

# Commentary

## Does A Subpoena Constitute A 'Claim' For Purposes Of D&O Insurance Coverage?

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The current financial crisis will produce claims against directors and officers, who will turn to their directors and officers (D&O) insurance policies for protection. D&O policies provide broad coverage, but also contain many gaps. D&O policies issued by different insurance companies all have the same basic framework, but differ in the exact wording of key terms, and also as to endorsements added to the policy by brokers or consultants. Often seemingly minor differences can be coverage-determinative.

Investigations into the financial crisis, whether by an attorney general, the Securities and Exchange Commission (SEC), or a grand jury, will commence with subpoenas. A body of case law already exists

on whether subpoenas constitute claims covered by a D&O policy. Most of the historical case law has found coverage for subpoenas, but those cases are fact intensive as to both the wording of the definition of 'claim' and the particular facts surrounding the subpoena. Three recent cases demonstrate how this inquiry remains fact specific.

### **Jemmco v. Executive Risk Indemnity**

In *Jemmco Partners v. Executive Risk Indemnity, Inc.*, [Docket No. L-486-07](#) (N.J. Superior Ct., filed March 22, 2007), Jemmco was insured under a D&O policy which provided coverage against 'claims.' 'Claims' was defined in pertinent part as: (a) "any civil proceeding in a court of law or equity including any mediation or alternative dispute resolution ordered or sponsored by such court"; (b) "any criminal proceeding in a court of law"; and (d) "any administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order, or similar document." See *Jemmco*, Transcript of Oral Argument on Motion to Dismiss at 36-37 (Oct. 12, 2007). See also Order For Motion to Dismiss Plaintiffs' Complaint dated Oct. 24, 2007. Subsection (c) of the policy definition was deemed not applicable by the court.

Jemmco, a hedge fund, received subpoenas seeking documents from the SEC, the Commodities Futures Trading Commission (CFTC), and a grand jury. The subpoenas involved market timing and late trading. The insurer argues that the subpoenas related to other parties and mutual funds, and not Jemmco, while Jemmco replied that it was a tar-

get of the investigation. When Jemmco sued for coverage, its insurer filed a motion in New Jersey Superior Court to dismiss with prejudice, asserting that the subpoenas were not 'claims' as defined in the policy. Jemmco took the position that the grand jury proceedings were criminal proceedings in a court of law, falling within subsection (b) of the definition of a claim.

Analyzing this dispute, the court first found that the grand jury proceeding was a criminal proceeding, and that the SEC and CFTC matters were administrative or regulatory proceedings. Next, the court addressed the subsection (d)'s requirement that regulatory proceedings be commenced by 'the filing of a notice of charges, formal investigative order or similar document.' The court found sufficient an affidavit from Jemmco's attorney stating that he had seen the formal investigative orders, which were not public, when he met with lawyers for the SEC and CFTC.

The court then noted that the policy's definition of 'claim' required that the claim be against an insured 'for a wrongful act,' and found that there were disputed issues of fact as to whether the subpoenas asserted such 'wrongful acts' by the insured. The court noted that a subpoena, unlike a complaint or an indictment, does not 'allege particular conduct or make accusations.' *Jemmco Transcript* at 37. The court stated that it was unwilling to find that a document such as a complaint or indictment was necessary for a subpoena to be a claim. It said that a subpoena with a target letter would be sufficient, and that other circumstances or notices may also qualify.

**Diamond Glass Companies v. Twin City Fire Insurance Company**

In *Diamond Glass Companies v. Twin City Fire Insurance Company*, No. 06-CV-13105 (S.D.N.Y. Aug. 18, 2008) (Decision on Motion to Dismiss), the insured received a grand jury subpoena to produce documents and testify. The D&O insurer denied coverage, and the insured brought suit. This D&O policy defined an entity claim in pertinent part as follows:

- (1) written demand for monetary damages or non-monetary 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

*Diamond Glass* at 5.

On November 17, 2005, a grand jury issued a subpoena to Diamond's custodian of records to testify and produce documents. The next day, the company's vice president for information technology received a similar subpoena. By time of the decision, at least twenty current and former Diamond employees had either testified before the grand jury or were interviewed by federal investigators. Also, the FBI conducted a search of Diamond's headquarters and seized business records.

The court quickly found that the grand jury was a 'proceeding' pursuant to subsection (3) of the definition of a claim in the policy. However, the court nonetheless denied coverage, finding that the grand jury subpoena was not 'commenced by the return of an indictment, filing of a notice of charges, or similar document.' *Diamond Glass* at 7-8. The *Jemmco* policy's definition of 'claim' also included the phrase 'formal investigative order,' which was absent from the *Diamond Glass* policy, although it is not clear that this would have made a difference on the facts of *Diamond Glass*.

The court also addressed the first prong in the definition of 'claim,' namely a 'demand for monetary or non-monetary relief.' Relying on a prior case and Black's Law Dictionary, the court equated 'relief' with 'redress or benefit.' See *Diamond Glass* at 8-9. It then found that the grand jury subpoena seeking documents and testimony did not seek such redress or benefit.

The insured also sought coverage under another provision in its policy which is found in some recent policies:

A formal civil, criminal, administrative or regulatory investigation commenced by the

service upon or 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 may be commenced.

*Diamond Glass* at 10.

While this is undoubtedly a useful provision in a D&O policy, the court found that it was not relevant to the grand jury subpoena in issue.

**Ace American Insurance Company v. Ascend One Corporation**

In *Ace American Insurance Company v. Ascend One Corporation*, No. 1:06-cv-03371-CCB (D. Md. Aug. 7, 2008) (Decision on Motion For Partial Summary Judgment), the court addressed the issue that *Jemmco* did not reach, namely whether or not the government asserts wrongful acts when it issues a subpoena? In *Jemmco*, the court noted that a subpoena does not list factual allegations. Thus, the first hurdle before the court is whether to permit extrinsic evidence. In both *Jemmco* and *Ace*, the court did so.

Pursuant to the state consumer protection law, the Maryland attorney general issued an administrative subpoena against the insured, Amerix. That subpoena sought a broad array of documents from Amerix, including its relation to any credit counseling service, its marketing or advertising communications with clients and creditors, comprehensive financial information, and information relating to consumer complaints. Amerix next received a Civil Investigative Demand issued by the Texas Attorney General's Consumer Protection Division pursuant to the Texas Deceptive Trade Practices and Consumer Protection. The Demand sought documents 'relevant to the subject matter of an investigation of possible violations' of the Act, including documents relating to marketing and selling of credit counseling services. *Ace* at 2.

The D&O policy at issue defined "claim" to include:

A civil, administrative or regulatory investigation against any Insured commenced by the

filing of a notice of charges, investigative order or similar document.

*Ace* at 5.

The court found that while mere discovery subpoenas were not claims, 'the case law suggests that Subpoenas and Investigative Demands may constitute Claims when they are issued by government investigative agencies related to an investigation of the insured.' *Ace* at 12. The court noted that the subpoena was captioned '*In re Amerix*' and that the Demand made specific inquiries into Amerix's activities. The court also looked at the deposition of the president of Amerix, at which an assistant attorney general stated on the record at the commencement of the deposition that the state was investigating Amerix for violations of the law. Based on these and similar facts, the court found that the subpoena and Demand were in fact 'claims.' *Ace* at 14.

There are two key lessons to be learned from these three cases. The first is that, at the underwriting stage, it is essential that the insurance broker or consultant be expert in D&O policies and negotiate with the insurer for the best possible definition of claim. All D&O insurance policies are not created equal. More expensive D&O policies frequently provide better coverage than less expensive ones. Optimally, the insurance broker or consultant should not simply present the insured with a policy, but a consideration of different policies, so that the insured can perform a cost/benefit analysis.

The second lesson is to give notice early and broadly. D&O policies provide a broad definition of 'claim.' This is both good and bad. The bad part is that while most insureds know to provide notice to the insurer of a complaint, they may not realize that other types of documents, such as a subpoena and even angry letters from shareholders, constitute claims. Failure to provide timely notice under a D&O policy voids coverage. Many insureds are hesitant about giving notice of potential claims, fearing that their insurer might raise their premium. However, the downside of delaying notice too long is no coverage. ■