

No E&O or D&O Coverage for Investigation by Attorney General

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Applying California law, a federal district court has held that a social networking website could not recover under its professional liability policy for amounts incurred in connection with an investigation by the New York Attorney General (NYAG) because the matter did not involve professional services within the scope of the policy's errors and omissions coverage and because the allegations triggered the professional services exclusion in the directors and officers liability (D&O) coverage section. *Tagged, Inc. v. Scottsdale Ins. Co.*, 2011 WL 2748682 (S.D.N.Y. May 27, 2011).

The NYAG issued a notice that it intended to commence litigation against the website for illegal, fraudulent or deceptive business acts and practices and for false advertising. The notice asserted that the website had made misleading statements about its efforts to protect users of the website's social network from inappropriate content, including child pornography and sexual communications by adults to minors. The website provided notice of the investigation to the insurer, which refused to defend the website in the investigation. After the website settled the investigation by agreeing to pay a fine, the website filed a suit alleging that the insurer owed the website a duty to defend and indemnify it in connection with the investigation.

The district court granted the insurer's motion to dismiss the website's complaint. First, the court considered the insurer's argument that the investigation was not covered by the policy's technology, media and professional services coverage section, which afforded errors and omissions coverage for claims only "if committed by an Insured in the course of performing Professional Services." The policy defined "Professional Services" as "providing advertising services for others, for a fee." The court agreed with the insurer that the NYAG's investigation did not fall within the professional services definition because the investigation had no relationship to the website's provision of advertising services to others. The court explained that the investigation had focused on content posted by the website's users, "who did not pay to use the website," and on the website's statements and advertising regarding its own services. The court also held that even if the investigation fell within the policy's definition of professional services, it still would be barred by the technology coverage section's sexual harassment exclusion, which barred coverage for any claim "in any way involving any sexual action."

Next, the court addressed the insurer's argument that the investigation was not covered by the policy's D&O coverage section due to that section's professional services exclusion. The professional services exclusion barred 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." The court observed that, unlike the technology coverage section, the D&O coverage section did not define the term "professional services." Because the term was undefined, the court relied on past decisions interpreting the term. Under those precedents, the court held that the investigation clearly fell within the scope of the exclusion because the website had provided professional services by determining and regulating the content posted on the social networking site.

In holding that the professional services exclusion applied, the court dismissed as irrelevant the fact that the website had delegated the task of reviewing the social networking site for inappropriate content to "unskilled workers." In this regard, the court noted that the nature of the services provided were "professional," and the website's management had chosen to advertise and promote the social network as being safe for minors. The court also rejected the website's argument that "professional services" should be construed narrowly to avoid rendering the D&O coverage section illusory. The court held that the exclusion's use of the term without further definition meant that the parties had intended to adopt the broad definition found in prior California decisions, and the exclusion did not render the coverage section illusory because it included an exemption for claims by a plaintiff in her capacity as a security holder. Finally, the court explained that it was not incongruous to conclude that the policy did not cover the investigation under either the technology coverage section or the D&O coverage section since the technology coverage section defined "professional services" more narrowly than did the D&O coverage section. Accordingly, the court granted the insurer's motion to dismiss the website's coverage action.