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NEWSLETTER

Court Asserts That Special Litigation Committee and Regulatory Investigation Costs Covered Under Corporation's D&O Policy

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Applying New York law, the United States District Court for the Southern District of New York has held that an insured is entitled to reimbursement for costs incurred to respond to regulatory subpoenas and to investigate shareholder derivative demands. *MBIA, Inc. v. Fed. Ins. Co.*, No. 06-CV-4313 (S.D.N.Y. Dec. 30, 2009). Specifically, the court held that: (1) a regulatory subpoena constitutes a "Claim" under the policies; (2) subsequent oral requests for documents by regulators were made pursuant to a "formal or informal administrative or regulatory proceeding or inquiry" of the insured and thus implicated coverage under the policies; (3) costs associated with an independent consultant retained by the insured were not reimbursable under the policies because the insured failed timely to notify the insurers of the consultant's retention and the insurers were denied the ability to associate effectively in the defense and settlement of the claim; and (4) fees and costs by the law firm representing the company's special litigation committee were covered by the policies.

In 2001, the United States Securities and Exchange Commission (SEC) issued a formal order of investigation in connection with certain loss mitigation products offered by the insured, a financial services company. In 2004 and 2005, the New York Attorney General (NYAG) and the SEC issued subpoenas to the insured requiring the production of certain documents. In 2005, the insured agreed to comply voluntarily with additional informal document requests from the regulators. The insured later agreed to retain an independent consultant to review its accounting as part of a settlement with the SEC.

In November 2005 and April 2006, shareholder derivative lawsuits were filed against the insured and various of its directors and officers regarding the conduct at issue in the investigations. In response, the insured formed a special litigation committee (SLC) to investigate the shareholder demands. The derivative lawsuits were dismissed after the law firm that represented the SLC filed a motion to dismiss on behalf of the company. The insured sought from its primary and first excess D&O insurance carriers reimbursement for $29.5 million allegedly spent to defend the litigation and respond to the regulatory investigations.

In the resulting coverage litigation, the parties filed cross-motions for summary judgment. The court first considered whether subpoenas by the NYAG constituted "Securities Claims" under the policies. The policies defined a "Securities Claim" as "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." Although the definitions did not refer to subpoenas, the court concluded that, under the terms of the policies, the subpoena qualified as a formal or informal investigative order or "similar document," based on the common understanding of those words. The court also noted that the NYAG subpoenas sought the same information as SEC subpoenas, and that the insurers were not contesting coverage for the SEC subpoenas. Accordingly, the court concluded that the NYAG subpoenas triggered coverage under the policies. Next, the court held that the NYAG's oral requests for documents likewise implicated coverage because the oral requests were part of the same "formal or informal administrative or regulatory proceeding or inquiry."

The court then addressed the insured's attempt to recoup the fees it paid to the independent consultant required by its settlement with the SEC. The court found that the insured waited four months before informing the insurers that it had retained the consultant. The court held the insured therefore failed to comply with the policies' "right to associate" clause, which specified that the insurers have "the right . . . and shall be given the opportunity to effectively associate with [the insured] in the . . . settlement . . . of any Claim."

Finally, the court considered whether the insured was entitled to coverage for fees paid to the law firm that represented the SLC. The insurers contended that the SLC was a distinct entity charged with independently investigating the shareholder demands and that the SLC was not an insured under the policies. The court rejected the arguments, noting that the undisputed record demonstrated the law firm had entered an appearance in the derivative litigation as counsel for the insured company. In addition, the court opined that, even if the law firm only had represented the SLC and not the company itself, its fees and costs should be covered by the policies because the committee "was part of the Board and part of [the insured's] governing body." The court also rejected the argument that counsel for the SLC could not be considered counsel for the insured because the SLC was required to engage in independent decision-making. The court opined that the SLC "could readily reach independent decisions without being independent of [the insured]."