

D&O Coverage for Corporate Criminal Investigations

By Patricia A. Bronte

Surprisingly few reported decisions discuss whether criminal investigations of corporate wrongdoing are covered under directors' and officers' liability ("D&O") insurance policies. This is amazing because the past decade has been marked by waves of corporate scandals, and federal and state prosecutors and regulators will likely continue to launch broad investigations of corporate conduct in the decade to come. Meanwhile, the costs and risks of defending against these investigations are growing.

A criminal indictment can spell disaster, if not death, for a corporation. The most infamous example of this was Arthur Andersen LLP's indictment and conviction in 2002 for obstructing justice — a conviction that was overturned by the Supreme Court three years after the accounting giant collapsed. *Arthur Andersen LLP v. United States*, 544 U.S. 696, 708 (2005). Despite the perceived or actual pro-corporate bent of the Bush Administration, federal prosecutors have resorted to aggressive enforcement tactics, prompting corporations anxious to avoid Arthur Andersen's fate to engage in unprecedented cooperation with the government. For example, federal prosecutors have successfully pressured corporations to refuse indemnification to corporate officers, to refrain from entering into joint defense agreements with their employees or others under investigation, and to waive the benefits of the corporation's attorney-client privilege.

On Nov. 13, 2007, the House of Representatives passed the Attorney-Client Privilege Protection Act (H.R. 3013) which, if enacted, would prohibit these aggressive

tactics. Last year, federal judge Lewis A. Kaplan of the Southern District of New York dismissed an indictment against 13 former partners and employees of the accounting firm KPMG, LLP, because the prosecutors had induced KPMG to place onerous conditions on the indemnification of legal expenses for employees and eventually to stop indemnifying them altogether. *United States v. Stein*, 495 F. Supp. 2d 390, 393 (S.D.N.Y. 2007). On Aug. 28, 2008, the Second Circuit Court of Appeals affirmed Judge Kaplan's decision, noting that "KPMG faced ruin by indictment" and had no choice but to follow the prosecutors' dictates regarding treatment of the employees, which effectively made KPMG a government agent in depriving the employees of their Sixth Amendment right to counsel. No. 07-3042-cr, 2008 WL 3982104, at *16 (2d Cir. Aug. 28, 2008). On the very same day, the Department of Justice announced new guidelines that instruct prosecutors to avoid the most aggressive tactics when investigating and prosecuting corporate crime. Dept. of Justice, Principles of Federal Prosecution of Business Organizations (2008), available at www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf, on Aug. 30, 2008. The new guidelines appear to be an effort to dissuade the Senate from passing the Attorney-Client Privilege Protection Act.

Whether or not Congress or the courts succeed in curbing federal prosecutorial abuses, it seems likely that white-collar criminal investigations and prosecutions in the next decade will meet or exceed the levels of the past decade. For one thing, state attorneys general have been expanding the scope and number of their investigations in recent years, in a trend that is likely to continue. Thomas L. Sager and Bernard Nash, *The "New" Regulators: Why Corporate Compliance Strategies Must Address the Growing Influence of State Attorneys General*, ACC DOCKET, Sept. 2008, at 66, 67. And the stakes for corporations facing possible indictment will remain high.

Defending against allegations of corporate wrongdoing at the investigation stage is therefore crucial, but it can also be quite

expensive, for several reasons. First, corporations can act only through their directors, officers, and employees, so most corporate criminal investigations involve numerous individuals as well as the corporate entity. Generally some or all of those individuals are entitled to indemnification by the corporation, and many will need separate counsel, which multiplies the legal defense costs. The average pretrial defense cost for each KPMG employee was approximately \$1.7 million, and Judge Kaplan noted that defense costs through trial could exceed \$12 million per employee. *Stein*, 495 F. Supp. 2d at 424. Second, corporate criminal investigations typically drag on for years. For example, almost half of all SEC enforcement actions filed in 2007 followed an investigation period of more than two years. U.S. Securities and Exchange Commission, 2007 Performance and Accountability Report at 27, available at www.sec.gov/about/secpar2007.shtml, on Aug. 26, 2008. On Sept. 3, 2008, an ongoing five-year criminal investigation of bribes to Nigerian officials by Halliburton Company and others resulted in the first guilty plea; future indictments appear likely. Russell Gold, *Halliburton Ex-Official Pleads Guilty in Bribe Case*, WALL ST. J., Sept. 4, 2008, at A1.

In fact, the high cost of defending against accusations of corporate wrongdoing is one of the reasons that corporations purchase D&O insurance. See *Onvoy, Inc. v. Carolina Cas. Ins. Co.*, No. 06-165 (DSD/JJG), 2006 WL 1966757, at *6 (D. Minn. July 11, 2006). Covering the defense costs of directors and officers was the original purpose of D&O insurance, but most D&O policies now include "entity" coverage as well. Without indemnification by the corporation, competent directors and officers would be unwilling to serve. But see *United States v. Galante*, 2006 WL 3826701, at *2 (D. Conn. Nov. 28, 2006) (modifying *ex parte* restraining order to permit corporations to access their frozen funds to pay their own defense costs but not those of indemnified employees). And without insurance, corporations would risk potentially catastrophic legal expenses resulting from the indemnification obligation, combined of

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course with the costs of defending the corporation itself.

Whether a D&O policy covers the cost of defending against corporate criminal investigations depends, of course, on the language of the policy. Unlike comprehensive general liability (CGL) policies, D&O policies are manuscript policies. This does not mean every D&O policy is actually negotiated between the insurer and policyholder. Most D&O insurers have their own preferred wording, with some similarities among policies of certain insurers. Nevertheless, the truism that the terms of the policy must control its interpretation is especially apt in the D&O context.

Another distinction between D&O and CGL policies is that, under most D&O policies, the insurer's duty is not to defend the policyholder but, rather, to reimburse the policyholder for his defense costs. This may be a distinction without much difference as a practical matter. See *In re WorldCom, Inc. Sec. Litig.*, 354 F. Supp. 2d 455, 470 (S.D.N.Y. 2005). Many if not most D&O policies require the insurer to reimburse its policyholder contemporaneously, as defense costs are incurred, and to do so until the insurer can establish as a matter of law that there is no potential for coverage under the policy. See, e.g., *Id.* at 465; *Pepsico, Inc. v. Continental Cas. Co.*, 640 F. Supp. 656, 659-60 (S.D.N.Y. 1986). The insurer may be able later to recoup from the policyholder any reimbursed defense costs that are ultimately determined to have been outside the policy's coverage. *Federal Ins. Co. v. Kozlowski*, 792 N.Y.S.2d 397, 404 (N.Y. App. Div. 2005).

THE INSURING AGREEMENT

When determining whether a D&O policy covers criminal investigations, the first and most obvious place to look is the insuring agreement. Typically D&O insuring agreements promise to cover losses the insureds are legally obligated to pay on account of any "claim" for a "wrongful act." As a result, most of the cases addressing D&O coverage for criminal investigations have focused on the proper interpretation of the terms "claim" and "wrongful act."

A 'Claim' Undefined

Many D&O policies issued in the 1980s and 1990s did not define the term "claim," and most courts construing these policies held that a criminal investigation directed at the corporation or its employees qualified as a "claim." For example, in *Polychron v. Crum & Forster Insurance Cos.*, 916 F.2d 461 (8th Cir. 1990), the Eighth Circuit Court of Appeals, construing Arkansas law, held that a bank officer was entitled to reimbursement of his pre-indictment legal expenses in con-

nection with two grand jury investigations. The first grand jury subpoenaed documents from the bank, and a federal prosecutor from that district and two Internal Revenue Service agents questioned the bank president, Polychron. Two years later, after the D&O policy expired, a second grand jury from a neighboring jurisdiction indicted Polychron for the same offenses that the first grand jury had investigated. Eventually a jury acquitted Polychron of all charges. The insurer argued that no "claim" arose until Polychron was indicted. The court disagreed, holding that the first grand jury investigation was a "claim" against Polychron under the policy because the subpoena to the bank commanded the production of documents relating to Polychron's conduct. *Id.* at 463.

Similarly, the court in *Richardson Electronics, Ltd. v. Federal Insurance Co.*, 120 F. Supp. 2d 698 (N.D. Ill. 2000), held that an

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antitrust investigation by the Department of Justice ("DOJ") involving subpoenas for documents and testimony qualified as a "claim" under a 1989 executive risk policy that did not define the term "claim." Typical of policies at the time, the Federal policy insured Richardson for its indemnification of directors and officers and also covered the directors and officers for unindemnified losses, but did not provide entity coverage for defense of the company itself. Richardson's insurance broker notified Federal of the investigation, but said, "[a]t this time there is no claim being filed." Federal acknowledged "notice of a potential claim regarding possible antitrust violations." *Id.* at 700. DOJ did not indict any Richardson employees, but the company pleaded guilty to one count under the Sherman Antitrust Act and agreed to pay \$1.5 million in exchange for dismissal of all civil claims against Richardson and its employees. (In connection with its guilty plea, Richardson also paid a \$500,000 fine, for which Richardson did not seek insurance coverage.) Federal refused to cover Richardson's legal defense costs, contending that the antitrust investigation was not a demand for the payment of money and, therefore, not a "claim" under the policy. The court rejected this narrow

definition of "claim" as inconsistent with Illinois law, which defined "claim" as "a demand for something due." *Id.* at 701. The court interpreted the broker's notice of a "potential claim" as notice of the claim, but not yet a claim for reimbursement of defense costs. *Id.* at 702 n.4. Citing *Polychron*, the court held that the investigation was a claim "because it required Richardson and its officers and directors to comply with various demands for testimony and production of documents." *Id.* at 701. The court agreed with Federal that the policy did not cover the \$1.5 million civil settlement because only Richardson — and not its directors and officers — was obliged to pay it. "[T]he civil settlement forestalled any actual claim from arising against an insured person." *Id.* at 704.

Similar issues have occasionally arisen under non-D&O policies. In *Joseph P. Bornstein, Ltd. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, 828 F.2d 242 (4th Cir. 1987), for example, the court examined a professional liability policy covering the defense of "any proceeding or suit brought by any government regulatory agency seeking nonpecuniary relief" — terms left undefined in the policy. The DOJ, the Internal Revenue Service ("IRS"), and a grand jury investigated Bornstein for alleged tax violations, and the grand jury issued an indictment that was later dismissed. National Union argued that the grand jury investigation was not covered because its "purpose ... was to gather information, not to seek nonpecuniary relief." *Id.* at 244. National Union also argued that the post-indictment proceedings were not covered because they were initiated by the grand jury, not a "government regulatory agency." Bornstein countered that the grand jury's investigation and indictment both sought nonpecuniary relief — the imposition of criminal liability against him. Bornstein also argued that the DOJ and IRS are government regulatory agencies, and they initiated and directed the grand jury proceedings. *Id.* at 244-45. The district court granted National Union summary judgment, but the Fourth Circuit Court of Appeals reversed. The Court of Appeals held that both sides had presented "reasonable" interpretations of the policy, and under Virginia law, therefore, the court was obliged to construe the policy in favor of coverage for Bornstein. *Id.* at 245; see also *Bodell v. Walbrook Ins. Co.*, 119 F.3d 1411, 1415 (9th Cir. 1997) (holding that Postal Service investigation was brought by "governmental regulatory agency" despite federal prosecutor's role in convening grand jury investigation).

DEFINITIONS OF A 'CLAIM'

Most D&O policies now define the term "claim," and — except for policies limiting coverage to criminal proceedings in which the policyholder is subject to a binding adjudication of liability — courts generally hold that these definitions encompass corporate criminal investigations.

"Criminal Proceedings": Unlike the 1989 Federal executive risk policy construed in *Richardson*, Federal's executive risk policies as of 2003 defined a "claim" as a "written demand for monetary damages, a civil proceeding commenced by the service of a complaint or similar pleading, a criminal proceeding commenced by a return of an indictment, or a formal administrative or regulatory proceeding commenced by the filing of a notice of charges, formal investigative order or similar document." See *National Stock Exchange v. Federal Ins. Co.*, No. 06 C 1603, 2007 WL 1030293, at *1 (N.D. Ill. Mar. 30, 2007) ("NSX"). In *NSX*, the Securities and Exchange Commission ("SEC") Office of Compliance Inspections and Examinations sent NSX a letter and inspection report in October 2003 and informed NSX that the inspection report had been referred to the SEC's Division of Enforcement. A few days later, the Division of Enforcement requested that NSX produce documents. In February 2004, the SEC issued an "Order Directing Private Investigation and Designating Officers to Take Testimony." In May, the SEC sent "Wells Notices" informing NSX and three current and former officers that the SEC was recommending prosecution. *Id.* One year later, in May 2005, the SEC issued an order instituting administrative proceedings against NSX and one of its officers. *Id.* at *2. Federal argued that there was no "claim" until May 2005, when the SEC instituted the administrative proceedings, because the SEC does not view an investigation as an "administrative proceeding." The court agreed with NSX, however, and held that the policy clearly provided coverage from February 2004, when the SEC issued the investigative order. *Id.* at *3. In contrast, the SEC's letter, inspection report, and request for documents did not meet the policy's definition of "claim," because no process could issue and no testimony could be compelled before the investigative order of February 2004. *Id.* at 6.

Around the same time it issued the NSX policy, Federal included an identical definition of "claim" in a nonprofit organization liability policy. In *American Center for International Labor Solidarity v. Federal Insurance Co.*, 518 F. Supp. 2d 163 (D.D.C. 2007) ("ACILS"), the court relied on *NSX* in

holding that an employee's charge of discrimination, filed in August 2002 with the Equal Employment Opportunity Commission ("EEOC"), constituted a "claim" even though EEOC investigations are non-binding and somewhat informal. *Id.* at 172. In *ACILS*, it was Federal that contended that the EEOC proceedings qualified as a claim under the policy, in order to advance a late notice defense. ACILS did not notify Federal of the claim until the employee sued ACILS in federal court in December 2003, months after the EEOC dismissed the employee's discrimination charge. The court held that ACILS was not entitled to coverage for the federal lawsuit because it had failed to notify Federal of the earlier EEOC investigation, a "claim" under the policy. *Id.* at 173.

Other insurers adopted "claim" definitions similar to Federal's. Carolina Casualty Insurance Company, for example, issued a management liability policy in 2002 that defined a "claim" as:

1. a written demand for monetary or non-monetary relief, or
2. 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
 - B. return of an indictment (in the case of a criminal proceeding), or
 - C. receipt or filing of a notice of charges, or
3. any proceeding brought or initiated by a federal, state or local government agency.

Onvoy, Inc. v. Carolina Cas. Ins. Co., 2006 WL 1966757, at *1.

The United States Attorney's office issued a grand jury subpoena relating to an investigation of Onvoy. Onvoy forwarded a copy of the subpoena to Carolina, along with a letter stating that the subpoena "may give rise to a potential Claim sometime in the future." After the exchange of additional correspondence, Carolina accepted the "notice of a potential claim" and asked Onvoy to provide further notice in the event of "an actual claim." *Id.* The grand jury did not indict Onvoy, and Carolina refused to reimburse Onvoy for the legal expenses incurred in defending against the criminal investigation. The magistrate denied Carolina's motion to dismiss Onvoy's claim for breach of contract, finding that the grand jury subpoena and investigation qualified as a "proceeding brought or initiated by a federal ... government agency" under section 3 of the definition of a "claim." *Id.* at *7. Because it found a duty to defend under section 3, the magistrate found it "unnecessary"

to determine whether the subpoena also constituted a "written demand for ... non-monetary relief" under section 1. *Id.*, n.1.

The district court overruled Carolina's objections to the magistrate's ruling. *Id.* at *1-2. Carolina contended that the grand jury subpoena could not fall within section 3 of the "claim" definition because section 2 of the definition applied specifically to criminal proceedings and, therefore, a criminal proceeding could not constitute a "claim" unless it was commenced by a complaint, indictment, or notice of charges. To hold otherwise, Carolina contended, would render the requirements of section 2 "superfluous." *Id.* at 3. The court disagreed, because the grand jury proceeding satisfied the "plain language" of section 3. To the extent sections 2 and 3 conflicted, the court noted, the ambiguity should be construed against Carolina, the drafter of the policy. The court also rejected Carolina's argument that Onvoy's notice was inadequate because it referred to a "potential claim." *Id.*

"Written Demand for Non-Monetary Relief": Many D&O policies define "claim" to include, among other things, a written demand for monetary or non-monetary relief. Some insurers have argued that a grand jury subpoena should not be considered a "written demand for non-monetary relief" — either because other portions of the definition of a "claim" refer specifically to criminal proceedings (the argument rejected in *Onvoy*) or because the production of documents or testimony cannot qualify as legal "relief." Neither argument has met with much success. Both arguments were rejected in *Minuteman International, Inc. v. Great American Insurance Co.*, No. 03 C 6067, 2004 WL 603482 (N.D. Ill. Mar. 22, 2004).

The SEC issued a private investigation order and subpoenas for documents and testimony by various officers and employees of Minuteman. Minuteman notified its D&O insurer, Great American, and requested reimbursement of approximately \$500,000 spent on lawyers to defend the officers and employees at their depositions and to produce the company's documents. Great American denied that the SEC investigation was a "Claim" and moved to dismiss the complaint. *Id.* at *2. The Great American policy defined a "Claim" as "a written demand for monetary or non-monetary relief" or "a ... criminal ... proceeding ... seeking monetary or non-monetary relief and commenced by the service of a complaint or similar pleading, the return of an indictment, or the receipt or filing of notice of charges or similar document, including any proceeding initiated against any Insured be-

fore the [EEOC] or any similar governmental body.” *Id.* at *3. The policy separately defined a “Securities Claim” as “any Claim (including a civil lawsuit or criminal proceeding brought by the Securities and Exchange Commission) made against an Insured alleging a violation of any law, regulation or rule ... arising out of ... the (a) purchase or sale, or (b) offer or solicitation of an offer to purchase or sell, any securities of the Company[.]” *Id.*

The *Minuteman* court first held that “[a]s long as the SEC proceedings constitute a Claim, there is coverage regardless of whether the Claim also falls into the subcategory of being a Securities Claim.” *Id.* at *4. The court then addressed Great American’s argument that “an SEC investigation is not a proceeding in which relief is sought” because the investigation merely “leads up to” a proceeding seeking criminal charges or injunctive relief. Relying on *Richardson* and *Polychron*, the court held that the investigative order and subpoenas constituted “demands for relief in that they were demands for something due. 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.” *Id.* at *7. The investigation met the “written demand for ... relief” portion of the definition of a “Claim,” therefore, and nothing more was required to trigger coverage under the policy. *Id.*

Of course, not just any subpoena constitutes a “claim” under a D&O policy. If that were the case, then insurers would be obliged to pay the attorneys’ fees of every corporation required to respond to a third-party subpoena for documents or information in a civil case — a result far removed from the purposes of D&O liability insurance. For this reason, courts have drawn a sharp distinction between requests by civil litigants for information from a third party and subpoenas from governmental entities investigating the recipient’s possible violation of the law. See *St. Paul Mercury Ins. Co. v. Foster*, 268 F. Supp. 2d 1035, 1047 (C.D. Ill. 2003).

“Binding Adjudication of Liability”: There is one category of D&O policies that has been held not to cover criminal investigations: policies that qualify the definition of a “claim” by requiring that the insured be “subject to a binding adjudication of liability for damages or other relief.” For example, the D&O policy in *Foster v. Summit Medical Systems, Inc.*, 610 N.W.2d 350 (Minn. Ct. App. 2000), defined a “Securities Action Claim” as a “judicial or administrative proceeding initiated against any of the

Directors and Officers or the Company ... in which they may be subjected to a binding adjudication of liability for damages or other relief[.]” *Id.* at 354 (emphasis in original). The parties agreed that the SEC investigation against Summit Medical constituted an administrative proceeding, but, as the court held, the investigation — which included a subpoena *duces tecum* — was not one in which Summit was subject to a binding adjudication for relief. *Id.*

The First Circuit Court of Appeals reached a similar result in construing a nonprofit organization liability policy that defined a “claim” as a “demand ... for monetary damages” or a “judicial or administrative proceeding in which any INSURED(S) may be subjected to a binding adjudication of liability for damages or other relief.” *Center for Blood Research, Inc. v. Coregis Ins. Co.*, 305 F.3d 38, 40 (1st Cir. 2002). The United States Attorney issued a subpoena *duces tecum* to the custodian of records of the Center for Blood Research, which incurred \$77,000 in responding to the subpoena. Noting “[t]here was no suggestion in the subpoena that the government was seeking anything other than information from the Center,” the court concluded that the Center was “nothing more than a custodian of records.” *Id.* at 42. Because “there could not have been a binding adjudication in the investigation,” the court held, the policy did not cover the Center’s costs in responding to the subpoena. *Id.* at 43.

Later cases have made clear that the *Summit Medical* and *Blood Research* decisions rest substantially on those policies’ definition of a “claim,” which limited coverage to proceedings that could subject the policyholder to “a binding adjudication of liability for damages or other relief.” See, e.g., *Minuteman*, 2004 WL 603482 at *5-6. And, as one court recently noted, the holding in *Blood Research* does not apply to government subpoenas that make “specific inquiries” into the corporation’s operations — as opposed to subpoenas directed at a records custodian. *ACE American Ins. Co. v. Ascend One Corp.*, No. CCB-06-3371, 2008 WL 3275644, at *6-7 (D. Md. Aug. 7, 2008).

In addition to the definition of a “claim,” policy language involving “adjudications” can also be found in certain exclusions in D&O policies for fraudulent or criminal conduct by the insured. Many such exclusions provide that they will not be operative “unless a judgment or other final adjudication” establishes the insured’s intentional acts. E.g., *Pepsico*, 640 F. Supp. at 659. Absent specific policy language to the contrary,

courts generally construe these exclusions to mean that the insurer must pay the costs of defense until there has been a judgment or final adjudication of the insured’s deliberate wrongdoing. Unlike the “claim” definitions in *Summit Medical* and *Blood Research*, therefore, the “adjudication” language in these exclusions increases the insurer’s obligation to fund defense costs.

Moreover, to the extent that the insuring agreement leaves open the possibility of coverage for criminal investigations, the existence of an exclusion for criminal conduct established through a judgment or final adjudication suggests that costs incurred in defending against an investigation should be covered. Otherwise, the “judgment or adjudication” limitation to the exclusion would be superfluous. If the policy did not cover criminal investigations or proceedings at all, then the exclusion would be a blanket one and would not need to be limited to cases in which the insured was found guilty of the crime. “An exception to an exclusion does not create coverage not otherwise available under the coverage clause.” *Greer v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.* 211 F.3d 1273, 2000 WL 234488, at *2 (9th Cir. 2000) (unpublished opinion). But an insurance policy must be construed as a whole, and if the insuring agreement is ambiguous, the court should review the entire policy, including its exclusions, in arriving at the proper interpretation.

‘WRONGFUL ACT’

As noted above, D&O insuring agreements typically cover losses the insureds are legally obligated to pay on account of any claim for a “wrongful act.” At first blush, one might assume that the “wrongful act” requirement would be easier to meet in criminal matters rather than civil litigation. But the distinctions between criminal and civil procedures introduce a few wrinkles into the analysis.

Civil litigation commences with the filing of the plaintiff’s allegations in a formal complaint, FED. R. CIV. P. 3, *i.e.*, allegations of a wrongful act. Generally, a plaintiff cannot conduct formal discovery in order to learn whether a cause of action exists. *Caliper Techs. Corp. v. Molecular Devices Corp.*, 213 F.R.D. 555, 558 (N.D. Cal. 2003). All — or at least virtually all — of the costs of defending a civil action are incurred after one has been formally accused of a wrongful act.

Not so with criminal proceedings. Prosecutors (through grand juries or otherwise) have broad powers to investigate potential

criminal wrongdoing *before* a complaint or indictment is ever filed. A corporation's best hope for a favorable outcome — and sometimes the only way to avoid disaster — is to persuade the prosecutor not to file any formal criminal charges at all. That usually means the corporation must pay significant pre-indictment defense costs to respond to government demands for documents, information, witness interviews, and/or depositions. These demands often lack an explicit allegation that the corporation violated the law.

In cases where the definition of "claim" in the D&O policy does not require the filing of a complaint or indictment to trigger coverage for a criminal proceeding, some insurers have attempted to avoid coverage on the theory that without a formal accusation or admission of wrongdoing, there can be no "wrongful act." But D&O policies do not require the policyholder to fall on his sword and admit to wrongdoing before qualifying for insurance coverage. See *Uniroyal v. Home Ins. Co.*, 707 F. Supp. 1368, 1378 (E.D.N.Y. 1988). Most policies define a "wrongful act" to include "actual or alleged" misconduct. See *Polychron*, 916 F.2d at 462 n.3 (emphasis added). Thus, an SEC investigative order alleging that the policyholder "may have" violated federal securities laws suffices as an allegation of a "wrongful act." NSX, 2007 WL 1030293, at *5 (emphasis in original).

Many corporations first learn they are the subject of a criminal investigation not by receiving an indictment or investigative order, but instead by receiving a subpoena demanding the production of documents. Subpoenas generally do not "allege" anything; they simply demand information. Most courts examine all the circumstances to determine whether a subpoena is part of a criminal investigation of the corporation or its officers and directors. If it is, most courts have deemed this investigation a sufficient allegation of a "wrongful act." For example, a federal district court recently considered the caption of an administrative subpoena ("In re: Amerix Corporation") and the fact that it was issued by the Consumer Protection Division of the state attorney general's office and concluded that the corporation "is indeed the focus of an inquiry for violation of the Maryland Consumer Protection Act." *Ascend One*, 2008 WL 3275644 at *7-8. The court held, therefore, that an investigation into possible violations of consumer laws constituted an alleged "wrongful act" within the meaning of an errors and omissions policy. *Id.* Similarly, the Eighth Circuit Court of Appeals held that a grand jury subpoena

and the "questioning by the Assistant United States Attorney amounted, as a practical matter, to an allegation of wrongdoing" against the bank's president. *Polychron*, 916 F.2d at 463.

If the corporation receives a subpoena solely in its capacity as a custodian of records, however, the subpoena alone may be insufficient to establish an alleged "wrongful act." In *Blood Research*, the district court held that a records custodian subpoena "was not predicated on any 'wrongful act'" by the policyholder and, therefore, did not trigger coverage under a nonprofit organization liability policy. 2001 WL 34088617 at *3 (D. Mass. Nov. 14, 2001). The district court also held that coverage was barred because the policy limited the definition of a "claim" to proceedings in which the policyholder was subject to a "binding adjudication of liability for damages or other relief." *Id.* The First Circuit Court of Appeals affirmed the second holding but did not mention the first, except to note the lack of any indication that the government was investigating the Center for Blood Research. 305 F.3d at 42-43. *Blood Research* did not address the coverage implications of multiple subpoenas or other indicia that the policyholder might be the subject of a government investigation, but the tenor of the district court and appellate decisions suggests that these indicia would have affected the outcome of the case.

Occasionally a corporation learns that it is being investigated when it is served with a search warrant instead of a subpoena. The "wrongful act" analysis in these cases is much more straightforward. The Fourth Amendment requires that a search warrant be supported by probable cause. *Illinois v. Gates*, 462 U.S. 213, 238 (1983). Before issuing a search warrant, a judge or magistrate must find "a fair probability that contraband or evidence of a crime will be found in a particular place." *Id.* Although the evidence underlying a finding of probable cause customarily is sealed and therefore unavailable to the policyholder or its insurer, the issuance of the search warrant should constitute ample evidence of an alleged "wrongful act."

CONCLUSION

Sparse as the case law is, it nevertheless highlights a number of lessons for both policyholders and insurers. First, they should monitor the developing case law in this area. Second, they must understand that the language of the D&O policy is critical, and both contracting parties should pay particular attention to the policy's definition of a "claim." This is especially true because most insur-

ance professionals are familiar with the terminology of civil but not criminal litigation. The receipt of a grand jury subpoena is not the time for either the insurer or the policyholder to begin considering whether the D&O policy covers a criminal investigation. Brokers and risk managers should press for "claim" definitions and coverage limits that adequately protect the corporate entity from the expense of criminal investigations, which almost inevitably involve multiple teams of lawyers defending the corporation and its employees. Third, corporations should take special care in the manner in which they notify insurers of criminal investigations. Insurers are likely to challenge the existence of a "claim" under the policy, and policyholders do not advance their position if they or their brokers characterize the criminal investigation as merely a "potential claim." *Richardson* and *Onvoy* correctly recognized that the policyholders intended to notify their insurers of a "claim" under the policy that could ripen into a claim by the policyholder for reimbursement of defense costs, but ambiguous or cryptic terminology is unnecessary and counterproductive.

From the standpoint of an individual corporation, the risk of a criminal investigation may seem remote. But if that risk materializes, the corporation will need to maximize all available resources to stave off disaster. With proper planning, D&O insurance will provide the essential safeguard that could enable a corporation to survive a potentially catastrophic criminal investigation.