

Policyholders Should Take Steps to Review Their D&O Policies and Take Other Steps to Increase the Potential for Coverage for Whistleblower Claims

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On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which includes new whistleblower protections—and resulting risk to policyholders. The Dodd-Frank Act provides incentives for whistleblowers to report information “relating to a violation of the securities laws” to the U.S. Securities and Exchange Commission (SEC).

The whistleblower provisions provide a powerful monetary incentive to report suspected violations of the Securities Exchange Act of 1934. For instance, Section 922 of the Dodd-Frank Act amends the Securities Exchange Act to provide for monetary awards if reported information leads to the “successful enforcement” of a covered judicial or administrative action by the SEC. If the SEC recovers more than \$1 million, the whistleblower is entitled to 10% to 30% of the imposed monetary sanctions. The Dodd-Frank Act provides for an April 15, 2011 deadline for SEC’s implementation of the reward program.

In advance of the enactment of this rewards program, policyholders should review their D&O insurance programs to determine whether the insured entity and insured persons will be covered under the current D&O policy wording if they are compelled to respond to whistleblower investigations and any resulting administrative, criminal, or civil proceedings. Policyholders that determine that there are potential gaps in coverage in the current policy should explore whether these gaps can be closed on renewal or even midterm—and before a claim is made.

Potential coverage issues that should be explored include (1) whether any “insured vs. insured” exclusions commonly found in D&O policies may provide a basis for the insurer to argue that the whistleblower investigation claim is excluded from coverage, (2) whether costs associated with a whistleblower investigation are covered, and (3) whether the SEC bounty portion of any resolution would be considered a covered loss.

D&O policies often contain exceptions to the “insured vs. insured” exclusion; one common exception is that the exclusion does not apply to shareholder derivative claims. Insureds should consider whether to seek an express exception to the “insured vs. insured” exclusion for whistleblower investigations and any resulting proceedings. Although the SEC (not the whistleblower) conducts the investigation, having an express exception for whistleblower investigations and resulting proceedings in the policy would avoid the potential for a dispute about the applicability of this exclusion if a whistleblower claim is brought under a D&O policy.

Policyholders should also examine their D&O policies to determine whether the obligation to defend or to pay defense and investigation costs would apply from the inception of the whistleblower investigation and before the formal commencement of an administrative, criminal, or civil proceeding. As with the activities that are associated with investigating a shareholder derivative demand, the corporation's response to a whistleblower investigation may be costly and is often integral to the coordinated defense of subsequent proceedings flowing from the investigation.

In addition, policyholders should determine whether, if they are required to pay a fine to the SEC to resolve any proceeding, their D&O policies would cover as "loss" the amount that is paid to the whistleblower as a "bounty." Policyholders should consider negotiating for policy language that would provide that any "bounty" does not increase or decrease the amount of a covered loss.

In conclusion, with an always evolving regulatory landscape, it is good practice for policyholders to regularly analyze their policies to make certain their insurance coverage is aligned with these changes and that their expectations regarding the scope of their insurance coverage match the language of their policies, and to seek amendments or clarifications of their insuring provisions.

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