Subpoena Defense Cost Ruling Gets Insurance Law Wrong

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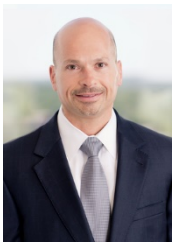

On Sept. 14, the U.S. District Court for the District of Connecticut decided Connecticut Municipal Electric Energy Cooperative v. National Union Fire Insurance Co. of Pittsburgh, PA,[1] ruling that an insurer has no duty to advance defense costs for a policyholder's response to a grand jury subpoena.

The opinion makes two crucial mistakes that contravene long-standing insurance law principles. First, it improperly narrows the duty to advance defense costs only to when there is actually coverage, not just when there is a possibility of coverage. Second, it incorrectly concludes that a subpoena issued as part of a government investigation into criminal wrongdoing is not a covered claim under the specific wording of the directors and officers policy at issue.

The Decision

Connecticut Municipal Electric Energy Cooperative, or CMEEC, brought suit against National Union alleging that National Union had improperly refused to advance defense costs. The dispute began when the U.S. attorney's office issued two grand jury subpoenas to CMEEC seeking the production of documents as part of a criminal investigation. CMEEC retained counsel to respond to the subpoenas.

After a two-year investigation, the grand jury indicted five CMEEC officers and directors for fraud. National Union denied CMEEC's claim for coverage of its legal fees in connection with the subpoenas, and CMEEC brought suit.

CMEEC's not-for-profit risk protector insurance policy provided coverage for a claim "for any actual or alleged Wrongful Act of the Organization." A claim was defined to include "a written demand for monetary, non-monetary or injunctive relief" or a "civil, criminal, regulatory or administrative proceeding for monetary, non-monetary or injunctive relief."

The policy stated that National Union "does not assume any duty to defend," but where National Union did not assume the defense it was obligated to advance defense costs.

Finally, the policy provided:

> The Insureds shall not ... incur any Defense Costs without the prior written consent of the Insurer. Only those ... Defense Costs which have been consented to by the Insurer shall be recoverable as Loss under the terms of this policy. The Insurer's consent shall not be unreasonably withheld. ... and

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> provided further that in all events the Insurer may withhold consent to any ... Defense Costs, or any portion thereof, to the extent such Loss is not covered under the terms of the policy.

The court first rejected CMEEC's argument that the duty to advance defense costs was equivalent to the duty to defend. It held that the policy expressly disavows any duty to defend and that National Union's duty to advance defense costs extended only to cases where such costs are actually covered, pointing to the clause stating that the insurer may withhold its consent to defense costs if "Loss is not covered." The question thus became whether there was coverage for loss related to the subpoenas.

Next, the court recognized that Connecticut courts have not addressed whether subpoenas like those issued to CMEEC satisfied the policy's definition of claim as written demands for nonmonetary relief. It never reached a conclusion on that issue, however, because the court found that, even if the subpoenas were a claim, they were not a claim "for any actual or alleged Wrongful Act," so there was no coverage.

The court explained that the subpoenas did not allege any wrongful acts by CMEEC, but were merely issued as part of an investigation into the possible commission of a felony. The subpoenas did not state that the government was pursuing a criminal investigation against CMEEC as an organization.

Duty to Advance Defense Costs

The CMEEC decision impermissibly narrows the duty to advance defense costs by breaking with precedent holding that the duty to defend and the duty to advance defense costs are equivalent for the purposes of determining an insurer's obligation to pay legal fees and expenses incurred in defense of a claim. Yet the CMEEC court correctly recognized that the Connecticut Supreme Court has held that an insurer's duty to defend is "broader than the duty to indemnify" and is triggered based on the mere "possibility of coverage" under the policy.[2]

Those same defense obligations are imposed on insurers with a duty to advance defense costs, which requires advancement if the underlying claim contains allegations that might fall within the scope of coverage. For that reason, according to the U.S. Court of Appeals for the Eighth Circuit in its 2011 decision Liberty Mutual Insurance Co. v. Pella Corp. and contrary to the CMEEC court's ruling:

> [S]tate courts generally have viewed an insurer's duty to advance defense costs as an obligation congruent to the insurer's duty to defend, concluding that the duty arises if the allegations in the complaint could, if proven, give rise to a duty to indemnify.[3]

The CMEEC court summarily distinguished the litany of state and federal court cases that equate the duties to defend and advance, noting that those cases "do not address the impact of a contract provision that disavows a duty to defend."[4] But in doing so, the court ignored numerous decisions that explicitly address identical policy language.

Time and time again, courts that considered a policy that disavows the duty to defend, but provides for a duty to advance defense costs and states that the insurer does not have to consent to defense costs if there is no coverage, have held that the insurer has a duty to advance defense costs whenever there is a reasonable possibility of coverage.[5]

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The CMEEC court misinterpreted the consent provision. It is not intended to narrow the scope of the duty to advance defense costs. Instead, it merely allows the insurer to control costs and refuse to pay unreasonable and exorbitant legal bills.[6] However, when an insurer improperly declines coverage entirely, as was the case here, it gives up its right to approve defense costs.[7]

Even if it was correctly decided, the CMEEC decision is limited to the specific policy language. It is a narrow ruling based on the inclusion of a clause in the policy stating that the insurer can withhold consent for defense costs when there is no coverage. The decision does not modify the broader duty to advance defense costs in the absence of such a provision.

Coverage for Government Investigations

The District of Connecticut's decision that a grand jury subpoena is not a claim "for any actual or alleged Wrongful Act" is also out of step with decisions in the U.S. Court of Appeals for the Second Circuit and other jurisdictions. Although the existence of coverage will depend on the exact policy wording, the New York Supreme Court held that there was coverage for a grand jury subpoena under an identical policy. The policy provides two alternate definitions of claim, including a "written demand for monetary, non-monetary or injunctive relief" or a "criminal proceeding."

In Syracuse University v. National Union Fire Insurance Co. of Pittsburgh, PA, the Supreme Court of New York for Onondaga County found in 2013 that there was coverage under either definition of claim. First, the court reasoned that a grand jury subpoena sought nonmonetary relief because the "relief sought by a subpoena is the production of documents or testimony."[8] Second, the court found that the grand jury subpoena constituted a criminal proceeding because "a criminal investigation is an integral part of a criminal proceeding."[9]

Having found that the subpoena satisfied either requirement under the definition of a claim, the New York Supreme Court found the insurer owed a duty to advance defense costs for responding to the subpoenas.[10] Unlike the CMEEC court, the Syracuse University court also held that the policyholder did not need to prove that it was the target of the investigation.[11] Other courts have also held that the duties to defend or advance defense costs are triggered when a D&O policyholder is served with a subpoena.[12]

Although CMEEC cited Syracuse University in its brief, the court failed to even consider the case. In fact, the only case that the court cited was Employers' Fire Insurance Co. v. ProMedica Health System Inc.[13], a 2013 U.S. Court of Appeals for the Sixth Circuit decision, which held that a subpoena issued by the Federal Trade Commission as part of an antitrust investigation was not a covered claim.

But the CMEEC court, which is guided by the Second Circuit, should have followed Second Circuit precedent — not Sixth Circuit precedent — holding that a subpoena triggers the duty to advance defense costs.[14] Moreover, the majority of decisions — and better-reasoned decisions — have held that a subpoena is a claim, for the reasons explained in Syracuse University.

Conclusion

Although it improperly narrows both the duty to advance defense costs and coverage for a government investigation, the CMEEC decision is not a death knell for D&O policyholders. The plaintiff has already filed a motion for reconsideration. Even if the decision stands, it is narrow and turns on the specific policy

language at issue. A different policy will necessitate a different result.

The diverging views on government investigations coverage discussed above also highlight the importance of choice of law and forum selection in resolving coverage disputes, which may be affected by the terms of the policy. Policyholders seeking coverage for their legal costs when responding to a government investigation should carefully review the policy language and submit a claim for any potentially applicable coverage.

Notes

1. Connecticut Municipal Electric Energy Cooperative v. National Union Fire Insurance Co. of Pittsburgh, PA, No. 3:19cv839 (JBA), 2021 WL 4170757 (D. Conn. Sept. 14, 2021).

2. Connecticut Municipal, 2021 WL 4170757, at *8 (quoting Nash St., LLC v. Main St. Am. Assurance Co., 251 A.3d 600, 606–607 (Conn. 2020)); see also Beazley Ins. Co., Inc. v. ACE Am. Ins. Co., 197 F. Supp. 3d 616, 631 (S.D.N.Y. 2016) (duty to defend is "broader than [an insurer's] obligation to indemnify.").

3. Liberty Mut. Ins. Co. v. Pella Corp., 650 F.3d 1161, 1170 (8th Cir. 2011) (collecting cases); accord Goldberg v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA., 143 F. Supp. 3d 1283, 1293 (S.D. Fla. 2015) (same), aff'd, 861 F.3d 1335 (11th Cir. 2017); Beazley, 197 F. Supp. 3d at 631 n.22 (duty to defend and duty to advance defense costs are equivalent); Hurley v. Columbia Cas. Co., 976 F. Supp. 268, 275 (D. Del. 1997) ("[T]here does not exist a significant difference between the duty to defend and the promise to advance defense costs, other than the difference between who will direct the defense."); Acacia Research Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, No. SACV 05-501 PSG (MLGx), 2008 WL 4179206, at *11 (C.D. Cal. Feb. 8, 2008) ("as with a duty to defend, [insurer's] duty to advance defense costs arose on tender of a potentially covered claim"); Worthington Fed. Bank v. Everest Nat'l Ins. Co., 220 F. Supp. 3d 1211, 1222 (N.D. Ala. 2015) (same); Aspen Ins. UK, Ltd. v. Fiserv, Inc., No. 09-CV-02770-CMA-CBS, 2010 WL 5129529, at *3 (D. Colo. Dec. 9, 2010) ("[T]here are no material differences between a duty to defend and a duty to advance Defense Expenses."); Julio & Sons Co. v. Travelers Cas. & Sur. Co. of Am., 591 F. Supp. 2d 651, 660 (S.D.N.Y. 2008) (same); Sherwin-Williams Co. v. Certain Underwriters at Lloyd's London, 813 F. Supp. 576, 583 (N.D. Ohio 1993) (duty to defend standard applies to insurer's duty to reimburse defense costs).

4. 2021 WL 4170757, at *9.

5. See, e.g., Am. Chem. Soc. v. Leadscope, Inc., No. 04AP-305, 2005 WL 1220746, at *4–8 (Ohio Ct. App. May 24, 2005) ("when a policy imposes a duty to advance defense costs but no duty to defend, the pleadings test and the one claim-all claims principle apply to determine the duty of the insurer to advance defense costs"); Brown v. Am. Int'l Grp., 339 F. Supp. 2d 336, 346 (D. Mass. 2004) (requiring insurer to "advance defense costs only if the claim suggests a 'reasonable potential for coverage' . . . appropriately 'giv[es] effect' to both the duty and the consent provisions."); Renovate America, Inc. v. Lloyd's Syndicate 1458, No. 3:19-CV-01456-GPC-WVG, 2019 WL 6716735, at*3–4 (S.D. Cal. Dec. 10, 2019) (insurer had duty to advance defense costs even though policy required prior written consent of insurer prior to incurring defense costs).

6. Brown, 339 F. Supp. 2d at 346 (consent provision allows insurer to "address the reasonableness of the costs").

7. Renovate America, 2019 WL 6716735, at *4 ("the requirement of prior written consent for certain insurance coverage provisions is obviated when the insurer denies coverage").

8. Syracuse Univ., 975 N.Y.S.2d 370 (Table), 2013 WL 3357812, at *2 (N.Y. Sup. Ct. 2013).

9. Id. at *3.

10. Id. at *5.

11. Id. at *3.

12. See, e.g., MBIA Inc. v. Federal Ins. Co., 652 F.3d 152, 160 (2d Cir. 2011) (New York Attorney General subpoena triggered duty); Polychron v. Crum & Forster Ins. Cos., 916 F.2d 461, 463 (8th Cir. 1990) (grand jury subpoena triggered duty).

13. 534 F. App'x 241 (6th Cir. 2013).

14. MBIA, 652 F.3d at 160.

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