FI and D&O

CLYDE&CO

International review

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Keeping you in touch with international developments

Contents

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We have commented in previous editions of this Review on the impact that developments in one jurisdiction can have in another. This edition is no exception: at the time of going to press, the Financial Stability Board had recently announced that it believes that the United Kingdom's Senior Manager and Certification regime is ripe for expansion elsewhere. The impact of the United States' Supreme Court decision in *Morrison* continues to unfold as a series of cases have debated the exact parameters of that "F-cubed" decision. Its impact can also be seen in the development of collective shareholder actions, and we examine whether "Dieselgate" will be a game changer in Germany. Development of class actions continues apace elsewhere, and we also look at proposals for a regime for claims against listed companies in Saudi Arabia.

Exposures for directors, financial institutions and their insurers continue to develop. We examine the first disqualification of a director by the Competition and Markets Authority in the UK, the rise in criminal prosecutions brought by the Australian financial regulator ASIC and the Tata-Cyrus Mistry fall-out in India. At Clyde and Co we have been tracking developments in environmental and climate change related exposures for directors, pension trustees, investment managers, and other financial services professionals and entities, and we examine developments in South Africa on this issue.

We also take a look at the insurance landscape, including proposals for consideration of the current PII arrangements for regulated firms in the UK, radical proposals and an important decision on conditions precedent in Singapore.

The first disqualification of a director by the CMA

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Financial penalties being imposed on companies for breaches of competition law is relatively common place. However, there can also be adverse consequences for the directors involved, as a decision reached by the Competition and Markets Authority (CMA) has recently demonstrated.

In December 2016, the CMA announced that it had secured its first director disqualification undertaking.

This decision sends a clear message that those individuals who show disregard for the law will be punished.

The Power to Disqualify Directors

Since 2003, the Competition and Markets Authority (CMA) has had the power, under the Company Directors Disqualification Act 1986 (the Act), to seek the disqualification of an individual, for a maximum of 15 years, from acting as a company director where: (i) a company of which he is a director has breached competition law; and (ii) his conduct makes him unfit to be concerned in the management of a company.

The CMA has the power under the Act to apply to the court for an order disqualifying a director from performing certain roles, for a specific period.

Alternatively, the CMA can accept a disqualification undertaking from a director to avoid the need for proceedings. This will usually result in a reduction being applied to the period of disqualification that the CMA is prepared to accept.

Both orders and undertakings are legally binding with the result that individuals can be criminally prosecuted if they act in breach of the disqualification.

The Competition Law Infringement

Mr Aston was the managing director of an online poster supplier, Trod Limited (Trod).

The CMA commenced its investigation into a price fixing scandal, concerning posters and frames in 2015, by carrying out dawn raids at Trod's business premises and the domestic premises of one of its directors, Mr Aston.

In July 2016, Trod admitted to the cartel. In particular, that it had agreed with one of its online competitors, GB Eye Limited, not to undercut each other's prices for items sold on Amazon UK for a period of more than four years.

In August 2016, Trod was fined GBP 163,371 as a result, which reflected a discount of 20% owing to its admission of breach and co-operation with the investigation.

GB Eye Limited was granted full immunity from fines having acted as the whistle-blower under the CMA's leniency programme.

In November 2016, the CMA accepted a disqualification undertaking from Mr Aston instead of applying to the court for a disqualification order.

The undertaking provides that, amongst other activities, he will not act as a director of any UK company for five years. This was a significant reduction against the 5-10 years that the CMA were considering seeking from the court.

As GB Eye Limited was granted leniency in relation to their part in the breach, its current directors are protected from disqualification under CMA policy provided that they cooperate with the investigation and leniency process.

Commentary

The disqualification of Mr Aston marks the first time the CMA has obtained a disqualification undertaking from a company director under the Act.

However, when discussing Mr Aston's disqualification, the Executive Director for Enforcement at the CMA, Michael Grenfell, said that the *"business community should be clear that the CMA will continue to look at the conduct of directors of companies that have broken competition law"* and stated that where appropriate, the CMA *"are absolutely prepared to use this power again"*.

This case should therefore serve as a useful reminder to directors that breaches of the competition law will have serious consequences for them, personally, as well as their businesses.

In this case, Mr Aston was personally involved in the competition law breach. However, the CMA can also seek disqualification of directors where: (i) they had reasonable grounds to suspect a breach but did not prevent it, or (ii) they ought to have known about the breach.

This emphasises, once again, the onus placed on directors to ensure there is a culture of compliance within the companies that they are involved in.

In addition to potential disqualification, an individual director may face criminal sanctions for cartel activity.

Although, the CMA has found it difficult to obtain such sanctions (with only four individuals being sentenced since the cartel offence was introduced in 2003) the threshold of the criminal offence has now been lowered, with the subjective element of dishonesty being removed.

This may result in an increase in the number of criminal sanctions being obtained for cartel activity. However, the CMA has also confirmed that it is not afraid to exercise these powers again. There is, therefore, also a real risk of CMA using director disqualification orders to punish individuals for competition law infringement where a robust criminal case cannot be established.

Impact for Insurers

The desire to clamp down on competition law breaches may trigger more investigations (internally and external) and result in further director disqualifications.

This could lead to an increased costs exposure to D&O Insurers. Whilst any fine imposed will not be recoverable from insurers, legal costs incurred in the investigation stage, and possibly the negotiation phase, might be.

Various exclusions may also come into play depending on the actual words used in the undertakings, and any admissions made during the negotiation process.

FCA policy statement applying conduct rules to non-executive directors (NEDs) in the senior managers and certification regime (SM&CR) and senior insurance managers regime (SIMR)

On 3 May the FCA published a policy statement introducing final rules to extend the conduct rules in the Code of Conduct sourcebook (COCON) to standard non-executive directors ("NEDs") in banks, building societies, credit unions, dual-regulated investment firms (banks) and insurance firms. (The PRA refers to standard NEDs in banks and insurers as "notified NEDs"). The aim of doing so is to raise the standards of conduct and reduce future misconduct and mis-selling. Standard NEDs are those not subject to regulatory pre-approval under the senior managers and certification regime ("SM&CR"), the senior insurance managers regime ("SIMR") or the FCA-revised approved persons regimes for insurance firms. The policy statement appends the final rules which are contained in the Individual Conduct Rules (Non-Executive directors) Instrument 2017, and come into force on 3 July 2017. The policy statement flags up that those affected by the changes will need to make sure that standard NEDs receive appropriate training on COCON, and that any breaches of COCON by standard NEDs resulting in disciplinary action are reported to the FCA using form H (this applies only to banks at present). For the first reporting period, the notification must cover breaches occurring between 3 July 2017 and the end of August.

Deadline for PPI complaints introduced

Following consultation, the FCA has published a policy statement PS17/3 in which it has introduced a final deadline for making a payment protection insurance (PPI) complaint of 29 August 2019. This deadline will come into force on 29 August 2017, with policies sold after that date being excluded. In advance of the deadline, the FCA will run a two year consumer communications campaign. In addition, the FCA has made final rules and guidance following the Supreme Court judgement in *Plevin v Paragon Personal Finance* (2017), following which consumers may have grounds to complain regarding the amount of money providers received for the sale if the failure to disclose commission made the relationship unfair under s140A of the Consumer Credit Act 1974. There is a 50% commission tipping point at which firms handling PPI complaints should presume that the failure to disclose commission gave rise to an unfair relationship and that profit share should be included in firms' calculation of commission. Redress will be calculated as the excess commission over 50%. Firms that previously rejected complainants that are eligible to complain following *Plevin* will be required to write to the complainants explaining the new basis for complaining by the end of 2017. The new rules and guidance on this area will also come into force on 29 August 2017.

FCA's Renewed Interest in PII arrangements for regulated firms

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The prudential rules of the UK financial services regulators require that certain regulated firms maintain professional indemnity insurance ("PII") and provide certain minimum criteria to be met (depending on the size and type of regulated activity which the firm undertakes). However, the regulated financial services sector is not currently required to maintain mandatory PII subject to standardised terms in the way that other professions are (for example, solicitors).

In December 2016, the Financial Conduct Authority ("FCA") published two documents regarding PII held by regulated financial services firms. The motivation behind the FCA's reengagement with PII issues appears to be the strained funding position of the Financial Services Compensation Scheme ("FSCS") and comments in last year's Financial Advice Market Review's final report on the efficacy of the PII market for smaller advice firms . The FSCS has had to foot a considerable bill in recent years arising out of the collapse of a number of insurers and also firms who have given unsuitable investment advice to customers.

Thematic Review: General Insurance Intermediaries

Overview

The FCA's thematic review of the effectiveness of the PII market for general insurance intermediaries (TR16/9) evaluated the individual policies purchased by a sample of 200 firms (from a population of approximately 6,000) to assess whether they complied with the FCA requirements.

Key Findings

The FCA found there is sufficient breadth within the market to provide choice, and that firms were able to obtain cover for high limits of indemnity. However, concerns were raised regarding exclusion clauses within policies which could reduce the level of cover below that required by the FCA's relevant prudential rules (the "MIPRU"). Those types of exclusion clause were: (i) suitability of insurer; (ii) unrated insurers; (iii) non-admitted insurers; and (iv) insurer insolvency.

The review also identified a high level of inaccuracies or gaps in coverage, which indicates that the policies have not been subject to appropriate review. Examples include a lack of clarity as to whether policies provided cover for awards by the Financial Ombudsman Service ("FOS") and out of date language.

Next Steps

Following the review, the FCA raised clear examples of non-compliance with the firms at issue and ensured that corrective action was taken. Those insurance intermediaries that were not included in the review are expected to review their own PII policies to ensure that they meet the relevant requirements. Similarly, the FCA expects insurers that provide such policies and managing general agents to review their products in light of the FCA's findings, to ensure they are consistent with the needs of the intermediaries and meet the necessary requirements.

Where the FCA has identified issues, they are considering whether there is a need for further regulatory action.

Consultation Paper: Funding of the FSCS

Overview

The second publication touching on PII is the FCA's paper regarding the funding of the FSCS (CP16/42). The FSCS is the UK's statutory compensation scheme of last resort, compensating individuals and small businesses for losses when authorised financial services providers are unable to pay claims. The paper includes a section dedicated to a consideration of PII for "personal investment firms" (including financial advisers and other intermediaries). In particular, the FCA has sought views on the current and future interaction between a firm's PII and FSCS cover.

The paper follows a statement by the FCA chief, Andrew Bailey, in November 2016 that PII is not always performing reliably in the financial advice sector, as insurers were frequently writing contracts that excluded losses in this area, leaving the FSCS to make payments. He called on the insurance industry to put forward ideas as to how to make the PII market work more effectively.

Key Issues

The consultation puts forward various proposals regarding how PII in the financial services industry ought to be revised. The FCA has raised concerns with the impact that existing PII requirements appear to have on the FSCS such that the FSCS has become the "first line of defence" in many instances where a firm fails. The FCA is seeking views with a view to improving the reliability of PII so it acts as a "front stop" ahead of firms failing and resulting claims being made on the FSCS.

The paper invited submissions on whether the FCA should introduce more comprehensive mandatory PII cover, such as requirements to have run off cover in place and additional requirements for legal defence costs. The FCA recognises that defence costs can often be high in the event of a claim and the current Handbook guidance says it is not considered reasonable for a firm's policy to treat defence costs cover as part of the limits of indemnity if this reduces the cover available for any individual larger claim. The paper questions whether the PII market is working, acknowledging that there are few providers in the market and some firms find it hard to purchase appropriate cover.

The paper identifies a number of issues in the PII market in the personal investment firm arena, and the FCA's desire to address indications that PII is not functioning as effectively as it should. Some firms have reported to the FCA that they find it difficult to purchase appropriate PII cover or, in some cases, any PII cover at all. Moreover, the FSCS and other industry stakeholders have provided evidence to the FCA that not all PII policies respond adequately to claims made. In particular, some polices exclude the insolvency of the policyholder or the FSCS as a claimant. The paper focuses, in particular, on exclusions, recognising that Insurers can find it hard to price the risks inherent in the financial advice market but that, for example, product exclusions can leave firms unprotected if they chose to provide certain types of advice. In the FCA's view, the analysis shows that there is justification for strengthening PII, particularly for personal investment firms through the use of, for example, mandatory terms.

Comment

Clearly the FCA views PII as an important protection for firms and customers. However, the prevailing view of the regulator appears to be that too much is falling to the FSCS and if FSCS funding reforms are to be successful, reforms will also need to be made to PII cover in the financial services sector.

Part of the problem with financial adviser's PII is as a consequence of changing expectations of the regulator, unpredictable FOS outcomes (which decides cases on a "fair and reasonable" basis, and not strictly in accordance with established legal principles) and the associated uncertainty as to exposures that these practices bring for insurers.

Enforcing standard wording and extending the level of cover required will undoubtedly raise the overall cost of PII cover through the imposition of higher premiums (and so, cancelling out if not exceeding any savings for firms in terms of reduced FSCS levies). It may also lead to some insurers withdrawing from the already relatively small market.

The consultation period closed on 31 March 2017 and it is currently expected that the FCA will publish a further consultation paper on proposed rule changes in autumn 2017.

R (Aviva Life & Pensions (UK) Ltd) v Financial Ombudsman Service [2017] EWHC 352

When determining a complaint, the FOS must do so by reference to what is fair and reasonable in all the circumstances, taking into account all relevant law, guidance and practice.[1] It has been accepted as the law and referred to in decisions for many years that the FOS can depart from the relevant law, guidance and practice provided the ombudsman explains its reasoning to do so. However, this successful application for judicial review, where the High Court quashed the FOS' decision, highlights the importance of the ombudsman to take relevant law, guidance and practice into account when making decisions and give full reasons for its decisions when departing from it.

Mr and Mrs McCulloch took out a 23-year joint life policy in 2006 which they cancelled, in 2013, when they separated. In November 2013, Mr McCulloch applied for a single life policy on his own from Aviva, but failed to disclose on the application form: that he had been consulting his GP in relation to possible mental health issues since September 2013, that he had been referred for psychiatric assessment, and that he was awaiting a CT scan. He later sought to claim for terminal illness benefit following being diagnosed with a rare terminal form of early-onset dementia identified by the CT scan. Aviva declined the claim on the grounds of misrepresentation, and avoided the policy owing to negligence or careless, rather than innocent, non-disclosure. Aviva stated that it would not have offered the policy if disclosure had been made.

The FOS decided that special consideration had to be given to Mr McCulloch's illness as he could not be expected to make the same disclosures expected of a reasonable person and, accordingly *"[i]n cases of innocent misrepresentation, the appropriate remedy is to disregard the information that wasn't included in the application form. So Aviva should reinstate the policy on its original terms and consider Mr McCulloch's claim"*. Aviva sought judicial review of the decision.

The High Court decided that the Ombudsman had not given sufficient reasons for its decision nor had it followed the relevant law, guidance and practice. The FOS' jurisdiction was derived from the Financial Services and Markets Act 2000 and when exercising its compulsory jurisdiction, a complaint had to be determined with reference to what was, in the opinion of the ombudsman, fair and reasonable in all the circumstances and this included taking into account relevant laws and regulations and, where appropriate, good industry practice at the relevant time. When the ombudsman did not follow the relevant law, guidance and practice (as it is entitled to do so), it is incumbent on the ombudsman to explain why it had not.

It was not disputed that Aviva had followed the relevant law, guidance and practice and so, as a result, its decision was not prima facie unfair or unreasonable. At the same time, it would not be unreasonable for the FOS to hold the insurer to its contract given the unusual circumstances of the case. However, if it did, careful reasons had to be given for any lawful decision to uphold a complaint

In light of its conclusions, the High Court quashed the Ombudsman's decision with the effect that the FOS had to reconsider the complaints.

1. FCA Handbook Disp 3.6.1R and 3.6.4R.

Collective actions on the rise in Germany and Europe – Dieselgate as game changer?

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For many years, the pros and cons of collective redress have been intensively discussed in Germany and Europe, with the debate often influenced by fears of US-style class actions and litigation industry. However, this focus risks failing to take into account that many European legal systems, including Germany, still lack an efficient mechanism to enable litigants, and consumers in particular, to enforce their rights in an efficient manner. 2017 might, however, become a turning point.

In the past, the European Commission has conducted various initiatives, with a particular focus on consumer and competition law. As part of this, in June 2013, the European Commission published a Recommendation on Collective Redress inviting the European member states to implement collective redress mechanisms to ensure effective access to justice. The European Commission also announced it would re-assess the state of play, based on the yearly reports of the member states, and evaluate whether further measures to strengthen collective redress in the European Union are needed. The European Commission is currently undertaking this work.

Looking at the European member states, the landscape of collective redress has evolved over the last few years. Many countries offer some form of collective action mechanism including Spain, Belgium, Austria, Italy, Poland and others. For example, in France, certain consumer associations can bring a Common Representative Action for damages and there is also a Consumer Class Action mechanism available. In the UK, the options include Representative Proceedings, Group Litigation Orders and, in the competition sphere, class actions. Following the US Supreme Court's ruling in *Morrison v National Australia Bank* (see our article on page 8), there has been renewed interest in these procedures, including in particular, the WCAM collective settlement procedure in The Netherlands.

This trend is at least partly also reflected in Germany. While Germany does not have class or group actions, certain forms of collective redress are available, including for example the ability for (consumer) associations and other organisations to bring certain claims under consumer and competition law, including test cases, representative actions and skimming-off procedures. However, the practical relevance remains rather limited. The best known mechanism is the Capital Market Model Claims Act Procedure (KapMuG procedure), introduced in 2005, which was implemented in the wake of damage claims brought by investors against Deutsche Telekom AG following its second public offering in 1999 and third public offering in 2001. The KapMuG proceedings in relation to the 1999 offering have just recently been resolved by a decision of the German Federal Court of Justice confirming the Higher Regional Court Frankfurt's finding that the underlying prospectus gives no basis for liability. By contrast, the much larger proceedings concerning the 2001 offering, involving around 17,000 shareholders, are still ongoing and, in a decision in late 2016, the Higher Regional Court Frankfurt found that Deutsche Telekom AG is responsible for faults in the respective prospectus. However, this finding does not determine that the shareholders are entitled to damages. In the KapMuG proceedings, the courts only determine common factual and legal questions with a binding effect for those plaintiffs participating in the collective action. Accordingly it remains to be determined in the individual disputes whether the individual shareholders can claim damages and whether the hurdles of establishing causation and loss can be met in each individual case.

It remains to be seen whether the Volkswagen Dieselgate scandal will become a game changer for Germany. KapMug proceedings have recently been commenced before the Higher Regional Court Braunschweig, encompassing around 1,500 plaintiffs pursuing claims of about EUR 1.9 billion. In total, shareholder claims for roughly EUR 8.8 billion are pending with the Braunschweig courts. However, compared to the US, it is still perceived as an uphill battle for consumers to enforce their potential rights in Germany. This recognition has led to the production by the Department of Justice, at the end of 2016, of an (unpublished) draft proposal for introducing a model declaratory action. This action was supposed to allow for a model claim similar to the KapMuG procedure, to be brought by certain associations on behalf of consumers who could electronically register, and with the option of a collective settlement unless 30 per cent of the claimants opt out. Over the past few months, this proposal has faced political opposition, and it is clear that the proposals will not become law before the general elections in September 2017. Given the high thresholds for individual consumers to pursue claims for damages, it appears probable that this discussion has only been postponed rather than shelved.

While the German legislator is still deliberating the need for reform and the European Commission continues to assess the need for further measures in the European member states, the Volkswagen scandal also shows, however, that plaintiffs will not necessarily wait for legislative action. In fact, in the wake of

the Volkswagen case, the organisation of plaintiff lawyers has reached a completely new level, with US and domestic firms cooperating closely, litigation funders entering the scene and private initiatives stepping in where the legislator has not yet taken action. In particular, the platform myright.de has attracted much attention, seeking car owners as potential claimants to pursue their claims against a success fee of 35 per cent. Whilst it remains to be seen whether the actions against Volkswagen will prove successful or whether the platform can build up enough pressure to incentivise settlement discussions, it is quite clear that the new litigation industry has come to stay and has the potential to quite fundamentally change the playing field.

Winners and losers in the end of Parliament wash-up

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Theresa May's decision to call a snap general election was a surprise to most. Several pieces of key legislation relating to tax avoidance and tax evasion were in the process of being considered by Parliament when the election was announced. In the close of Parliament wash-up period the failure to prevent the facilitation of tax evasion provisions were passed but the legislation relating to penalties for enablers of tax avoidance schemes have, for now at least, been shelved.

Criminal Finances Act 2017 – failure to prevent the facilitation of tax evasion

The Criminal Finances Act 2017, received royal assent on 27 April 2017, and makes provision for a number of important changes to the Proceeds of Crime Act 2002 and the laws governing money laundering. Of particular importance to tax advisors and promoters of financial products, Part 3 of the Criminal Finances Act also introduced a new corporate offence of failure to prevent the facilitation of tax evasion in the UK or overseas.

Broadly, facilitation of tax evasion involves knowingly assisting another person (such as a client) by aiding, abetting, counselling or procuring them to commit a UK tax evasion offence. A professional firm could be found liable of the corporate offence if, for example, a partner, employee or agent, is found to have been involved in criminally facilitating tax evasion.

This offence was first announced in 2015 and is aimed at forcing boards and senior management to take positive pre-emptive measures to prevent their staff from facilitating tax evasion. The potentially unlimited fine in the event of a conviction should certainly focus the minds of most boards.

It is a strict liability offence but there is a defence, based on section 7 Bribery Act 2010, if a corporate body can demonstrate that it put in place prevention procedures which were *"reasonable in all the circumstances"* to prevent the facilitation of tax evasion offences. Draft guidance was published in October 2016 to assist relevant bodies to devise reasonable prevention procedures (such as undertaking risk assessments and training staff). Finalised guidance is expected imminently (subject to the general election). The government has now issued the commencement regulation SI 2017/739 which brings the Criminal Finances Act 2017 corporate offences for failing to prevent tax evasion into force from 30 September 2017.

In the meantime, professional firms will no doubt wish to consider the draft guidance and review their existing procedures to ensure that they have appropriate systems in place when the provisions come into force.

Finance Act 2017 – enablers of tax avoidance measures dropped

The first draft of the Finance Bill 2017, introduced to Parliament on 20 March 2017, targeted those who profit from enabling abusive tax arrangements, with two anti-avoidance measures namely:

- Penalties for "enablers" of defeated tax avoidance and changes to the penalties for taxpayers using defeated tax avoidance (at section 125 and Schedule 27 of that Bill); and
- The requirement to correct past off-shore non-compliance (at section 128 and schedule 29 of that Bill).

"Enablers" of tax avoidance include a manager, a marketer or a financial enabler. Penalties for enablers are up to 100% of the fee charged.

These provisions followed the Government's consultation in 2016. Our note on the consultation can be found at: https://www.clydeco.com/blog/insurance-hub/article/penalties-for-enablers-of-tax-avoidance-consultation-document.

However, these and other more controversial measures in the Finance Bill were removed, in order that the Bill could be passed before Parliament was dissolved, and a drastically shorter version received royal assent on 27 April 2017. This is welcome, as it is important that these sections receive sufficient Parliamentary scrutiny. The Government has announced on 13 July 2017, that the second 2017 Finance Bill will be introduced in the Autumn and will legislate for the policies already announced including tax enabler penalties.

Government statement available at http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-07-13/HCWS47/

Recent Decisions Clarify the Extraterritorial Reach of U.S. Securities Laws Under the Second Prong of *Morrison*

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In view of the high potential exposure in U.S. litigation, it is important that global companies and their insurers understand the extraterritorial reach of U.S. laws. Despite the U.S. Supreme Court's 2010 ruling in *Morrison v. National Australia Bank* limiting the application of U.S. securities laws to foreign transactions, shareholders continue to file record numbers of U.S. securities class actions against companies based outside of the U.S. We discuss below some of the recent court decisions applying *Morrison* in different factual scenarios and clarifying further the exterritorial reach of U.S. securities laws under the second prong of its transactional test.

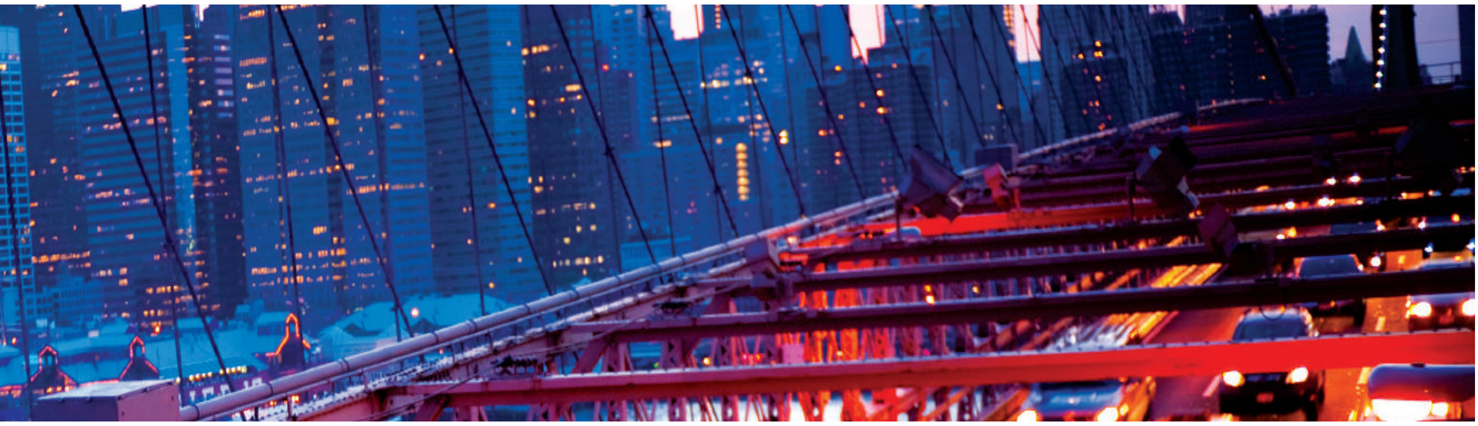
The *Morrison* decision limited the ability of investors who purchased shares in a company based outside of the U.S. to file securities actions against the company and its directors and officers ("D&Os") in U.S. courts. ***Morrison*** rejected the prior "conduct and effects test," which considered whether the alleged conduct occurred in the U.S. or whether conduct occurring overseas had a substantial effect in the U.S. Instead, the Court created a two-part "transactional test" intended to provide more certainty and consistency regarding the extraterritorial reach of U.S. securities laws. Specifically, *Morrison* held that §10(b) of the Securities and Exchange Act of 1934 (the "Exchange Act") only applies to (i) "transactions in securities listed on domestic exchanges" and (ii) "domestic transactions in other securities." With respect to securities not listed on a domestic exchange, the Court found that the exclusive focus should be on domestic purchases and sales.

While *Morrison* was generally viewed as favorable for defendants, it did not end U.S. securities lawsuits against foreign companies and likely contributed to an increase in litigation in other countries. By limiting access to U.S. courts, *Morrison* encouraged investors to develop and pursue class or collective actions in new jurisdictions. At the same time, in the years after *Morrison*, purchasers of American Depository Receipts ("ADRs") of companies based outside of the U.S. have filed high numbers of U.S. securities class actions. In 2016, shareholders filed 42 new securities class actions against foreign issuers, which is well-above the annual average number of such lawsuits prior to *Morrison*.

Morrison also did not limit the rising number of U.S. regulatory investigations and actions against foreign companies and their D&Os. Within a month after the Supreme Court issued its decision in *Morrison*, the U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank"). Pursuant to Section 929P of Dodd Frank, the broad conduct and effects test determines jurisdiction in actions brought by the Securities and Exchange Commission (the "SEC") or the Department of Justice (the "DOJ") under the antifraud provisions of the Exchange Act, the Securities Act of 1933 (the "Securities Act") and the Investment Advisers Act. Accordingly, the SEC and DOJ have asserted that Dodd Frank essentially overruled *Morrison* with respect to their regulatory and criminal actions, and they continue to aggressively pursue investigations and actions against foreign companies and their D&Os around the world.[1]

Since *Morrison*, appellate and district courts have provided further guidance regarding when shareholders may bring securities fraud claims against foreign companies and their D&Os in the U.S. Pursuant to the first prong of the *Morrison* test, U.S. courts consistently allow shareholder claims against foreign companies that listed securities on one of the U.S. registered securities exchanges. Determining whether U.S. securities laws apply to transactions in securities that are not listed on a U.S. exchange has been more challenging. A consensus has emerged, however, that under *Morrison's* second prong, the U.S. securities laws apply to foreign companies where irrevocable liability was incurred or title was transferred in the U.S. for the relevant securities transaction. Further, a number of recent decisions have found that U.S. securities laws apply with respect to transactions in sponsored ADRs, but not unsponsored ADRs.[2]

1. *See Sec. & Exch. Comm'n v. Traffic Monsoon, LLC*, 2017 WL 1166333 (D. Utah Mar. 28, 2017) (finding that with respect to actions by the SEC, pursuant to § 929P(b) of Dodd Frank, Congress intended §§ 10(b) and 17(a) of the Exchange Act to apply to extraterritorial transactions to the extent that the conduct and effects test is satisfied).
2. ADRs are issued by U.S. depository banks and each represents one or more shares of a foreign stock. They allow foreign equities to be traded on U.S. exchanges. Sponsored ADRs are issued by a bank on behalf of a foreign company whose equity serves as the underlying asset for the ADR. Unsponsored ADRs are issued by a depositary bank, usually in response to investor demand, without the involvement, participation or consent of the foreign issuer whose stock underlies the ADR. (See www.investopedia.com)



The Second Circuit Line of Cases Addressing *Morrison's* Second Prong

The U.S. Court of Appeals for the Second Circuit has issued a series of decisions addressing the second prong of *Morrison* and taken the lead among U.S. courts on this issue.

In *Absolute Activist Master Fund Ltd. v. Ficeto*,[3] the Second Circuit examined whether transactions involving securities that were not traded on a U.S. registered exchange, could still be subject to § 10(b) as "domestic transactions" under *Morrison's* second prong. The plaintiffs were Cayman Islands hedge funds that allegedly suffered $195 million in losses in a pump-and-dump scheme by their U.S. broker and investment manager. The defendants allegedly advised the funds to purchase through the U.S. broker penny stocks of thinly capitalized U.S. companies that were not traded on a U.S. registered exchange. The defendants had secretly invested in the stocks, and after causing the funds to purchase the stocks directly from the companies, they allegedly artificially inflated the stock prices for their own benefit.

The court first noted that *Morrison* provided little guidance as to what constitutes a domestic purchase or sale. Under the Exchange Act, the definitions of the terms "purchase" and "sale" "suggest that the act of purchasing or selling securities is the act of entering into a binding contract to purchase or sell securities." In other words, "the 'purchase' and 'sale' take place when the parties become bound to effectuate the transaction." Accordingly, the point of irrevocable liability determines the locus of a securities purchase or sale. Therefore, the Second Circuit held that *Morrison's* second prong applies to securities transactions where (i) the parties incurred irrevocable liability to purchase or deliver a security within the U.S., or (ii) title was transferred within the U.S.

Applying this test to the complaint in *Absolute Activist*, the court found that the plaintiffs failed to allege facts demonstrating that the purchaser incurred irrevocable liability within the U.S. to "take and pay for a security" or "deliver a security", or "that title to the shares was transferred within the [U.S.]." Specifically, the court determined that the following facts and allegations alone were insufficient to allege a domestic transaction in the U.S.: (a) a conclusive allegation that the transactions took place in the U.S.; (b) the investors wired money to the funds in the U.S.; (c) the funds were marketed in the U.S.; (d) investors in the U.S. were harmed; (e) certain defendants were U.S. citizens or resided in the U.S.; and (f) some of the fraudulent conduct occurred in the U.S. As these factors did not demonstrate that the purchases and sales were made in the U.S., the court dismissed the complaint, although it allowed plaintiffs to file an amended complaint pleading facts regarding the location of the securities transactions.

Two years later, the Second Circuit expanded upon its analysis in *Absolute Activist* in two other cases involving different securities transactions. In *City of Pontiac Policemen's and Firemen's Retirement System, et al. v. UBS AG, et al.*[4], the court examined whether *Morrison* applied to claims by U.S. investors who purchased securities of a foreign issuer on a foreign exchange through a buy order initiated in the U.S. First, the court rejected the plaintiffs' so-called "listing theory," which argued that the dual listing of the securities on both domestic and foreign exchanges satisfied the first prong of *Morrison*. Next, the court found that "the fact that a U.S. entity places a buy order in the [U.S.] for the purchase of foreign securities on a foreign exchange" did not constitute a domestic transaction under *Morrison*. As both prongs of the *Morrison* test focus on the domestic location of the securities transaction, the mere cross-listing of the security on a U.S. exchange is insufficient to satisfy *Morrison* with respect to claims brought by foreign and American plaintiffs who purchased their shares on a foreign exchange.

Shortly after its decision in *City of Pontiac*, the Second Circuit revisited *Morrison* under more complex circumstances in *Parkcentral Global Hub Ltd. v. Porsche Auto Holdings SE*.[5] In the Parkcentral case, U.S. investors asserted §10(b) claims for losses incurred on swap agreements they purchased in the U.S., but which were tied to the value of Volkswagen shares traded on foreign exchanges. For purposes of the defendants' motion to dismiss, the court assumed that the swap agreements were executed and performed in the U.S. and the underlying transaction therefore constituted a domestic securities transaction. Nevertheless, the court declined to allow the case to proceed, finding that while a domestic transaction is necessary, it is not alone sufficient under *Morrison*, as the Supreme Court did not hold that §10(b) applies to any domestic securities transaction. Applying the statute whenever a claim is predicated on a domestic transaction, "regardless of the foreignness of the facts constituting the defendants' alleged violation, would seriously undermine *Morrison's* insistence that §10(b) has no extraterritorial application."

In granting the defendants' motion to dismiss, the district court found that the "value of securities-based swap agreements is intrinsically tied to the value of the referenced security [and] the economic reality is that [the swaps] are essentially 'transactions conducted upon foreign exchanges and markets,' and not 'domestic transactions' that merit the protection of §10(b)." The Second Circuit determined that applying U.S. securities laws based only on the execution of such swap agreements in the U.S. "would subject to U.S. securities laws conduct that occurred in a foreign country, concerning securities in a foreign company, traded entirely on foreign exchanges, in the absence of any congressional provision addressing the incompatibility of U.S. and

3. *677 F.3d 60 (2d Cir. 2012)*. 4. 752 F.3d 173 (2d Cir. 2014). 5. 763 F.3d 198 (2d Cir. 2014).

foreign law nearly certain to arise." Therefore, as the claims were "so predominantly foreign as to be impermissibly extraterritorial," the court held that the transactions did not satisfy the standards for a domestic transaction under *Absolute Activist*.

The Second Circuit acknowledged in *Parkcentral* the complexity of determining the extraterritorial reach of U.S. securities laws under the second prong of *Morrison*, particularly "in a world of easy and rapid transnational communications and financial innovation," and declined to adopt a comprehensive rule or "bright-line" test for extraterritoriality in §10(b) cases. Instead, courts must carefully consider the facts of every case "so as to eventually develop a reasonable and consistent governing body of law on this elusive question."

In 2016, the Second Circuit revisited *Morrison* in *In re Vivendi, S.A. Securities Litigation*.[6] Shareholders in Vivendi common stock filed a securities class action against the company, which is a foreign media corporation, and certain of its D&Os. The plaintiffs argued that they incurred irrevocable liability in the U.S. and thus satisfied *Morrison's* second prong because they were located in the U.S. when a three-way merger through which they acquired Vivendi ordinary shares was completed. The Second Circuit upheld the dismissal of the securities fraud claims, finding that incurring irrevocable liability means either "becom[ing] bound to effectuate the transaction" or "entering into a binding contract to purchase or sell securities." The location of the investors in the U.S. who acquired ordinary shares as a result of the merger, but were not parties to the merger, was irrelevant to a determination of whether the merger qualified as a "domestic purchase or sale." The plaintiffs did not point to any evidence that the parties to the merger otherwise incurred irrevocable liability in the U.S.

On July 7, 2017, the Second Circuit applied the second prong of *Morrison* with respect to the certification of plaintiff classes in *In Re Petrobras Securities Litigation*.[7] In *Petrobras*, the defendants appealed an order by the district court certifying two plaintiff classes of all otherwise eligible persons who purchased Petrobras ADSs on the NYSE and Petrobras debt securities in "domestic transactions" as defined in *Morrison*. As the debt securities traded over-the-counter ("OTC") and not on a domestic exchange, the district court was required to assess whether those securities transactions were domestic transactions under *Morrison*.

In their appeal, the defendants asserted that the debt securities class failed to satisfy the ascertainability and predominance requirements for class certification because the class members were required to establish on an individual basis that they acquired their securities in a "domestic transaction."[8] With respect to ascertainability, the defendants argued that it would be too difficult to determine which of the OTC trades were "domestic transactions" under *Morrison*. The Second Circuit disagreed, finding that the district court's criteria for identifying the securities purchases was "clearly objective", and it was therefore "objectively possible" to determine whether the debt securities were acquired in domestic transactions.[9]

Next, the Second Circuit considered whether the predominance requirement for class certification was satisfied, which would require a finding that the resolution of any "material 'legal or factual questions… can be achieved through generalized proof', and 'these [common] issues are more substantial than the issues subject only to individualized proof.'" In *Petrobras*, this analysis raised two predicate inquiries about the role of *Morrison*, including (i) whether the determination of domesticity is material to the plaintiffs' class claims, and (ii) if so, is that determination susceptible to generalized class-wide proof such that it represents a common, rather than an individual, question.

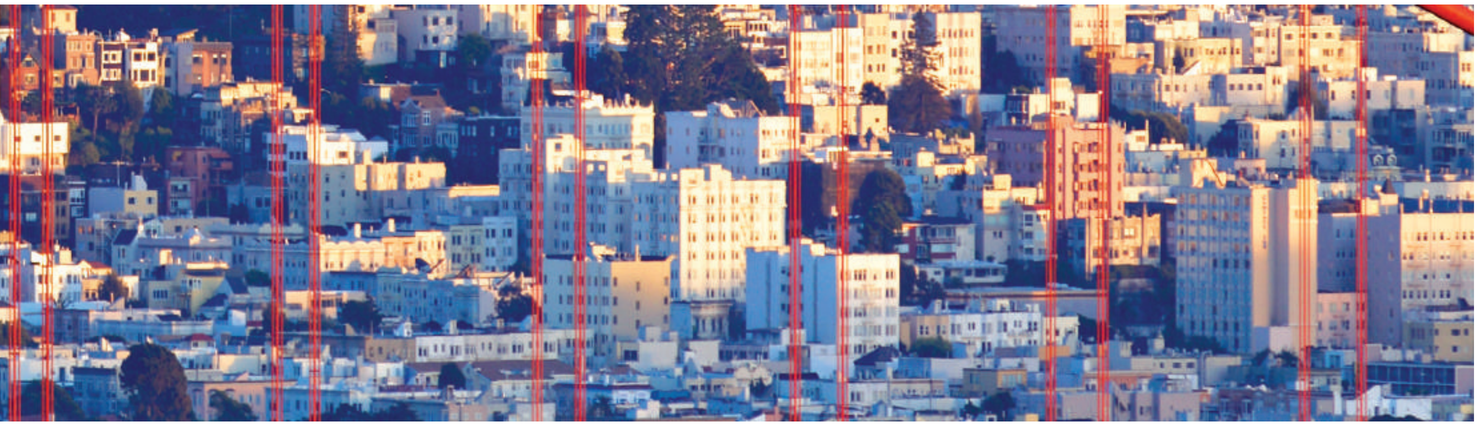
The Second Circuit found that although the lower court sought to certify classes that extended as far as *Morrison* would allow, it failed to carefully scrutinize whether the domesticity of the debt security transactions was susceptible to class-wide proof. Under the second prong of *Morrison*, a plaintiff must produce evidence of, among other things, "facts concerning the formation of the contract, the placement of purchase orders, the passing of title, or the exchange of money." While the need to show a "domestic transaction" applies equally to putative class members and may therefore present a common question, the "Plaintiffs bear the burden of showing that, more often than not, they can provide common answers." The district court suggested that the pertinent locational details for each transaction were likely to be found in the "record[s] routinely produced by the modern financial system," and "are likely to be documented in a form susceptible to the bureaucratic processes of determining who belongs to a Class." This did not, however, obviate the need to consider the plaintiff specific nature of the *Morrison* inquiry. The district court did not consider the ways in which evidence of domesticity might vary in nature or availability across the various permutations of the transactions, including who sold the relevant securities, how the transactions were effectuated, and what forms of documents might be offered to support domesticity. Therefore, the Second Circuit vacated the class certification and directed the district court to conduct a robust predominance inquiry with respect to the domesticity of the underlying transactions. The Second Circuit's ruling in Petrobras demonstrates that *Morrison* may create substantial hurdles to class certification, even after investors have sufficiently pleaded a domestic transaction under *Morrison*.

6. *838 F.3d 223 (2d Cir. 2016)*.

7. --F.3d --, 2017 WL 2883874 (2d Cir. July 7, 2017).

8. 1Plaintiffs seeking class certification bear the burden to satisfy the numerosity, commonality, typicality, and adequacy requirements of Rule 23 of the Federal Rules of Civil Procedure. They must also show that "questions of law or fact common to class members… predominate over questions affecting only individual class members." Courts have also recognized an implied requirement of ascertainability under Rule 23.

9. The Second Circuit rejected application of a heightened ascertainability requirement applied by other Circuit Courts, under which any proposed class must be "administratively feasible," over and above the requirement that a class be definite and "defined by objective criteria," and separate from the predominance and superiority requirements.



Court finds Bank owes an "intermediate" duty to retail customer in relation to switch to fixed rate loans

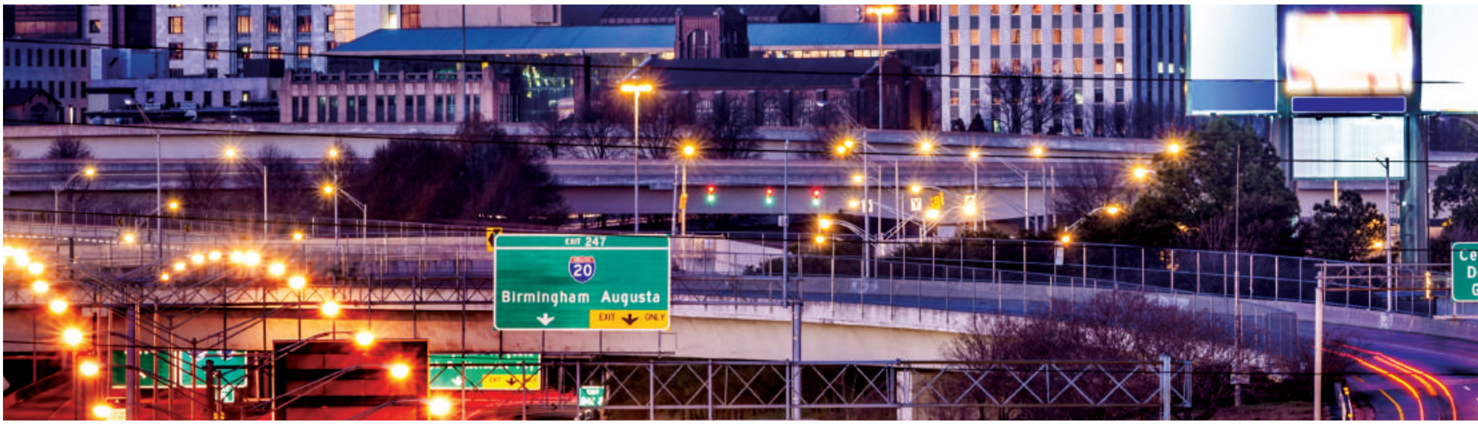
In *Thomas v Triodos Bank* (2017) the claimants owned a farming business and, in 2008, became concerned about the potential for interest rates to rise. They had various discussions with individuals at the defendant bank, with whom they had a number of loans, and then switched from a variable into a 10 year fixed rate in respect of two of their loans. Following the financial crisis the claimants found it difficult to service the loans and were told that if they repaid the loans the redemption penalty on the second loan would be GBP 96,000, subsequently revised to GBP 55,000. This was far in excess of the penalty that the claimants expected, and a claim was brought against the bank for various misrepresentations and breach of duty.

Judge Havelock-Allan QC noted that fixed rate lending is not a regulated activity under FSMA and even if it was, the claimants were unlikely to qualify as private persons under the COBS Rules. This was also held not to be an advice case. The Judge considered the authorities and noted that there is a clear distinction between the duty owed in relation to the sale of financial products by banks where advice is given whether to purchase, and the duty owed where all that is provided is information. Where advice is given, there is a duty to ensure the advice is full and accurate, covers the available options and the pros and cons of any product being recommended that enables the customer to make an informed decision. It was held in *Green v Rowley* (2012) (and the relevant analysis approved in the Court of Appeal) that where a bank gives information only about a product, the only duty owed to the customer is a *Hedley Byrne* duty to take reasonable steps not to mislead. The Judge in this case found that there could be an intermediate duty between the two, outside of the advisory relationship, the existence of which would depend on the facts of the case. In this case the Bank had advertised to the claimants that it subscribed to the Business Banking Code ("BBC"), which included a promise that if the bank was asked about a product, that it would give a balanced view of the product in plain English, with an explanation of its financial implications. The Judge found that when the claimants had asked about fixing the rate, the Bank had therefore owed a duty to explain what fixing the rate entailed and its consequences. The Judge held that the bank had made a misrepresentation and breached this duty by making comment that the claimants would be sensible to fix for 10 years rather than a lesser period as the rate was lower, without explaining the financial downside of a longer fix with regard to redemption penalties. There was also a misrepresentation and breach of duty when the Bank failed to correct the claimant when he asked whether the maximum penalty was likely to be in the range of GBP 10,000 - GBP 20,000.

This demonstrated that the claimants did not understand how the relevant clauses relating to redemption penalties worked, and there should have been an accurate description given in relation to them.

There are some conflicting first instance authorities regarding the duties of banks where they are providing information rather than advice to customers, and this is an issue that will no doubt, at some stage, be the subject of consideration by the appeal courts. This case suggests that where a bank advertises that it subscribes to a voluntary code of conduct, it may owe more than the *Hedley Byrne* duties in respect of giving information.

It is also notable in this case that the Court indicated that, in relation to the question of how far a bank should go in providing information in response to questions from a customer in a non-advised transaction, the approach to be adopted in considering materiality is that in the case of *Montgomery v Lanarkshire* (2015). This meant that the relevant question is: would a reasonable person, in the position of the customer, be likely to attach significance to a piece of information. In *O'Hare v Coutts* (2016) the High Court recently held that the *Montgomery* test would apply rather than the traditional *Bolam* test (which is whether the defendants were acting in accordance with the practice of competent respected professional opinion) in an advisory case. This applied in relation to the question of the required level of communication about the risks of the investments. *O'Hare v Coutts* is under appeal.



Application of Morrison to Sponsored and Unsponsored ADRs

A number of recent district court decisions have examined whether U.S. securities laws apply to foreign companies' ADRs purchased and sold in the U.S. In Stoyas v. Toshiba Corp.,[10] investors who purchased unsponsored ADRs in Toshiba traded on the OTC market in the U.S. alleged that the company and certain of its D&Os violated U.S. securities laws as well as Japan's Financial Instruments & Exchange Act. The defendant argued that under *Morrison*, §§10(b) and 20(a) of the Exchange Act did not apply because Toshiba had not listed the ADRs on a U.S. exchange or sold the securities in the U.S.

The district court found that the first prong of *Morrison* did not apply because the OTC market is not a domestic exchange. The plaintiffs also could not satisfy the second prong of *Morrison* because they had not alleged any affirmative act by Toshiba related to the purchase and sale of securities in the U.S. Although the ADRs were based on Toshiba common stock traded on a foreign exchange, they were sold by U.S. depository banks without the participation of Toshiba. There were no allegations that Toshiba sponsored, solicited or committed any other affirmative act with respect to the ADRs. The court reasoned that holding companies like Toshiba liable in the U.S. for secondary securities they had not approved would "create essentially limitless reach" for U.S. securities laws.

Other courts have determined that U.S. securities laws may apply where the defendant company sponsored the ADRs at issue. In *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Product Liability Litigation*,[11] the Northern District of California found that under *Morrison*, Volkswagen and certain of its D&Os could be liable under U.S. securities laws with respect to ADRs sponsored by the company and traded in the U.S. Investors in Volkswagen ADRs filed a alleged that the defendants misled investors by failing to disclose that the company had utilized a "defeat device" in its diesel cars that allowed the cars to temporarily reduce emissions during testing. The defendants filed a motion to dismiss arguing that under *Morrison* the U.S. securities laws did not apply to the ADR transactions.

As the ADRs traded on the OTC market and were not listed on a U.S. exchange, *Morrison's* first prong did not apply. The defendants, citing *Parkcentral*, argued that *Morrison's* second prong also did not apply because the ADR transactions were predominately foreign. Unlike the swap agreements in Parkcentral, however, the defendant company had taken affirmative steps to make its sponsored ADRs available to investors in the U.S. The court also noted that the ADRs had numerous connections to the U.S., including that they were traded in the U.S. pursuant to an agreement subject to New York law and a Form F-6 Registration Statement submitted to the SEC. As a result, the ADRs were not predominately foreign and were sufficiently domestic to satisfy the "domestic transactions" requirement under *Morrison*.

Most recently, in *Vancouver Alumni Asset Holdings Inc., et al. v. Daimler AG, et al.*,[12] another district court in California held that U.S. securities laws apply to OTC transactions in Daimler A.G.'s sponsored ADRs. As in *Volkswagen*, the ADR shareholders alleged damages from misrepresentations and omissions pertaining to emission control systems in certain of the defendant company's diesel vehicles. The defendants also cited *Parkcentral* and argued that the plaintiffs could not satisfy either prong of *Morrison* because the ADRs were "predominantly foreign in nature." The court disagreed, noting that the *Parkcentral* test was not binding on its determination and the plaintiffs in that case had not alleged that the defendant company was a party to the relevant swap agreements or participated in the market for the swaps. In contrast, the ADRs were not independent from Daimler foreign securities or from Daimler itself, and the company sponsored and was directly involved in the domestic offering of the ADRs. Further, Daimler took affirmative steps to make its securities available to investors in the U.S., and all broker-dealers, settling agents and clearing houses associated with the transactions were U.S. institutions. Therefore, the court determined that the plaintiffs alleged a sufficient connection between the ADR transactions and the U.S. as required under *Morrison's* second prong.

As plaintiffs continue to target foreign companies and their D&Os in U.S. securities actions, it is important that they understand whether they could be subject to claims under U.S. securities laws. The cases discussed above have provided greater certainty regarding the exterritorial reach of U.S. securities laws. As the Second Circuit noted in *Parkcentral*, however, application of *Morrison's* "transactional test" is often not a straightforward exercise, and U.S. courts will likely continue to update and refine the extraterritorial reach of U.S. securities laws to increasingly complex fact patterns and securities transactions. Therefore, global companies and their insurers should closely monitor developments in this area.

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10. *191 F. Supp. 3d 1080 (C.D. Cal. 2016).*
11. *2017 WL 66281 (N.D. Cal. Jan. 4, 2017.*
12. *2017 WL 2378369 (C.D. Cal. May 31, 2017).*

Director liability for nuisance call fines

On 23 October 2016, the government announced that it would amend the Privacy and Electronic Communications (EC Directive) Regulations 2003 (SI 2003/2426) in "spring 2017" to give the Information Commissioner's Office (ICO) the power to fine directors personally, up to £500,000 for nuisance calls. If multiple directors were culpable, then each could be liable for a fine, in addition to any fine imposed on the company.

This reflects the government's intention to strengthen the ICO's enforcement powers in order to protect individuals' rights and, follows the recommendation of the UK Information Commissioner, Elizabeth Denham, at a parliamentary meeting about the Digital Economy Act (passed on 27 April 2017). The Commissioner noted that the ICO had issued a total of GBP 4 million in fines in 2016 but only collected a small percentage of that figure. The Commissioner welcomed the proposal as, *"Making directors responsible will stop them ducking away from fines by putting their company into liquidation. It will stop them leaving by the back door as the regulator comes through the front door"*.

Increased ICO powers

The ICO does not yet have the power to fine directors, although it recently imposed a fine of GBP 400,000 on Talk Talk, its largest ever fine for a breach of data protection law.

Enforcement of the General Data Protection Regulation ("GDPR") commences on 25 May 2018. This gives the ICO the power to impose fines of up to the greater of EUR 20 million or 4% of worldwide turnover. In the event that personal liability is extended to directors for all data protection breaches (as recommended by the Information Commissioner) then it could be extremely costly for individuals who receive these fines.

Impact on insurance for regulatory fines and the costs of the associated investigations

Insurance cover for fines is typically limited, either by any applicable levels of indemnity or by wording which limits cover for fines and costs *"to the extent that they are conclusively determined to be legally insurable"*. Whether a cyber policy will cover a fine imposed by the regulator following, for instance, a data breach depends on what is meant by "legally insurable". The difficulty with insuring fines arises from the law on public policy (often referred to, by lawyers at least, as the ex turpi causa rule). Broadly speaking, this prevents companies and individuals negating the deterrent effect of fines for wrongful conduct by insuring their exposure. The application of the rule to criminal behaviour is clear. However, the position becomes more difficult in respect of behaviour which is wrongful without being criminal. In addition, it is not simply the fine that poses a risk to the assured as the costs of responding to the regulator's investigation could also be significant.

There is currently no precedent which establishes how a fine flowing from a breach of data protection legislation may be treated, however *Safeway v Twigger* (2010)[1] suggested that the ex turpi causa principle can be engaged by conduct which reaches a certain level of moral turpitude falling short of criminal behaviour. Although the case law is not entirely clear cut, it is likely that conduct falling short of deliberate or reckless (and possibly negligent) acts will not be sufficient to engage the principle. The GDPR, as well as the current form of the Data Protection Act 1998, focus on the nature of the conduct in question when considering whether to impose a fine, and provide that when fines are assessed, the nature of the conduct will be taken into account setting the level of the fine[2]. There may therefore be the possibility that the most serious fines under the GDPR will not be recoverable, but each case will of course turn on its own facts.

With the scale of fines about to dramatically increase beyond current levels (up to 4% of worldwide turnover under the GDPR), Insurers may wish to review their policy wordings and sub-limits on fines and the associated investigation costs and consider their approach for future policy years.

1. Other cases such as *Bilta (UK) Ltd (In Liquidation) v Nazir* and *Les Laboratoires Servier v Apotex Inc* also considered the issue in non-insurance scenarios which are nonetheless relevant.

2. S55A(1) of the DPA 1998 provides that a penalty may be imposed if there has been a serious contravention of s4(4) which was of a kind likely to cause substantial damage or distress and the contravention was deliberate (s55A(2)) or the data controller knew or ought to have known there was a risk of such contravention and it would be likely to cause substantial damage or distress but failed to take steps to prevent the contravention (s55A(3)). Art 83 of GDPR sets out the general conditions for imposing administrative fines. Art 83(2)(b) provides that when deciding whether to impose administrative fines and deciding on the amount regard shall be had to the intentional or negligent character of the infringement. Sub-sections (a) – (k) list other factors which should be taken into account when imposing fines, including nature, gravity and duration of infringement (a); and action taken to mitigate damage (c).

"Lifting the fear and suppressing the greed": The upwards criminal enforcement trend in Australia, recommended penalty reform and what this means for insurers and insureds

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Market Misconduct

In Australia the corporate regulator, the Australian Securities and Investments Commission (**ASIC**), can institute criminal proceedings or civil penalty proceedings against directors and officers for a range of breaches of the *Corporations Act 2001* (Cth) (**the Corporations Act**). This is the central piece of legislation which governs the duties of those who direct or manage corporations in Australia (beyond the common law and equity) and it imposes a range of sanctions against those who misinform the market and for general corporate misconduct.

In recent times, there has been a spike in criminal prosecutions instituted by the regulator in Australia against individual directors and officers, along with a steady continuation of enforcement action taken by way of civil penalty proceedings. This is a trend we expect to continue. Whilst both enforcement options are instituted in order to establish a contravention of the general law and to obtain the imposition of an appropriate penalty, it has often been said that a civil penalty action is "quasi-criminal". However, the High Court of Australia has recently confirmed that "a civil penalty proceeding is precisely calculated to avoid the notion of criminality as such" [1]. Irrespective of the form in which such claims are brought, insurers will continue to have to grapple with 'the old chestnut' of whether a conduct exclusion is enlivened, which is a question that depends on an examination of the nature of the conduct and factual findings ultimately made.

We set out below a statistical analysis of these regulatory litigation trends, against the background of the Senate Economics References Committee Report released on 27 March 2017: 'Lifting the fear and suppressing the greed: Penalties for white-collar crime and corporate and financial misconduct in Australia' (the Senate Report).

At this stage it is not clear which recommendations from the Senate Report will be progressed in the Australian Parliament, but significant reform is expected. We expect harsher financial penalties and other sanctions to be imposed on individuals and corporations – particularly for civil penalty offences - to bring Australian enforcement into line with community expectations and trends in global markets.

Lifting the Fear and Suppressing the Greed

The Senate Report is focused on penalties for white-collar crime and corporate and financial misconduct in Australia. It is the product of a referral from the Upper House of the Parliament of Australia for an inquiry into inconsistencies and inadequacies of current criminal, civil and administrative penalties for corporate and financial misconduct or white-collar crime.

A key recommendation from the report is that the Australian Federal Government gives consideration to increasing the current level of civil penalties for market misconduct offences. That recommendation is predicated upon submissions received from the public expressing the view that current monetary penalties are inadequate. A central submission relied upon by the Committee in relation to the inadequacy of penalties was of the Australian Shareholders' Association, which pointed to the disparity between the maximum civil penalty of AUD200,000 for

[1] Joint judgment delivered by French CJ, Kiefel, Bell, Nettle and Gordon JJ on 9 December 2015 in *Commonwealth of Australia v Director, Fair Work Building Industry Inspectorate; Construction, Forestry, Mining and Energy Union v Director, Fair Work Building Industry Inspectorate* [2015] HCA 46.

individual directors and officers for breaches of duty on the one hand, and executive remuneration levels on the other. It was also found that current civil penalty levels are out of step with international equivalents.[2]

Regulatory Litigation Trends

The penalty regime found in the Corporations Act is important to assist in promoting investor confidence and market integrity. ASIC has said that on average it has 96 matters under investigation at any one time.[3] Not all of those matters proceed to enforcement action through the Courts. Before going down a civil penalty or criminal prosecution route (the most severe enforcement tool), ASIC has a number of enforcement avenues available to it which range in severity, including education programs, enforceable undertakings and infringement notices. These tools may enable stakeholders to engage with the regulator at an early stage to reach a swift and inexpensive resolution compared with Court action.

Not all matters are capable of such an early resolution. The table below sets out the number of civil penalty matters against individuals that have been commenced by ASIC compared with the number of criminal prosecutions referred to the Director of Public Prosecutions in the past three years,[4] up to the end of the first quarter in 2017:

Year	Civil Proceedings	Criminal Proceedings	Total
2017 (first quarter)	1 (20%)	4 (80%)	**5**
2016	2 (12%)	15 (88%)	**17**
2015	3 (18%)	14 (82%)	**17**
2014	7 (30%)	16 (70%)	**23**
Total	**13 (21%)**	**49 (79%)**	**62**

The data demonstrates that Australia has had its fair share of corporate scandals in recent years, and that criminal penalties have overtaken civil penalties as the primary vehicle by which the regulator seeks to combat white collar crime. In those cases, the standard of proof (beyond reasonable doubt) is higher, and as such, only the clearest of cases are likely to be confined to such a vehicle.

The criminal matters in the above table overwhelmingly capture traditional white collar-crime. This was considered in the Senate Report as *"financially motivated non-violent crimes committed by businesses or individuals acting from a position of trust or authority."*[5] They include matters such as insider trading, fraud, engaging in phoenix activity, dishonest use of position to gain an advantage, the making of false and misleading statements to ASIC, individuals acting as directors whilst disqualified, embezzlement, falsifying books and records and so on.

However, the table also includes matters where the regulator has a choice to make as to the vehicle with which to pursue a penalty. For example, ASIC has for many years been keen to ensure market integrity by taking action to deter and punish those involved in making a misleading disclosure to the Australian Securities Exchange (**ASX**)[6] and/or the non-disclosure of material information[7] to the market in contravention of the ASX listing rules.[8] Whilst both are civil penalty offences, individual directors can also be pursued criminally for aiding, abetting, counselling or procuring the commission of an offence by the corporation which they manage or direct.[9] Such matters are also included in the above analysis.

One observation we can make is that following the regime introduced into the Corporations Act in 2004 allowing ASIC to issue an infringement notice and impose a financial penalty to avoid future action by ASIC, there were very few cases in which ASIC pursued a director for a criminal penalty for breaches of the continuous disclosure requirements. However, that has started to change.

2. Other recommendations made in the Senate Report relate to increasing clarity around evidentiary thresholds in litigation procedure in civil penalty proceedings, enhancing accessibility to registered of banned and disqualified individuals and increasing ASIC's disgorgement powers where misconduct has resulted in illegal gains by a company or individual.
3. ASIC's Market Integrity Report: July to December 2015.
4. These are the matters we are aware of sourced from public records. The statistics do not include enforcement proceedings commenced against corporations. For the purposes of our current analysis we have focused only on individual directors and officers.
5. As above.
6. See sections 1309(1) and 1311(1) Corporations Act.
7. Information is material if a reasonable person would expect it to have a material effect on the price or value of the entity's securities.
8. See section 674(2) of the Corporations Act.
9. See s 11.2 of the Criminal Code.

For any individual that has committed an offence of aiding and abetting a continuous disclosure breach, and leaving aside the possibility of a term of imprisonment being imposed, there is no discretionary Court ordered disqualification (as may be the case when civil penalties are pursued). If convicted, the individual will be automatically disqualified from managing a corporation for a period of five years.[10] This compares with discretionary disqualification where a director or officer is pursued for a civil penalty breach.

In civil penalty matters generally (irrespective of whether they involve the continuous disclosure provisions of the Corporations Act), the Court is able to exercise a discretion, with orders ranging from life disqualification to much less (for example, between a few months and 3 years).[11] Factors which tend toward longer periods of disqualification involve large financial losses combined with dishonesty and intent to defraud. From the insurer's perspective, these are the cases that are easiest to decline cover, but at the other end of the spectrum (e.g. disqualifications of up to three years), the factors can be quite different in terms of personal gain (or lack thereof) and contrition / remorse. These cases can involve contravention over a short period of time, which results from negligent conduct by the corporation or an individual, rather than deliberate or reckless conduct.[12] In those cases, an insurer may (depending on the nature of the claim, factual findings and specific policy terms and conditions) be required to indemnify.

The more difficult cases are those which attract the benefit of cover for part of the claim. Those are the ones in which insurers and the insured may find themselves having to consider and attempt to negotiate on what would be a fair and equitable allocation of defence costs. These costs can be financially crippling for the individual defendant and may also involve the insurer having to secure assets at an early stage in case it needs to exercise a claw-back right.

Predicted Reforms and Impact on Insurers/Insureds

Significant reform is expected following release of the Senate Report. In the words of the Committee:

> *"Providing an overall assessment of the adequacy and consistency of current penalties for white-collar crime and misconduct is not straightforward. Just as the types of wrongdoing that might be considered white-collar crime and misconduct are extremely varied, so too are the penalties available in relation to that wrongdoing. However, the committee agrees that, broadly speaking, there appear to be serious inadequacies and inconsistencies in the current penalty framework."*[13]

Those inconsistencies are illustrated by the broad discretion for disqualification in civil penalty matters and the automatic disqualification consequences in certain criminal matters, with the potential for a civil penalty contravention to be met with a longer disqualification period.

One clear expectation we have is that the reform process will address current perceived inadequacies in the penalty framework, including increased financial penalties for non-criminal matters (currently only AUD200,000 for an individual and AUD1million for a corporation). No specific penalty amount has been recommended by the Senate Committee, but it has urged the Australian Parliament to have regard to penalties in other jurisdictions for similar offences.[14] The current flexibility for ASIC to pursue civil and criminal proceedings will also remain but tougher civil penalties could equate to an increase in civil penalty actions.

Any increase in the quantum of penalties will also have the consequence of increasing exposures for insurers if such penalties are capable of being indemnified. In the regulatory litigation environment, insurers will continue to have to engage proactively with conduct exclusions and advance defence costs along the way.

This article was written with the assistance of Matthew Blake, paralegal.

10. Section 206B of the Corporations Act.
11. See *ASIC v Adler* (2002) 42 ACSR 80.
12. See *ASIC v Chemeq Limited* [2006] FCA 936 and French J's non-exhaustive list of influential factors in considering penalty.
13. Senate Report, para 2.47.
14. Senate Report, para 6.52.

Financial Sanctions Reform

Rebecca Lowe, Senior Associate, London

Financial sanctions are EU and UK regulations which prohibit or restrict the giving and receiving of funds and other resources for the benefit of a person or entity that is on the EU or UK's sanctions list, usually subject to obtaining a licence. Sanctions may also take the form of financial market restrictions to prevent trade in financial instruments issued by specific persons or entities.

Last year, the Treasury dealt with over 100 suspected breaches of financial sanctions. Breaches varied significantly: the most expensive breach of financial sanctions was worth around GBP 15 million although the authorities' enforcement options were limited to pursuing a formal criminal prosecution or sending a warning letter. Authorities lacked an alternative means to impose fines or penalties, unless a criminal prosecution was of sufficient public interest.

The PCA 2017

However, the position has changed following the Police and Crimes Act 2017 (PCA) coming in to force on 1 April 2017.

In line with the trend in the UK of moving towards a more robust approach to the enforcement of sanctions for financial crime, the PCA gave the Treasury's new Office of Financial Sanctions Implementation ("OFSI") powers to impose potentially significant monetary penalties on companies and individuals for breaches of financial sanctions law. These penalties are an alternative to criminal enforcement, which remains an option.

Part 8 of the PCA makes changes to financial crime sanctions in three main areas:

1. **Sentencing:** the PCA increases the maximum penalties for the sanctions offences under:

   a. Schedule 3 to the Anti-terrorism, Crime and Security Act 2001 (failure to comply with freezing orders); and

   b. Schedule 7 to the Counter-Terrorism Act 2008 (failure to comply with requirements such as undertaking customer due diligence, limiting or ceasing certain types of business).

The maximum penalty was previously two years' imprisonment but the PCA 2017 increased the penalty to seven years. Penalties for summary offences under the same legislation have also increased from six months to twelve months.

2. **Enforcement**: currently, financial sanctions breaches are punishable by administrative warning letter or criminal prosecution. The PCA 2017 supplements these by:

   a. Extending the deferred prosecution agreement ("DPA") regime so that a breach of financial sanctions is in the list of offences for which a DPA may be given (see Schedule 17 to the Crime and Courts Act 2013). A DPA may be used where prosecutors believe that criminal proceedings are more appropriate than a civil penalty but it is in the interests of justice to enter into a DPA rather than pursuing a prosecution;

   b. Adding sanctions breaches to the list of offences for which a serious crime prevention order ("SCPO") may be imposed. An SCPO is a civil order, which prohibits a company from undertaking certain targeted activities, such as preventing business dealings with an individual or company. Breach of a SCPO carries a maximum five year prison sentence, an unlimited fine or can lead to an order for forfeiture, or for winding-up of a company;

   c. Creating a new civil monetary penalty which may be imposed by OFSI where it is satisfied on the balance of probabilities that a prohibition has been breached and the person in breach either knew or had reasonable cause to suspect that they were in breach. The maximum penalty provided for is GBP 1m or 50 per cent of the estimated value of the funds to which the breach relates, whichever is greater; and

   d. A new penalty for senior management which can be imposed where a company has also had to pay a civil penalty for sanctions breaches. This can be imposed on a senior manager if the company's breach took place with the senior manager's consent or is attributable to their neglect.

3. **Implementation:** UN sanctions are given effect in the UK by EU regulations. This means that when the UN introduces a new sanction, the EU must then adopt sanctions regulations implementing any associated asset freeze. The asset freeze cannot be given effect in the UK until the EU regulations have been adopted, which leads to average delays of four weeks (international best practice is for asset freezes to be given effect within 48 hours). PCA 2017 remedies this by giving new UN sanctions regimes immediate effect in the UK for a period of up to 30 days (extendable to 60 days) pending the introduction of the necessary EU legislation.

Conditions Precedent in Singapore – good news for insurers

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The Singapore High Court has examined the construction of general conditions in the case of *Grace Electrical Engineering Pte Ltd v EQ Insurance Co Ltd* [2016] SGHC 233 and, in particular, whether the conditions in question were capable of being construed as conditions precedent.

The Plaintiff ("**GE**") was the occupier of a factory unit used for the assembly and testing of electrical equipment and an insured under a public liability policy (the "Policy") issued by the Defendant ("**EQ Insurance**").

In September 2012, a fire started at the unit spreading to an adjoining unit occupied by Te Deum Engineering Pte Ltd ("**Te Deum**").

After an investigation by the Singapore Civil Defence Force, GE was charged under the Fire Safety Act ("**FSA**") with eight charges concerning the unauthorised use of the unit as accommodation for workers and for carrying out unauthorised fire safety works. GE pleaded guilty to five of the charges.

Te Deum (successfully) sued GE for the damage to its unit and GE commenced proceedings against EQ Insurance for an indemnity under the Policy.

EQ Insurance raised defences relating to a number of general conditions in the Policy and, in particular, relied on General Conditions 4, 9, 12 and 13 ("**GC4**", "**GC9**", "**GC12**" and "**GC13**" respectively).

GC9 provided that GE:

> *"shall exercise reasonable care … that all statutory requirements and bye-laws and regulations imposed by any public authority are duly observed and complied with".*

The court decided that a determination would have to be made as to whether there had been a breach of a relevant regulatory provision and whether such non-compliance occurred due to the insured's failure to "exercise reasonable care". The court had no difficulty in construing GC9 as applying to breaches of the FSA as *"fire safety was [GE's] responsibility and any outbreak of fire would present a significant risk to the nearby third party property"* and, in the circumstances, found that GE had failed to exercise reasonable care.

The question then was whether GC9 was a condition precedent by virtue of general declaration clause GC13 which stated:

> *"due observance and fulfilment of the terms provisions and conditions of this Policy insofar as they relate to anything to be done or not to be done by the Insured … shall be condition precedents to any liability of [EQ Insurance] to make any payment under this Policy".*

The court stated that the effect of such a clause must be examined alongside each clause purported to be a condition precedent. The use of the term *"condition precedent"*, whilst relevant, is not decisive especially in circumstances where *"the label is attached to a number of terms of different nature"*.

The factors a court will take into account include:

- The workability of the contractual obligation as a condition precedent to liability;
- The purpose of the condition or that of the policy itself; and
- In the event of ambiguity, the *contra proferentem* rule

The court found that there was no ambiguity and there was no reason not to interpret GC9 as a condition precedent as *"the insured is required to comply with fire safety regulations so as not to increase the insured risk during the period of insurance"*. EQ Insurance was therefore not liable to indemnify GE under the Policy.

GC4 required that GE obtain the consent of EQ Insurance before making *"any admission … in connection with any accident or claim"*. GE had pleaded guilty to five of the charges under the FSA. However, the court considered that a criminal charge was not a "claim" in the circumstances and the guilty pleas were not an "admission" within the meaning of GC4 as the charges related to strict liability offences.

GC12 provided that if legal proceedings are not commenced within 12 months from the time when EQ Insurance *"shall offer an amount in settlement or disclaim liability for any claim"* then such claim shall be deemed abandoned. EQ Insurance argued it had disclaimed liability in a letter dated March 2013 whereas proceedings against it had not commenced until July 2014. The court held that, as the objective of the Policy was to indemnify GE against *"legal liability"*, no claim for an indemnity could arise under the Policy until the *"establishment of liability and quantum of the underlying third party claim"*. GE's liability to Te Deum had not been established in March 2013 and GE was therefore not in breach of GC12.

This case is good news for insurers, confirming the Singapore courts' willingness to give effect to general declaration clauses, albeit their effect on any individual condition will need to be considered on an individual basis.

UK Government consultation on reforming the law on corporate liability for economic crime.

Rebecca Lowe, Senior Associate, London

On 13 January 2017, the UK government opened a consultation on its proposals to reform the law on corporate liability for economic crime. It requested responses by 24 March 2017.

In the consultation document the Government noted that the existing "identification doctrine" for corporate liability, attracts criticism and is regarded by prosecutors, practitioners and legal academics as not being fit for purpose when applied to large modern companies. The identification doctrine allows for corporate entities to be convicted for the criminal acts of their directors and senior managers if they represent the "directing mind" of the business. In practice, this is restricted in application to the actions of the Board of Directors, the Managing Director and other senior officers who carry out functions of management and speak and act as "the company". This has led to more prosecutions of smaller companies where it is often easier to identify the "directing mind" and link that person with the criminal act.

According to the consultation, the Government is concerned to explore whether the operation of the identification doctrine is hindering the effective administration of justice and has requested evidence in response to five different options:

Option 1: Amendment of the identification doctrine

Legislation could amend the common law identification doctrine by broadening the scope of those regarded as a directing mind of a company.

However, this appears unlikely to be adopted as the consultation states that *"retaining the identification doctrine in any form...would encourage corporate efforts to limit potential liability through the adoption of evasive internal structures. It would not promote the prevention of economic crime as a component of corporate good governance."*

Option 2: Strict (vicarious) liability offence

The creation of a strict liability offence based on the principles of vicarious liability would make the company guilty, through the actions of its employees, representatives or agents, of the substantive offence, without needing to prove any fault element (such as knowledge or complicity) at the corporate centre. The U.S. already has a similar doctrine based on respondeat superiore or "let the master answer".

The consultation notes that, *"If the solution is to create such a new statutory form of vicarious liability, one needs to consider whether it should be subject to a due diligence type defence if it is to be effective as a means of incentivising economic crime prevention as part of corporate good governance".*

Option 3: Strict (direct) liability offence

A strict direct corporate liability offence would focus on the responsibility of a company to make sure that offences are not committed in its name or on its behalf. A company would be convicted without the need to prove any fault of the substantive offence (which is needed for vicarious liability). Instead the company would be convicted of a separate offence, more akin to a breach of statutory duty, for failing to ensure that economic crime is not conducted on its behalf.

The consultation states, *"By focussing on a failure to exercise supervision over the conduct of those pursuing a company's business objectives, this model may more accurately target the real nature of corporate culpability."*

This model is already employed by section 7 of the Bribery Act (Failure to prevent bribery). This offence is subject to a due diligence type defence which is expressed in terms of a company having adequate procedures in place to prevent the offence from occurring.

Option 4: Failure to prevent as an element of the offence

In this option, the concept of a failure on the part of those managing the company to prevent the relevant offending from occurring is an element of the offence. It is for the prosecution to prove not only that the offence occurred but also that it occurred as a result of a management failure, manifested either as negligent conduct or as systemic inadequacies in the company's mechanisms, which failed to prevent such offences from occurring.

The consultation states that *"In effect this model takes the principles of option 3 but places on the prosecution the burden of proving that the company had not taken adequate steps to prevent the unlawful conduct occurring rather than placing the burden on the defence to prove that the company had done so."*

The Government's starting position is that this statutory offence should initially apply to a short list of the most common serious economic crime offences (which could be added to if necessary by secondary legislation) for example:

- The common law offence of conspiracy to defraud;
- The offences at section 1 of the Fraud Act 2006;
- The offence of false accounting at section 17 of the Theft Act 1968; and
- The money laundering offences at section 327 to 333 of the Proceeds of Crime Act 2002.

The consultation document also states that the formulation of a defence appropriate for economic crimes (other than bribery and the facilitation of tax evasion) and the extent to which such a defence would have similar policy benefits, would need to be carefully considered.

The Government's press release in May 2016, which launched the consultation, appeared to favour option 4, stating that *"the consultation will explore whether the "failure to prevent" model should be extended to complement existing legal and regulatory frameworks. The consultation follows the recent announcement by the Prime Minister to bring forward a criminal offence for corporations who fail to stop their staff facilitating tax evasion and two recent prosecutions for the offence of failure of a commercial organisation to prevent bribery on its behalf".*[1]

Option 5: Investigate the possibility of regulatory reform on a sector by sector basis

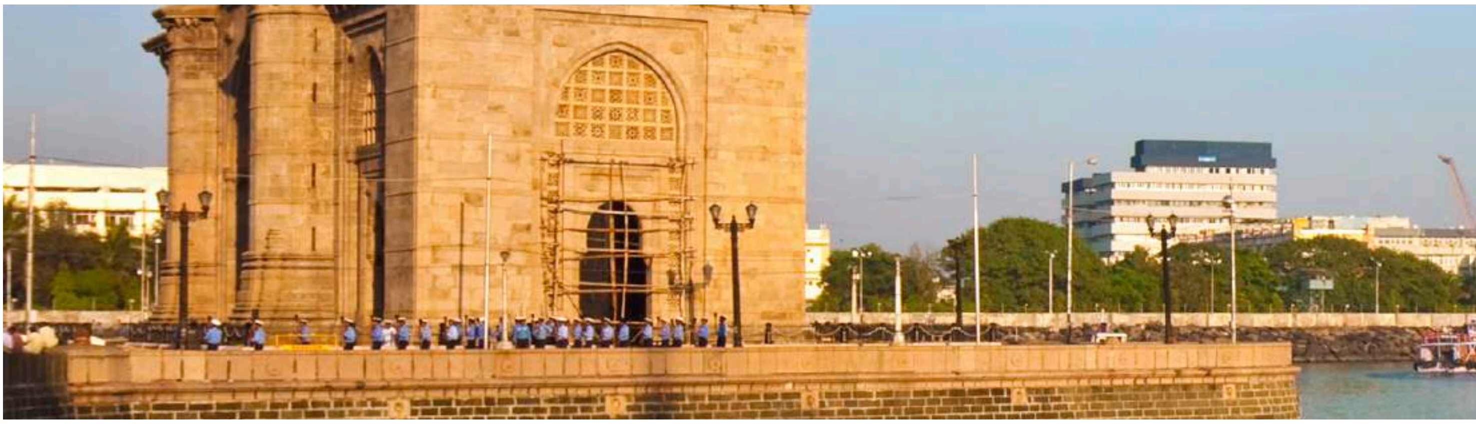
The consultation states that *"There has been significant reform in the regulation of the financial services industry in order to deter misconduct through strengthening individual accountability, particularly at senior manager level. There is also the potential for lessons to be learned from the experience of strengthening the regime for financial services which may be applicable more broadly."*

Comment

In a shift from the Government's May 2016 press release, the consultation includes five options to reform the law. We suspect that this is both due to the change to the Prime Minister in the intervening period and, as the consultation recognises, the advantages and disadvantages of option 4 and reform generally, will need to be carefully considered against the alternatives. For example, one potential issue raised by a due diligence type defence is that, in the financial services sector, firms already have extremely sophisticated systems. Therefore it is questionable whether it would be worthwhile pursuing prosecutions to examine the adequacy of such systems. Potentially trials will only be brought where there are no procedures in place which, is still, more likely to target smaller, less sophisticated companies.

The next step will be for the government to respond to the consultation evidence.

1. Link to press release: https://www.gov.uk/government/news/new-plans-to-tackle-corporate-fraud



The Tata-Cyrus Mistry fallout causes shockwaves in India

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Shockwaves have been felt in India, following the Tata-Cyrus Mistry fallout, which could result in potentially significant exposures for Indian Insurers and global Reinsurers.

Background

On 24 October 2016, in an unexpected turn of events, Cyrus Mistry, the Chairman of Tata Sons since October 2012 was removed as the Group Chairman after a brief stint of four years.

After Mistry's dismissal, there were calls for him to be ousted from the boards of other Tata connected companies.

In November, Mistry was dismissed as Chairman of Tata Consulting Services and then dismissed as Chairman of Tata Steel.

In December, Mistry resigned from the boards of several Tata companies before scheduled EGMs occurred, at which resolutions to dismiss him were expected.

In a private letter disclosed to the media, Mistry alleged that the Tata companies were mis-managed, that there was a lack of corporate governance and a breach by other directors of their fiduciary duties, as well as ethical concerns.

Mistry then filed a petition before the National Companies Law Tribunal (NCLT) against Ratan Tata, Tata Sons and some of its directors for oppression and mismanagement. This petition was recently dismissed although there is an appeal process that could be followed to the National Company Law Appellate Tribunal (NCLAT) and thereafter to the Hon'ble Supreme Court of India.

The Tata-Mistry battle has caused a shockwave in India, where the Tata companies have been widely regarded over the years to be amongst the best-run Indian companies and have served as a benchmark in corporate governance and ethics for all Indian companies.

The fallout and consequent litigation is expected to be a test case of the provisions in the 2013 Indian Companies Act, which came into force in 2014 and constituted an overhaul of the previous 1956 Companies Act.

The Landscape in India Relating to Corporate Governance and Directors' Duties

Over the years, there have been several high profile scandals in India, including the 2G scam, which related to bribery and corruption issues in the awarding of telecom licences amounting to an alleged loss of USD 4.6 billion and the 2009 Satyam accounting scandal alleged to be worth around USD 1.1 billion.

The 2013 Companies Act was a much-needed overhaul of company legislation and designed to enhance corporate governance standards. The changes were partly responsive to the increasingly global nature of Indian businesses, which are seeing a significant influx of international investment, including private equity investment and as Indian businesses are now significant global corporates, often with US and European exposures.

Some of the key provisions of the 2013 Companies Act include Section 166, which now expressly sets out the duties of a director, including the duty to exercise due and reasonable care and independent judgment.

Under Section 166 (2) there is now a new provision where directors have a duty to act in the best interest of a company, including for the protection of the environment.

The 2013 Companies Act now defines "*fraud*" and imposes imprisonment for up to 10 years, regardless of whether there is wrongful gain or loss. Further, Section 447 which defines "*fraud*" also provides for fines which may extend to three times the amount involved in the fraud.

The role of non-executive directors has been clarified by Section 150 (12); they can be held liable for the acts or omissions of a company, if those occurred with the directors' knowledge (attributable through the board process) and where the director consented/ connived or failed to act diligently.

A further key change in the 2013 companies' law is Section 245 which allows class action suits to be filed under company law for mismanagement/ prejudicial conduct of the company's affairs.

Suits filed before the NCLT allow claimants to seek restraining orders, as well as orders for compensation.

Partly to give confidence to investors and to enhance domestic standards, several other measures have been implemented in the last few years.

These include the setting up of a standalone Ministry of Corporate Governance and a significant increase in regulatory investigations, for example by the Serious Fraud Investigation Office.

Also, in 2016, a new Act came into force which provided for the setting up of commercial courts, designed to speed up the resolution of commercial cases (the definition of which includes insurance disputes) and which provides for active case management. This move was aimed at tackling the notorious delays in the Indian judicial system and to encourage confidence in the legal system.

D&O Insurance in India

Due to the increasingly global nature of Indian businesses, especially in the technology and business servicing/ outsourcing industries and manufacturing industries, D&O insurance has, in the last ten years become a vital purchase for Indian companies on behalf of their directors and officers.

There are often significant levels of cover purchased, especially where the company has a US exposure or attracts the remit of listing authorities/ regulators.

High profile cases such as the Satyam scandal and now the Tata case are likely to reinforce the need for directors to have adequate cover in place.

Whilst policy pricing has historically been a key determinant for policy purchases, Indian Insureds are increasingly sophisticated international players who are focused on wordings and structures. Brokers are becoming more and more innovative in ensuring that cover for directors and officers is protected, if the policy also provides for entity cover.

Conclusion

The focus by regulators on good corporate governance and transparent and ethical conduct of business is a global trend.

In light of this, we expect that claims and regulatory action against Indian companies and their directors/ officers, both in India and internationally are likely to continue to increase.

Whilst the Indian government is taking welcome steps to tackle the delays and costs associated with Indian domestic litigation, the Tata case will be a test-case for both the interpretation of the 2013 Indian Companies Act, and whether the court reforms recently introduced do constitute an improvement in the court process.

Indian conglomerates and their Re/Insurers will be watching the developments in the Tata case closely, as well as being nervous about the potential exposures that they may face.

Saudi Arabia: new class action regime proposed for claims against listed companies

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The change in leadership in 2015 and subsequent launch of Vision 2030 has led to significant economic and political reforms in the Kingdom of Saudi Arabia. In addition to these reforms, there are notable changes and developments taking place within the legislative and regulatory framework, relating specifically to the transparent management of listed companies and enforcing good standards of corporate governance.

The Kingdom has relaxed its rules on foreign direct investment, actively encouraging growth in foreign capital into listed Saudi companies. In order to support that change, a key focus of the legislators and regulators in the Kingdom is to introduce regulatory improvements which will boost confidence in the market and ensure transparency in order to attract investors. This comes at a time when the Kingdom is suffering from the depreciation of oil prices and is looking to diversify its economy. The most high profile development is the proposed initial public offering (**IPO**) of part of Saudi Aramco, which is predicted to be one of the largest IPOs in history.

In this article, we provide a general overview of the remit of the Capital Markets Authority (the **CMA**), which regulates the issuance of securities and the activity of listed companies in Saudi Arabia. We highlight some of the high profile CMA investigations and securities disputes that are ongoing in Saudi Arabia, with possible implications for D&O and professional liability Insurers.

Finally, we look at new proposed changes recently published to the existing Securities Disputes Proceedings Regulations, by which a mechanism for class action suits in Saudi Arabia is proposed. This is a significant change and the first of its kind in the onshore regimes in the GCC. We discuss the implications of this below.

The Current Regulatory Framework

The CMA was established under Chapter Two of the Capital Markets Law which was passed in 2003. The remit of the CMA includes regulating and monitoring securities, as well as the activities of issuers of securities (i.e. listed companies) in Saudi Arabia. The Capital Markets Law emphasises the need for transparent disclosure of information connected with securities to shareholders and the public.

Pursuant to Article 25 of the Capital Markets Law, a quasi-judicial court was established known as the Committee for the Resolution of Securities Disputes (the **CRSD**), which has jurisdiction over matters which arise from breaches of the Capital Markets Law, including Shareholder claims.

The CRSD can determine both civil and criminal matters and, amongst its broad powers, it can issue inter alia an award of damages, fines, an order for production of documents and restitutionary orders.

A decision of the CRSD can be appealed to the Appeal Committee for the Resolution of Securities Disputes (**ACRSD**). The decisions of the ACRSD are considered final decisions and are not subject to appeal.

Recent High Profile Matters

There has been a visible increase in investigations commenced by the CMA against listed companies, their management individuals and other parties, such as auditors. These investigations are largely related to financial or accounting irregularities and have resulted in both civil and criminal sanctions.

A high recent high profile CMA investigation took place into a Saudi Arabia based engineering, procurement and construction contractor which underwent a IPO in 2008, raising sums in the region of SAR 6.5 billion.

In November 2014, the CMA issued proceedings before the CRSD against that company and management individuals and other related parties. The CMA's case was

that misrepresentation occurred at IPO stage, so that the IPO share price was incorrectly valued. There were also allegations of actual deliberate wrongdoing on the part of some of MMG's key management individuals.

Subsequently, the CRSD banned the company's auditors, a "Big 4" from carrying out audit work in Saudi Arabia for a period of 2 years, arising from their involvement in this case.

In June 2016, the CRSD imposed imprisonment on two management individuals of the company, as well as an order to pay the sum of SAR 1.62 billion (which the CRSD considered to be the level of unjust enrichment received by the directors, following the IPO). That decision was appealed to the CRSD and upheld in February 2017, so that the convictions and orders for payment are now final and not subject to further appeal.

Another accounting scandal that has struck Saudi Arabia and has wide ranging ramifications for international insurers is the CMA investigation and ongoing CRSD proceedings (led by the CMA) into Mobily (Saudi Arabia's second largest telecoms provider) and its management individuals.

Following a revision by Mobily of its financial statements, cutting its stated profit, a well-publicised CMA investigation took place leading to proceedings before the CRSD and share trading was suspended. Consequently shareholder claims have arisen.

Given the CRSD procedures in place at the moment, any shareholder claims that arise would each have to be progressed separately by different claimants with different legal representation, at different times. This can be a significant administrative challenge for the CRSD defendant companies and their management.

The Proposed Introduction of a Class Action Suit

On 15 May 2017, the CMA Board published a draft regulation to introduce a class action regime within the CRSD and the ACRSD process.

This development is the first of its kind within the onshore GCC regimes although the DIFC Court (which is a common law system within a financial services free zone in Dubai) does have provision for a Group Litigation Order (GLO) to be made under the DIFC Court Rules.

The regulation proposed by the CMA provides that under Article 1, a suit may be filed by one or more plaintiffs "on behalf of a group of persons who share an identical or similar suit in terms of legal bases, grounds and merits".

The CRSD /ACRSD will approve a request subject to its discretion and when considering whether to allow a class action suit to proceed, consistency and fair treatment will be considered.

Under Article 5, there will need to be at least 10 requests to register a class action suit within 3 months after the announcement of the first request. Under Article 6, the CRSD/ACRSD could take the initiative to join identical or similar suits once a class action suit has been registered although a member of a class action suit could request to exit the group by way of a 30 days written notification.

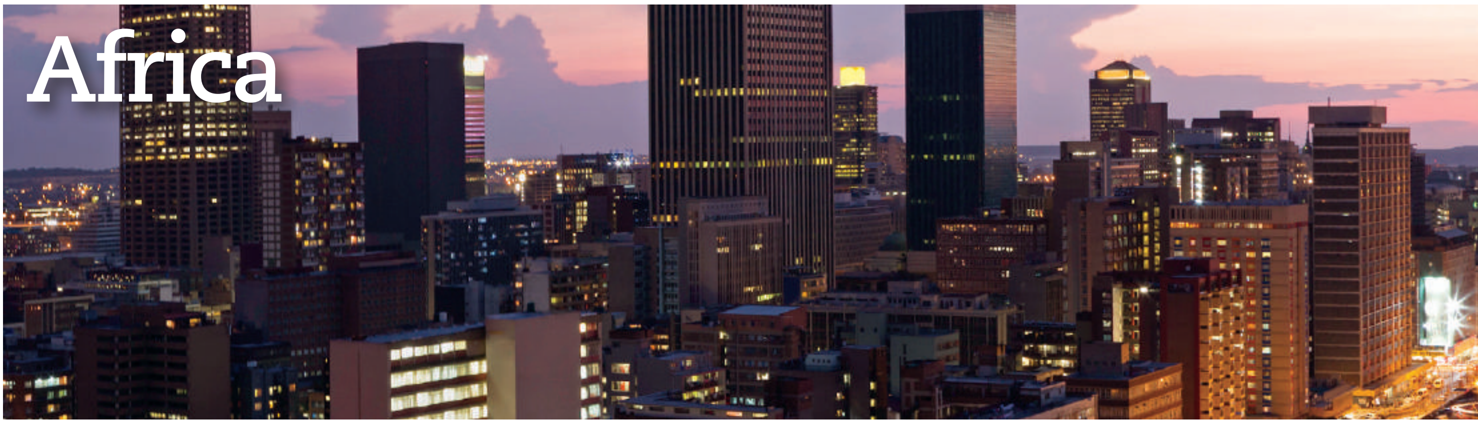
Implications and Summary

This development has various benefits and should enable more efficient management of high volumes of shareholder claims that may arise from future scandals or ongoing high profile CMA investigations involving listed companies in Saudi Arabia.

In particular, the benefit of this development in the context of the current CRSD and ACRSD proceedings is that a class action regime will mean administrative ease, uniformity of the committee's approach and uniformity in terms of the matters pleaded. It also means consistency of outcomes and judgments. This will in turn result in lower litigation costs, where one claim is pleaded and responded to (rather than multiple differently pleaded claims).

The development does however present a risk to management individuals of listed companies in Saudi Arabia, its Directors and Officers (D&O) and consequently D&O Insurers. Whilst there are great procedural advantages to a class action regime, this proposed change could signal an intention by the CMA to become even more aggressive in its approach against listed companies, such that it envisages increased shareholder action in the Kingdom. Finally, the availability of a class action regime may encourage shareholders to join and take collective action, where the costs of doing so will now be lower, if shared amongst multiple parties.

In summary, this is a notable development in this region and one which highlights the Saudi Arabian government and regulators' determination to make it a place that is (i) robustly regulated, (ii) investor-friendly, both in terms of standards of transparency but also ease of litigation.



Liability of directors for corporate environmental transgressions – a South African case study

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The risk environment for directors of companies that pollute is changing. In South Africa, a raft of recent prosecutions of directors and officers for corporate environmental transgressions bring into focus the limits of D&O cover for claims of this nature, and the importance of ensuring adequate cover is in place.

At the heart of environmental legislation in South Africa is Section 24 of the Constitution, which gives everyone the right to an environment which is not harmful to their health or wellbeing, and to have the environment protected for the benefit of present and future generations through reasonable legislative and other measures that:

(a) Prevent pollution in ecological degradation,

(b) Promote conservation; and

(c) Secure ecologically sustainable development and the use of natural resources while promoting justifiable economic and social development.

This section is given effect through the National Environmental Management Act 107 of 1998 (NEMA), an umbrella act, and a suite of sector-specific environmental acts. These include acts related to air and water pollution, land waste, biodiversity and conservation of protected areas.

The obligations and liability provisions in these acts are broad and far-reaching, particularly for directors of companies in pollution-intensive industries.

NEMA places an overarching duty of care on every person who causes, has caused or may cause significant pollution or degradation of the environment to:

> *"…take reasonable measures to prevent such pollution or degradation from occurring, continuing or recurring, or, insofar as such harm to the environment is authorised by law or cannot reasonably be avoided or stopped, to minimise and rectify such pollution or degradation of the environment."*

The legislated penalties for non-compliance under NEMA and its related acts are severe. These include fines of up to ZAR10 million, imprisonment for a period of between one and ten years, or both a fine and imprisonment.

The reach of these acts means that directors (both past and present) who occupy positions of authority in companies at the time when offences are committed by those companies may be guilty of offences, and liable upon conviction for monetary penalties, in addition to potentially having to compensate organs of state or affected third parties by way of damages for carrying out remediation, as well as the costs of the prosecution.

In a recent claim, local and foreign D&Os of a multinational industrial producer were indicted for serious air and land pollution offences by their company. Their company operated in a competitive industry with tight margins and, over a number of years, fell behind in its compliance with progressively more onerous emissions and land remediation standards.

The local subsidiary of the company did not remedy these failings despite repeated compliance ultimatums by the environmental inspection authority, with the result that the D&Os were charged with environmental offences after the local entity entered receivership. It appears likely that the indicted D&Os may receive substantial fines together with suspended sentences.

Claims were brought against the D&O policies of the local entity and its international parent. In the case of the local policy, the usual Side A & B cover was extended to include an extension for environmental impairment defence costs. This extension operates to permit the advancement of defence costs for a claim for environmental impairment (which is generally excluded from D&O cover in terms of very wide pollution exclusion clauses).

The growing risk of environmental liability for D&Os has led underwriters to offer a range of bolt-on extensions

of this nature to their standard liability wordings. These extensions generally do not extend to cover liability for fines, penalties or damages consequent upon an environmental transgression but, importantly, provide cover to affected D&Os for the costs of defence subject, to the usual D&O policy terms and exclusions.

In a similar prosecution recently reported in the press, the CEO of a waste management company was criminally charged, together with the company, for serious breaches of air quality legislation at a landfill site near Durban. He faces a maximum fine of ZAR 10 million.

These cases demonstrate that the authorities responsible for enforcing environmental compliance do not hesitate to use the personal liability provisions of legislation to indict D&Os in positions of responsibility.

The South African example is a reminder of the importance of ensuring that your D&O cover is bespoke to your risk environment. D&Os in pollution-intensive businesses would be well advised to make certain that their cover includes the necessary extensions to mitigate this risk.

Over in England & Wales, environmental considerations in the D&O sphere have been increasing as well, particularly since the Companies Act 2006 introduced a new duty on directors to *"have regard to…the impact of the company's operations on the community and the environment"* as part of a director's duty to promote the success of the company.

Many environmental offences provide that when a company is found guilty of an offence, its directors and other officers could be concurrently criminally liable. This could mean that an individual director or other officer may be tried for offences arising out of the same facts as those that give rise to the offence that the company is charged with. Generally, the regulator will have to prove that the individual director or officer knowingly caused or knowingly permitted the offence which could be challenging in large companies.

Where penalties are imposed on directors and officers, a key issue will be whether these can be recovered under a D&O policy. Of course, the first question is the policy wording. However, even if the policy positively provides cover for fines and penalties, there remains a question over whether the insurer can be required to pay out if the fines and penalties are uninsurable at law. The starting point here is often the public policy question of whether it is possible to recover an indemnity for a loss that results from your own wrongdoing, but complexities arise when one deals with conduct which is, in effect, criminal negligence.

As environmental issues and particularly the impact of climate change continue to be hot topics on the global political stage, it certainly seems like D&Os could face significant exposures in years to come from a variety of sources.

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