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Directors & Officers coverage for wrongful acts by a company's officers and directors can play an important role in defending litigation over foodborne illness, particularly cases implicating the responsible corporate officer doctrine and wire fraud, attorneys J. Wylie Donald, Brian J. Osias and Kelly A. Lloyd say.

The authors urge food providers to consider their D&O coverage when facing litigation, government investigations and claims of market stigma.

Dishing Up Directors & Officers Insurance Coverage for Foodborne Illness

By J. Wylie Donald, Brian J. Osias and Kelly A. Lloyd

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One of the amazing accomplishments of modern civilization is the vast variety and amount of food available in advanced economies. Still unvanquished, however, is the peril of foodborne illness, which sickens and even kills.

The Centers for Disease Control estimate that in the United States 128,000 people are hospitalized annually; and 3,000 people die.[1] Food providers, whether restaurants, abattoirs, groceries, packing houses, or otherwise, spend millions to ensure their products are healthful and free of contamination.

But even the best sometimes stumble. And what if one is not the best, but merely doing the best one can?

[1] Centers for Disease Control and Prevention, *Estimates of Foodborne Illness in the United States*, http://www.cdc.gov/foodborneburden/ (last visited March 12, 2015).

The results of an error, an oversight, or a misconception can be catastrophic for individual consumers. Their injuries will be vindicated by lawsuits,[2] governmental investigations,[3] and market stigma.[4] And that in turn, can lead to business catastrophe.

Businesses protect against catastrophe with, among other things, insurance. This article addresses Directors and Officers insurance, commonly known as ''D&O,'' which, as its name suggests, protects one of the most important assets a business has: its management and leadership.

All in the food business are familiar with Peanut Corporation of America (PCA). Its distribution of salmonella-contaminated peanuts resulted in nine deaths with hundreds more sickened.[5] What really focused everyone's attention were the felony indictments by the Department of Justice (DOJ), and the subsequent jury convictions on wire fraud, Food, Drug & Cosmetic Act (FDCA) violations, and obstruction of justice. But PCA is an outlier. The facts as established at trial were extreme. Tainted product was intentionally shipped before test results were received back from the laboratory. Knowing product was contaminated, the company president sent an email saying: ''Just ship it.''[6]

Using D&O Coverage to Temper DOJ Actions

Flying under the radar, perhaps, is the DOJ approach to less egregious failings. In incidents involving contaminated cantaloupes and contaminated eggs, the DOJ relied on the ''responsible corporate officer'' doctrine to take down corporate officers and directors. In *U.S. v. Jensen*, the government charged the individual owners of Jensen Farms with misdemeanors under the FDCA for their sale of listeria-contaminated cantaloupes that killed at least 33 people.[7] In *U.S. v. Quality Egg, LLC*, charges again were against individual owners, this time for sickening more than 1,900 people from salmonella-tainted eggs.[8]

Under the responsible corporate officer (RCO) doctrine,[9] a corporate officer with the authority and responsibility to prevent or correct the distribution of adulterated food can be found liable for a violation of Section 333 of the FDCA.[10] It is a misdemeanor violation even if there is no evidence of an intent to defraud or mislead.[11] That can mean up to one year in prison plus significant fines. Significantly, the prosecutions in *Jensen* and *Quality Egg* did not involve allegations of knowing sales of contaminated food. As one commentator noted:

> The DOJ's willingness to bring charges under the RCO doctrine absent any knowledge of wrongdoing creates a significant risk for all food industry executives with ultimate supervisory authority over food sales. . . . There is nothing to stop the DOJ (aside from its own discretion) from responding to the next contaminated food outbreak by charging the CEO and any other executives who had the authority to stop the sale of the contaminated food as RCOs and seeking a prison sentence and a large fine. . . .[12]

We might suggest one thing that could stop, or at least temper, the DOJ's pursuit is a competent defense paid for by insurance.

As might be expected, defending against a DOJ investigation and proceeding can be exceedingly expensive. Worse, because of the cost, a corporate officer may skimp on quality when he or she selects counsel. This would be a mistake and (hopefully) is unnecessary. Protection against personal and professional disaster may be found in D&O insurance.

Stated simply, D&O coverage is insurance for wrongful acts by a company's officers and directors.[13] Liability for bodily injury and property damage is excluded (it is covered by a general liability policy). Instead, a D&O

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[2] *See, e.g.*, *Peanut Corporation of America Peanut Butter Salmonella Outbreak Lawsuits—Nationwide (2008-2009)*, http://www.marlerclark.com/case_news/view/salmon (last visited March 12, 2015).

[3] Agencies that investigate food borne illnesses include the CDC, state and local health departments, the United States Food and Drug Administration, and the United States Environmental Protection Agency. *See* Centers for Disease Control and Prevention, *CDC's Role in Outbreak Investigations*, www.cdc.gov (last visited March 5, 2015). The United States Department of Agriculture also brings enforcement actions. For example, in 2007, it issued a Notice of Suspension to Topps Meat Company, over meat allegedly contaminated with salmonella. Notice of Suspension to Topps Meat Company, L.L.C. (Sept. 26, 2007), *available at* www.marlerblog.com/files/2013/01/Topps-Attachment-No.-2.pdf.

[4] For example, despite Tylenol's highly praised response to the 1982 Tylenol contamination incident, stigma from the incident cost Tylenol $1.2 billion. James Flynn et al., *Introduction*, in Risk, Media and Stigma: Understanding Public Challenges to Modern Science Xiii (James Flynn et al. eds., 2001). The mad cow incident in Great Britain caused tremendous stigma to the British beef industry resulting in a 20% drop in beef sales. Douglas Powell, *Mad Cow Disease and the Stigmatization of British Beef*, in Risk, Media and Stigma: Understanding Public Challenges to Modern Science 226 (James Flynn et al. eds., 2001).

[5] Moni Basu, *Unprecedented verdict: Peanut executive guilty in deadly salmonella outbreak*, CNN, Sept. 19, 2014, http://www.cnn.com/2014/09/19/us/peanut-butter-salmonella-trial/ (last visited March 12, 2015).

[6] *Id.*

[7] Press Release, United States Attorney's Office, District of Colorado, *Eric and Ryan Jensen Charged with Introducing Tainted Cantaloupe into Interstate Commerce* (Sept. 26, 2013), *available at* http://www.justice.gov/usao/co/news/2013/sept/9-26b-13.html (last visited March 5, 2015).

[8] *United States v Quality Egg*, LLC, No. 14-cr-3024 (N.D. Iowa). Officers of the company pleaded guilty in 2014. *See* Carla Gillespie, *Guilty Plea in 2010 Salmonella Egg Outbreak*, Food Poisoning Bulletin (June 3, 2014), http://foodpoisoningbulletin.com/2014/guilty-plea-in-2010-salmonella-egg-outbreak/ (last visited March 12, 2015).

[9] *See United States v. Park*, 421 U.S. 658, 670 (1975) (holding a ''corporate agent, through whose act, default, or omission the corporation committed a crime'' in violation of the Food, Drug, and Cosmetic Act may be held criminally liable for the wrongdoing of the corporation ''whether or not the crime required 'consciousness of wrongdoing' '' by the agent).

[10] 21 U.S.C. § 333.

[11] 21 U.S.C. § 333(a)(1).

[12] Helen V. Cantwell, et al., *Food for Thought: Corporate Executives on Notice that DOJ Will Seek to Hold Them Criminally Liable for Contaminated Food Outbreaks and Product Failures*, *Bloomberg BNA Product Safety & Liability Reporter* 1377, 1380 (Nov. 24, 2014).

[13] Although traditionally D&O policies only covered the directors and officers, more modern policies expand coverage to include managers and other non-executive directors, employees and the company itself. Willis, *D&O FAQ*, *available at* http://www.willis.com/Documents/Services/executive%20risks/Willis_DandO_FAQ.pdf.

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policy addresses economic and other loss. Further, it is important to note that the intentionality of the act is not determinative of coverage. Indeed, one would hope that most acts of corporate officers and directors are intentional. Instead, coverage will depend (among other things) on whether the act was deliberately fraudulent.[14]

We would be remiss in discussing D&O policies if we did not acknowledge that they nearly always are an officer's or director's second line of defense, the first being indemnification by the corporation. The indemnification will include both the defense of any claim, as well as the payment of any judgment or settlement against the indemnified officers or directors. But that indemnification may have flaws. Here are two:

First, in certain circumstances corporations are forbidden by either their bylaws or public policy from indemnifying. A common example is when the corporation's shareholders bring a derivative suit.[15]

Second, a corporate indemnification is only as good as the corporation's balance sheet. In a foodborne illness catastrophe, it may be the case that the corporation becomes insolvent.[16] Even if not insolvent, cash flow problems may make funding a defense problematic.

The issue of funding indemnification payments is addressed through insurance, what has historically been known as Side B insurance. In Side B coverage the corporation procures coverage for its indemnification of its officers and directors. Typically, there is a substantial deductible or retention underlying the coverage.

In circumstances where the corporation is not permitted or is unable to indemnify its officers and directors, the triggered coverage is known as Side A. In the usual case there is no deductible or retention where Side A is invoked.[17] Side A coverage is essential for directors and officers and not merely in situations where the corporation cannot pay. It does not require a fertile imagination to concoct a scenario where, notwithstanding the obligation, a company simply does not want to pay for the defense or indemnification of its Ds and Os. It may be personality issues, or simply a case where it is concluded that the monies are better spent elsewhere.

Procurement Issues Explained

Further, many D&O policies contain yet a third coverage, Side C, which protects the corporation itself from its own wrongful acts (which often are part and parcel of the same circumstances giving rise to the travails of its managers that are under attack). Defending the corporation and the officers and directors can burn through policy limits quickly (defense costs are typically ''within limits'').

A corporation might attempt to manipulate its policy so that the corporation's expenses are paid first, perhaps by challenging the right of the officer to collect under the policy. Even without such manipulation, in a bankruptcy where the corporation and the officers are both depleting a corporate asset (the shared policy limits), a bankruptcy trustee might attempt to block the officer's access. Accordingly, officers and directors are well-advised to seek what is called Separate-Side-A coverage, which ensures that the directors' and officers' limits are not impacted by whatever is going on with the company.[18] In addition, D&O policies often contain priority of payment provisions, which can play a significant role in protecting officers and directors in the event the company liquidates.[19]

Focusing now on the DOJ (or state attorneys general or other regulators), entanglement with the government will not first come with an indictment or information. There very likely will be an investigative subpoena, or maybe several. Even if another regulator is already involved, there is nothing to keep a second regulator from jumping in. In fact, some would say that one subpoena begets additional subpoenas.

Coverage for the cost of responding to a subpoena can be hit-or-miss. But it shouldn't be. As part of the procurement of the D&O policy this kind of coverage should be explicitly sought. Further, the mechanics of paying the defense costs is significant. Many policies provide that the insured has the right and obligation to defend itself, transforming the carrier's obligation into a duty to reimburse, which carriers often argue can only be at the end of the case.[20] This can be problematic where there are cash flow issues. Much better is a

[14] Some policies exclude coverage for intentional acts. For example in *Greenwich Insurance Co. v. Media Breakaway, LLC*, No. 2:2008-cv-00937 (C.D. Cal. July 22, 2009), the policy contained an exclusion for claims ''brought about or contributed to in fact by any: (1)intentionally dishonest, fraudulent or criminal act or omission or any willful violation of any statute, rule or law; or (2) profit or remuneration gained by any Insured to which such Insured is not legally entitled.''

[15] For example, Delaware law restricts corporate indemnification of judgments or settlements of derivative suits. *See Del. Code Ann*. tit. 8, § 145 (b) (2015), *available at* http://delcode.delaware.gov/title8/c001/sc04/.

[16] Peanut Corporation of America filed for bankruptcy. *See* Dawn McCarty, *Peanut Corp. to Liquidate Following Peanut Deaths*, Bloomberg, Feb. 13, 2009, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=al9aOLMU4CQ8&refer=home (last visited March 12, 2015). In 2007, the Topps Meat Company was forced to file for bankruptcy after recalling millions of pounds of meat that was allegedly contaminated with *E. coli*. *See* Ken Belson & Kareem Fahim, *After Extensive Beef Recall, Topps Goes Out of Business*, The New York Times, Oct. 6, 2007, *available at* http://www.nytimes.com/2007/10/06/us/06topps.html?pagewanted=all&_r=0 (last visited March 12, 2015).

[17] For example, although Delaware limits a corporation's ability to indemnify its directors and officers in a derivative suit, it permits a corporation to purchase insurance for its directors and officers, regardless of whether the corporation would have the power to indemnify. Del. Code Ann. tit. 8, § 145 (g) (2015), *available at* http://delcode.delaware.gov/title8/c001/sc04/.

[18] For example, a 2008 Delaware decision found nothing wrong with a company revising its bylaws to restrict the company's obligation to indemnify former directors and officers. *Schoon v. Troy*, 948 A.2d 1157, 1166-67 (Del. Ch. 2008).

[19] *See, e.g., In re Allied Systems Holding Inc.*, No. 1:12-11564-CSS, 524 BR 598 Docket No. 1248 (Bankr. D. Del. June 4, 2013) (arguing priority of payments provision made policy proceeds assets of bankruptcy estate); *In re MF Holdings*, 469 B.R. 177, 181 (Bankr. S.D.N.Y. 2012) (holding former customers of corporation had standing to object to insurers' payment of defense costs).

[20] *See Liberty Mut. Ins. Co. v. Pella Corp.*, 650 F.3d 1161, 1171 (8th Cir. 2011) (rejecting argument by insurer that duty of reimbursement requires a factual determination of an occurrence, rather than merely an allegation).

policy where the carrier has the obligation to make timely advances.[21]

D&O policies are what are known as ''claims made'' policies, or ''claims made and reported'' policies. These terms mean that the coverage is not triggered until either a claim is made against the insured, or the claim is made and the insured has given notice to its insurer.

Absent express purchase of a ''tail'' or extended reporting period,[22] the claim or the report has to be made during the policy period (or some short extension). This is quite different from the ''occurrence'' policies some may be familiar with, where the trigger of coverage is when something happened, not when someone got around to noticing.

The significance of this is that coverage expires from one period to the next. And since a carrier will argue that a policy excludes coverage for a claim by the policyholder that should have been made in an earlier policy period, a policyholder that fails to put its carrier on notice puts itself at substantial risk of forfeiting its coverage.

Another timing wrinkle in a D&O policy is the role of the retroactive date. D&O carriers are not interested in insuring every possible claim that might come in based on a company's activities since the time of the pharaohs. Hence a policy will carry a retroactive date; events occurring before that date cannot be the source of a covered claim.[23]

What happens if the contamination event occurred over several months, or years, as investigation pieced together disparate data of what turned out to be a chronic low-level contamination problem?[24] An intervening new retroactive date (which might be inserted as the result of changing carriers, a merger or acquisition, or a consolidation of coverages) could eliminate coverage.

Some may question whether the ubiquitous pollution exclusion would defeat a claim for coverage for alleged wrongful acts by officers and directors with respect to food contamination. The answer should be no, except in cases where the officers and directors were actually involved in the contamination incident. Where the wrongful act is a failure to implement policies, or false or misleading statements to the public, or other ''responsible corporate officer'' activities, the better analysis is that a pollution exclusion does not apply.[25]

Another way coverage can be lost, even before the claim comes in can be in the disclosures made in the policy application. The application is typically certified by some corporate officer. On occasion (some would say frequently), a carrier that does not want to pay a claim will scrutinize the application and disclaim coverage based on some alleged misstatement.

Officers and directors should seek a severability provision in the policy to protect them from misstatements by others.[26] Similarly, they should look for a non-imputation provision,[27] which will prevent losing coverage through the bad acts of others or an incontestability provision, which will cut off the insurer's right to rescind the policy based on misstatements in the application.

We stated earlier that the Peanut Corporation case is an outlier, but one of its elements bears close watching. The DOJ pursued theories of wire fraud and conspiracy to commit wire fraud based on false communications made by the Peanut Corporation officers to its customers.[28]

In the heat of a contamination crisis it is a certainty that a company's investigation will not be perfect from inception; some misstatements will be collected.

Transmission of those misstatements to customers, regulators or the public could be used as a basis for an allegation of wire fraud by a zealous prosecutor. Fraud (knowing misstatement of facts) voids coverage. But under the right D&O policy language, it is not the allegation of fraud that voids coverage, but a final determination by a court.[29]

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[21] *In re Worldcom, Inc. Secs. Litig.*, 354 F. Supp. 2d 455, 466 (S.D.N.Y. 2005).

[22] International Risk Management Institute, Glossary, *Tail Coverage*, http://www.irmi.com/online/insurance-glossary/terms/t/tail-coverage.aspx.

[23] International Risk Management Institute, Glossary, *Retroactive Date,* http://www.irmi.com/online/insurance-glossary/terms/r/retroactive-date.aspx.

[24] It is not difficult to imagine a situation where contamination could span years. A recent widely publicized enforcement action against New Yung Wah Trading Company, a Brooklyn-based purveyor of Chinese food products, may be just such a situation. The company sold perishable, short-term products, as well as products that would be used over a longer term, such as large quantities of monosodium glutamate (MSG). Distributed and used over time, these contamination incidents from one source could lead to years of claims. *See* Warning Letter, Public Health Service, Food and Drug Administration (Dec. 9, 2014), *available at* http://www.fda.gov/iceci/enforcementactions/warningletters/2014/ucm426882.htm.

[25] *Owens Corning v. National Union Fire Insurance Co.*, No. 97-3367 (6th Cir. Oct. 13, 1998) (alleged wrongful disclosure regarding asbestos is not reached by asbestos exclusion); *Sealed Air v. Royal Indem. Co.*, 961 A.2d 1195, 404 N.J. Super. 363 (App. Div. 2008) (same).

[26] D&O policies may contain different types of severability provisions. One type, the ''full'' severability provision typically states either that the insurance application is deemed to be a separate application by each insured or that one insured's knowledge cannot be imputed to another. In contrast, under a typical ''limited'' severability provision, one insured's knowledge is not imputed to another for purposes of the application, except that the knowledge of either the signer of the application or a certain designated executive is imputed to all Insureds. *The Evolving Terms of D&O Coverage*, Directors & Officers, The ACE Report (Issue 51 October 2003), *available at* http://www.acegroup.com/bm-en/media-centre/the-evolving-terms-of-do-coverage.aspx (last visited March 12, 2015).

[27] These provisions provide that intentional misstatements or omissions in the insurance application are not imputed to, and therefor do not bar coverage, for insureds who did not sign the application. International Risk Management Institute, Glossary, *Non-Imputation Provision*, http://www.irmi.com/online/insurance-glossary/terms/n/nonimputation-provision.aspx.

[28] Press Release, United States Department of Justice Office of Public Affairs, *Peanut Corporation of America Former Officials and Broker Convicted on Criminal Charges Related to Salmonella-Tainted Peanut Products* (Sept. 19, 2014), http://www.justice.gov/opa/pr/peanut-corporation-america-former-officials-and-broker-convicted-criminal-charges-related (last visited March 7, 2015).

[29] As the Fifth Circuit explained:

> When a D&O policy requires a 'final adjudication' to trigger an exclusion, 'courts have consistently held that the adjudi-

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The perils of foodborne illness have been with us since the time of the pharaohs. D&O insurance policies are much more recent, as are the application of responsible corporate officer doctrine and wire fraud theories to food contamination cases. Food company officers and directors should ensure their coverage keeps up.

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cation must occur in the underlying D&O proceeding,' rather than in a parallel coverage action or other lawsuit. The distinction is important because under a 'final adjudication' clause, some courts bar insurers, after settlement of the underlying case, from litigating 'whether the settled claims were in fact attributable to defendants' dishonest acts.' Read this way, a final adjudication exclusion limits the insurer's recourse if the parties settle—the most likely outcome—or if the insured is otherwise absolved of liability or guilt in the underlying action.

Pendergest-Holt v. Certain Underwriters at Lloyd's of London, 600 F.3d 562, 572-73 (5th Cir. 2010) (citations omitted).