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Insurance Coverage for Government Investigations

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Government investigations of companies have increased over the last several years. These government investigations can come from many sources – the Securities and Exchange Commission ("SEC"), the Food and Drug Administration ("FDA"), the Department of Justice ("DOJ"), the Department of Labor, the Environmental Protection Agency ("USEPA"), state Attorneys General and other regulatory agencies to name a few. Class actions or shareholder derivative actions can soon follow. For example, recently the number of Foreign Corrupt Practices Act ("FCPA")[1] actions initiated by the DOJ and the SEC has skyrocketed with shareholders and other litigants following by filing their own civil lawsuits based on FCPA violations. Government investigations and lawsuits can be extremely costly to companies and their directors and officers - in legal fees, fines, penalties, settlements, and verdicts. A company's Directors and Officers ("D&O) insurance policy is available to help minimize the substantial costs associated with government investigations and civil lawsuits. It is important, however, that companies make sure that the terms and conditions in their D&O policy provide the type of coverage needed. The language in D&O policies vary.

D&O policies provide coverage to directors and officers for non-indemnified claims as well as provide reimbursement coverage to the entity (company) that is indemnifying the directors and officers in the underlying matter. Most D&O policies are written on a "claims-made and reported" basis. That is, to trigger the policy to respond, the claim must be made against the insureds and reported to the insurance company during the policy period. Some policies may include a "retroactive date" which provides that the claim must arise out of conduct subsequent to that specified date and the wrongful act

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[111] The FCPA is primarily comprised of two provisions: (1) anti-bribery provisions which make it illegal for any U.S. person to pay a foreign official to obtain or retain business for any person or company; and (2) accounting provisions require public companies to maintain accurate records and implement an adequate system of internal accounting controls. Violations of the FCPA bring strong penalties, including large fines and criminal charges against corporate employees.

must take place during the policy period. The policies can contain "Side A Coverage," "Side B Coverage," and/or "Side C Coverage."

"Side A Coverage" in a D&O policy provides insurance to cover the directors' and officers' liabilities for which the company cannot indemnify them. Under Side A Coverage, the insurance company agrees to indemnify the directors and officers for all "Loss" that they become legally obligated to pay arising out of a "Wrongful Act" committed in their capacity as a director or officer.

"Side B Coverage" in a D&O policy provides reimbursement coverage to the corporate entity for all "Loss" for which the company is required to indemnify, or has legally indemnified, the corporate directors or officers for a claim alleging a "Wrongful Act."

"Side C Coverage" provides the corporate policyholder with reimbursement coverage for liability arising out of a defined group of claims filed directly against the corporation. Side C Coverage may be limited to securities liabilities, but it can be extended to other types of claims.

The disputed issues with insurance companies over coverage for claims under D&O policies often involve whether there is a "Claim," a "Loss," and a "Wrongful Act" as defined by the policy. Insurers define these terms differently in their policies so it is important that companies carefully review the definitions of these terms at the time of renewal and make sure that the definitions are broad enough to meet the needs of the company. In addition to the foregoing definitions, insurers often rely on several exclusions and policy provisions to deny coverage. Those exclusions and policy provisions include: (1) conduct exclusions; (2) known claims exclusions; (3) severability; (4) misrepresentation; (5) consent and cooperation; and (6) defense costs.

Conduct exclusions exclude liability that arises from a director's or officer's fraud, self-dealing, dishonesty, criminal acts or intentional wrongful conduct. Some policies exclude claims arising out of payments made to a foreign government's agents or employees – an exclusion that directly addresses non-coverage for FCPA claims. Policyholders should negotiate with insurance carriers to try and remove any exclusion that specifically precludes coverage for FCPA actions. Moreover, policyholders should negotiate with insurance carriers to insert "final adjudication" language into the fraud, dishonesty and criminal acts exclusion. Similarly, they should negotiate to remove any language excluding coverage for fines and penalties.

The known claim exclusion provides that the insurance company shall not provide coverage for a Loss on account of any Claim based upon, arising from or in consequence of: (1) any fact, circumstance, situation event or Wrongful Act that, before the inception date of the policy, was the subject of any notice given under any policy or coverage section of which the policy is a direct or indirect renewal or replacement; (2) any written demand, suit or other proceeding pending against, or order, decree or judgment entered for or against any Insured Person; or (3) any administrative or regulatory proceeding or investigation of which any Insured Person had notice. Limit knowledge to only certain Insured Persons such as the CEO, General Counsel and Risk Manager.

Make sure that there is a severability provision in the policy so that the insurance companies cannot impute the Wrongful Acts of one Insured Person to any other Insured Person. Also make sure that there is policy language that provides that under the Side C Coverage, that only Wrongful Acts of any CEO, General Counsel or CFO of an organization shall be imputed to the organization.

Carriers will assert a "misrepresentation" argument to avoid coverage. Typically there is language in the policy that states that in granting coverage under the policy, "it is agreed that the Insurer has relied upon the statements, warranties and representations contained in the Application as being accurate and complete." With respect to the statements, warranties and representations contained in the insurance application, it is important to make sure that there is a separation of insured provision that sets forth that no knowledge or information possessed by any insured, such as an officer or director, is imputed to any other insured. That way, no knowledge possessed by any insured person, shall be imputed to any other insured person for the purpose of determining the availability of coverage with respect to any claim made against such other insured person(s).

The Consent and Cooperation provision in the policy often provides that the policyholder shall not admit liability, consent to any judgment, agree to any settlement or make any settlement offer without the Insurer's prior written consent, such consent not to be unreasonably withheld. Consent is required prior to incurring defense costs and if a policyholder fails to get consent from the insurer before hiring a law firm, insurance companies use this provision to limit coverage. Keep the insurance company in the loop before finalizing any decisions so as to avoid any argument from them that you have breached the Consent and Cooperation clause in the policy.

Defense costs are often another basis to deny a claim. Defending a D&O claim can be very expensive. Make sure that the definition of claim includes investigations. Then, it is important to notice the insurer as soon as it becomes aware of an investigation. Also, some insurance companies use their "billing guidelines" to try to limit or exclude defense costs. Other insurance companies assert that defense costs are not covered because they relate to non-covered portions of a claim. Be careful with billing guidelines. Don't necessarily agree with the insurance company's billing guidelines. Draft your own billing guidelines and work with the insurance company to reach a mutually agreeable format for defending the claim. There may be disputes with the insurance company over what portion of a claim is covered and not covered and what defense costs apply to the covered portion of the claim. Try to avoid this argument at the time you are renewing the D&O policy. Look for policy provisions that permit 100% of defense costs incurred in a mixed claim to be considered part of the covered loss.

What steps should companies follow upon receipt of a claim or becoming aware of an investigation? First, review the D&O policy to determine what provisions apply to the claim or investigation. Second, provide timely notice to the D&O carriers (including the umbrella and excess carriers). Make sure that the notice provisions in the insurance policies are followed. Make sure that the wording used in the notice letter does not limit coverage. If possible, show how efforts to defend an investigation are helpful in the defense of a similar civil action. Third, carefully evaluate the insurance company's response to the notice letter. Did the insurance company accept coverage, reserve rights or deny the claim? If it reserved rights or denied the claim, evaluate the proper response – a letter or a

lawsuit? Fourth, provide updated status reports as the investigation evolves – usually every three to four months if not sooner. Be careful about the disclosure of attorney-client or work product documents. Seek a confidentiality agreement with the carriers. Make sure umbrella and excess carriers are also kept apprised of developments. Fifth, evaluate the selection of defense counsel. Who chooses defense counsel? If it is the insurance company, demand a say in the selection. What amount of the defense costs are to be paid? Are there insurance company billing guidelines to address? What costs are reasonable and necessary? Sixth, make sure you understand the policy language regarding consent to settle. Make sure you document the reasons for settlement to counter any "reasonableness" arguments from the insurance companies.

The more a company does to protect itself when negotiating its D&O coverage, the better off the company will be should a government investigation be initiated against it. Government investigations and subsequent civil lawsuits are very costly. Yet, a properly worded D&O policy can help companies weather the storm.