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Failure to Disclose Prior False Claims Act Investigation Not Fatal to Insured's Coverage For Related Employee Retaliation Claim Under EPL Coverage

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In *SHH Holdings v. Allied World Specialty Insurance Co*., 2020 WL 7385384 (N.D. Ohio, Dec. 16, 2020), the United States District Court for the Northern District of Ohio held that the insured's failure to disclose a prior False Claims Acts investigation did not bar coverage for a related employee retaliation claim under the policy's claims-made EPL coverage.

SHH Holdings, LLC ("SHH") obtained an insurance policy with Allied World providing coverage for directors & officers, employment practices, and fiduciary liability. During the policy period, former SHH employees sued SHH for employment-related retaliation. SHH filed a claim with Allied World seeking defense and indemnity. Allied World, however, denied coverage claiming the retaliation claims were related to a January 2017 Department of Justice ("DOJ") False Claims Act investigation against SHH that SHH failed to disclose when applying for the Allied World policy. After Allied World denied coverage, SHH defended the retaliation suit and later settled the employee retaliation claims for $2.2 million. SHH then sought reimbursement for the settlement and its legal fees in defending the retaliation claims.

The relevant factual timeline is as follows. In November 2016, a False Claims Act *qui tam* suit was filed under seal claiming that SHH, its subsidiaries, and SHH-affiliated nursing facilities violated the False Claims Act by repeatedly claiming Medicare reimbursement for unreasonable, unnecessary, or non-existent patient medical costs. The sealed complaint also claimed that SHH had retaliated against employees who internally reported the fraudulent billing practices. In January 2017, SHH (still unaware of the sealed *qui tam* complaint) received a Civil Investigative Demand from the DOJ informing SHH of a pending False Claims Act investigation for fraudulent billing and requesting information about recently terminated SHH employees. The Investigative Demand, however, did not mention the sealed complaint retaliation allegations.

Nearly two years later, SHH applied to Allied World for a directors & officers, employment practices, and fiduciary liability policy. The insurance application asked SHH various questions about pending matters that could lead to claims under the claims-made Allied World policy. Despite the DOJ False Claims Act investigation, SHH indicated that no such matters were pending and that it was not aware of any act, error or omission which could give rise to a claim or suit. The same section of the application set forth an exclusion that was later incorporated into the policy precluding coverage for any claims or lawsuits arising from any prior claims, charges, inquiries, or investigations required to be disclosed in the policy application (the "Application Exclusion").

During the policy period, the *qui tam* action was partially unsealed and SHH received a copy of the complaint. Although SHH had already effectively settled the fraudulent billing issues with the DOJ, SHH learned for the first time of the SHH employee retaliation claims after receiving the complaint. SHH submitted a claim with Allied World for the retaliation lawsuit, seeking reimbursement of legal costs under the policy. Allied World denied coverage and took the position that SHH's failure to disclose the DOJ investigation defeated coverage because of the Application Exclusion.

Allied World argued that SHH's answers to two questions on the policy application precluded the carrier from providing coverage. The questions inquired whether SHH or SHH's employees had any knowledge of any "inquiries, investigations, administrative charges, claims and lawsuits filed within the last three (3) years against [SHH]" or whether they knew of "any act, error or omission which could give rise to a claim, suit or action." Both of these questions, the carrier alleged, should have prompted SHH to disclose the DOJ investigation, even if it was unaware of the actual complaint. SHH, however, interpreted the questions to only include matters related to the employment practices liability coverage involved with the retaliation claim, and therefore, argued that it was unnecessary to disclose the DOJ investigation into fraudulent billing practices.

The District Court found that the insured's interpretation was reasonable and that failing to disclose the investigation in either question was not a fatal error. Notably, the insured was only seeking coverage related to settlement and defense of the retaliation claims – not settlement of the government's false claims demand. Question 1 asked whether SHH received inquiries or investigations within the preceding three years but limited to those related to "any coverage for which the Applicant *is applying*." Because the government's overbilling inquiry was unrelated to the employment practices liability policy for which it was applying, SHH argued that the false claims investigation was outside the scope of the question and it reasonably believed disclosure was unnecessary.

Allied World argued that the language of the Application Exclusion applied to *all* inquiries, investigations, etc. against SHH, regardless of the inquiries' relevance to the policy coverage type. While the District Court agreed that from a "syntactic perspective" Allied World had an advantage, by taking its interpretation to its logical conclusion, the overall structure of the exclusion would require SHH to disclose wholly unrelated matters that have no impact on the policy coverage at all. As such, the District Court found that SHH could reasonably read the application questions as requiring disclosure of only those matters related to the employment practices liability coverage involved with the denied retaliation claim. At the time of the application, for example, SHH had largely resolved the government's improper billing claim. Further, the government's improper billing claim could never be dragged into the D&O coverage period, and therefore, would not impact coverage under the D&O coverage part. Thus, because SHH did not intend coverage to apply to the False Claims Act allegations, SHH could reasonably have read the questions not to require disclosure of the January 2017 False Claims Act Investigative Demand for which coverage was not sought or intended. Finally, because the Application Exclusion incorporated the specific application questions into the exclusion itself, Allied World could not rely on the exclusion to independently bar coverage. As SHH reasonably interpreted the application questions to not cover the DOJ investigation, the District Court ruled that the Investigative Demand fell outside the exclusion's use of the term "such inquir[ies]" and did not apply.