pillsbury

Coverage for Actions in Response to Governmental Investigations and Prosecutions

This article was originally published by the American Bar Association on October 3, 2014.

by Joseph D. Jean and Danielle Vrabie

Joseph D. Jean
Litigation
+1.212.858.1038
joseph.jean@pillsburylaw.com

Joseph D. Jean is a partner in Pillsbury's Insurance Recovery & Advisory practice in New York. He also is a member of the firm's Crisis Management focus team.

Danielle Vrabie
Litigation
+1.212.858.1683
danielle.vrabie@pillsburylaw.com

Danielle Vrabie is an associate in Pillsbury's Litigation practice in New York and also is a member of the firm's Insurance Recovery & Advisory practice.

Governmental investigations of businesses are on the rise. In 2013 alone, the U.S. Department of Justice (DOJ) recovered $3.8 billion in settlements and judgments under the False Claims Act (FCA)—the second largest recovery in history.

The rise in FCA prosecutions affect nearly every industry in the United States. But an FCA prosecution is not the only government enforcement action that companies should be thinking about. Both the Securities and Exchange Commission (SEC) and the DOJ have also announced they will continue to bring major Foreign Corrupt Practices Act (FCPA) cases so companies operating internationally can expect increasing scrutiny. This increased activity makes it all the more important for businesses to secure proper insurance coverage prior to such investigations and to preserve and pursue existing coverage should an investigation or prosecution occur.

Receiving a subpoena or a federal grand jury "target letter" in connection with an FCA or FCPA investigation is likely to prompt a company to ask a multitude of questions, not the least of which is: "Does our insurance cover this?" The frequency with which policyholders will ask this question—and the stakes raised by the answer—will increase with the rise in governmental investigations and prosecutions. Expenses associated with responding to a subpoena or civil investigative demand (CID) against a company, or one or more of its directors or officers, are often incurred at the same time as the company is incurring legal fees and costs in connection with a corollary internal investigation. A company's obligations to cooperate with the governmental investigation are usually substantial as targets usually find themselves at the will of the investigator and compliance is required regardless of the costs.

The broad scope of investigations, and corresponding litigation, may implicate several types of insurance policies, including directors and officers (D&O). Depending on the wording of each particular policy, costs associated with responding to subpoenas and the corresponding internal investigation may be covered. Companies can often overlook potential sources of recovery simply because the conventional wisdom says that those types of policies "aren't meant for these types of claims."

Are Subpoenas and CIDs Claims?

Governmental investigations can take on many forms — the government may commence an inquiry, either formal

or informal, issue a subpoena, a CID, or a Wells notice (which is a notification from the SEC that it intends to recommend that enforcement proceedings be commenced against the prospective defendant or respondent, not to be confused with a notice of inquiry, which requests information from the company, but states that it is not an indication that the SEC believes that a crime was committed), file an administrative complaint, or file a lawsuit. A lawsuit or a Wells notice are almost certainly claims. But whether insurance coverage is available for the legal fees and costs incurred in connection with responding to subpoenas or CIDs frequently depends upon the facts and circumstances surrounding the government action, the specific language of the policy at issue, and the law of the relevant jurisdiction. Some policies define "claim" broadly to include lawsuits, administrative proceedings, investigations, and target letters. Other policies might define "claim" to include only demands for monetary and non-monetary relief, civil or criminal proceedings, or actions commenced by the return of an indictment. When negotiating policies, the more conservative approach, especially when given the opportunity to do so, clearly is to secure a broad definition of "claim" so as to maximize coverage opportunities. This would include specific terms such as "subpoena" and "civil investigative demands" among others

Indeed, one common dispute between insureds and insurers is whether a governmental subpoena or CID constitutes a claim. Insurers frequently assert they do not. Court decisions vary. Some courts have held governmental subpoenas or CIDs may constitute a written demand for non-monetary relief and thus the costs associated with the subpoena are covered by the policy. *See, e.g., Minuteman Int'l v. Great Am. Ins. Co.*, No. 03-C-6067, 2004 U.S. Dist. LEXIS 4660 (N.D. Ill. Mar. 22, 2004). Other courts have held that a demand for documents is not a demand for relief at all. *See, e.g., Employers' Fire Ins. Co. v. ProMedica Health Systems, Inc.*, No. 12-3104, 524 F. App'x 241 (6th Cir. Apr. 30, 2013).

For example, courts have narrowly interpreted policies to find that a grand jury subpoena was not a "claim" under circumstances where no indictment had been returned and where the policy's definition of "claim" specifically required "the return of an indictment." Courts also have found that an investigation, in and of itself, may not constitute a "request for non-monetary relief" within the definition of a "claim."

Richardson Electronics

But not all courts construe subpoenas or investigative demands so narrowly. Indeed, courts have found subpoenas and investigative demands to constitute "claims" where, for example, the insured was required to produce testimony and documents pursuant to an ongoing investigation of its activities. In *Richardson Electronics, Ltd. v. Federal Insurance Co.*, 120 F. Supp. 2d 698, 699 (N.D. Ill. 2000), the executive risk insurance policy at issue covered: directors' and officers' unindemnified losses "due to legal liability for wrongful acts"; and the company's indemnification of the directors and officers for such acts. The Antitrust Division of the U.S. Justice Department served a CID and subpoenas on the company and the individual directors and officers that required them to comply with various demands for testimony and production of documents for an ongoing investigation of the company.

The central issue in the Richardson Electronics case turned on the meaning of the term "claim," which the policy did not define. Looking to Illinois law, which relied upon Webster's Fifth New Collegiate Dictionary, the court found the "term claim means 'a demand for something due or believed to be due.' The word has no different usage in the insurance industry. . . . A claims made provision in the policy mandate[s] the conclusion that a claim must be a third party demand. . . ." *Id.* at 701 (alterations in original). To avoid coverage, the insurer, Federal Insurance Company (Federal), argued the DOJ's investigation did not constitute a claim because the DOJ did not demand any money. But the court rejected that argument as inconsistent with Illinois law and the notion a claim is a "demand for something due." The court also rejected Federal's argument that a demand for money is required, especially where the policy contained no such requirement.

Ascend One

So too, in *Ace American Insurance Co. v. Ascend One Corp.*, 570 F. Supp. 2d 789 (D. Md. 2008), the District Court for the District of Maryland found an errors and omissions (E&O) insurer liable for its insured's—Amerix Corporation (Amerix)—past and future costs in responding to an Administrative Subpoena issued by the Consumer Protection Division of the Maryland Office of the Attorney General (Subpoena) and a CID by the Consumer Protection Division of the Texas Office of the Attorney General (Investigative Demand).

The subpoena and the investigative demand both sought production of documents related to Amerix's corporate activities. Amerix retained two law firms to represent it in responding to both demands, in response to which it "produced hundreds of thousands of pages and tremendous quantities of electronic data to the Maryland and Texas officials" and paid "more than $140,000 in fees and expenses for the matter." *Id*. at 792.

ACE denied Amerix's request for coverage for these costs, based in part upon an assertion that the subpoena and investigative demand were not claims under the E&O policy. The E&O policy at issue defined "claim" to include: "A civil, administrative or regulatory investigation against any Insured commenced by the filing of a notice of charges, investigative order or similar document." *Id*. at 793.

Finding in favor of Amerix, and noting Maryland law permitting a court to review facts beyond the four corners of a subpoena and investigative demand and allowing an insured to introduce extrinsic evidence to establish a potential for coverage, the court stated:

[C]ase law suggests that Subpoenas and Investigative Demands may constitute Claims where they are issued by government investigative agencies related to an investigation of the insured. Courts give weight to the seriousness of government subpoenas in considering whether they constitute an investigation.

Id. at 796. Because extrinsic evidence demonstrated the purpose of the subpoena and the investigative demand as investigating potential violations of the Maryland Consumer Protection Act, the court found the subpoena and investigative demand constituted a claim.

Despite the fact courts have found subpoenas and investigations can constitute claims, policyholders should not wait until a subpoena or a "target letter" comes in before figuring out whether they have coverage. As previously mentioned, court decisions vary and are invariably dependent upon the facts and the specific language of the policy. The more conservative approach, especially when given the opportunity to do so, clearly is to secure a broad definition of "claim" so as to maximize coverage opportunities.

Office Depot and *MBIA*

Another issue that requires attention is whether costs incurred from informal investigations are covered. Two decisions – *Office Depot, Inc. v. Nat'l Union Fire Ins. Co.*, 734 F. Supp. 2d 1304 (S.D. Fla. 2010), aff'd, 453 F. App'x 871 (11th Cir. Oct. 13, 2011) and *MBIA Inc. v. Federal Ins. Co.*, 652 F.3d 154 (2d Cir. 2011)—are frequently cited by insurers and policyholders, respectively, with respect to coverage disputes involving governmental investigations. In *Office Depot*, the Eleventh Circuit held there was no coverage under Office Depot's D&O policy for an SEC investigation until a subpoena and Wells notices were issued. The Eleventh Circuit rejected Office Depot's argument that "proceedings" were the same as "investigation." The court analyzed the use of proceedings within the context of the policy as well as the Merriam-Webster definition of "proceeding" as a "legal action." The SEC activity in that case was neither — informal "notice of inquiry" did not identify particular officers or respondents as potential targets of civil, criminal, administrative or regulatory proceedings and only noted "possible violations" of the securities laws.

In contrast, the Second Circuit in *MBIA* rejected the insurer's argument that because theIn contrast, the Second Circuit in MBIA rejected the insurer's argument that because the documents were produced voluntarily by an oral request and not by a subpoena or other formal means that it did not constitute a "claim." The court also conducted an analysis of New York law and the use of subpoenas in attorney general investigations, finding it is the standard method used by that office to conduct investigations rather than a "mere discovery device." The court held the Special Litigation Committee investigative expenses and independent consultant costs were indeed covered by the policy.

While one can reconcile the two cases on their facts, including the policy language and the stage of the investigation, one thing is clear: a company must understand the coverage implications when it decides to cooperate with government investigators on a "voluntary" basis or wait until a formal order of investigation is issued. Because the potential expense associated with responding to government subpoenas and investigative demands can be quite high, the insured should understand whether it can expect coverage for the costs prior to incurring them and whether the timing of the costs may make any different in coverage.

Conclusion

Companies that have a particularly high risk for receiving a subpoena or being the subject of governmental investigations should be sure to closely review their policies and the law. Because subpoenas and investigations typically require an immediate response and substantial legal work, policyholders should seek to procure coverage for subpoenas and investigations well in advance to avoid shouldering legal fees for the work required to comply with those demands.

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | +1.877.323.4171
ATTORNEY ADVERTISING. Results depend on a number of factors unique to each matter. Prior results do not guarantee a similar outcome.
© 2014 Pillsbury Winthrop Shaw Pittman LLP. All rights reserved.