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NEWSLETTER

Contra Proferentem Rule Creates Broad Coverage for Claims Alleging Investment Counseling

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A New York federal court, applying New York law, has held that an E&O policy provided coverage for claims alleging "investment counseling" even though the insured was not in fact acting as an "investment counselor." *Morgan Stanley Group, Inc. et al. v. New England Insurance Co. et al.*, 222 F. Supp. 2d 381 (S.D.N.Y. 2002).

The insurers issued an "Investment Counselors Errors and Omissions and Fiduciary Liability Insurance" policy to Morgan Stanley Group, Inc. (Morgan Stanley). The policy provided coverage for "Loss which the Insured shall become legally obligated to pay, from any claim made against the Insured during the Policy Period, by reason of any actual or alleged negligent act, error or omission committed in the scope of the Insured's duties as investment counselors." Two banks purchased participation interests in a loan transaction promoted by Morgan Stanley. When material misrepresentations by the loan seller emerged and the investment failed, the banks filed lawsuits against Morgan Stanley, alleging that it provided false information on the investment. Morgan Stanley then sought coverage for the suits under its E&O policy, and the insurer denied coverage because Morgan Stanley was not acting as an "investment counselor." The insured filed suit.

In an earlier decision in the litigation, the Second Circuit had held that Morgan Stanley was not acting as an "investment counselor" in the transaction at issue. However, the appeals court held that Morgan Stanley might nevertheless be entitled to coverage for a claim by one of the banks because the complaint "alleged" that Morgan Stanley acted as an "investment counselor," even if it did not in fact do so. The insurer argued that "alleged" modifies "act, error or omission" and that coverage is therefore available only for alleged acts, errors or omissions while Morgan Stanley was acting as an investment counselor. Morgan Stanley argued that "alleged" modifies the entire provision and therefore provides coverage where a claim alleges that Morgan Stanley was acting as an "investment counselor" even if it is not in fact playing that role.

Finding the policy language ambiguous, the court looked at extrinsic evidence to determine the parties' intent. The court concluded that the extrinsic evidence offered by the parties (including testimony from Morgan Stanley that its risk manager obtained the insurance to "cover losses that might arise from allegations or actually giving negligent advice to clients," letters offered by Morgan Stanley in which the insurer stated "Morgan Stanley is not alleged [in the...complaint] to have acted as an investment advisor or investment

counselor" and testimony from the insurer's underwriter that the words "actual or alleged" were not intended to obviate the requirement that the acts occur in the insured's capacity as an investment counselor) failed to resolve the policy's ambiguity. The court therefore applied the *contra proferentem* rule, construing the policy in favor of the insured as including coverage for claims alleging "investment counseling."

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