

Professional Services Exclusion Bars Coverage for Claim Involving Alleged Mortgage Servicing Errors and Negligent Supervision

November 2010

The United States District Court for the Northern District of Indiana, applying Indiana law, has held that a professional services exclusion from D&O coverage bars coverage for a claim involving alleged mortgage servicing errors and negligent supervision of mortgage servicing staff. *Neighborhood Housing Servs. of Am., Inc. v. Turner-Ridley*, 2010 WL 3825725 (N.D. Ind. Sept. 24, 2010).

The policy at issue provided specified coverage for, among other things, D&O Wrongful Acts, which the policy defined as any actual or alleged "act, error, omission, misstatement, misleading statement, neglect, breach of duty or Personal & Advertising Injury committed or attempted by an Individual Insured in his/her capacity as an Individual Insured; or by the Organization." The policy also contained an exclusion that applied to any Claim "based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving the Insured's performance of or failure to perform professional services for others." The exclusion further provided that it was not applicable "to any derivative action Claim alleging failure to supervise those who performed or failed to perform such professional services."

A mortgage holder sued the insured nonprofit organization and three of its employees, including its executive director, for alleged errors in mortgage loan servicing. These purported errors included: failing to collect payments and maintain accurate records; failing to segregate amounts due and inform the mortgage holder regarding loan payoffs; allowing loan defaults; and failing to protect the mortgage holder's security interests. The mortgage holder also alleged that the executive director was negligent in her supervision of the organization's mortgage servicing staff. The insureds sought coverage under the policy, and the insurer denied coverage pursuant to the policy's professional services exclusion.

In the coverage litigation that followed, the insureds argued that the alleged actions were merely "nonspecialized, clerical and administrative" tasks and thus did not constitute professional services sufficient to trigger the policy's professional services exclusion. The court disagreed. The court first noted that the policy did not define "professional services" but that, under Indiana law, "professional services" means "any business activity conducted by the insured which involves specialized knowledge, labor or skill and which is predominantly mental or intellectual as opposed to physical or manual in nature." Applying this definition, the

court concluded that the alleged failure to collect payments, segregate funds, maintain accurate records and make accurate reports regarding loan payoffs "required the [insureds] to draw upon specialized knowledge, experience and training to protect [the mortgage holder's] interests" and thus triggered the professional services exclusion. The court further held that the allegations regarding the executive director's negligent supervision of the organization's staff also triggered the exclusion because, "if anything, the [Executive Director's] supervision of individuals performing professional services requires heightened knowledge, experience and training."

The court also rejected the insureds' argument that the derivative action carve-out from the professional services exclusion rendered the exclusion ambiguous. In this regard, the insureds argued that, because another policy provision barred coverage for claims made against an insured "brought or maintained by, at the behest of, or on behalf of the Organization," the term "derivative action" in the professional services exclusion was ambiguous. The court disagreed, noting that, although the policy may include more than one reference to a derivative action, "there is nothing in the [p]olicy to lead reasonable persons to differ as to the term's meaning."

The court additionally disagreed with the insureds' contention that, because its "core business practices constitute professional services," the policy's professional services exclusion rendered the policy's D&O coverage illusory. The court pointed to the policy's broad definition of D&O Wrongful Acts and held that, notwithstanding the exclusion for professional services, there was still coverage for "some reasonably anticipated risk."