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Hiding in Plain Sight:

Obtaining Insurance Coverage in White Collar Criminal Investigations and Complex Civil Litigation

An attorney is outside counsel to a midsized, closely held corporation. The attorney reports to a group of officers and directors. The client was just served at corporate headquarters with a grand jury subpoena in connection with a yet unknown fraud investigation. Although the client has been reliable and solvent for many years, the president of the company confides in counsel that the company is currently experiencing cash flow issues and cannot afford representation by counsel's firm in this serious matter. Appropriately concerned that a new, less experienced attorney might not sufficiently protect the company's interests, the president looks to outside counsel for a solution. Cutting counsel's billable rate is not a viable option. Counsel thinks there might be another path: previously purchased and fully funded insurance policies.

Insurance proceeds allow many companies and executives to retain highly qualified counsel when they otherwise would not be in a financial position to do so. When a client calls a defense attorney upon

receiving that subpoena and says he is afraid he cannot afford the attorney's services, the attorney's reaction need not be a rush to a list of contacts to refer the case to a colleague. Instead, hopefully, counsel will be able to explore insurance coverage with the client and obtain funding for the client's defense.

An insurance policy's main purpose is to indemnify an organization against certain enumerated liabilities. Insurers provide coverage through various types of liability policies, and companies are buying the coverage and faithfully paying these premiums. But are companies using the coverage they purchased?

Companies that own liability policies may not realize that they can look to that source for coverage of defense costs, expert fees, and other related litigation costs. Given that investigations and enforcement proceedings for white collar cases continue to be pervasive, defense counsel need to be "well-versed in insurance contracts and prepared to negotiate language that works for their clients."¹

White Collar Investigations and Related Civil Litigation Are on the Rise

According to Federal Bureau of Investigation statistics, white collar crime costs the United States over \$300 billion per year in total economic impact with no end in sight.² This is further supported by various scholarly studies.³ Related — and often concurrent — civil litigation has been on the rise in recent years for myriad white collar offenses.⁴ The Securities and Exchange Commission, for its part, brought 754 enforcement actions in 2017.⁵ Just recently, the U.S. Attorney in the Eastern District of Pennsylvania

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launched a Civil Enforcement Strike Force.⁶ The “ACE” Strike Force, as it has been named, is comprised of five Assistant U.S. Attorneys who will be dedicated to investigating and filing lawsuits in the prosecution of fraud and abuse against government programs.⁷ While recent statistics have demonstrated that penalties imposed in white collar cases have decreased during the Trump administration,⁸ the total economic impact of white collar crime does not appear to have decreased.

For fiscal year-end 2017, the Department of Justice obtained more than \$3.7 billion in settlements and judgements from civil cases involving fraud and false claims against the government.⁹ Of this amount, \$2.5 billion was from the healthcare industry alone.¹⁰ Healthcare paid the most out of all industries: 67 percent of all money collected by the government. Defense contracting and the financial industry follow in second and third place for claim volume. The crackdown on individual liability is expected to continue to be a focal point, as the DOJ’s efforts to target fraud has focused not only on organizations, but also has concentrated on individual offenders.¹¹

Know the Client’s Insurance Policies

Regardless of the type of white collar investigation clients may be facing, the need for ensuring effective insurance protection is paramount. Whether clients are in the process of purchasing insurance coverage or have policies in place, counsel must be prepared to advise clients on how to maximize coverage for their investigative, pretrial, and trial defense costs. White collar investigations can lead to criminal, civil and administrative exposure, and restitution and civil penalties are not insignificant.¹²

While no specific insurance policy exists exclusive to “white collar” offenses per se, there are generally four types of insurance coverages to consider for indemnifying against white collar type exposure. The types of coverages available include the following: (1) Directors and Officers (“D&O”), (2) Errors and Omissions (“E&O”), (3) Employment Practices Liability (“EPL”), and (4) Commercial General Liability (“CGL”).

Management liability policies provide protection for individual directors, officers, other members of senior and midlevel management, and the business entity itself for claims involving mis-

management, breach of a particular duty, negligence, or certain regulatory enforcement actions. Injuries under these coverages are financial in nature. Generally, CGL policies indemnify against physical damage, i.e., bodily injury or property damage. However, broad definitions in any given policy could extend that coverage.

D&O coverage is most heavily implicated in white collar matters.¹³ The different layers or types of coverage are called “sides.” Sides to D&O coverage include the following: Side A coverage directly indemnifying individual directors and officers; Side B coverage is for the company’s indemnification of these directors and officers; Side C provides coverage to the entity for securities-type claims.¹⁴ Not all policies have all three sides; it is important to analyze what layers the client purchased or seeks to purchase.

D&O coverage can apply to criminal, civil, and/or regulatory actions facing an individual director or officer. This coverage provides for a “loss” incurred as a result of “claims” arising out of “wrongful acts” committed by a director or officer during the scope of the director or officer’s duties. Under this coverage, clients can secure help with advancement of attorneys’ fees or even a claim for settlement.¹⁵

Counsel should be prepared to advise clients regarding pre-purchase negotiation of potential insurance policies, as well as post-purchase navigation of existing insurance policies. The scenario counsel wants to avoid is the current one: the client just received a subpoena, and counsel is not familiar with any of the insurance policies owned and funded for years by the client.

Multiple Insurance Policies Can Be Triggered by a Single Multifaceted Government Investigation

Let’s change the hypothetical. Instead of a grand jury subpoena, assume the client called with a Civil Investigative Demand in hand. This calling card of an investigation under the False Claims Act can strike fear into the heart of its recipients. While tips from whistleblowers can lead to criminal investigations, civil claims under the Act can easily become “bet the company” litigation with civil monetary penalties, treble damages, exclusion, debarment, and much more. When analyzing a False Claims Act complaint, it is commonplace to find a claim for damages for alleged retaliation against the whistleblower — commonly referred to as an “h-

claim.”¹⁶ This claim is likely to fall under the definitions found in an EPL policy.

Likewise, a civil complaint under the False Claims Act can contain claims for tortious interference with a contractual relationship, defamation, retaliation, slander, unjust enrichment, and other causes of action under a variety of state laws. Regardless of whether the client owns multiple policies with a single insurer or multiple policies with multiple insurers, overlapping coverage for a single investigation is common and available for many clients.

Proactive Involvement of Counsel

Counsel should be involved in purchasing and negotiating insurance policies whenever and wherever possible. It can make a significant difference for a client. Policy applications require clients to declare whether there are pending claims against the client or if there are any circumstances that may “give rise” to a claim. If the client answers in the negative and such circumstances do exist and are known to the client, insurance carriers can deny payment of coverage by asserting that the client breached the policy contract for misrepresentation of a statement. Counsel can assist clients in avoiding a situation in which they inadvertently set themselves up for a breach of warranty statement by unintentionally representing that they were unaware of any wrongful act that might result in a claim. This issue arose in *Freedom Specialty Insurance v. Platinum Management*.¹⁷

In *Freedom Specialty*, the primary insurer advanced payment for the insured’s defense costs up to the \$5 million limit. However, the excess carriers insuring \$5 million per carrier alleged breach of warranty in the policy application.¹⁸ They claimed the insured breached the warranty statement and the Prior Pending Demand or Litigation exclusion barred Platinum Management from receiving a payout from the policy.¹⁹ Ultimately, the court found no breach of warranty in *Freedom Specialty*.

If an insured is made aware that it is the subject of a government investigation (in any form), it is prudent — and depending upon the insured’s policy, it may be required — to notify promptly and properly all the insured’s insurance carriers.

What Constitutes a ‘Claim’?

A claim against a D&O policy is generally a lawsuit, or an administrative or regulatory proceeding served

on a director or officer during a specified policy period. It is essential to review the policy language to determine what the threshold is for a claim. For white collar cases in particular, it is important to know if “governmental investigations occurring prior to filing of formal charges” is covered under the definition of a claim.²⁰ Counsel would be wise to try to incorporate “criminal proceedings” into the definition of a “claim” during the negotiation phase with the insurer.²¹ No client plans on being in the government’s crosshairs, but in the current enforcement environment and increasing

ity of the allegations. Substantive written updates should be provided to carriers as more information becomes available to ensure that the full scope of the claim is reviewed.

First Horizon National Corp. v. Houston Casualty Co., before the U.S. Court of Appeals for the Sixth Circuit, is illustrative of this point. DOJ officials, the U.S. Attorney’s Office, and state prosecutors informed the insured company at a meeting in May 2013 that the company was in violation of the False Claims Act. Officials “projected theoretical damages and penalties upward of \$1.19 billion.”²⁴

Companies that own liability policies may not realize that they can look to that source for coverage of white collar litigation-related costs. Overlapping coverage for a single investigation is available for many clients.

numbers of *qui tam* actions and their related proceedings, it is wise to plan for all possibilities.

What if a client receives a Wells Notice? Such notices are used routinely by the SEC to inform targets of the agency’s investigations that enforcement proceedings against a person or institution are likely.²² Recent industry trends show that insurance companies have been recognizing a Wells Notice in the “claim” capacity.²³ Insurance coverage can be triggered by administrative proceedings just as it would for civil litigation instituted by an agency such as the SEC.

Notify the Insurer of Each Claim in a Timely and Complete Manner

Clients must err on the side of caution and notify the insurer immediately of anything that could potentially be considered a claim. The simple process of notifying the insurance carrier is sometimes not so simple, and, is often mishandled by the insured or is done too late. Notifying the carrier of a claim starts by writing a letter to the insurance company with a plain statement of the claim. While a call to the client’s insurance agent or broker might technically be sufficient, having written proof of the filing of the claim is critical. This letter should explain the allegations against the client, but the letter should *not* include any discussion of strategy or the verac-

While the DOJ agreed not to file a civil action under the False Claims Act on or before March 3, 2014, “so as to allow for ongoing settlement discussions,” First Horizon did *not* at this point provide notice to its insurers. Instead, the company waited a full year and notified its insurers in May 2014.²⁵ The bank said that it construed the discussions with, and settlement offer from, DOJ as “preliminary.” All the insurers involved in the tower of coverage reserved the right to deny coverage and ultimately did so.²⁶

At the trial level, the district court denied all claims and counterclaims and the U.S. Court of Appeals for the Sixth Circuit affirmed, finding that a group of insurance companies did not have to pay \$75 million toward First Horizon’s \$212.5 million False Claims Act settlement because First Horizon “provided insufficient notice to the insurers of the circumstances that led to the deal.”²⁷ Moreover, First Horizon provided “notice of circumstances” (circumstances that could potentially become a claim), but the court found that they should have provided “notice of a Claim.”²⁸

Be Clear in Identifying ‘the Insured’

It is necessary to define who the insured is. An officer? A director? A CEO? Consider that “officers” as a class, is limited.²⁹ Only a select group fit this category. More modern stan-

dard D&O policy forms have now broadened this.³⁰ Defense counsel and the client should decide how far down the defined insured road they want to go. How big is the client? How many executives are in the C-Suite? Should counsel ask for comptrollers to be included? What about the head of Investor Relations?³¹ It depends what business the client is in.³² The industry in which the client operates could merit such an addition. Further, there needs to be a capacity evaluation: Was the target of the investigation acting within the scope of his or her professional capacity?

The Devil Is in the Policy Details

Insurers are looking to sell policies, and many terms can be negotiated. Traditional policy forms have excluded all fines and penalties. Increasingly however, insurance carriers have been more amenable to an exclusion to limit fines and penalties assessed for willful types of violations. Consider enabling coverage for “reckless” conduct.³³ Defense counsel should look at the description in the policy to see if the policy describes the conduct as deliberate fraud or willful violation. Consider negotiating an exclusion for “deliberate fraud.” Exclusions are typically “triggered if there is a final non-appealable adjudication in the underlying proceeding.”³⁴ Counsel wants to ensure this type of language for the client. The exclusion could otherwise be triggered by a mere allegation.³⁵

Another term to look for or negotiate is a carve-out for defense costs. This can help to ensure the client will receive the advancement of defense costs. If the client does not have a carve-out and the insurer’s exclusion is triggered, the insurer may try to recoup costs. Counsel can help assist the client to avoid the “recoupment risk.”³⁶

As defense costs can reduce the amount of coverage under the policy limits, counsel and the insured need to carefully examine the language to ensure coverage for both claims and legal expenses.³⁷ If the policy is a “defense-within-limits” type of policy, any defense costs paid out in the underlying litigation will reduce the policy limits.³⁸ In the application/negotiation process, it is recommended to inquire as to whether this will be the case. Outside-the-limit coverage means there are “separate limits for legal defense costs and court-awarded damages,” therefore, “the cost of defending your case does

not erode policy limits available to pay settlements resulting from a suit.³⁹

Clients and their brokers can negotiate into a policy a provision to protect clients who invoke their Fifth Amendment right.⁴⁰ The essence of the provision would be as follows: If an insured does invoke the Fifth Amendment right in a claim for which he or she is seeking coverage, the insurer agrees *not* to use it as a coverage defense.⁴¹ This is important because some courts have held that the invocation of the Fifth Amendment is a “breach of duty to cooperate with the insurer.”⁴² Therefore, in order to avoid such a ruling, and limits on coverage, it is recommended to negotiate a provision that expressly addresses the issue.⁴³ When assisting the client in choosing and negotiating coverage, these provisions can mean the difference between an informed client with optimal protection and an uninformed client left exposed.

Lastly, and most important to the client, defense counsel can negotiate the ability for the insured to select its own counsel. Many policies allow the insurer to select counsel of its choice to represent the insured. That will likely result in the insurer appointing a firm that handles many cases for the insurer and has negotiated lower rates based upon the volume of work performed for the insurer. White collar investigations are significantly more complex than premises liability or automobile negligence cases. The client should be able to use experienced counsel of choice to defend itself in complex investigations.

Sometimes You Must Play the Hand You Are Dealt

When the client has existing coverage, defense counsel can drive a review of certain provisions in the policy and discuss them with the client and insurer to help maximize coverage.

Dialogue with the insurer is critical, but how much information should the insured/defense counsel provide to the insurance company?⁴⁴ The attorney-client privilege does not extend to insurers. However, all public documents and correspondence from the government are generally fair game. Counsel must be sure not to run afoul of confidentiality agreements, seal provisions, protective orders, and/or Federal Rule of Criminal Procedure Rule 6(e).⁴⁵ It is essential to communicate with the insurance carrier early and to get the

insurance carrier claims examiner comfortable with the situation at the first hint of a claim.⁴⁶ It is important for counsel to establish a relationship with the claims examiner and identify the carriers’ expectations.⁴⁷ Counsel should ask how frequently the insurer wants reports about the claim.⁴⁸ The key is to avoid surprises.

For both defense and settlement of civil claims involving D&O coverage, defense counsel and clients should bring the insurance carrier into the matter early and not engage in settlement discussions with the plaintiff without the carrier consenting to — or at the very least being aware of — it.⁴⁹ Continued communication and avoiding surprises are advisable even in the worst-case scenarios. When an insured individual enters into a plea agreement, it does not constitute a “final judgment.”⁵⁰ The prosecution could utilize the plea agreement to compel testimony from others, which could take months or even years.⁵¹ Defense cost coverage should continue until sentencing. A final judgment exists only when the court accepts the plea agreement and imposes sentence.⁵² Many defense lawyers miss this scenario.⁵³

Insurers Usually Play It Safe

The client’s insurer will undoubtedly issue a reservation of rights letter to the insured when accepting a claim. This is not unusual. Counsel should review such letters with a critical eye to make certain the insurer has specified which defenses to coverage the insurance company contemplates invoking.⁵⁴ Moreover, an insurance company should be held to the possible defenses as delineated and “precluded from asserting any defense which it did not specifically set forth in its reservation of rights letter.”⁵⁵

Be Prepared

Planning ahead is always the best defense. In a perfect world, clients would hire counsel to negotiate their insurance policies during the application or renewal stages. Of course, this scenario is highly unlikely. But with a firm grasp of insurance terminology and common areas of negotiation in policy language, counsel becomes invaluable as a white collar practitioner. Counsel will be able to represent both corporate and individual defendants who would not otherwise be in a financial position to retain counsel.

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Contact the NACDL® Ethics Advisory Committee for insight and guidance on ethical issues in individual cases. All requests are handled in confidence. Ethics Hotline available for emergency situations. Written opinions may be available.

Notes

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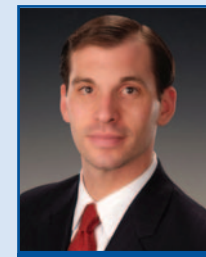
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