

## MARKET CONDITIONS AND THE RESULTS OF THE MARKET SURVEY

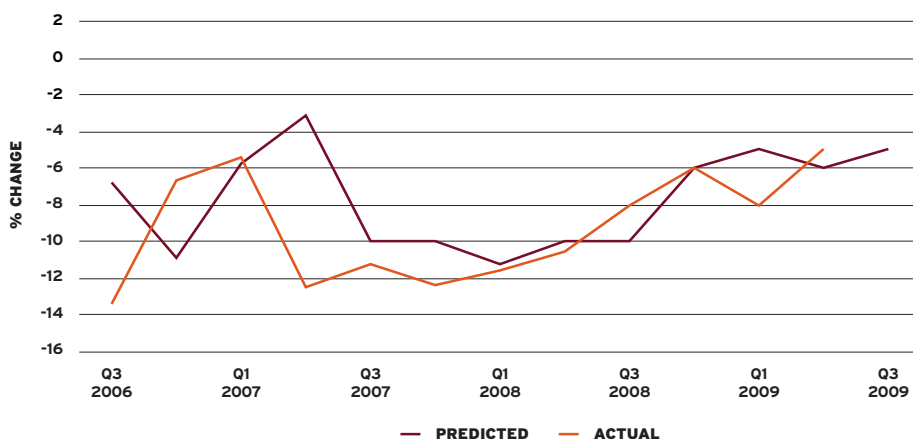
### COMMERCIAL SECTOR RESISTS RATE INCREASES

The commercial sector continues to resist the rate increases which have been seen in the financial institutions sector, with the fallout of the banking crisis yet to filter through into significant claims. The commercial market continues to benefit from significant capacity for business domiciled outside of the USA, with new entrants into the market providing significant excess competition.

Over the last three months insurers reported an averaged premium reduction of 5% on renewal business which was less than the 6% reduction predicted prior to the year-end reinsurance renewals, while the outlook for the next three months is for continued reductions of around 5%.

Policy coverage remains extremely broad, although we are experiencing an increased level of underwriting analysis meaning that it is essential to begin renewal negotiations early in order to effect a timely renewal – particular attention should be paid to information which insurers ask to be disclosed – specifically all forms of No Claims Declaration should be avoided on all renewal business.

### PREDICTED VS ACTUAL RATE CHANGE



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# TOUGHER ACTION BY PROSECUTORS PUTS DIRECTORS AND OFFICERS AT INCREASED RISK

**BY HICKMAN & ROSE SOLICITORS**

As global banking and finance systems face the abyss, there are calls for tougher action by prosecuting agencies against both the fraudulent and the reckless. The public mood is grim and arrest for workplace offences is an increasing risk.

The regulatory agencies are flexing their muscles. The Financial Services Authority is gaining new powers and additional funding, doubling the resource allocated to insider trading. In March this year inhouse lawyer Christopher McQuoid received Britain's first prison sentence for insider dealing. Similarly, in 2008 the Office of Fair Trading obtained its first convictions for bid rigging, sending three executives to prison and barring them from directorships for periods of five to seven years. With the government still smarting from the BAe debacle, there could well be face saving prosecutions for overseas corruption in the months leading up to the next election. The City of London police have been beefed up with extra staff to deal with fraud.

Meanwhile the law keeps getting tougher, with new offences including corporate manslaughter, committed by companies. This power to prosecute a company does not cut the risk to the individual director or employee. Rather it creates a ripe strategic environment for police in pursuit of a suitable corporate defendant to arrest senior staff who may then be subject to exhaustive questioning. Once that is done, both will be defendants. On June 17 this year, Cotswold Geotechnical Holdings Ltd. appeared in court charged with corporate manslaughter alongside its sole director Peter Eaton who is charged with gross negligence manslaughter. If the prosecution win this case, we can expect a pincer movement taking company and directors down together to be repeated.

For many professionals the big fear is money laundering. This offence is horribly easy to commit by doing nothing. People under pressure, worn out by the need to report every single suspicious transaction down to the last fiver, only need to fail once to face arrest. In July 2006 Phillip Griffiths, a solicitor who let the wrong conveyancing transaction slip through the net, found himself serving an 18 month sentence for failing to disclose a suspicious transaction.

Many potential corporate defendants also face the impact of the U.S. legislation. A directorship of, for example a small U.K. subsidiary of a New York brokerage firm could expose an individual to an extradition request from the U.S. Attorney for the Southern District of New York – the functional equivalent of our Serious Fraud Office. Just as serious, the U.S. Securities and Exchange Commission can and does use the Foreign Corrupt Practices Act to prosecute individuals



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and companies in countries which recently have included Nigeria, Mexico, Saudi Arabia, France and the U.K.

Even more alarming is the decision of the United States Supreme Court in 2005 (**Pasquantino v United States**), a 'wire fraud' case where tax evaders were tried, convicted and imprisoned by a Maryland court because they had evaded Canadian tax laws. The U.S. claimed jurisdiction on the basis that the conspirators had made a phone call on U.S. soil. Anyone who does business with the U.S. should beware.

U.S. authorities have a Rottweiler quality which makes their use of so-called 'long-arm' powers a terrifying prospect. The U.K. – U.S. extradition agreement just opens the door and sends you off on a one way flight. At worst, you can actually be kidnapped. During a hearing in 2007 in the Court of Appeal, Lord Justice Moses asked Alun Jones QC, representing the U.S. government, about its treatment of U.K. citizen Gavin Tollman, head of holiday company Trafalgar Tours. U.S. federal agents attempted to abduct Tollman during a visit to Canada in 2005. 'If you kidnap a person outside the United States and you bring him there, the court has no jurisdiction to refuse it,' said Jones. The rule is said to date back to bounty hunting days in the 1860s. Extraordinary rendition for errant bankers is a chilling thought.

Anyone facing investigation in either country therefore needs the best advice. But how can that be funded? If the investigator starts by freezing an individual's assets, the uninsured detainee is cast onto the mercy of the publicly funded system. Public funding pays a lawyer a fixed fee for advice in a police investigation of around £300. (Not the hourly rate, but the total fee for the first 18 hours after which anything further earns £60 an hour). This rate is deeply

unattractive to lawyers versed in corporate arrangements. In reality, most publicly funded police station advice is delivered by unqualified paralegals. The best of them do a good job advising on police station strategy in U.K. law, but do not know when good advice in Britain may open the door to prosecution in the U.S. Since it was co-operation with U.K. police which resulted in the extradition of the Nat West Three to Texas, this is worth remembering.

It is even worse in court. The legal aid rate for serious matters is graduated according to page count and trial duration. For example, a solicitor preparing a two week trial with 500 pages of 'used' prosecution evidence and 10,000 pages of 'unused material' receives £3,902 plus VAT. The Legal Services Commission boasts that this is a quality assured service but critics say that this charging structure cannot provide for proper representation and point to the top criminal firms which charge up to £400 an hour and would probably spend a hundred hours or more on a case this size.

There is therefore an argument for paying an experienced lawyer to give the matter personal attention, even though it is expensive. Currently, people acquitted of criminal charges have their legal costs reimbursed in full. But the MOJ has been quietly consulting on how to cut the costs being paid to acquitted defendants. The Minister for Legal Aid, Lord Bach, announced on June 8 that a new scheme would apply from January 2010, limiting acquitted defendants to legal aid rates when they recover costs.

An innocent defendant who sidesteps the state scheme may therefore face a colossal bill, no matter how heinous or irrational the conduct of the prosecutor. Those without insurance must therefore ask themselves – is it better to take a low cost lawyer and maybe go to prison, or aim to improve the odds with the expensive one? You might pay privately and lose anyway. Interestingly, such a decision is aptly termed by economists 'the prisoner's dilemma'.

It would therefore be a brave soul who undertakes a senior post or a directorship without knowing suitable insurance is in place to meet the cost of criminal and regulatory investigations. This is the moment therefore to dust off the D&O policy and consider whether it does what it says on the tin. The insured directors of any company should consider collectively and without delay whether their brokers have done the best they can. 'Without delay' because D&O insurance works on a 'claims made' basis – i.e. it only covers insured events occurring while the policy is current. If you change insurers or terms, you may find past events which come to light are excluded. Directors need to act now, before that hand falls upon their shoulders.

An important provision to check is the fraud and dishonesty exclusion, of which the most innocent director can fall foul. In general, a deliberate criminal act will normally invalidate the wrongdoer's liability insurance, as may a reckless act in some circumstances. But such a clause should be able to invalidate the insurance only once a final adjudication has been made and a finding of fraud upheld by a court. And a finding of fraud against one director should not bar the making of assistance to his colleagues.

Where there is final adjudication, matters will be clear. But in an increasing number of criminal investigations the prosecuting authorities can be satisfied by a compromise. In such cases, the burden of proving dishonesty, fraud or malice will normally rest with the insurers. This burden will be more than the normal balance of probabilities, and the greater the fraud alleged the higher it will be. Advice from a lawyer used to operating in this environment is critical if the suspect is to get the best outcome both in the criminal justice system and from their company's insurance policy. Otherwise the suspect may not be prosecuted but will face an enormous bill.

But employees must note that it is not enough for the company to buy the insurance. Senior employees must ensure that the right to payment of legal costs is in their contract of employment or partnership agreement as well as in the policy itself. Otherwise it is perfectly possible for companies to withhold access to the insurance, or even conceal its existence.

This has been illustrated vividly in a recent prosecution across the pond. The case of **Stein v U.S.** [S.D.N.Y. 2007] has been described as 'the perfect storm'. The U.S. government permits companies which co-operate with investigators to avoid criminal penalties, and set this out in writing in the 'Thompson Memo'. (The U.K. takes a similar stance across the regulatory piste, but not in a single published policy document).



In 2002 KPMG LLP came under investigation by the U.S. Inland Revenue Service for the 'largest tax fraud case in United States History'. KPMG retained law firm Skadden, Arps, Slate, Meagher and Flom LLP to help with this co-operation process and to shift the focus to its employees who included Jeffrey Stein, KPMG deputy chairman. KPMG and 16 senior employees were all charged. The prosecution met with KPMG lawyers and raised the question of reimbursing employee legal fees, referring to a warning in the Thompson memo 'misconduct should not or cannot be rewarded'. Shortly thereafter KPMG's lawyers told the prosecutors that legal fees would be limited and their payment conditional on employees' full co-operation. In May 2005 KPMG cut off Jeffrey Stein's legal fees altogether.

In August 2005 KPMG and the government entered into a deferred prosecution agreement (DPA), under which KPMG and its employees admitted what they had done. KPMG was not prosecuted, but this left the sixteen employees facing trial in the New York Southern District Court. At this point the employees won a ruling that the government's interference with the right of defendants to legal assistance was unjustified. Later on the Court made a further

ruling that DPA statements made by some defendants had been coerced by threat of stopping legal payments. The case against 13 of the defendants was dismissed. Since then there has been widespread criticism of the Thompson Memo, resulting in its amendment.

The case of **U.S. v Stein** has clarified matters for defendants in the U.S., but the position is substantially less clear in the U.K., which attaches similar importance to the settlement of investigations outside Court. Conflict (in the legal sense) between the interests of the company and its employees in this scenario is inevitable. So what is it best to do? Some now argue that senior employees and directors would be well advised to carry their own insurance. This is particularly so for those who have several directorships and need to cover a variety of situations.

In summary, any senior employee or director who is arrested and in the police station will have the right to cheap and cheerful legal advice at public expense, probably from a paralegal. But only a specialist who has a firm grip on media relations, the implications upstream for the company, and knows both U.S. and international human rights law, is likely to give a senior member of staff the best advice. This is where a properly tailored D&O policy is crucial, along with the number of a real expert in corporate crime.

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## MEET THE TEAM

### NICK WILSKI

Nick joined FINEX in September 2008 as a graduate, having completed an M.A. degree in Middle Eastern Studies at the School of Oriental and African Studies. He joined the D&O team in March 2009 and is an account executive focusing on Directors' and Officers' Insurance, Pension Trustee and Employment Practices Liability. His primary focus is on advising clients in the U.K. and Europe on their exposures and insurance solutions, and negotiating cover on their behalf.

Nick has been learning Arabic for three years, having previously worked in Sudan and Lebanon, and is now trying to master Russian. In his spare time he enjoys travelling and has recently developed an interest in boxing.

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