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Tenth Circuit Holds That Governmental Investigation Of Potential Criminal Violations Is Not A 'Claim' Under A D&O Policy

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D&O insurance policies are key components of a corporation's risk transfer portfolio, purchased to protect it against lawsuits presenting significant liability exposure to itself and its key officers and directors. In recent years, as an alternative to targeted formal litigation and discovery in uncovering corporate wrongdoing, federal and state governments have increasingly utilized informal investigations. This trend has created an expensive new financial exposure in the business world, particularly for large corporations, which are often the targets of such inquiries, and corresponding questions about how D&O insurance policies cover such costs.

Although many D&O policies have evolved to explicitly protect policyholders from the costs of responding to government investigations, many have not been amended, forcing courts to determine whether the existing language is sufficient to trigger coverage. D&O policies traditionally define a "claim" as, in part, a "demand for monetary or non-monetary relief." A number of courts have held that subpoenas issued in connection with government investigations constitute demands for "relief," thereby triggering a "claim," because a subpoena is in effect a demand for something due. *See, e.g., Polychron v. Crum & Forster Ins. Companies*, 916 F.2d 461, 463 (8th Cir. 1990) ("The defendants' characterization of the grand-jury investigation as mere requests for information and an explanation underestimates the seriousness of such a probe."); *Minuteman Int'l, Inc. v. Great Am. Ins. Co.*, No. 03 C 6067, 2004 WL 603482, at *7 (N.D. Ill. Mar. 22, 2004) (finding that certain SEC subpoenas "were demands for relief in that they were demands for something due); *Syracuse Univ. v. Nat'l Union Fire Ins. Co.*, 975 N.Y.S.2d 370 (N.Y. Sup. Ct. 2013), *aff'd*, 976 N.Y.S.2d 921 (N.Y. App. Div. 2013).

A recent decision in the Tenth Circuit, however, illustrates that some courts may not follow this approach, at least under the narrow circumstances present in that case. *MusclePharm Corp. v. Liberty Insurance Underwriters, Inc.* was an outgrowth of an investigation directed at MusclePharm, a nutritional supplement company, and several of its officers by the U.S. Securities and Exchange Commission (SEC).

In July 2013, MusclePharm received an order from the SEC directing the company to conduct a private investigation of potential violations of securities law and indicating that SEC officers might subpoena witnesses, seek evidence and require the production of documents. The order stated that "it should be understood that the [SEC] has not determined whether any of the persons or companies mentioned in the order have committed" any wrongful

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acts or violation of the law. Eventually, after MusclePharm incurred more than $3 million in costs in responding to SEC subpoenas and document requests, it settled with the SEC. MusclePharm sought coverage of more than $3 million in costs it incurred in responding to the SEC investigation under its D&O policy issued by Liberty Insurance Underwriters, Inc. The Liberty policy did not expressly define “claim” as including informal governmental investigations. It, did, however, define “claim” as a “written demand for monetary or non-monetary relief” against an insured.

The principal dispute between MusclePharm and its insurer was whether the subpoenas issued by the SEC in the course of its investigation were demands for “non-monetary relief” that triggered Liberty’s duty to reimburse MusclePharm. The Tenth Circuit agreed with the carrier, rejecting the authorities holding that government subpoenas were demands for “relief.” The court justified its holding on two principal grounds. First, it turned to dictionary definitions of “relief” as a “legal remedy or redress” to conclude that subpoenas did not seek a remedy, but rather sought to investigate whether there was a basis for seeking a remedy at all. To the court, the fact that the subpoena itself could require action by the policyholder was not significant. Second, the court placed great weight on the fact that the SEC expressly stated that it had not determined that anyone had violated the law. Because the policy covered “claims” for “wrongful acts,” the court concluded that the SEC subpoenas were not “claims” because they expressly avoided making allegations of wrongdoing.

While many courts have construed D&O policies as covering the policyholder’s costs of responding to government investigations, *MusclePharm* is a cautionary tale about how some courts may conclude there is no coverage under a particular set of facts. Indeed, the very efforts of the SEC in reassuring MusclePharm that there were no specific allegations of wrongdoing against anyone became a key basis on which the court ultimately concluded there was no coverage.

While many D&O policies have specific language that expressly cover informal investigations and subpoenas, many do not. While the lack of such language does not necessarily result in an outcome like that in *MusclePharm*, policyholders should consider reviewing their coverage carefully and look closely at the choice-of-law analysis likely to apply to their policies, as these issues could affect the outcome in cases involving governmental subpoenas and investigations.