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### INSURANCE AND INVESTIGATIONS

# Ensuring Coverage for Actions In Response to Investigations

Receiving a subpoena or a federal grand jury “target letter” 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—are likely to increase as the economic climate brings a rise in governmental investigations. The time to know the answer to this question is not upon receipt of a subpoena or a target letter. Rather, the time to know that your insurance will provide a solid line of defense is before you receive the subpoena or target letter. This can be achieved during the negotiation process when procuring and renewing the terms and conditions of Directors and Officers (D&O) and Errors and Omissions (E&O) liability policies.

Expenses associated with a subpoena or investigation against a company, or one or more of its directors or officers, are often incurred at the same time as the company also is incurring legal fees and costs in connection with a corollary administrative or internal investigation. But, unlike civil litigation where strategic decisions can reduce the amount of legal work necessary and help contain expenses, governmental investigations generally place companies at the will of the investigator and require cooperation and compliance, regardless of cost. A company’s obligations to cooperate with an investigation can be substantial and expensive. During these challenging economic times, paying for mounting legal fees and costs associated with responding to subpoenas and investigations is a substantial issue for many companies.

Fortunately, companies can purchase insurance to help defray these costs. For example, D&O and E&O liability policies



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can cover costs associated with subpoenas and investigations, but a policyholder must negotiate for such coverage up front and before the subpoena arrives and/or investigation begins. And although policyholders with favorable risk factors and in good financial standing often have more leverage at the



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bargaining table, all companies should be proactive in their renewal negotiations with insurers. In fact, even companies in industries that are subject to increased governmental scrutiny can emphasize positive elements of their risk profile and successfully negotiate favorable policy language.

D&O and E&O insurance products often are confusing and complex, and frequently contain multiple variables, any one of which can affect whether, and in what amount, insurance dollars are available to respond to receipt of a subpoena or an investigation. Policyholders therefore should be certain to review their policies carefully and to understand the coverage afforded by them.

#### Subpoena: Is It a ‘Claim’?

Generally, subpoenas served upon companies and individuals by regulatory agencies and government entities seek production of records and testimony. Regardless of the entity that issues the subpoena, compliance is generally mandatory, and because policyholders often require the assistance of counsel, costly.

Whether insurance coverage is available for the legal fees and costs incurred in connection with responding to a subpoena often depends upon the facts and circumstances surrounding the subpoena as well as the specific language of the policy at issue. The critical question almost always boils down to whether or not the subpoena comes within the policy’s definition of a “claim.” Some D&O and E&O policies define “claim” broadly to include lawsuits, administrative proceedings, investigations, and “target letters.” Other D&O and E&O policies might define “claim” to include only demands for monetary and non-monetary relief, criminal proceedings, or actions commenced by the return of an indictment. Although insurers frequently assert that a subpoena does not constitute a “claim,” decisions by courts that have addressed this issue vary.

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.”

But not all courts construe subpoenas

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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 Company*, 120 F.Supp.2d 698, 699 (N.D. Ill. 2000), the executive risk insurance policy at issue covered: (i) directors’ and officers’ unindemnified losses “due to legal liability for wrongful acts”; and (ii) the company’s indemnification of the directors and officers for such acts. The Antitrust Division of the U.S. Justice Department served a Civil Investigative Demand (Demand) and subpoenas on the company and the individual directors and officers which 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 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 that 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). The court also stated that the fact that the insured “‘reasonably conclud[ed] that a claim would inevitably be brought’ would be insufficient to trigger coverage under a claims-made policy.” Id. (alteration in original).

To avoid coverage, the insurer, Federal Insurance Company (Federal), argued that the Justice Department’s investigation did not constitute a claim because the Justice Department did not demand any money. But the court rejected that argument as inconsistent with Illinois law and the notion that 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.

So too, in *Ace American Insurance Company (ACE) v. Ascend One Corporation*, 570 F.Supp.2d 789 (D. Md. 2008), the U.S. District Court for the District of Maryland found an 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 Civil Investigative Demand 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:

case 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 that the Subpoena and Investigative Demand constituted a claim.

Although policyholders with favorable risk factors and in good financial standing often have more leverage at the bargaining table, all companies should be proactive in their renewal negotiations with insurers.

Despite the fact that courts have found that 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.

#### Conduct Exclusions

D&O and E&O policies also typically contain so-called “conduct exclusions” that bar coverage for claims related to criminal or fraudulent activity, or claims alleging that

the insured profited unlawfully or inequitably. Insurers often attempt to rely on these exclusions to deny coverage for claims that are related to criminal investigations. As with the definition of “claim,” the exact wording of these exclusions can vary widely.

Some exclusions arguably bar coverage when the excluded conduct is merely alleged. But, in most policies, the exclusions do not apply unless the insurer meets its burden of proving that the excluded conduct occurred “in fact” or unless the excluded conduct is established via a “final adjudication.” When the policy at issue includes the “in fact” test or “final adjudication” test, insureds are often entitled to coverage for defense costs or settlements that are made without any finding or admission with respect to the excluded conduct. Under some policy language, insureds could also be entitled to coverage for their defense costs up until such time as the final adjudication is made.

#### Conclusion

D&O and E&O policy language can vary and is generally amenable to negotiation. But the terms are often complex and confusing. Policyholders should review their policies closely to determine whether they can afford the best available coverage. Companies that have a particularly high risk for receiving a subpoena or being the subject of governmental investigations should consider ways to maximize their coverage for such events. Moreover, 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.