

Sales of Allegedly Defective Products Are Not Excluded Professional Services

August 2013

Applying California law, the United States District Court for the Northern District of California has held that a medical equipment company's sales of allegedly defective products are not professional services excluded under a D&O liability policy. *Scottsdale Ins. Co. v. Coapt Sys., Inc.*, 2013 WL 3146781 (N.D. Cal. June 18, 2013). In addition, the court held that the company's alleged fraudulent conveyance of corporate assets to evade the claims of injured patients was not derivative of the patients' injuries such that it is barred by the policy's bodily injury exclusion.

Numerous physicians and patients brought claims against a medical device company that allegedly sold defective products to the physicians. The claimants asserted that the physicians' use of the products caused serious side effects to the patients, which, in turn, caused damage to the physicians' reputations. In addition, the claimants contended that once the medical device company and its directors and officers learned of the harm caused by their products, they transferred the company's assets to hinder the physicians and patients from collecting on their claims. The company's directors and officers sought coverage under a D&O liability insurance policy. The insurer denied coverage based on the policy's bodily injury and professional services exclusions.

In the subsequent coverage litigation, the court ruled that the exclusions did not bar coverage for the claims. First, the court addressed the professional services exclusion, which precluded 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 insurer argued that the reputational injury and fraudulent conveyance claims came within the exclusion because the medical device company was involved in the manufacturing and sale of its products, which constitute professional services under California law. The court disagreed that all sale and marketing activities constitute professional services, finding instead that the company's alleged activities were ordinary commerce and thus not within the professional services exclusion.

The insurer also contended that coverage for the fraudulent conveyance claims was precluded by the policy's bodily injury exclusion, which barred coverage for claims "for actual or alleged bodily injury" The directors and officers argued that the claims were not "for" bodily injury. The insurer asserted that the claims were derivative of the patients' personal injury claims, which were excluded bodily injury claims, and thus, the

derivative claims were also excluded. The court disagreed, finding that the patients had asserted two separate and distinct torts: the sale of defective products that caused injury, and the transfer of corporate assets to defraud creditors. The latter did not flow directly from the former, the court held, and thus, they were not subject to the same exclusion. Further, the court stated that the exclusion was narrowly drafted, omitting broad phrases like “arising out of.” As such, the court held that the fraudulent conveyance claims did not come within the bodily injury exclusion.