

Professional Liability Insurance for the Ethics and Compliance Professional

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¶61,300 Introduction

After your initial delight at being offered the position of chief ethics and compliance officer (CECO), before accepting the position, you should consider the professional and personal risks you may encounter in undertaking the role. By its very nature, serving as an ethics and compliance (E&C) professional can entail potential legal liabilities as well as internal career risks. E&C professionals, if doing their jobs effectively, may be called upon to challenge the senior officers of the organization, suggest structural changes to the status quo, or seek greater transparency of business practices. Now more than ever, it is important for E&C professionals to understand the legal protections available to them and, just as important, the limits of those protections.

For an ethics and compliance program to be truly effective, it is critical that the CECO and staff have a high degree of autonomy with full commitment and support from the organization. An important—but often neglected—consideration in this regard is whether the CECO is afforded protection by the company if the company or its directors and officers are named in a lawsuit for alleged actions or omissions. Because the CECO role can involve stepping into the line of fire in significant matters of potential misconduct, the E&C professional is a potential litigation target, and thus the prospective or

active CECO should carefully review the company's indemnification and insurance arrangements.¹

External E&C professionals (*i.e.*, consultants and compliance lawyers) also need to consider insurance protections. Lawyers, accountants, and other professionals who are retained to investigate and assess difficult compliance issues are similarly at risk of professional liability. Prosecutors and regulatory authorities have raised the issue of improper consulting practices that can expose both consultants and their clients to potential legal liability.²

¶61,310 Liability Exposure of Ethics and Compliance Professionals

When organizational failures and misconduct occur, litigation is bound to follow. The professional duties and relationship between a corporation and its directors and officers can result in the personal liability by those officers and directors to the corporation or its shareholders through various forms of litigation, including derivative actions (usually alleging waste or mismanagement), in which shareholders seek to recover on behalf of the corporation for damages allegedly suffered by the corporation and class action lawsuits (usually alleging violations of federal securities laws), in which shareholders bring suit to recover damages allegedly sustained by the shareholders personally.³ Officers of a corporation have a fiduciary relationship to the corporation and its shareholders, which is defined under state law. The courts typically have described the fiduciary

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¹ There are additional protections to explore beyond the scope of this chapter, such as use of employment contracts, severance

packages/golden parachutes, and board of directors resolutions. Joe Murphy, of-counsel to Compliance Systems Legal Group, has written extensively on "Protections for Compliance People," including the importance of establishing the clout, role, and mandate necessary to protect and empower the E&C professional. See Society of Corporate Compliance and Ethics (SCCE), *Working for Integrity*, 2006; ETHIKOS AND CORPORATE CONDUCT QUARTERLY, Jan./Feb. 2006.

² See Office of Inspector General (OIG), *Special Advisory Bulletin: Practices of Business Consultants*, June 2001.

³ Paul D. Krause, *Professional Liability Insurance Including "E&O" and "D&O" Policies*, 673 PLI/LIT 77, 90 (April 2002).

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duties of a corporate officer as consisting of the duties of loyalty, good faith, and due care.⁴ When a plaintiff alleges that a corporate officer violated his fiduciary duties and caused harm to the corporation because of mismanagement, waste or misconduct, the shareholders may maintain an action on behalf of the corporation if the directors refuse to sue or a demand upon them to sue would be futile.⁵

Other types of actions that may be brought against corporate officers include claims brought by employees or former employees, which usually involve allegations of wrongful discharge or discrimination, claims by the corporation's competitors or customers, or claims brought by other third parties. The claims made in such lawsuits, if successful, could bankrupt most individuals without indemnification from the company or adequate directors and officers (D&O) insurance coverage. Just the cost of defending against such lawsuits, even if lacking merit, can be extremely expensive.

Any of these potential actions against officers—shareholder derivative actions, class actions, actions by employees, former employees, clients, competitors, or others—could be a devastating event in the career of a CEO, if named as a defendant. (Whether a CEO is considered an “officer” as defined by the Securities and Exchange Commission (SEC) is discussed below.) Directors and officers have two types of potential protection against such suits—indemnity from the corporation and D&O insurance. This chapter seeks to explore both of these potential protections from the perspective of the E&C professional.

Liability for intentional misconduct. Of course, E&C professionals can face liability exposure for their direct conduct (*e.g.*, actual participation in an intentional tort such as fraud or criminal miscon-

duct). In what may be a foreshadowing development, more actions are being brought against general counsels for alleged wrongdoing.⁶ The government also has indicted lower-ranking in-house counsel for alleged involvement in corporate fraud.⁷ Notably, the U.S. Department of Justice filed a complaint alleging that a former general counsel had violated the False Claims Act when serving in the role of an organization's Corporate Integrity Program Director.⁸

Though criminal complaints against E&C professionals are (thankfully) quite rare, the number seems to be increasing, perhaps given the renewed focus on corporate crimes after passage of the Sarbanes-Oxley Act and the United States Sentencing Commission's (USSC's) 2002 Economic Crime Amendment. Examples of legal and regulatory actions involving E&C personnel include criminal charges brought against the chief compliance officer of a medical device manufacturer,⁹ the Senior Lawyer/Director of Ethics of a major technology company,¹⁰ and the Compliance Officer of a private hospital in Hawaii.¹¹

In *United States v. Caputo*,¹² a chief compliance officer was tried and convicted in federal court along with the company president and chief executive officer. The court took the opportunity during sentencing to discuss the importance of organizational compliance efforts. The judge in that case—Judge Ruben Castillo, the former Vice Chair of the USSC—addressed the value of E&C personnel, describing compliance professionals as corporate “fire personnel” and noting that they “are often the company's ‘first responders’ and must focus on both proactive and reactive efforts to be effective.”¹³ The court observed that the organization's system of corporate compliance was a total failure and the chief compli-

⁴ *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001).

⁵ 18B AM. JUR. 2D CORPORATIONS § 1583 (2007).

⁶ Pamela A. MacLean, *Record Number of General Counsel Charged in 2007*, NAT'L L.J., Oct. 2, 2007.

⁷ Sue Reisinger, *Aiming Lower*, CORPORATE COUNSEL, April 1, 2006.

⁸ *United States v. Sulzbach*, Case No. 07-61329 (S.D. Fla., Sept. 18, 2007). For a period of time, the former general counsel was also the chief compliance officer serving in a dual role.

⁹ Memorandum Opinion and Order in *United States v. Caputo*, No. 1:03-CR00126 at 26 (N.D. Ill., Oct. 16, 2006). The Chief

Compliance Officer was also the Vice-President of Regulatory Affairs.

¹⁰ See the criminal complaint brought in California involving the Hewlett-Packard pretexting incident, Felony Complaint, DA No: 061027481, Oct. 4, 2006.

¹¹ *Hospital Compliance Officer Indicted for Alleged Mail Fraud and Awarding Compliance Consulting Contracts to Herself*, AIS HEALTH BUSINESS DAILY, Nov. 1, 2007.

¹² *Supra* note 9.

¹³ *Id.* at 26.

ance officer's actions were "woefully and criminally inadequate" under any standard.¹⁴

As discussed below, when E&C professionals or other officers have acted in bad faith or engaged in self-dealing, indemnity or D&O coverage likely will be unavailable as a matter of law. However, given the sensitive nature of many E&C positions—with responsibility for investigating and responding to allegations of misconduct and establishing and implementing systems for preventing and detecting misconduct—it is not difficult to imagine scenarios in which E&C professionals could be brought into litigation or investigations, as witnesses or even as defendants. The cost of defending against such claims or obtaining legal representation when called upon as a witness can prove prohibitive.

Challenging management. Having an effective E&C program can help organizations prevent and detect misconduct, and also can help decrease penalties when misconduct does occur.¹⁵ But while E&C professionals can help organizations avoid or limit liability for the misconduct of their employees and agents, they also can find themselves in the unenviable (and often career limiting) position of being required to challenge the highest levels in the organization in their efforts to prevent or address illegal conduct.

The E&C professional is best served to keep in mind professional obligations and standards when faced with these types of difficult situations. Although there are no specific laws or regulations that currently provide guidance on such issues for the CECO, there are emerging professional codes that the E&C professional can turn to for support.

For example, the Health Care Compliance Association (HCCA) adopted a *Code of Ethics for Health Care Compliance Professionals* in 1999, which provides guidance on dealing with difficult compliance di-

lemmas.¹⁶ The HCCA Code describes the compliance professional's obligations to the public as "beyond [that of] other professionals" due to the responsibility of preventing misconduct.¹⁷

Another E&C professional code was recently promulgated by the Society of Corporate Compliance and Ethics (SCCE). That Code sets forth steps that E&C professionals should consider when faced with proposed misconduct. Rule 1.4 of the SCCE Code provides that an E&C professional should not consent, or passively appear to accede to, misconduct. Instead, he or she should object clearly. If the objections do not prevent the misconduct, the E&C professional should escalate the issue, including to the highest governing authority (*e.g.*, the board of the parent company) when appropriate. If these steps fail, the E&C professional may consider resignation.¹⁸

Both the HCCA and SCCE Codes make clear that an E&C professional should consider resignation only as a last resort, as he or she may be in a position to contest misconduct, and removing the E&C professional from the situation may make the misconduct more likely to occur. It is not difficult to imagine a scenario in which an E&C professional is left with the stark choice of whether to abandon principle to keep the job or do the right thing and lose the job.

¶ 61,320 Indemnification

The concept of indemnification provides that the company will bear the expense against liability, and often costs of defense as well, for acts arising out of an individual's performance of duties on behalf of the organization. Indemnification is a customary protection for board directors and officers. Most public companies have bylaws providing that the company shall indemnify directors and officers to the fullest extent permitted by the corporation's state

¹⁴ *Id.*

¹⁵ For a discussion of the potential benefits of adopting an E&C program, see Jeffrey M. Kaplan, *The Sentencing Guidelines: The First Ten Years*, ETHIKOS AND CORPORATE CONDUCT QUARTERLY, Nov./Dec. 2001.

¹⁶ For discussion on the HCCA Code see Joe Murphy, *Ethics for Ethicists? A Code for Ethics and Compliance Professionals*,

ETHIKOS AND CORPORATE CONDUCT QUARTERLY, March/April 2004.

¹⁷ HCCA, *Code of Ethics for Health Care Compliance Professionals*, R1.4.

¹⁸ *Id.*; SCCE *Code of Ethics for Compliance and Ethics Professionals*, R 1.4.

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of incorporation.¹⁹ Many states have enacted indemnification statutes to support the recruitment and retention of corporate leaders, and to protect them from frivolous lawsuits.

Indemnification statutes typically cover any person who is or was a party to a pending or threatened action, suit, or proceeding due to the person serving as a director, officer, employee, or agent of the corporation.²⁰ For example, for indemnification under California law, “agent” includes any person who was serving at the request of the corporation.²¹

Arguably, a chief ethics and compliance “officer” and other staff should be covered under a basic interpretation of these statutes. The language and purpose of indemnification statutes—to encourage capable individuals to serve in positions of corporate management, secure in the belief that the company will stand behind them—would seem to apply to the E&C professional and enable him or her to benefit from indemnification protections.

Indemnification practices, however, vary considerably by organization, with some companies’ bylaws and policies more flexible and generous than others.²² Further, indemnification is dependent on state law, and it is possible that management could erroneously refuse to indemnify an E&C professional (as well as a director or other officer).

In addition to reviewing the governing indemnification statute and company bylaws, it is recommended that the CECO and other E&C staff ask the following from their organization regarding indemnification coverage:²³

- *Does the company provide indemnification against claims and expenses in litigation?* Do not assume that indemnification is available.
- *Who may claim protection?* Determine specifically if you are included in the coverage and, if possible, get confirmation in writing.

- *What issues trigger coverage?* In addition to court proceedings, are other types of actions or proceedings indemnified? This includes pending and threatened grand jury investigations, internal corporate investigations, and Securities Exchange Commission (SEC) and other regulatory investigations.
- *What expenses are covered?* At a minimum, an E&C professional should seek to be indemnified for expenses and attorneys’ fees resulting from litigation. In some circumstances, E&C professionals also can be reimbursed for judgments, fines, and settlement costs arising from litigation. Whether particular expenses are covered depends on the nature of the action (*e.g.*, third-party lawsuits versus actions brought by or in the name of the corporation). It would be worth assessing the scope of expenses that are covered.
- *Are expenses advanced?* Indemnification statutes and corporate bylaws typically provide for the advancement of attorneys’ fees and other legal expenses in connection with the defense of the matter triggering the coverage. It is not expected that the right to receive such advances be conditioned on the merits of the proceeding even if wrongdoing against the corporation is alleged.²⁴

Statutes generally categorize indemnification as either permissive or mandatory. Permissive provisions do not impose a duty on the corporation to provide indemnification—implementation of the permissive authority requires action by the board of directors. The board typically has discretion to decide whether to grant indemnification absent a governing provision in the bylaws or other agreement with the affected individual.

On the other hand, mandatory provisions require the corporation to provide indemnification and can result in a judicially enforceable right. Some states extend mandatory indemnification beyond di-

¹⁹ See Fried Frank, Client Memorandum, *D&O Insurance: What Directors and Officers Should Be Thinking About in the Sarbanes-Oxley World*, March 11, 2003.

²⁰ See, *e.g.*, CAL. CORP. CODE § 317(d); 8 DEL. CODE ANN. § 145.

²¹ CAL. CORP. CODE § 317(a).

²² John Copeland, *Corporate Directors get ‘SOX’ ed by Insurers*, J. INS., RISK & PUBLIC RISK MGMT. (Spring 2005).

²³ For more discussion of indemnification coverage issues, see Copeland, *supra* note 22, and a collection of practical articles published by Directors & Boards, *D&O Insurance*, BOARDROOM BRIEFING, Spring 2007.

²⁴ See *e.g.*, CAL. CORP. CODE § 317(f); 8 DEL. CODE ANN. § 145(e); N.Y. BUS. CORP. L. § 724(c) (allowing advancement if the person seeking indemnification has raised a genuine issue of fact or law).

rectors and officers to employees and agents.²⁵ In most cases, when one is successful on the merits of a proceeding, indemnification is mandatory; if one is not successful, then indemnification is permissive.

Contractual indemnification agreements also can be drafted and tailored for particular individuals and to limit issues of potentially overbroad coverage concerns by the organization. Contractual indemnification rights can be even broader than those set out in the applicable statute and thus more attractive to the beneficiary, so long as the indemnification rights are consistent with public policy and the scope of the corporation's power to indemnify.

Indemnification typically is limited to cases in which the individual acted in good faith and in a manner he or she believed to be in the best interest of the organization. Thus indemnification will not be available if the individual is determined to have acted in bad faith or to have been motivated by improper personal interests. In addition, the advancement of legal expenses typically is conditioned upon repayment if it is determined that the individual is not entitled to indemnification.²⁶ Permissive indemnification usually is authorized only when the individual is found to have acted in good faith and in the best interest of the corporation. For mandatory indemnification, however, demonstration of success on the merits is often all that is required without a separate determination of good faith.²⁷

Because the scope of indemnification and its application can differ in many respects from company to company, a prospective CECO should carefully review the company's bylaws and any agreements and policies governing indemnification.

¶ 61,330 Directors and Officers Liability Insurance

D&O liability insurance protects corporate officers, directors, and the corporation itself from liabilities arising as a result of the conduct of directors and officers in their official capacity. For public companies, the primary source of D&O risk is share-

holder litigation, both in terms of claims brought and liability exposure.²⁸ D&O policies, however, are not limited to securities claims and, for privately held and not-for-profit organizations, can cover an array of acts and claims.

While organizations typically indemnify their directors and officers, sometimes they are financially unable to provide this protection (*e.g.*, due to insolvency or bankruptcy) or are unwilling to do so for economic or other reasons. Indemnification is only as secure as the balance sheet of the organization providing the protection, so directors and officers usually require the purchase of D&O insurance as additional protection in the event the company becomes financially unable to indemnify.

It therefore has become customary for organizations—even if financially sound—to insure against the risk of indemnification obligations through D&O liability insurance. One should think of indemnification as shifting the financial responsibility from the indemnified individual to the company, as compared to insurance, which shifts the risk to a third party, an insurance company (which anticipates that ultimately premiums will exceed loss payouts).

To make board service attractive, companies often seek to offer the best possible D&O insurance available as a way to recruit and retain board members, especially independent directors. When indemnification does not occur, directors will depend on the D&O insurance coverage to protect their personal assets.

While traditionally only “directors and officers” were covered (hence the term D&O insurance), coverage often is expanded in current practice to include at least some managers and nonexecutive employees. Policies should be carefully reviewed to ensure that those individuals who are intended to be covered are actually covered.²⁹

For example, an issue of coverage could arise if a nonofficer serves on a board-level committee, and

²⁵ See CAL. CORP. CODE § 317(d); 8 DEL. CODE ANN. § 145.

²⁶ *Homestore, Inc. v. Tafeen*, 888 A.2d 204 (Del. Super. 2005).

²⁷ See *Green v. Westcap*, 492 A.2d 260 (Del. Super. 1985).

²⁸ Towers Perrin, 2006 Directors and Officers Liability Survey, 53, April 2007 (reporting that 49% of the claims against participating public companies were brought by shareholders).

²⁹ The authors contacted several insurance carriers and agents who specialize in D&O insurance and asked if Ethics and Compliance Officers are generally covered. All responded that if properly written, D&O coverage can include the Ethics and Compliance Officer.

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the definition of “insured” appears restricted to directors and executive officers. This may be addressed by having board committee members included in the definition of “insureds.” Another practical consideration is to include junior executives in the definition of insureds where the junior officers traditionally are not considered officers, but their sub-certifications of quarterly financial reports are relied upon by the chief executive officer and the chief financial officer.

Additionally, there may be issues in determining if an insured was acting in the capacity of a defined director or officer, especially for those who may be acting in multiple roles, such as outside directors and general counsel.³⁰ A standard D&O policy may restrict coverage for individuals holding multiple roles or, in the case of the general counsel, explicitly exclude coverage for acts involving professional legal services.

Is the CECO a company “officer?” What is uncertain is whether a high-ranking ethics and compliance professional, such as a CECO, should be considered covered as a company officer if the D&O policy definition does not explicitly include the role of the CECO, or other comparable job title. The fiduciary obligations of the CECO to the public corporation and its shareholders is currently uncharted territory.

An argument can be made that the CECO should be considered an “executive officer” as defined by the SEC. As provided in the Securities Exchange Act of 1934 and defined in 17 C.F.R. § 240.3b-7, the “term executive officer, when used with reference to a registrant, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant.”

The definition of “high-level personnel” under the Federal Sentencing Guidelines for Organizations indicates the appropriateness of including the CECO within the category of the officers or even the executive officers of an organization. The Guidelines provide that “specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.”³¹ In other words, according to the Federal Sentencing Guidelines, the CECO should be a member of high-level personnel. The Guidelines further define high-level personnel to mean “individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization.”³²

In a poll conducted by the Open Compliance and Ethics Group³³ (OCEG) in November 2007, 32.3 percent of 421 participants responded that their CECO is considered a company officer as defined by the SEC. (We note that 18 percent of the poll respondents were not with publicly-held companies.) As many as 10 percent of respondents did not know if their CECO is considered an officer under SEC standards.

As with evaluation of indemnification protections, the E&C professional likely would benefit from careful review of the company’s D&O policy. The CECO should attempt to confirm coverage under the policy. Depending on the terms of the existing policy, an organization may need to work with its carrier to expand the definition of insureds explicitly to include the position of CECO. Depending upon their individual duties, inclusion of other E&C staff also should be considered.

In the OCEG poll discussed above, respondents also were asked whether the CECO is covered under their organization’s D&O policy. Of 323 respondents, 37 percent indicated that the CECO is covered under the D&O policy, whereas 14 percent stated that the CECO is not covered. In addition, 37 percent

³⁰ See Mitchell Auslander & Leah Campbell, “Coverage for Corporate General Counsel Under Directors and Officers Liability Insurance Policies,” Willkie Farr & Gallagher LLP, March 27, 2007, for discussion of issues regarding applying D&O coverage to the general counsel and other in-house attorneys. Claims against in-house counsel generally combine allegations of corporate officer wrongdoing with legal malpractice.

³¹ USSC Federal Sentencing Guidelines for Organizations, § 8B2.1(b)(2).

³² *Id.* at Commentary to § 8B2.1.

³³ OCEG (<http://www.oceg.org/>) is a nonprofit organization that provides thought leadership on corporate culture and the integration of governance, risk management, and compliance processes.

of respondents stated that they do not know whether their CECO has coverage. (The remainder either do not have a CECO or do not have organizational D&O coverage.) In other words, the number of respondents who *do not know* whether the CECO has coverage is equal to the number of respondents whose organizations provide such coverage to the CECO, evidencing the need for E&C professionals to perform additional due diligence in this important area.

In the healthcare industries, this unfamiliarity with liability insurance coverage appears to be supported by the HCCA's *2007 Profile of Health Care Compliance Officers* (9th Annual Survey). The HCCA survey asked, "Does the Chief Compliance Officer have additional liability coverage through the organization?" Of the 836 respondents, 35 percent were "not sure" (22 percent answered "yes" and 42 percent said "no").

The D&O policy. Assuming that the E&C professional is covered, what are the critical issues to consider when examining the organization's D&O policy? The following are some of the key coverage considerations:³⁴

- *What is normally covered?* D&O policies generally have three different types of coverage, and a company may select one or some combination of these options. Side A coverage is for the personal liability of officers and directors when the company is unable to indemnify them due to insolvency or because the corporation's by-laws or applicable law precludes indemnity. This is the coverage of most concern to the E&C professional, as it would pay for their defense and the satisfaction of claims and judgments if the company is unable to do so. The E&C professional should assess whether there is adequate side A coverage.³⁵ Side B coverage

reimburses a corporation for financial losses incurred from indemnifying directors and officers, while Side C protects the corporation itself from its own acts.

- *What is typically excluded?* D&O coverage is often narrowed through contractual exclusions.³⁶ Standard exclusions include fraud, personal profiting, other illegal compensation, pending and prior litigation, bodily injury/property damage, and ERISA claims. Some of these exclusions refer to claims usually covered by some other type of insurance. The fraud exclusion is important to closely examine; the better coverage insures you as long as you have not been "finally adjudicated" to have committed a fraudulent act. Most exclusions require a court determination or admission of guilt before a fraud exclusion can apply. Defense costs usually are covered until such time as the wrongful conduct is determined to have occurred. Because most civil cases are settled before adjudication, the exclusion usually is not triggered. Some insurers have removed the final adjudication limitation or have added language that the final adjudication can be in a separate declaratory judgment action. Competition among insurance carriers has influenced the increasing use of subtle wording differences and carve-out clauses as a means to restrict the scope of a policy.³⁷
- *How does the policy's limit of liability apply?* Typically there is a single aggregate limit of liability that applies to all claims that fall within the terms of the policy. Thus the number of insureds will affect the amount of coverage available because the aggregate limit will be reduced by the defense costs and indemnity of all insureds. Most D&O policies are wasting policies; that is, defense costs reduce the amount of cov-

³⁴ For chart comparisons and sample policy forms see THE D&O BOOK: A COMPARISON GUIDE TO DIRECTORS & OFFICERS LIABILITY INSURANCE POLICIES (The National Underwriter Company 1997). For more comprehensive discussion of D&O coverage issues and public policy considerations, see Copeland, *supra* note 22; Tom Baker & Sean Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, GEORGETOWN L.J., Vol. 95, Issue 6 (Aug. 2007); The Conference Board, *D&O Liability: Insurance Audit Practices* in CORPORATE GOVERNANCE HANDBOOK 2007.

³⁵ Statistically, the majority of D&O claims can be indemnified by the corporation and therefore would not trigger Side A coverage. Keith A. Martinsen, "What Directors Don't Know about Their Personal Risk," ABD Insurance and Financial Services, 2006.

³⁶ Gia H. Weisdon, Linnea B. McCord, & Melanie S. Williams, *What Board Members Need to Know About Insurance*, 17(2) J. MGMT. CONSULTING 48 (2006).

³⁷ The Conference Board, *supra* note 34.

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erage. Once the limit is exhausted, there is no more coverage available. This may be a factor in determining whether a CECO is added as an insured because the board of directors may be reluctant to dilute its own coverage.

- *Is there coverage for a criminal indictment or subpoena?* Coverage of costs incurred in responding to government subpoenas can be potentially valuable, as responding to a subpoena can require significant expenditures and the involvement of counsel. In addition, issuance of a subpoena often precedes an indictment. Because, under many policies, issuance of a subpoena will not trigger a claim, these expenses may not be covered, even though the early response may determine the outcome of an investigation. Some policies do not cover the expense of responding to a criminal indictment. Criminal indictments, however, may precede civil claims. It would be worth researching the extent of coverage under your organization's policy and possibly recommending that the company consider additional coverage to include pre-claim expenses and criminal matters.
- *What does a policy cover in terms of expenses?* A D&O policy typically will pay for the costs associated with the defense, investigation, negotiation, and settlement of a covered claim. This includes attorneys' fees, court costs, and filing fees. Most policies use the language "reasonable defense costs," and carriers may object to certain expenses as being "unreasonable." Policies also cover the judgment or court award. Most policies will specifically exclude criminal or civil fines or penalties or punitive damages, though these are additional coverage areas that can be negotiated with the insurer. Some policies require that the company use a lawyer who has been pre-approved by the carrier, which may preclude the covered individuals from using the law firm that he or she prefers or normally uses.

There are a number of difficult issues faced by an organization as it purchases or renews its D&O liability insurance. Like other insurance, D&O poli-

cies are affected by ongoing changes in the insurance market. The likelihood of a coverage dispute involving the E&C professional can be reduced if the policy terms are understood and questions addressed in advance. The E&C professional should consider seeking legal advice in reviewing the D&O coverage along with the assessment of indemnification.

¶61,340 Errors and Omissions Insurance

External E&C professionals are also at risk for liability and should consider obtaining professional liability insurance, also known as errors and omissions (E&O) insurance. E&O liability coverage is intended to protect against loss from a claim of alleged negligent acts, errors, or omissions in the performance of professional services, including failure to perform as promised in an engagement agreement with a client. If you are in the business of providing a service to clients for a fee, you have an E&O exposure. To put it simply, even with the best employees and risk management practices in place, mistakes will be made—or, even if not made, can be alleged to have occurred.

Most E&O policies cover judgments, settlements, and defense costs. As with in-house E&C professionals, even if allegations in a lawsuit are found to be groundless, extensive sums may be needed to defend the action. Litigation can more readily bankrupt the smaller firm or individual. By not purchasing liability insurance, an E&C consultant may be taking a serious financial risk.

Although there are E&O policies for almost any type of service "under the sun," a challenge for the E&C consultant is that he or she is working in a relatively new profession that, while growing in recognition, is not yet well understood. It can be difficult to ensure that insurance agents and underwriters really understand the business of health care compliance consulting. At this time, there are limited E&O products available for the broad range of ethics and compliance professionals, and, based on conversations with insurers, it seems that the market has not been inundated with a flood of requests.³⁸

³⁸ The authors contacted several insurance carriers and agents who specialize in D&O and/or E&O products and asked if they see a potential market need for more products geared toward

compliance and ethics professionals, internal and external. The general consensus was that there currently is not an immediate need for more specialized products.

E&C health care compliance professionals particularly need to keep in mind the distinction between consulting and those services falling under regulated professions such as law and accounting. Guidance provided by E&C health care specialists can run the gamut from legal to accounting to medical-clinical advice. E&C consultants with legal, accounting, or other professional licenses should evaluate whether the work they will perform will constitute a service that is regulated in their field. For example, an attorney who will be providing legal advice as part of his or her health care consulting services should secure the necessary legal malpractice insurance, and the same holds true for other types of licensed professionals.

Consulting can be viewed broadly as various trades practiced by individuals with assorted employment backgrounds and training. Unlike regulated professions, such as law and medicine, there is no licensure requirement for those practicing as health care consultants, nor is there any governmental regulation for that line of work. Depending on the individual consultant, one can provide a wealth of practical knowledge—for example, advice on the selection of the proper CPT® codes and implementation of operational procedures. Reliance on a consultant for advice on interpreting and applying the federal anti-kickback law or what conduct is permissible by the Fair Debt Collection Practices Act, however, would be ill advised, as such issues likely fall within the purview of legal advice requiring a lawyer who should have the necessary malpractice insurance.

As with any insurance, the best time to purchase an E&O policy is before the risk is taken, or, in other words, before professional services are performed. Many contracts with clients will require insurance to be in place and, in some cases, having appropriate insurance coverage can be an important selling point with your clients.

There doesn't appear to be standard policy language for E&O coverage. Each policy should be read carefully to make sure that the coverage being offered fits your exposures. Most E&O policies are written on a "claims made" basis. This means that any claims must be made or, in some cases, made and reported, within the policy period. These poli-

cies have a retroactive date that therefore becomes very important. Claims that arise out of acts committed prior to the retroactive date will not be covered. The farther back the retroactive date, the more coverage provided. Some policies also include defense expenses within the limit of liability. Some will exclude punitive damages. The wording of these policies can vary greatly, and, again, each policy must be carefully read.

The cost of E&O insurance may vary greatly depending on the class of business, location, claims experience (both of the individual insured and of the industry he or she is in), and from insurance company to insurance company. An insurance underwriter may ask for copies of contracts, a description of quality control procedures, documentation procedures, training procedures, etc., or, on the other hand, the carrier may ask for nothing more than a completed application.

The underwriter typically will review not only the E&C professional's experience to determine if he or she has had claims, but also will try to determine the reason that the professional has not been the subject of claims, if that is the case. Is it luck, or is the E&C professional engaging in activities or precautions that prevent the claims from being made? And, if the E&C professional has had claims, what steps has he or she taken to prevent the same or similar errors from occurring again? The more comfortable the E&C professional can make the underwriter with his or her operation and professional practices, the more likely the underwriter is to offer a competitive price on a policy and provide the coverage needed.

Because there may be a limited basis for comparison, the E&C consultant needs to be careful regarding which practice service area the insurance carrier and underwriter place them in. Being placed in the "wrong" practice area may make it difficult to obtain an affordable policy. However, insurance carriers with underwriting expertise and an appetite for underwriting niche-oriented professional risks can be found.

Key features to consider when evaluating a professional liability policy for the health care consultant include:

- *What is the extent of the coverage?* Does it include assignment areas where there is some impact on

patient or medical services? What is the definition of a claim?

- *Does the coverage include legal defense costs?* E&O liability insurance should pay for any resulting judgments against you including court costs up to the coverage limits on the policy. Is there coverage for punitive damages?
- *Does coverage extend to both W2 employees and 1099 subcontractors?* Coverage should protect you and your firm from claims resulting from the work done by 1099 subcontractors on your behalf. (It is important to note that 1099 personnel need their own E&O insurance because your policy will not cover them if they are sued separately or in addition to you. This is a question that E&C professionals should ask prior to utilizing the services of subcontractors.)
- *Is there optional coverage for allegations of copyright infringement and intellectual property infringement?* Intellectual property infringement coverage protects you against claims alleging copyright infringement. Software, systems, and processes are some of the most common types of “intellectual properties.”
- *Does the policy include coverage for personal injury?* Personal injury coverage protects you against claims of libel, slander, and invasion of privacy.

¶61,350 Steps to Take if You Are Charged or Named in a Lawsuit

Despite best efforts, a CECO still can potentially find him- or herself a named defendant in a civil lawsuit or the subject of a criminal investigation. If you face litigation in your capacity as an E&C professional, there are practical steps you can take to protect your rights:

- *Immediately retain independent and experienced counsel.* The time to respond to a lawsuit or subpoena varies by jurisdiction, and there is limited time to act. It is critical to quickly retain counsel who can assist in determining when and how to respond. Because the interests of the various defendants in a corporate action can diverge, it also is important to retain an attorney who is independent from those employed or

retained by the organization. In some cases it may be practical for individual defendants to have common representation, but that should be determined with advice from independent counsel.

- *Understand the rights and protections available.* As described in this chapter, you may be entitled to indemnification and D&O coverage, including the advancement of attorneys’ fees and expenses in connection with a lawsuit or other legal proceeding. You may be required to take certain steps, such as submitting a claim, to secure those rights. Your attorney can assist in determining whether the company has D&O insurance, as well as the applicability of the coverage and the availability of indemnification from your employer. Counsel also can advise on other legal defenses that may be available.
- *Preserve documents.* As soon as you are aware that a lawsuit has been or is likely to be filed or that a government investigation is contemplated, it is important to take those steps necessary to preserve documents and other material that may be relevant. Documents have a much broader connotation in this digital world and can include e-mails and other electronic files as well as meeting minutes and personal notes. Moreover, Sarbanes-Oxley imposes certain requirements on public companies regarding document destruction and retention.³⁹ Once an action is threatened, you should preserve all relevant materials without regard to the organization’s document retention policy and practices.

¶61,360 Conclusion

For most E&C professionals, the consideration of professional liability insurance and other protections has been—at best—an afterthought. Most CECOs and external consultants are not likely to need every type of coverage or the most extensive protections available. E&C professionals, however, should not downplay the importance of adequate protection in this regard, especially in light of the fact that their roles entail dealing with sensitive investigations, litigation, and enforcement actions. It

³⁹ Sarbanes-Oxley Act of 2002 §§ 802, 1102.

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should be no surprise if the CECO becomes increasingly targeted as a source of information by the government or plaintiffs' attorney due to his or her proximity to the company's handling of alleged misconduct.

In addition to litigation risks, being in the middle of conflicts with management is a difficult posi-

tion in which any CECO can find him- or herself. Early discussions with senior management by the prospective E&C professional (ideally *before* accepting the role) should include a discussion about the CECO's ability (and responsibility) to report issues to the board, the availability of indemnification, D&O, and other professional liability insurance, and other appropriate institutional protections.

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