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PLUS Journal Reprint

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An Increased Focus on Individual Accountability? What it Might Mean for D&O Insurance

By Tammy Yuen, Rachel Simon & Joshua Sato

Corporate malfeasance is nothing new. Not surprisingly, the government's pursuit of wrongdoers often intensifies following particularly egregious episodes that draw public sentiment or have implications for the markets or during difficult economic times. Also predictably, corporations often protect their individual employees, directors and officers for a variety of reasons including that liability against these individuals exposes the corporation to liability based on respondeat superior. On September 9, 2015, Deputy Attorney General Sally Quillian Yates of the U.S. Department of Justice issued a memorandum (the "Memo") that may test the bonds between corporations and these individuals and may change the way that both defend government investigations and lawsuits. While it is too early to know, the Memo may increase the exposure of individuals under D&O policies.

The Memo recommits the DOJ to focusing on individual accountability in dealing with corporate misconduct. In summary, the Memo lays out the following six steps aimed at ensuring that individual wrongdoers are held accountable for corporate wrongdoing:

1. Corporations must provide all relevant facts about the individuals involved in corporate misconduct to the DOJ to be eligible for any cooperation credit.

2. Criminal and civil investigators should focus on individual wrongdoers from the start of an investigation.
3. Criminal and civil attorneys handling corporate investigations should be in regular communication with each another.
4. Absent extraordinary circumstances or approval by the relevant Assistant Attorney General or U.S. Attorney, the DOJ will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation.
5. When resolving corporate cases, DOJ attorneys must have a clear plan to resolve related individual cases before the statute of limitations expires.
6. DOJ civil attorneys should consistently focus on individuals as well as the company and ensure that their decisions to bring suit against an individual are based on considerations beyond that individual's ability to pay.

Recent commentary focuses largely on the Memo's first point addressing the threshold for a corporation to obtain cooperation credit—namely, that a corporation must turn over all relevant

facts to be eligible for any such credit. Previously, pursuant to the Principles of Federal Prosecution of Business Organizations issued in 2008 (and commonly referred to as the "Filip Memo" for its author, then-Deputy Attorney General Mark Filip¹), turning over information about individuals involved in wrongdoing was important, and even critical, in assessing the adequacy of a corporation's cooperation with an investigation for the purposes of granting a corporate deferred or non-prosecution agreement. However, providing information on individuals was never mandatory.²

One group of commentators believes that the Memo reiterates long-standing policy at the DOJ to vigorously pursue individual wrongdoers, and simply reflects a change in tone backed by stronger rhetoric. For example, one such commentator believes that the DOJ felt compelled to issue the Memo in order to: (i) address public sentiment that the DOJ has been too lenient on Wall Street executives; (ii) exert added pressure on defense counsel to encourage their corporate clients to cooperate with investigations against individual employees suspected of wrongdoing; and (iii) to ensure that the DOJ attorneys account for their investigations of individuals as they pursue charges against corporations.³

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Another group of commentators believes that the Memo marks a significant shift in DOJ policy toward increasing the scrutiny on individual wrongdoers and their corporate employers. They also believe that this shift will have a number of consequences for how corporations defend government investigations and the coordination between corporations and employees, directors and officers.

Those commentators argue that while corporations have long felt pressure to turn over information about individual wrongdoers, in the past they did not have to turn over every stone and give up every employee involved in malfeasance in order to obtain cooperation credit. The Memo appears to incentivize corporations to turn over significantly more information in order to get that same level of credit, thus ensuring that corporations will conduct more robust internal investigations.⁴ Some speculate that the DOJ will scrutinize the nature and scope of those internal investigations, along with the individuals conducting and supervising them, in deciding whether to award cooperation credit—another departure from the past.⁵ The Memo's new cooperation requirement also forces companies to reconsider withholding the results of internal investigations on the basis of privilege for fear of being deemed as failing to hand over complete factual information.⁶

The relationship and coordination between corporation and individuals are also predicted to change, as their interests are no longer completely aligned. Corporations should no longer expect to have the opportunity to negotiate a release of liability for individual employees as part of a corporate resolution.⁷ Rather, after turning over all its information, the corporation should expect to negotiate on

its own behalf while the investigation continues against the individuals.⁸

For D&O carriers, the Memo raises concerns about increased costs in defending government investigations. In particular, we could expect to see an uptick in the number of investigations as well as an increase in the length and intensity of the DOJ investigations and the pursuit of discovery. The DOJ may pursue investigations with greater resources in claim scenarios that may not have generated as much governmental interest in the past.

Whether the Memo demonstrates an actual shift in the DOJ's policy may be clarified if the DOJ makes examples of a few individuals early on in order to send a clear message to the markets. There may also be increased political pressure with the DOJ to show results, and that could lead to more aggressive pursuit of investigations, less willingness to settle without a finding against individual wrongdoers, or a greater likelihood of keeping investigations open against individuals even after settling with the corporation. However, it is unclear whether the Memo may lead to an increased focus on lower-level employees who may or may not fall under the definition of Insureds under the relevant D&O policy, as the Memo makes clear that individuals should be pursued regardless of their ability to pay.

As the stakes increase, we can expect insureds to seek to devote more resources to the defense of the investigation, and individual insureds to seek to retain their own independent counsel sooner and taking on greater roles. This move toward retaining individual representation sooner could be driven by earlier targeting of individuals, the seniority of the individuals under scrutiny, and the potential for the corporation providing evidence against its own

directors, officers and employees. The Memo may be interpreted as removing any level of comfort that a settlement with the corporation would include an agreement to dismiss charges against individuals.

The scope, depth, length and cost of internal investigations may also increase as corporations seek to earn cooperation credit that may help to mitigate their own exposure, and to ferret out individual wrongdoers. Insured entities may engage more lawyers, financial and accounting consultants, experts, and e-discovery vendors as they conduct broader and deeper review of electronic documents in their internal investigation. Whether these internal investigations are covered by insurance may depend, for example, on the policy's definition of claim and the scope of any pre-claim investigation coverage.

Side B coverage could also be implicated sooner than it had been in the past if increased cooperation from corporations leads to earlier scrutiny of individuals. Also, query whether this increased scrutiny will have implications for Side A D&O coverage to the extent that a corporation under increased pressure to cooperate and turn over information that could implicate its executives in wrongdoing may consider refusing to provide indemnification.

The next twelve months may be telling in light of the political climate during the current election season. There is the possibility that with a new administration, there may be new directives that either expand or retract the scope of the directive. However, it seems the DOJ has made clear that we can expect an increase in its investigation into the conduct of individual corporate actors in the near term. 🌈

Endnotes

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- 7 *Id.*