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NEWSLETTER

SEC Investigation Is “Claim,” but Cost of Complying with SEC Order Is Not “Loss”

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The United States District Court for the Northern District of Illinois, applying Illinois law, has held that an SEC investigation that concluded in a cease and desist order constitutes a claim under a D&O policy but that expenses incurred in complying with the SEC order are not "loss" under the policy. *Minuteman Int'l, Inc. v. Great Am. Ins. Co.*, 2004 WL 603482 (N.D. Ill. Mar. 22, 2004). The court also held that the company was not entitled to recover the attorneys' fees it incurred in prosecuting its coverage claim.

A company purchased a claims-made D&O policy from the insurer. The policy defined "claim" as "a written demand for monetary or non-monetary relief." The policy, as amended by Endorsement 1—the Illinois Amendatory Endorsement—defined "loss" as "compensatory damages, punitive or exemplary damages...settlements and Costs of Defense." Endorsement 2 excluded from the definition of "loss" "any obligation of the Insured Entity as a result of a Claim seeking relief or redress in any form other than monetary damages."

The SEC investigation that gave rise to the coverage dispute commenced with an SEC order initiating an investigation of the company's activities. The ensuing investigation included subpoenas of the company's officers and directors. The company and its officers and directors expended more than $500,000 in fees in connection with the investigation. Ultimately, the company and the SEC reached a settlement pursuant to which the SEC issued a cease and desist order that compelled the company to hire a general accounting officer and an outside auditor to monitor its compliance with generally accepted accounting principles. The insurer denied coverage for all facets of the SEC investigation on the grounds that the investigation did not constitute a "claim" under the policy. Coverage litigation ensued.

The court held that the policy afforded coverage for the SEC investigation because "[a] demand for ‘relief' is a broad enough term to include a demand for something due, including a demand to produce documents or appear to testify." The court also held that the company's costs of complying with the SEC order did not constitute "loss" since the policy expressly excluded such costs from the definition of the term. In so ruling, the court rejected the company's argument that Endorsement 1 to the policy overrode all other definitions of loss included in the policy and thus the language limiting the definition of loss in Endorsement 2 was inapplicable. The court reasoned that Endorsement 2 was not inconsistent with Illinois law and therefore applied to bar coverage for expenses incurred in complying with the SEC order.

Finally, the court granted the insurer's motion to dismiss the company's claim for its attorneys' fees incurred in litigating the coverage action under 215 ILCS 5/155. The court held that the statute only provides for fee awards in cases in which the insurer's conduct in delaying payment is unreasonable and vexatious, and that "[t]aking an unsuccessful position is not enough to impose a penalty under this provision; the insurer's behavior must be willful and without reasonable cause." Regarding the instant case, the court noted that some precedent supported the insurer's position as to the definition of "claim" under the policy and that reasonable litigants could differ on the issue.

For more information, please contact us at 202.719.7130.