

E&O Policy Exclusion Barred Coverage for Claims Made by State Agency

November/December 2002

A federal district court in Maine, applying Maine law, has held that seven errors and omission insurance policy forms would not provide coverage for the cost of repurchasing unregistered securities pursuant to a state securities agency's order because exclusions in each of the policies barred coverage for claims made by state agencies. *New Life Brokerage Servs., Inc. v. Cal-Surance Assoc., Inc.*, no. 01-172-B-C, 2002 WL 31059287 (D. Maine Sept. 16, 2002).

A securities broker-dealer in Maine was investigated by the Maine Securities Division for selling unrestricted securities ("selling away"). The Securities Division required the broker-dealer to surrender its license unless it would repurchase a substantial quantity of the unregistered securities. Because the broker-dealer's E&O policy did not cover "selling away," it surrendered its license. The broker-dealer then brought suit against its insurance broker for failing to design and obtain appropriate insurance coverage. The broker-dealer alleged that the insurance broker could have obtained insurance coverage for "selling away." The insurance broker moved for summary judgment on the ground that no policy that existed at the time it obtained the E&O insurance would have provided coverage for a claim brought by a state agency for "selling away."

The court examined seven policy forms available before the broker-dealer engaged in "selling away" to determine if the policies would have covered such a claim. The court noted that each policy contained an unambiguous exclusion for actions by a state agency, and therefore concluded that coverage would not have been available under any of the policies. The court rejected the broker-dealer's argument that the repurchase of securities would have been covered as "damages" under the policies because the money would have been "passed through" to the consumers who purchased the securities. The court reasoned that the factual record did not show that the purchasers of the unregistered securities had been injured by their purchase, and therefore, the Securities Division claim could well include costs beyond what the broker-dealer would have been liable for in damages. Indeed, the court noted that there had not been any claims by individuals who had purchased securities. Accordingly, the court ruled that because the policy forms providing coverage for "selling away" would not have helped the broker-dealer in these circumstances, it had no claims against its insurance broker.

For more information, please contact one of WRF's Professional Liability Attorneys at 202.719.7130