

Obtaining Insurance Coverage for a SEC Investigation

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A corporation's directors and officers ("D&O") insurance Policy is meant to provide coverage for securities claims and administrative or regulatory proceedings. Insurers argue, however, that an SEC Formal Order directing the company to provide information, documents and testimony does not constitute a "claim" under the corporation's D&O Policy and thus the often-substantial legal fees and costs incurred in responding to the Formal Order are not covered under the D&O Policy.

The insurers are wrong, and companies responding to a SEC Formal Order should immediately notice its D&O insurer and engage coverage counsel.

While D&O insurers' attempt to draw a hard line between a regulatory or administrative proceeding and a SEC investigation, both the SEC and the courts have consistently characterized a SEC Formal Order as a proceeding before an administrative and regulatory agency.

A SEC Formal Order empowers the SEC to administer oaths; subpoena witnesses and compel their attendance; take evidence; require document production; and determine whether securities law violations have occurred.

The SEC's rules and enforcement manual plainly state that a Formal Order triggers a "formal investigative proceeding". The rules relating to SEC investigations — adopted pursuant to authority delegated to the SEC by Congress — begin by defining a SEC Formal Order as a formal investigative proceeding (see 17 C.F.R. Section 203.4(a)).

The courts agree. See, e.g., *United States v. Senfner*, 280 F.3d 755,761 (7th Cir. 2002) (holding that "(a)n SEC investigation is a 'proceeding'—a term that is defined rather broadly...and reasoning that "sufficient to distinguish an investigative proceeding (from a mere police investigation) is the authority to issue subpoenas and administer oaths". See also *United States v. Batten*, 226 F. Supp.492,494 (D.D.C. 1964) ("the term 'proceeding' ..should be construed broadly enough to include any investigation directed by a formal order of the Securities and Exchange Commission").

These cases are consistent with a plethora of cases involving investigations by governmental agencies other than the SEC that hold that an agency investigation is a proceeding when the agency can issue subpoenas and administer oaths as the SEC Formal Order empowers the SEC to do. Examples include investigations by the Inspector General, the Agency for International Development, Defense Contract Audit, Customs Service, and the Federal Trade Commission.

The company's receipt of a Formal Order from the SEC results in the engagement of counsel for the company and for its directors and officers. These legal costs should be covered under the corporation's D&O Policy, but the insurer has no obligation to reimburse these costs until notice is provided to the insurance company. Retention of coverage counsel to assist in noticing your insurer and ensuring compliance by defense counsel with your D&O insurer's billing guidelines greatly improves the company's ability to obtain coverage without litigation.



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