GETTING COVERAGE RIGHT: PROFESSIONAL SERVICES EXCLUSION

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Much litigation has spawned from cryptic endorsements and exclusions contained in today’s D&O policies. If you have trouble interpreting what these exclusions mean, there is no need to feel unsophisticated, as even seasoned Federal and State judges have difficulty deciphering and applying the intricacies of such language. This article focuses on the coverage issues the “Professional Services Exclusions” creates, and some approaches courts are taking when coverage disputes arise with respect to this exclusion.

Insurance claim handlers often use the Professional Services Exclusion to deny coverage under D&O Policies by asserting that the claim arises out of the “performance or failure to perform Professional Services for others . . .” Those of you with companies that provide professional services to clients are probably saying to yourselves that virtually every claim could be subject to this exclusion, which would essentially render your D&O insurance worthless.

To avoid this conundrum, courts have given the exclusion a much more narrow application in the D&O policy context, and have held that the exclusion applies only to claims involving the company’s “implementation of expertise and judgment” in the company’s particular industry.

Example

A biotechnology company has a claim arise regarding its directors’ and officers’ allegedly negligent approval to build a parking structure. Although this occurred in the course and scope of the insured’s business, this claim would not be subject to the exclusion, because decisions about a parking structure are homogenous among all businesses that require parking, and not germane to the biotechnology business. By contrast, however, if the same biotech company had a claim arise out of the alleged negligent decision of management to move forward with human trials of a medical device that was not adequately tested, and which later failed and caused the company’s stock to plummet, this would be properly excluded from coverage, because the decision required the implementation of expertise and judgment in the biotech industry.

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Why Is This Important and What Does This Mean for You, the Insured?

 Courts are not in total agreement when it comes to applying this exclusion, and slight factual variances can often mean the difference between a proper and improper coverage denial. As such, instead of embarking on the often lose-lose venture of coverage litigation, it is best to maintain a separate policy designed to cover the company’s errors and omissions. Let someone else spend the money, time, and effort fighting a coverage battle with the insurance carrier.

 Although maintaining a separate E&O policy is prudent, unfortunately it does not guarantee that no coverage disputes will arise. We have seen claims where our client’s D&O insurer believes a claim involves professional services and their E&O insurer takes the opposite position. There is no way to eliminate the possibility that such a situation will arise. Nevertheless, by ensuring that the E&O policy’s definition of “professional services” is broad enough to include every service the company performs for others, and by also ensuring that the D&O policy’s professional services exclusion is narrow enough that it reaches only matters that would be covered under the E&O policy, the potential problem can be minimized.

Professional services exclusions can be fertile ground for disputes with D&O insurers. While insurers typically try to do the right thing and don’t indiscriminately invoke the exclusion, patient work is sometimes needed to help them understand the claim and the nature of the company’s business. In such situations companies should enlist the help of their insurance broker and its claims advocacy resources to obtain the best outcome.