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# INSIGHTS

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## The Yates Memo and D&O Insurance

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In my last blog, I wrote about the “Yates Memo.” As a refresher, the Yates Memo was delivered to Department of Justice attorneys in September 2015 from Deputy Attorney General Sally Yates of the DOJ. The memo directs DOJ attorneys to prioritize the prosecution of individuals (not just companies) when it comes to corporate misconduct.

In light of the Yates Memo, I want to explore how individual directors and officers can protect themselves from non-meritorious prosecution, and how insurance might respond in light of the DOJ’s enhanced interest in individual liability.

I’ll address the issues by looking at three pillars directors and officers **can** control when it comes to personal protection:

1. Corporate Governance
2. Indemnification
3. D&O insurance

### Corporate Governance

Since the Yates Memo, everyone is on notice that the DOJ is very seriously looking at individuals. If anyone in Corporate America thinks it’s OK to be cavalier about compliance, they’re in for a rude awakening.

Corporations already find it (appropriately) difficult to shield bad actors; the Yates Memo makes this all the more true. If there were ever a time for a company’s directors and officers to take a hard look at whether their company has a **culture of compliance**, now is the time.

### Indemnification

The Yates Memo makes it clear that corporations cannot settle with the DOJ unless the corporation identifies for the DOJ individual wrongdoers, and gives the DOJ the information it needs to prosecute these individuals. The issue, of course, is that the mandate might create an incentive for corporations to scapegoat individuals.

When it comes to finding a scalp to hand over to the DOJ, it might be very tempting for a corporation, in the name of expediency, to serve up **someone** instead of the **right** one.

To the extent the DOJ is relying on a corporation to do much of the heavy lifting when it comes to investigations—and the DOJ is explicitly asking corporations to do this work for it—the DOJ might inadvertently encourage scapegoating.

Clearly people with good intentions both at the DOJ and within corporations will attempt to be conscientious about prosecuting only bad actors. The reality, however, is that folks do not always display the best judgment in “pressure cooker” situations.

This means the protections that directors and officers have in their personal indemnification agreements are more important than ever. If you haven’t had your personal indemnification agreement reviewed and updated in many years (or you don’t have one), now is the time to do that.

A corporation may find it hard to defend a director or officer on a voluntary basis in the face of government pressure. The benefit of a well-drafted indemnification agreement is that the contractual obligation helps corporations to do the right thing

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when it comes to providing individual Ds and Os important protections like the advancement of legal fees. As an additional benefit, individual Ds and Os will feel more secure knowing these protections can be accessed should they ever be needed.

## D&O Insurance

Given the seriousness of the Yates Memo and its content, consider the following areas for review of your D&O insurance program:

1. Carrier experience
2. Policy language
3. Policy structure: Side A DIC insurance
4. Investigation coverage

### Carrier Experience

The first item is somewhat more obvious: it's critical to place a policy with a strong carrier that is experienced in paying claims. Experience matters when the government does things like change its normal practices by going after individuals more aggressively.

It's no good to be with an insurance carrier that might regard a change in government appetite as an opportunity to attempt to weasel out of obligations to directors and officers who purchased one of its D&O policies. It's worth remembering that, as in most things, the best carriers are often not necessarily the cheapest.

### Policy Language

When individuals are prosecuted by the DOJ, carriers and others can start to take a very negative view of the innocence of the individuals being prosecuted.

During litigation is definitely the wrong time to find out that your D&O policy gives your insurance carrier unwanted discretion around things like advancing legal fees. The concern is that a carrier might decide to use this discretion to cut off the advancement of legal fees prematurely. The relevant policy exclusion that allows a carrier to stop advancing legal fees should only be triggered upon a "final adjudication" of fraud, ideally in the particular underlying proceeding in question. It should be noted, however, that this exact formulation may not be something your particular insurance carrier is willing to offer.

Another important area to review carefully is the policy's "severability" language. Severability is a provision that, if worded correctly, allows a policy to continue to respond on behalf of good actors even after a bad actor has admitted or been convicted of wrong-doing.

Here's the issue: the point of the Yates Memo is to put the world on notice that the DOJ is looking for individuals to admit guilt. The question you want to ask your broker is this: if an officer or director admits civil or criminal wrongdoing, can the carrier stop paying to defend everyone else?

Without solid, protective severability language, the answer in many cases may be an unfortunate "yes, the carrier can cut you off."

There are other policy wording issues to consider in light of the Yates Memo. Sidley Austin LLP has done a nice job on a [list of policy points to review](#) in a recent memorandum it published on this subject.

### Policy Structure: Side A DIC Insurance

Most public companies purchase D&O insurance programs that combine traditional ABC coverage with extra stand-alone Side A Difference-in-Condition (DIC) coverage. The Yates Memo is another good reason to do this. (For a reminder of what ABC versus stand-alone Side A DIC insurance is, take a quick look at [this article](#).)

If a public company, perhaps in the face of pressure from the DOJ, is less than promptly cooperative about advancing legal fees to a D or O being investigated, the individual being investigated is in a vulnerable position. Properly brokered D&O insurance will respond to pay defense fees for individuals under investigation, but in most cases this response occurs only after the self-insured retention (like a deductible) has been exhausted.

### What Happens If A Company Refuses To Pay The Self-Insured Retention?

The answer is that the individual may be forced to pay the self-insured retention out of his or her own pocket. The amount will not be trivial: for some public companies the self-insured retention is millions of dollars.

One way an individual can avoid this potential exposure is the placement of stand-alone Side A DIC coverage on top of the regular ABC program. A feature of such a Side A policy is its ability to respond when a corporation fails to do so. The Side A carrier can advance legal fees in the amount of the self-insured retention, and then that carrier (and not the individual) will pursue reimbursement from the corporate entity.

### Investigation Coverage

Finally, it's worth considering whether it would be prudent to purchase insurance to cover the investigation of a corporate entity by the DOJ, SEC or other regulatory authority.

It seems likely that if the DOJ will not let a company settle absent a clear plan for getting convictions against individuals, companies will spend more time (and hence more money) on corporate investigations. This kind of expense may be something to consider insuring.

Currently, this coverage can be obtained on a stand-alone basis, or as an add-on to some D&O insurance policies. Coverage of investigations of corporate entities has only recently become widely available. If you haven't specifically endorsed this coverage in your D&O policy, it's unlikely that you have it.

If you do decide to endorse the D&O policy to expand its scope of coverage for the investigation of the corporate entity, consider that the cost may include the additional premium for the endorsement as well as the cost of purchasing additional limits of insurance. With an expanded scope of coverage, you're going to need higher insurance limits than previously contemplated.

The decision of whether or not to pay additional premium for corporate entity investigation coverage (and in some cases purchase additional D&O insurance limits) is a tricky one. For some companies, the better choice might be to preserve coverage for the Ds and Os by not expanding the scope of coverage to include investigations of the corporate entity.

Given that board members are directly impacted, this is a board-level decision. I recommend you seek guidance from your outside counsel and a trusted D&O insurance broker to work through this nuanced decision.

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