



## WHEN THE GOVERNMENT CALLS, PROTECT YOUR ASSETS

Professional liability policies can cover cost of corporate investigations

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Government investigations of corporations are complicated affairs. In the rush to respond to and comply with an investigation, it is easy to overlook a critical component: paying for it.

Once a government investigation commences, corporations are immediately thrust into an adverse relationship and must protect their interests as they would in a formal lawsuit. Costs, including defense counsel and employee hours lost in compliance with the investigation, can multiply exponentially and include both those costs to defend the company and to defend individual directors and officers.

Professional liability insurance, usually in the form of a Directors and Officers (D&O) policy, should be available to cover these critical expenses. Securing coverage is fraught with potential pitfalls, however, and policyholders must carefully review their policies to ensure there is coverage available.

### DON'T WAIT

Policyholders facing corporate investigations must be proactive in notifying their insurers. Most D&O policies are written on a "claims-made" basis, with coverage being triggered when the insured receives notice of a claim or becomes aware of circumstances likely to create a claim.

It's easy for a policyholder to expect a

more formal initiation of a "claim," such as a lawsuit, and then face a coverage denial because the policyholder failed to apprise its insurer of the initial investigation. Instead of focusing solely on compliance with the investigation, the policyholder now has the added burden of a coverage fight.

Whether defined in the policy or not, "claim" generally means "a demand for specific relief owed because of alleged wrongdoing," *Windham Solid Waste Management v. National Casualty Co.*, 146 F.3d 131, 134 (2d Cir. 1998), and notice must be given "as soon as practicable."

Importantly, according to *Windham*, a claim "can be some demand well short of a formal

enforcement proceeding." Likewise, "relief" is not a one-dimensional term and can require that a company

produce documents or appear for a deposition: "A demand for 'relief' is a broad enough term to include a demand for something due, including a demand to produce documents or appear to testify." *Minuteman*

*International Inc. v. Great American Ins. Co.*, No. 0366067, 2004 U.S. Dist. LEXIS 4660, at \*22 (E.D. Ill. March 22, 2004) (Securities

and Exchange Commission investigation constituted a "claim" under an errors and omissions policy).

Accordingly, government investigations, which typically demand that the investigated party comply with some directive to produce documents or witnesses, constitute a "claim" that requires the policyholder to notify its insurer. The policyholder must be careful, therefore, to involve its insurer immediately upon any indication, formal or otherwise, that an investigation may commence.

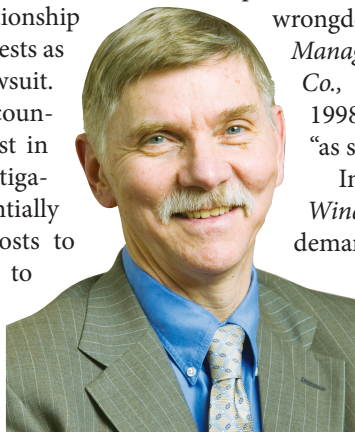
### GET A DEFENSE

Upon giving notice, the policyholder should demand that its insurer assume responsibility for all related costs. There

are several bases for this obligation. First, D&O policies cover all "loss" that an insured becomes legally obligated to pay on account of a "claim," which typically includes damages, judgments, settlements and defense costs.

Additionally, D&O policies provide the insurer with the right and duty to defend any "suit" alleging a claim against the insured. "Suit" is often undefined, but courts are apt to find a "suit" so

long as the claimant has "assume[d] a coercive adversarial posture and threatens the insured with probable and imminent finan-



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cial consequences.” *Hartog Rahal Partnership v. American Motorists Insurance Co.*, 359 F.Supp.2d 331, 332 (S.D.N.Y. 2005).

For example, in *Avondale Industries Inc. v. Travelers Indemnity Co.*, 887 F.2d 1200 (2d. Circuit 1989), the insured received a demand letter from the Department of En-

**POLICYHOLDERS FACING CORPORATE INVESTIGATIONS MUST BE PROACTIVE IN NOTIFYING INSURERS. MOST D&O POLICIES ARE WRITTEN ON A ‘CLAIMS-MADE’ BASIS, WITH COVERAGE TRIGGERED WHEN THE INSURED BECOMES AWARE OF CIRCUMSTANCES LIKELY TO CREATE A CLAIM.**

vironmental Quality commencing an administrative process to clean up environmental waste. The Second Circuit Court of Appeals had “little trouble” viewing the

administrative proceeding as a “suit” and held that the insurer was obligated to defend its insured. The court recognized that the demand letter commenced a formal proceeding against the insured, advised the insured that the agency had assumed an adversarial posture towards it, and that disregarding the demand could result in substantial loss to the insured. The court deemed these elements the “hallmarks of litigation.”

Government investigations, often initiated by subpoena, usually bear these same hallmarks because the government is able to utilize all of the tactics of traditional litigation to construct its entire case before filing a single pleading. “[A]n SEC subpoena is not a mere request for information, but a substantial demand for compliance by a federal agency with the ability to enforce its demand.” *Minute-man*, 2004 U.S. Dist. LEXIS 4660 at \*22.

Under these circumstances, policyholders must respond to the government and incur all related costs. Because the policyholder is forced to defend the government’s investigation, so too should its insurers.

**INVESTIGATION RESOLVED**

The policyholder’s coverage dispute may not end with securing defense of the investigation. Although D&O policies define “loss” to exclude penalties imposed by law, do not assume that such resolution is penal in nature simply because the government is involved.

For example, a violation of the Federal False Claims Act contains a treble damage component that courts have widely recognized as being compensatory in nature and, therefore, the exclusion should not apply. Precision is important here and it is imperative that the policyholder and counsel scrutinize the basis for any payments being made to accurately assess coverage.

A corporation targeted for government investigation already faces an uphill climb and an unnecessary coverage battle will only make compliance more difficult and costly. Policyholders and practitioners alike should be careful to analyze and involve all available insurance in order to have the best success at limiting exposure. ■