BARNES & THORNBURG LLP

Quality Egg Appeal Serves As A Reminder To Look For Cracks In D&O Coverage For Responsible Corporate Officers

July 24, 2015 | D&O, Policyholder Protection

Christopher L. Lynch
Partner

Earlier this week, Peter and Austin DeCoster submitted their opening briefs in their appeal of the three-month prison sentence they each received for pleading guilty to misdemeanor violations of the federal Food Drug and Cosmetic Act (FDCA). You may recall that the DeCosters owned Quality Egg, LLC, the Iowa-based egg production company that had a salmonella outbreak in 2010 that resulted in a recall of millions of eggs and, according to the court's order on the DeCosters' sentencing motions, sickened thousands of consumers. In connection with that outbreak, the DeCosters pled guilty to a charge of introducing adulterated food into interstate commerce in violation of the FDCA.

Although there was a dispute as to whether and how much the DeCosters actually knew about the conditions at the Quality Egg facilities that led to the salmonella outbreak, as characterized in their appellate briefs, the DeCosters pled guilty under the Responsible Corporate Officer (RCO) doctrine. At its broadest, that doctrine allows the government to prosecute, and obtain convictions of, corporate executives based primarily, if not entirely, on the executive's status in the company and without any showing that the executive participated in or knew of the company's misdeeds. While not an insurance coverage case, the DeCosters' appeal should give corporate executives pause to consider whether and to what extent their companies' Directors & Officers (D&O) insurance will cover them in the event they are prosecuted under the RCO doctrine or a similar strict liability statute or regulation.

Strict Liability for Corporate Executives

The RCO doctrine has its roots dating back to a 1943 U.S. Supreme Court decision, *United States v. Dotterweich,* 320 U.S. 277 (1943), in which the Court recognized that the FDCA "dispenses with the conventional requirement for criminal conduct – awareness of some wrongdoing." *Id.* at 281. In *United States v. Park,* 421 U.S. 658 (1975), the Court reaffirmed that a misdemeanor conviction under the FDCA did not require any showing that the responsible executive acted with bad intent, rather "the Government establishes a prima facie case when it introduces evidence sufficient to warrant a finding by the trier of the facts that the defendant had, by reason of his position in the corporation, responsibility and authority either to prevent in the first instance, or promptly to correct, the violation complained of, and that he failed to do so." *Id*. at 673-74. The RCO doctrine was reinvigorated in 2010 when FDA announced its intent to increase use of the doctrine to

RELATED PRACTICE AREAS

Commercial General Liability
Copyright, Trademark, and Media Liability
Credit and Mortgage Insurance
Directors and Officers Liability
Employment Practices Liability
Fidelity Bonds and Commercial Crime Policies
First-Party Property
Insurance Recovery and Counseling
Ocean Marine and Cargo Coverage
Professional Liability
Representations and Warranties
Workers' Compensation and Employers' Liability

RELATED TOPICS

Food Drug & Cosmetic Act (FDCA)
Responsible Corporate Officer doctrine

prosecute of pharma and food industry executives. Amendments to the FDA's Regulatory Procedures Manual confirmed the agency's belief that it could obtain misdemeanor convictions of company executives "without proof that the corporate official acted with intent or even negligence, and even if such corporate official did not have any actual knowledge of, or participation in, the specific offense." And the RCO doctrine is not limited to the FDCA. Federal and state agencies have used the RCO doctrine to varying degrees to prosecute criminal charges, and seek civil penalties, against individual corporate executives under a host of public welfare statutes and regulations including environmental laws, securities and tax laws, and consumer fraud and protection laws. In short, any executive of a company in a regulated industry is potentially at risk for individual prosecution under the RCO doctrine.

Insurance Implications of RCO Claims

Because the RCO doctrine allows the government to obtain criminal convictions without a showing of criminal intent, it raises unique issues for executives seeking D&O coverage for their defense against and any convictions under RCO doctrine charges. At first blush, it may seem counterintuitive to suggest that an executive should be able to get any insurance coverage for criminal conduct. But the RCO doctrine is unusual in that it enables the government to obtain a criminal conviction based almost entirely on an executive's status without showing bad intent or even knowledge. Nevertheless, an insurer to whom a RCO doctrine claim has been tendered may raise a number of policy provisions and exclusions to contest coverage. And given the variability in D&O policy language, the existence and extent of coverage in any given case is likely going to depend on the particular language used in the policy at issue.

For example, many D&O policies exclude coverage for claims involving criminal conduct. But the scope of those exclusions varies. An executive who is insured under a policy that excludes only "deliberate" criminal conduct may have a stronger case for coverage than an executive insured under a policy that excludes "any" criminal conduct. Similarly, an executive's chances of having coverage for at least her or his defense costs are probably better under a policy with a criminal conduct exclusion that only applies if the conduct is established by "final adjudication" or, better yet, by "final adjudication in an action other than an action commenced by the insured to determine coverage."

RCO doctrine prosecutions also pose unique issues with respect to coverage for defense or defense costs. It remains unclear whether or to what extent an executive may have any viable defenses to the near-strict liability that can be imposed under the RCO doctrine. And the only "settlement" available to an executive prosecuted under the RCO doctrine may be a plea bargain. These factors make pursuing an aggressive defense against a RCO prosecution challenging. That challenge, and an executive's willingness to accept that challenge, can be exacerbated if the D&O policy the executive needs to fund the defense contains language requiring the executive to repay those defense costs upon a conviction, guilty plea, or some other final adjudication. If there is a guilty plea or conviction, coverage for the executive's resulting losses may be limited.

Obviously, an insurance policy can't protect an executive from serving a jail sentence. And many D&O policies exclude coverage for fines, penalties or repayment of illegal profits (sometimes with a “final adjudication” requirement). A guilty plea or conviction under the RCO doctrine may also serve as the basis for the executive’s exclusion or disbarment from participating in any government-funded programs, which can effectively make the executive unemployable in her or his chosen industry. The resulting income loss such an executive would incur is likely not within the scope of a typical D&O policy.

Because the RCO doctrine doesn’t fit the traditional mold of criminal prosecutions, corporate executives working in regulated industries would be wise to review their D&O policies with their brokers or coverage counsel to try to determine the existence and extent of coverage that may be available to protect them in the event of a RCO prosecution. As discussed above, even minor tweaks to the D&O policy language may have significant consequences on the coverage that may be available. Additionally, there may be alternative products available with coverage features that address some of the challenges posed by RCO prosecutions. The RCO doctrine shows that what a company’s executives don’t know definitely can hurt them. By taking steps to review their D&O policies now, companies may be able to help better protect those executives from that unknown.