

# Client Alert

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## **Patriarch Partners Decision Confirms Government Subpoenas May Constitute a “Claim” Under D&O Policy; Warns Policyholders to Think Broadly When Representing Facts and Circumstances to Insurers**

The Second Circuit recently confirmed in *Patriarch Partners, LLC v. Axis Insurance Co.* that a warranty letter accompanying the policyholder’s insurance application barred coverage for a lengthy SEC investigation, which ripened into a “Claim” prior to the policy’s inception date. The opinion left intact the lower court’s finding that the SEC subpoena constituted a “demand for non-monetary relief” and thus qualified as a “Claim” under the directors and officers (D&O) insurance policy.

In August 2011, Patriarch purchased from Axis a third excess layer of \$5 million in its tower of D&O insurance. The policy provided coverage for “any Claim first made against an Insured ... during the Policy Period.” “Claim” was defined to include, among other things, a “demand” for “non-monetary relief” or “an Investigation of an Insured alleging a Wrongful Act.” “Investigation” further was defined to include “a formal ... regulatory investigation or inquiry,” including specifically “an order of investigation or other investigation by the [SEC].”

### **Representations to Insurers**

Before binding coverage, Axis required Patriarch to execute a warranty. The negotiated warranty, dated August 12, 2011, read in relevant part that:

The undersigned, on behalf of Patriarch and all of its directors and officers, hereby represents that as of the date of this letter neither the undersigned nor any other director or officer of Patriarch is aware of any facts or circumstances that would reasonably be expected to result in a Claim under the Captioned Policy. It is understood that the Captioned Policy and any renewal thereof does not provide coverage for Claims relating to facts or circumstances that, as of the date of this letter, Patriarch was aware of and would reasonably have expected to result in a Claim covered by such Captioned Policy (or future renewal thereof).

In December 2009, the SEC notified Patriarch by letter that the SEC was conducting an “informal inquiry” and suggested that Patriarch voluntarily provide information and produce documents. Patriarch immediately retained outside counsel. On May 27, 2011, the SEC again wrote to Patriarch, describing that the SEC now was proceeding as an “informal investigation.” On June 3, 2011, the SEC internally issued a formal order of investigation. Although not public information, Patriarch’s outside counsel became aware of the formal order on June 13, 2011, after which the SEC requested interviews and additional documents and, on July 1, 2011, began issuing subpoenas.

Patriarch itself received an SEC subpoena on February 27, 2012. On March 5, 2012, Patriarch tendered notice of the subpoena to all of its D&O insurers as a “new matter.” The primary insurer acknowledged the subpoena was a Claim for a Wrongful Act. Axis also acknowledged it to be a Claim, but reserved its right to deny coverage.

In August 2015, Patriarch notified Axis that it had exhausted all underlying policy limits and asked Axis to assume responsibility for ongoing defense costs. Axis denied coverage, contending that the SEC investigation was not a Claim first made against Patriarch during the Axis policy period because the investigation had begun before the policy inception.

The Second Circuit affirmed summary judgment, holding the warranty excluded coverage. The court held that as of the warranty's effective date, Patriarch " 'was aware' of the SEC Order of Investigation, the escalating severity and focus of the SEC investigation, the subpoena of a former employee, [ ] notice of an impending subpoena to be issued to Patriarch itself" and that it had accrued almost \$400,000 in legal expenses. These facts, as well as the SEC's increasing insistence in its demands to Patriarch, are " 'facts and circumstances' that could reasonably be expected to give rise to a Claim." More specifically, the subpoena issued on July 1, 2011, was a "demand" for "non-monetary relief," and thus a "Claim."

The court rejected Patriarch's argument that the warranty applied only to the signatory's subjective knowledge of facts and circumstances. Rather, the court pointed to the warranty's plain language, which expressly refers to facts or circumstances "Patriarch was aware of," and thus includes knowledge of Patriarch's outside counsel, in-house counsel and Patriarch itself.

Finally, the court rejected Patriarch's position that the warranty applied only to facts or circumstances Patriarch reasonably expected to result in a Claim exceeding \$20 million and reaching Axis's layer of coverage. Claim is not defined in such a manner, especially where, as here, the Axis policy followed form to the primary policy, which defined the term to include losses under the primary policy.

The decision underscores the importance of understanding how a policy's language and definitions impact the scope of information that policyholders must consider when representing facts and circumstances in insurance applications. Where, as here, a broad definition of "Claim" may mean a broader scope of coverage, it also means, however, that the policyholder must broadly consider whether facts and circumstances exist at the time of procurement that might give rise to a Claim under that broad definition. Conversely, while a narrower definition of "Claim" or "Investigation" may not have required as broad a disclosure in the warranty, it also may not have allowed for coverage of the SEC's investigatory action. Regardless of the scope of coverage, it is important for policyholders to understand that representations and warranties made in policy applications will be scrutinized in the event of a Claim. Policyholders should therefore engage in that critical self-analysis themselves when executing the policy to guard against unanticipated surprises when coverage is needed.

### **Government Investigation and Subpoena Constitute a "Claim"**

In the lower court, the Southern District of New York had held that the SEC investigation constituted a "Claim" (albeit one excluded from coverage under the policy's pending and prior claim exclusion). The policy defined "Claim" in relevant part as "a written demand for monetary damages or non-monetary relief (including but not limited to injunctive relief)" *or* an "Investigation of an Insured alleging a Wrongful Act." The district court held that the subpoena constituted a "demand for non-monetary relief" because "an SEC subpoena is not a mere request for information, but a substantial demand for compliance by a federal agency with the ability to enforce its demand." The court further held that the subpoena sought "non-monetary relief" because it requested the production of documents. Implicit in the Second Circuit's affirmation is agreement with the district court's conclusion that the SEC subpoena constituted a "Claim" under the D&O policy.

The costs of responding to government subpoenas or civil investigative demands can be significant. Policyholders facing government subpoenas, civil investigative demands, or other formal or informal government demands should not hesitate to seek coverage for such costs under their D&O insurance policies. The Second Circuit and Southern District's rulings in *Patriarch* confirm that government subpoenas or civil investigative demands constitute a "Claim" that ought to trigger coverage under fairly standard D&O policy language.

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