Recent Rulings May Support False Claims Act Coverage

By Geoffrey Fehling
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In the latest annual False Claims Act report from the U.S. Department of Justice, the federal government announced that it had obtained more than $5.6 billion in settlements and judgments in civil cases involving fraud and false claims over the last fiscal year ending Sept. 30, 2021.[1]

The 2021 total was the largest recovery since 2014 and the second-largest annual total ever in the history of the FCA. While health care-related fraud remained the leading source of FCA recoveries, the DOJ also emphasized its pursuit of claims in other areas, such as procurement fraud involving the government's purchase of goods and services and fraud related to the COVID-19 pandemic.

Because the past two years have seen record-breaking new investigations and actions, FCA litigation and investigations are likely to continue to rise. As FCA exposures grow, companies and their directors and officers will look to their insurance policies to mitigate those losses. The good news for policyholders is that numerous recent decisions have ruled in favor of coverage under a variety of director and officer and professional liability policies.

In Affinity Living Group LLC v. Starstone Specialty Insurance Co., the U.S. Court of Appeals for the Fourth Circuit applying North Carolina law overturned a professional liability insurer's coverage win in May 2020 following the insurer's refusal to defend an assisted living operator in an FCA lawsuit alleging more than $60 million in damages.[2]

The court held that the insurer should not have denied coverage under the operator's professional liability policy — covering "damages resulting from a claim arising out of a medical incident" — because the alleged improper billing at issue in the FCA action had a causal connection to the operator's failure to render medical professional services and, therefore, arose out of a covered "medical incident."

In August 2021, the Superior Court of Delaware held in Guaranteed Rate Inc. v. ACE American Insurance Co. that a D&O insurer must advance defense costs to a mortgage broker targeted in a federal government investigation of alleged FCA violations.[3]

The court held, among other things, that the government's civil investigative demand constituted a claim and that the policy's professional services exclusion did not apply to the underwriting and mortgage origination activities at issue in the investigation.

U.S. District Judge Franklin Valderrama for the U.S. District Court for the Northern District of Illinois issued an October 2021 ruling in Astellas US Holdings Inc. v. Starr Indemnity & Liability Co. giving a convincing victory to a pharmaceutical company seeking reimbursement from its D&O insurer following the insurer's improper refusal to contribute its $10 million policy limits to an FCA settlement with the DOJ.[4]

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The court ruled in favor of the policyholder on numerous issues, including the availability, and insurability, of remedies available under the FCA, limiting coverage based on the definition of "loss" and the significance of labels like "restitution" in evaluating coverage for FCA settlements. The Astellas ruling has been appealed to the U.S. Court of Appeals for the Seventh Circuit.

On Feb. 25, 2022, in Call One Inc. v. Berkley Insurance Co., U.S. District Judge Andrea Wood for the U.S. District Court for the Northern District of Illinois rejected a D&O insurer's attempt to dismiss a telecommunication company's declaratory judgment action seeking coverage for a $2.5 million settlement it made with the state attorney general to resolve claims under the Illinois False Claims Act.[5]

The insurer argued that any settlement of claims brought under Illinois False Claims Act is uninsurable as a matter of Illinois law. The court disagreed, finding that the insurer ignored the plain language of the statute, which allows for remedies in the form of both damages and penalties.

The court also concluded that Illinois False Claims Act claims are not uninsurable as a matter of public policy and that the insurer could have drafted its D&O policy more clearly had it in fact deemed FCA claims to be too risky to cover. Thus, not only could the policyholder proceed on its breach of contract claim, but it also adequately stated a claim for bad faith denial of coverage based on the insurer's vexatious and unreasonable positions in refusing coverage.

To be sure, not all decisions involving FCA claims rule in favor of coverage.[6] However, policyholders should be optimistic regarding recent trends recognizing coverage for FCA investigations, enforcement actions and settlements, and look to those decisions for guidance in how to maximize coverage for FCA-related losses. Below are several key takeaways for structuring settlements and pursuing D&O or other insurance coverage for FCA exposures.

Follow the Policy Language

It seems simple, but policyholders should ensure that their claims are being measured by the actual policy language used — which in many cases affords broad coverage for a wide range of damages based on any act or omission by an insured — and not the presumed intent or expectation that a particular exposure won't be covered.

Coverage grants should be interpreted broadly to protect the policyholder, and that coverage should be restricted only if the insurer's intent to exclude a particular kind of claim is clearly and unambiguously stated in the policy.

The Call One case discussed above made clear that the policy language did not support the insurer's narrow view of coverage and concluded that if the insurer believes FCA claims to be "too risky to cover, it could have drafted its policy terms accordingly."[7] Because it had not, the court did not "go outside the language of the policy to fill in this gap" against the policyholder.[8]

Understand and Leverage the Parties' Respective Burdens to Establish or Negate Coverage

Policyholders carry the initial burden of establishing coverage under the terms of the policy. But once an insured shows that a claim falls within the scope of the policy's insuring agreement, the burden then shifts to the insurer to demonstrate that any exclusions or limitations clearly apply to bar coverage. Because

exclusions are interpreted narrowly against the insurer and in favor of coverage, this can be a strong tool to leverage in disputed FCA claims.

In the Affinity case, for example, the court expressly recognized that "arising out of" must be interpreted broadly to require only a causal connection when used in a provision extending coverage but that the same phrase is given a narrower meaning to require proximate causation when used in a provision excluding coverage.[9]

Likewise, in the Astellas case, the court held that the insurer, not the policyholder, must bear the burden of proof where it seeks to bar coverage for settlement payments based on exceptions to the definition of "loss," even where the applicable language is not contained in an express policy exclusion.

This burden-shifting on both exclusions and exceptions to coverage should favor policyholders in negotiating coverage for losses in FCA matters.

Government Investigations of FCA Violations Can Trigger Coverage

FCA exposures can take many forms, long before a complaint is filed or regulators initiate a formal enforcement action. While policies vary with respect to what constitutes a "claim" sufficient to trigger coverage, companies and their officers and directors implicated in government investigations of alleged FCA violations should not assume that coverage is unavailable in the absence of civil or criminal litigation.

Depending on the policy language, facts and governing law, coverage may be available upon issuance of a subpoena or civil investigative demand to produce documents or testimony in connection with alleged FCA-related misconduct.

Following established Delaware precedent, the court in Guaranteed Rate concluded that a civil investigative demand triggered the insurer's broad duty to defend against an investigation and that for the purposes of determining coverage, there is no distinction between investigation or unlawful acts — as referenced in civil investigative demands and subpoenas — and actually alleging such acts, as in a complaint.[10]

Similarly, the broad definition of "claim" favored the policyholder in Astellas where the policy included a written request to toll or waive the applicable statute of limitations, which occurred during the course of the DOJ's investigation of FCA violations.

FCA Remedies Are Insurable

Insurers often take the position that FCA-related settlement payments are uninsurable as a matter of law and violate public policy because they amount to restitution. Recent case law suggests otherwise, with two federal judges concluding that the FCA does not even allow for restitution in the form of disgorgement of the violator's unjust gains. Rather, the statute permits only compensatory damages, civil penalties or actual loss.[11]

This may be true even where an FCA settlement expressly labels a payment as "restitution." The Astellas court declined to even consider the restitution label in the company's settlement as persuasive evidence that the payment was, in fact, restitution paid to the government. Instead, it looked to the dictionary definition of "restitution," which included both "disgorgement" and "compensation."

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Relying on statements from policyholder's lead counsel in the DOJ negotiations, the court also recognized that use of the "restitution" label in the settlement agreement was for the sole purpose of complying with the Tax Cuts and Jobs Act of 2017.

The court ruled that, in the absence of any contradictory evidence from the insurer, the policyholder had demonstrated that restitution labels were used for tax reasons and that the portion of the settlement agreement referencing "restitution" did not support a finding that the government sought disgorgement of profits from the company.

Coverage for FCA settlement payments may also extend to fraudulent conduct where fraud is only alleged and a settlement contains no admissions of wrongdoing or liability evidencing intentionally or willful conduct. Insurers again may turn to general public policy and uninsurability defenses, but courts have found those are not enough in the absence of clearly articulated, governing public policy against insuring for those allegations.

In Call One, the court discussed at length the various moral hazards and types of insurance found to be against public policy but concluded that "fraud is not among them."

In fact, the Astellas court found that articulated public policy actually supported insurability based on the parties' freedom to contract for coverage based on allegations of fraud.

Those cases are in line with other recent decisions, like the Delaware Supreme Court's landmark March 2021 decision in RSUI Indemnity Co. v. Murdock, holding that fraud-based claims are insurable under D&O policies.[12]

Conclusion

Coverage disputes in FCA matters are likely to rise alongside growing regulatory scrutiny and enforcement. Some recent policyholder-friendly decisions remain active or are on appeal, so time will tell how these and other courts will rule on critical issues like investigation coverage and insurability.

Policyholders facing actual or potential FCA exposures through investigations, enforcement actions, or otherwise should consider the issues discussed above in handling both the underlying defense and related insurance claims..

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Notes

1. Justice Department's False Claims Act Settlements and Judgments Exceed $5.6 Billion in Fiscal Year 2021, https://www.justice.gov/opa/pr/justice-department-s-false-claims-act-settlements-and-judgments-exceed-56-billion-fiscal-year.

2. Affinity Living Group, LLC v. Starstone Specialty Ins. Co., 959 F.3d 634 (4th Cir. 2020).

3. Guaranteed Rate, Inc. v. ACE Am. Ins. Co., No. N20C-04-268 MMJ CCLD, 2021 WL 3662269 (Del. Super. Ct. Aug. 18, 2021).

4. Astellas US Holdings, Inc. v. Starr Indemnity & Liability Co., No. 17-cv-08220, 2021 U.S. Dist. LEXIS 195236 (N.D. Ill. Sep. 23, 2021), on appeal, No. 21-03075 (7th Cir. filed Nov. 8, 2021).

5. Call One, Inc. v. Berkley Ins. Co., No. 21-cv-00466, 2022 WL 580802 (N.D. Ill. Feb. 25, 2022).

6. See, e.g., Springstone, Inc. v. Hiscox Ins. Co., No. 20-6014, 2021 WL 4240779 (6th Cir. Sept. 17, 2021) (affirming no-coverage ruling for company's claim for defense costs in connection with a whistleblower suit alleging FCA violations and related government-issued subpoena on the grounds that suit was first made prior to policy period, the subpoena was not a "Claim," and even if subpoena was a claim the policy precluded coverage for fines, penalties, and non-monetary relief).

7. Call One, supra.

8. Call One, 2022 WL 580802, at *10.

9. Affinity Living Group, 959 F.3d at 641.

10. Guaranteed Rate, 2021 WL 3662269, at *2.

11. See Astellas, 2021 WL 4711503, at*15 (stating that "the FCA allows only for civil penalties and compensatory damages, not for restitution in the form of disgorgement"); Call One, 2022 WL 580802, at *7 (stating that the IFCA "provides for compensatory damages or actual loss, not disgorgement, as a remedy").

12. Rsui Indem. Co. v. Murdock, 248 A.3d 887 (Del. 2021).

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