Pollyanna Deane's insurance column: June 2018

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In her column for June 2018, Pollyanna considers D&O insurance and corporate governance in the light of the report on the collapse of Carillion produced by the Work and Pensions and BEIS Committees, the FCA's finalised guidance on Part VII insurance business transfers (FG18/4), and recent developments relating to good faith.

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D&O insurance and corporate governance

The Carillion collapse and its attendant *report* highlights both the current regulatory focus on corporate governance and the implications for senior management and their D&O insurers of getting it wrong. The report's findings and proposals on culture and governance will be of interest to all firms subject to current or upcoming scrutiny from government and regulators concerning their culture and corporate governance, including firms in scope for the upcoming extension of the senior managers and certification regime (SM&CR). The report urges investigation into the role of Carillion's former directors, and that action be taken accordingly in respect of any breaches, including disqualification as a director. The Carillion board is assessed as having been unaware of the full nature or scope of their duties, and either "negligently ignorant of the rotten culture at Carillion or complicit in it". Their failures include:

- The pursuit of "short-term gains over the long-term sustainability of the company", funding expansion through rising debt, ignoring a rising pension deficit, with "scant regard for long-term sustainability or the impact on employees, pensioners and suppliers".
- A climate of "misguided self-assurance" and an excess of optimism of senior board members.
- A failure of other board members to scrutinise or challenge "reckless executives".
- Ignoring or overriding internal peer reviews that raised concerns about the financial position of particular contracts.
- Using "aggressive accounting practices" to recognise as much revenue upfront and present an overly positive picture of the financial position.

The content of the report supports a belief that any claims against the directors and officers relating to their own conduct (for example, from shareholders) are likely to fall within the standard definition of "wrongful act". Bearing in mind the potential losses and the costs that may be incurred in relation to the recommended potential investigations, the limits of indemnity and apportionment may become areas of focus for both insurers and insured persons.

With the case of *Woodford v AIG Europe Ltd and another [2018] EWHC 358 (QB)*, we saw the first D&O case reported in the UK for years. Briefly, the policyholder of a D&O insurance policy had not had knowledge of alleged breaches of duty by its directors until after the policy's coverage start date. It had not breached its duty to the insurer to provide information, so the insurer was not entitled to decline cover. The directors were, therefore, entitled to claim against the insurer for their legal expenses of defending against the policyholder's claim. Their expenses were reasonable and were awarded on the indemnity basis as required by the policy. The insurance policy indemnified the insured against losses suffered arising out of their role as directors, including legal costs. The policy was in German and subject to German law, so the case is perhaps not as UK-focused as it might have been. Nevertheless, there is recognition for the fact that D&O policy claims are complex and rarely straightforward.

The really knotty problem that HHJ Moulder ducked by making a finding of fact that the policyholder did not have knowledge of the alleged breach is whether it is possible for a director to be deprived of cover under the D&O policy by virtue of the policyholder having knowledge that the director concerned does not. It would seem wholly unfair if an innocent director (who was unaware that such a breach had occurred) found itself deprived of cover because of that, and at a time when the cover is so clearly required. Clearly, there are questions of knowledge where one director knows and another does not and how knowledge is acquired by a company. But given the onerous liabilities that a director takes on by virtue of its appointment, and the reassurance that a D&O policy is supposed to give, doesn't it mean that a director would be subjected to considerable disquiet if it cannot then rely on the D&O cover being available? Had this case addressed the question it would have been a much more interesting decision.

FCA final guidance on Part VII transfers

A depressingly large *document* has emanated from the FCA covering its guidance on Part VII transfers (FG18/4). It is fair to say that what were once some of the most fun things that any corporate insurance lawyer could be involved with have become joyless, expensive procedures that suck any pleasure out of the idea of a reorganisation (to the extent that there ever was any). Many firms, understandably, now do everything that they can to avoid the process and the latest guidance goes no way towards improving the situation. The best thing that the FCA could have done was to recuse itself from participation, enabling the PRA to lead and perhaps, behind the scenes, cover off anything that might interest the FCA, because of its slightly different objectives and the competition aspects. What the FCA can add in terms of checking the independence of the independent expert (IE) is minimal at best, and if the PRA isn't capable of checking that, one has no hope for the financial aspects of any Part VII. One positive – the FCA doesn't appear to seek to check the prudential aspects of the deal, though it does want to consider the resources available for the transfer. The dumbing-down of the IE report is regrettable. Boards may struggle to understand their actuaries at times, but the IE report has now got to satisfy the policyholders' understanding as the FCA sees it. Can't we rely on the Financial Reporting Council's (FRC) principles for technical actuarial work (TAS 100) requirement for actuarial communications to be "clear, comprehensive and comprehensible so that users are able to make informed decisions understanding the matters relevant to the actuarial information" - after all, the actuary's professional requirements are paramount and they already need to do this – do we really need the FCA to get involved?

Additionally, the FCA is going to be considering the expert evidence and technical actuarial guidance (the FRC's technical actuarial standards (TAS)) in its review of the IE report – well isn't that something you'd be likely to expect the PRA to do and be better equipped to do so? There's no merit in duplication of regulatory effort. I suppose we should be grateful that the FCA stops short of telling the Court what it must do – though there are enough hints throughout that there is something of a frustration there. Potentially unrealistic expectations of the Financial Ombudsman Service (FOS) appear. I was amused to see at paragraph 5.7 that reference should be made in the Scheme to the FCA's Dispute Resolution: Complaints sourcebook (DISP) provisions setting out the scope of the FOS' jurisdiction, as much, I suspect for the FCA's benefit as for anyone else, given the expectation outlined at paragraph 6.12 that the FOS' jurisdiction is expected to be preserved, notwithstanding sometimes that being impossible.

The entire framework appears over-wrought and burdensome to those it is meant to assist, which is a tremendous shame and the FCA's guidance a severe case of overkill. My views on the guidance have not changed from my column in June 2017 (see *Article, Pollyanna Deane's insurance column: June 2017*).

Good faith: further developments

I've commented before on the removal of the duty of "utmost good faith" under the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) and Insurance Act 2015. I would further suggest, following on from various conferences in March that I attended, that there is a bleakly ironic view in the industry that just when insurers might need the protections that such a duty offered once again (particularly in areas such as health insurance where an insured may well know rather more about their state of health than an insurer could be expected to, right down to their genomes), we see the concept of good faith being introduced back into the law of contract by Leggatt J (as he then was) first of all, in the case of *Yam Seng PTE Ltd v International Trade Corporation Ltd* and then in the case of *Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Ioannis Kent (AKA John Kent)*.

While the English courts have previously been reluctant to consider introducing the concept of an implied duty of good faith into English contract law, the *Tahnoon* case expands on *Yam Seng*, and determined that because the contract in dispute was a "relational" one, it was therefore "essential that a duty of good faith be implied into it in order to give effect to the parties' reasonable expectations, …". Leggatt J was unable to define precisely what the implied duty of good faith might require – noting that "It is unnecessary and perhaps impossible to attempt to spell out an exhaustive description of what this obligation involved." This one-man crusade may have to be taken seriously as Leggatt J has since been elevated to the Court of Appeal and will, no doubt, be keen to continue to promulgate the concept of an implied duty of good faith in contracts from there.

To what extent an insurance policy might be considered "relational", especially given the tendency and trend much advocated by the FCA to shop around, is moot, but I would argue that there are some commercial insurance and reinsurance treaties that might be considered relational and it's worth noting that commercial contracts involving a long-term relationship might have the concept of good faith (re) introduced. Is it worth excluding or adopt a "wait and see" approach?

As we all know, insurers have tended to assume that the duty of utmost good faith no longer works in their favour and have introduced questionnaires and extensive fact-finding exercises, at least in the retail end of the sector, to mitigate the risks occasioned by its loss. To what extent is this (re)introduction something that they would be concerned about? It's never going to replace the stronger "utmost good faith" test and it's not specifically concerned with insurance, but it does ask questions of long-term contractual relationships. Interesting if a reinsurer and reinsured are better protected in their dealings with one another than an insurer and insured.