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NEWSLETTER

Sixth Circuit Holds That Coverage for Arbitration Claims Barred by Policy Exclusion

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The United States Court of Appeals for the Sixth Circuit has held that, under Ohio law, the insured was not entitled to defense costs where allegations in the underlying complaint did not state a claim potentially within the scope of the policy's coverage. *Ganim v. Columbia Casualty Co.*, 2009 WL 2176632 (6th Cir. July 23, 2009).

The insurer provided errors and omissions liability coverage to the insured financial services agency and its registered representatives. The policy limited coverage to "investment advisory services" and the "sale or attempted sale or servicing of securities . . . approved by" the insured financial services agency, and excluded "products or services not approved by [the insured]" or "any security that is not registered with the Security [sic] and Exchange Commission."

In October of 2004, the underlying claimant brought suit against one of the insured's advisors for inducing him to invest his entire savings of more than $500,000 in an untested investment vehicle neither previously approved by the insured financial services agency nor registered with the Securities and Exchange Commission (SEC). The advisor timely notified the insurer of the claim, and the insurer agreed to defend under a reservation of the right to disclaim both defense and indemnity costs. The insurer likewise informed the advisor that it would not provide coverage for losses resulting from any financial instruments that had not been previously approved by the insured financial services agency. The insurance company, however, defended the advisor, and the court dismissed the case without prejudice in 2005. The claimant subsequently filed an arbitration claim against the advisor alleging counts arising out of the same inducement to invest in an unapproved financial instrument. After receiving timely notice of the arbitration claim, the insurer disclaimed defense and indemnity costs on the basis that the claims fell within an exclusion of the policy. The advisor filed suit against the insurer in district court asserting breach of contract and bad faith claims for the insurer's failure to undertake a defense. The district court subsequently granted the insurer's motion for summary judgment on all of the claims, and the advisor appealed.

The Sixth Circuit affirmed, holding that the insurer had "a reasonable justification" to disclaim coverage because the underlying claimant did not allege any facts that reasonably could fall within the scope of the policy. The court reasoned that while "an insurer's obligation to defend against claims 'potentially' within the scope of coverage prevents an insurer from strictly or narrowly construing a complaint's allegations and

refusing to defend," the underlying claim's allegations in the instant matter made specific references to financial instruments not previously approved by either the insured financial services agency or the SEC. As such, "[t]here was no potential that a later development could have changed the nature of the investment at issue," bringing it within the scope of coverage. Further, the court rejected the registered representative's assertion that the insured denied his claim in bad faith, citing the fact that the underlying claim did not meet the criteria for coverage under the policy.