D&O Coverage for Costs Incurred in Response to SEC Inquiries

In response to the financial crisis and concerns about corporate governance, the SEC has dramatically increased its investigations of publicly-held companies in the last several years. More companies now find themselves responding to SEC inquiries. These SEC probes typically involve multiple phases with different consequences for insurance coverage. The SEC may begin an investigation through an informal "voluntary" process, which may require a company to produce extensive information, including financial records and other documentation. The SEC inquiry may proceed at an informal level for months or even years. The SEC may not issue a formal order of investigation, subpoenas, or Wells notices until a company has spent hundreds of thousands, if not millions, of dollars in its "voluntary" responses. Companies are often unpleasantly surprised to learn that their D&O coverage does not extend to the early (and often most expensive) period of an SEC probe. In a case recently decided by the Eleventh Circuit, *Office Depot Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, Case No. 11-10814 (11th Cir., October 13, 2011), $24 million in legal fees incurred by Office Depot Inc. in response to a SEC letter inquiry seeking the company's voluntary cooperation were not covered by the company's D&O policies. The court relied on the policies' definition of "Securities Claim," which excluded coverage for "investigations" and "proceedings" but restored coverage for "proceedings" (not investigations) through a carve-back provision. Because the court construed the SEC's requests as an investigation rather than a proceeding, Office Depot's expenses incurred after receipt of the SEC letters were excluded from coverage. The policies paid only for defense costs incurred after events "such as the issuance of subpoenas and Wells Notices"; those amounts were below the policies' retention, resulting in no insurance payout to Office Depot.

Although the court's opinion left Office Depot with no insurance coverage, the court's acknowledgement that the policy would insure costs incurred in responding to a subpoena could be helpful to other insureds. Earlier this year, another federal appeals court similarly concluded that a government subpoena triggered securities claim coverage. In *MBIA, Inc. v. Federal Insurance Co.*, No. 10-0355-cv (2d Cir. July 1, 2011), the Second Circuit held that the SEC's subpoenas and oral request for documents constituted "claims" that triggered coverage. MBIA's policies broadly defined "Securities Claim" to include "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." The court held that a subpoena could be construed as a "formal or informal investigative order," or, at a minimum, "a similar document," and thus constituted a covered "Securities Claim."

As these cases illustrate, D&O policies differ in their definition of a "Securities Claim" and "Claim" and their use of terms such as "proceedings" and "investigations". When purchasing coverage, insureds should seek insurance products with the broadest available language to increase the potential for coverage. D&O policies available on the market span a broad range, with some policies' definitions and coverage grants significantly broader than others. Companies also may want to consider stand-alone company investigation coverage, which is now available from one insurer, although the policy incorporates a significant self-insured retention, a large co-insurance component, and offers relatively low limits. After purchasing coverage, and when faced with a SEC probe of any kind, companies should scrutinize the language in their D&O policies, preserve any potentially available coverage through notice to their insurers, and, depending upon their policy language, be prepared for insurer resistance to coverage.

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