

# I Want My Money Back: Fraud by Insured Results in Rare Attorney's Fee Claw-Back Award for Insurance Company

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They say fraud doesn't pay—or, at least they say that about crime. Anyway, it sure didn't pay in the case of *Protection Strategies, Inc. v. Starr Indem. & Liab. Co.*, in which the U.S. Court of Appeals for the Fourth Circuit agreed that an insurance company should get its money back from the company it insured.

Specifically, the Fourth Circuit said the insurance company should recover amounts paid (attorney's fees and expenses) to defend its insured against civil and criminal charges in connection with an alleged conspiracy involving the Small Business Administration's Section 8(a) program. Such a recovery, known as "recoupment," is available under various types of insurance policies, including the directors and officers (D&O) policy at issue in the *Protection Strategies* case.

What makes *Protection Strategies* an unusual case is that even though recoupment provisions are contained in most D&O (and other types of) policies, courts rarely apply such provisions; indeed, in light of that reality, insurance companies do not frequently seek recoupment. Of course, as a practical matter, most litigation is resolved by settlement before any fraud is "adjudicated," thereby precluding insurers from obtaining recoupment. Furthermore, as discussed below, there are many other factors that must be accounted for or satisfied before an insurer can even consider seeking recoupment.

## *Case Background*

Protection Strategies, Inc. (PSI) and its officers were investigated in 2012 for fraud and conspiracy in connection with the SBA's Section 8(a) program, which is designed to aid businesses owned by certain socioeconomic groups in accessing the federal procurement market.

PSI sought, and after filing suit obtained, reimbursement from its insurer Starr for legal costs and fees expended in connection with the civil and criminal investigations against PSI. Starr reimbursed PSI about \$846,000 in legal expenses by the time PSI pled guilty to criminal charges. Specifically, in 2013, PSI's former chief executive officer, former chief financial officer, former vice president, and former president pled guilty to criminal charges for fraud (or conspiracy to commit fraud) in connection with the SBA's Section 8(a) program.

After PSI's officers pled guilty, Starr contended several policy exclusions applied to bar coverage (specifically, the exclusions for profit, fraud, and prior knowledge), and sought to recoup the \$846,000 and change. The district court granted Starr's summary judgment motion on these issues, 2014 WL 1655370 (E.D. Va. 2014); the Fourth Circuit said "good call."

### *Pertinent Policy Terms*

The fraud exclusion in Starr's policy said the policy did not cover claims "arising out of, based upon or attributable to any deliberate fraudulent act or any willful violation of law by an Insured if a final judgment or adjudication establishes that such act or violation occurred." The district court found the fraud exclusion unambiguously applied to bar coverage, because PSI's chief executive officer, whose knowledge and acts were imputed to PSI, pled guilty to fraudulent transactions. Moreover, the plea agreement was a final judgment or adjudication, as required under the fraud exclusion.

PSI tried to avoid recoupment under the terms of the policy's broadly worded "100% Allocation Provision," which provided as follows:

"(a) If both Loss covered under this policy and Loss not covered under this policy are incurred by the Insureds on account of any Claim because such Claim against the Insureds includes **both covered and uncovered matters and/or parties...**

(i) ... One hundred percent (100%) of reasonable and necessary Defense Costs incurred by the Insured on account of such Claim will be considered covered Loss."

Under the 100% Allocation Provision above, if the claims against PSI involved mixed claims (i.e., some individual claims or persons were covered by the policy while others were not), Starr would have been obligated to cover its insured's defense costs in full. Here, however, the claims against PSI did not present any "mixed" claims; the district court found each of the claims was completely excluded from coverage.

### *The Takeaway*

Though recoupment provisions are contained in fraud exclusions in just about every D&O policy (as well as other types of policies), the Protection Strategies case is a relatively rare instance in which the insurer successfully obtained a judgment entitling it to recoupment of advanced legal expenses.

Whether Starr will be able to collect its judgment is another matter. Still, the case is a reaffirming, perhaps reassuring (hence, likely valuable) precedent for insurers in Starr's shoes, and may have a deterrent effect. And, whether or not Starr gets its money back, we can surely say crime didn't pay for PSI and its officers.

By Casey F. Wong

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