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Expert Analysis

Insurance Coverage for Government Investigations in a Post-‘MBIA’ World

The U.S. Court of Appeals for the Second Circuit’s recent opinion in *MBIA Inc. v. Federal Insurance Co.*, ___ F.3d ___, 2011 WL 2583080 (July 1, 2011), significantly impacts many key facets of D&O insurance coverage and claims under D&O policies. Namely, the *MBIA* court found that: subpoenas issued by the Securities and Exchange Commission (SEC) and the New York State Attorney General constituted “securities claims”; costs incurred by a special litigation committee formed to terminate derivative litigation are covered “defense costs”; and the insurers were liable for the cost of an independent consultant retained by MBIA as part of a settlement with regulators.

The *MBIA* court’s ruling that subpoenas are “claims” is arguably the most important, and is likely to have broad significance for policyholders across industry lines. The Second Circuit is, of course, not alone in finding coverage for these “claims” under standard D&O policies. Nonetheless, the decision is a boon to policyholders everywhere.

Subpoenas as ‘Claims’

When subpoenas or grand jury “target letters” are served on a company, they typically come with a side of anxiety and a sizeable portion of legal fees. Complying with regulators’ requests requires diligence and, frequently, teams of attorneys. Concurrent internal investigations are also often advisable or even necessary, which adds to the costs.

Whether insurance coverage is available for expenses incurred to comply with a subpoena (and related investigations) often depends on the



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facts and circumstances surrounding the particular subpoena. Much also turns on the language of the policy at issue.

The critical question is almost always whether the subpoena falls within the policy’s definition of “claim.” Some policies contain broad language that explicitly covers lawsuits, administrative proceedings, investigations, and subpoenas. Others define “claim” more narrowly, and include, for example, only demands for monetary and non-monetary

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relief, criminal proceedings, or actions commenced by the return of an indictment. Courts’ interpretations of these provisions vary. Courts have held “claim” to exclude grand jury subpoenas where the policy required more, such as “the return of an indictment.” Others have found that an investigation may not constitute a “request for non-monetary relief” within the definition of “claim.” And still others have found that governmental investigations initiated by subpoenas constituted a “claim” under similar definitions.

In *MBIA*, after receiving subpoenas from the Securities and Exchange Commission and the New York Attorney General, MBIA sought cover-

age under two D&O policies issued to it by separate insurers. Both policies defined “claim” 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.” Neither policy specifically mentioned subpoenas.

After issuing a formal order of inquiry into certain companies’ accounting practices and compliance with securities laws, the SEC began an investigation, and served a subpoena on MBIA seeking documents related to accounting practices. The attorney general issued a similar subpoena shortly thereafter. Before further subpoenas could be issued, MBIA agreed to cooperate with their investigations, to avoid adverse publicity. Even so, MBIA was obligated to pay for an independent consultant to review its transactions and report misconduct.

Seeking Coverage in Court

Meanwhile, MBIA’s insurers denied coverage under the policies for MBIA’s investigation costs. Although they had received notice of the subpoenas, the insurers accepted the subpoenas not as claims, but merely as “notices of circumstances that might lead to claims.” They also declined to participate in the settlement negotiations or any stage of the investigations, despite being notified of all developments. MBIA filed suit in the Southern District of New York, seeking to recover costs associated with investigations by the regulators as well as the independent consultant.

The District Court ruled that the D&O policies covered only the former. But on appeal, the Second Circuit ruled in favor of MBIA on both issues. The insurers argued that the subpoenas were simple discovery devices, not “claims.” The court, however, called this “a crabbed view of the nature of a subpoena.” It noted that “a subpoena is the primary investigative implement in the NYAG’s toolshed.”

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Citing policy language, the court held that the subpoenas were, at the least, “a similar document” to a “formal or informal investigative order” that commenced a regulatory proceeding. Moreover, the Second Circuit confirmed the District Court’s finding “that a businessperson ‘would view a subpoena as a “formal or informal investigative order” based on the common understanding of these words.’”

Equally significant, the court found that MBIA’s decision to cooperate with the investigations and voluntarily produce documents did not defeat coverage, despite the fact that these concessions prevented the issuance of further subpoenas. The insurers could not require MBIA to risk public relations damage in order to obtain coverage that “a reasonable person would think was triggered by the initial investigation.”

‘MBIA’ is Not Alone

MBIA is an important decision and is likely to have far-reaching consequences, in part because the court’s holding is not limited to insureds in the financial industry or to securities-related investigations or claims. Indeed, the language in *MBIA*’s policies referred to administrative or regulatory proceedings in general, not to securities investigations in particular. Further, the *MBIA* court’s strongly worded statements that subpoenas are an “investigative tool” rather than a mere discovery device, and acknowledgment that subpoenas may constitute the commencement of regulatory proceedings, breathe new life and leverage to arguments frequently advanced by policyholders seeking coverage for subpoena-related costs. Specifically: the perennial policyholder assertion that subpoenas are claims, and related costs compensable under D&O policies.

The Second Circuit is not the first court to find coverage for subpoenas and related costs. For example, in *Dan Nelson Automotive Group, Inc. v. Universal Underwriters Group*, No. 05-4044, 2008 WL 170084 (D.S.D. Jan. 15, 2008), the U.S. District Court of South Dakota found “claim” included costs arising from subpoenas and investigations, notwithstanding that the policy did not mention formal regulatory or criminal proceedings. There, the Iowa Attorney General, while pursuing an investigation into possible violations of Iowa’s Consumer Fraud Act and Consumer Credit Code by a car dealership and consumer lender, served documents titled Civil Investigative Demand and Notice of Intent to Proceed (CIDs) on Dan Nelson Automotive Group. The CIDs, which are one way in which the Iowa attorney general may carry on an investigation, made requests for information and documents. The Iowa Attorney General

followed its investigation with a petition alleging violation of the statutes.

The insurer for the dealership and the lender refused to defend both the CIDs and the petition under general liability policies, and the policyholders sued. As in *MBIA*, the court agreed with the policyholders that CIDs qualified as “claims” under their policy. But because the policies did not define “claim,” the court relied on *Polychron v. Crum & Forster Ins. Cos.*, 916 F.2d 461 (8th Cir. 1990), and found the term “sufficiently broad to encompass the CIDs as claims of an alleged violation” of Iowa law. There, the U.S. Court of Appeals Eighth Circuit had noted part of the Black’s Law Dictionary definition of “claim”—“demand as one’s own or as one’s right; to assert; to urge; to insist.” And, because the CIDs “functioned to command the Plaintiffs to produce documents and provide information,” the court found that they constituted claims.

A still broader reading of “claim” is found in *Minuteman International, Inc. v. Great American Insurance Co.*, No. 03-C-6067, 2004 WL 603482 (N.D. Ill. March 18, 2004), another case arising out of an SEC investigation. There, Minuteman expended more than \$450,000 complying with document production and depositions. The definition of “claim” in Minuteman’s D&O policy included “a written demand for monetary or non-monetary relief.” The court denied the insurer’s motion to dismiss, finding that this definition was not limited to lawsuits. The subpoenas had demanded “relief,” a broad enough term to include a demand for something due—in this case, document production or depositions. Moreover, had Minuteman or its employees failed to comply with the subpoenas, the SEC could have brought suit to achieve that “relief.”

Behind all this was the fact that the agency was not merely requesting information, but had the authority to enforce its demand. The agency’s investigatory proceedings were therefore “claims” within the policy definition. See also *Onvoy, Inc. v. Carolina Cas. Ins. Co.*, No. 06-165, 2006 U.S. Dist. LEXIS 47198, at *9-11 (D. Minn. July 11, 2006) (where “claim” was “a civil, criminal, administrative or arbitration proceeding for monetary or non-monetary relief which is commenced by...a service of a complaint or similar pleading, or...return of an indictment..., or...receipt or filing of a notice of charges, or...any proceeding brought or initiated by a federal, state or local government”; a grand jury subpoena relating to a criminal investigation triggered duty to defend); *Richardson Elecs., Ltd. v. Fed. Ins. Co.*, 120 F.Supp.2d 698, 701 (N.D. Ill. 2000) (the Antitrust Division of the Justice Department’s issuance of a Civil Investigative

Demand and subpoenas constitutes a “claim,” i.e., “a demand for something due”).

Conclusion

Government investigations and the subpoenas that frequently herald them are a reality of a regulated society. Industry tides may turn depending on current administrations and agency objectives, but the prospect of being called to respond to government demands for information or testimony—whether the context is civil or criminal—remains constant. Indeed, by way of example, in mid-August 2011, New York Attorney General Eric Schneiderman subpoenaed three major energy companies over claims they made about the potential yield of oil and gas wells.

The subpoenas, which were reported to be part of a broad investigation into whether the companies accurately described to investors the prospects for their natural gas wells, requested documents relating to the formulas that companies use to predict how much gas their wells are likely to produce in the coming decades. The subpoenas reportedly also requested documents related to a number of topics, and doubtless have caused the companies to incur fees and expenses to comply with the demands.

In issuing the subpoenas, Mr. Schneiderman’s office not only widened the debate over hydraulic fracturing (“fracking,” as it is known), but also demonstrated that no industry is beyond the reach of a governmental subpoena. With its decision in *MBIA*, the Second Circuit helped to advance policyholders’ efforts in their quest to cause insurers to respond and provide coverage for unexpected, and insurable, real-world circumstances.