



## THE PROFESSIONAL SERVICES EXCLUSION: A CAUTIONARY TALE FOR D&O INSUREDS

### CONTACT

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### ABOUT THE AUTHOR

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Professional services exclusion is found in most private company D&O policies, as well as in D&O policies issued to publicly traded companies that provide professional services including banks, financial advisory companies, technology service firms and more. This is a very critical coverage issue to watch, as we have seen numerous claim denials based upon this exclusion. In some cases, the denials appear as though the professional exclusion could be used for any situation involving the primary operations of the insured.

The following hypothetical scenario illustrates some of the circumstances under which the professional services exclusion may result in a coverage determination contrary to the expectations of an insured:

*ScripCorp is a wholesale pharmacy that dispenses prescriptions for nursing and rehabilitation facilities. Among its customers is KomfortKare, Inc., which owns and operates a chain of orthopedic rehabilitation facilities. A former customer relationship manager at ScripCorp commences a whistleblower lawsuit alleging that ScripCorp secretly pays incentives to its nursing home customers based on the volume of prescriptions filled, which is in violation of state and federal laws and regulations. Shortly thereafter, state and federal law enforcement authorities commence an investigation of KomfortKare and Huxtable Medical, the medical group contracted to provide medical services at KomfortKare facilities. The goal of the investigation is to determine whether the prescription insurance billing and reimbursement practices of KomfortKare and Huxtable are fraudulent. Neither the whistleblower suit nor the investigation contain allegations that improper or inappropriate medications were prescribed or dispensed, only that improper benefits were paid or received.*

*ScripCorp, KomfortKare, and Huxtable provide notice of the claims and investigations to their respective D&O insurers. ScripCorp's D&O insurer denies coverage relying on the professional services exclusion. The D&O insurers for KomfortKare and Huxtable both reserve their rights, identifying the professional services exclusion as one of the bases for reservation. Out of an abundance of caution, each insured also provides notice to its Professional Liability insurer. In each instance, the Professional Liability insurer denies coverage, taking the position that the alleged conduct is not included within the scope of professional services.*

### COVERAGE DETERMINATIONS

Why the different initial coverage determinations? The D&O insurance policies issued to the three insureds each contain different versions of the professional services exclusion.

The exclusion contained in ScripCorp's D&O policy states that:

*The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging, based upon, attributable to, directly or indirectly arising out of, in consequence of, or in any way involving the performance of or failure to perform professional services.*

The corresponding exclusion in KomfortKare's D&O policy provides that:

*The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured for the performance of or failure to perform professional services.*

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The professional services exclusion in Huxtable's D&O policy provides that:

*The Insurer shall not be liable to make any payment for Loss for any Claims made against an Insured alleging, based upon, or involving the performance of or failure to perform professional services for others.*

Many, if not most, insurance professionals instinctively recognize the difference between the wrongful acts covered by a D&O policy and the breaches of a professional standard of care covered by a professional liability policy. But what happens if policy language allows for a coverage determination contrary to the expectations of the insured, or the relevant policy language lends itself to an overly broad application?

This is the situation experienced by the insureds – and ScripCorp, in particular – in our hypothetical scenario. Each insured provides professional services, or services that presuppose some level of professional expertise. But the claims against each of the insureds do not allege that the insured committed some breach of a duty of care in the course of providing professional services or services requiring a special level of expertise. The claims against each insured allege that the insured entity wrongfully provided or received improper benefits or submitted fraudulent billing statements.

The professional services exclusion in the D&O policy issued to ScripCorp illustrates the hazards posed for policyholders. For a business providing professional services, there is a risk that an insurer could determine that virtually any activity conducted by that business can be characterized as “based upon, attributable to, directly or indirectly arising out of, in consequence of, or in any way involving” professional services. Compounding the hazards for an insured, there is a risk that its insurers will argue that a particular claim falls into a gap in coverage -- excluded by the D&O policy's professional services exclusion but not falling within the scope of a professional liability insurance policy.

## HOW TO PROTECT YOUR INSURED

What can an insured's advisors and counsellors do to protect against the dilemma in which ScripCorp finds itself in our hypothetical?

- If you see a professional services exclusion in the policy or endorsements, read it carefully. If the insured's primary operation is providing a service, they are susceptible to problems with these exclusions.
- If the insured performs services, try to avoid policy forms that contain the broad “based upon, attributable to, directly or indirectly arising out of, in consequence of, or in any way involving” language in the preamble of the exclusion. Using “for” wording is more advantageous.
- Even if the broadly worded exclusions are unavoidable, other policy amendments can be sought in an effort to mitigate the potential consequences of the preamble language. Language that limits the exclusion to services provided “for others” may be a means to prevent the application of the exclusion to ordinary tasks that are performed in the course of any business such as billing.
- In any event, it may be necessary to dispute a coverage determination based on an overly broad application of the professional services exclusion. Certainly, D&O policies should not be construed so broadly that they cover professional errors and omissions. By the same token, the professional liability exclusion should not be applied so widely that it applies to virtually any claim brought against a business that provides services requiring some level of professional expertise. Construing the professional services exclusion so broadly that it could apply to virtually any claim for a wrongful act would render the coverage of a D&O policy largely illusory.

## CONCLUSION

Seemingly minor differences in the wording of insurance policy terms, such as the professional services exclusion, can have significant consequences. It is important for the insured and its advisors to be attentive to and aware of the consequences of those policy terms before being caught by surprise by an insurer's denial based on an expansive reading of an exclusion.

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There are other potential remedies that can be negotiated by sophisticated insurance brokers. Please contact a broker from the AmWINS Professional Lines Practice to assist with the placement of Directors & Officers liability, especially when a professional services exclusion may be applied.

