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Insurance Policy Covers Defence Costs Incurred for Directors and Officers in Security Regulators' Investigation

As regulatory investigations and litigation against corporate directors and officers become increasingly complex and extensive, insurance policies covering defence costs are all the more important. But how far does this coverage stretch? The recent decision of *Liberty Silver v Liberty Insurance* demonstrates the significant value these policies can provide in covering an early and proactive legal defence. The court rejected the Insurer's narrow and technical interpretation of the insurance policy, and affirmed that legal costs incurred on behalf of senior officers and directors to respond to an Investigative Order by security regulators, even before any formal charges or accusations were laid, were covered.

In 2012, the Liberty Silver Corporation ("Liberty Silver") was the recipient of an Investigative Order from the United States Security and Exchange Commission (the "SEC"). This quickly involved the Ontario Securities Commission (the "OSC") and became a cross-border investigation into market manipulation and stock market fraud. Liberty Silver's lawyers carried out a significant amount of work on behalf of senior officers and directors to respond to investigators, and were ultimately successful in having the investigation abandoned. Liberty Silver claimed these legal fees from its Insurer, Liberty Insurance Underwriters Inc., under its Executive Advantage Policy.

After a protracted study of the claim, the Insurer refused to repay these defence costs. It claimed that: i) the Investigative Order did not constitute a "Claim" against an Insured Person; ii) it was not in respect of any "Wrongful Act"; and iii) there was no "Loss" which the Insured Persons or Liberty Silver was legally obligated to pay.

First, as legal fees were only recoverable under the Policy if incurred as the result of a “Claim” (which included “a formal criminal, administrative, or regulatory investigation against an Insured Person”), the Insurer argued that the Investigative Order did not constitute a formal investigation and that, in any event, it was commenced against Liberty Silver and not its officers or directors.

The Court rejected this argument on a plain meaning reading of the Policy, finding that the Investigative Order clearly commenced a regulatory investigation. Even though the Investigative Order was styled “In the Matter of Liberty Silver”, the operative portions of the Order showed that the investigation “clearly included the directors and officers of Liberty Silver.”

Second, as the Policy only insured claims arising from of any “actual or alleged” wrongful act, the Insurer argued that the Investigative Order only referenced “possible” violations of securities law, which was not sufficient to engage the “Wrongful Act” requirement of the policy.

The Court rejected this narrow definition of “alleged”, noting that if a Wrongful Act had to be “asserted to be true”, this would create an ambiguity in the Policy which covered a “formal ... regulatory investigation”. Investigations are undertaken to determine whether a regulatory offence has occurred. They are not undertaken to assert such an offence as true. This narrow interpretation thus created a clear inconsistency in the Policy which could not have been intended. Read as a whole, the court found that Wrongful Act included “any matters raised which gave rise to the investigation.”

Third, the Insurer also argued there was no “Loss” which Liberty Silver was legally obligated to pay, as it had agreed to assign all proceeds of the Application to its law firm creditors in exchange for release from all claims by the law firms. This agreement occurred almost 2 years after Liberty Insurance refused to pay the legal invoices.

The court was not pleased with this argument, saying “it can hardly have been the intention of the parties to allow the insurer to escape payment of justly incurred debts on the basis of a compromise it reached long after the claim crystallized.” This would be tantamount to allowing the insurer to “profit from its own wrongdoing in failing to pay legitimate claims in the first place.”

Ultimately, the court dismissed the Insurer’s technical arguments and allowed the application. Liberty Silver was entitled to indemnity under the Policy for the defence costs

incurred for directors and officers while responding to the SEC/OSC investigation. This case is a good example of how courts will interpret such policies in the future, and the breadth of coverage that they can provide.

With notes from Graham Henry.