

Corporate Insurance Law

Expert Analysis

Insurance Implications of New Justice Department Policy Directive

In September, the U.S. Department of Justice issued a new policy directive that puts the emphasis on individuals, promising an increased commitment to pursuing the individuals within corporations that are responsible for corporate wrongdoing. Corporate executives may, in some circumstances, have a right to indemnification from their company. However, if such indemnification is unavailable, insurance may be the only viable source to fund legal fees associated with the defense of a Justice Department investigation or other proceeding.

In light of the Justice Department's commitment to focus on individuals, risk managers as well as directors and officers themselves have reason to be more vigilant with regard to their directors' and officers' (D&O) or management liability insurance policies, making sure that the policies provide them with the best protection available. In this column, we will review the Justice Department's directive and discuss some of the D&O insurance issues that may now take on heightened importance.

Justice Department Directive

On Sept. 9, 2015, the Justice Department issued a memo to all U.S. Attorneys and other enforcement bureaus titled "Individual Accountability for Corporate Wrongdoing." The memo provides guidance on the following six key steps intended to strengthen the pursuit of individuals involved in corporate wrongdoing:

- (1) In order to qualify for any cooperation credit, corporations must provide to the department all relevant facts relating to the individuals responsible for the misconduct;
- (2) Criminal and civil corporate investigations should focus on individuals from the inception of the investigation;
- (3) Criminal and civil attorneys handling corporate investigations should be in routine communication with one another;



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(4) Absent extraordinary circumstances or approved departmental policy, the department will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation;

(5) Department attorneys should not resolve matters with a corporation without a clear plan to resolve related individual cases, and should memorialize any declinations as to individuals in such cases; and

Directors and officers will want to make sure that they have access to insurance that will protect them from the start of the investigation.

(6) Civil attorneys should consistently focus on individuals as well as the company and evaluate whether to bring suit against an individual based on considerations beyond that individual's ability to pay.¹

It is too soon to know what the practical effect of the Justice Department policy directive will be. A *New York Times* article suggested that this directive merely codifies practices already in place in the Justice Department office in Washington, D.C. and in U.S. Attorneys' offices in Manhattan and Brooklyn, which are accustomed to handling complex cases.² The Justice Department has acknowledged that it will take time for the directive to have an impact and conceded that there is no way to predict whether it will result in an increase in cases filed against individuals.³ Nevertheless, publication of the Justice Department

memo has certainly grabbed the attention of the regulated community.

Definition of Claim

The second item in the Justice Department policy directive mandates that criminal and civil investigations focus on individuals from the inception of the investigation. Consequently, directors and officers will want to make sure that they have access to insurance that will protect them from the start of the investigation. In this context, the most meaningful term in the D&O policy may be the definition of Claim.

While the traditional definition of Claim typically required a written demand seeking a remedy or alleging liability, most insurers have expanded this definition in order to provide at least some coverage for defense costs incurred in connection with government investigations. However, these expanded definitions come in a variety of forms and some are broader than others. For example, some policies will consider a subpoena issued to an entity under investigation to be a Claim. Other policies will require that the subpoena actually identify individuals or alleged wrongful acts or will require a more formal document like a Wells notice or a target letter.

More liberal policies may define a Claim to include any formal request for documents or an interview from a government agency in connection with an investigation. For the individual executive, the broader the definition of Claim the better. Often, by the time a target letter or other similar writing is issued, individuals under investigation will have already incurred significant legal fees, and the definition of Claim may control whether or not such legal fees are covered by insurance.

In the case of a government investigation, as is the case with nearly all claims, it is critical to provide prompt notice to the insurer. Whatever the terms of the policy, the insurer is rarely obligated to pay defense costs incurred prior to the date of notice. Consequently, upon receipt of a subpoena or other formal request from a government agency, notice to the insurer should be a high priority.

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Priority of Payments

Historically, D&O insurance policies typically covered only claims against the directors and officers and did not provide coverage for claims asserted against the corporate entity itself. The traditional D&O policies offered coverage to individuals for loss arising from non-indemnifiable claims (Coverage A) and reimbursed the corporate entity to the extent that it indemnified the directors and officers for loss arising from indemnifiable claims (Coverage B). Over time, the market responded to demand, and insurers also began to offer coverage for loss arising from claims against the entity (Coverage C).

Despite the availability of Coverage C, D&O insurance is still, first and foremost, intended to be for the benefit of the directors and officers. This concept has been reinforced in recent years by numerous court decisions. For example, in the bankruptcy context, courts most often rule that the proceeds of a D&O policy will be made available to defend the directors and officers against claims arising out of their management of the debtor, even though payment of those defense costs will reduce the limits of insurance available to pay creditors' claims against the debtor's estate.

D&O insurance policies that include Coverage sections A, B and C offer coverage to both individuals and to the entity. While this broad scope of coverage has merits, it does mean that the insurance limits are accessible by the insured entities as well as the individuals. Where a covered entity is facing insolvency or other financial difficulties, the shared access to limits can create a concern, particularly if there are not enough limits to address the pending claims. This can also be a concern in the context of regulatory investigations and proceedings because the entity and the individuals may run up extensive legal bills that can threaten to exhaust insurance limits.

The fourth item in the Justice Department directive stresses that the department may resolve proceedings with a corporation without resolving the individuals' liability, leaving the individuals facing the prospect of a continued legal fight and continued legal bills. To protect the individual insureds against exhaustion of limits through payments made to or on behalf of the corporate entity, many insurers now include an Order of Payments clause in the policy. While the specific terms may vary, this clause generally gives priority to payments to the individual insureds over payment to the entity insureds. The clause typically provides that loss due under Coverage A will be paid first, followed by loss due under Coverage B and then loss due under Coverage C. In addition, payment under Coverage C and sometimes Coverage B may be conditional on instructions from the insured's general counsel or other designated executives.

Protection Through the End

While an appropriate definition of Claim should help to ensure coverage for legal fees at the start of an investigation, executives who face a lengthy legal battle will also want to ensure that their defense costs are covered through the end of the proceedings. Nearly every D&O insurance policy contains conduct exclusions, which bar coverage for deliberate fraudulent or criminal behavior, willful violations of law and gaining of any illegal profits. In many cases, a government investigation or proceeding includes these types of allegations. In order to protect the individual insureds throughout the pendency of the proceedings, D&O policies should contain a final adjudication clause which provides that the conduct exclusions do not bar coverage unless and until there is final adjudication that such conduct actually occurred. In addition, the exclusions should not be triggered until the final adjudication is non-appealable—i.e., all appeals have been exhausted. These clauses help to ensure that the insureds are protected until the proceedings are resolved with finality.

An individual executive's access to insurance should also be protected from the bad acts of other individual insureds. In order to safeguard the coverage for innocent individuals, D&O insurance policies should contain a non-imputation clause. This clause provides that, for the purpose of applying the conduct exclusions, the acts of one individual insured will not be imputed to other individuals. In this way, if one individual forfeits coverage due to his or her deliberate fraudulent acts, innocent insureds who were not part of the fraudulent scheme will not lose the right to access the insurance.

Limits and Side A Coverage

The first item in the Justice Department directive announces that corporations will not qualify for any cooperation credit unless they turn over to the Justice Department all relevant facts regarding the individuals responsible for the conduct. When combined with items four and five, which emphasize that proceedings against individuals may continue even after resolution of claims against the corporation, these items raise the possibility that corporations (who are, after all, run by individuals) may be less inclined to settle, resulting in lengthier legal battles.

Defending government investigations and proceedings is already an expensive proposition for entities and individuals. The threat of more lengthy proceedings should cause companies to review whether they are purchasing adequate policy limits to protect themselves in the event they are faced with a lengthy legal battle.

One way to address such limits concerns, consistent with a focus on protecting the individuals, is through the purchase of excess

Side A or Side A Difference In Conditions (DIC) coverage. Such coverage provides a layer of additional protection for the individual directors and officers. The coverage is excess of the existing insurance tower, is only available for non-indemnifiable loss, and can only be reached by the individuals—the limits are not available to the insured entities. In addition, Side A DIC coverage will often offer narrower exclusions than the standard D&O policy. In light of the Justice Department's focus on individuals, if additional limits are necessary, excess Side A coverage may be the appropriate solution for some insureds.

Looking Forward

The author of the Justice Department policy directive, Deputy Attorney General Sally Q. Yates, has acknowledged that it is going to take time for the changes identified in the policy directive to take effect and for the actual impact to be realized. Nevertheless, risk managers, general counsel and directors and officers would be wise to review their D&O insurance programs sooner rather than later, to make sure that they adequately protect individual insureds in the event of a government investigation or other proceedings.

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1. "Individual Accountability for Corporate Wrongdoing," U.S. Department of Justice, Office of the Deputy Attorney General (Sept. 9, 2015).

2. Prottess, B. and Apuzzo, M., "Justice Dept. Vow to Go After Bankers May Prove a Promise Hard to Keep," New York Times, Sept. 10, 2015 http://www.nytimes.com/2015/09/11/business/dealbook/challenges-remain-for-justice-dept-in-prosecuting-executives.html?_r=0

3. *Id.*

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