The results of the recent national elections may change many things, but one thing the results are unlikely to change is the United State Department of Justice’s focus on criminal and civil accountability for individuals involved in corporate wrongdoing. The current administration owes its electoral victory to a populist wave in rural America that was fueled in part by contentions that the previous administration did not sufficiently prosecute or punish perpetrators of the 2008 financial crisis. Given the need to retain its populist support, political survival likely will counsel the new administration to avoid being perceived as backing off of the Justice Department’s push to hold individuals accountable. If the Justice Department’s efforts continue, corporate executives would be well advised to have their corporations broaden directors’ and officers’ (“D&O”) insurance protections to meet the challenges posed by the Justice Department’s actions. The easiest way for most corporations to obtain the necessary protections is by seeking changes in the corporation’s D&O insurance policies of last resort, the policies known in the industry as “Excess Side-A Difference-in-Conditions D&O Policies.”

In September 2015, the Deputy Attorney General, Sally Yates, issued a memorandum (“the Yates Memo”), setting forth guidance on how the Justice Department would handle future corporate investigations and, to the extent practicable, pending ones. The memo listed six guideposts. First, the Justice Department made clear that, to be eligible for any cooperation credit in a criminal or civil matter, a corporation must provide the Justice Department all relevant facts concerning the individuals involved in or responsible for the corporate misconduct.
Corporations depend on cooperation credit to lessen the financial impact of any resolution with the government. Thus, conditioning any cooperation credit on full disclosures regarding individuals puts enormous pressure on corporations to make those disclosures. Second, the Justice Department specified that it would focus on individuals from the beginning of both criminal and civil corporate investigations. Third, the Justice Department stated that its criminal and civil attorneys would routinely communicate with each other to ensure that individuals are effectively pursued. Fourth, the Justice Department warned that, except in extraordinary circumstances, no corporate resolution would provide individuals with protection from criminal and civil liability like such settlements often had in the past. Fifth, the Justice Department directed that cases should not be resolved without a clear plan to resolve related cases against individuals. Finally, the Justice Department directed its civil attorneys to evaluate whether to bring suit against an individual based on considerations beyond the individual’s ability to pay.

Since the publication of the Yates Memo, the Justice Department has strongly focused on individual accountability for corporate wrongdoing. For example, the Justice Department recently entered two settlements alleging corporate wrongdoing with each settlement requiring individuals to pay. In a False Claims Act case that the government brought against North American Health Care, Inc., the settlement required the corporation to pay $28.5 million, the chairman of the company’s board to pay $1 million, and a senior vice president to pay $500,000. Similarly, the government recently entered a settlement with the former CEO of Tuomey Healthcare System for healthcare kickback violations. That settlement required the executive to pay $1 million and barred him from participating in federal health care programs for four years. The settlement also mandated the former CEO’s assistance to the government in connection with the investigation of other entities and individuals.
Speaking on June 9 last year, the Acting Associate Attorney General, emphasized the importance of the Yates Memo and the Justice Department’s intent to apply it across the board in its civil enforcement matters. According to the official, “[w]hether the conduct implicates the False Claims Act, or our tax, antitrust, environmental or other laws, we have made clear that it is department policy to pursue civilly those individuals who are responsible and hold them accountable, in addition to pursuing our civil case against the organization.” Acting Associate Attorney General Bair pointed to four additional recent settlements involving individuals:

- A $4 million settlement with the estate of a former bank CEO that defrauded the Troubled Asset Relief Program;
- A $1.65 settlement with a home health agency owner;
- A $10.3 million settlement with a medical company and its owner for violating Medicare billing rules; and
- A $20 million settlement with a government contractor and its former president for misrepresenting its status as a woman-owned small business.

**Implications for Director and Officer Protection**

The government’s focus on individual accountability has substantial implications for the defense of corporate wrongdoing investigations and lawsuits. It also has substantial implications for how and by whom the costs associated with the defense are paid.

First, the Justice Department’s focus on individuals and the benefits offered to corporations for disclosure of information concerning individuals creates an increased potential for conflicts between the interests of the corporation and its executives in cases in which they are jointly investigated, prosecuted, or sued by the Justice Department. The increased risk of conflicts is bound to lead to a proliferation of lawyers in these cases and an increase in defense
costs. Each defendant will want separate counsel, and it may be dangerous for the individuals not to insist on it.

In addition, if the Justice Department makes good on its commitment to pursue individuals, irrespective of their ability to pay a judgment or settlement, the resolution dynamics in these cases could change substantially. Corporate indemnification and D&O insurance has worked so well in the past because both are built for a world in which monetary settlements are the rule rather than the exception. If the government brings civil cases to trial for a finding of liability, that very finding could have enormous implications for indemnification and D&O insurance. Under many current arrangements, individuals could be forced to repay the corporation or the insurance company for defense costs previously advanced, and the corporation and the individual may not be able to count on any contribution from insurers for the resolution of the case or related cases.

The Justice Department’s focus on individuals also is likely to lead to more insurance disputes involving corporate executives. D&O policies work best for individuals when the individuals are able to freely settle a government or private action without any finding of liability. That type of resolution usually does not trigger a well-negotiated D&O policy’s fraud and illegal benefit exclusions and seldom allows the insurer to recoup defense costs that it already has paid for the executive’s defense. To the extent the Justice Department now seeks to pursue civil cases based on factors other than obtaining a monetary resolution, the Justice Department is more likely to drive cases to a finding or an acknowledgement of the executive’s wrongdoing. Either would make it much more likely for an insurer to dispute coverage for the individual and seek to recoup sums already paid.
Before the Justice Department’s new policy, directors and officers had only moderate concerns about the payment for the defense of corporate wrongdoing cases. Generally, the corporation’s counsel (even when the individual executives had separate counsel) took the lead in the cases and effected settlements with the government and private plaintiffs that seldom required any contributions from the directors and officers. The director’s or officer’s separate counsel was paid for by the insurance company or the corporation. Because the cases usually settled without a finding or admission of liability on the part of the directors and officers, there was no fear that they would have to repay any defense costs.

The Yates Memo has created a new world. The focus on individuals, the increased pressure on corporations to provide information about their officers and directors, the pursuit of individuals irrespective of payment ability, and the concomitant proliferation of lawyers and potential for insurance disputes put executives at a very real risk that they may have a less than ideal defense or that they may have to repay amounts insurers or the corporation paid for their defense. Individual directors and officers should insist that their corporation’s D&O programs are changed in ways that ensure the directors or officers have separate independent counsel to defend them in federal statutory cases, that the fees of that counsel are paid in full (rather than the portion an insurance company tries to get away with paying), and that, if the director or officer settles or suffers an adverse judgment, they will not have to repay any defense costs that they received from their company or the insurer.

*A Very Short Primer on Indemnification and D&O Insurance*

Corporations generally protect directors and officers through indemnification agreements (or corporate bylaw indemnification provisions) and D&O insurance.
Corporate indemnification agreements require corporations not only to indemnify directors and officers for their legal expenses, settlements, and judgments, these agreements also require the corporation to pay the legal fees in advance to the directors and officers to ensure they are adequately protected. There are three major concerns about the efficacy of indemnification agreements at protecting directors and officers. First, if the corporation is insolvent, it likely will not be able to indemnify the directors and officers. Second, to indemnify a director or officer, a corporation must first determine whether the director or officer acted legally, not opposed to the interests of the corporation, and in good faith. If there is substantial evidence (or an admission or judgment) of illegal conduct or self-dealing, a corporation may not be able to indemnify. Third, if a director or officer is held not to be entitled to indemnification, then the director or officer must repay the defense fees that the corporation previously advanced.

Most corporations also purchase two types of D&O insurance to protect their directors and officers: traditional D&O insurance and Excess Side-A Difference-in-Conditions D&O insurance (“Side-A DIC”). Traditional D&O insurance protects directors and officers in some circumstances in which their corporation cannot indemnify them, and it also protects the corporation from its own liability for securities claims and its liability to indemnify its directors and officers. Traditional D&O insurance, like corporate indemnification, requires the insurer to advance defense fees but also allows the insurer to recoup those fees in certain instances in which it is later determined that the director or officer was not entitled to the fees.

Side-A DIC insurance is often thought to be the insurance of last resort for directors and officers because it only protects them (and thus cannot be used by the corporation) and it is intended to apply in instances in which traditional D&O insurance may not. For example, Side-A DIC insurance may protect the director and officer when the traditional D&O insurers are
insolvent or when their policies are held to be property of the corporation’s bankruptcy estate. Typically, like traditional D&O insurance, Side-A DIC insurance allows the insurer to recoup previously advanced defense costs if it is determined that certain exclusions (such as the fraud and illegal benefit exclusions) apply and the director and officer is held not to have been entitled to the insurance. Some Side-A DIC insurers, however, have started offering endorsements that remove their ability to recoup previously advanced defense costs. Notably, Side-A DIC insurers receive substantial premiums, but are thought to be well-insulated from having to pay on their D&O policies for most D&O claims. They usually pay only when other D&O insurers and the corporation do not. The amount of premium paid and the remoteness of potential responsibility for a loss often makes Side-A DIC insurers willing to offer very broad coverage.

**The Yates Memo and Broadening your Side-A DIC Insurance**

In light of the Yates Memo, corporations and their directors and officers would be well advised to discuss the following changes with their Side-A DIC insurers. The changes are intended to broaden coverage in a way that provides protections to directors and officers against the risks posed by the Justice Department’s focus on individual liability.

**Recoupment**

Efforts to recoup previously advanced defense costs are likely to increase with the Justice Department’s focus on individual accountability. Directors and officers should have their corporation seek endorsements from their Side-A DIC insurers that protect against the risk of the corporation or another insurer or the Side-A DIC insurer seeking to recoup previously advanced defense costs from a director or officer. Not only should Side-A DIC insurers foreswear their ability to seek recoupment, they should protect the director or officer if the corporation or
another insurer seeks recoupment. In a post-Yates Memo world, this change approaches necessity. There is absolutely no public policy against an insurer paying without recourse the defense costs of a person later found to be guilty or liable.

**Separate Counsel**

The Justice Department’s individual accountability efforts increase the likelihood that a director or officer involved in a government investigation or lawsuit should have his or her own separate counsel. Many traditional D&O insurers put hurdles in the way of an executive obtaining separate counsel. Accordingly, directors and officers should have their corporations seek amendments to their Side-A DIC insurance that offer protection against the risk of another insurer refusing to provide a director or officer separate counsel when a civil action has been filed against the director and officer and others or the director or officer is being investigated.

**Reasonable Fees**

The Justice Department’s individual accountability efforts also are likely to increase the defense costs insurers will have to pay in connection with corporate wrongdoing matters. If past is prologue, insurers are likely to seek to reduce these defense costs by contending that they will not pay hourly rates for lawyers greater than the amount that insurers ordinarily pay in other lawsuits. The problem with this approach is that lawyers who defend against corporate wrongdoing investigations and cases have specialized expertise, are usually employed at large national law firms, and command rates that are a multiple of the rates that insurers pay for other types of cases.
Insurers often have little basis under their D&O insurance policies to insist on lower-rate lawyers, but insurers nevertheless do so. This creates a great risk for directors and officers. They can either accede to the insurer just paying a portion of the defense costs or engage in protracted litigation with the insurers to pay reasonable rates. Before the Yates Memo, directors and officers often would accede to the unreasonably low rates and their corporation would make up the difference so that the directors and officers could retain experienced counsel. In the post-Yates Memo world, that approach is more dangerous because a director or officer is more likely to have to return previously advanced defense costs to the corporation. Accordingly, directors and officers should insist on their corporations seeking changes in their Side-A DIC insurance that protects against traditional D&O insurers refusing to pay the standard rates of the specialized lawyers that directors and officers typically hire to defend them against major government investigations and litigation.