Managing FCA Risks With Directors And Officers Insurance

By Marialuisa Gallozzi and Scott Levitt, Covington & Burling LLP

Law360, New York (January 19, 2017, 12:21 PM EST) -- In December 2016, the U.S. Department of Justice announced that it had obtained more than $4.7 billion in settlements and judgments in False Claims Act cases in the prior fiscal year, which it said was the third highest annual recovery in FCA history. That figure, of course, does not capture the legal bills and other costs that individual and company defendants incurred to defend against those FCA claims, some of which may have been covered by directors’ and officers’ liability or other insurance.

Although we do not yet know whether the new administration will continue the same level of FCA enforcement activity, there can be little doubt that FCA claims will remain a substantial concern for government contractors. Just last month, the U.S. Supreme Court eliminated one silver-bullet defense against an FCA claim when it held that public disclosure of an FCA complaint filed under seal does not require dismissal of the complaint, resolving a split among the circuits on this issue.[1]

In this article, we discuss a sometimes overlooked way to manage the risk of FCA cases — directors and officers (D&O) liability insurance.

To date, the cases that have considered D&O coverage for FCA claims have focused on threshold issues like timely notice.[2] The reported cases have not yet addressed coverage for settlements of FCA claims, which insurers continue to dispute.

D&O policies provide coverage for alleged wrongful acts of directors and officers (often referred to “sides A and B” of a D&O policy), whether indemnified by the company (side B) or not (side A). For privately held companies, D&O policies also insure the company (often referred to as “side C” coverage) for a “claim” made against the company for a “wrongful act.” For public companies, side C coverage typically is limited to securities claims. We discuss the main coverage requirements and limitations below, and conclude with some practical advice to policyholders to maximize their prospects of insurance recovery for an FCA claim.

The two main threshold requirements for coverage under a D&O policy are (1) a “claim” against an insured; and (2) an allegation of a “wrongful act.” We look at these in the FCA context below.
Existence of a “Claim”

The typical definition of a “claim” in a D&O policy includes a formal assertion of liability, such as a complaint or request for arbitration, but the definition also extends to less formal “written demands for monetary or non-monetary relief.” Insurers often argue that a government request for information, such as via a subpoena or civil investigative demand (CID) served on the company, is not a claim, or not demonstrably based on a wrongful act. Accordingly, insurers often refuse, with varying degrees of success, to pay the defense costs incurred by the policyholder in responding to information or interview requests or subpoenas. See, e.g., Nat’l Stock Exch. v. Fed. Ins. Co., No. 06 C 1603, 2007 WL 1030293, at *6 (N.D. Ill. Mar. 30, 2007) (ruling that there is no coverage for defense costs incurred in connection with an informal SEC investigation); Minuteman Int’l Inc. v. Great Am. Insurance Co., 2004 WL 603482 (N.D. Ill. Mar. 22, 2004) (ruling that an SEC subpoena served on the company qualified as a written demand for non-monetary relief). The context for the government’s request for information may be determinative in whether the insurer deems the subpoena to be a covered claim. An insurer is more likely to acknowledge coverage when the request is coupled with an assertion of potential wrongful conduct under the FCA or the insured is subject to sanctions for failing to comply with the request. Moreover, the typical FCA claim usually satisfies the “claim” requirement, as it either is made through a qui tam complaint, a direct Department of Justice complaint, or a letter from the government demanding monetary relief.

The “Wrongful Act” Requirement

D&O policies typically define “wrongful act” broadly to mean any “breach of duty, neglect, error, misstatement, misleading statement, omission or act” by a company. In the typical FCA case, one need not look very hard to find at least some allegation by the government or qui tam plaintiff that satisfies the definition of “wrongful act.” As a general matter, so long as the government or qui tam plaintiff is alleging some wrongful conduct in an FCA claim against a company, the definition of “wrongful act” should be satisfied. But there is the separate question of whether the conduct is captured by the many exclusions in a D&O policy.

Key Condition of Coverage — Notice

D&O policies typically have two notice provisions: (1) required notice of a “claim” and (2) optional notice of “circumstances” that might give rise to a claim in the future. These notice issues can be difficult for an insured facing an FCA claim to navigate.

Notice of Claim. D&O policies are typically written on a “claims first made and reported basis,” meaning that the claim must not only be made against the insured during the policy period, but such claim must also be reported by the insured during that period, or within a short specified period thereafter. Notice of a claim is usually required “as soon as practicable” after the insured becomes aware of a claim. Under some policies, the notice obligation is triggered only when specific senior executives become aware of a claim.

It is a good practice for an insured to give notice of an FCA claim or potential claim as soon as possible, even if it is not clear whether the matter satisfies the policy’s definition of a “claim.” This is a good precaution because a D&O insurer may attempt to deny coverage based on untimely notice for a claim that started out as an informal investigation, but for which notice was not provided until a complaint was filed.
The notice issue is even more complex in the FCA context because qui tam claims are held under seal until the government has investigated the matter and determined whether to intervene. One court, alarmingly, has held that a claim was deemed to have been made when the original complaint was filed, even though the policyholder did not know about the qui tam claim until four years after its former employee filed the claim (since it was held under seal). The current insurer denied the claim because it was first made during a prior policy period. But the policyholder could not have given notice during the earlier policy period when a different claims-made primary insurer was on the risk because it did not know about the claim. See AmerisourceBergen Corp. v. Ace Am. Insurance Co., 100 A.3d 283 (Pa. Super. 2014). To make matters worse, even if a policyholder somehow learns that it is the target of a qui tam lawsuit that is under seal, it cannot legally disclose such claim to an insurer until the seal order is lifted unless it obtains permission from the government to do so.

Notice of Circumstances. Even if a matter might not satisfy the definition of a “claim,” a policyholder might wish to provide notice of circumstances that might give rise to a claim under the policy, such as when it learns the government might allege improper billing practices or other conduct that could serve as the basis for a claim under the FCA. A policyholder might provide such notice, for example, when it receives a request for information from the Department of Justice, or receives an adverse finding from an agency inspector general. Providing notice of circumstances will essentially “park” that claim under the current policy. A claim made in the future will be deemed to have been made when the policyholder provided notice of circumstances, but the insured might still be required to provide timely notice of the claim when it is actually made. Such notice of circumstance may not only help avoid an insurer contending that notice was late, but it also ensures that the claim falls under the current policy, rather than perhaps a less favorable policy (e.g., with different exclusions) in effect when the claim is ultimately made against the policyholder.

In addition to giving notice, a policyholder must also comply with other important conditions of coverage, such as cooperating with the insurer, which requires forwarding pleadings and other pertinent materials, and obtaining the insurer’s consent for the policyholder’s choice of defense counsel and the settlement of any claim. An insurer will likely treat the insured’s failure to satisfy any of the above conditions as grounds to deny coverage.

Key Limitations on Coverage

Definition of “Loss”

D&O insurers often argue that their policies exclude FCA claims, even though D&O policies don’t typically contain FCA exclusions. Insurers often base this argument on the definition of covered “loss,” which typically excludes civil or criminal fines or penalties imposed by law. However, “loss” is commonly defined to include multiplied damages, which are sought by the government in all FCA cases and typically make up the great majority of amounts paid in FCA settlements. The challenge for policyholders is to assert that the relief sought by the government is not a fine or penalty, but rather is compensatory damages, including multiplied damages. Fortunately, damages and penalties are distinct liabilities under the FCA. See U.S. ex rel. Davis v. D.C., 679 F.3d 832, 839 (D.C. Cir. 2012) (“The False Claims Act imposes two types of liability: First, a defendant who submits a false claim ... is liable for civil penalties regardless of whether the government shows that the submission of that claim caused the government damages. Second, the defendant is liable for ‘3 times the amount of damages which the Government sustains because of the act of [the defendant].’” (quoting United States v. Sci. Applications Int'l Corp., 626 F.3d 1257, 1277–78 (D.C. Cir. 2010))).
**Fraud/Dishonesty/Improper Profit Exclusions**

The main exclusions likely to be invoked by D&O insurers in an FCA case will be those applicable to deliberate criminal, fraudulent or dishonest acts, or for the gaining of any profit or advantage to which the policyholder is not entitled. These exclusions often contain language that the exclusions will not apply until there is a “final adjudication” adverse to the insured establishing such conduct. The most favorable variants of D&O policies require that adjudication of the wrongful conduct must be made in the underlying action, which would prevent an insurer from attempting to establish such wrongful conduct in a coverage action. In the event of a final adjudication of such conduct, the policy might allow the insurer to seek reimbursement of defense costs paid by the insurer. See, e.g., Prot. Strategies Inc. v. Starr Indem. & Liab. Co., 2014 U.S. Dist. LEXIS 56652, at *23–28 (E.D. Va. Apr. 23, 2014). In practical terms, if a policyholder settles an FCA claim without admitting wrongdoing, these exclusions should not apply, so long as they have favorable final adjudication language.

**Professional Services Exclusion**

It is increasingly common for D&O policies to exclude claims arising out of the policyholder’s professional services. Such exclusions can be very broad, encompassing performance of or failure to perform services, or any acts, errors or omissions relating thereto. An insurer might assert that an FCA claim is essentially an errors and omissions claim that is excluded by the policy—a reading that could undercut the broad coverage provided by the policy in the first place. Assuming the facts justify it, the policyholder could respond that a professional services exclusion should be limited to situations where the actual quality of the policyholder’s professional services is at issue, and not to ancillary matters such as the proper billing for such services.

While pursuing a claim under D&O insurance may not be a company’s first thought after receiving an FCA claim or notice of an investigation, it is important to pursue insurance coverage that might be available to help to fund the defense and settlement of such claims. The prospects of coverage can be maximized by taking the following steps:

1. Before a claim is asserted, a policyholder should evaluate its insurance coverage to ensure it has obtained favorable policy language available in the market, including with respect to the issues described in this article.

2. A policyholder also should ensure it has in place a protocol for notifying insurers.

3. When a claim is asserted, a policyholder should provide prompt notice and cooperate with the insurer on retention of defense counsel and litigation and settlement strategy.

4. Before settling any claim, the policyholder should seek the insurer’s consent.

5. When settling an FCA claim, the policyholder should be careful to avoid admitting any wrongdoing in a settlement or characterizing the relief as a fine or penalty, which an insurer would likely use as ammunition to avoid coverage.

Insurance policies evolve to address emerging liabilities. We have not seen insurers marketing niche policies for FCA liabilities. Going forward, however, insurers might take steps to exclude FCA claims explicitly or to limit coverage to defense costs incurred in connection with those claims even if they refuse to cover settlements; this is the approach that has been used with respect to Foreign Corrupt
Practices Act matters. This is an important area for companies to watch as they attempt to manage the risks of potential FCA claims.

Marialuisa S. Gallozzi is a partner and Scott J. Levitt is a special counsel with Covington & Burling LLP in Washington, D.C.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.


[2] See, e.g., Carolina Cas. Insurance Co. v. Omeros Corp., No. C12–287RAJ, 2013 WL 5530588 (W.D. Wash. Mar. 11, 2013) (rejecting insurer’s claim that late notice barred coverage for defense of a qui tam action, because “related wrongful acts” deemer clause tied the qui tam action to a previous claim that had been timely noticed by the insured); Community Health Ctr. of Buffalo Inc. v. RSUI Indem. Co., No. 10–CV–813S, 2012 WL 713305 (W.D.N.Y. Mar. 5, 2012) (denying insurer’s motion for judgment on the pleadings that FCA claims were excluded by the related acts exclusion under the policy).