

D&O Coverage Considerations For FCPA Claims

Law360, New York (June 08, 2010) -- Congress enacted the Foreign Corrupt Practices Act to prevent corporate bribery of foreign officials.[1] The number of FCPA actions initiated by the United States Department of Justice and the U.S. Securities and Exchange Commission has skyrocketed over the past few years. In turn, shareholders and other litigants have increasingly filed “follow-on” civil lawsuits based on FCPA violations. Because of the significant costs associated with FCPA-related litigation, companies must understand and be in a position to negotiate the broadest coverage available under their directors and officers liability insurance policies.

FCPA Background

The FCPA is primarily comprised of two pieces — the anti-bribery and accounting provisions. The anti-bribery provisions make it illegal for any U.S. person to pay a foreign official to obtain or retain business[2] for any person or company. The accounting provisions require public companies to accurately maintain records and implement an adequate system of internal accounting controls.

While FCPA prosecutions began to rise during the Bush administration, the number of prosecutions has reached historic levels during the Obama administration. Increased FCPA enforcement has been accompanied by stronger penalties for FCPA violations, including large fines and criminal charges against corporate employees.

The dramatic increase in FCPA enforcement actions has led to an equally dramatic increase in costly civil litigation. Because the FCPA does not provide for a private cause of action, shareholders and other litigants must file “follow-on” civil lawsuits based on the government’s alleged FCPA violations. The “follow-on” lawsuits usually are brought as securities class actions filed by shareholders or derivative lawsuits filed on the company’s behalf.

Impact on D&O Insurance

Policyholders should keep FCPA-related litigation in mind when evaluating their D&O exposure and policies:

1) Exclusions

Whether a D&O policy provides coverage for an FCPA lawsuit hinges on the specific exclusions contained within the policy. Some policies exclude claims arising out of payments made to a foreign government’s agents or employees. Moreover, most D&O policies exclude coverage for claims arising out of fraudulent, dishonest or criminal acts. Policyholders should (1) negotiate with carriers to remove any exclusion that specifically precludes coverage for FCPA actions and (2) negotiate “final adjudication” language into the fraud, dishonesty and criminal acts exclusions.

2) Fines and Penalties

FCPA enforcement actions often result in the imposition of fines and penalties. D&O policies ordinarily define “loss” in such a way that it excludes coverage for fines and penalties. Consequently, policyholders should attempt to negotiate for the removal of such exclusionary language or face significant uncovered exposure for FCPA enforcement actions.

3) Defense for Enforcement Actions

Many FCPA enforcement actions are settled during the investigation phase, before actual litigation is commenced. Policyholders thus should ensure that the policy’s definition of “claim” includes such investigations.

4) Separation of Insureds

Prospective policyholders are ordinarily required to fill out an application when purchasing D&O insurance. The policy application often requires policyholders to disclose any facts that are likely to give rise to a claim. Moreover, many D&O policies have a provision which states that the insured represents that the statements contained in the policy application are true. If any material information in the policy application is untrue, the provision may render the policy void.

Consider the following example. A company representative bribes a foreign official before D&O coverage is purchased. Unaware of the bribery, management later purchases the policy and does not disclose the bribery in the application. If the policy contains a separation of insureds and/or non-imputation provision, which provides that no knowledge or information possessed by any insured, such as an officer or director, is imputed to any other insured, then innocent directors and officers and the company (depending on who had knowledge of the bribery) still may be covered.

5) Notice Issues

D&O policies ordinarily provide “claims-made” coverage. This means that coverage is available only for claims that are made during the policy period. Many policy forms require the policyholder to provide notice “as soon as practicable” after it first becomes aware of a claim. “Claims-made-and-reported” policies further require that notice of the claim be given during the policy period or some other reporting period.

If a policyholder is successful in amending the term “claim” to include formal investigations, the policyholder must provide notice to its insurer as soon as it becomes aware of any investigation. If the policyholder waits to provide notice to the carrier until after a FCPA-related lawsuit is filed, it may violate the notice provision. In some jurisdictions, failing to provide timely notice under a claims-made policy automatically precludes coverage.

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[1] 15 U.S.C. §§ 78dd-1, et seq. (1998).

[2] This has been viewed broadly by courts to include anything that gives a company an unfair business advantage.