THOMSON REUTERS
Westlaw®

You've been served: Seeking D&O coverage for regulatory subpoena compliance costs

By Finley Harckham, Esq., and Luma Al-Shibib, Esq., *Anderson Kill PC*

MAY 7, 2019

Subpoenas served on a company or its directors and officers are common investigatory tools used by federal and state regulatory authorities, such as U.S. attorney's offices, the FBI, and the Securities and Exchange Commission. Compliance with such subpoenas may require consultation with outside legal counsel and may involve time-intensive tasks associated with the production of documents and preparation of witness testimony. Not surprisingly, response costs often can become substantial, but a company may be able to recoup many of these costs through its directors-and-officers liability insurance policies.

Beyond determining whether a subpoena rises to the level of a "claim," coverage determinations for subpoena response costs also depend on whether the subpoena alleges a "wrongful act."

Whether a particular D&O policy covers a company's subpoena response costs depends on a number of factors, including the policy's specific provisions, the particular underlying circumstances, and which state's laws apply. Courts across the country have reached widely divergent results even in cases involving similar policy language.

This commentary identifies some of the common obstacles that corporate policyholders encounter when they seek D&O coverage for regulatory subpoena response costs and the approaches taken by different courts.

TRIGGERING COVERAGE FOR A SUBPOENA

D&O policies generally provide coverage for liability arising from allegations of wrongful acts asserted against either a company's insured directors or officers or against the company itself.

Under a typical D&O policy, an "insured person" is covered for "loss arising from a claim first made during the policy period ... against such insured person for any wrongful act."[1] If the company has elected to purchase coverage for its own liability as well, the policy typically will cover the company for "loss arising from a claim first made during the policy period ... against the company for any wrongful act."

A "claim" generally is defined, in pertinent part, as "a written demand for monetary, non-monetary or injunctive relief made against an insured." "Wrongful act" generally means "any actual or alleged act, error, omission, neglect, breach of duty, ... misstatement, or misleading statement" by the insured person "in his capacity as such or any matter claimed against an insured person by reason of such capacity," or by the company.

Thus, D&O coverage is triggered only if (1) there is a "claim" made against an insured director or officer or, in the case of entity coverage, against the company itself, (2) that alleges a "wrongful act" committed by that insured director or officer or, in the case of entity coverage, the company, (3) which is first made during the "policy period."

Courts addressing whether D&O policies cover claims relating to subpoenas have reached different conclusions.

IS THE SUBPOENA A CLAIM?

Where a D&O policy does not explicitly include "the issuance of a subpoena" as part of the definition of a claim, courts examining potential D&O coverage for subpoena response costs focus on whether the subpoena satisfies the definition of a claim as "a non-monetary demand for relief."[2]

'CUSTODIAN OF RECORD' SUBPOENAS

Subpoenas issued to a company's custodian of records generally have been found to be information-gathering devices that do not qualify as "demands for relief." For example, in *Diamond Glass Companies Inc. v. Twin City Fire Insurance Co.*, No. 06-cv-13105, 2008 WL 4613170, *4 (S.D.N.Y. Aug. 18, 2008), a New York federal court held that grand jury investigative subpoenas served upon the custodian of records of a company under government investigation were not "demands for non-monetary relief" and therefore did not constitute a D&O "claim."

The court stated that:

Interpreting "demand for non-monetary relief" to include any investigative subpoena would require defendants to insure Diamond's costs responding to any subpoena, notwithstanding the

absence of any assertion of civil or criminal liability against Diamond or any of its directors or officers. Such a result would be absurd. D&O insurance policies are intended to protect insureds from potential liability based on allegations of wrongdoing or other breaches of duty; they are not means of holding insureds harmless from costs associated with any participation in the legal system.3

Outside of the context of "custodian of record subpoenas," there is little agreement or uniformity in the case law. Among other things, courts disagree on whether to apply a broad or narrow definition of the term "relief."

'RELIEF' DEFINED AS A REMEDY REQUESTED FROM A COURT

In *Employers' Fire Insurance Co. v. ProMedica Health Systems Inc.*, 524 F. App'x 241 (6th Cir. 2013), the 6th U.S. Circuit Court of Appeals held that subpoenas issued by the Federal Trade Commission to the insured entity and its employees prior to the policy period did not meet the definition of "claim" under the policy as demands for non-monetary "relief."

> Policyholders must be mindful of late-notice issues and assess any reporting obligations in light of the language of the provisions in their policies.

In that case, the insurance company attempted to use the pre-policy subpoenas as a basis to deny coverage under various exclusions related to pre-policy "claims." The court stated that under the "common, ordinary, usual meaning," "relief" means "the redress or benefit, esp[ecially] equitable in nature (such as an injunction or specific performance), that a party asks of a court."

The 6th Circuit stated that the subpoenas sought information related to the FTC's investigation — not a remedy provided by a court. Additionally, the subpoenas did not redress an antitrust violation; they simply enabled the FTC to further investigate whether any such violation would occur as a result of the proposed corporate acquisition. Accordingly, the court decided that the pre-policy subpoenas were not "claims" that triggered exclusions to coverage in the policy.

In other cases, the same definition of the term "relief" has had the effect of denying coverage. Recently, the 10th U.S. Circuit Court of Appeals in *MusclePharm Corp. v. Liberty Insurance Underwriters Inc.*, 712 F. App'x 745 (10th Cir. 2017), held that costs incurred prior to the issuance of an SEC Wells Notice, in response to 21 subpoenas, did not rise to the level of a D&O "claim" as written demands for non-monetary "relief."

The court rejected a broad construction of the term "relief" as "a demand for something due," instead adopting the "plain and ordinary meaning" of the term as "legal remedy or redress" or "the redress or benefit, especially equitable in nature ... that a party asks of a court."

It concluded that the subpoenas sought information to determine whether there would ultimately be any basis for seeking monetary or non-monetary relief from the company, stating that "the SEC was not seeking relief, but was only gathering information."

'RELIEF' BROADLY DEFINED

On the other hand, some courts have adopted a broader definition for "relief" as "demands for something due." For example, in *Minuteman International Inc. v. Great American Insurance Co.*, No. 03-cv-6067, 2004 WL 603482 (N.D. Ill. Mar. 22, 2004), the court applied this broader definition to hold that SEC subpoenas demanding documents and testimony constituted a D&O "claim."

Courts adopting this broad definition do not view a regulatory subpoena as "a mere request for information," but instead as "a substantial demand for compliance by a federal agency with the ability to enforce its demand."4

DOES THE SUBPOENA ALLEGE A 'WRONGFUL ACT'?

Beyond determining whether a subpoena rises to the level of a "claim," coverage determinations for subpoena response costs also depend on whether the subpoena alleges a "wrongful act." Here too, courts diverge in their reasoning and outcome.

In *Employers' Fire v. ProMedica*, the 6th Circuit held that FTC-issued subpoenas did not "allege" a "wrongful act," defined as "any actual or alleged" antitrust violation. The policy did not define the term "alleged." Under its plain and ordinary meaning, which the court applied, "alleged" means "asserted to be true as described" or "accused but not yet tried."

The court observed that the subpoenas stated that they were issued to determine "whether there is, has been, or may be a violation" of laws and discussed in "hypothetical terms" the possibility of an antitrust violation, but did not affirmatively accuse the insured of any antitrust violations. The absence of an affirmative accusation was insufficient to "allege" wrongdoing.5

On the other hand, in *Astellas US Holding Inc. v. Starr Indemnity & Liability Co.*, No. 17-cv-8220, 2018 WL 2431969 at *5 (N.D. Ill. May 30, 2018), the court found that a Justice Department subpoena was issued "for a wrongful act" despite the presence of disclaimer language in the subpoena that its issuance should not be construed as an indication of wrongdoing.

The court held that the subpoena itself did not need to allege a "wrongful act" because the policy only required that a "claim" be made "for any wrongful act." The complaint's allegation that the subpoena was issued because of alleged health care violations was sufficient to satisfy this standard.6

INTERRELATED CLAIMS, LATE NOTICE AND NOTICE OF CIRCUMSTANCE ISSUES

Generally, a policyholder's failure to give notice of a claim during the policy period when the claim is "first made" is fatal to the claim. In addition, D&O policies commonly include related wrongful act provisions, prior claim exclusions or both. The purpose of these provisions is to ensure that related claims, i.e., those based upon the same set of circumstances or related "wrongful acts," are classified together as having been made at the time the first such related "claim" was made.

Insurance companies often rely on these provisions to argue that a "claim" is "related" to an earlier "claim" arising under a previous period's D&O policy, and thus, the policyholder would have to look to the earlier D&O policy in effect when the "claim" was first made for coverage. Of course, issues of late notice often hamper policyholder efforts at recovery in this regard.

For example, if a policyholder failed to provide notice of the earlier related "claim," whether because it mistakenly believed that the earlier matter did not rise to the level of a "claim" or otherwise, then the insurance company will argue that the later claim is barred because the policyholder failed to timely notice the related earlier "claim."7

Typically, however, an insurer must demonstrate that the prior claim actually meets the definition of a "claim" under the policy in order to exclude coverage on the basis of an "interrelated claims" provision.8

Beware, however, of broadly worded prior acts exclusions that bar coverage for a noticed claim if it arises from wrongful acts that predate the inception of the policy period — even if such prior wrongful acts do not meet the definition of a "claim."9

Conversely, "notice of circumstance" provisions allow a policyholder to provide notice of a circumstance that the policyholder believes may later give rise to a claim, but which is not yet a claim. If a policyholder chooses to report such circumstances, which subsequently do give rise to a claim under a later policy period, that claim will be covered under the policy in effect at the time the notice of circumstance was given (assuming no other barriers to coverage).

Reporting a notice of circumstance requires a particularized level of detail, and a policyholder that provides too generalized a notice may risk forfeiting coverage when a claim later develops.10

CONCLUSION

As the divergent case law explored in this commentary demonstrates, there is a potential for recovery under a D&O policy for the costs a corporate policyholder or its directors or officers expend in responding to investigatory subpoenas. The ability to obtain such coverage depends in large part on the particular provisions of the policy at issue, the underlying factual circumstances, and the governing law likely to apply to issues of coverage determination.

NOTES

[1] Although D&O policies do not contain standardized language, the policy language used in this commentary is representative of the type of provisions commonly included in D&O policies.

[2] Typically, a policyholder that seeks coverage for subpoena response costs also seeks coverage for costs incurred in connection with the underlying government investigation pursuant to which the subpoena was issued. Courts that have adjudicated whether a subpoena constitutes a covered D&O claim, therefore, often also examine whether the underlying government investigation also qualifies as a claim under a different provision of the policy — one that defines claim as including either a formal administrative or regulatory investigation or proceeding. Because the policy language for a covered investigation or proceeding varies widely, cases adjudicating whether government actions rise to the level of a claim as a covered investigation or proceeding are heavily fact-specific and not examined in this commentary. *See, e.g., MBIA Inc. v. Federal Ins.* Co., 652 F.3d 152, 159 (2d Cir. 2011) (D&O policy defined a claim to be, inter alia, a formal investigative order; court held that the claim was made when the corporate policyholder was served with a subpoena (three years after the entry of the SEC's order of investigation) because "the outward-facing form that [the] investigation takes is the service of a subpoena.")

[3] See also *Ctr. for Blood Research Inc. v. Coregis Ins. Co.*, 305 F.3d 38, 43 (1st Cir. 2002) (subpoena to company's "keeper of records," issued in connection with an investigation of federal health care laws brought by the state attorney general, was not a "claim" for "relief" covered under the policy).

[4] *See also Astellas US Holding Inc. v. Starr Indem. & Liab. Co.*, No. 17-cv-8820, 2018 WL 2431969 (N.D. Ill. May 30, 2018); *Syracuse Univ. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 40 No. 2012EF63, 2013 WL 3357812, *2-*3 (N.Y. Sup. Ct., Onandaga Cty. Mar. 7, 2013); *MBIA Inc. v. Fed. Ins. Co.*, 652 F.3d 152, 160 (2d Cir. 2011).

[5] *See also MusclePharm Corp. v. Liberty Ins. Underwriters Inc.*, 712 F. App'x 745, 756 (10th Cir. 2017) (presence of language disclaiming any assertion of a legal violation in subpoenas negated allegation of wrongdoing).

[6] *See also Syracuse Univ.*, 2013 WL 3357812 at *4-*5 (subpoenas issued to the university "sought 'facts ... of a wrongful act'" concerning the university's conduct and thus the subpoenas satisfied "the standard of a potential claim implicating the policy's coverage").

[7] *See Fed. Ins. Co. v. Ill. Funeral Director's Ass'n*, No. 09-cv-1634, 2010 WL 5099979, *9 (N.D. Ill. Dec. 8, 2010) (no D&O coverage for timely noticed subpoenas because they arose out of same facts as earlier demand letter, arising under earlier policy period, for which the policyholder had not provided notice); *Biochemics Inc. v. Axis Reinsurance Co.*, 83 F. Supp. 3d 405, 407-08 (D. Mass. 2015) (insurer had no duty to defend SEC subpoenas issued during policy period which related to a pre-policy "claim").

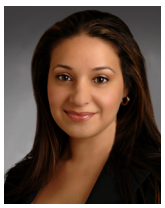
[8] *See, e.g., S.D. Network LLC v. Twin City Fire Ins. Co., No. 16-cv-47031, 2017 WL 4233019, *6 (D.S.D. Sept. 22, 2017)* (holding that there was no claim under earlier policy period where parties quickly and informally resolved their dispute; thus, insurer could not deny coverage for claim based on interrelated claims exclusion).

[9] *See Zucker v. U.S. Specialty Ins. Co., 856 F.3d 1343, 1349 (11th Cir. 2017)* (prior acts exclusion barring a "claim ... arising out of ... any wrongful act committed ... prior to" policy inception).

[10] *See, e.g., Univ. of Pittsburgh v. Lexington Ins. Co., No. 13-cv-335, 2016 WL 7174667, *5 (S.D.N.Y. Dec. 8, 2016)*. Thus, policyholders must be mindful of late-notice issues and assess any reporting obligations in light of the language of the provisions in their policies.

This article first appeared on the Practitioner Insights Commentaries web page on May 7, 2019.

ABOUT THE AUTHORS



Finley Harckham is a senior litigation shareholder in the New York office of **Anderson Kill PC**, where he represents and advises corporate policyholders in insurance coverage matters. He has litigated, arbitrated and settled hundreds of complex coverage claims. He can be reached at fharckham@andersonkill.com. **Luma S. Al-Shibib**, a shareholder in the firm's New York office, focuses her practice on insurance recovery for corporate policyholders, with an emphasis on directors-and-officers liability insurance, errors-and-omissions/professional liability insurance, and comprehensive general liability insurance. She can be reached at lal-shibib@andersonkill.com.