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ALERT

Tenth Circuit Holds That Multiple Arbitrations Concerning "Churning" of Annuity Accounts Constitute "Interrelated Wrongful Acts"

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The United States Court of Appeals for the Tenth Circuit, applying New York law, has reversed and remanded a district court's ruling in favor of an insured, holding that an arbitration concerning allegations that the insured broker/dealer for a financial services firm "churned' annuity accounts in order to generate higher commissions related back to claims made in two earlier arbitrations that occurred prior to the insurer's policy period, thus falling outside of coverage under that policy. *Brecek & Young Advisors, Inc. v. Lloyds of London Syndicate 2003*, 2013 WL 1943338 (10th Cir. May 13, 2013). However, the court also determined that the carrier was estopped from raising that coverage defense due to its failure to raise the defense promptly and subsequent involvement in connection with the defense and settlement of the arbitrations.

The insured broker/dealer was a respondent in an arbitration before the National Association of Securities Dealers in which 26 claimants generally alleged that the insured, among other things, sold unsuitable investments products and "churned" annuity accounts of retirees in order to generate higher commissions. The insured tendered notice of the arbitration to its professional liability insurer, which agreed to defend the action under a reservation of rights. At the time, the insurer was aware of two prior arbitrations involving the insured concerning churning allegations that were submitted to the insured's prior carrier. However, the current insurer advised the insured that the prior claims were not "Interrelated Wrongful Acts," and that each of the 26 individual claimants asserted separate claims, such that 26 separate $50,000 retentions applied.

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The policy provided that "[a]ll Claims based upon or arising out of the same Wrongful Act or Interrelated Wrongful Acts shall be considered a single Claim and each such single Claim shall be deemed to have been made . . . when the earliest Claim arising out of such Wrongful Act or Interrelated Wrongful Acts was first made." "Interrelated Wrongful Acts" was defined to mean "any Wrongful Acts that are . . . similar, repeated or continuous; or connected by reason of any common fact, circumstance, situation, transaction, casualty, event, decision or policy or one or more series of facts, circumstances, situations, transactions, casualties, events, decisions or policies."

In the declaratory judgment action concerning coverage, the district court granted summary judgment to the insured, holding that the claims by the 26 claimants were each Interrelated Wrongful Acts subject to a single retention, but the court denied the insurer's alternative argument that, if the 26 claims in the latest arbitration were related, then they relate back to the claims made prior to the insurer's policy period.

On appeal, the Tenth Circuit reversed the district court, finding that the most recent arbitration and the two prior arbitrations "were connected by common facts, circumstances, decisions, and policies" such that the claims "ar[o]se from wrongful acts interrelated to the wrongful acts committed outside the insurer's policy period." In reaching this conclusion, the court recognized that, under New York law, whether certain claims constitute interrelated wrongful acts "depends upon whether there exists a sufficient factual nexus between" the claims at issue. In finding that the latest arbitration and the two prior arbitrations were interrelated, the court focused on "[s]everal common facts" that connected the three arbitrations, including: (i) all named as respondents the insured and several other parties; (ii) "[a]ll of the misconduct was alleged to have taken place during roughly the same time period—from the late 1990s to the mid 2000s"; (iii) "[a]ll claims allege the respondents sold unsuitable investment products including various types of annuities"; (iv) "all claims involved allegations of churning or flipping of investment accounts in order to enrich the broker/agents at the expense of account holders"; and (v) the insured's "liability was predicated on theories of vicarious liability and failure to supervise its broker/agents in each of the claims." The Tenth Circuit rejected the insured's contention that the "Interrelated Wrongful Acts" provision should be interpreted narrowly, commenting that the policy defined the term and that the parties agreed the term was unambiguous. Because the court found that all three arbitrations were interrelated, the court held that the most recent arbitration related back to the first such arbitration, which was first made prior to the relevant policy period.

Next, the court held that the district court abused its discretion in holding that the insurer was not estopped from raising the defense that all of the arbitrations were interrelated because the insurer "waited too long" to assert that defense after agreeing to defend the arbitration and settling that arbitration. In this regard, the court emphasized that, where "for three years [the insurer] consistently acted as though the [] claims were covered under the Policy, subject only to a dispute as to the amount of applicable retentions" and the insurer "controlled the defense of the [] Arbitration throughout its entirety to its termination and contributed to the settlement," "[s]uch a showing is more than adequate to establish prejudice under New York law." The court then remanded the action back to the district court to determine whether the insured was entitled to any recovery beyond the funds the insurer already paid out as indemnity for the settlement, which were paid out under the insurer's argument at the time that 26 separate retentions should apply.