D&O Coverage for Government Investigations: When is my Policy Triggered?

Formal investigations into the activities of corporations and their directors and officers remain increasingly hot topics in the news. In 2017, for example, the FTC opened an investigation into the Equifax data breach and recently announced a settlement.[1] Similarly, just this past March, the FBI and Department of Transportation opened a formal investigation into Boeing related to its certification of the 737 Max plane.[2] While many of these investigations make headlines, whether or not a company might have coverage for fees incurred defending these investigations is seldom mentioned. Depending on the policy language, Director's and Officer's Liability ("D&O") may be a crucial risk management tool for companies faced with governmental investigations.

As with any contract, the language of the insurance policy is imperative. SEC investigations are lengthy and involve multiple steps. The subject of an investigation typically receives informal notices that an investigation has begun, which includes requests for production, formal subpoenas, a Wells Notice, and, in some instances, formal fines or prosecution. This drawn out process is costly for the subjects of these investigations and a D&O policy might cover defense fees for expenses incurred. However defense fees are only available if the policy is triggered, and the language defining a "Claim" is critical.

The SEC and other government agencies remain active. The SEC, for example, reported a 9% increase in filed enforcement actions from 2017 to 2018.[3] D&O insureds should pay special attention to how their policies define "Claim" with respect to government investigations and take proactive steps to insure themselves against the costly defense fees associated with these investigations. Thus, it is of utmost importance for insureds to be proactive in negotiating policy language which defines "Claim" and "Suit" broadly to encompass various forms of government investigations or administrative actions. There are typically no standard ISO forms for policies in the professional liability context, and the variation of policy language in the cases discussed above illustrates the flexibility that many insurers have.

A typical D&O policy provides coverage for any "Claim" made during the policy period for any "Wrongful Act." This means that an insured may be entitled to a defense even where formal litigation has not yet been initiated. One such example is a government investigation into wrongful conduct on behalf of a company and its management. Though the case law analyzing D&O coverage for government investigations is limited, the recent cases discussed below illustrate the wide range of specificity in defining a "Claim."

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[1] "Equifax Data Breach Settlement," https://www.ftc.gov/enforcement/cases-proceedings/refunds/equifax-data-breach-settlement.

[2] "FBI Joining Criminal Investigation into Certification of Boeing 737 MAX," https://www.seattletimes.com/business/boeing-aerospace/fbi-joining-criminal-investigation-into-certification-of-boeing-737-max/.

[3] Enforcement actions filed by the SEC increased from 754 in 2017 to 821 in 2018. U.S. Securities and Exchange Commission, Annual Report, Division of Enforcement, pg. 9 (https://www.sec.gov/files/enforcement-annual-report-2018.pdf).

Some D&O policies contain language specifically addressing formal investigations by the government or another entity. For example, "Claim" may be defined generally to include "an Investigation of an Insured alleging a Wrongful Act." Other policies contain language with much more specific triggers of coverage, such as the following: "Claim means…a civil, criminal, administrative or regulatory investigation commenced by the service upon or other receipt by an Insured Person of a written notice of subpoena from the investigating authority identifying such Insured Person as an individual against whom such a proceeding…may be commenced." These varying definitions can have a significant impact on an insured's coverage for defense fees.[4]

The manner in which "Claim" is defined with respect to investigations is key to a coverage determination. Government investigations are often lengthy and include numerous steps, typically beginning with a simple notification or "informal inquiry," continuing with subpoenas or warrants, and concluding with official subpoenas and charges or fines. A specific definition leaves little room for ambiguity and makes clear that coverage is not triggered until, for example, a subpoena is issued. A broad definition, on the other hand, leaves open the possibility of coverage much earlier in the process.

The *Patriarch Partners, LLC v. Axis Insurance Company*[5] case, decided in early 2018, is illustrative of the effect that a broad definition of "Claim" can have on the scope of defense coverage. *Patriarch Partners* carried $20 million of D&O coverage at the time it received an "informal inquiry" from the SEC. The policies defined a "Claim" to include "an Investigation of an Insured alleging a Wrongful Act." Approximately two years into the government investigation, *Patriarch* had exhausted its policy limits and purchased an extra $5,000,000 in excess coverage. The excess carrier, however, denied coverage arguing that the "Claim" existed before the policy period and that a warranty statement prevented coverage.[6] The determinative question was whether *Patriarch* had previous knowledge of a "Claim." The Second Circuit Court of Appeals affirmed the decision of the district court, holding that Patriarch was aware of a "prior or pending claim" and accordingly, that the warranty barred coverage.

Patriarch illustrates the importance of a policy's definition of "Claim" with respect to government investigations. The investigation in this instance was lengthy and multi-faceted; arguably, there was a "Claim" when the SEC first provided *Patriarch* with an informal inquiry. In the alternative, a more restrictive definition would limit coverage to when a formal subpoena was issued by the SEC; a difference of over two years and millions of dollars under the facts of this case.

In the *MusclePharm Corporation v. Liberty Insurance Underwriters, Inc.*[7] case, decided immediately prior to *Patriarch*, the court considered the application of a much more restrictive definition of "Claim." The relevant policy defined "Claim" as "(a) a written demand for monetary or non-monetary relief against an Insured Person…; (c) a formal administrative or regulatory proceeding against an Insured Person." On May 16, 2013, *MusclePharm* received an inquiry notice from the SEC which notified the company of its investigation and requested various documents. By February 13, 2015, the SEC issued Wells Notices to *MusclePharm*—a formal notice that the SEC is likely to

[4]Other relevant definitions in the policy include "Loss," "Defense Costs," and "Wrongful Act."
[5]758 Fed.Appx. 14 (2d. Cir. 2018).
[6]The warranty statement signed by Patriarch when it procured the additional insurance stated the following: *The undersigned, on behalf of Patriarch and all of its directors and officers, hereby represents that as of the date of this letter neither the undersigned nor any other director or officer of Patriarch is aware of any facts or circumstances that would reasonably be expected to result in a Claim under the Captioned Policy.*
[7]712 Fed. Appx. 745 (10th Cir. 2017).

recommend enforcement against a recipient. *MusclePharm* provided notice to its D&O carrier who subsequently denied coverage because the letter did not rise to the level of a "Claim." *MusclePharm* initiated a coverage action, but ultimately the Tenth Circuit agreed with the carrier. According to the court, the SEC's inquiries and subpoenas did not qualify as "written demands for monetary relief" or "formal administrative or regulatory proceedings." *MusclePharm* was entitled to coverage once it received the Wells Notice, but not before. In this case, a broader definition might have allowed for defense fees earlier in the process.

Since these two decisions were released in 2018, the issue of what constitutes a "Claim" for purposes of D&O and Professional Liability insurance has become more frequently litigated, with *MusclePharm* and *Patriarch* serving as guideposts for recent decisions on the issue. In the case of *Crowley Maritime Corporation v. National Union Fire Insurance Company of Pittsburgh, PA*[8], the Eleventh Circuit Court of Appeals decided whether a DOJ/FBI investigation, which included a search warrant, affidavit, and subpoenas rose to the level of a "Claim" under the plaintiff's professional liability policy. The policy defined "Claim" as (1) a written demand for relief; (2) a criminal proceeding commenced by return of an indictment, information, or similar charging document or receipt or filing of a notice of charges; or (3) a criminal investigation of an Insured Person "once such Insured Person is identified in writing by such investigating authority as a person against whom a proceeding [described in section 2(b)(2)] may be commenced."[9] The affidavit clearly identified an individual in writing against whom a criminal proceeding might be commenced. Though the court determined that there was no coverage based upon a notice issue, the Court noted that "the substantive content of the Affidavit clearly *did* constitute a claim."[10]

In May 2019, the Delaware Superior Court in *Conduent State Healthcare, LLC v. AIG Specialty Insurance Company*[11] discussed the *Patriarch Partners* case at length, as well as other authority on the issue. The court acknowledged the split in case law across the country before holding that a Civil Investigative Demand from the Texas Attorney General constituted a "'Claim' alleging a 'Wrongful Act.'" Notably in that case, the definition of "Claim" was incredibly broad, encompassing a written demand for money or a suit.

The wide scope of language used to define "Claim" is indicative of the many options that insurers have in expanding and limiting coverage. Some policies choose to use very broad language, simply defining the coverage trigger as a demand for relief or a "Suit," while others specifically enumerate the type of actions, demands, or investigations that might be considered a "Claim." As case law on this issue continues to develop, it will become clearer to insurers and insureds what ramifications these variations in language have on coverage.

Please feel free to reach out to any of the attorneys in our D&O practice group with questions. The attorneys at SDV have experience in navigating these multi-faceted claims. SDV can assist in a number of ways—by reviewing policy language when selecting a carrier or at renewal, counseling you through submission of a claim, negotiating coverage, or initiating litigation when necessary. The case law on this issue continues to evolve, but policyholders can avoid surprise by staying proactive in their insurance buying process.

For more information please contact Andrew G. Heckler at 203-287-2122 or agh@sdvlaw.com.

[8]931 F.3d 1112 (11th Cir. 2019).
[9]Id. at 1122.
[10]Id.
[11]No. CVN18C12074MMJCCLD, 2019 WL 2612829 (Del. Super. Ct. June 24, 2019).