

Alleged Kickback Scheme Constitutes "Professional Services"

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The United States Court of Appeals for the Ninth Circuit, applying California law, has determined that an alleged kickback scheme constituted "professional services" within that term's definition in a financial institution professional liability policy. *PMI Mortgage Ins. Co. v. Am. Int'l Specialty Lines Ins. Co.*, 2005 WL 77155 (9th Cir. Jan. 14, 2005).

The policyholder was a financial institution that sold mortgage guaranty insurance to residential mortgage lenders. Several customers filed a purported class action alleging that the policyholder engaged in a kickback plan in violation of the Real Estate Settlement Procedures Act (RESPA). Specifically, the complaint alleged that the policyholder charged lower fees to lenders who provided customer referrals. However, the plaintiffs did not receive the benefit of the reduced fees. The plaintiffs also alleged that the policyholder failed to disclose the kickback plan and "acted in concert with its lenders to violate [the] duty to disclose" imposed by RESPA.

The insurers issued primary and follow-form excess financial institution professional liability policies. The policies provided coverage for claims arising from "any actual or alleged Wrongful Act of any Insured in the rendering or failure to render Professional Services." "Professional Services" was defined as "those services of the Company permitted by law or regulation rendered by an Insured . . . pursuant to an agreement with the customer or client as long as such service is rendered for or on behalf of a customer or client of the Company (i) in return for a fee, commission or other compensation" The insurers denied coverage for the underlying complaint, asserting that the alleged kickbacks did not constitute Professional Services under the policies. The trial court granted summary judgment in favor of the insurers, finding that the alleged kickbacks were administrative tasks, not Professional Services.

The Ninth Circuit reversed, holding that the kickback plan allegations constituted claims for wrongful acts committed "in the rendering of Professional Services." Opining that it was "tak[ing] this broad policy language at face value" in favor of coverage as required by California law, the court held that the alleged kickbacks were, "'services' under various (allegedly improper) 'agreements' with lender 'clients.'" As the court explained, a Professional Service "must arise out of the special risks inherent in the practice of the profession." Administrative acts, including billing, do not qualify, but the court distinguished the alleged kickback scheme from administrative acts of billing. According to the court, the "alleged kickback scheme goes to the heart of

[the policyholder's] business. It implicates the way in which it finds and serves its customers, the business opportunities that it enjoys and the network of professional relationships through which it operates."

Although the appellate court observed that the preceding analysis was dispositive, it then considered the district court's determination, based on California precedent, that the kickback scheme did not satisfy prior judicial constructions of Professional Services. Rejecting the district court's reasoning that the billing at issue was an "effect" of a Professional Service rather than a Professional Service itself, the appellate court reasoned that the insured entity was not engaged in a traditional "profession," therefore, the policy's definition should not be limited by case law developed in a different context. Further, the appellate court indicated that the acts at issue were not mere "billing" but instead went to the "heart" of the insured's business.

Lastly, the appellate court declined to hold that all RESPA claims are covered by professional liability policies. RESPA requires certain disclosures regarding referrals and real estate transactions. The policyholder argued that since RESPA requirements are "inherent" risks to its business, these claims should be presumptively covered. While other federal courts have found coverage for RESPA claims, the appellate court refused to accept the presumption. However, the court found coverage on the facts before it, explaining that "the centrality of RESPA to the real estate industry in general (and the mortgage insurance industry in particular) supports the [policyholder's] claim as to its expectations in purchasing insurance," particularly in light of the specific language of issue.