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TLSS Partner Jonathan R. Harwood Prevails in the United States Court of Appeals for the Second Circuit on Appeal of a Favorable Jury Verdict on Interpretation of Broker/Dealer Insurance Policy

Related Attorneys: Jonathan R. Harwood

TLSS Partner Jonathan R. Harwood obtained a jury verdict in a declaratory judgment action brought on behalf a TLSS client in October 2013. After a three and one half day jury trial before the Honorable Lorna G. Schofield, in the United States District Court for the Southern District of New York, a jury determined that the TLSS client, an insurer, had no further obligation to pay its insured under a Broker/Dealer and Registered Representative Liability Policy. That verdict was affirmed on appeal in a decision issued on November 3, 2015 by the United States Court of Appeals for the Second Circuit.

The insured was a broker-dealer financial services corporation engaged in the sale of securities through a network of Registered Representatives. Its representatives recommended that certain clients invest in private placements, which are securities that are exempt from registration under Securities and Exchange Commission regulations and by their nature involve higher risk. Private placements were originally excluded from coverage under the standard policy. At the broker-dealer's request, the insurer added an endorsement to the policy modifying the insuring agreement and policy declarations to provide coverage for these investments, subject to \$1 million aggregate limit. All other covered claims under the policy were subject to a \$7.5 million aggregate limit if liability.

When the financial crisis hit in 2008-2009, the broker-dealer was inundated with investor claims arising from failed private placement investments. The sponsors of those products declared bankruptcy and were unable to pay investors. The investors, thereafter, pursued the broker-dealer and its registered representatives for the losses. The broker-dealer submitted these claims to its insurer, which agreed to defend the claims subject to the \$1 million aggregate limit of liability contained in the endorsement. The broker-dealer disputed this position, contending that the \$7.5 million general policy aggregate should apply to the claims. The dispute led to the insurer filing the declaratory judgment action seeking a determination that its reading of the policy was correct and that, having exhausted the \$1 million limit, it owed no further obligation to the broker-dealer. The broker-dealer filed a counterclaim alleging breach of contract and bad faith seeking compensatory, consequential and punitive damages in excess of \$10 million. During the pre-trial phase, TLSS successfully obtained dismissal of the broker-dealer's bad faith claim.

At trial, the court permitted the parties to submit extrinsic evidence of their intent with respect to the applicable limits of liability and the endorsement. At the conclusion of the case, the judge rejected the broker-dealer's request to instruct the jury to apply the doctrine of *contra proferentem*. The judge also rejected the broker-dealer's request to instruct the jury that the insurer could only prevail if it established that its interpretation of the policy was the only reasonable reading of the endorsement. In seeking this charge, the broker-dealer asserted that the limitation of liability constituted an exclusion. Instead, the trial court instructed the jury that it only need find in favor of the insurer if such finding was supported by a preponderance of the evidence. After deliberations of approximately 45 minutes, the jury returned a verdict in the insurer's favor, finding that the \$1 million limit applied and that it owed nothing further under the policy.

The broker-dealer appealed the jury verdict, arguing that the trial court committed reversible error when it failed to instruct the jury to apply either *contra proferentem* or the heightened burden of proof. It also sought a reversal of the dismissal of its bad faith claim. In affirming the trial court's decision, the Second Circuit did not address whether *contra proferentem* applied in this case. Instead, it held that, assuming it was applicable, the jury instruction that was provided did not mislead the jury, as it advised that the insurer had to prove its case by a preponderance of the evidence and, if it failed to do so, the jury must find against the insurer. The Second Circuit also rejected the broker-dealer's argument that a heightened burden of proof applied, finding that the language at issue was a limit of liability and that such provisions do not constitute exclusions from coverage.

Finally, the Second Circuit affirmed the dismissal of the broker-dealer's bad faith claim. Here, the court held that the jury's verdict established that the insurer's position was, in fact correct. This precluded the broker-dealer from establishing, as it was required to do, that the insurer's position was less than arguable.