

Billing Services Not Covered Under E&O Policy

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In an unreported decision, a Pennsylvania federal court, applying Pennsylvania law, has held that billing practices do not constitute "professional services" under an E&O policy, but that mishandling accounts may be professional services. *Nat'l Recovery Agency, Inc. v. AIG Tech. Serv., Inc.*, 2005 WL 2100702 (M.D. Pa. Aug. 26, 2005). The court also held that the policy could afford coverage for a breach of contract claim, if a negligent act causes the breach. Additionally, the court dismissed allegations of fraudulent statements as to the insurer, its parent and its investigation services company before the policy was purchased because the policyholders failed to plead fraud with particularity.

The policyholders were a collection agency and a company that performs precollect work. The defendants were an insurer, its parent and an insurance litigation management company, which also was a member of the parent company. The policyholders bought an E&O policy from the insurer. The policy covered "'Damages' which the 'Insured' shall become legally obligated to pay for any 'Claim' first made against the 'Insured' or another for whom the 'Insured' is legally responsible committed solely in the conduct of the 'Insured's' 'Professional Services.'" The policy provided that the insurer had a duty to defend against "'Claims' for Damages for a covered 'Wrongful Act'" and to indemnify "Claims Expense[s]." "Claim" was defined to include judicial proceedings where the policyholder "may be subjected to a binding adjudication of liability for 'Damages.'" The policy defined "Wrongful Act" to include "a negligent act, error or omission." "Professional Services" was defined to include "Performance as a 'Debt Collector.'" "Debt Collector" was defined as "any obligation or alleged obligation of a 'Consumer' to pay money." The policy defined "Debt" as "those obligations which are the subject of billing services provided to 'Clients or Customers' for a fee." The policy excluded coverage for claims "seeking the return of fees or charges for services performed by any 'Insured.'"

A client sued the policyholders in state court for claims arising out of billing practices, consulting services, including "mishandling" accounts, terminating a contractual relationship and practices regarding posting accounts. The insurer denied coverage. The policyholders then filed suit against the insurer and the other defendants seeking a declaration of a duty to defend and indemnify, bad faith and damages resulting from the alleged fraudulent sale of the policy.

The court held that billing practices are not professional services as defined in the policy. The court explained that "[e]ven though debt collectors' compensation may be tied to the amount of money they collect, their billing for their services is still a business function," not a professional service. Additionally, the court held that "terminating a contractual relationship is a business decision and is not a rendering of professional services."

As such, the court concluded that there was no E&O coverage for these claims.

By contrast, the court found that the allegations relating to the policyholders' actions as a consultant for call center operations, collections and customer billings may constitute professional services. The underlying plaintiff alleged that the policyholder breached a consulting contract by over- and double-billing and "mishandling of accounts." The court found that allegations of "mishandling of accounts" might constitute professional services, thereby triggering a duty to defend. Similarly, the court found that the allegations relating to the proper credit, failure to post payments and lost revenue arising from the policyholders' breach of contract "address at least in part how the plaintiffs posted debtor payments to accounts" and may constitute professional services.

Next, the court rejected the insurer's argument that breach of contract claims are not covered by E&O policies. The court assured that if a negligent act causes the contractual breach, E&O coverage could apply. The court also rejected the insurer's argument that under the gist of the action doctrine, "the gist of [the underlying plaintiff's] claims is breach of contract and not tort," focusing on the underlying conduct, not the cause of action.

The court declined, at the early stage of the case, to rule on the bad faith claim. The court noted that, under Pennsylvania law, to prevail on such a claim "a plaintiff must show by clear and convincing evidence that the insurer (1) did not have a reasonable basis for denying benefits under the policy; and (2) knew or recklessly disregarded its lack of reasonable basis in denying the claim." The court explained that based on the pleadings, some of the allegations in the underlying case might be covered and declined to rule on this issue.

Regarding the fraud claims as to all defendants, the court held that the alleged statements made prior to when the policy was purchased were not pled with particularity as required by Federal Rule of Civil Procedure 9(b) and the alleged misrepresentations in the denial letters were precluded by the gist of the action doctrine. Under Pennsylvania law, "the elements of intentional misrepresentation are: 1) a representation; 2) which is material to the transaction at hand; 3) made falsely, with knowledge of its falsity or recklessness as to whether it is true or false; 4) with intent of misleading another into relying on it; 5) justifiable reliance on the misrepresentation; and 6) resulting injury proximately caused by the reliance." The policyholders alleged that the insurer had "an undeviating policy of attempting to deny coverage," and as a result, imposed the risk of litigation costs on the policyholders. The policyholders alleged that the insurer made deceptive statements about investigations and exclusions both before they purchased and when they purchased the policy. The court held that the policyholders failed to plead with particularity under Federal Rule of Civil Procedure 9(b) the fraudulent statements allegedly made before the policies were purchased because the policyholders did not identify the statements, the persons who made the statements or the context of the statements. The court, however, granted leave to amend the complaint. Predicting Pennsylvania law, the court held that the gist of the action doctrine precluded the fraud allegation relating to the insurer's denial of coverage.

Finally, the court considered the claims alleged against the parent and the insurance investigation services company. The court ruled that the complaint did not allege declaratory judgment, breach of contract or bad faith causes of action against these defendants. The court explained that these defendants did not issue or

sign the insurance policy. The court rejected the argument that as a parent or an agent, the defendants were liable, explaining that "mere ownership of a subsidiary does not justify the imposition of liability on the parent." The court, however, granted leave to file an amended complaint.

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