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Five Questions to Ask to Maximize D&O Insurance Coverage of FCPA Claims

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Companies spend hundreds of millions of dollars annually to ensure compliance with the FCPA. But, regardless of robust policies and regular training, some employees may take shortcuts in seeking to obtain business abroad. To fully manage the risk of FCPA claims, companies should examine their liability insurance policies – specifically their directors and officers (D&O) policies as they are most likely to respond to FCPA claims – to protect themselves from this risk.

Businesses purchase D&O policies to cover claims made against their directors and officers and, in some instances, the company. However, not all policies are identical, and the protection provided can vary greatly depending on the applicable language. In assessing the possibility and breadth of coverage for FCPA claims, here are a few critical (though not exhaustive) questions a company should consider:

1) Will the Policy Cover Pre-Suit Investigation Costs?

The majority of expenses stemming from FCPA claims are incurred even before a formal lawsuit is filed and can even exceed the cost of a settlement. Indeed, several companies have reported spending more than $100 million in investigation costs alone.

Understand What Triggers Coverage

Most D&O insurance policies are written on a claims-made basis, meaning a "claim" must be made during the policy period in order to trigger coverage. The definition of "claim" varies from policy to policy but is critical because, depending on how it is defined, a business may be covered for the initial costs in responding to a government inquiry.

Undoubtedly, the definition of "claim" will include a civil complaint, but it may also include a written or oral demand for monetary damages or equitable relief, a subpoena, or a civil investigation demand and courts have taken differing approaches. For example, in Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.[1], a court in the Southern District of Florida found that an SEC inquiry did not constitute a claim based in part on how "claim" was defined, but in *MBIA Inc. v. Fed. Ins. Co.*[2], the Second Circuit found that a subpoena from the New York Attorney General related to possible securities fraud was a claim.

Insurance under a D&O policy also may be tied to the assertion of a "wrongful act." This requirement may limit coverage where, for example, the SEC or DOJ has issued a subpoena or request for information but no formal allegations of wrongdoing have been made.

For the broadest possible coverage, and to capture coverage for early defense expenses, policyholders should seek coverage for "claims" that do not require the allegation of a wrongful act. For example, a policy could expressly provide coverage for "any civil, criminal, administrative or regulatory investigation of an Insured Person commenced by his or her receipt of a target letter, Wells Notice or other written notice from an investigating authority identifying by name such Insured Person as an individual against whom a proceeding may be commenced[.]"

Assure the Policy Includes a Broad Definition of "Loss"

Businesses also should review the definition of "loss." "Loss" generally is defined to include settlements, judgments and defense costs, but there may be restrictions on coverage hidden in this definition.

For example, in *Office Depot*, the court held that the company's investigation costs in responding to both a whistleblower complaint and an SEC inquiry were not covered because the definition of "defense costs" was limited to costs "resulting *solely from*" a claim, and the allegations of a whistleblower indisputably did not constitute a claim.

To avoid these issues, policyholders should avoid limitations in the definition of "loss" and seek an expansive definition such as "defense costs and any damages, settlements, judgments (including pre- and post-judgment interest) or other amounts that an Insured Person is legally obligated to pay as a result of any Claim."

Special Endorsements for Investigation Costs

In the absence of these expanded definitions of "claim" and "loss," some insurance companies may offer special endorsements that provide insurance for costs and expenses incurred in responding to regulatory investigations that have not yet developed into a lawsuit. Insurance companies, however, may offer this coverage only with a sublimit, meaning that the full limits of the policy will not be available to pay the insured's costs. Where the company is investigating a regulatory inquiry, and no claim has been asserted, this may be the only option.

See this two-part series on how to conduct an anti-corruption investigation: "*Ten Factors to Consider at the Outset*" (Dec. 18, 2013); "*Developing and Implementing the Investigation Plan*" (Jan. 8, 2014).

2) What Exclusions Are in the Policy, and How Are They Worded?

In addition to their consideration of what is covered, businesses need to understand what is excluded under their policies and how pertinent exclusions are worded. For FCPA claims, the most significant exclusions may include a) dishonesty or fraud exclusions; b) regulatory and FCPA exclusions; and c) prior acts exclusions.

Dishonest or Fraudulent Act Exclusions

D&O policies commonly contain exclusions for claims alleging fraudulent or intentionally dishonest acts of the company's directors and officers. Given some of the conduct proscribed by the FCPA, some insurance companies may attempt to assert dishonest or fraudulent act exclusions to deny coverage for FCPA claims. Policyholders should seek to make the exclusion as narrow as possible. There are a number of steps policyholders can take to minimize the effect of such exclusions on coverage, such as a) limiting the application of the exclusion to instances where there has been a final adjudication in the underlying case; and b) including a severability clause so that the exclusion applies to only the wrongful actor.

Even with a broadly worded exclusion, insureds should not assume that there is no coverage for FCPA claims, because FCPA claims do not necessarily allege fraudulent or dishonest conduct. Under the FCPA books and records provisions, for example, a company can be held liable for FCPA violations even absent intentional misconduct. If a claim asserts both covered and uncovered allegations, the insurers will have a defense obligation for some or all of the lawsuit.

Regulatory Exclusions and FCPA Exclusions

As the names suggest, regulatory exclusions expressly bar coverage for claims by federal or state regulators, and FCPA exclusions expressly bar coverage for FCPA claims. Depending on the circumstances, these exclusions may clearly and unambiguously bar coverage for FCPA claims by the government. To preserve coverage for FCPA claims, these exclusions should be avoided. To the extent a policy contains such an exclusion, some jurisdictions will not recognize its validity unless it is properly filed with state regulatory authorities prior to issuance of the policy.

Prior Acts Exclusions

The vast majority of D&O policies contain prior acts or prior litigation exclusions that bar coverage for claims arising out of wrongful acts or "related" lawsuits that took place, or allegedly took place, prior to the policy period. The language of these exclusions again differs from policy to policy.

Where possible, insureds should seek a narrower and clearer exclusion so that there is little doubt about what is excluded. For example, some prior acts exclusions contain broad prefatory language, barring coverage for claims "based upon, arising out of or attributable to any demand, suit or other proceeding pending" against the insured prior to a specific date, "or any fact, circumstance or situation underlying or alleged therein." This type of exclusion lacks clarity but sometimes is the basis for insurers seeking to contest coverage.

3) Is There a Proper Protocol in Place for Notifying the Insurer?

Policyholders are required to provide notice of claims to their insurance companies and should comply with any specific requirements stated in the policy. Providing notice is not hard, but failure to comply with these requirements sometimes may result in the loss of coverage. The penalty for failure to provide timely notice varies from state to state. Under the law of some states, policyholders may be able to avoid the forfeiture of coverage from late notice by showing that the insurer had constructive notice of the claim or was not prejudiced by the late notice.

Guiding Questions for Creating a Notice Plan

To avoid these issues altogether, however, legal departments and risk managers should have a thorough plan in place to make sure that notice is properly provided. Companies should be asking themselves the following questions before a claim is made:

- What insurance policies and/or business contract may respond to a claim?
- What triggers the company's notice obligations under the applicable policies?
- What are the company's notice obligations in the event a claim is made (e.g., when must notice be given, where must notice be sent, etc.)?
- Who at the company is responsible for assessing coverage?
- Who at the company is responsible for providing notice?
- Are there any specific details required by the notice provision?

Brokers are often delegated these duties but, given the importance of notice, these issues should be checked to make sure a proper notice process is in place. Policyholders should consider working with experienced coverage counsel to develop a strategy to assure that they are getting the most out of their insurance assets.

Notice of Circumstances Provisions

There also may be instances where a business receives allegations of foreign bribery from a whistleblower before a formal claim has been asserted. To preserve coverage in these situations, policyholders should understand the significance of "notice of circumstances" provision in their policies, which allows insureds to provide notice of circumstances that may lead to a future claim. If the anticipated future claim or a related claim is later made, it then is treated as having been made during the earlier policy period.

Due to the various ramifications to coverage and variations in policy language, it is best to seek guidance from insurance brokers or coverage counsel before providing notice of circumstances. As an example, some policies require detailed information regarding the potential claim, including the identity of the potential claimants, the specific identity of the potential wrongful actors and the specifics regarding the wrongful acts potentially giving rise to a claim. Even if the required information is provided, the insurer still may seek to avoid coverage in the event of a claim by contending that the subsequent claim is not the claim that was described in the notice. The insurer also is likely to attempt to add exclusions in subsequent policies to bar coverage broadly for claims arising out of the wrongful acts described in the notice of circumstances.

That being said, providing notice of circumstances may sometimes be the best way to secure coverage for an expected claim.

4) Will the Policy Cover Damages Resulting From Any Judgment or Settlement?

Beyond investigation and defense costs associated with allegations of foreign bribery, companies are exposed to other losses for FCPA claims. For civil liability for violations of the FCPA's anti-bribery provisions, companies are subject to penalties of up to $16,000 per violation, equitable remedies and disgorgement of profits related to the violation. For criminal liability, companies face up to the greater of $2 million per violation or twice the benefit obtained from the violation. As part of settlements or deferred prosecution agreements, companies also frequently are required to retain independent monitors to oversee compliance with the FCPA at their significant expense. In addition, although there is no private cause of action under the FCPA, there can be collateral consequences of FCPA violations, such as shareholder derivative class actions.

Fines and Penalties

D&O insurance policies generally respond to loss to the company or the directors and officers. The loss definition sometimes does not include fines and penalties. To ensure that coverage will be available for FCPA claims, policyholders should seek to avoid these limitations. For the most favorable language, some insurance companies offer language to make clear that loss includes civil penalties assessed pursuant to the FCPA.

Disgorgement

In addition, insurance companies may contend that no coverage is available for disgorgement on public policy grounds that a wrongdoer should not profit from its own actions. The case law on this issue is mixed and fact-specific. In *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*,[3] the New York State Court of Appeals found that coverage was not barred where the disgorgement payment was "linked to gains that went to others." However, in *Level 3 Communications, Inc. v. Fed. Ins. Co.*,[4] the Seventh Circuit upheld a ruling that "loss" within the meaning of an insurance contract does not include the restoration of an ill-gotten gain. How the damages are characterized can be critical. Where a payment is not purely a return of money, but includes other amounts, policyholders will have stronger arguments that there should be coverage.

See "*A Close Look at the DOJ's New Declination-Plus-Disgorgement Settlement Approach*" (Oct. 12, 2016); and "*SEC Enforcement After Kokesh*" (Jun. 21, 2017).

Settlement Approval

Most FCPA claims are resolved by settlement before a trial takes place. Prior to entering into a settlement, businesses should consider carefully the implications on insurance. For example, most policies require the insured to obtain the insurer's consent prior to settlement. In some (but not all) states, these provisions may bar coverage for a settlement without the insurer's consent, so companies need to review the applicable law on the "consent to settle" provision before settling.

In some states, an insured must seek the insurer's consent even if the insurer has denied coverage. Additionally, if an FCPA claim alleges both covered and uncovered claims, the policy and the applicable law should be evaluated as to whether the settlement will be allocated between the insurer and the policyholder.

5) Would Special Insurance Products for FCPA Coverage Be Suitable?

In view of the heightened risk of FCPA claims and, correspondingly, the need for businesses to minimize that risk, several insurance companies have developed special insurance products to provide coverage for FCPA claims. These insurance policies vary from insurer to insurer, but they may provide coverage for corporate internal investigations arising from FCPA allegations and, in some instances, fines and penalties resulting from FCPA claims. While these supplemental policies or coverages may entail additional underwriting and a larger premium, a company should consider whether pursuing an add-on policy is in its business's best interest.

See "*FCPA Investigation Protection: D&O Insurance and Beyond*" (Aug. 8, 2012).

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[1] 734 F. Supp. 2d 1304, 1323 (S.D. Fla. 2010).
[2] 652 F.3d 152, 160 (2d Cir. 2011).
[3] 21 N.Y.3d 324, 337 (N.Y. 2013).
[4] 272 F.3d 908, 910 (7th Cir. 2001).