

## Court Applies Securities Exclusion to Coverage under E & O Policy

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July 2004

In an unreported decision, a California appellate court has held that a securities exclusion in an E&O policy did not bar coverage for lawsuits alleging that an insurance agent was liable for investment advice provided in connection with unregistered securities. *Susman v. Fireman's Fund Ins. Cos.*, 2004 WL 1178773 (Cal. Ct. App. May 28, 2004). However, the court held that coverage was unavailable because the policy's insuring agreement did not provide coverage for investment advice.

The policyholder was an insurance agent who sold homeowners insurance, life insurance and other insurance products. The agent was covered under a group E&O policy, procured through a managing insurance company. The policy provided coverage for damages based on "any act, error or omission of the *Insured*, or any person for whose acts the *Insured* is legally liable, in rendering or failing to render *Professional Services* for others in the conduct of the *Named Insured's* profession as a licensed Insurance Agent...but only while soliciting, servicing, placing or binding business on behalf of a carrier other than [the managing company] providing that the Agent has been authorized by the [managing company] to broker such business." The policy also contained a number of exclusions, including one barring coverage for "[a]ny claim arising out of the sale or servicing of *Securities*; however this exclusion shall not apply to variable life insurance, variable annuity products or mutual funds approved for sale by [the managing insurance company] and/or its subsidiaries and affiliates."

In the underlying action, the agent was solicited for an investment opportunity in a communications company. The managing insurance company learned of this investment and directed the agent to provide information regarding the investment opportunity to his clients. During this time, unbeknown to the agent, the state of Arizona issued a cease and desist order against the communications company, whose securities were not registered. Later, investors attempting to redeem their shares found that the communications company lacked the funds to repurchase the shares. The company was placed into receivership in Arizona. A group of investors brought suit against the agent alleging breach of contract, fraud, negligence, unfair trade practices and securities violations, contending that the agent "marketed, sold or otherwise promoted the sale of unregistered securities." The agent tendered defense of the underlying actions to his E&O insurer. After the insurer declined to defend, the agent sued.

The appellate court first rejected the insurer's argument that the securities exclusion barred coverage, holding that it could not find, as a matter of law, that the securities exclusion was applicable. The court explained that an insured could reasonably expect that the "sale or servicing" of securities, as used in the exclusion, did not include providing investment advice or information regarding securities offered by others as the agent did in this case.

However, the court held that the policy did not afford coverage because even if the securities exclusion was inapplicable, coverage must first be implicated before a duty to defend may be imposed. The court concluded that the policy provided no basis for coverage because the underlying allegations did not establish that the plaintiff was "soliciting, servicing, placing or binding business on behalf of a carrier other than [the managing company]." According to the court, the use of the terms "binding" and "carrier" in the policy "made it clear that it applies to insurance. It cannot reasonably be interpreted to include providing investment advice or promoting investment opportunities in a corporation." The court therefore affirmed the trial court's grant of a demurrer in favor of the insurer.

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