

E&O Policies and Professional Services

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INTRODUCTION

A recent decision by the United States District Court for the District of Minnesota shines a spotlight on an important coverage issue for errors and omissions ("E&O") claims professionals. In *Pacific Insurance Co. v. Burnet Title, Inc.*,⁽¹⁾ the court addressed the issues of whether (1) setting rates and billing, and (2) making referrals, were "professional services" within the scope of coverage of an E&O insurance policy. The policy did not contain its own definition of "professional services." Thus, the court's determination of what types of services were "professional" is most instructive.

PACIFIC INSURANCE CO. V. BURNET TITLE, INC.

A. The Facts

In *Pacific*, the underlying plaintiff, Teresa Boschee ("Boschee"), refinanced her home mortgage through Burnet Title Company ("Burnet"). She subsequently sued Burnet, as the lead plaintiff in a class action, alleging that Burnet fraudulently inflated the bills of third-party vendors and that Burnet failed to disclose certain relationships with third-party vendors.⁽²⁾ Burnet notified its E&O insurer, Pacific Insurance Company ("Pacific"), of the lawsuit. Pacific initially acknowledged coverage, but reminded Burnet that intentional and/or willful conduct was not covered, as it was against public policy to do so.⁽³⁾ After more correspondence was exchanged, Pacific sought to withdraw from the defense of the case. Pacific maintained, among other points, that the activities complained of in the underlying matter did not constitute "professional services," and thus not within the scope of the policy's insuring agreement.

B. The Court's Analysis

The court analyzed the issue of whether the alleged billing fraud and failure to disclose certain relationships with third-party vendors implicated "professional services," so as to trigger coverage under the Pacific policy. The court first looked at the dictionary definition of "professional service". The Court noted that "[a] professional service, within the meaning of an E&O policy is one calling for specialized skill and knowledge in an occupation. . . [t]he skill required to perform a professional service is predominately intellectual or mental rather than physical."⁽⁴⁾

The court observed that "[p]urely ministerial acts requiring no expertise fall without the scope of professional services."⁽⁵⁾ The court also stated that in determining whether an act is a "professional service," courts look at the act, itself, "not the title or character of the person who performs the act."⁽⁶⁾ Accordingly, the court determined that "even tasks performed by professionals are not considered *professional services* if they are ordinary activities that can be performed by those lacking the relevant training and expertise."⁽⁷⁾

According to the court, the difficulty in determining whether an activity is a professional or non-professional activity can be even more pronounced where, as was the case in *Pacific*, the allegedly improper conduct occurred in the performance of tasks that are "inherent in the practice of the insured's profession."⁽⁸⁾ In such a situation, "it is the unskilled nature of the specific task – not the absence of a professional endeavor – that can render services *unprofessional*."⁽⁹⁾

The Pacific court looked at another recent case for guidance. In *Medical Records Associates v. American Empire Surplus Lines Ins. Co.*,⁽¹⁰⁾ the defendant, Medical Records Associates ("MRA"), a medical records processing company, which provided copies of medical records to

patients and/or their attorneys, was sued for allegedly overcharging for copies. MRA notified its E&O insurer of the claim and sought coverage for "errors or omissions committed in the rendering or failure to render the Professional Services."(11)

The *Medical Records* court determined that:

Simply because a task is regulated does not make it "professional." And, while knowing how to access a patient's file, determining whether a medical file is complete, and judging who is a proper recipient of medical records are activities that reasonably may be viewed to require particularized knowledge, we fail to see how setting a price for photocopies and producing accurate invoices are other than generic business practices.(12)

The *Medical Records* court then rejected MRA's argument that its billing practices were a professional service, affirming the lower court's dismissal of MRA's coverage action against its E&O insurer.

The facts of *Pacific* are, in some respects, comparable to those in the *Medical Records Assocs.* case. In *Pacific*, one of the claims was that Burnet allegedly engaged in fraudulent billing practices. With respect thereto, the *Medical Records Assocs.* court stated, "[s]etting a price for services and sending bills are functions of every business."(13) Similarly, the *Pacific* court found that "[s]etting prices and sending bills are not unique to Burnet's business."(14)

Burnet argued that because real estate service providers are required to comply with RESPA, such compliance was a "professional responsibility," thus making its billing practices "professional services." The court, however, was unpersuaded. Relying on *Medical Records Assocs.*, the court observed that a nearly identical argument had been rejected in that case. The court stated, "Statutory requirements or limitations on billing practices do not automatically make billing a *professional* activity."(15) The court further noted that if Burnet's contention were true, every regulated industry could declare that all rate-setting activities are "professional" activities – a conclusion which goes against established precedent.(16)

While the court in *Pacific* found Burnet's billing practices were not "professional" activities which give rise to E&O coverage, it ultimately found that *the allegations that Burnet had failed to disclose certain referrals was sufficient to give rise to E&O coverage.* Specifically, the court determined that "making referrals is close enough to the professional end of the spectrum to be included in the E&O policy."(17) The court compared Burnet's referrals to those made by a general practitioner physician, who uses professional judgment when referring a patient to a particular specialist for treatment of a particular problem. Thus, the court found that the underlying complaint implicated professional services in this regard, and it refused to excuse *Pacific* from the duty to defend the action.

OTHER CASES

There have been several other cases which have interpreted the meaning of "professional services" within the context of an E&O coverage action. The most frequently quoted case on this issue is *Marx v. Hartford Accident & Indem. Co.*, from the Supreme Court of Nebraska.(18) In *Marx*, the plaintiff was sued for negligence because its employee, while refilling a hot water sterilizer, mistakenly poured benzene, instead of water, into the sterilization container. Fumes exploded causing a fire. Extensive damage to a building resulted.(19) The issue in the coverage case was whether the employee's act constituted a "professional" act, thus giving rise to coverage under Hartford's E&O policy.

In *Marx*, the Nebraska Supreme Court denied coverage, stating the following with regard to the definition of "professional services":

Something more than an act flowing from mere employment or vocation is essential. The act or

service must be such as exacts the use or application of special learning or attainments of some kind. The term "professional" in the context used in the policy provision means something more than mere proficiency in the performance of a task and implies intellectual skill as contrasted with that used in an occupation for production or sale of commodities. A "professional" act or service is one arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, skill, and the labor or skill involved is predominantly mental or intellectual, rather than physical or manual. . . . In determining whether a particular act is of a professional nature or a "professional service," [the court] must look not to the title or character of the party performing the act, but to the act itself.(20)

In *Western World Ins. Co. v. American and Foreign Ins. Co.*,⁽²¹⁾ the professional liability insurer of a town in Maine sued the town's CGL insurer in connection with an underlying negligence claim arising from a police shooting. The court found that the town's CGL insurer had no duty to defend the underlying case in which the underlying plaintiff alleged negligence by the police in enforcing a baton policy. This activity, according to the court, fell within a professional liability exclusion contained in the CGL policy. The court found that enforcement of a baton policy required professional judgment and professional authority and was necessarily intertwined with the professional training and judgment of a police officer.⁽²²⁾ Thus, the CGL insurer had no duty to defend.

In *Titan Indem. Co. v. Williams*,⁽²³⁾ the court stated that whether in the classroom or on the playground, a teacher's specialized skills, knowledge and training encompass not just the academic subject to which he is assigned, but also discipline and supervision. All of these many roles, according to that court, are part of the professional services provided by teachers.⁽²⁴⁾

WHAT SHOULD AN E&O CLAIMS PROFESSIONAL DO?

Clearly, a claims professional cannot assume, for the purposes of a coverage analysis, that just because an action or service is performed in the scope of an insured's employment that the action or service is a "professional service." A closer look is necessary. Consider the following issues:

- Whether the action is integral to the core of the business
- Whether the action is necessary in order to carry out the purpose of the business
- Whether the action involves any particular skills or analysis which are unique to the insured
- Whether the action is simply a function common to all businesses

Do not simply assume that because a "professional" is charged with negligence, that negligence necessarily was in the course of rendering "professional services." Dig deeper. Was the activity of the professional common to all businesses, professional and otherwise? Remember that E&O coverage is typically in addition to CGL coverage. Be sure that the act complained of is one which the E&O policy (rather than the CGL policy) was intended to cover. Be sure the alleged negligence arises from a "professional" service.

Footnotes:

1 2003 WL 22283355 (D.Minn.)

2 See *Pacific*, *1.

3 See *Id.*

4 *Id.* at *4 (internal quotation marks omitted), citing *Piper Jaffray Co. v. National Union Fire Ins. Co. of Pittsburgh, Penn.*, 967 F. Supp. 1148, 1156 (D.Minn.1997).

5 *Pacific*, *4 (internal quotation marks omitted) (citations omitted).

6 *Id.* (citations omitted).

7 *Id.*, citing *Medical Records Assocs. v. American Empire Surplus Lines Ins. Co.*, 142 F.3d 512, 514 (1st Cir. 1998).

8 *Pacific*, *5, citing *Medical Records Assocs.*, 142 F.3d at 515.
9 *Pacific*, *5, citing *Medical Records Assocs.*, 142 F.3d at 515. (internal quotation marks omitted).
10 142 F.3d 512, 514 (1st Cir. 1998).
11 *Medical Records Assocs.*, 142 F.3d at 515-16.
12 *Id.*
13 *Id.*
14 *Pacific*, *5.
15 *Id.*
16 *Id.*, *5-6.
17 *Id.*, *6.
18 183 Neb. 12, 157 N.W.2d 870 (Neb.1968).
19 *Id.* at 13.
20 *Id.* at 871-72.
21 180 F. Supp. 2d 224 (D.Me. 2002).
22 *Id.* at 233.
23 743 So. 2d 1020 (Miss. Ct. App. 1999).
24 *Id.* at 1026. See *Atlantic Mut. Ins. Co. v. Continental Nat'l Am. Ins. Co.*, 123 N.J. Super. 241, 302 A.2d 177, 181 (N.J. Sup. Ct. Law Div. 1973) ("The main thrust of the original plaintiffs' cause of action was the alleged failure of Killam Associates to observe that the contractor was violating the New Jersey State Construction Safety Code as to the manner in which the trench was fortified. The acts of Killam Associates in this respect clearly required the specialized knowledge and mental skill of a professional engineer.").