AGREEING IN THE SHADOW OF THE POLICY: HOW CORPORATE INSURANCE POLICIES IMPACT THE RESOLUTION OF GOVERNMENTAL INVESTIGATIONS INTO CORPORATE CRIME

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Since 1999, prosecutors have increasingly utilized deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) to resolve investigations into corporate criminal conduct. Corporations are often eager to enter into such agreements in order to avoid indictment, believing that the consequences set forth in the terms of the DPA or NPA are less harmful than are the consequences of a corporate indictment. However, the impact that a DPA or NPA may have on a corporation's insurance coverage may not be readily apparent or even contemplated when the corporation elects to enter into the agreement.

This Note analyzes the ways in which corporate insurance coverage interacts with and is impacted by white-collar criminal investigations and the resolution of such investigations through the use of NPAs and DPAs. Specifically, this Note discusses situations in which corporations have lost insurance coverage as a result of entrance into a DPA or NPA and identifies ways in which such consequences could be avoided. Finally, this Note anticipates the impact that the Department of Justice's (DOJ) new emphasis on individual prosecution for white-collar crimes will have on corporate insurance availability and policies.

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I. INTRODUCTION

When a corporation finds itself under criminal investigation by federal prosecutors, it will likely attempt to resolve the investigation by entering into a DPA or NPA.[1] From a risk aversion perspective, it makes

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[1] NPAs and DPAs are agreements between the government and a corporate entity (or, less commonly, an individual) that is alleged to have engaged in some kind of wrongdoing. The agreement may impose upon the corporation a range of sanctions such as fines, restitution, institutional changes, and additional reporting

sense that a corporation would prefer to accept the known costs associated with entering into a DPA or NPA rather than face the uncertain, and potentially devastating consequences of a corporate indictment, trial or even conviction.[2] This fear of indictment gives prosecutors enormous leverage in any negotiation with a corporation relating to the corporation's allegedly criminal conduct. Although some critics maintain that DPAs and NPAs exploit the appreciably unequal bargaining power between prosecutors and corporations,[3] corporations appear rational in seeking to enter into DPAs or NPAs, despite their burdensome conduct requirements, sizeable penalties and often-unfavorable admissions. This risk aversion rationale is premised on the expectation that a corporation understands and can compare the relative costs of a DPA or NPA, on the one hand, and of the consequences of non-cooperation (such as an indictment, trial or conviction), on the other. Thus, corporate counsel should be well aware of the collateral consequences that can flow from a DPA or NPA in determining how valuable such an agreement is and what concessions a corporation should be willing to make within the agreement, so as to ensure that entering into a DPA or NPA will produce a better outcome for the corporation than would non-cooperation.

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or cooperation duties. In exchange for the corporation's acceptance of the sanctions, the government agrees not to prosecute in a non-prosecution agreement, or the government agrees to dismiss filed charges in a deferred prosecution agreement. The government's agreement to refrain from prosecuting or dismiss charges is contingent upon the corporation's adherence to the terms of the agreement, which can be quite onerous. *See generally* Roma W. Theus II, *What Cooperating with the Government Really Means for a Company*, 48 No. 1 DRI FOR DEF. 32 (Jan. 2006).

[2] A person or entity is risk averse where the certainty equivalent, meaning the amount they are willing to pay or accept to avoid a high risk gamble, is greater than the expected value of taking the risk.

[3] S*ee, e.g.*, James R. Copland, *The Shadow Regulatory State: The Rise of Deferred Prosecution Agreements*, CIV. JUST. REP., May 2012, at 1, http://www.manhattan-institute.org/html/cjr_14.htm (discussing how prosecutors have ample bargaining power to force companies to "implement onerous training and reporting programs, hire senior officials to oversee companies' compliance' with prosecutors' legal interpretations, modify sales-force practices and compensation plans, contract with independent 'monitors' empowered to dictate modifications to business practices, and even fire and replace directors or chief executives"); Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 853 (2007) (identifying and discussing "some indications of [prosecutorial] overreaching, if perhaps not abuse of prosecutorial discretion").

This paper will discuss the subtle, but significant, impact that DPAs and NPAs can have on a corporation's access to the benefits of its insurance coverage. Part II will discuss the functions of insurance in society, and provide a breakdown of the different types of corporate insurance coverage that is available, both for individuals and for corporate entities. Part III lays out the evolution of the guidelines that have been promulgated for prosecutors concerning how to make charging decisions in the corporate context. Part IV will present a discussion of the impact that corporate insurance has had on corporate cooperation and prosecutorial discretion, as demonstrated through an analysis of DPAs and NPAs. Part IV provides specific examples of past DPAs or NPAs that have jeopardized or eliminated a corporation's insurance coverage and lays out new insurance concerns for corporate counsel to consider when entering into DPAs and NPAs in light of the DOJ's recent shift towards increasing individual accountability for corporate crimes.

II. THE PURPOSE OF INSURANCE GENERALLY AND INSURANCE IN THE CORPORATE SETTING

A. THE GENERAL GOALS OF INSURANCE

One of the primary purposes of insurance is to take risks that would otherwise be borne entirely by an individual or a corporate entity and distribute the costs of such risks efficiently throughout a larger population.[4] In considering the extent to which a prosecutor might contemplate a corporate defendant's insurance coverage in making charging decisions and entering into agreements, it is important to be thinking about what types of corporate conduct we want to be insurable, and the potential impact of such insurability on the deterrent goals of the criminal justice system. At the same time, the interest in deterrence should be balanced against the restitutionary interest of compensating the victims of corporate malfeasance.[5]

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[4] For an interesting discussion of how the economic justifications for insurance in a corporate setting differs from those that are applicable to individuals *see* Kenneth A. Froot, David S. Scharfstein & Jeremy Stein, *Risk Management: Coordinating Corporate Investment and Financing Policies,* 40 J. FIN., 1629, 1639-1658 (1993).

[5] The extent to which the criminal justice system's interest in deterrence should yield to, or even consider, the restitutionary interests of victims in being

Where a corporation may face other liabilities or losses related to the conduct covered by a NPA or DPA, should such losses or liabilities be uninsurable as a matter of public policy or be cast outside the scope of a policy's coverage because of the contents of a contract between the government and the corporation?[6] In situations when a corporate entity is itself subjected to criminal charges, the prosecuting governmental entity will consider whether a charging decision is likely to result in rendering the corporation insolvent, potentially jeopardizing thousands of jobs.[7]

In much the same way that individuals pay premiums to secure health insurance coverage in the event that they experience a costly medical expense in the future, corporations purchase a range of insurance products to protect against potential astronomical liabilities that could threaten their

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compensated when making charging decisions is not something that has been clearly established. This is in part because restitution or victim compensation may be considered a goal of both the civil and criminal justice systems, and there is debate as to the system to which it most appropriately belongs. *See* Bridgett N. Shephard, *Classifying Crime Victim Restitution: The Theoretical Arguments and Practical Consequences of Labeling Restitution as Either a Criminal or Civil Law Concept,* 18 LEWIS & CLARK L. REV. 801, 808 (2014) ("Victim restitution has commonly been cited as an example of the blurring between civil and criminal law. Some commentators argue that restitution is clearly a civil idea, and others argue that it is clearly criminal. Other commentators believe that restitution is a hybrid criminal-civil concept, while still others see restitution as neither criminal nor civil, but rather, as a concept that is sui generis, something entirely of its own likeness that cannot be based on existing legal frameworks."). Restitution to victims of corporate crime may be accomplished through civil suits, through the award of damages, but DPAs and NPAs may provide for the establishment of trusts for compensation of victims and will consider the extent to which the corporation has made efforts to make full restitution in determining a suitable penalty. *See e.g.*, Press Release, DOJ, SunTrust Mortgage Agrees to $320 Million Settlement (July 3, 2014), http://www.justice.gov/opa/pr/suntrust-mortgage-agrees-320-million-settlement (explaining that SunTrust's Agreement with the DOJ required SunTrust to pay $179 million in restitution to compensate borrowers for damage caused by its conduct, and further, that if more than $179 million was needed to sufficiently compensate the victims, the bank would guarantee an additional $95 million for additional restitution).

[6] Whether, as a policy matter insurance coverage should be available to cover the penalties agreed upon in a DPA or NPA is outside the scope of this paper. As a practical matter, such coverage is usually precluded based on state public policy or insurance policy exclusions. N.Y. Ins. Law § 1101(a)(1) (McKinney 2000).

[7] This consideration has been particularly compelling in the wake of Arthur Anderson's collapse following its indictment related to providing accounting services to Enron, which will be discussed more extensively later on in this paper.

solvency. These types of general corporate liability insurance policies function as cover for the corporate entity itself. Although they may operate indirectly to protect the interests of a corporation's executives, by helping to maintain share prices in the face of litigation or preventing a corporation from becoming insolvent due to the owing of a massive claim, the policies themselves do not provide coverage for the individual executives. Thus, in addition to purchasing insurance coverage for liabilities incurred by the corporate entity, most corporations also secure coverage for the directors and officers of their corporation through D&O Policies.

B. COVERAGE FOR THE CORPORATE ENTITY

Corporations have a range of different insurance products available to protect the corporate entity both from potential liabilities to third parties, risks inherent in their business, and a host of other hazards. For instance, car manufacturers have commercial liability policies protecting them from potential tort claims related to their cars, energy companies have property insurance protecting their power plants. Generally, these policies have provisions which cover actual settlements or liabilities resulting from litigation, provide for a legal defense (or the costs of one), and losses incurred by the corporation as a result of property damage or some other event.

C. COVERAGE FOR INDIVIDUALS: INDEMNIFICATION AND D&O POLICIES

When an individual serves as a director or officer of a corporation, he is subjected to the risk of being sued as an individual when his decisions or conduct in running the corporation results in some sort of litigation. Additionally, serving as an officer of a corporation may expose an individual to an array of expenses associated with defending governmental agency investigations for actions that he has taken in his official capacity.[8]

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[8] Indeed, the Delaware Supreme Court has acknowledged that a corporation's capacity to indemnify its officers serves the dual policies of "(a) allowing corporate officials to resist unjustified lawsuits, secure in the knowledge that, if vindicated, the corporation will bear the expense of litigation; and (b) encouraging capable women and men to serve as corporate directors and officers, secure in the knowledge that the corporation will absorb the cost of defending their honesty and integrity." *See* VonFeldt v. Stifel Fin. Corp., 714 A.2d 79, 84 (Del. 1998).

Given these risks, it makes sense that a corporation seeking to recruit the best and the brightest individuals to serve as its officers would want to protect them against the aforementioned risks to the extent that is allowable by law.[9] One way in which corporations "insure" their executive officers against these risks is by providing for the indemnification of such officers. In addition to indemnification, corporations are explicitly permitted to purchase D&O liability insurance policies for the protection of corporate directors and officers, even when the corporation could not itself indemnify the individual.[10]

Indemnification refers to the reimbursement by the corporation of liabilities, including judgments, amounts paid in settlement expenses, and attorneys' fees incurred by directors, officers, employees, and sometimes agents in the course of their service to the corporation. Such indemnification is vital in that it "encourages corporate service by capable individuals by protecting their personal financial resources from depletion by the expenses they incur during an investigation or litigation that results

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[9] As will be discussed more extensively in the below section regarding uninsurable and unindemnifiable risks, state law and public policy objections sometimes prohibit the purchasing of insurance for certain types of risks and losses. *See e.g.*, Level 3 Comm., Inc. v. Fed. Ins. Co., 272 F.3d 908 (7th Cir. 2001) (disgorgement of unlawfully obtained funds was uninsurable as a matter of state public policy); State Farm Fire & Cas. Co. v. Superior Court, 191 Cal. App. 3d 74, 77-78 (1987); Wausau Ins. Co. v. Valspar Corp., 594 F. Supp. 269, 273 (N.D. Ill. 1984); Grant v. North River Ins. Co., 453 F. Supp. 1361, 1370 (N.D. Ind. 1978) (punitive damage awards uninsurable as matter of public policy); *see also* Checkley v. Ill. Cent. R.R. Co., 100 N.E 942, 944 (Ill. 1913) ("A fire insurance policy issued to anyone, which purported to insure his property against his own willful and intentional burning of the same, would manifestly be condemned by all courts as contrary to a sound public policy...").

[10] State laws expressly permit corporations to purchase D&O insurance. *See e.g.*, 8 DEL. LAWS § 145(g) (1953) ("A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section."); 32 ILL. COMP. STAT. 5 § 8.75(g) (2012) (authorizing Illinois corporations to purchase D&O insurance).

by reason of that service."[11] Corporate indemnification can be voluntarily assumed by a corporation through the corporation's bylaws or other founding documents (permissive indemnification), or may also be mandatory in certain situations under state law (mandatory indemnification).[12]

Under Delaware law,[13] a corporation has broad discretion to enter into indemnification agreements with its officers or draft provisions of its bylaws providing indemnification beyond that which is explicitly contemplated by the state statute (§145).[14] Section 145 applies to any person involved in actual or threatened litigation or an investigation by reason of his status as an officer, director, employee, or agent of the corporation or of another entity he or she served at the request of the indemnifying corporation.[15] Specifically, §145(a) permits indemnification of officers, directors, employees, or agents for attorneys' fees and other expenses, as well as judgments or amounts paid in settlements in civil cases brought by third parties.[16]

Although the advancement of fees is a distinct concept from indemnification, the Delaware Supreme Court has acknowledged, "advancement is an especially important corollary to indemnification as an inducement for attracting capable individuals into corporate service."[17] Section 145(e) permits the advancement of attorneys' fees and other legal expenses to officers and directors in connection with defending any civil,

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[11] Homestore, Inc. v. Tafeen, 888 A.2d 204 (Del. 2005).

[12] *See generally* Stacy Kalberman, *Director and Officer Liability: An Overview of Corporate and Insurance Indemnification*, 7 No. 4 ANDREWS SEC. LITIG. & REG. REP. 17 (2001) (corporations are typically required by statute to indemnify directors and officers for the cost of their defense where the officer or director has prevailed in litigation or other proceedings).

[13] Delaware law is a good place to look for the general provisions concerning corporate indemnification. This is because Delaware is the most favored state of incorporation for U.S. businesses and home to more than half of the corporations that make up the Fortune 500. *See* L.S. Black, *Why Corporations Choose Delaware,* DEL. DEP'T OF STATE (2007), http://corp.delaware.gov/pdfs/whycorporations_english.pdf.

[14] DEL. CODE ANN. tit. 8, § 145 (1953) [hereinafter *Section 145*].

[15] *Id.*

[16] *See* Cochran v. Stifel Fin. Corp., C.A. No. 17350 (Del. Ch. Mar. 8, 2000), slip op. at 26-29; In re Massey Energy Co. Derivative & Class Action Litig., C.A. No. 5430-VCS (Del. Ch. May 31, 2011), slip op. at 38 n.123.

[17] Homestore, Inc. v. Tafeen, 888 A.2d 204, 211 (Del. 2005).

criminal, administrative, or investigative proceeding. These expenses may be paid "in advance of the final disposition" of the proceeding. Corporations generally have fairly wide latitude in determining the conditions under which they will advance defense costs to a director or officer, subject to Section 145(e)'s requirement that such advancement be conditioned "upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the corporation."[18] When a corporation adopts charter provisions or otherwise provides for broad, mandatory advancement to the fullest extent allowable under the law, a corporation must advance such funds upon receipt of an undertaking, and may not stop such advancement until the conclusion of the proceeding if it is determined that the individual did not meet the standard of conduct for indemnification under Delaware law.[19]

There are several limitations on the circumstances in which a corporation may indemnify an officer. First, a corporation may not indemnify an officer who has not "acted in good faith and in a manner he [] reasonably believed to be in, or not opposed to, the best interests of the corporation."[20] Second, in criminal matters, a corporation may only indemnify when, in addition to acting in good faith, the officer did not have reasonable cause to believe his conduct was unlawful.[21] Third, in actions brought by or in the right of the corporation (such as derivative actions), a corporation may indemnify only for expenses and attorneys fees, and cannot indemnify at all "in respect of any claim, issue or matter as to which [an officer] shall have been adjudged to be liable to the corporation."[22] These limitations on the extent of corporate indemnification do not apply to the scope of D&O coverage.[23] When a corporation is unable to indemnify

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[18] Del. C. § 145; *But see* Homestore, 888 A.2d at 211 (explaining that § 145(e) of Delaware's statute "provides corporations with the flexibility to advance funds to former corporate officials…without an express undertaking.").

[19] *See* Blankenship v. Alpha Appalachia Holdings, Inc., C.A. No. 10610-CB (Del. Ch. May 28, 2015) (holding that where corporation agreed to advance defense costs to fullest extent allowed under law, the corporation could not later condition the advancement upon the individual's statements regarding his belief that he believed he had acted lawfully).

[20] *Section 145*.

[21] *Id.*

[22] *Id.*

[23] *See id.* § 145(g) (providing that a corporation can buy D&O insurance even when it would not have the power to personally indemnify directors or officers).

its officer, the officer may still be covered under his D&O policy.[24] Thus, D&O policies can function as an important safety net for an officer in situations where, for whatever reason, the corporation cannot or will not indemnify him.[25]

A typical D&O policy contains three different types of coverage; "Side A" coverage, which protects individual managers directly from the risk of shareholder litigation (so reimbursement for claims is paid directly to the officers), "Side B" coverage, which reimburses the corporation for its indemnification payments to officers and directors, and "Side C" coverage, which protects the corporation from the risk of shareholder litigation to which the corporate entity itself is a party. A standard insuring clause within a D&O policy provides:

> (For Side A) This policy shall pay the Loss of each and every Director or Officer of the Company arising from a Claim first made against the Directors or Officers during the Policy Period ... for any actual or alleged Wrongful Act occurring on or prior to the Effective Time in their respective capacities as Directors or Officers of the Company, except when and to the extent that the Company ... has indemnifed the Directors or Officers. The Insurer shall ... advance Defense Costs of such Claim prior to its final disposition.[26]
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> (For Side B) The Insurer shall reimburse the Company for Loss arising from any claim first made against the Insureds and reported to the Insurer during the Policy Period by reason of any Wrongful Act but only when and to the extent the Company has indemnified the Insureds for such Loss pursuant to law, statutory or common, or pursuant to

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See also Stacy Kalberman, *Director and Officer Liability: An Overview of Corporate and Insurance Indemnification*, 11 ANDREWS' PROF. LIAB. LITIG. REP. 18 (2001).

[24] However, as will be discussed further below, D&O policies contain a number of exclusions, so it is possible that a corporation will be unable to indemnify an officer and the officer's conduct will fall within an exclusion under the D&O policy and thus the officer will have no coverage either through indemnification or his D&O insurance.

[25] Kalberman, *supra* note 23, at 3.

[26] *See, e.g.*, In re Allied Digital Techs Corp., 306 B.R. 505, 510 (Bankr. D. Del. 2004).

the Charter or By-Laws of the Company.[27]

These policies will often contain a number of exclusions, some of which are relevant in the context of a corporate criminal investigation or the ensuing civil litigation. "Conduct" exclusions eliminate coverage for particular conduct that is considered so self-serving or egregious that insurance coverage is deemed inappropriate. These "conduct" exclusions preclude coverage for dishonest or fraudulent acts[28]; claims alleging that directors engaged in conduct detrimental to the corporation for their own personal gain; willful violation of the law; and illegal renumeration.[29] "Prior Claims" exclusions eliminate coverage under the policy in situations where the insured corporation or officer was on notice of a claim or a claim was actually pending prior to the commencement of the policy period.[30] Additionally, many D&O policies will exclude coverage for claims "made against the Insureds...based upon or arising out of any deliberate…act or omission by such Insureds."[31]

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[27] *See* Jennifer M. Schwartz, *Insurance Defense Costs in a Mixed Action: Scope of Duty: D&O Insurers*, 28 CBA REC. 28, at 29 (2014) (citing Art Bookbinders of Am., Inc. v. Tudor Ins. Co., 409 Ill. App. 3d 1144, *11-12 (1st Dist. June 7, 2011)).

[28] *See e.g.*, AIG, *D&O Policy* at 17, http://www.aig.com/public-company-do_295_391889.html (last visited Dec. 5, 2015) (excluding coverage for claims "arising out of, based upon or attributable to the committing in fact of any deliberate criminal or deliberate fraudulent act by the Insured.").

[29] *See e.g., id.* at 6 (excluding coverage for claims "arising out of, based upon or attributable to payments to an Insured of any remuneration without the previous approval of the stockholders or members of an Organization, which payment without such previous approval shall be held to have been illegal.").

[30] *See e.g., id.* at 5 (excluding coverage for claims, "[a]lleging, arising out of, based upon or attributable to the facts alleged, or to the same or related Wrongful Acts alleged or contained in any Claim which has been reported, or in any circumstances of which notice has been given, under any policy of which this policy is a renewal or replacement or which it may succeed in time…[and] any pending or prior: (1) litigation; or (2) administrative or regulatory proceeding or investigation of which an Insured had notice, or alleging or derived from the same or essentially the same facts as alleged in such pending or prior litigation or administrative or regulatory proceeding or investigation…[and] if any Insured, as of such Continuity Date, knew or could have reasonably foreseen that such Wrongful Act could lead to a Claim under this policy.").

[31] *See* J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 42 Misc. 3d 1230(A), 988 N.Y.S.2d 523 (N.Y. Sup. 2014).

D. RISK THAT IS UNINSURABLE AS A MATTER OF PUBLIC POLICY

Even when insurers would like to provide coverage, certain losses or risks are deemed uninsurable as a matter of public policy. One common example is punitive damage awards, which a number of states consider uninsurable based on public policy grounds.[32] Not surprisingly, most states also prohibit insurance coverage for conduct that is intended to cause injury.[33] Recently, D&O insurers have attempted to use the intentional harm public policy exception to preclude coverage for SEC settlements, though the efficacy of this argument remains to be seen.[34] The issue of whether restitutionary or disgorgement payments may be considered an insurable loss has not been conclusively established by each state, but a number of cases suggest that such insurance coverage may not be allowed.[35]

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[32] *See generally* McCullough, Campbell & Lane LLP, *Chart of Punitive Damages by State*, http://www.mcandl.com/puni_chart.html (last visited Dec. 5, 2015); *See also* Nw. Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 433 (5th Cir. 1962) (excluding coverage for punitive damages and comparing insurance coverage for punitive damages to insurance coverage for criminal liability.).

[33] Debates exist as to how subjective the intent must be in order to be considered an intentional act that cannot be covered. *See* City of Carter Lake v. Aetna Cas. & Ins. Co*.,* 604 F.2d 1052, 1058-1059 (8th Cir. 1979) (an act is intentional and uninsurable if actor knew or should have known that there was a substantial probability that his conduct would produce such a result); *See also* Physicians Ins. Co. of Ohio v. Swanson, 58 Ohio St. 3d 189, 193 (1991) (act is intentional where the insured subjectively intended to produce the particular result).

[34] *See* J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 126 A.D.3d 76, 88 (N.Y. App. Div. 2015).

[35] *See generally* Katherine C. Skilling, *Coverage for Ill-Gotten Gains?: Discussing the Uninsurability of Restitution and Disgorgement,* 72 WASH. & LEE L. REV. 1077 (2015) (surveying recent case law addressing the insurability of disgorgement payments); *See e.g.* Level 3 Commc'ns, Inc. v. Fed. Ins. Co., 272 F.3d 908, 910 (7th Cir. 2001) (excluding coverage for a restitutionary payment based on the language of the policy and finding that a "loss" within the meaning of the policy could not include the restoration of an ill-gotten gain); Conseco, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, 2002 WL 31961447, at *16 (Ind. Cir. Ct. Dec. 31, 2002) (where portion of settlement of securities class action and derivative litigation constituted ill-gotten gains, coverage was unavailable because settlement was not a loss under the policy); Dobson v. Twin City Fire Ins. Co., 2012 WL 2708392, at *9-10 (C.D. Cal. July 5, 2012) (excluding from coverage

III. CORPORATE ACCOUNTABILITY: CHARGING DECISION GUIDELINES

The criminal justice system in the United States is intended to further the goals of deterrence, retribution, incapacitation, rehabilitation, and restitution. These goals endure whether the subject of a criminal investigation is an individual or a corporation, and irrespective of the nature of the purportedly illegal conduct at issue. Nonetheless, distinctions between so-called "white collar crimes" and other forms of crime have resulted in debates as to whether and to what extent subjecting corporations to criminal liability furthers the underlying goals of our criminal justice system.[36] In the 1990's, as the number of corporations facing criminal charges increased, it appeared to many as though decisions as to whether to charge corporations were unpredictable. In response to complaints that there were no uniform rules in deciding whether to bring charges in corporate cases,[37] then-Deputy Attorney General Eric Holder, Jr. released the first set of guidelines on indicting corporations, in a memorandum titled "Bringing Charges Against Corporations," (Holder Memorandum).[38] These

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claims seeking restitution for fraud in the underlying action, and also breach of fiduciary duty claim to the extent that it was based on the same restitution allegations). *But see* U.S. Bank Nat'l Ass'n et al. v. Indian Harbor Ins. Co., 2014 WL 3012969 at *3 (D. Minn. July 3, 2014) (finding that a restitutionary "settlement is not uninsurable under Delaware law because no Delaware authority has held that restitution is uninsurable as a matter of law" and distinguishing the case from *Level 3* based on the policy language).

[36] *Compare* Sara S. Beale, *A Response to the Critics of Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1481, 1482 (2009) (arguing that corporate criminal liability continues to makes sense and is preferable to a system in which corporations are not subject to criminal liability) *with* Albert W. Alschuler, *Two Ways to Think About the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359, 1369-1370, 1372, 1376 (2009) (arguing that subjecting corporations to criminal liability unnecessarily punishes innocent shareholders and creates irresolvable conflicts of interest, while not substantially furthering the goals of our criminal justice system).

[37] In a 2006 interview with the Wall Street Journal, Holder explained that "back in 1999 there were a group of private practitioners complaining that there was no uniformity in the way in which prosecutors decided to indict corporations" and that the Holder memorandum was a response to these complaints. *See* Peter Lattman, *The Holder Memo and its Progeny,* WALL STREET J. LAW BLOG (Dec. 13, 2006), http://blogs.wsj.com/law/2006/12/13/the-holder-memo/.

[38] Memorandum from Eric Holder, Deputy Att'y Gen., U.S. Dep't of Justice to Component Heads and U.S. Attorneys on Bringing Criminal Charges Against

guidelines have subsequently been amended and updated a number of times to reflect perceived inadequacies or new developments in corporate crime.

A. THE GUIDELINES UP UNTIL 2015

In 1999, the Holder Memorandum memorialized Chapter Eight of the U.S. Sentencing Guidelines'[39] consideration of a corporation's cooperation as a factor in making charging decisions[40] and combined the U.S. Sentencing Guidelines with the U.S. Attorneys' Manual to create a directive for prosecutors to make charging decisions in the corporate context.[41] The Holder Memorandum emphasized the "substantial federal interest in indicting the corporation," and laid out non-mandatory guidelines that a prosecutor could, but was not obligated to consider in deciding how to charge a corporation.[42] However, the Holder Memorandum also suggested that prosecutors should utilize NPAs or DPAs as a mechanism of pre-trial diversion that would reward cooperation. Specifically, the Holder Memorandum set forth eight factors for prosecutors to consider:

> 1. The nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;
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> 2. The pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management;

Corps. (June 16, 1999), http://www.justice.gov/sites/default/files/criminal-fraud/legacy/2010/04/11/charging-corps.PDF [hereinafter Holder Memorandum].

[39] Chapter Eight was incorporated into the Federal Sentencing Guidelines in response to the increase of corporate criminal prosecutions that occurred during the 1990s. Specifically, Chapter Eight sought to ensure that the sanctions imposed upon corporations provided adequate deterrence and incentivized the adoption and maintenance of effective mechanisms for discovering, reporting, and preventing criminal conduct within the corporation. *See* U.S. SENTENCING COMMISSION ANNUAL REPORT (1991), http://www.ussc.gov/guidelines-manual/1991/1991-federal-sentencing-guidelines-manual.

[40] Holder Memorandum, *supra* note 38.

[41] *Id.*

[42] *Id.* at Part II (internal citations omitted).

3. The corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it;

4. The corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product privileges;

5. The existence and adequacy of the corporation's compliance program;

6. The corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies;

7. Collateral consequences, including disproportionate harm to shareholders and employees not proven personally culpable; and

8. The adequacy of non-criminal remedies, such as civil or regulatory enforcement actions.[43]

The Holder Memorandum was replaced in 2003 when then-Deputy Attorney General Larry Thompson released the "Principles of Federal Prosecution of Business Organizations" (Thompson Memorandum).[44] The Thompson Memorandum included the same eight factors that had been enumerated in the Holder Memorandum, but added the additional factor of "the adequacy of the prosecution of individuals responsible for the

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[43] *Id.*

[44] *See generally* Memorandum from Larry D. Thompson, Deputy Att'y Gen., on Principles of Federal Prosecution of Busienss Organizations to to Heads of Dep't Components and U.S. Att'ys (Jan. 20, 2003), http://www.americanbar.org/content/dam/aba/migrated/poladv/priorities/privilegewaiver/2003jan20_privwaiv_dojthomp.authcheckdam.pdf [hereinafter Thompson Memorandum].

corporation's malfeasance."[45] While the Holder Memorandum's factors had merely been advisory, consideration of the Thompson Memorandum's factors, in charging decisions, was mandatory.[46] In another significant departure from the Holder Memorandum, the Thompson Memorandum underscored that only rarely should individuals not be pursued, irrespective of whether the corporation offers to plead guilty.[47] The Thompson Memorandum further emphasized the value of pre-trial diversion strategies (such as NPAs or DPAs) and "permit[ted] a non prosecution agreement in exchange for cooperation when a corporation's timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective."[48]

In December of 2006, the DOJ overhauled its guidelines for charging decisions in corporate criminal investigations with "The Principles of Federal Prosecution of Business Organizations" (McNulty Memorandum).[49] The McNulty Memorandum sought to "expand[] upon the [DOJ's] long-standing policies concerning how [it] evaluate[s] the authenticity of a corporation's cooperation with a government investigation."[50] Specifically, the McNulty Memorandum was primarily intended to address public concern regarding a cooperating corporation's waiving of attorney-client privilege and the potential for prosecutors to consider a corporation's advancement of attorney's fees in making charging decisions.[51] In a public statement concerning the guidelines, then-

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[45] *Id.* at 3.

[46] *See* United States v. Stein, 435 F. Supp. 2d 330, 338 (S.D.N.Y. 2006) ("The Thompson Memorandum sets forth nine factors that federal prosecutors *must* consider in determining whether to charge a corporation or other business organization.") (emphasis added).

[47] Thompson Memorandum, *supra* note 44, at 2. Notably, the Memorandum specifically stated that "only rarely should *provable* individual culpability not be pursued." (emphasis added). Thus, it is within the prosecutor's discretion to determine what constitutes "provable" culpability.

[48] Thompson Memorandum, *supra* note 44, at 6.

[49] *See generally* Memorandum from Paul J. McNulty, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys, regarding Principles of Fed. Prosecution of Bus. Orgs., http://www.usdoj.gov/dag/speeches/2006/mcnulty_memo.pdf [hereinafter McNulty Memorandum].

[50] *Id.* at 2.

[51] Thompson Memorandum, *supra* note 44; *See also* Wulf A. Kaal & Timothy A. Lacine, *The Effect of Deferred and Non-Proseuction Agreements on Corporate*

Deputy Attorney General Paul McNulty stated that they were intended to "further promote public confidence in the [DOJ], encourage corporate fraud prevention efforts, and clarify [the DOJ's] goals without sacrificing [its] ability to prosecute these important cases effectively."[52]

The Holder, Thompson and McNulty Memoranda's emphasis on the value of pre-trial diversion methods resulted in a proliferation of the use of DPAs and NPAs to resolve corporate criminal investigations. Indeed, between 2001 and 2014, prosecutors entered into 306 DPAs and NPAs with corporations.[53] In the majority of situations in which a corporation entered into a DPA or NPA, officers or employees of the corporation were not charged.[54] When individual employees were prosecuted, the individuals were typically not high-level executives and, if convicted, received short terms of imprisonment (if any) and paid on average a fine of $382,000.[55] Despite statements in prior iterations of the guidelines that individuals should be pursued even when a corporation cooperates,[56] the general public consensus has been that the individuals responsible for corporate crimes rarely face criminal responsibility for their conduct.[57]

Governance: Evidence From 1993-2013, 70 BUS. L. 61, 77 (2014) (discussing how the McNulty Memorandum differed from prior guidelines).

[52] Paul J. McNulty, Deputy Att'y Gen., U.S. Dep't of Justice, Prepared Remarks at the Lawyers for Civil Justice Membership Conference Regarding the Dep'ts Charging Guidelines in Corporate Fraud Prosecutions (Dec. 12, 2006), http://www.usdoj.gov/archive/dag/speeches/2006/dag_speech_061212.htm.

[53] Brandon L. Garret, The Corporate Criminal as Scapegoat, 101 VA. L. REV. 1789, 1791 (2015).

[54] *See id.* (noting that of the 306 DPAs or NPAs, "only 34%, or 104 companies, had officers or employees prosecuted, with 414 total individuals prosecuted.").

[55] *See id.* (explaining that "of the individuals prosecuted in these cases, thirteen were presidents, twenty-six were CEOs, twenty-eight were CFOs, and fifty-nine were vice-presidents" and that only 42% of those individuals who were convicted received any jail time, with "the average sentence, including those who received probation but no jail time, [being] eighteen months.").

[56] *See* Thompson Memorandum, *supra* note 44, at 2 (explaining that, "because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Only rarely should provable individual culpability not be pursued, even in the face of offers of corporate guilty pleas.").

[57] *See e.g.,* James B. Stewart, *In Corporate Crimes, Individual Accountability is Elusive,* N.Y. TIMES (Feb. 19, 2015), http://www.nytimes.com/2015/02/20/business/in-corporate-crimes-individual-accountability-is-elusive.html?_r=0.

B. A FUTURE OF INDIVIDUAL ACCOUNTABILITY: THE YATES MEMORANDUM

On September 9, 2015, Deputy Attorney General Sally Quillian Yates released a memorandum to the DOJ's prosecutors titled "Individual Accountability for Corporate Wrongdoing" (hereinafter Yates Memorandum).[58] Like the Holder, Thompson, and McNulty Memoranda that preceded it, the Yates Memorandum set forth guidelines as to how to make charging decisions in the corporate context. Unlike its predecessors, however, the Yates Memorandum encouraged prosecutors to "seek accountability from the individuals who perpetrated the wrongdoing."[59] Previously, corporations typically settled claims and the DOJ had generally opted not to pursue cases against individuals except in the most egregious instances involving fraud. Specifically, the Yates Memorandum outlined six "key steps" that were intended to bolster the government's pursuit of individual wrongdoing:

> 1. In order to qualify for any cooperation credit, the corporation must provide investigators with all relevant facts related to the individuals responsible for the misconduct.
>
> 2. Both 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 government will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation.

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[58] *See generally* Memorandum from Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys regarding Individual Accountability for Corp. Wrongdoing, http://www.justice.gov/dag/file/769036/download [hereinafter Yates Memorandum].

[59] *Id.* at 2.

> 5. Government attorneys should not resolve matters with a corporation without a clear plan to resolve related individual cases and memorialize any declination as to individuals in such cases.
>
> 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.[60]

IV. THE RELATIONSHIP BETWEEN DPAS/NPAS AND CORPORATE INSURANCE COVERAGE

Prosecutors are aware of the presence of corporate insurance coverage when they negotiate and enter into NPAs and DPAs. This awareness is demonstrated through the inclusion of provisions in some NPAs or DPAs specifically concerning the potential availability of insurer funds to cover, either in part or in its entirety, the penalty that the corporation has agreed to pay. The 2005 DPA between KPMG and the USAO, for the Southern District of New York,[61] serves as a particularly illustrative example of the extent to which the prosecutor may consider a corporation's insurance coverage in setting the terms of an agreement. The KPMG Agreement provided in relevant part that,

> KPMG has represented to the United States that no portion of the $456,000,000 that it has agreed to pay to the United States under the terms of this Agreement will be covered by any insurance policy in existence at the time of the conduct alleged in the Information or at the time any notice of claim was made to its insurer(s), *which representation was material to the United States in determining KPMG's ability to make full restitution and pay penalties to the United States,* which amounts, in the Government's view, were far in excess of the $456,000,000 agreed to herein.

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[60] *Id.*

[61] Letter from David N. Kelley, U.S. Att'y for S.D.N.Y., to Robert S. Bennett, KPMG Counsel (Aug. 26, 2005), http://www.corporatecrimereporter.com/documents/kpmgdeferred.pdf (last visited Nov. 29, 2015) [hereinafter KPMG Agreement].

> KPMG agrees that, in the event that any portion of KPMG's $456,000,000 obligation to the United States is ultimately covered by insurance, 50 percent of any insurance funds received by KPMG shall be remitted to the United States. The payment to the United States of a portion of the amounts received from insurance shall be over and above the $456,000,000 that KPMG has agreed to pay, but in no event shall the total payments made by KPMG to the United States (which total payments include both the underlying $456,000,000 and insurance proceeds) exceeds $600,000,000. In addition, KPMG agrees that it will not enter into any agreement or understanding with its insurance carrier(s) to receive insurance coverage for any portion of that $456,000,000 in exchange for increased insurance premium payments made by KPMG in the future.[62] (emphasis added)

This provision is noteworthy in several respects. First, it indicates that the USAO may take into account the extent to which a payment will come directly out of the company coffers (meaning that there is no insurance coverage for it) in deciding the amount of the penalty. The USAO here considered the availability of insurance funds "material" in agreeing to a $456,000,000 penalty, and implied that a larger amount would have been preferable but considerations of KPMG's solvency and capacity to pay militated against a higher figure. In requiring that, should KPMG be entitled to insurance coverage for any portion of the $456,000,000 payment, KPMG was obligated to remit fifty percent of all funds resulting from such coverage up to a total payment of $600,000,000, but only requiring KPMG to pay $456,000,000 in the event that no insurance coverage was available, the agreement suggests that the USAO would have preferred a penalty of $600,000,000, but recognized that such a sum might jeopardize the solvency of KPMG[63] or reduce the likelihood that

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[62] *Id.* at 3-4.

[63] It is worth noting that this agreement was entered into just a few years after the collapse of the accounting firm Arthur Anderson, which many attribute directly to the firm's 2002 indictment by the DOJ for obstruction of justice charges resulting from their accounting work for Enron. *See generally* Kathleen F. Brickey, *Anderson's Fall From Grace*, 81 WASH. U. L. Q. 917 (2003) (discussing the collapse of Arthur Andersen and noting that the DOJ should have known that an

KPMG would be willing to enter into the agreement. Second, by forbidding KPMG from entering into future insurance arrangements that would provide coverage for the $456,000,000 penalty, the agreement explicitly contemplates that the conduct admitted to by KPMG[64] is the type of conduct which may be insurable and is not necessarily uninsurable due to public policy or state law. One possible implication of provisions like that in the KPMG Agreement is that the governmental agency entering into the agreement with the defendant corporation may attempt to structure the terms of the agreement and the statement of facts in such a way as to avoid completely precluding insurance coverage for the conduct at issue. This would make sense if the governmental agency's goal is to optimize the amount of money that is recoverable from the defendant corporation.

Where the prosecuting agency is less interested in merely recovering funds (restitution), irrespective of whether they come directly from the corporation or are recouped from an insurer, an NPA or DPA may explicitly prohibit the stipulated penalty from being paid by the corporation's insurer. For instance, the 2004 DPA between Computer Associates International and the USAO for the Eastern District of New York stipulated that Computer Associates International "will not, in connection with the monies it pays into the Restitution Fund, seek, obtain or accept any reimbursement or other payments or credits from any insurer of [Computer Associates International] or of any of its divisions or subsidiaries" in order to satisfy the terms of the agreement.[65] In January of 2015, the SEC entered into a DPA with PBSJ Corporation resolving their FCPA violations and requiring PBSJ to pay a $3,407,875 penalty and

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indictment would deal the firm a fatal blow); Peter Lattman, *SAC Capital is Indicted, and Called a Magnet for Cheating*, N.Y. TIMES (July 25, 2015), http://dealbook.nytimes.com/2013/07/25/sac-capital-is-indicted/?_r=0 (explaining that the justice department's indictment of Arthur Andersen "lead[] the firm to collapse and terminate 28,000 jobs.").

[64] *See* Press Release, DOJ, KPMG to Pay $456 Million for Criminal Violations in Relation to Largest-Ever Tax Shelter Fraud Case (Aug. 29, 2005), http://www.justice.gov/archive/opa/pr/2005/August/05_ag_433.html (noting that KPMG admitted that it had "design[ed], market[ed] and implement[ed] illegal tax shelters" by concocting "tax shelter transactions-together with false and fraudulent factual scenarios to support them-and targeted them to wealthy individuals who needed a minimum of $10 or $20 million in tax losses so that they would pay fees that were a percentage of the desired tax loss to KPMG, certain law firms, and others instead of paying billions of dollars in taxes owed to the government.").

[65] United States v. Computer Assoc. Int'l, Inc., No. 04-837 (ILG) (E.D.N.Y. Sept. 22, 2004).

prohibiting PBSJ from "seeking or accepting reimbursement or indemnification from any source, including, but not limited to, payment made pursuant to an insurance policy or employment contract, with regard to any civil monetary penalty paid pursuant to this Agreement."[66] Almost identical prohibitions exist in a number of other DPAs.[67] As is outlined above, there is direct evidence that the prosecuting agency may take into consideration the potential existence of insurance coverage when determining the appropriate dollar amount for a penalty. To what extent a prosecuting agency may be willing to consider the availability of insurance coverage when determining the actual terms of the agreement is a more complicated question.

V. WHEN EXPECTED COVERAGE VANISHES: LEARNING FROM THE PAST AND ANTICIPATING THE IMPACT OF THE YATES MEMORANDUM ON COVERAGE

DPAs and NPAs between a corporation and governmental agency do not exist in a vacuum. The corporate conduct that gave rise to the criminal investigation will in almost all cases result in some form of civil litigation in which the corporation could face massive additional monetary liabilities. The availability of insurance funds to cover the costs (attorney's fees, lost business and the like) as well as any potential findings of liability associated with these civil litigations can be essential to maintaining the solvency of the defendant corporation. There are a number of ways in which the contents of an NPA or DPA can impact civil proceedings[68]

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[66] *Id.*

[67] *See e.g.,* Regions Deferred Prosecution Agreement, U.S. SEC. AND EXCH. COMM'N, http://www.gibsondunn.com/publications/Documents/Regions_DPA.pdf (Requiring Regions "to refrain from seeking or accepting reimbursement or indemnification from any source, including, but not limited to, payment made pursuant to an insurance policy or employment contract, with regard to any civil penalties paid pursuant to this Agreement or to the Federal Reserve Board related to or in com1cction with the conduct described in Paragraph 6.").

[68] NPAs and DPAs can also have unanticipated collateral impacts on a corporation's capacity to enter into contracts for work with the government and may even indirectly preclude a corporation from entering into a contract with another corporation if that corporation is functioning as a government contractor. *See* Stephanie Martz, *Trends in Deferred Prosecution Agreements*, 29 THE CHAMPION 43 (2005) (explaining that "the Federal Acquisition Regulations state that only 'adequate' evidence of fraud need be present to result in a suspension

arising from the same or intimately related conduct. On a basic level, the admissions of guilt and narrative contained in a statement of facts can be used as evidence against the corporation in a later civil proceeding,[69] increasing the likelihood that it will be found civilly liable as well as the amount it will be required to pay.[70] Additionally, most NPAs and DPAs prohibit the corporate defendant from publicly contesting or disputing its admission of wrongdoing, so-called "muzzle clauses".[71] In addition to directly affecting civil litigation, admissions contained in the statement of facts, particularly coupled with the prohibitions on conduct (such as "muzzle clauses"), may even jeopardize a corporate defendant's claims for non-third-party/liability insurance coverage.[72]

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from government contracting" and how "certain flow-down provisions can prevent other government contractors from doing business with a debarred entity.").

[69] *See* Sarah Kelly-Kilgore & Emily M. Smith, *Corporate Criminal Liability*, 48 AM. CRIM. L. REV. 421, 453 (2011) (noting that a corporate defendant's admission of wrongdoing "will be admissible in subsequent civil litigation and disclosures will likely be discoverable"); Michael R. Sklaire & Joshua G. Berman, *Deferred Prosecution Agreements: What is the Cost of Staying in Business?,* WASH. LEGAL FOUND. (June 3, 2005), at 2 ("While a company is not required to admit guilt as part of the agreement, the company very often will be required to stipulate to the Government's presentation of facts--a stipulation that a plaintiff will seek to use against the corporation in a later civil proceeding.").

[70] *See* Martz, *supra* note 68 ("for corporations, the ripple effect of these admissions could be devastating. To the extent outstanding shareholder suits are not resolved in the agreement, public disclosures of wrongdoing could operate as admissions, and the information pertaining to these admissions could very well be discoverable….There would seem to be only one avenue left once companies have agreed to extensive factual admissions—to settle.").

[71] These provisions have been called "muzzle clauses" by some commentators. *See generally* Michael Koehler, *The 'Muzzle' Clause,* FCPA PROFESSOR (Mar. 26, 2013), http://www.fcpaprofessor.com/the-muzzle-clause; *see also* Cort E. Golumbic & Albert D. Lichy, *The "Too Big to Jail" Effect and the Impact on the Justice Department's Corporate Charging Policy*, 65 HASTINGS L.J. 1293 (2014) (discussing the standard provisions contained in modern DPAs and NPAs).

[72] Third-Party/Liability insurance provides coverage to the insured for the costs of the harms that happen to others as a result of the insured's conduct, whereas first-party insurance is coverage for harms that can happen to the individual or corporate entity itself. On a basic level, Third Party/Liability Insurance shifts the risk of liability for potential tort claims away from the insured and onto the insurer.

A. PRE-YATES INSURANCE ISSUES CREATED BY DPAS AND NPAS

Beyond the potential that a DPA will jeopardize insurance coverage for the costs of related civil litigation, there is also the possibility that the admissions contained within a DPA, which cannot be contested due to the non-contradiction "muzzle clauses", will be used directly by an insurer to preclude a corporation from receiving coverage under a non-liability or first-party policy. The circumstances that followed the DPA between FirstEnergy Nuclear Operating Company (FEOC) and the DOJ[73] provide a perfect example of this type of unanticipated consequences to an unrelated insurance policy.

On January 20, 2006, FEOC entered into a DPA regarding false statements that it had allegedly made to the Nuclear Regulatory Commission, concerning the safety of the Davis-Besse Nuclear Power Station located in northwest Ohio.[74] Specifically, FEOC admitted that its employees, acting on its behalf, knowingly made false statements to the Nuclear Regulatory Commission in an attempt to mislead them into believing that the power station at Davis-Besse was safe to operate beyond December 31, 2001.[75] Notably, in the DPA's statement of facts, FEOC admitted that it had failed for years to properly maintain its corrosion program.[76] In addition to these admissions, the FEOC DPA included a non-contradiction clause that stated, "FirstEnergy agrees that it shall not, through its attorneys, agents, or employees, make any statement, including in litigation, contradicting the statements of facts, or its representations in this agreement."[77] In the event that the DOJ determined that the FEOC had materially breached the terms of the agreement, the DOJ "may prosecute FEOC for any violations known to it at that time, including the conduct described in the Statement of Facts…and in any such proceeding the

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[73] FirstEnergy News Release, U.S. Dep't of Just., Nuclear Operating Company to Pay $28 Million Relating to Operation of Davis-Besse Nuclear Power Station (Jan. 20, 2006), http://www.justice.gov/archive/opa/pr/2006/January/06_enrd_029.html.

[74] *Id.*

[75] *Id.*

[76] *See* Memorandum from U.S. Att'ys Off., DOJ, on Deferred Prosecution Agreement Between the United States and FirstEnergy Nuclear Operation Company (Jan. 20, 2006), http://www.corporatecrimereporter.com/documents/fenco.pdf. [hereinafter FEOC DPA].

[77] *Id.* at 3.

Statement of Facts shall be admissible in evidence."[78]

In March of 2002, FEOC discovered that the plant's reactor head had been eroded by leaking acid and would need to be shut down for two years.[79] As was customary, FEOC had purchased insurance coverage[80] for business losses owing to having to shut down one of their reactors for repairs from Nuclear Electric Insurance Limited (NEIL).[81] Accordingly, after FEOC had entered into the DPA, it filed a claim with NEIL seeking coverage for the hundreds of millions of dollars in losses that it incurred while the damaged reactor was shut down for repairs.[82] NEIL denied FEOC 's claim, and the parties ended up in arbitration over whether the losses FEOC incurred during the time the reactor had to be shut down for repairs were covered under the policy. FEOC 's policy excluded coverage for losses incurred as a result of the intentional acts of the insured.[83] In the NEIL arbitration, FEOC argued that it had done nothing to intentionally cause the corrosion damage to the reactor head at Davis-Besse, and thus was entitled to coverage under the policy.[84] On December 18, 2006, in support of this position, the FEOC submitted an analysis, prepared by

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[78] *Id.* at 2-4.

[79] *See* Tom Henry, *Regulators Skeptical of Davis-Besse Report*, THE TOLEDO BLADE (May 19, 2007), http://www.toledoblade.com/frontpage/2007/05/19/Regulators-skeptical-of-Davis-Besse-report.html.

[80] For an in-depth discussion of the insurance system for nuclear energy, *see* Taylor Meehan, *Lessons From the Price-Anderson Nuclear Industry Indemnity Act for Future Clean Energy Compensatory Models*, 18 CONN. INS. L.J. 339 (2011).

[81] *See* Tom Henry, *FirstEnergy Drops Insurance Claim,* THE TOLEDO BLADE (Dec. 8, 2007), http://www.toledoblade.com/Energy/2007/12/08/FirstEnergy-drops-insurance-claim.html.

[82] *See* Joseph G. Block & David L. Feinberg, *Look Before You Leap: DPAs, NPAs and the Environmental Criminal Case,* A.L.I.-A.B.A. BUS. L. COURSE MATERIALS J. 5 (Feb. 2010), https://www.venable.com/files/publication/4307e686-a055-41ca-9150-b2ccfd550365/presentation/publicationattachment/83ca143f-8819-4478-8422-b820340fa10d/cmj1002-block_feinberg.pdf.

[83] *Id.* This is based largely on concerns for moral hazard, as excluding recovery for intentional losses discourages insureds from purposefully causing losses for which they know they will be able to recover. *See generally* RESTATEMENT OF THE LAW: LIABILITY INSURANCE § 34 (AM. LAW INST., Tentative Draft No. 1 Apr. 11, 2016) (noting that insurance for intentional acts may "insulat[e] the insured from the financial consequences of such liability [which] would contravene the public purpose of the liability.").

[84] *See FirstEnergy and Davis-Besse*, OHIO CITIZEN ACTION (Dec. 6, 2015), http://www.ohiocitizen.org/campaigns/electric/nucfront.html.

Exponent Failure Analysis Associates and Altran Solutions Corporation, (Exponent Report) of the root cause of the erosion that had resulted in the closing of the reactor at Davis-Besse as expert testimony in the NEIL arbitration.[85] The Exponent Report maintained that most of Davis-Besse's old head had deteriorated from leaky reactor acid in the final three weeks before the February shut down.[86] FEOC's posture in the NEIL arbitration that it had done nothing to intentionally cause the corrosion which necessitated a shut down, was irreconcilable with its admissions in the DPA that it had failed to properly maintain a corrosion program for the Davis-Besse reactor.[87] Thus, if FEOC continued to dispute the denial of coverage in the NEIL arbitration, it was in danger of breaching the terms of its DPA and being prosecuted for the underlying false statements to the NRC. When the NRC learned of FEOC's position in the NEIL arbitration, it demanded that FEOC reconcile the Exponent Report with the admitted statement of facts in the DPA, and threatened to refer the matter over to the DOJ if the FEOC continued to take a position contrary to that admitted to in the DPA.[88] Not surprisingly, FEOC promptly dropped its insurance

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[85] NUCLEAR REGULATORY COMMISSION, FirstEnergy Nuclear Operating Co.; Davis-Besse Nuclear Power Station, 72. Fed. Reg. 161 (Notice Aug. 21, 2007), https://www.justice.gov/archive/opa/pr/2006/January/06_enrd_029.html.

[86] *Id.; see also supra* note 78.

[87] *Supra* note 76, at 8 (statement from the FEOC) ("For several years prior to the summer of 2001, Davis-Besse emoloyees had failed to properly implement the plant's Boric cid Corrosion Control and COrrecitve Action programs. These programs were designed to ensure that Davis-Besse employees discovered boric acid leaks, identified their sources, documented their extent, and dealt with any corrosion properly. Since 1996, some Davis-Besse employees knew that boric acid deposits were left on the reactor pressure vessel head from outage to outage. Some employees also knew that the service structure surrounding the reactor pressure vessel head impeded inspection of some of the nozzles. Inspection and cleaning steps under the Boric Acid Corrosion Control program were not performed properly during the refueling outages in 1996, 1998, and 200. Instead, Davis-Besse engineers prepared analyses without removing all of the boric acid. *See* FEOC DPA at B-2.").

[88] *See* JONATHON S. SACK & ELIZABETH HAINES, MORVILLO, ABRAMOWITZ, GRAND, IASON, ANELLO & BOHRER, P.C., *Be Careful What You Wish For: How Deferred and Non-Prosecution Agreements Can Be Used in Civil Litigation*, BLOOMBERG BNA (Dec. 6, 2015), http://www.bna.com/deferred-and-non-prosecution-agreements/.

coverage claim.[89]

At the time the DOJ and FEOC entered into the DPA, it seems as though neither party specifically contemplated the impact that such an agreement would have on FEOC's first-party insurance coverage from NEIL. FEOC filed its claim with NEIL only shortly after entering into the DPA.[90] Given that FEOC dropped its claim for reimbursement from NEIL as soon as it was made aware that it may have been in breach of the DPA, FEOC would likely not have filed or argued its claim with NEIL as it did if it believed that such acts would constitute violations of the DPA. This is not to say that FEOC would have refused to enter into the DPA if it had considered this consequence, but it may have impacted the way in which it negotiated the DPA and how it chose to pursue its claim with NEIL.

B. SPECIFIC ISSUES ARISING POST-YATES MEMORANDUM

NPAs and DPA's capacity to impact insurance coverage, and the attendant implications for prosecutorial discretion in drafting and entering into agreements, will persist under the new guidelines emphasizing individual accountability. However, the Yates Memorandum also introduces a host of other potential insurance issues for corporations. Unlike the prior memoranda, the Yates Memorandum does not underscore the necessity for prosecutors to continue to consider the collateral consequences of criminal conviction when making charging decisions. But, it specifically states that a decision not to charge a potentially culpable individual should not be dependent upon that individual's capacity to pay.[91] It remains to be seen whether, and to what extent, charging decisions for individuals will take into consideration the potential collateral consequences for the corporation. Thus, the discussion below regarding potential collateral insurance implications for corporate entities may also prove useful to counsel for individuals facing potential criminal charges for their corporate conduct.

In requiring that corporations "identify all individuals involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all facts relating to that

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[89] *See* Tom Henry, *FirstEnergy accepts blame for Davis-Besse oversight,* THE TOLEDO BLADE (JUNE 15, 2007), http://www.toledoblade.com/frontpage/2007/06/15/'-accepts-blame-for-Davis-Besse-oversight.html.

[90] *See supra* note 84.

[91] Yates Memorandum, *supra* note 58, at 6.

misconduct" and cannot "decline[] to learn of such facts" in order to receive any cooperation credit,[92] the Yates Memorandum could give rise to several new forms of liability for the corporate entity. First, individual employees may attempt to pursue claims against the corporate entity arising out of the corporation's actions in turning over information to the government. Second, the prohibition on a corporation "declining to learn of such facts" may create a new breed of derivative shareholder suit, based on the theory that a corporation who fails to receive cooperation credit had inadequate internal mechanisms for gathering and retaining "all facts relating to [the misconduct at issue]." Presently, corporate general liability insurance policies may not be drafted so as to provide coverage for such types of liability. Thus, corporations should consult with their insurers in order to ensure that they obtain a policy that would be inclusive of such risks.

A corporation's capacity to be reimbursed by its Side B D&O policy may be jeopardized in situations where the corporation has caused its director or officer to face the criminal investigation or proceeding for which he is entitled to receive, at the very least, the advancement of attorney's fees. Thus, corporations may find themselves in a position where they turn over documents or information supporting an investigation or indictment of one of their executives, all the while knowing that they will have to, at least initially, pay the legal fees for such executive in the proceeding. Furthermore, depending on the language of their Side B D&O policy, in the event that the executive is convicted of a crime based on the information that they turned over (and they are thus unable to indemnify him as a matter of law), their D&O insurer could decline to reimburse their indemnification[93] if the policy excludes coverage for losses that are unindemnifiable as a result of the corporation's own actions. Where the corporate entity and the executive officer are both deemed "insureds" under

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[92] *Id.*

[93] The defense costs for individuals in white-collar cases can be enormous. Even for a large corporation, the capacity to recover advanced defense costs from its D&O insurer can be important. *See e.g,.* Walter Pavlo, *The High Cost of Mounting a White-Collar Criminal Defense,* FORBES (May 30, 2015), http://www.forbes.com/sites/walterpavlo/2013/05/30/the-high-cost-of-mounting-a-white-collar-criminal-defense/; Peter Lattman, Dealbook, *Goldman Stuck with Defense Tab, Awaiting Payback*, N.Y. TIMES (June 18, 2013), http://dealbook.nytimes.com/2012/06/18/gupta-legal-bills/ (discussing the over $30 million in defense costs associated with the insider trading case against former Goldman Board member Rajat Gupta.).

the Policy's definition, the corporation's deliberate act of turning over information related to that executive officer could be sufficient to trigger the "deliberate act" of an insured exclusion.[94] Again, corporate counsel should look closely at the current D&O policies and discuss with their insurers the extent to which this may create a gap in coverage.[95]

Another potential hazard that could create coverage gaps for an executive under his D&O policy stems from the standard policy language excluding coverage for claims about which an insured had "known or should have known." If corporations generally comply with the guideline's requirements regarding turning over information regarding individuals, then it is not unreasonable to assume that an executive who was involved in the misconduct for which a corporation is being investigated "know[s] or should [] know" of the likelihood of an impending claim being brought against him once he becomes aware that the corporation is cooperating. In practice, it seems unlikely that this would eliminate coverage for the executive here, but it would likely create disputes about which period of time, and thus which policy, the claim falls into, which could impact the available limits of liability, particularly where the policies at issue are from different insurers. Yet another concern is the potential for situations in which an insurer could deny coverage based on the contention that the insured gave late notice of the claim to the insurer, so long as the insurer can demonstrate that it was prejudiced by the late notice.[96] Although it might not be good business practice on the part of D&O insurers, there is at

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[94] *See* J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 42 Misc. 3d 1230(A), 988 N.Y.S.2d 523 (N.Y. Sup. 2014) (regarding exclusions that typically preclude coverage for claims) ("The Policy "shall not apply to any Claim(s) made against the Insured(s) … based upon or arising out of any deliberate…act or omission by such Insured(s).").

[95] Beyond the explicit exclusions identified within a D&O policy, a corporation may find itself unable to recover the money it advanced to its executive for attorney's fees if the executive is charged and is convicted or enters into a settlement agreement in which he provides a detailed admission of his conduct based on public policy grounds. *See supra* notes 32-34 and accompanying text. If the Yates Memorandum has its intended impact, and more individuals are charged, then it is likely that there will be a commensurate increase in D&O insurers willingness to dispute claims.

[96] *See* Arrowood Indemnity Co. v. King, 304 Conn. 179, 201-203 (2012) (expressing the view of the vast majority of jurisdictions that where an insurer denies coverage due to late notice, the insurer bears the burden of proving that it was prejudiced by the late notice.).

least some potential for a late notice argument from an insurer, particularly because most D&O policies require that notice be given to the insurer "as soon as practicable…after the Named Entity's Risk Manager or General Counsel (or equivalent position) first becomes aware of the Claim."[97]

In order to best avoid some of these coverage issues, corporate counsel should consult the relevant D&O policies that could be implicated in any action against an executive or officer that may result from corporate cooperation, and be cognizant of the points at time in which an executive may be deemed to have known or should have known that a claim would be forthcoming. In particular, in cooperating with the government and negotiating NPAs or DPAs, corporate counsel should pay close attention to how the term "Claim" is defined in the potentially relevant D&O policies. For instance, where claim means "a civil, criminal, administrative or regulatory investigation of an Insured Person [meaning executive] once such Insured Person is identified in writing by such investigating authority as a person against whom a proceeding may be commenced,"[98] the insurer must be put on notice as soon as the named entity (meaning the corporate entity for whom the director works) becomes aware of such an investigation. Thus, in situations where the corporate entity knows that the executive is likely going to be the subject to a proceeding because it is cooperating and has turned over information on him, a Claim may have arisen within the meaning of the policy even if the executive himself is completely unaware of it. In an age of increased emphasis on individual accountability in corporate crime, acting quickly to alert the insurer as soon as the corporation begins to cooperate (perhaps even earlier) could go a long way towards ensuring that D&O coverage will be available, or is less likely to be contested.

VI. CONCLUSION

Both prosecutors and corporations engage in a balancing equation throughout the course of a corporate criminal investigation. For prosecutors, charging decisions are supposed to be based on the consideration of a variety of factors, and the terms of a DPA or NPA will be impacted by both the corporation's purportedly wrongful conduct and its remedial or cooperative steps. For corporate entities, cooperating with a

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[97] *See* AIG, *D&O Policy*, http://www.aig.com/public-company-do_295_391889.html (last visited Dec. 5, 2015).

[98] *Id.*

government investigation, or deciding to enter into a NPA or DPA necessitates an understanding of all the consequences that ensue from such actions. Insurance coverage considerations are not always at the forefront of a corporate counsel's mind when he learns of an investigation into the company. By addressing the potential insurance problems that may ensue from a governmental investigation early on, and being familiar with the particular policies likely to be implicated, a corporation can avoid unexpected coverage pitfalls and be best situated to make decisions about cooperation that reflect the corporation's long-term best interests.