

Guest Blog: What is the scope of the “professional services” exclusion in D&O liability policies issued to private companies?

The Hotchalk case highlights a coverage defense that some D&O insurers have aggressively asserted and courts across the country have struggled to address. What is the scope of the “professional services” exclusion in D&O liability policies issued to private companies?

Such policies issued to private companies provide sweeping coverage for a wide variety of claims asserted directly against the company. Subject to certain exclusions, they cover companies against claims asserted against them alleging “acts, errors, omissions, misstatements, misleading statements and breaches of duty”. As a result, private companies reasonably expect broad coverage under their D&O policies for claims made against them. This is in contrast to public company D&O liability policies, which generally only cover the company for “securities claims” against it.

Most private company D&O liability policies contain a “professional services” exclusion. It typically bars coverage for claims “based on” or, in some instances, “arising out of” the rendering or failing to render professional services to others for a fee.

Until recently, there was little case law construing this exclusion in the D&O context. A similar exclusion found in commercial general liability (CGL) policies has a long history in the courts, though, and not all favorable to policyholders. The exclusion has been interpreted in that context to broadly eliminate coverage for claims alleging some relationship with services that the policyholder performed.

As courts have begun to grapple with the exclusion in the D&O context, some have imported the analysis of the exclusion from the CGL cases. This has resulted in some findings of no coverage, particularly

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where the exclusion uses the broad “arising from” formulation, despite policyholders’ strong and legitimate expectation of coverage.

A broad application of the exclusion in the D&O context, especially when the policyholder’s primary business is to provide services, potentially renders the coverage offered by the policy illusory. This is because, as some insurers have effectively argued, pretty much any claim asserted against a service provider arises in some way out of the services it provides.

The exclusion cannot work that way. It would thwart the purpose of the policy altogether by eliminating coverage for claims arising out of management-level decisions relating to the policyholder’s business operations – precisely what D&O policies are intended to protect against.

Hotchalk is one such case. See [Hotchalk Inc v Scottsdale Ins. Co.](#) It involves allegations that the company violated the False Claims Act by deciding to characterize its workers in a way that was not permitted for government contractors under federal rules. The company’s characterization, if proved to be true and wrongful, does not arise out of the service it provided, but rather a management level decision about how to deal with its workers. This is precisely what corporate policyholders expects to be covered by its D&O liability policy.

The Ninth Circuit Court of Appeal’s decision in the Hotchalk case could provide some clarity regarding the boundaries of the “professional services” exclusion in the D&O context. We hope that its decision will favor the reasonable expectation of policyholders.

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