conclusions." *DLH, Inc. v. Russ*, 566 N.W.2d 60, 71 (Minn. 1997). Speculation is likewise insufficient to defeat summary judgment. *Bob Useldinger & Sons v. Hangsleben*, 505 N.W.2d 323, 328 (Minn. 1993). Accordingly, judgment is appropriate when no reasonable factfinder could find in favor of appellants on their claims. *DLH*, 566 N.W.2d at 69. And this court "will affirm a district court's grant of summary judgment if it can be sustained on any grounds." *Presbrey v. James*, 781 N.W.2d 13, 16 (Minn. App. 2010).

Resolving the issues in this appeal requires us to interpret the financial-institution bonds (FIBs or bonds) issued by respondents. FIBs "insure against the dishonesty of a financial institution's employees and provide coverage for other crime risks." Robert J. Duke, *A Brief History of the Financial Institution Bond*, *in Financial Institution Bonds* 1 (Duncan L. Clore, ed., 3d ed. 2008). Courts have treated FIBs as insurance policies, applying general rules of contract construction to derive their meaning. *See, e.g.*, *KW Bancshares, Inc. v. Syndicates of Underwriters at Lloyd's*, 965 F. Supp. 1047, 1051 (W.D. Tenn. 1997) (articulating insurance-contract canons of construction in bond-coverage dispute); *cf. In re Guardianship of Hampton*, 359 N.W.2d 740, 743 (Minn. App. 1984) (explaining that fidelity bonds issued by bonding companies "are now regarded as insurance policies, in substance, and are governed for the most part by insurance law rather than suretyship law"), *aff'd in part and rev'd in part*, 374 N.W.2d 264 (Minn. 1985). Under Minnesota law, which the parties agree applies to the bonds, insurance

contracts are construed in accordance with their plain meaning. *Am. Family Ins. Co. v. Walser*, 628 N.W.2d 605, 609 (Minn. 2001). "When the language of [an insurance] policy is ambiguous, the ambiguity is to be construed in favor of the insured and in accordance with the reasonable intent of the parties, but this court will not redraft insurance policies to provide coverage where the plain language of the policy indicates that no coverage exists." *Lott v. State Farm Fire & Cas. Co.*, 541 N.W.2d 304, 307 (Minn. 1995) (quotation omitted).

I

Appellants first challenge the district court's determination that the loan losses did not fall within respondents St. Paul Mercury Insurance Company and Federal Insurance Company bonds' insuring clauses for employee dishonesty.[1] The appellants' assertions that their losses are covered by these clauses center on the conduct of Dierking, the attorney who closed the five Pearlman loans, and particularly on Dierking's admitted failure to disclose to appellants his discovery, before closing the second loan, that the amended articles of incorporation necessary to authorize the stock being used as collateral had not been filed with the Florida Secretary of State. Appellants also allege that Dierking had a conflict of interest in representing both appellants (as lenders) and NACM (an agent for Pearlman, the borrower), and that Dierking should have disclosed this conflict to them.

[1] The employee-dishonesty claim against respondent Kansas Bankers Surety Company has been dismissed.

Although not identically worded, the insuring clauses for employee dishonesty in both the St. Paul and Federal bonds provide as requisites to coverage of loan losses that (1) an employee (2) commits dishonest or fraudulent acts (3) with the intent to cause the insured to suffer a loss and (4) seeks or obtains improper financial gain.[2] The bonds define an employee to include an attorney who was "retained by" and was "performing legal services for" the insureds. The district court determined that Dierking was not an employee of appellants as a matter of law, relying on both the language of the participation agreements between the servicing and participating banks and the Minnesota Supreme Court's decision in *McIntosh Cnty. Bank v. Dorsey & Whitney, LLP*, 745 N.W.2d 538 (Minn. 2008).

Under Minnesota law, the existence of an attorney-client relationship is a question of fact that can be established under a contract or tort theory. *Gramling v. Memorial Blood Ctrs. of Minn.*, 601 N.W.2d 457, 459 (Minn. App. 1999), *review denied* (Minn. Dec. 21, 1999). Appellants rely on the contract theory, under which "the parties to the alleged attorney-client relationship must have either explicitly or implicitly agreed to a contract for legal services." *Id.*; *McIntosh*, 745 N.W.2d at 549. "The agreement can be deduced from the circumstances, relationship, and conduct of the parties." *McIntosh*, 745 N.W.2d at 549 (quotation omitted). But "[t]he simple fact that one party benefitted from the services of the other does not impose contractual liability." *Id.*

[2] Under the St. Paul bond, coverage is also contingent on the employee acting in collusion with a party to the loan.

In *McIntosh*, our supreme court addressed facts similar to this case and concluded as a matter of law that no attorney-client relationship existed between an attorney who prepared loan documents and the banks who purchased participations in the loans. *Id.* In that case, a number of banks brought suit against Dorsey for malpractice allegedly committed in closing a loan in which the banks subsequently bought participations. *Id.* at 541–44. The supreme court held that the "undisputed facts demonstrate[d] that there was no implied agreement between Dorsey and [the participating banks]," reasoning:

> There were no communications between the Bank Participants and Dorsey before closing. There was no notice to Dorsey that it was expected to represent the Bank Participants. Indeed, Dorsey was unable to identify the Bank Participants before closing. . . . [The] evidence is not sufficiently probative of an implied contract to allow reasonable persons to draw different conclusions.

Id. at 549.

Appellants contend that the district court erred by relying on *McIntosh*, arguing that the case is distinguishable on its facts. Appellants particularly emphasize that, in *McIntosh*, Dorsey was unaware of the identity of the bank participants until after the closing when they purchased their participations, whereas in this case, Dierking became aware of the bank participants before closing because he inserted their names into the loan-participation agreements that he drafted. We agree with the district court that this is a distinction without a difference. Dierking's awareness of the identities of the participating banks does not support an inference that he was on notice that he was expected to represent them—much less that he agreed to do so. Accordingly, we agree with the district court that *McIntosh* is comparable to this case in all relevant respects.

Appellants also challenge the district court's reliance on the language of the participation agreements, arguing that the agreements only governed the relationship between the servicing and participating banks, and do not bear on the relationship between Dierking and the participating banks. Appellants' position is technically accurate, but we agree with the district court that the participation agreements provide relevant context. In particular, appellants represented in the agreements that they were "relying upon [their] own due diligence, credit investigation and credit analysis, and not on any representations, warranties or statements of [the servicing banks]. . . ." Although the participation agreements may not be dispositive of whether Dierking was appellants' employee, they provide relevant evidence that was appropriately considered by the district court.

Notwithstanding the similarity of this case to *McIntosh*, and the language of the participation agreements, appellants identify four types of evidence that they assert create genuine issues of material fact regarding whether Dierking was their employee within the meaning of the FIBs. For the reasons discussed below, we conclude that none of the cited evidence is sufficiently probative to create a genuine issue of material fact precluding summary judgment.

Appellants first rely on affidavits by representatives of the three servicing banks and twenty-one participating-bank representatives stating their understanding that Dierking was representing the participating banks and that it would be "normal" for the attorney representing the servicing banks to also represent the participating banks. The banks' subjective belief that they were represented by Dierking, however, is not sufficient

to demonstrate an implied contractual attorney-client relationship between Dierking and appellants. *See, e.g.*, *Riley Bros. Constr., Inc. v. Shuck*, 704 N.W.2d 197, 202 (Minn. App. 2005) ("Minnesota follows the objective theory of contract formation, under which the parties' outward manifestations are determinative, rather than either party's subjective intent."). None of the bankers' affidavits identifies any outward manifestation—by themselves or by Dierking—to support the existence of an attorney-client relationship.

Second, appellants cite language in an e-mail from NACM officer Stu Harrington. Harrington's e-mail attaches an e-mail which Harrington describes as being sent from "Jim Dierking from Winthrop that *represented all the banks* for the Loan closing to Lou Pearlman" (emphasis added). Contrary to appellants' assertion, this vague passing reference does not support the inference that NACM believed that Dierking represented both servicing and participating banks. In fact, although there are numerous copies of the e-mail in the record, there is no evidence that the e-mail was sent to anyone other than representatives of the servicing banks. Thus, contrary to appellants' assertion, if anything, the e-mail suggests that NACM believed that only the servicing banks were Dierking's clients. And appellants cite no other evidence to support their assertion that NACM believed that Dierking was representing the participating banks.

Third, appellants rely on evidence that Dierking was paid out of loan proceeds to which they contributed. In some circumstances, determining who paid an attorney may help in identifying the client, but we conclude that it is not helpful in this case. While Dierking testified that he was paid from loan proceeds, he also testified that it was Pearlman, as the borrower, who actually paid his fees. Because none of the participating

banks directly paid Dierking's fees, we reject appellants' assertion that their contribution to Dierking's fees creates a genuine issue as to whether Dierking was their employee.

Finally, appellants rely on an expert opinion from Robert A. Zadeck to support their assertion that there are genuine issues of material fact. Zadeck asserts that Dierking was representing both servicing and participating banks, but he does not base this assertion on any experience in the industry. To the contrary, he concedes that servicing banks are usually the clients in participation-loan transactions. Zadeck premises his opinion that Dierking was representing both servicing and participating banks on the fact that Dierking performed services for the loans before he knew who the servicing banks would be. But it does not necessarily follow, as Zadeck asserts, that Dierking had to be representing all of the banks. And the only evidence in the record on this point is Dierking's testimony that his clients were the servicing banks, "whoever that ended up being." Accordingly, we reject appellants' reliance on Zadeck to create a genuine issue of material fact.

In sum, we agree with the district court that Dierking was not appellants' employee as a matter of law and, accordingly, any losses attributable to his alleged misconduct are not covered by the bonds. And, having adopted the district court's basis for granting summary judgment, we do not reach respondents' alternative arguments for affirming summary judgment on appellants' claims for coverage under the insuring clauses for employee dishonesty.

II

Appellants next challenge the district court's determination that the loan losses did not fall within their bonds' coverage for losses resulting directly from reliance on certain forged documents. Appellants' claims for coverage under these insuring clauses center on Pearlman's admission to the forgery of certain signatures on stock certificates and written corporate actions authorizing and ratifying Pearlman's execution of guarantees on behalf of the corporation. The district court granted summary judgment to respondents on the forgery claims based on its determinations that appellants' loan losses were not directly caused by reliance on the forged documents as a matter of law and that the forged corporate actions were not guarantees within the meaning of the bonds.

Although the bonds do not define "resulting directly from," a majority of courts that have addressed the issue have held that loan loss is not directly caused by reliance on forgeries in documents constituting or referencing collateral when the collateral is worthless at the time of the loan. *See KW Bancshares*, 965 F. Supp. at 1054-55 (concluding that coverage did not exist because loan losses were not caused by forged signatures on a letter, but by nonexistence of collateral referenced in the letter); *French Am. Banking Corp. v. Flota Mercante Grancolombiana*, 752 F. Supp. 83, 91 (S.D.N.Y. 1990) (granting motion to dismiss because loan losses were not caused by forged signatures on bills of lading, but by nonexistence of assets represented therein), *aff'd*, 925 F.2d 603 (2d Cir. 1991); *Liberty Nat'l Bank v. Aetna Life & Cas. Co.*, 568 F. Supp. 860, 866-67 (D.N.J. 1983) (granting summary judgment because loan losses were not caused by forged signatures on CDs, but by lack of assets to back the CDs). *But see Pine Bluff*

Nat'l Bank v. St. Paul Mercury Ins. Co., 346 F. Supp. 2d 1020, 1030 (E.D. Ark. 2004) (denying summary judgment in case of worthless collateral, reasoning that bank suffered loss after extending credit in reliance on document containing forged signatures and that the language of the insuring clause "requires no more"). Most recently, the Ninth Circuit released a decision affirming the dismissal of claims by other participating banks seeking to recover under FIBs for losses occasioned by Pearlman's fraud based in part on its determination that "it was the worthlessness of the underlying collateral that directly caused the Participant Banks' losses, as several courts construing Agreement (E) have held in similar circumstances." *Bank of Bozeman v. BancInsure, Inc.*, No. 09-36088, 2010 WL 4683825 (9th Cir. 2010).

Like the district court, we are persuaded to adopt this majority rule. As the *Liberty Nat'l Bank* court observed: "It is well settled that the standard bankers bond is not a form of credit insurance." 568 F. Supp. at 866. And a proper interpretation of the insuring clauses for forgery construes the insuring clauses in the context of the bond as a whole, taking into consideration the purposes of the bond. *See Brookfield Trade Ctr., Inc. v. County of Ramsey*, 584 N.W.2d 390, 394 (Minn. 1998) (holding that courts are to read contract language "in the context of the entire contract" and interpret it "in such a way as to give meaning to all of its provisions"); *Reinsurance Ass'n of Minn. v. Johannessen*, 516 N.W.2d 562, 565 (Minn. App. 1994) (rejecting appellant's interpretation of insurance policy "because it isolates words and phrases from their context rather than giving them meaning in accordance with the obvious purpose of the whole policy"), *review denied* (Minn. Aug. 24, 1994). Accordingly, we conclude that appellants' loan losses are not

covered under the insuring clauses for forgery because those losses did not result directly from the forgeries, but rather from the worthlessness of the TCA guarantees and stock.

Appellants argue that summary judgment is nevertheless inappropriate because there are genuine issues of material fact regarding the value of TCA at the time of the loan. We disagree. Pearlman has admitted that TCA did no business and that it existed only on paper and for the purpose of facilitating his fraudulent schemes. On this record, we reject appellant's assertion that positive balances in TCA banking accounts create a genuine issue of material fact regarding its value.

Because we agree with the district court that appellants' loan losses were not caused by the forged documents as a matter of law, we do not reach the district court's alternative basis for its ruling, nor do we reach the respondents' alternative bases for affirming summary judgment on appellants' claims for coverage under the insuring clauses for forgery.

Affirmed.