

DEFERRED PROSECUTION AGREEMENTS AND YOUR D&O POLICY

Amnesty is always a good thing and the fact that Deferred Prosecution Agreements (DPA) provide amnesty is a very good thing. However, the cost of a DPA and the perils of noncompliance for a corporation can make it an unexpectedly expensive proposition.

In the words of one skeptic, “[a]ll of the punishment, none of the guilt. What’s not to like about deferred prosecution agreements for corporations? A corporate deferred prosecution agreement is basically a way of imposing a term of probation before a conviction.”¹

But whether one is a supporter or a detractor, it may be important to note that DPAs are generally public documents, so whether they contain admissions of fact or merely the pertinent “facts” in the eye of the prosecutor, they are likely to have something of a life of their own once they are public.²

WAIVING PRIVILEGE GOODBYE

Perhaps the most controversial provision of some deferred prosecution agreements is the waiver of the corporation’s attorney-client privilege.³ In addition to the immediate impact on the organization, waiver of the corporate attorney-client privilege can have very significant ramifications. Specifically, such a waiver could result in compliance programs being deemed ineffective. This could lead to the firm’s employees being less willing to report internal problems, seek advice in resolving possible legal issues or cooperate with internal and external auditors who may be investigating corporate misconduct.

ME, MYSELF AND I

Deferred Prosecution Agreements often provide that the government itself is the sole determining body of any breach by the corporation. Some DPAs also spell out that the determination by the government is not subject to third-party review. In



DEFERRED-PROSECUTION AGREEMENT

A voluntary alternative to adjudication in which a prosecutor agrees to grant amnesty in return for the defendant abiding by certain requirements. For example, a case of corporate fraud may be settled using a deferred-prosecution agreement in which the defendant agrees to pay fines, enact corporate reforms, and fully cooperate with the investigation. Fulfilling the requirements will result in dismissal of the charges.

The American Heritage Dictionary of Business Terms

addition, DPAs may hold that any admissions made by a company in reaching an agreement with the government will be deemed admissible. At least one DPA goes so far as to allow the government to select the remedy it desires from several different options for the purported breach of the agreement by the company;⁴ thereby, making the prosecutor, both judge and jury.

NOT AN EXCLUSIVE CLUB

Generally, a DPA runs between a specific enforcement entity and the company and doesn't restrict or eliminate the threat of additional litigation from other governmental entities and/or other stakeholders (shareholders, bond holders, business partners, customers, etc.). DPAs can potentially be helpful with respect to enforcement activities by other governmental entities; for example:

The Respondent understands and agrees that this Agreement does not bind other U.S. federal, state or self-regulatory organizations, but the Commission may, at its discretion, issue a letter to these organizations detailing the fact, manner, and extent of its cooperation during the Proceedings or Other Proceedings, upon the written request of the Respondent.⁵

However, since these other enforcement entities are not themselves a party to the DPA, they are not bound by it and may well thumb their collective noses at it.⁶

DPAS AND YOUR D&O POLICY

Some agreements prohibit the corporation from seeking insurance coverage, as in this sample:

During the Deferred Period, the Respondent understands and agrees to comply with the following prohibitions:

... 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 monies paid pursuant to this Agreement.⁷

The good news in this case is that, since the "Respondent" is the company itself, this provision would not seem to stop the individual directors and officers from seeking insurance coverage.

SEEK AND YOU WILL FIND

In any D&O coverage analysis, we start by asking if we have a "Claim" against or involving an "Insured" alleging a "Wrongful Act" that has been reported in a timely fashion and that is not otherwise excluded from coverage. All of these terms will be defined by the specific D&O policy under review, but for our purposes here, we'll look at some typical industry wording.

As DPAs are often brought after one has passed the informal investigation stage, then while the agreement itself may not be a claim as defined in a D&O policy,⁸ the circumstances surrounding the agreement means that we are likely to have a covered claim for the individual directors and officers, at least with regard to defense costs. However, settlements or court awards that involve fines, penalties and/or express disgorgement are not likely to be covered under a typical D&O insurance policy.

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¹ “Corporate Deferred Prosecution Agreements The Brewing Debate,”

http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_cjm_ag_21_2_corporatedeferred.authcheckdam.pdf.

² According to the Securities and Exchange Commission Enforcement Manual, “[u]nless the Commission directs otherwise, deferred prosecution agreements will be made available to the public upon request.” Securities and Exchange Commission Enforcement Manual, page 139: <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>. Also note that the enforcement entity may well put out its own press release without waiting for a request from the public.

³ In this *Alert* we are focusing on corporate DPAs and not those which may run between an individual person and an enforcement entity. DPAs are also similar to and often confused with Non-Prosecution Agreements.

⁴ “Back Against the Wall Corporate Deferred Prosecution Through the Lens of Contract ‘Policing’”

http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_cjm_ag_23_3_zierdt.authcheckdam.pdf.

⁵ <http://www.sec.gov/news/press/2011/2011-112-dpa.pdf>, page 10, Compliance with Agreement.

⁶ In more than one instance the SEC has brought charges and settled with entities that simultaneously had DPAs with the Department of Justice arising from the very same matter. See: <http://www.sec.gov/news/press/2008/2008-86.htm>.

⁷ <http://www.sec.gov/news/press/2011/2011-112-dpa.pdf>, page 7 under Prohibitions.

⁸ In the strictest sense, a deferred prosecution agreement in itself, while it might set out what would be a wrongful act under a D&O policy, is unlikely to make a demand for relief that would trigger either defense costs and/or a settlement payable under a D&O policy. However, it may well be sufficient to trigger a notice of circumstance of a claim—as it would include facts and detail circumstances in many cases that could reasonably lead to a D&O claim – and so if notice has not previously been provided to one’s D&O carrier, now might be the time to consider it. Typically, a notice of a claim is mandatory under a D&O policy, while a notice of a circumstance that could reasonably lead to a claim is permissive but not required. You will, of course, consider the terms of your own specific D&O policy in this regard.