

Cost of Repurchasing Securities That Were Unlawfully Sold Is Not "Loss" or "Damages"

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The United States Court of Appeals for the First Circuit, applying Maine law, has held that costs that a securities broker-dealer incurred to repurchase unlawfully sold securities do not constitute "Loss" or "Damages" under an E&O policy issued to the broker-dealer. *New Life Brokerages Serv., Inc. v. Cal-Surance Assoc., Inc.*, 2003 WL 21448838 (1st Cir. June 24, 2003).

The Securities Division of Maine's Bureau of Banking (Securities Division) investigated a broker-dealer for engaging in the unlawful practice of "selling away," which involved the sale of securities that were not registered or approved for sale by the broker-dealer. The Securities Division sought to revoke the broker-dealer's license and conditioned any agreement not to revoke the license on the broker-dealer repurchasing a substantial number of the unlawfully sold securities. The broker-dealer's E&O insurer refused to provide coverage for the repurchase of the securities, and the broker-dealer then sued its insurance broker for failing to procure coverage for liability resulting from selling away.

The First Circuit held in favor of the insurance broker, reasoning that because the cost of repurchasing securities was not "loss" or "damages" under Maine law, the insurance broker would not have been able to procure coverage from any insurer. The First Circuit based its conclusion on a prior decision by the Supreme Judicial Court of Maine in which that court had held that "damages" in an insurance policy did not include expenses that an insured incurred in eradicating pollution damages because such costs are "remedial." *Patrons Oxford Mut. Ins. Co. v. Marios*, 573 A.2d 16 (Me. 1990). Like the equitable remedial costs in *Marios*, the First Circuit explained, "the broker-dealer's equitable remedial buy-back costs, insisted on by the Securities Division, are distinguishable from any actual direct damages that [the broker-dealer] would have been obligated to pay its customers."

For more information, please contact us at 202.719.7130.