

Broad Allegations in Complaint Against Investment Adviser Trigger Duty to Defend

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The United States District Court for the Southern District of California has held that an insurer breached its duty to defend when a complaint alleged that an insured provided investment advice that “includ[ed],” but was not specifically limited to, investments not covered under the policy, and where the insurer failed to investigate whether the allegations could have encompassed covered investments. *Isaacs v. Chartis Spec. Ins. Co.*, 2014 WL 1286565 (S.D. Cal. Mar. 31, 2014).

An insurer issued an E&O policy to a broker/dealer. The policy classified a registered investment adviser and its principal as insureds and “Registered Representatives” under the policy. The insuring agreement provided specified coverage to the investment adviser only for professional services rendered “in connection with an Approved Activity.” “Approved Activit[ies]” required prior approval by the broker/dealer.

The investment adviser allegedly recommended investments to a customer in two business entities controlled by the adviser without disclosing the adviser's interest in those companies. The investment adviser did not have approval from the broker/dealer to recommend investments in either of the two business entities. The customer eventually brought suit against the investment adviser for breach of his fiduciary duties “to provide competent and accurate financial advice and services related to his estate plan, including his investments in” the two business entities. The investment adviser sought coverage from the insurer, which denied coverage on the grounds that the complaint arose out of investments for which the investment advisor did not have approval from the broker/dealer.

In the ensuing coverage litigation, the court held that the insurer breached its duty to defend the investment adviser. The court focused on the broad language of the allegations of the complaint, which sought damages for breach of duty for services “related to [the claimant's] estate plan, including [the claimant's] investments in” the two entities. The court found that the word “including” indicated that the allegations were not limited to investments in these two entities and could be read to encompass approved activities. Because the allegations were so broad, the burden shifted to the insurer, and it was not sufficient for the insurer to rely on the “narrow reasoning” that it had no duty to defend because the two specified entities were not approved by the broker/dealer.