

[Policyholders Group Backs D&O Coverage Denial Appeal](#)

Law360

A nonprofit insurance policyholders advocacy group asked the Ninth Circuit on Thursday to overturn a California federal judge's decision that an educational technology company isn't covered for a suit alleging an incentive program for its recruiters broke federal law, saying the lower court rendered the policy meaningless with an overly narrow interpretation.

In an amicus brief, United Policyholders argued the district court erred in finding Scottsdale Insurance Co. did not owe HotChalk Inc. for defense and settlement of the suit, saying that despite the insurer's escalating attempts, the D&O policy's "professional services" exclusion could not be stretched to cover a purely internal company policy.

"This interpretation of the professional services exclusion is so broad as to effectively eliminate D&O coverage for allegedly wrongful management decisions made by entities in the business of providing services, and is inconsistent with California law and the weight of national precedent," it said.

Campbell, California-based HotChalk helps universities create or expand online degree programs by providing promotional and administrative services, including recruiting students. From November 2013 through November 2014, the company held a D&O policy with Scottsdale.

In April 2014, former HotChalk employees filed a False Claims Act complaint accusing the company of falsely certifying to the U.S. Department of Education that it complied with Title IV of the Higher Education Act of 1965. The workers alleged that HotChalk provided several types of incentive payments to employees charged with recruiting students in violation of the law.

HotChalk requested a defense from Scottsdale in May 2014, but the insurer denied the tender on the grounds that the claims in the FCA suit arose out of the company's professional services.

In August 2015, HotChalk settled the claim for \$970,000. It claimed to have run up \$986,000 in legal costs defending the case..

Last June, HotChalk sued Scottsdale, alleging that the insurer had breached the policy and the duty of good faith and fair dealing. Scottsdale argued the policy had a professional services exclusion, and the district court dismissed the case, rejecting HotChalk’s argument the exclusion is inapplicable because the FCA action strictly related to its internal business practices, not its professional services. The alleged incentive-based compensation scheme could only have been improper because of the professional services that HotChalk provided to its clients, the judge said.

In its appeal HotChalk argued its alleged violations of the incentive compensation ban are unrelated to its professional services and “fall squarely” within the Scottsdale policy’s definition of covered “wrongful acts.” According to HotChalk, relevant California and Ninth Circuit precedent establishes that the professional services exclusion requires “more than an incidental connection” between a company’s services and the “underlying basis for the claim.”

United Policyholders agreed, and argued that any action taken by a service company is by necessity related to the services it provides in some way.

“The result, if the district court’s decision is allowed to stand, is that most, if not all, claims will fall within the professional services exclusion, rendering D&O coverage essentially illusory,” it said.

The group said while the majority of federal courts that have heard similar cases have come down on the side of a narrower interpretation of the exclusion, a growing number of D&O providers have been attempting to deny coverage based on a broad interpretation.

“Scottsdale’s position here exemplifies an unfortunate national trend that needs to be corrected,” it said.

Representatives of United Policyholders and counsel for HotChalk did not immediately respond to requests for comment Friday. Counsel for Scottsdale declined comment.

United Policyholders is represented in-house by Amy R. Bach and Daniel R. Wade and by Tyler Gerking and Deborah K. Barron of Farella Braun & Martel LLP.

HotChalk is represented by Peter Roldan and Christopher Wimmer of Emergent LLP.

Scottsdale is represented by Alexis Rogoski and Jonathan Andrew Sorkowitz of Skarzynski Black LLC and by Hee Young Lee of Herman & Lee LLP.

The case is HotChalk Inc. v. Scottsdale Insurance Co., case number 16-17287, in the U.S. Court of Appeals for the Ninth Circuit.

-Additional reporting by Jeff Sistrunk. Editing by Brian Baresch.