

Directors' Failure To Detect and Prevent Ponzi Scheme Not Covered "Professional Services"

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A Florida appeals court has ruled that a lawsuit alleging that certain directors violated fiduciary duties by failing to detect and prevent the company's president from operating a Ponzi scheme does not allege covered "professional services." *Appel v. Lexington Ins. Co.*, 2010 WL 667947 (Fla. Ct. App. Feb. 26, 2010).

The policyholder, a company that sold certain medical monitoring devices to the elderly, purchased a commercial general liability policy that included a professional liability endorsement that extended coverage to claims for "negligent acts, errors and omissions arising out of 'professional services' rendered for others by the insured." The policy defined "professional services" to mean services rendered in the business of selling, installing, maintaining and monitoring alarm and security systems as well as telephone network, cable, internet and other communications systems.

The claim at issue was a lawsuit filed against two of the policyholder's directors by certain investors. The investors alleged that the company was operated as a "Ponzi" scheme, by which their investment money was supposed to be used to purchase new equipment but instead was used to pay new investors. The scheme allegedly was carried out by the company's president without the directors' knowledge. According to the complaint, however, the directors breached their fiduciary duties by failing to detect and prevent the scheme.

The insurer refused to defend the directors on the ground that the lawsuit fell outside the scope of coverage afforded by the policy. In the coverage action that followed, the court agreed and held that the alleged failure of the directors to detect and prevent the fraud did not constitute "professional services" within the meaning of the policy. Accordingly, the court concluded that coverage was not available.