SUBPRIME AND CREDIT CRISIS INVESTIGATIONS: WHAT CONSTITUTES A CLAIM FOR THE PURPOSES OF PROFESSIONAL LIABILITY INSURANCE?

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I. INTRODUCTION

The subprime mortgage and credit crisis has generated an unprecedented wave of lawsuits and government investigations of lenders and financial institutions. The lending companies and financial institutions have turned to their Directors and Officers (D&O) and Errors and Omissions (E&O) liability insurance policies to cover the substantial costs of defending against the regulatory investigations and lawsuits.[1] The scope of coverage under D&O and E&O policies varies significantly, with a number of exclusions and policy limitations excusing insurance companies from their duty to defend or reimburse the insureds under certain circumstances. The financial crisis has given rise to controversy over what legal and investigative proceedings constitute a "claim" for the purposes of triggering coverage under D&O and E&O policies. With substantial legal fees and considerable government fines at stake, the definition of a "claim" is of increasing importance to insurance companies and the financial institutions they insure.

Although a number of jurisdictions have addressed the meaning of a "claim" in the context of a professional liability policy, the law regarding whether government and regulatory investigations trigger coverage under D&O and E&O policies continues to evolve. Two Court of Appeals decisions recently examined whether government and regulatory investigations fell within the policy definitions of a "securities claim" and reached divergent conclusions as a result of differing facts and policy language.[2] These cases will have important ramifications for the treatment of government and regulatory investigations of corporate wrongdoing, as

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[1] It is estimated that as many as 95% of Fortune 500 companies have D&O liability policies. David M. Gische, *Directors and Officers Liability Insurance*, FINDLAW (2000), http://library.findlaw.com /2000/Jan/1/241472.html.

[2] Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 453 F. App'x 871, 873-75 (11th Cir. 2011); MBIA Inc. v. Fed. Ins. Co., 652 F.3d 152, 155 (2d Cir. 2011).

well as the professional liability insurance industry as a whole. The purpose of this article is to examine the recent wave of government and regulatory investigations related to the subprime mortgage and credit crisis and its implications for D&O and E&O liability insurance. More specifically, this article will explore the kinds of legal proceedings that have been interpreted by courts to fall within policy definitions of a "claim," so as to evaluate whether government and regulatory investigations into subprime lending practices will be covered by D&O or E&O policies.

II. THE INVESTIGATIONS

Given the catastrophic financial losses associated with the 2008 subprime mortgage and credit crisis and the subsequent financial meltdown, it is not surprising that government and regulatory agencies have commenced investigations into corporate and lending behavior.[3] The financial crisis provoked investigations into corporate wrongdoing by a number of state and federal watchdogs, among them the Securities and Exchange Commission (SEC), the Federal Bureau of Investigation (FBI), the Federal Deposit Insurance Corporation (FDIC), the Federal Trade Commission (FTC), and several State Attorneys General.[4] The SEC began its investigation into subprime mortgage lending in 2007 when it formed a working group to investigate whether companies involved in subprime mortgage lending were liable under federal securities law for failure to disclose information to investors.[5] In the five years since, the SEC has brought lawsuits against a range of financial institutions, including Fannie Mae and Freddie Mac.[6] The FBI also launched investigations into subprime lending practices shortly after the crisis unfolded; in 2008, it announced it was investigating fourteen corporations that had been involved in subprime lending as part of its larger Subprime Mortgage Industry Fraud Initiative

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[3] John F. McCarrick, *Subprime Claims: D&O and E&O Liability and Coverage Implications*, 775 PLI/Lit 299, 303-04 (April 2008).

[4] Kenneth M. Breen & Thomas R. Fallati, *Subprime Lending Meltdown – Part Three: Federal and State Investigations*, STAY CURRENT (Paul Hastings LLP, New York, N.Y.), July 2007, at 1-2, *available at* http://www.paulhastings.com/assets/publications/742.pdf.

[5] *Id.* (citing Karey Wutkowski, *SEC's Cox Reveals CDO Probes, Fund Valuation Review*, REUTERS (June 26, 2007, 8:49 PM), http://www.reuters.com/article/2007/06/27/sec-congress-idUSN2625573520070627).

[6] Press Release, U.S. Sec. and Exch. Comm'n, SEC Charges Former Fannie Mae and Freddie Mac Executives with Securities Fraud (Dec. 16, 2011).

launched the prior year.[7] The FBI's probe focused on firms suspected of engaging in accounting fraud, improperly securing loans, and insider trading.[8]

In 2010, the FDIC, a federal agency responsible for investigating crime at financial institutions, announced that it was intensifying efforts to identify wrongdoing and punish recklessness, fraud, and other criminal behavior that contributed to the bank failures.[9] The agency launched fifty criminal investigations of bank executives, directors, and employees of failed U.S. banks across the country.[10] The Wall Street Journal reported that "[h]undreds of 'demand' letters [were] sent to former executives, directors and other employees, as well as their professional-liability insurers, putting them on notice of potential claim . . . ."[11] Since then, the FDIC has filed over two dozen lawsuits against failed institutions and authorized many more.[12] The FDIC investigations and lawsuits come several years after the initial wave of bank failures, but officials say it takes a minimum of 18 months to prepare for legal action after a bank fails.[13] It is thus entirely possible the investigations will continue to multiply as the agency turns its attention to more recent bank failures.

States have also assumed an active role in the subprime investigations. The Attorneys General in New York, California, Illinois, Massachusetts, Ohio and Connecticut have all initiated investigations of financial institutions that were involved in the subprime crisis in their

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[7] *Subprime Loans and More: It's a Bull Market for Financial Fraud*, FBI (Jan. 31, 2008), http://www.fbi.gov/news/stories/2008/january/fin_fradu013108.

[8] Kirke M. Hasson & Ernest T. Patrikis, *Here Come the Regulators*, PILLSBURY (June/July 2008), http://www.pillsburylaw.com/siteFiles/Publications/5217C99E2A691AA548942891FDB7C691.pdf.

[9] Jean Eaglesham, *U.S. Sets 50 Bank Probes*, WALL ST. J., Nov. 17, 2010, at A1, *available at* http://online.wsj.com/article/SB10001424052748703628204575619000289073686.html.

[10] *Id.*

[11] *Id.*

[12] The FDIC website states: "As of March 20, 2012, the FDIC has authorized suits in connection with 54 failed institutions against 469 individuals for D&O liability with damage claims of at least $7.9 billion. This includes 27 filed D&O lawsuits (2 of which have been dismissed after settlement with the named directors and officers) naming 222 former directors and officers." *Professional Liability Lawsuits*, FDIC, http://www.fdic.gov/bank/individual/failed/pls/ (last visited Mar. 21, 2012).

[13] *Id.*

states.[14] The state investigations have focused on whether mortgage lenders are liable under federal and state laws and regulatory statutes for deceptive disclosure practices with borrowers.[15] Depending on the state, consumer protection violations of this kind can result in both criminal and civil liability.[16] In his 2012 State of the Union address, President Obama announced that Attorney General Eric Holder would launch "a special unit of federal prosecutors and leading state attorneys general to expand [the] investigations into the abusive lending and packaging of risky mortgages that led to the housing crisis."[17]

In addition to government and regulatory investigations into subprime-related activity, financial institutions may commission internal or "special litigation committee" investigations of their own.[18] If a corporation believes its officers or directors may be involved in wrongdoing, it may choose to perform its own internal investigation. Sometimes the internal investigation is prompted by an external investigation similar to the examples discussed above. At other times, internal investigations are brought about in response to a demand by a shareholder who is planning to bring a derivative lawsuit.[19] Either way, corporations commonly form "special litigation committees" to conduct independent investigations of suspected misconduct.[20]

The costs of defending a policyholder against government or regulatory investigations of corporate wrongdoing are staggering. It is not uncommon for companies to spend millions of dollars responding to government and regulatory investigations and defending against follow-up litigation. For example, in a recent New York case a company sued its insurer to recover $29.5 million it spent responding to a SEC and state

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[14] Breen & Fallati, *supra* note 4, at 1; Nat'l Ass'n of Attorneys Gen., *The Housing Bust and Approaches to the Mortgage Foreclosure Crisis*, NAAGazette (2007).

[15] Breen & Fallati, *supra* note 4, at 1-3.

[16] *Id.* at 2.

[17] President Barack Obama, State of the Union Address (Jan. 24, 2012).

[18] AMERICAN COLLEGE OF TRIAL LAWYERS, RECOMMENDED PRACTICES FOR COMPANIES AND THEIR COUNSEL IN CONDUCTING INTERNAL INVESTIGATIONS 1 (2008).

[19] *Id.*

[20] Edwards Angell Palmer & Dodge LLP, *Addressing Coverage for SLC-Incurred Legal Costs*, LAW360 (Jan. 28, 2010), http://www.law360.com/articles/146250/addressing-coverage-for-slc-incurred-legal-costs.

investigation, only $6.4 million of which the insurer agreed to pay.[21] The costs associated with corporate investigations are substantial for several reasons. First, the investigations typically involve a large number of individuals, thus requiring a lot of time, money, and legal assistance.[22] Secondly, the investigation periods may consume months, or in some cases, years.[23] Moreover, indemnification obligations often require corporations to cover the legal expenses incurred by individuals employed by the corporation.[24] In many cases, state corporate indemnification statutes require companies to indemnify their directors and officers in order to shield them from personal liability should they make an unwise business decision.[25] If an investigation leads to a lawsuit, the insurer may find itself exposed to many more millions of dollars worth of claims. Indeed, a number of the biggest financial institutions have already reached $400 to $600 million-dollar settlements in subprime-related litigation.[26] Subprime-related investigations thus threaten to cost insurance companies vast sums under D&O and E&O policies, whether the investigations reach the courts or not.

III. WILL D&O AND E&O INSURANCE COVER THE COSTS OF DEFENDING AGAINST SUBPRIME-RELATED INVESTIGATIONS?

With so many subprime-related investigations surfacing on the heels of the financial crisis, both insurers and policyholders should be concerned with whether D&O and E&O (together sometimes referred to as "professional liability") policies will cover the costs of responding to investigative inquiries and paying for legal defense fees. D&O insurance,

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[21] MBIA Inc. v. Fed. Ins. Co., No. 08 civ. 4313, 2009 WL 6635307, at *4 (S.D.N.Y. Dec. 30, 2009), *aff'd in part*, *rev'd in part*, 652 F.3d 152, 172 (2d Cir. 2011).

[22] Patricia Bronte, *D&O Coverage for Corporate Criminal Investigations*, 7 NO. 11 INS. COVERAGE L. BULL. 1, 2 (2008).

[23] *Id.*

[24] *Id.*

[25] Joseph P. Monteleone & Nicholas J. Conca, *Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues*, 51 BUS. LAW. 573, 574 (1996).

[26] Kevin LaCroix, *A Status Update on the Subprime and Credit Crisis-Related Litigation*, THE D&O DIARY (Jan. 9, 2012), http://www.dandodiary.com/2012/01/articles/subprime-litigation/a-status-update-on-the-subprime-and-credit-crisisrelated-litigation.

which was developed after the 1929 stock market crash, is intended to cover the cost of indemnifying and defending a corporation's directors and officers for wrongful acts committed while carrying out their corporate responsibilities.[27] In contrast, E&O insurance provides more general coverage for defense costs arising from wrongful acts committed by the corporation and its employees.[28] Generally, the insurance company's duty to defend a policyholder is activated when a lawsuit is initiated.[29] If the allegations in the complaint support a cause of action that falls within the scope of the policy, coverage is triggered.[30]

Whether the policy will cover the costs associated with responding to and defending against a government or regulatory investigation depends, of course, on the actual language of the policy.[31] D&O and E&O insurers do not share a common form, so policies vary from carrier to carrier.[32] While most policies share similar conditions and exclusions, insurance companies have developed their own terms and wordings over the years.[33] What may seem like a trivial difference in the wording of a key term could make all the difference with regard to the policy's coverage.[34] Insurance policies feature a number of exclusions and limitations on coverage, and it is common for insurance companies to deny coverage as a result. Absent an applicable policy exclusion, insurers have relied on ambiguities in the policy terms to deny coverage. Recently, insurers have capitalized on ambiguity in the term "claim" to avoid covering fees and costs associated with investigations.

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[27] JOSEPH P. MONTELEONE & CARRIE E. COPE, DIRECTORS' AND OFFICERS' (D&O) LIABILITY: EXPOSURES, RISK MANAGEMENT AND INSURANCE COVERAGE 1 (2008).

[28] Charles Allen Yuen, *Errors & Omissions Insurance Coverage: Common Claim Scenarios*, 827 PLI/Lit 65, 67 (June 2010).

[29] 1 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSUREDS § 4:1 (5th ed. 2010).

[30] *Id.*

[31] Bronte, *supra* note 22, at 2.

[32] Randy Paar, *Directors and Officers Insurance*, *in* D&O LIABILITY & INSURANCE 2004: DIRECTORS & OFFICERS UNDER FIRE 9, 21 (2004).

[33] CATHERINE HANNA, SUBPRIME PRIMER: WHERE'S THE PRIMARY EXPOSURE? 4 (2008), *available at* http://www.hannaplaut.com/publications/Subprime Primer.pdf.

[34] Robert D. Chesler & Cindy Tzvi Sonenblick, *Does A Subpoena Constitute A 'Claim' For Purposes Of D&O Insurance Coverage?*, 14 MEALEY'S EMERGING INS. DISPUTES 1, 1 (2009).

Should a policyholder be denied coverage under its professional liability policy, it has a number of remedies. Most often, the insured brings a declaratory judgment action against the insurer seeking a declaration of coverage under the policy.[35] Policyholders also have the option of suing for breach of contract damages[36] or breach of good faith and fair dealing.[37] Insurers must therefore be cautious when denying coverage. In D&O and E&O coverage disputes, the policyholder has the burden of proving that the claim falls within the policy's coverage.[38] When a policy exclusion is at issue, however, the insurer has the burden of proving that the exclusion applies.[39]

IV. WHAT CONSITUTES A "CLAIM" FOR THE PURPOSES OF D&O AND E&O INSURANCE?

D&O and E&O policies are designed as "claims made" policies, meaning coverage can only be triggered when a "claim" is made against the insured.[40] The scope of the term "claim" is unclear. As companies are increasingly confronted with subpoenas, document requests and similar inquiries in connection with government and regulatory investigations and lawsuits prompted by the financial crisis, the companies have submitted claims to their insurers seeking coverage under their D&O and E&O policies. In turn, a number of insurers have denied coverage on the premise that the subpoena, document request or inquiry does not constitute a "claim" under the policy. As a result, the meaning of a "claim" has recently become a hotly contested issue in determining whether coverage extends to government and regulatory investigations.[41]

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[35] *See, e.g.*, Diamond Glass Companies, Inc. v. Twin City Fire Ins. Co., No. 06-CV-13105(BSJ)(AJP), 2008 WL 4613170, at *1 (S.D.N.Y. Aug. 18, 2008); St. Paul Mercury Ins. Co. v. Foster, 268 F. Supp. 2d 1035, 1040 (C.D. Ill. 2003); Foster v. Summit Med. Sys., Inc., 610 N.W.2d 350, 353 (Minn. Ct. App. 2000).

[36] *E.g.*, *Diamond Glass Companies*, 2008 WL 4613170, at *1.

[37] *E.g.*, Ctr. for Blood Research, Inc. v. Coregis Ins. Co., 305 F.3d 38 (1st Cir. 2002).

[38] WINDT, *supra* note 29.

[39] *Id.*

[40] Monteleone & Conca, *supra* note 25, at 588.

[41] ORRICK, HERRIGTON & SUTCLIFFE LLP, *When Is a Claim Not a Claim? Insurance for Government and Regulatory Investigations*, *Insuance Recovery Case Law Update,* ORRICK 1 (2009), www.orrick.com/fileupload/2055.pdf.

A. DEFINING A "CLAIM"

In determining whether or not coverage applies to an investigation or noncourt proceeding, the policyholder and insurer must ask themselves whether the action in question gives rise to a "claim," and whether that claim was made during the policy period.[42] It follows that the critical question is, "What is a claim?" In the 1980's and 90's very few professional liability policies defined the term.[43] In one early case, the court quoted Justice Frankfurter as saying that "claim" is one of those "words of many-hued meanings [which] derive their scope from the use to which they are put."[44] When the meaning of the term was disputed in the earlier coverage cases, courts looked to the accepted meaning of the word within the context of the agreement, since "an insurance policy, like any contract, must be construed to effectuate the intent of the parties as derived from the plain meaning of the policy's terms."[45] The courts have determined that the term has no special meaning in the insurance industry.[46] The Merriam-Webster Dictionary defines the word "claim" as "a demand for something due or believed to be due."[47] According to Black's Law Dictionary, a "claim" is:

> (1) The aggregate of operative facts giving rise to a right enforceable by a court. (2) The assertion of an existing

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[42] Peter S. Selvin, *Parsing Policies*, LA DAILY J., May 29, 2009, at 7.

[43] Bronte, *supra* 20*,* at 2. Examples of cases disputing the meaning of the term in the absence of a policy definition include Andy Warhol Found. for the Visual Arts, Inc. v. Fed. Ins. Co., 189 F.3d 208 (2nd Cir.1999); Winkler v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 930 F.2d 1364 (9th Cir. 1991); Polychron v. Crum & Forster Ins. Cos., 916 F.2d 461 (8th Cir. 1990); MGIC Indem. Corp. v. Home State Savs. Ass'n, 797 F.2d 285 (6th Cir. 1986); *In re* Ambassador Group, Inc. Litig., 830 F. Supp. 147 (E.D.N.Y. 1993); Mt. Hawley Ins. Co. v. Federal Sav. & Loan Ins. Corp., 695 F. Supp. 469 (C.D. Cal. 1987)).

[44] *MGIC*, 797 F.2d at 288 (quoting Powell v. U.S. Cartridge Co., 339 U.S. 497, 529 (1950) (Frankfurter, J., dissenting)).

[45] *Andy Warhol*, 189 F.3d at 215 (citing *In re* Prudential Lines, Inc., 158 F.3d 65, 77 (2d Cir. 1998)). *See, e.g.*, *Polychron,* 916 F.2d at 463; Joseph P. Bornstein, Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 828 F.2d 242, 245 (4th Cir. 1987); Richardson Elecs, Ltd. v. Fed. Ins. Co., 120 F. Supp. 2d 698, 700-01 (N.D. Ill. 2000); Resolution Trust Corp. v. Ayo, 1992 WL 245552, at *3 (E.D. La. Sept. 9,1992), *aff'd*, 31 F.3d 285 (5th Cir. 1994).

[46] Cent. Ill. Pub. Serv. Co. v. Am. Empire Surplus Lines Ins. Co., 642 N.E.2d 723 (Ill. App. Ct. 1994).

[47] MERRIAM-WEBSTER COLLEGIATE DICTIONARY 227 (11th ed. 2011).

> right; any right to payment or to an equitable remedy, even if contingent or provisional. (3) A demand for money, property, or a legal remedy to which one asserts a right.[48]

Many courts have relied on a definition of an insurance "claim" as the "assertion, demand or challenge of something as a right; the assertion of liability to the party making it to do some service or pay a sum of money."[49]

Due to the frequency of corporate scandals over the last decade, insurers have become more careful about defining key terms in insurance policies. Today, most D&O and E&O policies expressly define the term "claim," albeit with variation.[50] The majority of D&O and E&O policies associate a "claim" with a civil lawsuit commenced by the service of a complaint.[51] Apart from civil lawsuits, however, the scope of the definition varies from policy to policy.[52] Some policies include criminal or administrative proceedings within the definition, and others define a "claim" more broadly to include arbitrations and mediations as well.[53] The definition may explicitly include government or regulatory investigations.[54] A "claim" is also sometimes defined more generally as the start of a "judicial or administrative proceeding."[55]

Since the definition varies from one policy to the next, the precise wording is critical to determining if coverage extends to certain actions.[56] Where the definition specifically includes a "government or regulatory investigation" or a "judicial or administrative proceeding," it is likely a formal government investigation into a company's alleged wrongdoing related to subprime lending practices would fall within the meaning of a "claim." Likewise, definitions that encompass "investigations by any

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[48] BLACK'S LAW DICTIONARY 281-82 (9th ed. 2009).

[49] *See, e.g.*, Mt. Hawley Ins. Co. v. Fed. Savs. & Loan Ins. Corp., 695 F. Supp. 469, 479 (C.D. Cal. 1987).

[50] Bronte, *supra* note 22, at 3.

[51] *When Is a Claim Not a Claim?*, *supra* note 41. The service of a complaint is "relatively easily recognizable as a claim."

[52] *When Is a Claim Not a Claim?*, *supra* note 41.

[53] *Id.*

[54] *Id.*

[55] David E. Borden & Ellen B. Van Vechten, *Directors' and Officers' Liability Insurance*, *in* 4 LAW AND PRACTICE OF INSURANCE COVERAGE LITIGATION 47-12, 47-18 (David L. Leitner et al. eds., 2005).

[56] HANNA, *supra* note 33, at 4.

governmental entity into possible violation of law" will probably provide coverage for formal subprime investigations.[57]

The more challenging question is whether a preliminary investigation or proceeding – marked by a grand jury subpoena, document request, or informal inquiry or the like – falls within one of the policy definitions of a "claim." Professional liability policies are frequently unclear as to whether coverage extends to preliminary investigations and noncourt proceedings commenced before the corporation or its directors and officers are formally threatened with a suit or charged with misconduct.[58] The majority of D&O and E&O policies "intend to treat as covered only those SEC or government fees and expenses incurred after the date the SEC elevates an investigation to formal status or the government issues a 'target' letter to an insured party."[59] If the definition of a "claim" does not explicitly include the action in question (e.g. a subpoena, document request, target letter, etc.), the insurance company may have a basis for denying coverage for the costs associated with such an action.[60]

B. SUBPOENAS AND INVESTIGATIVE DEMANDS

Generally, investigations into corporate wrongdoing – whether led by an attorney general, a regulatory agency or a grand jury – begin with the issuance of a subpoena.[61] Most courts have held that a subpoena constitutes a "claim."[62] The decisions, however, have been highly fact sensitive.[63] Any variation in policy wording or the facts of a case may affect the insurer's duty to defend.

One of the first cases to address whether a subpoena or grand jury investigation falls within the meaning of a "claim" under a professional liability insurance policy was *Polychron v. Crum & Forster Ins. Co.*[64] After

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[57] R. Mark Keenan & Craig M. Hirsch, *Subprime Lending Litigation and Investigations: Insuring Against the Costs*, COMPLINET (May 2, 2007), http://www.andersonkill.com/webpdfext/Complinet-May2007-KeenanAndHirsch.pdf.

[58] Jonathan C. Dickey & Amy L. Goodman, Practicing Law Institute, *Indemnification, D&O Insurance, and Other Funding Mechanisms*, *in* SECURITIES LITIGATION: A PRACTITIONER'S GUIDE 14-1, 14-24 (Jonathan C. Dickey ed., 2008).

[59] McCarrick, *supra* note 3, at 312.

[60] *When Is a Claim Not a Claim?*, *supra* note 41.

[61] Chesler & Sonenblick, *supra* note 34, at 1.

[62] *Id.*

[63] *Id.*

[64] Polychron v. Crum & Forster Ins. Cos., 916 F.2d 461 (8th Cir. 1990).

a D&O insurer refused to reimburse a bank president for legal fees incurred during a grand jury investigation, the bank president (the policyholder) brought action to recover his losses.[65] He argued that the grand jury investigation, which began with receipt of a subpoena for documents, constituted a "claim" against him under the policy.[66] The insurance company, on the other hand, contended that a "claim" didn't manifest until the grand jury indicted him – which occurred after the policy had expired.[67] Since the insurance policy did not define a "claim," the court examined the ordinary meaning of the word and determined that the term was broad enough to encompass the grand jury investigation prior to the indictment:

> The function of a subpoena is to command a party to produce certain documents and therefore constitutes a "claim" against a party. The subpoena, it is true, was directed to the bank, but the documents demanded . . . related to the plaintiff's conduct as a bank official. Further, the grand jury's investigation and the questioning by the Assistant United States Attorney amounted, as a practical matter, to an allegation of wrongdoing against [the policyholder], for which he prudently hired an attorney. The defendant's characterization of the grand jury investigation as mere requests for information and an explanation underestimates the seriousness of such a probe.[68]

Likewise, in *Richardson Electronics, Ltd., v. Federal Insurance Co*. the U.S. District Court held that subpoenas and other demands made in a government investigation constituted a claim for the purposes of a professional liability policy.[69] After racking up more than $5 million in legal fees in connection with a criminal antitrust violation investigation by the Antitrust Division of the Justice Department, Richardson Electronics (hereafter "Richardson") sought reimbursement under its D&O policy.[70] As part of the investigation, the Justice Department served a Civil

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[65] *Id.* at 462.
[66] *Id.*
[67] *Id.*
[68] *Id.* at 463.
[69] Richardson Elecs., Ltd. v. Fed. Ins. Co., 120 F. Supp. 2d 698, 701 (N.D. Ill. 2000).
[70] *Id.* at 699.

Investigative Demand and subpoenaed documents and testimony by Richardson executives and employees.[71] When Federal Insurance Co. (hereafter "Federal") refused to pay, Richardson sued. Federal argued that the antitrust investigation did not constitute a "claim" under the policy, and as a result the costs associated with the investigation were not covered by insurance.[72] Although the policy defined a number key terms, like "wrongful act" and "losses,"[73] it did not supply a definition of the term "claim."[74] The court examined the dictionary definition of the term ("a demand for something due or believed to be due"[75]) and concluded that the Justice Department's investigation sufficed because it "required Richardson and its officers and directors to comply with various demands for testimony and production of documents."[76] The court emphasized that a claim is a "demand for *something* due," but not necessarily money.[77]

1. A "Claim" is More than a Mere Threat or Document Request

The mere threat of litigation or legal action does not give rise to a "claim."[78] By its very nature, a "claims-made" policy provides coverage for "claims" *made* against the insured. The threat of legal action is merely a potential claim, since it has not met the condition that a claim actually have been made.[79] The distinction between a potential claim and "claim" giving rise to coverage was described in *Bensalem Township v. Western World Insurance Co.*, where the court held that "'notice that it is [someone's] intention to hold the insureds responsible for a Wrongful Act' is an event

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[71] *Id.* at 700.

[72] *Id.* The policy provided that Federal would pay "on behalf of each of the insured persons all loss for which [he] is not indemnified by the insured organization legally obligated to pay on account of any claim(s) made against him . . . for a wrongful act committed . . . before or during the policy period." *Id.* at 699 n.3.

[73] *Id.* at 699 n.3.

[74] *Id.* at 700-01.

[75] Richardson Elecs., Ltd., 120 F. Supp. 2d at 701 (quoting Cent. Ill. Pub. Serv. Co. v. Am. Empire Surplus Lines Ins. Co., 642 N.E.2d 723, 725 (Ill. App. Ct. 1994)).

[76] *Id.*

[77] *Id.*

[78] Winkler v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 930 F.2d 1364, 1366 (9th Cir. 1991).

[79] *Id. See also* MGIC Indem. Corp. v. Home State Savs. Ass'n, 797 F.2d 285, 288 (6th Cir. 1986).

commonly antecedent to and *different in kind from* a 'claim.'"[80] Thus, letters or actions that "indicate the likelihood, if not inevitability, of some future claim . . . do not constitute a 'claim made' . . . ."[81] It is also well settled that "requests for explanations, expressions of dissatisfaction or disappointment, mere complaining, or the lodging of grievance" do not constitute "claims."[82]

Similarly, courts have differentiated between a mere request for information and a more serious government or regulatory investigation.[83] In *Trice v. Employers Reinsurance Corp*. it was held that a request for information did not constitute a "demand for money or services" within the meaning of a claim, even though the request specifically alluded to the possibility of a lawsuit.[84] The court said that "'an actual claim is distinguished from an 'event' which could give rise to an actual claim in the future.'"[85] In *St. Paul Mercury Insurance Co. v. Foster* the court held that a letter from an attorney requesting information about the company did not constitute a "claim."[86] The court distinguished between the letter at hand and the Justice Department's demand for documents in Richardson.[87] "[T]he seriousness of [the Justice Department's] investigation was clearly material to the district court's determination [in Richards Electronics] . . . ."[88] While "a formal lawsuit is not required to present 'a demand for money or services,' the inquiry must present more than a mere request for information."[89] The court explained that such a broad construction of a claim would be "bad public policy" because it would produce "a flood of notices of 'claims' based on requests for information or efforts at

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[80] Bensalem Twp. v. W. World Ins. Co., 609 F. Supp. 1343, 1348 (E.D. Pa.1985) (quoting language from Article VI of the policy in question).

[81] *In re* Ambassador Group, Inc., Litig. 830 F. Supp. 147, 154 (E.D.N.Y. 1993).

[82] Monteleone & Conca, *supra* note 25, at 589.

[83] *See, e.g.*, Richardson Elecs., Ltd., v. Fed. Ins. Co., 120 F. Supp. 2d 698, 701 (N.D. Ill. 2000).

[84] Trice v. Emp'rs Reinsurance Corp., No. 97-1271, 1997 WL 449736, at *3 (7th Cir. 1997) (citing Nat'l Fire Ins. Co. v. Bartolazo, 27 F.3d 518, 519 (11th Cir. 1994)).

[85] *Id.* (quoting Emp'rs Ins. of Wausaw v. Bodi-Wachs Aviation Ins. Agency, Inc., 39 F.3d 138, 143 (7th Cir. 1994)).

[86] St. Paul Mercury Ins. Co. v. Foster, 268 F. Supp. 2d 1035, 1047 (C.D. Ill. 2003).

[87] *Id.*

[88] *Id.*

[89] *Id.* (citing Trice, 1997 WL 449736 at *3).

intimidation by attorneys that may never materialize into demands against any insurance policies."[90]

A survey of the case law shows that the determining factor as to whether a demand for information constitutes a claim is its seriousness. For example, the court in *National Stock Exchange v. Federal Ins. Co*. found that a request for an informal document regarding subprime activities did not constitute a "claim."[91] The distinction drawn between a demand and a request in cases like *National Stock Exchange* can spell trouble for policyholders who comply with an informal request in hopes of nipping the inquiry in the bud. If a "regulatory request and investigation is informal and a settlement is made in compromise to avoid a formal investigation, coverage may be precluded entirely."[92]

In contrast, the court in *Dan Nelson Automotive Group v. Universal Underwriting* held that a civil investigative demand by various states attorneys general gave rise to a claim under an E&O policy.[93] The court found that the demands, which requested that the plaintiff produce certain documents regarding its business practices, "functioned to command the Plaintiffs to produce documents and provide information relevant to the alleged violations of statutes, and therefore constitute a claim . . . within the meaning of the policy."[94]

In *Ace American Insurance Company v. Ascend One Corporation*, the U.S. District Court for the District of Maryland weighed the seriousness of state subpoenas and investigative demands and whether they constituted a "claim."[95] In this case, Amerix, the policyholder, was served by the Office of the Attorney General of Maryland with an "administrative subpoena" pursuant to the Maryland Consumer Protection Act.[96] Among other things, the subpoena sought documents relating to the company's structure, governance, relationship and interactions with consumers. A year later, the Texas Attorney General's Consumer Protection Division served Amerix with a "civil investigative demand."[97] In response, Amerix hired

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[90] *Id.*

[91] Nat'l Stock Exch. v. Fed. Ins. Co., No. 06 C 1603, 2007 WL 1030293, at *6 (N.D. Ill. 2007).

[92] HANNA, *supra* note 16, at 5.

[93] Dan Nelson Auto. Grp. v. Universal Underwriting, 2008 U.S. Dist. LEXIS 4987 (D.S.D. Jan. 15, 2008).

[94] *Id.* at *16-17.

[95] Ace Am. Ins. Co. v. Ascend One Corp., 570 F. Supp. 2d 789, 796 (D. Md. 2008).

[96] *Id.* at 791.

[97] *Id.* at 792.

attorneys, produced "tremendous quantities" of information and data for the state officials, and paid over $140,000 in fees and expenses.[98] Unsurprisingly, ACE denied the claim on the basis that neither the subpoena nor the demand contained a "claim for wrongful acts," as required under the policy.[99] The court determined otherwise. "Claim" was defined as "a *civil, administrative or regulatory investigation* against any Insured commenced by the filing of a notice of charges, investigative order or similar document."[100] The court evaluated the seriousness of the documents in order to determine whether or not they constituted an "investigation" under the definition, noting that both documents came from state attorneys general offices.[101] It found that both the "caption on the subpoena ('In re: Amerix') and the specific inquiries into Amerix's marketing and credit counseling activities" indicated that the policyholder was the target of an investigation and "not simply a source of information."[102] It concluded that:

> The extent and specificity of the Subpoena and Texas Demand indicate that the documents were issued to serve the function of an investigative order. This is further supported by the fact that the sole investigatory tool granted to the Maryland Attorney General's office under the Consumer Protection Act is subpoena power. Therefore, the Subpoena . . . and related Texas Demand are, or at the very least are equivalent to, the filing of an investigative order or similar document.[103]

Some courts have drawn a distinction between a subpoena issued to a custodian of records for the purposes of producing records, and a subpoena seeking more than just information. In *Center for Blood Research, Inc. v. Coregis Insurance Co*. the First Circuit of the U.S. Court of Appeals addressed whether a subpoena served by an Attorney General constituted a "claim," when there was no indication that the government

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[98] *Id.*
[99] *Id.*
[100] *Id.* at 793.
[101] Ace Am. Ins. Co., 570 F. Supp. 2d at 796.
[102] *Id.* at 797.
[103] *Id.* at 798.

was seeking anything more than information from the organization.[104] The policy definition of "claim" included "any judicial or administrative proceeding in which any insured(s) may be subjected to a binding adjudication of liability for damages or other relief."[105] The court reasoned that a subpoena for the production of records "could not possibly" subject the policyholder "to a binding adjudication of liability in the investigation before the assistant United States attorney."[106] Even if the investigation uncovered information leading to the commencement of civil or criminal proceedings, those proceedings would "have had to have been pursued in a different form."[107] The court chided the policyholder on not recognizing the "limitations of the investigation and of the scope of coverage under the insurance policy."[108] Notably, subpoenas or investigative demands from private counsel are not enough to establish the existence of an "investigation" for these purposes.[109]

2. A "Claim" is a Demand for Damages or Relief

Most professional liability policies require a claim for damages.[110] Some define a "claim" as a "written demand for money"[111] or a "written demand for monetary or non-monetary relief."[112] Others include within the definition of a "claim" a requirement that there be a "binding adjudication of liability for damages or relief."[113] The damages and relief requirements can prove problematic for policyholders who are under investigation and seeking insurance coverage. When D&O and E&O policies require a claim for "damages," a policyholder may have difficulty convincing the court that

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[104] Ctr. for Blood Research, Inc. v. Coregis Ins. Co., 305 F.3d 38, 42 (1st. Cir. 2002).

[105] *Id.*

[106] *Id.*

[107] *Id.* at 42-43.

[108] *Id.* at 42.

[109] St. Paul Mercury Ins. Co. v. Foster, 268 F. Supp. 2d 1035, 1048 (C.D. Ill. 2003) (holding that a demand for documents from a private attorney was not a 'claim').

[110] Selvin, *supra* note 42.

[111] Borden et al., *supra* note 55.

[112] *When Is a Claim Not a Claim? Insurance for Government and Regulatory Investigations*, *supra* note 39.

[113] Foster v. Summit Medical Systems, Inc., 610 N.W.2d 350, 354 (Minn. 2000); Ctr. for Blood Research v. Coregis Ins. Co., 305 F.3d 38, 40 (1st Cir. 2002).

a regulatory action seeking restitution or civil penalties is covered.[114] In such cases, claims seeking restitution, disgorgement, fines or civil penalties have been found to fall outside of the policy's coverage. In *Bank of the West v. Superior Court*, for example, the court held that sums of money paid as disgorgement were not "damages" within the meaning of the insurance policy.[115]

The concept of "relief" as it relates to the definition of a "claim" has been a focus of much litigation. In *Foster v. Summit Medical Systems, Inc*. the Minnesota Court of Appeals held that a SEC investigation was not a covered claim because it did not subject the directors and officers or company to a binding adjudication for relief, as required by the D&O policy.[116] The policy defined a "Securities Action Claim" as "any judicial or administrative proceeding initiated against any of the Directors and Officers or the Company based upon, arising out of, or in any way involving [securities laws and regulations] . . . in which they may be *subjected to a binding adjudication of liability for damages or other relief* . . . ."[117] The court held that a SEC subpoena did not fit within either the ordinary or legal meaning of the term "relief."[118]

In *Minuteman International, Inc. v. Great American Insurance Co*. the court advanced a much broader interpretation of "relief."[119] The facts of the case resemble most other claim disputes. The SEC issued an order directing a private investigation of Minuteman International Inc. (hereafter "Minuteman") and sent it a subpoena and a notice of investigation.[120] Minuteman spent nearly $1 million complying with document production, retaining counsel, and complying with a subsequent SEC cease-and-desist order.[121] The insurance carrier declined to reimburse Minuteman, claiming that the SEC investigation did not constitute a "claim" under the D&O policy because no relief was sought.[122] The insurer tried to draw a distinction between "seeking relief in the form of monetary damages,

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[114] Selvin, *supra* note 42 ("One of the most challenging issues from a policyholder's perspective is establishing that the FTC or other regulatory action seeks damages, as distinct from restitution or penalties.").

[115] Bank of the West v. Superior Court, 2 Cal. 4th 1254 (1992).

[116] *Foster*, 610 N.W.2d at 351.

[117] *Id.* at 354.

[118] *Id.*

[119] Minuteman Int'l. Inc. v. Great Am. Ins. Co., No. 3 C 6067, 2004 WL 603482 (N.D. Ill Mar. 22, 2004).

[120] *Id.* at *2.

[121] *Id.*

[122] *Id.* at *3.

injunctive-type sanctions, or criminal charges and performing the investigation that leads up to a request for that type of relief."[123] The court disagreed, finding that the relief sought by the subpoena was the production of documents or testimony.[124] "Consistent with *Richardson* and *Polychron*, the [SEC] Order and subsequent subpoenas served on plaintiff were demands for relief in that they were demands for something due. A demand for 'relief' is a broad enough term to include a demand for something due, including a demand to produce documents or appear to testify."[125]

Not every court has agreed with *Minuteman's* broad interpretation of the term "relief." In *Diamond Glass Companies, Inc. v. Twin City Fire Insurance Co*., the court rejected *Minuteman's* conclusion, choosing instead to rely on the ordinary and accepted meaning of the word.[126] Diamond Glass Co. (hereafter "Diamond") was issued a subpoena by a federal grand jury seeking the production of documents and testimony as part of a government investigation into the company's business practices.[127] When Diamond submitted the claim to its insurer, the insurer categorized the matter as a "notice of a potential claim."[128] The insurer asked Diamond to notify it when an actual claim was made against the company, and said any defense costs incurred prior to the matter rising to the level of an actual claim would not be covered.[129] Litigation ensued over whether the grand jury investigation and subpoena constituted a "claim" for the purposes of the D&O policy.

Diamond made three unsuccessful arguments for why insurance coverage should have attached.[130] First, it unsuccessfully argued that the

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[123] *Id.* at *5.

[124] *Id.* at *7.

[125] Minuteman Int'l. Inc., 2004 WL 603482 at *7.

[126] Diamond Glass Cos. v. Twin City Fire Ins. Co., No. 06-CV-13105(BSJ)(AJP), 2008 WL 4613170 (S.D.N.Y. Aug. 18, 2008).

[127] *Id.* at *1.

[128] *Id.* at *2.

[129] *Id.*

[130] *Id.* The policy definitions, in pertinent part, are as follows:

> "Entity Claim" means any:
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> (1) written demand for monetary damages or nonmonetary relief commenced by the receipt of such demand; [or]
>
> (2) civil proceeding commenced by the service of a complaint or similar pleading; or
>
> (3) criminal proceeding, or formal administrative or regulatory proceeding commenced by the return of an indictment, filing of a notice of charges, or similar document;

investigation was a criminal proceeding within the definition of an "Entity Claim."[131] The court rejected the argument on the grounds that the policy language expressly required "the return of an indictment, filing of a notice of charges or similar document."[132] In the absence of such proceedings, the investigation was not a criminal proceeding within the meaning of the policy. Next, Diamond made an argument that the grand jury subpoenas constituted "written demands for non-monetary relief" as described in the definition of an "Entity Claim."[133] The court rejected Minuteman's broad description of the word "relief" and held that the ordinary meaning of the word and the term's context in the policy make clear that investigative subpoenas and search warrants are not "demands for non-monetary relief."[134] Diamond's last argument for why the investigation constituted a "claim" involved the "target" language under the definition of an Insured Person Claim.[135] Diamond claimed that it became a "target" within the meaning of the policy when it was subpoenaed to testify before a grand jury and informed that it was a subject in the grand jury investigation.[136] The court held that coverage did not apply because Diamond never received "written notice" identifying it as a "target individual against whom formal charges may be commenced."[137] For the reasons stated above, the court determined that Diamond had failed to state a claim and was not entitled to coverage under the liability policy.[138]

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against an Insured Entity.

"Insured Person Claim" means any:

(1) written demand for monetary damages or nonmonetary relief commenced by the receipt of such demand;

against an Insured Person

"Insured Person Claim" also means a formal civil, criminal, administrative, or regulatory investigation commenced by the service upon or other receipt by an Insured Person of a written notice from an investigating authority specifically identifying such Insured Person as a target individual against whom formal charges maybe commenced.

[131] *Id.* at *3.
[132] Diamond Glass Cos., 2008 WL 4613170 at *3.
[133] *Id.* at *4.
[134] *Id.*
[135] *Id.* at *5.
[136] *Id.*
[137] *Id.*
[138] Diamond Glass Cos., 2008 WL 4613170 at *5.

Furthermore, the court in *Andy Warhol Foundation for Visual Arts, Inc. v. Federal Ins. Co.* held that a letter that requested additional information and informed the insured of a willingness to take "all reasonable and necessary steps . . . to effect a recovery in this matter" did not state a "claim" because it made no demand for relief.[139] In *MGIC Indem. Corp v. Home State Sav. Ass'n*, the court emphasized that the policy agreement is "speaking not of a claim that wrongdoing occurred, but a claim for some discrete amount of money owed to the claimant on account of the alleged wrongdoing."[140] The court said that claims "made in the newspapers that directors and officers . . . engaged in wrongful acts" would "obviously not be the kind of 'claims' that could make [an insurance company] liable under the insuring agreement."[141] Only claims that demand payment of "some amount of money" could trigger the insurer's obligation to cover the expenses.[142]

V. RECENT DEVELOPMENTS: THE SECOND AND ELEVENTH CIRCUITS ADDRESS D&O COVERAGE FOR REGULATORY INVESTIGATIONS

Last year proved to be an important one in solving the recurring question whether D&O coverage extends to expenses incurred in connection with informal government and regulatory investigations of the policyholder. In 2010 both the Second and Eleventh Circuits for the U.S. Court of Appeals reviewed appeals addressing the issue and came to different results, one finding coverage and the other not. The cases highlight just how fact sensitive the determination remains, since both opinions relied heavily on the specific circumstances and key policy definitions at issue.

A. MBIA, INC. V. FEDERAL INSURANCE CO.

In the widely publicized case *MBIA, Inc. v. Federal Ins. Co.*, the U.S. District Court for the Southern District of New York was confronted with whether a company's D&O policy covered defense costs incurred in

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[139] Andy Warhol Found. for Visual Arts, Inc. v. Fed. Ins. Co., 189 F.3d 208, 216 (2d Cir. 1999).

[140] MGIC Indem. Corp, v. Home State Sav. Ass'n., 797 F.2d 285, 288 (6th Cir. 1986).

[141] *Id.*

[142] *Id.*

connection with an SEC order of investigation and several subpoenas issued by the SEC and the New York Attorney General (NYAG).[143] In 2001, the SEC issued an Order Directing Private Investigation and began an inquiry into alleged accounting misstatements in the insurance industry.[144] In 2004, it issued subpoenas compelling MBIA to produce various documents concerning transactions involving "non-traditional products."[145] That same year, the NYAG joined the investigation and served MBIA with similar subpoenas.[146] When MBIA alerted its insurers and asked for their consent to retain counsel and respond to the agency's inquiries, the insurers denied that the subpoenas triggered coverage under the D&O policies. Concerned with the investigation's negative market impact, MBIA asked regulators to forgo the issuance of further subpoenas and volunteered to comply with additional informal requests for information.[147] MBIA subsequently filed suit against its insurers for breach of contract and sought a declaratory judgment of coverage.[148]

MBIA's D&O policy provided coverage for defense costs for "Securities Claims," defined as "a formal or informal administrative or regulatory proceeding or inquiry commenced by the filing of a notice of charges, formal or informal investigative order or similar document" that "in whole or in part, is based upon, arises from or is in consequence of the purchase or sale of, or over to purchase or sell any securities issued by [MBIA]."[149] The district court found coverage under the definition for both the SEC and NYAG investigations. The NYAG subpoena was held to have triggered coverage because "an ordinary businessperson would view a subpoena as a 'formal or informal investigative order' based on the common understanding of these words."[150] Also of importance in the

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[143] MBIA, Inc. v. Fed. Ins. Co., No. 08 civ. 4313 (RMB), 2009 WL 6635307, at *1 (S.D.N.Y. Dec. 30, 2009). MBIA held a $15 million primary D&O insurance policy with Federal Insurance Company (Federal) and a $15 million excess policy with ACE American Insurance Company (ACE) (collectively, the insurers). *Id.* at *2. The two policies were the same in all relevant respects, and are thus collectively referred to as the policy. *Id.* at *1.

[144] *Id.*

[145] *Id.*

[146] *Id.*

[147] *Id.* at *3.

[148] *Id.* at *1.

[149] MBIA, Inc. v. Fed. Ins. Co., 2009 WL 6635307 at *2.

[150] *Id.* at *6. The subpoena stated, "WE HEREBY COMMAND YOU . . . [to] deliver and turn over to the [NYAG] all documents and information requested . . .

court's decision was the inclusion of the term "similar document" in the definition of a "claim." The court held that even if the subpoena were not an "order" within the policy definition of a "Securities Claim," it is a "similar document" capable of commencing an investigation.[151] The court also held that legal costs incurred by a special litigation committee (SLC) were covered under the company's D&O policy.[152] In the midst of the SEC and state investigations into MBIA's investments, several shareholders filed derivative suits against the company.[153] As is common, MBIA formed an SLC comprised of members of its Board of Directors to investigate the allegations made in the derivative actions.[154] The insurer declined to reimburse MBIA for the costs associated with the internal SLC investigation (namely attorney fees) because the committee engaged in "independent decision-making" and consequently the attorney that was hired to assist it "could not have represented the company through its representation of the SLC."[155] The court disagreed, noting that the SLC "was vested with full and exclusive authority . . . to determine whether pursuit of the litigation was in the best interest of MBIA."[156] The court thus held that the internal investigation fell within the policy's definition of a "Securities Claim."

On appeal, the Second Circuit affirmed the district court's holdings with regard to the SEC order, NYAG subpoena, and the SLC. The insurers' argument that the NYAG subpoena was a "mere discovery device" and dissimilar to an investigative order fell flat.[157] Referencing *ACE Am. Ins. Co. v. Ascend One Corp.*, the court said a NYAG subpoena is "at the absolute minimum, a 'similar document' to those listed in the definition of a 'Securities Claim' because it is similar to other forms of investigative demands by regulators."[158] The Second Circuit also agreed with the district court's assessment that a businessperson would view the NYAG subpoena as a "formal or investigative order" based on the common understanding of the words.[159] With regards to the SLC matter, the Second Circuit broadened

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." *Id.* The court noted that MBIA's failure to comply with the order "may subject [it] to prosecution." *Id.*

[151] *Id.* at *6.

[152] *Id.* at *9.

[153] *Id.* at *4.

[154] *Id.*at *4, *9.

[155] MBIA, Inc. v. Fed. Ins. Co., 2009 WL 6635307 at *9.

[156] *Id.*

[157] MBIA Inc. v. Fed. Ins. Co., 652 F.3d 152, 160 (2d Cir. 2011).

[158] *Id.* at 159-60.

[159] *Id.* at 159.

the district court's holding and ruled that the SLC expenses fell within the policy's definition of "Defense Costs."[160] The court based its decision on the fact that MBIA directed and acted through the SLC when the SLC moved to dismiss the derivative suit, and thus constituted an "insured person" under the policy.[161]

B. OFFICE DEPOT, INC. V. NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURG, PA.

In *Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburg, Pa.*, the U.S. District Court for the Southern District of Florida held that costs incurred by Office Depot, Inc. in connection with an informal SEC investigation and an internal investigation and audit were not covered by the office supply company's D&O insurance policy.[162] Upon receipt of a letter informing it that the SEC was "conducting an inquiry" into the company to determine whether it had violated federal securities laws, Office Depot voluntarily produced various documents and made its employees and officers available for sworn testimony.[163] Because the informal SEC investigation never culminated in the filing of any judicial or administrative complaints against the company or its directors or officers, coverage for the investigation was denied.[164] Office Depot sued for over $23 million in reimbursement for legal fees and expenses incurred in connection with the informal SEC investigation, as well as an internal audit and investigation of the company's accounting practices initiated in response to a whistleblower complaint.[165] Applying Florida law, the district court granted the insurers' motions for summary judgment, holding that the SEC investigation was not a "Securities Claim" within the policy's definition.[166]

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[160] *Id.* at 162.

[161] *Id.* at 163-64.

[162] Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburg, Pa., 734 F. Supp. 2d 1304 (S.D. Fla. 2010).

[163] *Id.* at 1310.

[164] *Id.* at 1308.

[165] *Id.* at 1312.

[166] *Id.* at 1309. The policy definition of "Securities Claim" was as follows:

> "(y) "Securities Claim" means a Claim, *other than an administrative or regulatory proceeding against, or investigation of an Organization,* made against any insured:
>
> (1) alleging a violation of any federal, state, local or foreign regulation, rule or statute regulating securities . . .; or

Thereafter, the U.S. Court of Appeals for the Eleventh Circuit issued an unpublished *per curiam* opinion affirming the lower court's holding and denying coverage for Office Depot's defense costs.[167] The Eleventh Circuit rejected Office Depot's argument that "administrative or regulatory proceeding" was an undefined and ambiguous term and could thus reasonably include an investigation of the insured entity.[168] The court determined that the expenses incurred after the SEC's request for voluntary cooperation were "in furtherance of its pre-suit discovery" and "constituted an 'investigation' rather than an 'administrative or regulatory proceeding.'"[169] Since the policy's definition of a "Securities Claim" expressly excepted both "an administrative or regulatory proceeding against" and "an investigation of" Office Depot,[170] the court held that the costs were not covered.[171] The Eleventh Circuit also affirmed the district court's holding that the investigation did not fall within the definition of a "claim" under the insured party indemnification provision, since the letters sent by the SEC "only broadly request[ed] information to assist the SEC in determining whether Office Depot committed securities violations."[172] Unlike a Wells Notice, which all parties agreed triggered a claim under the

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(2) brought derivatively on the behalf of an Organization by a security holder of such Organization.

Notwithstanding the foregoing, the term "Securities Claim" shall include an administrative or regulatory proceeding against an Organization, but only if and only during the time such proceeding is also commenced and continuously maintained against an Insured Person." (Emphasis added by court).

[167] Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., No. 11-10814, 2011 WL 4840951, at *1 (11th Cir. Oct. 30, 2011).

[168] *Id.* at *3.

[169] *Id.*

[170] *Id.*

[171] *Id.* at *3.

[172] *Id.* at *4 (alteration in the original). The policy defined, in relevant part, a 'Claim' as: (2) a civil, criminal, administrative, regulatory or arbitration proceeding for monetary, non-monetary or injunctive relief which is commenced by: (i) service of a complaint or similar pleading; (ii) return of an indictment, information or similar document (in the case of a criminal proceeding); or (iii) receipt or filing of a notice of charges; or (3) a civil, criminal, administrative or regulatory investigation of an Insured Person: (i) once such Insured Person is identified in writing by such investigating authority as a person against whom a proceeding described in Definition (b)(2) may be commenced; or (ii) in the case of an investigation by the SEC or a similar state or foreign government authority, after the service of a subpoena upon such Insured Person. *Id.* at *3.

definition, the SEC letters at issue did "not allege that violations have occurred or identify specific individuals that could be charged in future proceedings." Since the correspondence did not fall within the policy's definition of a "claim," it did not trigger coverage.

VI. CONCLUSION

Although a number of jurisdictions have addressed the meaning of a "claim" in the context of a government or regulatory investigation, the coverage analysis remains incredibly fact sensitive. The outcomes of the cases have depended in large part on the factual circumstances, seriousness of the investigation, and specific language of the policy. Because the Second Circuit broadly interpreted "Securities Claim" to include informal regulatory and government investigations, policyholders will likely "cite MBIA for the proposition that a company does not forfeit its D&O coverage when it volunteers to cooperate with investigative agency requests."[173] When seeking reimbursement under D&O and E&O policies, policyholders will also look to the Second Circuit's holding that coverage extends to expenses incurred by a special litigation committee. On the other hand, insurers will undoubtedly rely on Office Depot when denying coverage for costs associated with informal SEC investigations. Since both the Second and Eleventh Circuit opinions are heavily rooted in the policy language and specific circumstances presented, it may be easy for future litigants to distinguish *MBIA* and *Office Depot* from other cases. Nonetheless, both decisions are important examples of situations where a court found or denied coverage for costs associated with regulatory and government investigations into corporate wrongdoing.

A number of practical implications for insurers and policyholders flow from this discussion. The case law illustrates the importance of seeking the most favorable definition of the term "claim" or "Securities Claim" possible. Given the high cost of responding to subpoenas and investigations and defending against subsequent legal proceedings,

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[173] Richard Bortnick & Micah J. M. Knapp, *Guest Post: 2nd Circ. Holds D&O Policies Cover Voluntary Compliance Expenses and Special Litigation Committee Costs*, THE D & O DIARY (July 29, 2011, 3:30 AM), http://www.dandodiary.com/2011/07/articles/d-o-insurance/guest-post-2nd-circ-holds-do-policies-cover-voluntary-compliance-expenses-and-special-litigation-committee-costs/. *But see Id.* Observers have noted that the MBIA analysis was "heavily influenced by the facts" and the "impact of the decision may be limited based on the particular policy language at issue and the facts of the case."

insurance carriers should structure their policy agreements carefully. Likewise, it is of the utmost importance that companies and financial institutions carefully examine their current D&O and E&O liability policies to determine what types of noncourt proceedings and investigations constitute a "claim."[174] The uncertainty over government and regulatory investigations falling within the definition of a "claim" has provoked insurers and policyholders alike to take another look at their policies. As a result, the insurance industry continues to evolve. Insurance companies are now introducing professional liability policies that specifically agree to cover the costs of certain internal investigations, most often investigations commenced at the bequest of shareholders, and costs incurred in anticipation of a formal regulatory investigation.[175]As regulatory investigations become more frequent, at least one carrier has introduced a separate insurance product to provide coverage for informal SEC investigations.[176] It will be interesting to watch as D&O and E&O policies continue to evolve in the coming years as the law on coverage for investigations develops.

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[174] Michael R. Sarner, *Coverage Under a D&O Policy for Costs Related to a Subpoena Issued by a Government Agency*, PROFESSIONAL LIABILITY UNDERWRITING SOCIETY, Sept. 2009 Issue XXII Vol. 9, 10 ("From a policyholder perspective, the importance of the definition of Claim under a D&O policy cannot be overstated.").

[175] Dickey & Goodman, *supra* note 59.

[176] Kevin LaCroix, *The Top Ten D&O Stories of 2011*, THE D&O DIARY (Jan.4, 2012, 3:33 AM), http://www.dandodiary.com/2012/01/articles/d-o-insurance/the-top-ten-do-stories-of-2011/.