Professional Services: Where Do You Draw the Line?

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Directors and officers ("D&O") insurance policies typically exclude coverage for claims based upon or arising out of "professional services." Professional services exclusions contained in such policies generally provide that the insurer is not liable for defense or indemnity in response to a claim based upon or arising out of the insured's acts, errors, or omissions in performance or failure to perform such services. Such claims are instead generally covered under professional liability, or errors and omissions, policies ("E&O").

The demarcation line between the two coverages, however, is not determined merely by whether a claim involves wrongdoing arising from a primarily intellectual task requiring specialized knowledge. After all, typical claims falling within the scope of a D&O policy's insuring agreements often include lawsuits for mismanagement of the insured business and securities claims—both of which will necessarily involve intellectual tasks performed by individuals with specialized knowledge.

Instead, it is more useful to consider the broader risks that D&O and E&O policies are designed to cover. D&O policies are generally designed to cover general business management risks. Risks specific to and inherent in the insured's particular profession are then relegated to E&O policies, which are often more targeted to particular industries, such as medical professions, attorneys, or accountants.[ii] In some cases, this leads to a straightforward result. For example, a client's lawsuit against an insured-attorney for deficient legal advice is generally within the coverage of an E&O policy as a claim arising out of professional services.

But whether an activity constitutes a "professional service," such that it should be within the scope of an E&O policy instead of a D&O policy, is not always so clear. Variations in policy terms and caselaw, combined with the fact-specific nature of the inquiry, foreclose a universal, bright-line test for determining whether a claim involves professional services and its proper placement in either a D&O or E&O insurance program. Nonetheless, courts examining the issue have demonstrated that consideration of the fundamental risks covered by the two types of policies can serve as a useful guide.

A recent Third Circuit Court of Appeals case demonstrates as much. In *Benecard Servs. v. Allied World Specialty Ins. Co.*, the insured—a company that managed prescription drug benefit plans—was sued by a former business partner for breach of contract and fraudulent misrepresentation. [iii] The specific allegations were that insured failed to properly process beneficiary enrollments, provide information to beneficiaries, and process claims, among other things.[iv] The insured sought coverage under multiple policies, including separate D&O and E&O policies issued by the same insurer .[v] The relevant D&O policy excluded coverage for claims "relating to the rendering [of] or failure to render any professional services."[vi] The court held that the claim involved professional services, meaning the D&O policy's professional exclusion applied and that it was instead generally within the E&O policy's scope of coverage. In analyzing whether the insured's acts constituted professional services, the court noted that the insured allegedly "misrepresented its expertise in managing prescription drug plans," which was the insured's core business activity geared towards earning profit, not a general business risk potentially attributable to any operating business and, as such, found in the insured's favor[vii]

A decision issued by a New York federal court in *Tagged, Inc. v. Scottsdale Ins. Co.*, further illustrates these concepts.[viii] In *Tagged*, the insured operated a social media website specifically targeting teenagers and encouraging them "to meet and form other relationships with new people."[ix] To allay users' (and their parents') obvious concerns about potentially inappropriate contacts , the insured made a number of representations regarding the website's safety, including (i) a ban on sexually explicit content, (ii) a "Tagged Safety Squad" that monitored for harmful content, and (iii) a promise to remove any violative content.[x] Those representations turned out to be false—the website included numerous posts of child pornography, which the insured failed to remove even after receiving reports.[xi]

A New York Attorney General investigation resulted. The insured sought coverage for the investigation under a policy containing separate D&O and E&O coverage parts. The D&O coverage part excluded coverage for "any Claim alleging, based upon, arising out of, attributable to, directly or indirectly resulting from, in consequence of, or in any way involving the rendering or failing to render professional services."[xii] As to that section, "professional services" was undefined (as is generally the case in D&O policies), so the court applied the California common law definition: services "arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill, and the labor or skill involved is predominantly mental or intellectual, rather than physical or manual."[xiii] The court further emphasized conduct merely incidental to an insured's business—i.e., general business operations not specific to the insured's line of business—does not constitute professional services.[xiv]

Applying these principles, the services at issue in *Tagged*—determination and regulation of website content—were found to be professional services. The identification of inappropriate content was a mental or intellectual task, not physical. And the services were not merely incidental business services; they were specific to the insured's business.[xv] Accordingly, the D&O coverage part did not provide coverage. Unfortunately for the insured, however, neither did the E&O coverage part because it covered only professional services constituting advertising services to others for a fee.[xvi] Though the conduct at issue broadly constituted professional services, such services were not (i) advertising services, (ii) performed for others, or (iii) performed for a fee and, as such, the court did not find in the insured's favor.

Tagged underscores two important concepts. First, the court emphasized that the services at issue were not merely incidental to the insured's business. Second, even where the same insurer issued the relevant D&O and E&O policies, thorny questions may still emerge regarding the proper placement (if any) of a claim for coverage under either the D&O or E&O policies. Accordingly in view of decisions such as *Benecard* and *Tagged*, insureds and insurers alike are advised to closely examine the wording of their D&O and E&O insurance policies during the underwriting process to obviate, or at least minimize, questions relating to policy placement, if and when a claim later arises.

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[ii] *Search EDP, Inc. v. Am. Home Assurance Co.*, 267 N.J. Super. 537, 541 (Super. Ct. App. Div. 1993).

[iii] Nos. 20-2359, 20-2360, 2021 U.S. App. LEXIS 26978, at *2 (3d Cir. Sep. 8, 2021).

[iv] *Benecard Servs. v. Allied World Specialty Ins. Co.*, Civil Action No. 15-8593 (MAS)(TJB), 2020 U.S. Dist. LEXIS 94750, at *5-6 (D.N.J. May 31, 2020).
[v] *Benecard*, 2021 U.S. App. LEXIS 26978, at *2-3.
[vi] *Id.* at *10 (brackets original).
[vii] The court ultimately found no indemnity coverage under the E&O policy due to the insured's breach of a consent to settlement provision. *Id.* at *9.
[viii] 2011 U.S. Dist. LEXIS 75262 (S.D.N.Y. May 27, 2011).
[ix] *Id.* at *5-6.
[x] *Id.* at *6.
[xi] *Id.* at *7.
[xii] *Id.* at *5.
[xiii] *Id.* at *15 (quoting *Tradewinds Escrow, Inc. v. Truck Insurance Exchange*, 97 Cal. App. 4th 704, 713 (Ct. App. 2002)).
[xiv] *Id.* at *16.
[xv] *Id.* at *20.
[xvi] *Id.* at *4.