This article was originally published in the Policyholder Advisor *(Volume 21, Issue 1)*

Anderson Kill & Olick, P.C.
POLICYHOLDER ADVISOR
The Policyholder Law Firm

New SEC Settlement Policy — Implications For Your D&O Coverage

By Alexander D. Hardiman and Raymond A. Mascia Jr.

On January 6, 2012, the Securities and Exchange Commission announced a change in a policy which had previously permitted companies and their directors and officers to "neither admit or deny" allegations as part of any SEC settlement, notwithstanding any prior admissions in a criminal investigation or prosecution. The SEC's change in policy highlights some important considerations for corporate policyholders with respect to their D&O liability policies and admissions made in connection with settlements with the government.

New SEC Policy Takes Into Account Admissions In Parallel Criminal Proceedings

The SEC has long permitted companies and D&Os who settled SEC civil charges to "neither admit or deny" the SEC's allegations even where the companies or D&Os had already been convicted or otherwise admitted to facts in parallel criminal proceedings or investigations. That policy has now changed. According to a statement by SEC enforcement director Robert Khuzami, the SEC will no longer permit companies or individuals to "neither admit or deny" allegations that have formed the basis of a conviction or have been admitted to in parallel criminal investigations or proceedings. The SEC's new policy is not limited to cases in which there has been a conviction in a parallel criminal proceeding, but also appears to extend to any admissions made as part of a "non-prosecution agreement" or "deferred prosecution agreement" in a criminal prosecution or investigation. Although the SEC specifically noted its new policy was not related to any pending litigation, the SEC's policy change follows increasing criticism by some courts of SEC settlements in which there are no admissions of responsibility or wrongdoing, most notably in a federal district court's rejection of a settlement between the SEC and Citigroup last year.

Non-prosecution and deferred prosecution agreements have become an increasingly frequent tool used by the government to resolve corporate criminal proceedings or investigations. Typically, non-prosecution and deferred prosecution agreements involve the government's agreement to forgo prosecution in return for some combination of an admission of responsibility or facts, monetary penalties, cooperation and remediation steps. In contrast to deferred prosecution agreements, non-prosecution agreements are not filed with the court but both are public documents.

Admissions of facts or allegations made by a policyholder in a non-prosecution agreement, deferred prosecution agreement or civil SEC settlement may result in a policyholder's D&O insurance company asserting that such admissions trigger exclusions in a D&O policy

Alexander D. Hardiman is a shareholder, and **Raymond A. Mascia Jr.** is an attorney in Anderson Kill's New York office. Mr. Hardiman can be reached at (212) 278-1588 or ahardiman@andersonkill.com. Mr. Mascia can be reached at (212) 278-1359 or rmascia@andersonkill.com.

that may bar coverage for all related civil and criminal matters for which coverage is sought. Typically, D&O policies contain so-called "conduct" exclusions which, if triggered, may exclude coverage for claims involving: (1) any dishonest, fraudulent or criminal act or omission by an insured; (2) any willful or intentional violation of any statute, rule or law by an insured; or (3) the gaining of any profit, remuneration or advantage to which an insured is not entitled. In many D&O policies sold in recent years, however, these conduct exclusions will only be triggered if the prohibited conduct has been established by a "final adjudication."

When is the Final Adjudication Triggered?

Many courts traditionally have interpreted the final adjudication trigger to require a final judgment by a court or other tribunal establishing the prohibited conduct and generally have held that a settlement does not meet the final adjudication standard. *See, e.g., Pepsico, Inc. v. Cont'l Cas. Co.*, 640 F. Supp. 656 (SDNY 1986). Few courts, however, have considered whether an admission of facts contained in a non-prosecution agreement, deferred prosecution agreement or civil settlement meet the final adjudication trigger. In *International Association of Chiefs of Police, Inc. v. St. Paul Fire and Marine Insurance Co.*, 686 F. Supp. 115 (D. Md. 1988), however, the court considered whether admissions in a settlement with the government in connection with a criminal investigation were sufficient to trigger a conduct exclusion which required that the prohibited conduct be "proven." In the *Association of Chiefs of Police* case, the government and policyholder entered into settlement in which the policyholder admitted to overcharging the government and paid the government restitution in settlement of the government's claims. The policyholder made a claim with its insurance company for its defense costs, which the insurance company denied on the basis of the policy's exclusion barring coverage for dishonest acts and unlawful profits. In rejecting the policyholder's position, the court held that the admissions of dishonesty and unlawful profit in the settlement agreement were proven for insurance coverage purposes and therefore ruled that the policyholder was not entitled to its defense costs.

Although the *Association of Chiefs of Police* case did not consider whether an admission in a settlement agreement constituted a final adjudication sufficient to trigger an exclusion, the court's reasoning that an admission in a settlement was proven for the purposes of triggering an exclusion, illustrates the argument that D&O insurance companies may advance in connection with admissions made by companies or D&Os in non-prosecution agreements, deferred prosecution agreements, or civil settlements. Good arguments exist, however, that a non-prosecution agreement, deferred prosecution agreement, or civil settlement does not constitute a final adjudication for the purposes of triggering a conduct exclusion insofar as they are not the judgment or decision of a tribunal, and therefore any admissions made in those agreements cannot be used as a basis to deny coverage. In addition, even assuming that admissions in a non-prosecution agreement, deferred prosecution agreement, or settlement agreement are sufficient to trigger a conduct exclusion, "severability" provisions in a D&O policy — which govern whether one insured's conduct is imputed to another for the purposes of coverage — may significantly narrow the application of the exclusions to only the specific individuals whose conduct formed the basis of the admissions.

Conclusion

The SEC's new policy limiting the use of "neither admit or deny" in settlements, and the increased resistance by certain courts to government settlements in which there is no admission of wrongdoing or responsibility, raises the likelihood of an increasing number of corporate policyholders who are the subject of government investigations or proceedings making admissions in connection with agreements to resolve those investigations or proceedings. Policyholders should be aware that such admissions, even though made as part of a settlement, might lead to their D&O insurance company attempting to deny coverage for all related litigation. Whenever possible,

therefore, policyholders should consider carefully in advance how best to position themselves to maximize the likelihood of overcoming any coverage denial.

About Anderson Kill

Anderson Kill practices law in the areas of Insurance Recovery, Anti-Counterfeiting, Antitrust, Bankruptcy, Commercial Litigation, Corporate & Securities, Employment & Labor Law, Health Reform, Intellectual Property, International Arbitration, Real Estate & Construction, Tax and Trusts & Estates. Best-known for its work in insurance recovery, the firm represents policyholders only in insurance coverage disputes, with no ties to insurance companies and no conflicts of interest. Clients include Fortune 1000 companies, small- and medium-sized businesses, governmental entities, and nonprofits as well as personal estates. Based in New York City, the firm also has offices in Newark, NJ, Philadelphia, PA, Stamford, CT, Ventura, CA, and Washington, DC. For companies seeking to do business internationally, Anderson Kill, through its membership in Interleges, a consortium of similar law firms in some 20 countries, can provide service throughout the world.