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Do You Accept Insurance? A Practitioner's Guide to Coverage Issues in White Collar Cases

Consider a hypothetical in which a defense attorney receives an urgent telephone call from one of her firm's long-standing clients, a diagnostic imaging center with several locations in the tri-state area that just received a subpoena from the local U.S. Attorney's Office. The client knows nothing more than what the subpoena states: the government has initiated an investigation into allegations of healthcare fraud. The corporation has two weeks to produce all billing records for all patients at all locations for the past year. Having handled a number of similar matters, the defense attorney knows the drill. She will contact the prosecutor to get more time to respond and hopefully narrow the scope of the government's far-reaching request. Mindful of costs, she recalls that the law firm just received the balance of a large invoice from this client on another matter, and that was not an easy task. She recalls attending a CLE about a year ago, and one of the topics discussed was insurance coverage for corporations under investigation. She does not want to pick up the phone to call the government until she knows the firm will be paid.

A Potpourri of Policies

There are three main types of policies that could offer coverage in white collar cases: directors and officers (D&O) coverage, errors and omissions (E&O) insurance, and commercial general liability (CGL) policies. Corporations generally purchase D&O policies to cover potential defense costs and liabilities of individual directors and officers for alleged wrongful acts committed in their official capacity with the corporation. Businesses also purchase D&O coverage to insure the companies themselves against potential costs and liabilities that might arise from the acts of their officers and directors.[1] Criminal, civil, and administrative investigations and litigation can trigger coverage under D&O policies.

D&O coverage contains three "sides." Side A covers directors and officers when the company is unable to indemnify those individuals. Side B reimburses the company when it indemnifies its officers and directors. Finally, side C, known as "entity coverage," insures the company when it is named as a co-defendant with its individual officers and directors. Side C is generally limited to securities litigation.[2]

E&O policies are generally purchased by companies or firms to protect professionals, such as attorneys and accountants, from negligence claims made by clients.

Finally, CGL policies generally cover four types of potential losses: bodily injury and property damage liability, personal injury liability, medical payments, and ten-

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ants' legal liability (for those businesses that rent or lease their workspace).[3]

While a D&O policy might be the most logical place to find coverage for a criminal investigation or prosecution, E&O and CGL insurance policies may cover criminal subjects or targets as well. It is essential to review all of the client's policies. The company has likely paid premiums for policies for many years. If analyzed properly, these policies can save a client from potentially large, unbudgeted expenses.

The Artistry of Notice: Communicating With Carriers

The universe of insurance policies can be broken into two categories: claims-made policies and occurrence-based policies. D&O and E&O policies are nearly all claims-made policies. In other words, the insured purchases protection for any claims made within the coverage period. In occurrence-based policies, the insured purchases protection against losses for a particular period of time. It is of no moment when the claim is made, so long as the triggering event or loss occurred during the covered period.[4]

In the world of claims-made policies, insureds must satisfy two basic requirements within the period of coverage: (1) the loss must occur within the covered period, and (2) the insured must notify the insurer of the loss within the covered period. In other words, if a loss occurs prior to the effective date of the coverage and the insured waits to notify the insurer until coverage begins, the claim will be denied. Similarly, if a loss occurs within the covered period, but the insured fails to notify the insurer until after the expiration of the policy, the claim will be denied. Therefore, notice is paramount.

Notifying an insurance carrier of every potential loss can result in higher premiums. But failure to notify the carrier can lead to even more dire consequences for the financial viability of the company. In the instant hypothetical, the first decision is whether the subpoena received by the client represents a potential and substantial loss. Clearly, an investigation has begun into allegations of healthcare fraud. The subpoena does not state who the subjects or targets of the investigation are. The government might be investigating a physician who refers patients to the client for studies. In that case, assuming the client is simply a witness, the client's role will conclude once it has produced the requested documents. Conversely, the nature of the subpoena and the breadth of the records sought might suggest that the client is the subject or target of the government's investigation.

Before contacting the client's carriers, counsel could reach out to the government to discuss the subpoena. Depending upon the rapport the defense attorney has with the assigned prosecutor or agent, she might be able to learn more about the investigation. If the government is willing to share the client's status as a subject or target, the decision to notify the insurance carrier might be much easier. Despite these pejorative labels, counsel can adjust her strategy accordingly and take a more guarded approach in producing documents.

What if the government discloses nothing? The inherent uncertainty of criminal investigations makes the routine step of notification much more complex than in a civil case. To be safe, counsel should take the laboring oar in notifying the client's insurer of a potential loss. Counsel, however, should not label the alleged conduct of the client, thereby avoiding placing the client in an excluded category.

Each insurer also will undoubtedly ask whether the client has other coverage. Counsel should avoid labeling other potentially applicable policies when notifying an insurer of a claim. No two policies are exactly the same. Just because a client might have two policies in place does not necessarily mean that one will be secondary to the other. Coverage could be triggered under both policies, and multiple carriers could simultaneously be responsible for reimbursing the client for the first dollar spent in responding to the subpoena.

You're Covered … Sort Of

Insurance companies owe their insureds a prompt coverage determination. This is particularly important in litigation. When an insurer is not certain whether coverage is appropriate at the outset of litigation, the insurer generally has four options: (1) provide a defense and coverage under the policy; (2) deny coverage and a defense; (3) file a declaratory judgment action for a judicial determination of its obligations under the applicable policy; or (4) defend the insured under a reservation of rights.[5] It is important to remember that a duty to defend exists whenever an insured may be covered under a policy, which creates an obligation to pay defense expenses for all claims, *both covered and uncovered*.[6] However, if the insurer denies coverage and turns out to be wrong, "the insurer will be estopped from challenging the insured's handling of the underlying case, will be held liable for costs of defense and settlement/judgment up to policy limits, and may also be held liable for punitive damages for bad faith denial of claims."[7]

If coverage were a fighter jet, the insurer's reservation of rights would be the plane's ejector seat. If the insurer later discovers additional facts or a court makes certain adverse determinations, the insurer reserves the ability to "eject" the insured, denying coverage and recouping all funds advanced. While no two insurers use exactly the same language, all reservations of rights contain essentially the same elements. Specifically, the insurer conditionally provides defense coverage but reserves the right to later deny coverage outright, file a declaratory action, and/or seek reimbursement. The letter should put the insured on notice of the policy terms, conditions and exclusions which, based on the allegations made and the facts known to date by the insurer, could provide a basis for coverage denial. The practices of insurance carriers are governed by state statute. In West Virginia, for example, all forms used by insurers must be filed with, and approved by, the state's insurance commissioner.[8]

Courts interpret insurance policies using principles of state contract law.[9] When contract disputes arise, any ambiguous language in the contract is generally construed against the party that drafted it. In the insurance industry it is usually the insurer who drafted the language. Therefore, insurance policies should be construed liberally in favor of the insured and the insured's beneficiaries.[10] After all, the main purpose of the contracts is indemnification of the insured.

A common challenge facing counsel is obtaining coverage for defense of a criminal investigation that occurs prior to — and hopefully never results in — a criminal prosecution. In *Gold Tip v. Carolina Casualty Ins. Co.*,[11] the insured sought a declaratory judgment that its insurer was obligated to defend against a criminal investigation of the company's CEO for his role in the sale of the company to a newly formed entity. A complaining party alleged that the CEO engaged in communications fraud and filed a wrongful lien, both felonies in Utah.[12]

The court in *Gold Tip* had to decide whether the investigation by the Utah County Attorney's Office constituted a "claim" under the policy. The policy defined a claim as "a written demand for

monetary or nonmonetary relief including, but not limited to (1) a civil, criminal, administrative, arbitration proceeding, or (2) any proceeding brought or initiated by a federal, state or local government agency."[13] Further, the policy defined "costs of defense" as "reasonable and necessary fees, costs and expenses … resulting solely from the investigation, adjustment, defense, and appeal of a covered or potentially covered claim."[14]

Applying Utah law, the *Gold Tip* court found that a "written demand for nonmonetary relief" can encompass a letter that coerces conduct of the policyholder through the threat of using the legal process to compel that conduct.[15] The threat of a potential indictment coerced the company to participate in the investigation — the company reasonably believed that if it refused to comply with the government's request for production of documents or participation in a meeting, the government would be more likely to charge the CEO. At the end of the day, the company enjoyed the best of both worlds: the prosecutor decided not to charge the CEO, and the court ruled that the insurer was obligated to reimburse the company for all fees, costs, and expenses associated with the investigation.[16]

Fight for Coverage

What if the defense attorney is not so fortunate, and the client is not able to avoid criminal charges? In *XL Specialty Ins. Co. v. Level Global Investors, L.P., et al.*,[17] an insured sought a preliminary injunction requiring its insurer to resume advancing defense costs. In 2010, following the execution of a search warrant and service of a grand jury subpoena duces tecum, Level Global notified its insurer, XL Specialty, of a claim under its professional liability policy; XL began advancing defense costs subject to a reservation of rights.[18] In January 2012, Level Global's co-founder and others were indicted for securities fraud.[19] Simultaneously, the government moved to unseal a criminal Information and related guilty plea colloquy filed against a mid-level research analyst at Level Global nine months earlier.[20] On March 5, 2012, XL Specialty notified the insureds that it would no longer advance defense costs and filed a declaratory judgment action based upon the allocution of the midlevel analyst incriminating himself and other insureds.[21] By that time, XL Specialty had advanced approximately $7.3 million of the $10 million policy limit.[22]

The district court granted the insureds' motion for a preliminary injunction requiring XL Specialty to resume advancing defense costs. In so finding, the court observed that "[t]he potential injury to a criminal defendant or an investigative subject of losing counsel in midstream cannot be minimized."[23] "An insured's new counsel, starting from scratch in a highly complex matter, will not have, and may not be able to quickly acquire, predecessor counsel's familiarity with the evidence, legal principles, strategy, and witnesses."[24]

The court also took the insureds' finances into consideration in a variety of ways. First, the court noted, "[A] defendant without substantial assets to pay for counsel also has no assurance that the new counsel will have the talent and experience of the predecessor, with price now potentially a decisive factor in choosing counsel."[25] When weighing the balance of hardships in this case, the court found that Level Global stood to lose, among other things, the remainder of the policy limits and the proceeds of any potentially applicable excess coverage, while XL Specialty faced payment of the remaining $2.7 million of coverage under the policy.[26] The court agreed with Level Global's arguments that an additional $2.7 million was not going to "tank" XL Specialty as an insurer, but loss of counsel for Level Global and its executives could expose them to incarceration, potential civil actions by the SEC, and the financial viability of the company.[27]

Do-Si-Do: Negotiating With Multiple Carriers

The most significant costs associated with responding to criminal investigations and prosecutions are obviously legal fees. Insurers reduce their exposure by entering into agreements with attorneys hoping to receive a high number of referrals. These attorneys, often referred to as "panel counsel," work at reduced rates and agree not to bill for certain expenses. Defense counsel's hourly rate might be in the range of $300 to $350. While that rate might be very reasonable — especially compared to more experienced white collar practitioners and counsel in bigger cities — the client's D&O carrier pays panel counsel $215 for partners and $175 for associates. The E&O carrier is not much better at $250 for partners and $200 for associates.

Everything is negotiable, and advocacy is necessary when working with insurers. To avoid bad faith actions by insureds, insurance companies will make accommodations. If a defense attorney

communicates to the insurance company that her firm is familiar with this client and its operating procedures, she can make a compelling case that the carrier should pay for her firm to represent the client at her standard rate. In the long run, the insurer will save money, as the defense attorney will avoid a learning curve. If the insurer rejects this proposal, the client may still retain the defense attorney's firm, but it may have to fund the difference between panel counsel's rates and the defense attorney's rates.

Another opportunity for advocacy might arise if the client's D&O carrier and E&O carrier both approve coverage, but only as excess to other policies. The defense attorney (or the client's insurance broker) may suggest that the two carriers strike an agreement for the defense attorney's firm to represent the client with each insurer contributing half of the hourly rate and out-of-pocket expenses.

Tip of the Iceberg

In the hypothetical, while the government's subpoena was issued in connection with a criminal investigation into allegations of healthcare fraud, criminal prosecution could end up as the least of the client's financial woes. Related civil actions could be even more costly and a more important subject of insurance coverage.

In fiscal year 2012 the federal government recovered $4.9 billion from cases filed under the False Claims Act.[28] With such a massive return on enforcement resources, the government has been intervening in a record number of cases, with healthcare matters leading the way. It is not at all unusual — and is often a matter of office policy — for the U.S. Attorney to initiate a parallel criminal investigation for every False Claims Act case that is filed. Allegations under the Act[29] are grounded in fraud, which is often listed as an exclusion from coverage. However, when the government intervenes in a qui tam suit or files its own suit under the Act, it may add common law causes of action, such as unjust enrichment, which may be covered by one or more of the client's policies. Retaliation claims under the Act[30] might be covered by the client's insurers,[31] just as negligence actions or shareholder derivative suits might be.

Counsel must also be aware of potential exposure to state and local governments. Following in the financially successful footsteps of the federal government, 29 states and 11 municipalities across the country have enacted false claims acts. With language largely identical to the federal corollary, state and local governments use these statutes to recover unlawfully obtained Medicaid funds, grants, and more. Few have had more success than New York Attorney General Eric Schneiderman. The New York False Claims Act[32] was amended in 2010 to allow whistleblowers to file tax qui tam cases under the Act[33] — a provision specifically excluded under the federal Act.

If both civil and criminal actions arise against a client, it is possible that coverage might apply to one, but not both of the actions. It is critical to explore this issue with the client and *carefully record and bill* legal services to the respective matters to ensure maximum coverage.

Insurance Disputes in High-Profile Cases

Insurance disputes are not new and crop up frequently in high-profile cases. Coverage issues arose in the aftermath of the well-publicized phone hacking scandal of Rupert Murdoch's News Corp. In that investigation and prosecution, the company invoked D&O coverage under multiple policies totaling between $160

and $180 million.[34] As civil suits mounted, courts had not yet ruled on whether the conduct of the company's directors and officers implicated the policies' exclusions for criminal activity.[35]

Similarly, the recent sex abuse scandal involving former Penn State Defensive Coordinator Jerry Sandusky has spawned a series of insurance disputes. Penn State and its primary general liability insurer, Pennsylvania Manufacturer's Association Insurance Company (PMA), have filed suit against one another over legal expenses. PMA has asserted that it has no duty to defend; meanwhile, Penn State continues to incur fees and costs in defending the university, former University President Graham Spanier, former Athletic Director Tim Curley, and former Senior Vice President Gary Schultz.[36] Penn State has alleged that PMA "denied coverage or reserved its rights in response to certain claims and suits and has failed to issue any coverage determination in response to others."[37]

A second insurer involved in the Sandusky scandal sought a declaratory judgment that it has no obligation to provide coverage. Sandusky's charitable organization, the Second Mile, contracted with Federal Insurance Company to provide D&O and Employment Practices Liability (EPL) coverage. The court compared the allegations of sexual abuse by Sandusky to the four corners of the insurance policy and determined that Sandusky was not acting in his capacity as an employee or executive of the Second Mile when he abused and molested his victims.[38] Because the court determined that no coverage exists for the criminal and civil claims filed against Sandusky, the court did not determine whether coverage would be disallowed on public policy grounds.[39] Because Sandusky now stands convicted, he is collaterally estopped from denying the conduct underlying his criminal conviction.[40]

Lessons Learned

White collar criminal defense practice requires more civil expertise than most people realize. When defense attorneys are inevitably confronted by coverage issues in a white collar criminal matter, counsel should recall the essential components of (1) reviewing all policies and riders, (2) timely, yet cautiously, notifying the carriers of a potential loss, (3) considering the potential for related civil litigation, and (4) creatively negotiating an agreement for payment by the insurers. If defense attorneys find themselves analyzing coverage issues beyond their level of experience and knowledge, they should consult other competent attorneys who handle coverage issues on a more regular basis. The livelihood and liberty of clients could be at stake.

Notes

1. John E. Heintz & Stephen A. Weisbrod, *What Every White Collar Defense Attorney Should Know About Insurance*, The Champion, May 2006 at 18.

2. Peter R. Taffae, *The ABCs of D&O Insurance Clauses*, Property Casualty 360, Dec. 21, 2009, *available at* http://www.property-casualty360.com/2009/12/21/the-abss-of-do-insurance-clauses.

3. *Commercial General Liability (CGL): What Is It? What Does a CGL Policy Cover?*, Feb. 12, 2008, *available at* http://www.kanetix.ca/insurance-business-commercial-general-liability.

4. Heintz & Weisbrod, *supra* note 1.

5. *Armstrong Cleaners, Inc. v. Erie Ins. Exchange*, 364 F. Supp. 2d 797, 805 (S.D. Ind. 2005).

6. *Fed. Ins. Co. v. Tyco Intern., Ltd.*, No. 600507/03, 2004 WL 583829 (N.Y.Supp. Mar. 5, 2004).

7. *Armstrong Cleaners, Inc.*, 364 F. Supp. 2d at 805.

8. W. Va. Code § 33-6-8 (2013).

9. *See, e.g., Gold Tip, LLC v. Carolina Casualty Ins. Co.*, 2012 WL 3638538 at *3 (D. Utah Aug. 23, 2012); *Fed. Ins. Co. v. Sandusky*, 2013 WL 785269 at *4 (M.D. Pa. Mar. 1, 2013).

10. *Gold Tip*, 2012 WL 3638538 at *3; *Sandusky*, 2013 WL 785269 at **4.

11. 2012 WL 3638538 (D. Utah Aug. 23, 2012).

12. *Id.* at *2.

13. *Id.*

14. *Id.*

15. *Id.* at *4 (citing *Quaker State Minit-Lube, Inc. v. Fireman's Fed. Ins. Co.*, 868 F. Supp. 1278, 1309 (D. Utah 1994)).

16. *Id.* at *3, *8.

17. 874 F. Supp. 2d 263 (S.D.N.Y. 2012).

18. *Id.* at 266-67.

19. *Id.* at 267.

20. *Id.*

21. *Id.* at 268.

22. *Id.*

23. *Id.* at 273.

24. *Id.* at 273-74.

25. *Id.* at 274 (citing *United States v. Stein*, 435 F. Supp. 2d 330, 362, 371 (S.D.N.Y. 2006)).

26. *Id.* at 276.

27. *Id.*

28. Press Release, U.S. Department of Justice, Justice Department Recovers Nearly $5 Billion in False Claims Act Cases in Fiscal Year 2012 (Dec. 4, 2012), *available at* http://www.justice.gov/opa/pr/2012/December/12-ag-1439.html.

29. 31 U.S.C. § 3729, *et seq.*

30. 31 U.S.C. § 3730(h).

31. *See, e.g., Carolina Casualty Ins. Co. v. Omeros Corp., et al.*, 2013 WL 1561963 (W.D. Wash. Apr. 12, 2013).

32. N.Y. Fin. Law § 187, *et seq.*

33. *New York Says Yes to False Claims Act Qui Tam Tax Cases*, Corporate Crime Reporter, Dec. 3, 2012, *available at* http://www.corporatecrimereporter.com/news/200/krakowerquitamtax12032012/.

34. Judy Greenwald, *Bad News for D&O Insurers? Scandal-Plagued News Corp. Faces Lawsuits*, July 31, 2011, *available at* https://www.businessinsurance.com/article/20110731/NEWS07/307319983.

35. *Id.*

36. Chad Hemenway, *Penn State D&O Coverage May Pay for Employees' Attorney Fees*, Property Casualty 360, Mar. 23, 2012, *available at* http://www.propertycasualty360.com/2012/03/23/penn-state-do-coverage-may-pay-for-employees-attor; *see also Penn State Sues PMA Insurance Over Alleged Breach of Contract*, Insurance Journal, Mar. 6, 2013, *available at* http://www.insurancejournal.com/news/east/2013/03/06/283862.htm.

37. *Penn State Sues PMA Insurance Over Alleged Breach of Contract*, Insurance Journal, Mar. 6, 2013, *available at* http://www.insurancejournal.com/news/east/2013/03/06/283862.htm.

38. *Sandusky*, 2013 WL 785269 at *6.

39. *Id.* at *8.

40. *Id.*

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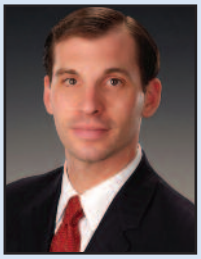

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