

FEDERAL COURT

INSURANCE: Rural electric claims arise from alleged failures to perform under contracts, excluded by policy notwithstanding reasonable expectations, labeling of counts as "breach of fiduciary duty"/"constructive fraud" ... no obligation to indemnify for \$2,001,759 settlement .. . Cebull.

The contract between Upper Missouri G&T Electric Cooperative and West Plains Electric Cooperative provided for how they would bill each other for units of power. West Plains developed the Tracy Mountain Substation to develop and produce power. Upper Missouri sued alleging breach of their operating contract and voted to expel West Plains from their cooperative and began withholding payment under the contract. West Plains counterclaimed alleging breach of contract, breach of fiduciary duty, and constructive fraud. The action settled in 1/06 for \$2,001,759, which Upper Missouri had deposited as "bill credits" under the contract. Upon settlement it retrieved the money from the Court and paid it to West Plains as "damages." Upper Missouri then requested Federated Rural Electric Management to reimburse it for the settlement amount. Federated denied coverage and Upper Missouri sued alleging bad faith. Upper Missouri contends that Federated is obligated to indemnify it in the amount of \$2,001,759 plus attorney fees and costs. Federated argues that it has no contractual obligation to indemnify Upper Missouri for any of the claims and asserts affirmative defenses including the exclusion for contractual obligations. It requests a declaratory judgment of no coverage.

Upper Missouri concedes that the policy contains an exclusion precluding contract-based claims by a member of the co-op, and that it is clear, does not violate public policy, and is enforceable as written, but relies on the doctrine of reasonable expectations. However, under Montana law the doctrine does not apply to create coverage where the policy demonstrates the intent to exclude it. Babcock (Mont. 2000). Further, "expectations which are contrary to a clear exclusion from coverage are not objectively reasonable." Counterpoint (Mont. 1998). Thus the doctrine of reasonable expectations does not apply in this case.

The breach of fiduciary duty and constructive fraud claims are actually attributable to Upper Missouri's obligations under the contract, and cannot be exempt from the policy exclusion. The irrefutable fact is that all claims are, in the words of the exclusion, "directly or indirectly based on, attributable to, arising out of, resulting from or ... relating to" the contracts themselves and Upper Missouri's actions in allegedly breaching the contracts. West Plains alleged that Upper Missouri violated its fiduciary duty and engaged in "oppressive and bad faith conduct" by expelling West Plains from its membership and repudiating the Wholesale Power Contract. This is a matter arising from a contract within the meaning of the exclusion. It also alleged that Upper Missouri violated a "duty to disclose and warn" if it "objected to energizing" Tracy Mountain or "did not agree to include" it as a delivery point under the Wholesale Power Contract. The duty to warn allegedly extended also if Upper Missouri "intended to take the position that energizing Tracy Mountain would constitute a violation of the by-laws or the Wholesale Power Contract." The allegations continue under various terms including "acquiesced in," "led to believe," and "lured," all regarding energizing the substation as a new delivery point under the Wholesale Power Contract. This conduct alleged to constitute breach of fiduciary duty arises from the contracts within the meaning of the policy exclusion.

West Plains further asserts constructive fraud, based on the same conduct. It states that the claim is based on "the surrounding circumstances and parties' relationship," which is entirely contractual. It alleges that Upper Missouri was required to inform it if it "had any problems" with energizing the substation, if it "did not intend to recognize Tracy Mountain as a new delivery point under the Wholesale Power Contract," or if it "did not intend to serve the West Plains load associated with Tracy Mountain." West Plains alleges that Upper Missouri had no objections to its energizing Tracy Mountain substation and that Upper Missouri would recognize and serve the substation and load as a new delivery point "under the Wholesale Power Contract." It then alleges that Upper Missouri's actions of "having given West Plains no reason to doubt that Upper Missouri would serve" the substation "under the Wholesale Power Contract," and voting to expel West Plains from membership (under the cooperative membership contractual agreements), constituted constructive fraud. Further, the Wholesale Power Contract, by-laws, and cooperative policies included provisions requiring specified metering and payment of certain bill credits, and those provisions were at the heart of the dispute. This conduct alleged to constitute constructive fraud arises from the contracts within the meaning of the Federated exclusion.

Coverage is based on the act that gives rise to the claim, not necessarily on the language of the complaint or other pleading that initiates a proceeding. Missoula Co. School Dist. (Mont. 1993). The actual language of the allegations in the counterclaim against Upper Missouri demonstrate that coverage under the Federated policy is excluded because they arise from contractual obligations of the insured. The mere labeling of Counts III and IV as "breach of fiduciary duty" and "constructive fraud" is insufficient to invoke coverage when the acts giving rise to the claims are clearly contractual within the meaning of the exclusion. Federated has no obligation to indemnify Upper Missouri for any amount it paid to defend or settle the underlying cause. Summary judgment for Federated.

Upper Missouri G&T Electric Cooperative v. Federated Rural Electric Management, 35 MRF 449, 9/5/07.

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