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Recent Developments In Insurance Coverage For FCA Claims

By **Dustin Cho and Josh Silver** (November 4, 2024, 4:34 PM EST)

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In the last two months alone, the U.S. Department of Justice has announced well over $1 billion in payments to settle claims under the False Claims Act.[1]

The act authorizes the government to collect, among other things, treble damages from one who "knowingly presents" to the U.S. government "a false or fraudulent claim for payment."[2] The payers in these recent announcements ranged from pharmaceutical companies, medical device manufacturers and hospitals to education providers, mortgage lenders, defense contractors, and accounting and law firms.

Each announcement is a reminder that FCA investigations and lawsuits often have a substantial impact on businesses and their directors, officers, employees, and shareholders. And these settlement payments reflect only a portion of the total exposure.

Companies typically incur substantial defense costs in connection with FCA investigations, and they and their directors, officers, and employees also may face parallel criminal investigations or follow-on securities litigation that arise from FCA claims.

Insurance coverage can play an important role in helping to defray the substantial costs related to many FCA investigations. Insurers, however, often raise a variety of defenses to coverage, and there may be traps for unwary policyholders, some of which are specific to these types of claims.

Recent court decisions have addressed three areas of dispute: which types of insurance policies cover FCA claims, which policy periods apply and which portions of FCA-related losses are covered.

Which Lines of Coverage May Apply

Given the wide variety of fact patterns that can give rise to a claim under the FCA, as well as the breadth of related litigation that may arise from such claims, several lines of insurance may provide relevant coverage. These include directors and officers, or management liability insurance; professional liability, or other errors and omissions, or E&O, insurance; and others.

Which line or lines of coverage may apply to a particular FCA claim can depend, among other things, on the nature of the target's business, the scope of potentially applicable coverage, the jurisdiction in which the claim may be brought, and the nature of the underlying allegations. Two commonly applicable lines of coverage are D&O and E&O insurance.

D&O insurance typically provides broad coverage for private companies — including some public companies' private subsidiaries[3] — that often encompasses a wide array of claims arising out of a company's management and other operations.[4]

Public companies' entity coverage under D&O insurance is typically narrower, often limited to "securities claims" against the company, but still may cover claims including certain investigations, shareholder class actions or derivative lawsuits that sometimes follow an FCA investigation.

Both public and private companies' D&O insurance typically also provides broad coverage for individual directors and officers. E&O insurance, which may not be routinely purchased by many businesses, can come in many forms, including professional liability insurance, which often covers claims arising out of conduct related to the policyholder's provision of professional services.

In the FCA context, D&O and E&O policies may provide coverage for, among other things, companies' and individual directors' and officers' defense costs and settlements associated with FCA investigations and related qui tam actions, as well as follow-on investigations and lawsuits.

Recent court decisions have recognized coverage for FCA investigations under both D&O and E&O policies.

Last year, for example, in ACE American Insurance Co. v. Guaranteed Rate Inc., the Delaware Supreme Court **upheld** coverage for an FCA claim under a D&O policy.[5] That case involved a mortgage lender that sought coverage under both its D&O and professional liability policies in connection with an FCA investigation and settlement.

The D&O policy contained an exclusion for loss "arising out of ... any Insured's rendering or failure to render professional services."[6] This type of "dovetailing" exclusion is sometimes added to a D&O policy to exclude certain claims that are covered under the policyholder's professional liability policy.[7]

In Guaranteed Rate, the same insurance company issued both types of policies, and first successfully argued that its professional liability policies did not cover the claim because the "investigation and settlement did not arise out of Guaranteed Rate's professional services."[8] After winning that argument, however, the insurer argued that coverage was also barred under the D&O policy by the professional services exclusion.

The Delaware Supreme Court rejected the insurer's attempt to have it both ways.[9] The outcome on such issues can depend on the nature of the FCA claim, the specific insurance policy language and the applicable state's law.[10] Guaranteed Rate is an important reminder that the interplay between coverage grants and exclusions in a company's suite of insurance policies can be a critical consideration in determining the applicable coverage for an FCA claim.

With respect to E&O coverage, in 2020, both the U.S. Court of Appeals for the Fourth Circuit and the U.S. Court of Appeals for the Fifth Circuit addressed whether an FCA claim was covered under a professional liability policy — and reached different results, based on the respective facts, policy language and applicable law.

In the Fourth Circuit **case**, Affinity Living Group LLC v. StarStone Specialty Insurance Co., an operator of adult care homes faced an FCA action for submitting Medicaid reimbursement claims for resident services that allegedly were not provided.[11] Its E&O policy covered "damages resulting from a claim arising out of a medical incident," which was defined to include an "act, error or omission in [the policyholder's] rendering or failure to render medical professional services [i.e., 'the health care services or the treatment of a patient']."[12]

The Fourth Circuit noted that in the context of a coverage grant, "the term 'arising out of' ... must be interpreted broadly to require only some 'causal connection.'"[13] Accordingly, the FCA claim fell within the scope of coverage because, while the "false-claims-act complaint does not seek damages for rendering or failing to render the personal-care services," the alleged false billing would not have occurred "but for the failure to provide the services."[14]

In contrast, the Fifth Circuit **held** that a mortgage lender's E&O policy did not cover an FCA investigation relating to certifications the mortgage lender had provided to the U.S. Department of Housing and Urban Development.[15] In that case, the E&O policy "only cover[ed] claims 'made by a third party client'" of the policyholder, and the court held that HUD was not the mortgage lender's client as specified under the policy.[16]

In addition to D&O and E&O policies, businesses and insurers should also consider whether other lines of coverage may apply to specific claims that may arise in connection with FCA investigations and lawsuits, such as general liability and cyber insurance policies.

Which Policy Periods May Apply

An unusual aspect of FCA claims is that a qui tam complaint against the policyholder may have been filed under seal, unbeknownst to the policyholder, months or even years before the policyholder even becomes aware of any claim or investigation. Some insurers may attempt to avoid coverage based on this procedural peculiarity.

Under the FCA, an individual whistleblower may bring an action for a civil violation of the FCA on behalf of herself and the U.S. government in the form of a qui tam complaint.[17] This qui tam complaint must be filed under seal and cannot be served on the defendant until a court orders service of the complaint.[18] The U.S. government can seek to keep the complaint under seal as it conducts an investigation.[19]

After a time, the government may reveal the existence of its investigation to a target, such as by issuing subpoenas or civil investigative demands. At that point, the target of the investigation might notify its current insurers — still without knowledge of whether or when a qui tam complaint was filed against it. As a result, it may be years into an FCA investigation before the target of the investigation sees a copy of the qui tam complaint or learns when it was filed.

D&O or E&O policies typically cover claims that are first made during their respective policy periods. When the timing of the qui tam complaint is eventually revealed, depending on how early the complaint happened to have been filed, some insurers that issued policies covering a later period when the policyholder first learned of any claim may argue that coverage is unavailable under those policies. They may advance various arguments, including that a "pending and prior litigation" exclusion may apply.

The strength of such arguments can depend on the specific language of the policies and the facts, as well as applicable state law. Although these might seem like "gotcha" arguments that are inconsistent with the purpose and intent of a claims-made insurance policy's terms, this May an insurer prevailed on an argument along these lines in In re: Insys Therapeutics Inc. before the U.S. Bankruptcy Court for the District of Delaware.[20]

Unfortunately, that court appears to have been unaware of contrary authority.[21] Kevin LaCroix, writing in "The D&O Diary," has observed that results such as the bankruptcy court's recent decision are "harsh, unsatisfying outcomes" that would suggest "the D&O policy just doesn't work well" in these situations, and has noted that policy language clarifications could help ensure courts do not reach such anomalous results.[22]

Companies facing an FCA matter should consider as early as possible which policies should be noticed; when they should be noticed; and how the nature, scope and timeline of the underlying FCA claim should be communicated to insurers.

Which Portions of the Loss Are Covered

Disputes also may arise regarding which portions of FCA losses are covered.

The U.S. Court of Appeals for the Seventh Circuit recently addressed one such dispute: whether FCA damages in a settlement or judgment can constitute "restitution" or "disgorgement" that insurers may argue is subject to an exclusion or is uninsurable as a matter of public policy under the law of the relevant state. In a May 2023 decision, the court categorically **rejected** the insurers' arguments on this issue, holding that FCA settlement amounts can never be restitution or disgorgement for such purposes because the FCA "allows only for civil penalties and compensatory damages, not for restitution."[23]

The court noted that, "[a]s best we can tell, no court has ever interpreted the False Claims Act as allowing restitutionary remedies."[24] The Seventh Circuit reached this conclusion even though the settlement amount in question was characterized in the settlement documentation expressly as "restitution to the United States."[25] The nature of the relief permitted and sought, not the label, controlled the Seventh Circuit's analysis.[26]

The Seventh Circuit explained that this use of the "restitution" label was not especially probative because the term "restitution" was only included in the agreement for tax purposes.[27] Specifically, money paid to the government "in relation to ... [an] investigation" by the government "into the potential violation of any law" is not tax-deductible unless the amount "is identified as restitution" in a "settlement agreement."[28] That characterization is required to be included in settlement agreements with DOJ.[29]

With respect to other types of relief that may sometimes be imposed in FCA claims, policyholders should carefully analyze their specific policies and relevant laws, which sometimes preserve or preclude coverage for the multiplied portion of multiplied damages and other relief.[30]

Conclusion

Recent decisions regarding insurance coverage for FCA claims have provided additional clarity in certain respects, while also raising new questions that are likely to lead to future disputes.

To protect their rights to potential insurance recoveries on an FCA claim, policyholders should make sure to consider these and other potential coverage issues throughout the claim, including at the outset when providing notice of the claim under potentially applicable insurance policies, when providing updates to insurers during the investigation and any settlement negotiations, and in corresponding with insurers regarding their coverage positions and information requests.

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[1] 31 U.S.C. §§ 3729-3733. See U.S. Department of Justice, Fraud Section Press Releases, https://www.justice.gov/civil/fraud-section-press-releases (last visited Oct. 25, 2024).

[2] 31 U.S.C. §3729(a)(1)(A).

[3] See, e.g., Astellas US Holding Inc. v. Starr Indem. & Liab. Co., No. 17-CV-8220, 2018 WL 2431969, at *1-3 (N.D. Ill. May 30, 2018).

[4] See, e.g., HotChalk Inc. v. Scottsdale Ins. Co., 736 F. App'x 646, 648 (9th Cir. 2018) (noting that the D&O insurer "does not contest that the claims in the FCA Lawsuit" fall within the insurance policy's coverage grant).

[5] ACE Am. Ins. Co. v. Guaranteed Rate Inc., 305 A.3d 339, 341 (Del. 2023).

[6] Id. at 342.

[7] See, e.g., "Professional Services Exclusion," International Risk Management Institute, Inc. (IRMI), https://www.irmi.com/term/insurance-definitions/professional-services-exclusion (last visited Oct. 25, 2024).

[8] Guaranteed Rate, 305 A.3d at 341.

[9] Id. at 345, 348.

[10] Compare, e.g., Gallup Inc. v. Greenwich Ins. Co., No. N14C-02-136FWW, 2015 WL 1201518, at *11-13 (Del. Super. Ct. Feb. 25, 2015) (holding that a D&O policy's professional services exclusion did not apply to an FCA claim), with HotChalk, 736 F. App'x at 648 (holding that a D&O policy's professional services exclusion barred coverage for an FCA claim).

[11] See Affinity Living Grp. LLC v. StarStone Specialty Ins. Co., 959 F.3d 634, 636 (4th Cir. 2020).

[12] Id. at 640.

[13] Id. at 642.

[14] Id.

[15] See IberiaBank Corp. v. Illinois Union Ins. Co., 953 F.3d 339, 342 (5th Cir. 2020).

[16] Id. at 346-47.

[17] See 31 U.S.C. § 3730(b)(1).

[18] See id. § 3730(b)(2).

[19] See id. § 3730(b)(3).

[20] See In re Insys Therapeutics Inc., No. 19-11292, D.I. Nos. 22 & 24 (Del. Bankr. May 29, 2024) (holding that when a qui tam complaint had been filed, it had been "brought" for purposes of a pending and prior litigation exclusion, thus precluding coverage for a later-filed shareholder derivative suit).

[21] See Mountainside Holdings LLC v. Am. Dynasty Surplus Lines Ins. Co., No. 2003-127, 2014 WL 3055881, at *14 (Pa. Ct. Com. Pl. June 30, 2014) (holding that when a qui tam complaint had been filed under seal, it had not been "brought" for purposes of a pending and prior litigation exclusion because "the term 'brought prior to' is not defined with enough specificity — or any specificity — to make that determination" and therefore "[t]he Court cannot determine from the language, either in the clause itself or through reference, whether the phrase 'brought prior to' is meant to include actions filed under seal, or whether a party must be served before the exclusion is to take effect").

[22] Kevin LaCroix, "Coverage for Later Claim Precluded Due to Qui Tam Action "Brought" Earlier," The D&O Diary (June 2, 2024), https://www.dandodiary.com/2024/06/articles/d-o-insurance/coverage-for-later-claim-precluded-due-to-qui-tam-action-brought-earlier/.

[23] Astellas US Holding, Inc. v. Fed. Ins. Co., 66 F.4th 1055, 1074 (7th Cir. 2023).

[24] Id. at 1076.

[25] Id.

[26] See id. at 1076-78.

[27] See id. at 1076-77.

[28] 26 U.S.C. § 162(f), as amended by the Tax Cuts and Jobs Act of 2017.

[29] See Astellas, 66 F.4th at 1076.

[30] In Astellas, the Seventh Circuit held that "even if the $50 million [single-damages amount] was probably restitutionary, the other $50 million [i.e., the multiplied portion of multiplied damages] would remain compensatory and insurable." Id. at 1078.