

ALERT

Guilty Pleas Bar Coverage and Entitle Insurer to Recoupment

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Applying Virginia law, a federal district court has held that guilty pleas and criminal convictions of officers of the insured company trigger fraud, profit, and prior knowledge exclusions and entitle the insurer to recoup all defense costs. *Protection Strategies, Inc. v. Starr Indem. & Liab. Co.*, No. 1:13-CV-00763 (E.D. Va. April 23, 2014). Wiley Rein LLP represented the insurer.

An insurer issued a D&O policy to a defense contractor. The company received a subpoena and a search and seizure warrant from the NASA Office of Inspector General as well as notification from the U.S. Department of Justice that it was the target of an investigation regarding federal contracting preferences. The insurer advanced defense costs to the company and its officers who also were identified as targets of the investigation. After the officers pleaded guilty to fraud and conspiracy charges and were sentenced, the insurer asserted that fraud, profit, prior knowledge, and warranty exclusions barred coverage for the investigations and criminal proceedings and that its policy entitled it to recoup all amounts it had paid.

The court agreed that all four exclusions barred coverage and that the insurer was entitled to recoup all defense costs. The court first rejected the insured's attempt to trigger coverage under two successive policies, noting that under the claims-made policies a claim can only be "first made" one time. The court next held that the statements of fact in the officers' guilty pleas and the judgments against those individuals triggered the fraud, profit, prior knowledge, and warranty exclusions. The court disagreed that a "100% preset allocation" provision in the policy applied. The company argued that the investigations included company employees that had not pleaded

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guilty, but the court held that there were no “Claims” against those fact witnesses, and the exclusions barred coverage for the entirety of the investigations and criminal proceedings. Finally, the court held that the policy’s recoupment provision entitled the insurer to repayment of all defense costs advanced. The court disagreed that the insurer’s “duty to defend” negated the plain language of the recoupment provision, noting that the duty to defend is contractual in nature. The court also held that once the exclusions were triggered, they barred coverage for the investigations from inception, and therefore the insurer was entitled to recoup all defense payments and not simply defense costs incurred after the guilty pleas were entered.

The opinion is available [here](#).