

Bond Case Briefs

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INSURANCE - PUERTO RICO

UBS Financial Services, Inc. of Puerto Rico v. XL Specialty Insurance Co.

United States Court of Appeals, First Circuit - July 3, 2019 - F.3d - 2019 WL 2864751

Insured underwriter and licensed broker-dealer, that sold shares of closed-end funds (CEFs) to brokerage customers in Puerto Rico, and insured manager of 23 CEFs filed suit against primary insurer and secondary insurers, claiming breach of liability policies by failing to reimburse insureds for defense costs incurred in connection with underlying disputed matters, including Securities and Exchange Commission (SEC) investigations, investors' civil litigation, Financial Institutions Regulatory Association (FINRA) investigation, and FINRA arbitrations.

The United States District Court for the District of Puerto Rico granted insurers summary judgment. Insureds appealed.

The Court of Appeals held that:

- Specific litigation exclusion barred coverage for disputed matters;
- Exclusion did not render policies illusory;
- Exclusion applied to entire claims against insureds;
- Allocation clause did not preclude application of exclusion to entire claims;
- Exclusion was not required to be construed in favor of insureds.

Under Puerto Rico law, specific litigation exclusion in primary and secondary liability policies barred coverage for disputed matters against insureds, including regulatory investigations, investors' litigation, and arbitrations, concerning closed-end funds (CEFs) for which insureds sold shares and also managed; exclusion barred coverage for "any Claim based on, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving" prior matters "or any fact, circumstance or situation underlying or alleged therein," disputed matters all involved facts, circumstances, or situations underlying prior matters that policies specified as regulatory investigation and investors' litigation, and substantial overlap was not required between disputed and prior matters.

Under Puerto Rico law, specific litigation exclusion in primary and secondary liability policies that barred coverage for underlying disputed matters against insureds, including regulatory investigations, investors' litigation, and arbitrations, concerning closed-end funds (CEFs) for which insureds sold shares to Puerto Rico customers and also managed, did not render policies illusory, although substantial portion of insureds' business was excluded from coverage because CEFs were insureds' core business, since exclusion did not bar coverage for all claims, such as claims for breach of fiduciary duties due to accounting errors or claims for self-dealing, failure to protect confidential customer information from disclosure, whistleblower protection, and deficient investment advisory services.

Under Puerto Rico law, specific litigation exclusion in primary and secondary liability policies that

barred coverage for underlying disputed matters against insureds, including regulatory investigations, investors' litigation, and arbitrations, concerning closed-end funds (CEFs) for which insureds sold shares to Puerto Rico customers and also managed, applied to entire "claims" against insureds, defined under policies as "any formal, civil, criminal, administrative, or regulatory investigation" of insureds, rather than merely applying to portions of claims that had nexus to prior matters specified in policies as regulatory investigation and investors' litigation regarding CEFs.

Under Puerto Rico law, allocation clause in primary and secondary liability policies, permitting parsing of claims into covered and uncovered matters in allocating loss, did not preclude application of policies' specific litigation exclusion to entire "claims" against insureds, defined under policies as "any formal, civil, criminal, administrative, or regulatory investigation" of insureds, since policies' definition of claim was more specific in context of determining scope of claim in exclusion than more general allocation clause.

Under Puerto Rico law, specific litigation exclusion in primary and secondary liability policies that barred coverage for underlying disputed matters against insureds, including regulatory investigations, investors' litigation, and arbitrations, concerning closed-end funds (CEFs) for which insureds sold shares to Puerto Rico customers and also managed, was not required to be construed in favor of insureds, rather than insurers, since terms of exclusion were clear, insureds were sophisticated financial players and engaged large and respected broker with expertise in Puerto Rican market to assist insureds in negotiating policies at arm's length, and insureds received advice and suggestions from coverage counsel regarding exclusion.