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NEWSLETTER

# Overlapping Prior Claim Not Barred by Prior and Pending Litigation Exclusion

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The United States District Court for the Southern District of California has determined that "prior and pending," specific matter and application exclusions in the second of two successive professional liability policies did not bar coverage for arbitrations having partial overlap with a claim made against the insured broker-dealer prior to the inception of the policy. *Endurance Am. Spec. Ins. Co. v. WFP Sec. Corp.,* No. 11-cv-2611 (S.D. Cal. Sept. 28, 2012). In granting the insured's motion for partial summary judgment, the court also ruled that the policy's duty to defend did not require satisfaction of a self-insured retention and that the potential for the insurer to rescind the policy based on misrepresentations and omissions in the application did not obviate the duty to defend.

A written demand, including a draft arbitration statement, was made against the insured broker-dealer during the first policy period. During the second policy period, 16 arbitrations were instituted against the insured alleging that its employees directed the claimants to make unsuitable investments. The initial claim and the subsequent arbitrations involved similar allegations and some of the same allegedly improper investments, and the insurer contended that the later arbitrations were derived from the same essential facts and circumstances as the initial claim and therefore were excluded by the prior and pending litigation exclusion that barred coverage for claims "based upon arising from or in consequence of . . . any written demand, litigation, proceeding, administrative action or hearing brought prior to pending as of the Prior and Pending Litigation Date . . . as well as any future [claim] based upon any such pending [claim] or derived from the essential facts or circumstances underlying or alleged in any such [claim]."

The court rejected the insurer's argument. According to the court, the subsequent claims include "a number of investments not at issue in, and wholly unrelated to any issue in the [initial] matter. As such, the [subsequent matters are] not entirely 'based upon, arising from or in consequence of' the [initial] claim." Noting that it was "[i]nterpreting the exclusion narrowly against the insurer," the court found that the prior and pending litigation exclusion did not bar coverage for the arbitration claims made in the second policy period.

The court made a similar determination with respect to an exclusion for any claim "based upon arising out of, directly or indirectly resulting from, in consequence of, or in any way involving: the [initial] matter." The court reasoned that the exclusion "does not clearly exclude claims involving both related and unrelated issues, securities and parties" and therefore did not exclude coverage of the subsequent matters. And because the

subsequent arbitrations "involve[d] claims not addressed in the [initial] claim," the policy's exclusion for claims "arising from any fact, circumstance, act, error, or omission disclosed or required to be disclosed" in the application did not bar coverage. The subsequent claims did not "entirely arise" from the initial claim and therefore, the court concluded, were not excluded.

The insurer of the latter policy also contended that a $50,000 retention applied before any duty to defend incepted. The insured argued that the insurer issuing the latter policy had a "first dollar" duty to defend because the policy failed expressly to provide that it owed no duty to defend until exhaustion of the policy's retention. The court found that policy language providing that the policy was "in excess of the amount of the applicable self-insured retention of [the] Policy and any other valid insurance available to the Insured . . ." did not expressly state the retention must be exhausted to trigger the duty to defend. The court also noted that the placement of the retention provision in the "conditions" section of the policy was not an "express limitation on coverage." Therefore, the court determined that the duty to defend was not conditioned on exhaustion of the self-insured retention.

The insurer also argued that that the insured's motion should be denied–and that the insurer had no duty to defend–because the insurer sought in a separate proceeding to rescind the policy based on misrepresentations and omissions in the application. The court rejected this argument. The court reasoned that the duty to defend turns on facts known by the insurer at the inception of the underlying lawsuit. The insurer could not rely on potential rescission to avoid a duty to defend, the court stated, because it had supplied no evidence showing that it could prove there was no potential for coverage at the time it denied a defense.