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Underwriters of D&O and Professional Liability Insurance

In this issue … *holding individuals responsible for corporate acts: The U.S. Department of Justice (DOJ) stakes out a new policy.*

Introduction

On September 9, 2015, after less than six months in that position, Deputy Attorney General Sally Quillian Yates sent an internal memorandum to an extensive list of recipients that included all United States Attorneys, Assistant Attorneys General, and the Director of the FBI. The title of the memo was "Individual Accountability for Corporate Wrongdoing," and, coupled with an explanatory speech that she gave the next day, it set off a flurry of commentary and speculation. This issue of the newsletter looks at that memo, its historical context, and possible ramifications for D&O liability.

Background

In a June 16, 1999 DOJ memo, the then–Deputy Attorney General Eric Holder provided guidance on bringing criminal charges against companies in a document called "Federal Prosecution of Corporations." Under the overall heading of "Charging Corporations," it listed twelve subheadings: I General, II Factors to Be Considered, III Special Policy Concerns, IV Pervasiveness of Wrongdoing Within the Corporation, V The Corporation's Past History, VI Cooperation and Voluntary Disclosure, VII Corporate Compliance Programs, VIII Restitution and Remediation, IX Collateral Consequences, X Non-Criminal Alternatives, XI Selecting Charges, XII Plea Agreements with Corporations.

This theme of this memo (the 'Holder' memo) was both perpetuated and revised, first in 2003 by Deputy Attorney General Larry D. Thompson (the 'Thompson memo'), second in December, 2006 by Deputy Attorney General Paul J. McNulty (the 'McNulty memo'), and then in August, 2008 by Deputy Attorney General Mark Filip (the 'Filip memo'). Each of these subsequent memos, to varying degrees and with some amendments, used Holder's twelve subheadings as the basis for their pronouncements. Each of the memos had its own particular emphasis, such as corporate cooperation, corporate immunity, compliance programs, or attorney-client privilege.

The Filip memo went beyond the informal guidance of the previous memos by codifying the Principles of Federal Prosecution of Business Organizations (as they had been known since Thompson) into Title 9 of the United States Attorneys' Manual. Differences aside, each of these four policy statements focused firmly on the corporation as the primary target for regulatory action. Prosecuting individual wrongdoers was not discounted, but was secondary to the pursuit of the corporation. "Charging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged," is a phrase first used by Holder, repeated verbatim by Thompson and McNulty, and nearly so by Filip: "…It does not necessarily follow

that individual directors, officers, employees, or shareholders should not also be charged." These almost off-hand comments reflect that DOJ attention was not on the individuals. In this historical context of the DOJ targeting companies, the Yates memorandum appears an almost revolutionary commitment to shifting priorities.

The Yates Memorandum

The Filip memo acknowledged the past McNulty memo; the McNulty memo acknowledged the past Thompson memo; the Yates memo acknowledges nobody in the past. In a break from the previous pattern, there is no regurgitation of the twelve original Holder provisions, as amended by the subsequent iterations. And it is soon apparent why, for the Yates memo detours from the former emphasis on corporate prosecution to focus almost entirely on the pursuit of individuals.

Paragraph two: "One of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing." While recognizing the difficulty in pursuing individuals, the memo states that "These challenges make it all the more important that the Department fully leverage its resources to identify culpable individuals at all levels in corporate cases."

After noting that the guidance laid down will apply equally to civil corporate matters as to criminal, the memo sets out six steps to "strengthen our pursuit of individual corporate wrongdoing."

The Six Steps, as summarized in the memo:

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;
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
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.

Underlining that this memo is meant to herald a new paradigm, Deputy Attorney General Yates stipulates that these changes are to be incorporated into the codification created by Filip for the U.S. Attorneys' Manual, and that the guidance "will apply to all future investigations of corporate wrongdoing. It will also apply to those matters pending as of the date of this memo, to the extent it is practicable to do so."

In her speech in New York the day following the release of her memo, the Deputy Attorney General expanded upon the topic, noting that the memo represents a "substantial shift from our prior practice," and that the "rules have just changed."

Comment

The Department of Justice is clearly sensitive to accusations of soft-pedalling on executives in the cases that followed the financial crisis from around 2008; among the more prominent critics was U.S. District Judge Jed S. Rakoff in a January 2014 New York Review of Books article entitled "Why Have No High Level Executives Been Prosecuted?" but perhaps closer to the bone was the bi-partisan displeasure with the DOJ expressed by members the U.S. Senate Banking Committee at a hearing on the Financial Regulatory System, September 9,

2014.

Sustained adherence to the pursuit of companies by the Justice Department has been lucrative. In a November, 2014 press release, the DOJ announced the amount recovered in civil and criminal collections in 2013 and 2014 alone at more than $32 billion, and the Yates memo acknowledged as much: "in the short term certain cases against individuals may not provide as robust a monetary return on the Department's investment… ." But the very size of that monetary return has begged the question that if the financial penalties were so severe, then so were the crimes, and so why had there been no individual prosecutions?

It is one thing to issue a memo and change the rules; it is quite another for those new rules to actually make a difference in practice. Among the extensive commentary following the Yates memo and the September 10 speech, there was much discussion of the possible effect on companies' behavior: Would they "cough up" their bad actors, or would they take their chance in the courts? Less was said about the possible effect on individuals' behavior, which is where it all begins. The new guidelines are freshly minted, and will take some time to percolate through the justice system, so it may be a while before any impact is known —but who wants to be the first executive to test the resolve and commitment of the United States Department of Justice and the Deputy Attorney General?

Possible Impact on D&O Insurance

One reason that pursuit of individuals was generally set aside in favor of targeting companies was the sheer difficulty involved. If the DOJ means to go after individuals regardless of the challenges, then the process almost certainly will become more protracted and costly. Enforcement actions that target individuals generally incur much higher costs due to the typically extensive discovery process and the multiple defense counsels retained separately by each defendant. For the DOJ, with U.S. government funding, the extended timeframe might be the greater problem, but for private-sector defendants —corporate and individual— with generally more limited resources, a longer process will almost certainly mean a greater financial strain. After payment of any applicable retention, this strain will typically be borne by the D&O insurers, and in "bad fact" cases where culpability appears to be evident, costs can escalate with alarming rapidity. The likely result: greater pressure on D&O liability policy limits, and the paramount need for a separate and robust Side A-only program for individuals.

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