

Insurance Recovery

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Closing Coverage Gaps: California Court Emphasizes the Importance of Coordinated Insurance Policies in Complex Claims Environments

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Policyholders must be vigilant in coordinating their insurance program across coverage lines in today's complex claims environment. Often resembling a "patchwork quilt" – modern businesses protect against a wide range of contingencies by purchasing separate insurance policies that cover various risks that may overlap when claims arise. A recent ruling by a California appellate court underscores the critical importance of understanding the interplay between different insurance policies and serves as a timely reminder that policyholders should (a) be proactive in negotiating policy language to avoid gaps in coverage and (b) provide notice broadly at the outset of a claim.

In *Practice Fusion Inc. v. Freedom Specialty Insurance Co.*,¹ the court held that the developer of a web-based health records software could not access coverage for a \$118 million settlement with the U.S. Department of Justice (DOJ) under its D&O insurance policy. The court relied on a "professional services" exclusion, which it interpreted broadly to preclude coverage for "Loss in connection with any Claim made against any Insured ... alleging, arising out of, based upon or attributable to an Insured's performance or failure to perform professional services for others, or any act(s), error(s) or omission(s) relating thereto." Because the term "professional services" was not defined in the policy, the court supplied its own definition through analogies to other cases and determined the exclusion applied because the company's development of its software was sufficiently connected to a "professional service" – which the DOJ alleged was to drive profits to pharmaceutical companies through push notifications recommending specific drugs to health care providers - when placed in the context of the claim.

The *Practical Fusion* opinion illustrates the importance of four key considerations for policyholders when placing or renewing coverage.

1. Coordinate Policy Language To Ensure Seamless Coverage

First, it is critical to negotiate insurance policies that provide seamless and consistent coverage across coverage lines to avoid gaps that could leave a policyholder exposed to significant risks. Just as a patchwork quilt must be stitched together without holes, insurance policies must be coordinated to ensure a business has comprehensive coverage.

For example, D&O insurance policies typically cover a wide range of conduct that may be narrowed through exclusions that are intended to eliminate overlap with other coverage lines, such as CGL, cyber, employment practices, and professional liability policies. If the coverage afforded by these separate policies is **narrower** than the corresponding exclusion in an insured's D&O policy, the policyholder may find themselves with an unexpected and unwelcome gap in coverage. Had the policyholder in *Practice Fusion* negotiated a professional liability policy broad enough to encompass the claims excluded under its D&O policy, it might have secured coverage for its settlement with the DOJ.

2. Negotiate Clearly Defined Terms and Narrow Exclusions

Second, the *Practice Fusion* case underscores the importance of defining critical policy terms, such as “professional services.” Particularly where, as in that case, an insured engages in a range of business activities that might be considered by a court in a number of different ways, defining the scope of “professional services” (or similarly broad terms in other exclusions) can help policyholders avoid unfavorable results.

Where it is not possible to negotiate defined terms in exclusions, policyholders should bargain for narrow “lead-in” language. Insurers frequently use prefatory language that operates to bar coverage for any loss or claim “arising out of,” “related to,” or “in any way connected with” the excluded conduct. Insurers often rely on this broad language to deny coverage for claims that are only remotely related to such conduct. Had the policyholder in *Practice Fusion* negotiated narrower lead-in language, the court may have been less inclined to find that its conduct was sufficiently connected to a “professional service” to exclude coverage.

3. Notice Provisions Across Policies

Third, particularly in cases like *Practice Fusion*, where a claim arises in the context of an ongoing and evolving investigation, policyholders should provide broad notice under every potentially applicable insurance policy. Policyholders that limit their notice to a single carrier may find their claim time-barred under other applicable policies as facts continue to develop. Instead, policyholders should assess their entire patchwork quilt insurance program to determine if the allegations could potentially trigger **any** of their insurance policies, and should notice all of those insurers at the outset of the claim.

4. Conduct Proactive Policy Review With Trusted Professionals

Fourth and finally, the *Practice Fusion* decision serves as a reminder that policyholders can avoid gaps in coverage by regularly reviewing the terms and conditions of their insurance policies. Had the policyholder in *Practice Fusion* identified the risk that its business activities might qualify as “professional services” excluded under its D&O policy before the DOJ’s investigation began, it would have been able to sync the definition of professional services in its professional liability policy (or understood the need to purchase such coverage) before facing such a substantial claim. Experienced insurance brokers and coverage counsel can ensure that the terms and conditions of a business’s policies are consistent and provide seamless access to coverage when it is needed most.

¹ No. A167130 (Cal. Ct. App. Jun. 21, 2024).

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