

Criminal Investigation Is a "Claim," But Company Not Entitled to Coverage for Settlement under D&O Policy

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A federal district court, applying Illinois law, has held that a criminal investigation constitutes a "claim" under a D&O policy. However, the court found no coverage for a civil settlement of potential antitrust allegations against the corporation and its directors and officers. *Richardson Electronics, Ltd. v. Federal Ins. Co.*, No. 98C6865, 2000 U.S. Dist. LEXIS 8728 (N.D. Ill. June 20, 2000).

The corporation, a distributor of electron tubes, and its directors and officers were investigated by the Justice Department for criminal antitrust violations in connection with a conspiracy to raise vacuum tube prices. The corporation subsequently entered a guilty plea for its criminally anti-competitive conduct, and entered into a civil settlement in which it agreed to pay \$1.5 million in exchange for Justice releasing all civil claims against the corporation or its executives arising from the antitrust investigation. Justice also separately indicted two corporate officers for, among other things, interstate transportation of stolen property.

The corporation had purchased a "claims made" D&O policy. Upon receiving notice of a claim, the insurer agreed to cover defense costs for the indictments against the officers insofar as the costs exceeded the policy deductible of \$1 million. The company also sought coverage for legal fees in the criminal antitrust investigation and for the amount of the civil settlement itself. The insurer declined to pay, and the corporation sued.

On cross motions for summary judgment, the court first held that the insurer could be liable for the costs of legal representation of the individuals in the Justice antitrust investigation because the subpoenas and demands made during the investigation constituted a "claim," a term that the policy did not define. Relying on *Central Illinois Public Service Co. v. American Empire Surplus Lines Ins. Co.*, 642 N.E.2d 723 (Ill. App. Ct. 1994), the court reasoned that the term "claim" means "a demand for something due or believed to be due." In order to constitute a claim, the demand must be actual; the mere fact that the policyholder "reasonably concluded that a claim would inevitably be brought" is insufficient to trigger coverage under a claims-made policy. The court rejected the insurer's argument that money must be demanded in order for a "claim" to exist, finding that this narrow reading was inconsistent with Illinois law and would "frustrate the point of an executive risk insurance policy to require such a demand unless it were expressly indicated in the policy

language." The court also rejected the insurer's argument that "requests for information" do not constitute a demand for money or services within the meaning of a claims-made policy because characterizing a Justice investigation as involving a "request" for information understates the seriousness of what such an investigation involves.

Although the court held that the subpoenas and other demands made in the investigation constituted a claim, the court held that whether the legal expenses incurred in connection with the investigation constituted defense costs of directors and officers (which were covered by the policy), or were solely defense costs for the corporation itself (which were not covered by the policy) was a question of fact. The court rejected the insurer's argument that it was not liable for such costs in any event because it was never notified of and never specifically consented to the legal costs. The court held that Illinois law allows for implied consent. Assuming that the insurer was notified that legal fees were being incurred, the court held that, by failing to object, the insurer tacitly consented to the defense arrangements.

The court next held that the Justice investigation of antitrust violations and the indictments of the individual officers and directors for the interstate transportation of stolen property were not "causally connected" as the policy required to give rise to a single loss, thus concluding that the defense costs for each claim were to be applied to separate retentions. According to the court, causally connected matters are "causes or effects of each other or integral parts of a single scheme, not merely independent effects of a common cause." Here, the court determined that the two matters were "mutually extraneous" because antitrust violations are a "separate sort of crime" from interstate transportation of stolen property, and the latter did not allege anti-competitive motives as a purpose of the conspiracy. That being said, the court nevertheless determined that the insurer's proffered evidence that the legal fees arising out of the investigation did not exceed the retention was insufficient to warrant summary judgment.

The court next determined that the civil settlement was not covered by the policy because the corporation's directors and officers, the insured persons under the policy, were not obligated to pay it. The corporation had argued that the civil settlement admits that its officers and directors committed crimes and, in consideration of the civil settlement amount, released any civil claims the government might have against those officers and directors. The court held, however, that a release of potential liability against corporate executives does not translate into an actual claim against them that generated losses for which they were liable. Rather, the court reasoned, the policy is triggered only if there is a claim against an insured person, and the court held that the civil settlement did not generate such a claim. Rather, the court determined that the civil settlement only forestalled an actual claim from arising against an insured person.

The court also rejected the company's argument that it was entitled to reimbursement under the "larger settlement rule," which allows a corporation to receive reimbursement of all settlement costs where the corporation's liability is purely derivative of the liability of the insured directors and officers. The "larger settlement rule" was inapplicable, according to the court, because the corporation's liability was not purely derivative. Instead, the corporation was directly liable to pay, and the directors and officers were not liable at all.

Lastly, the court rejected the company's argument that its liability was purely derivative because a corporation acts only through its agents, the directors and officers. According to the court, "[t]his novel theory, if accepted, would signal the end of the corporate form in America, and would also quite unjustifiably expand [the insurer's] liability over the plain language of the policy."