

D&O Coverage for Investigations

by Joshua Gold

Few who occupy positions in senior management of a publicly traded corporation have shown much interest in their companies' insurance program. There is one major exception to this proposition: D&O insurance. For at least the last decade, officers and directors have been keenly interested in the insurance coverage protection offered under their management liability insurance. World class corporate meltdowns and the boom of market bubbles popping spurred huge attention to D&O insurance for those serving corporations as officers and directors (as well as those considering such a role).

Unlike many other types of insurance policies these days, D&O coverage still provides a relatively broad scope of protection. One area where some insurance companies argue their insurance is not so broad, however, involves the coverage for government investigations. Most D&O insurance policies promise some measure of insurance protection against "regulatory and governmental" investigations, "administrative or regulatory proceedings" and criminal proceedings. However, many insurance companies will argue this coverage is not triggered until certain documents are prepared by the investigating entity and until they are prepared and drafted in a very specific way. For instance, does the investigation start when a subpoena is served or only when a "formal" investigative order is issued under the insurance policy? Insurance companies may argue that they are not on the hook for millions of dollars in "loss" until certain specific aspects of the investigation come to pass.

Policyholders should examine these arguments carefully as they may be without merit. For example, this past December, a New York federal court ruled that the policyholder had insurance coverage for the costs of dealing with a federal investigation and a state regulators' subpoena after the insurance company refused to pay the claim. Other courts have reached similar decisions. In a United States Court of Appeals case, the court held that viewing a grand-jury subpoena and investigations as "claims" was a reasonable construction of the D&O policy.

A District Court ruling from a few years ago followed this reasoning by recognizing at least some measure of D&O coverage exists for SEC investigations. The court there followed the Eight Circuit and held that the D&O policy provided coverage for legal expenses incurred during an SEC investigation. The court ruled: "an SEC subpoena is not a mere request for information, but a substantial demand for compliance by a federal agency with the ability to enforce its demand," and ruled that the SEC's investigation was a "claim" under the policy.

Another decision, this time from an Illinois federal court, supports the view that costs incurred in connection with regulatory investigations are covered under D&O insurance policies. The Illinois court held that a Justice Department investigation constituted a claim, stating that "[t]he subpoenas and other demands made in antitrust investigation constituted a claim within the meaning of the policy."

Given the enormous costs associated with defending against subpoenas and regulatory investigations, many insurance companies in the last few years have attempted to craft their D&O insurance policies in a manner that ostensibly preserves the promise of coverage for SEC-type investigations, but with an eye toward erecting obstacles to the actual triggering of those coverage grants. The result has been that many of these clauses are vague and confusing as to what activities by regulators and others are sufficient to trigger coverage. This will undoubtedly lead to further disputes resolved by the courts as to how broad or narrow the D&O coverage is for the policyholder's loss. Nevertheless, policyholders should continue to work with their brokers and consultants to find the best D&O policy provisions out there since senior management will expect no less. ■

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