Foreign Corrupt Practices Act Claims

by STEPHEN T. RAPTIS

With FCPA enforcement on the rise, companies must be protected. But for small and mid-sized companies that may not be in a position to purchase costly FCPA-specific insurance products, D&O policies can often provide the coverage they need.

The federal government has ramped up enforcement of the Foreign Corrupt Practices Act (FCPA) in recent years. Generally speaking, the FCPA prohibits U.S. companies (and foreign companies with certain U.S. ties) from bribing foreign government officials to further their business interests. This bribery does not have to involve cash payment, and may include non-monetary "favors" or items that may traditionally been considered merely "gifts." Through increased enforcement of the FCPA, the United States is better defining the sometimes blurry line between acceptable business practices and illegal corruption. Presenting a Chinese diplomat with a bottle of local Kentucky bourbon as a gesture of thanks for his hospitality should not be treated the same as handing that official an envelope of cash in the backseat of an unmarked car.

For those that violate the FCPA, the costs can be staggering. Companies may be fined millions, forced to forfeit profits and prohibited from doing future business with U.S. government entities.

The legal fees can be even greater. In 2010, Daimler AG settled an FCPA investigation by paying $93.6 million. But that wasn't the worst of it. The settlement paled in comparison to the more than $500 million a company source told *Forbes* that it cost the German automaker to comply with the investigation, which began in 2004, required the services of 85 outside attorneys and looked at transactions in 75 countries.

PROTECTIONS AND LIMITATIONS

Historically, companies facing FCPA claims have primarily turned to their directors and officers liability (D&O) policies for coverage. A policy will typically provide some protection, but the level of coverage can vary—often substantially—based upon its terms.

Insurance products introduced in 2011 by Chartis and Marsh (through XL Insurance) have been marketed as coverage for certain FCPA-related costs not typically covered by D&O policies. (Investigation costs, for example.) These FCPA-tailored policies can be expensive, however, and they do not purport to provide complete coverage against costs associated with FCPA claims. For many smaller and mid-sized companies exposed to FCPA claims, this coverage simply may not be cost-effective.

D&O policies typically insure against loss arising from a claim alleging a wrongful act committed by the company's officers and directors. The company can also elect to purchase optional entity coverage (often called Side C coverage), which protects the company itself against loss arising from covered claims. Because most FCPA claims involve at least some allegations directed at the company as well as its leadership, entity coverage is essential.

For most publicly traded and large private companies, however, the scope of available entity coverage is limited to "securities claims," as defined in the policy. Typically, this definition is not broad enough to include—and in some cases expressly excludes—FCPA claims. (Although it should be noted that costs resulting from some litigation, such as shareholder derivative actions from an FCPA investigation, may be covered). Small and mid-sized companies, on the other hand, are often able to obtain broader entity coverage that may cover certain FCPA-related costs, depending on the relevant policy language.

Ultimately, neither entity D&O nor FCPA-specific policies provide complete protection against FCPA claims. Neither is likely to cover the company against fines or penalties imposed under the FCPA, for example. (Although some D&O policies cover fines and penalties levied against the company's individual officers and directors).

That said, for most companies, incomplete coverage is preferable to no coverage, particularly given the potentially devastating costs associated with FCPA claims. Thus, companies that are able to purchase broader entity D&O coverage should carefully consider doing so.

CRITICAL D&O POLICY PROVISIONS

Seemingly inconsequential differences in D&O policy language can have profound consequences on coverage for FCPA claims. The following policy provisions should be of particular concern to companies with FCPA exposure.

1. Dishonest or Criminal Acts Exclusion

Most D&O policies contain exclusions for claims arising from acts or omissions that are intentionally dishonest or criminal. Given the nature of the conduct prohibited by the FCPA, these exclusions may be implicated by the circumstances of many FCPA claims.

D&O policy language differs meaningfully in the extent to which the excluded conduct must be established. In particular, the exclusion under many D&O policies applies only where there is an admission or formal adjudication that the acts or omissions at issue were intentionally dishonest or criminal. Many FCPA claims are settled or dismissed with no admissions or formal adjudication, and the exclusion would not apply to these claims.

Some exclusions, however, apply where the claim at issue merely alleges intentionally dishonest or criminal conduct. Because allegations of dishonest or criminal conduct are the norm in FCPA claims, exclusions containing this broad language may severely restrict coverage. While most companies probably will not be able to negotiate a complete removal of this exclusion from their D&O policy, they should assure that their policy contains the narrowest language possible.

2. Pre-Claim Defense Costs

D&O policies do not cover costs that the insured incurs in defending or investigating a matter that has yet to become a formal claim, even if the matter later becomes a formal claim or the pre-claim defense efforts ultimately benefit the defense of a later asserted claim.

Although the definition of "claim"

varies among policies, it often includes a written demand for monetary damages or injunctive relief. It also may include the commencement of formal civil or criminal proceedings through a written instrument, such as a civil complaint or criminal indictment. Insurers often contend that the issuance of a subpoena or commencement of an investigation by the government, without more, does not constitute a covered claim.

Thus, even though the company may spend substantial sums in responding to a subpoena or defending an investigation that ultimately aids in the defense of (or even prevents) a subsequent claim, insurers often assert that such expenses are not covered. While a company may not have the negotiating leverage to demand wholesale modifications to the definition of claim, it can seek to negotiate policy language that defines that term as broadly as possible.

3. Notice Issues

Most companies understand that they are required to provide timely notice to their insurer of claims against the company. Many do not realize, however, that under most D&O policies, companies are also required to provide notice of circumstances that could give rise to a covered claim once such circumstances become known to the company. Failing to comply strictly with both obligations can, in some cases, result in a reduction or forfeiture of coverage.

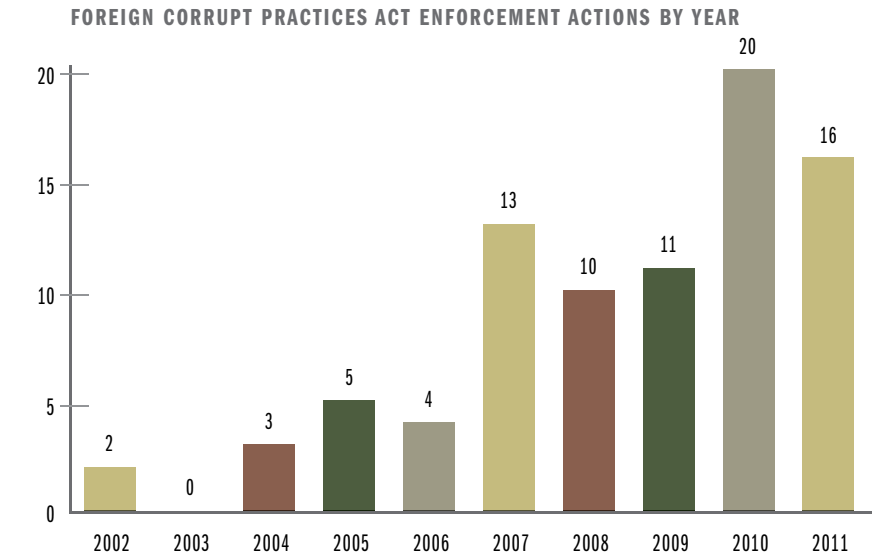
Circumstances that could result in a violation of the FCPA may become known to a company well before it materializes into an actual claim, as defined in the policy. At such a time, the company is likely to be focused on internal investigation and damage control rather than seeking insurance for a claim that has yet to be asserted. All too often, such companies fail to provide timely notice of these circumstances, thereby providing their insurer with a substantial defense to coverage.

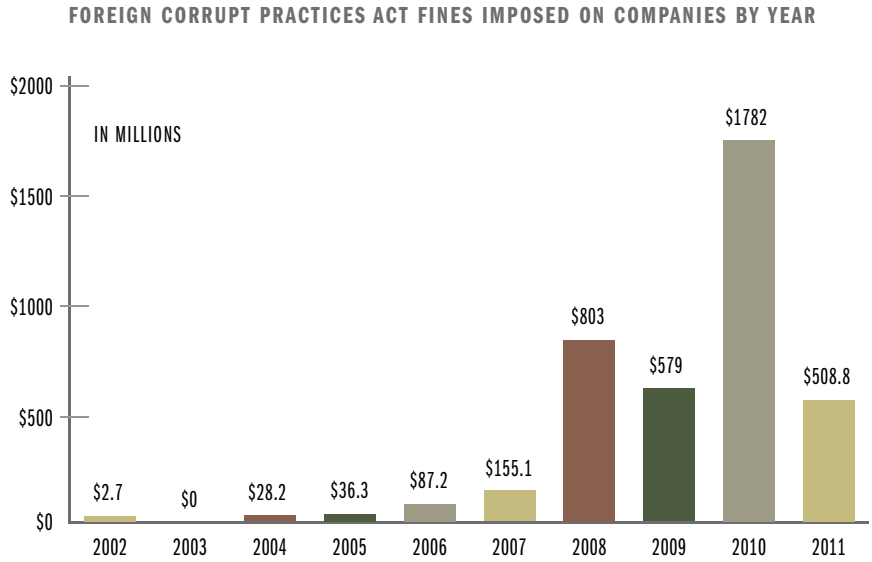
Accordingly, companies need to be mindful of, and strictly comply with, both notice obligations. Focusing on notice upon discovery of a potential FCPA violation may also provide the company an opportunity to conduct a more thorough investigation of the circumstances being reported, anticipate the insurer's potential defenses to coverage, and frame the notice in a manner that supports the insurance claim and avoids coverage defenses.

4. Cost Allocation Issues

Where a company elects not to purchase entity coverage and both the company and its officers and directors later become the subject of a potentially covered claim, most D&O policies contain allocation provisions governing the extent to which the insurer will pay for defense and indemnity of the officers and directors. These provisions also typically address allocation of defense and indemnity costs with respect to claims alleging both covered and uncovered matters.

These provisions may vary in critical ways. For example, some allocation provisions state that loss is to be allocated among covered and non-covered matters based on the relative legal and





financial exposure to the insured presented by each. Others simply state that if the parties cannot mutually agree to an allocation, the dispute will be submitted to arbitration. Likewise, some allocation provisions apply only to indemnity costs but not to defense costs, which, given the substantial costs of defending many FCPA claims, can have significant financial implications. In any event, companies need to review these provisions carefully at renewal time, particularly if they choose not to purchase entity coverage.

5. Non-Rescission and Severability

D&O policies typically do not cover claims where relevant facts underlying the claim were known to the company at the time the company applied for coverage but omitted (or misstated) in the company's application for coverage. Indeed, if during their investigation of a coverage claim, the insurer discovers information indicating that one or more individuals within the company had knowledge of relevant facts that may have affected the insurer's decision to issue the coverage but failed to report (or misstated) such facts, the insurer may seek to rescind the policy altogether.

In some cases, companies can purchase D&O coverage that, by its terms, cannot be rescinded by the insurer. This is often accomplished by the addition of a "non-rescindable coverage" endorsement. Companies would be well-advised to seek inclusion of non-rescission language in their D&O policies.

If non-rescission is not an available option, however, companies can also protect themselves through so-called "severability" provisions. Typically, these provisions limit the individuals within the company whose knowledge is deemed relevant (e.g., certain officers and directors) for purposes of representations in the coverage application (or for other purposes, such as operation of certain knowledge-based exclusions). They also may limit the imputation of coverage—preclusive knowledge among the various insureds, including the company.

The narrower the scope of individuals whose knowledge is deemed relevant or imputable, the less likely the company and its officers and directors are to lose coverage for an FCPA claim. This is particularly true when the circumstances underlying the claim are not widely known within the firm. Companies should therefore seek to negotiate the severability language in their D&O policies as broadly as possible.

For those that violate the law, the costs can be staggering. Companies may be fined millions, forced to forfeit profits and prohibited from doing future business with U.S. government entities.

READ CAREFULLY

For small and mid-sized companies that may not be in a position to purchase FCPA-specific insurance products, their D&O policies often provide coverage for certain costs associated with FCPA claims against the company's officers and directors. The company may also have coverage for certain costs associated with FCPA claims against the company itself if it elected to purchase entity coverage within its D&O policy.

The extent to which such costs are covered will often turn on specific policy language, which can vary substantially from policy to policy. Thus, companies should review the terms of their D&O policies carefully and, where warranted, seek more favorable terms at renewal time. ■

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