

D&O Policy Does Not Cover SEC or Internal Investigation Costs Merely Because They Benefit Defense of Covered Lawsuits

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Clarifying an October 15, 2010 order granting summary judgment to insurers, the United States District Court for the Southern District of Florida has determined that, under Florida law, an office supply company's D&O policies did not afford coverage for costs incurred in responding to a Securities Exchange Commission (SEC) investigation or conducting an internal investigation after the commencement of covered securities litigation despite the insured's contention that such costs related to and purportedly benefitted the defense of the litigation. *Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, No. 09-80544-CIV (S.D. Fla. Oct. 27, 2010). Wiley Rein LLP represents the first-layer excess insurer in the case.

The insured sought coverage under its D&O policy for costs incurred in connection with numerous matters: securities and derivative lawsuits against the company and insured directors and officers; an SEC investigation against the company itself; voluntary responses by directors, officers and employees to the SEC requests for documents and testimony; responses by insured persons to subpoenas and "Wells notices" issued by the SEC; and an internal investigation conducted by the audit committee of the insured's board of directors arising from an internal whistleblower complaint. In its October 15 order, the court rejected the insured's contentions that (1) the SEC investigation constituted a covered "Securities Claim" against the insured company and (2) all of the matters "related back" to a notice of circumstances provided before the SEC began its inquiry and that the costs incurred in connection with the matters therefore constituted covered "Defense Costs" starting on the date of the notice of circumstances. *Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 2010 WL 4065416 (S.D. Fla. Oct. 15, 2010).

Following the court's order, the insured sought clarification regarding whether amounts incurred in connection with the SEC's investigation of the company were covered after the filing of the covered securities lawsuits. The insured also questioned whether the court's prior ruling construed the policy to cover costs incurred on behalf of insured persons in response to the SEC after the securities lawsuits had been filed but before such insured persons received subpoenas.

The court granted the insured's motion for clarification but rejected its contentions as to the scope of coverage. The court made clear that the insured company's SEC investigation costs were not covered either before or after securities lawsuits were filed, stating that "[a]lthough these costs may have followed the securities lawsuits in time, they did not 'grow from' or 'flow from' the subject securities lawsuits, and therefore did not 'arise from' those Securities Claims or Claims within the meaning of the [policy]. Thus, by definition, these costs did not 'result solely from' the investigation or defense of the securities lawsuits within the meaning of 'defense costs.'" The court stated further that the fact that the insured continued to incur voluntary SEC response costs after the securities lawsuits were filed "does not transform the post-suit SEC response suits into covered 'Loss' under the policy, even though some of those response costs may have related to or had utility in [the insured]'s defense of the securities lawsuits."

Accordingly, the court granted the insured's motion for clarification, but reaffirmed that the policy covered only costs "arising from" and "resulting solely from" the securities lawsuits and SEC subpoenas and Wells notices issued to insured persons. Under the ruling, such amounts do not include voluntary SEC response costs whether incurred on behalf of the insured company or insured persons and whether incurred before or after the filing of the covered securities lawsuits, regardless of any purported benefit such activity may have for the defense of the litigation.