

California Court Holds Professional Services Exclusion Ambiguous

FRIDAY, JANUARY 13, 2012

In its recent decision in *Corky McMillin Construction Services, Inc. v. U.S. Specialty Ins. Co.*, 2012 U.S. Dist. LEXIS 3438 (S.D. Cal. Jan. 11, 2012), the United States District Court for the Southern District of California considered the application of an errors and omissions exclusion contained in a directors and officers insurance policy.

At issue in *Corky McMillin* was the insured's right to coverage for an underlying class action. Plaintiffs in the suit alleged that the insured, Corky McMillin, made various misrepresentations and omissions regarding the nature, value and desirability of certain residential neighborhoods. The policy provided coverage for "Insured Organization Loss arising from Claims first made against [the insured] during the Policy Period or Discovery Period (if applicable) for Wrongful Acts." By endorsement, however, the policy contained an errors and omissions exclusion, stating in relevant part that:

... the Insurer will not be liable to make any payment of Loss in connection with any Claim against the Insured Organization arising out of, based upon or attributable to the rendering or failure to render services for others, including without limitation services performed for or on behalf of customers or clients of the Insured Organization

U.S. Specialty denied coverage on the basis of this E&O exclusion. Corky McMillin argued that the exclusion was ambiguous since the term "services" was not defined in the policy. U.S. Specialty countered, and the court agreed, that the term "services" should be interpreted based on its common dictionary definition, meaning "the work performed by one that serves." The court further agreed with U.S. Specialty that while this definition of "services" was broad, the mere breadth of the term did not otherwise render it ambiguous.

The court nevertheless found the exclusion as a whole to be ambiguous when considered in the context of the policy's insuring agreement, which provided coverage for "wrongful acts," defined in pertinent part as "any other actual or alleged act, error, misstatement, misleading statement, omission or breach of duty (a) by the Insured Organization" The court noted that while the intent of the E&O exclusion was to bar coverage for liability arising out of the insured's services, it was not clear whether "services," with its broad meaning, encompassed, and therefore excluded, the same "wrongful acts" covered under the policy's insuring agreement. For instance, explained the court, while the definition of "wrongful act" included misstatements, misleading statements and omissions, the exclusion, on its face, would operate to bar coverage for misstatements, misleading statements and omissions contained in the insured's marketing materials – the very basis on which the insured was sued in the underlying suit. Given the "canons of construction" that insuring agreements are to be interpreted broadly in favor of the insured and that exclusions are to be interpreted narrowly against the insurer, the court concluded that "there is, at a minimum, ambiguity about the meaning of the term 'services' as used in the E&O Endorsement."