

Eleventh Circuit Holds that D&O Policy Does Not Cover SEC Investigation of Insured Entity

November 2011

The United States Court of Appeals for the Eleventh Circuit has held, under Florida law, that an office supply company's directors and officers liability insurance policies did not afford coverage for the company's response to an investigation by the Securities and Exchange Commission (SEC). *Office Depot, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, No. 11-10814 (11th Cir. Oct. 13, 2011). Wiley Rein LLP represented the first-layer excess insurer in the case. The district court's orders regarding summary judgment were discussed in the November and December 2010 and February 2011 issues of *Executive Summary*.

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 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. The insured contended that the policy's entity coverage for "Securities Claims" should extend to the SEC's investigation of the insured company itself and that the SEC's voluntary requests for information constituted covered claims against insured persons. In the alternative, the insured contended that all of these matters "related back" to a notice of circumstances provided shortly before the SEC began its informal inquiry and that the costs incurred in connection with these matters therefore constituted covered "Defense Costs" starting on the date of the notice of circumstances. The Eleventh Circuit rejected all of the insured's arguments.

First, the court rejected the insured's argument that the SEC investigation of the company constituted an "administrative or regulatory proceeding." The court examined the policy's definition of "Securities Claim," which included claims "other than an administrative or regulatory proceeding against, or investigation of an Organization." The court acknowledged that the policy did not define "administrative or regulatory proceeding" but reasoned that the definition of "Securities Claim" "creates a clear disjunctive through the use of 'or' [and] eliminates coverage for . . . Claims in the form of an administrative or regulatory investigation of [the insured entity]." Giving meaning to each phrase in the policy, the court found that the SEC's requests for information from the insured company constituted a non-covered "investigation."

Second, the court held that letters from the SEC asking the insured to preserve documents and requesting that individuals provide testimony did not constitute claims against insured persons. According to the court, the letters only requested information to assist the SEC in determining whether the insured entity committed securities violations but did not allege that violations had occurred or identify specific individuals who could be charged in future proceedings. Accordingly, these letters did not constitute claims under the policy definition.

Third, the court considered the policy definition of "Defense Costs," which included "reasonable and necessary fees, costs, and expenses consented to by the Insurer . . . resulting solely from the investigation, adjustment, defense, and/or appeal of a Claim." The court held that the definition of "Defense Costs" "unambiguously limits Defense Costs to those costs incurred after a Claim has been made." "Investigation of a Claim", the court reasoned, "necessitates that a Claim exist to investigate." The court held that "plain language demonstrates that the costs must 'result solely from' a Claim" and that only expenses incurred after a claim was made against the insured were potentially covered.

Finally, the court addressed the insured's argument that the policy's notice and reporting provisions created coverage for costs it incurred after submitting a notice of circumstances once a claim was eventually made relating to the notice. The court held that "[n]othing in the language of [the policy's notice section] indicates that it extends coverage to Defense Costs incurred after a notice is filed but before a Claim actually exists. Instead, it creates a notification process for Claims filed both inside and outside of the Policy Period." Accordingly, no coverage was available for the SEC investigation until the issuance of subpoenas and Wells notices, which the policy defined to constitute claims.