

LONDON
ONE HUNDRED
WHITE PAPER

September 2011



A question of balance

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Government intervention in business – is the balance right?



Regulation is there for a purpose. When created and implemented effectively, it provides consumer

protection and market stability, combats corruption and promotes transparency and competition. However, many would argue that government intervention has become increasingly frequent and intrusive in recent years, to the detriment of businesses' ability to operate effectively.

Anti-corruption measures

Take the Bribery Act 2010, which came into force on 1 July 2011. Concern has been expressed about its effect on the competitiveness of UK businesses in foreign jurisdictions, particularly emerging markets. Some claim the legislation is badly drafted and could criminalise innocuous activity, and even standard (re)insurance market practices.

The offences

The act is part of an effort to ensure a culture change in which UK companies no longer regard the payment of bribes in certain jurisdictions as a regrettable fact of life, but would forego business rather than do so. Indeed, in a manner reminiscent of the money laundering legislation, it effectively compels businesses to become self-policing. Its major innovation is the introduction of the corporate offence of "failure of commercial organisations to prevent bribery". A commercial organisation will be criminally liable if a person "associated with" it bribes another intending to obtain or retain business, or an

advantage in the conduct of business, for the organisation, irrespective of whether the organisation itself has any knowledge of the bribe. A person is "associated with" a commercial organisation if he or she carries out services for it or on its behalf. The obvious examples are employees and agents, but the definition is elastic and each case will turn on its own facts. The only defence – apart from contesting the facts – is for the organisation to show that it had in place "adequate procedures" designed to prevent associated persons from committing bribery.

The key concept is the act's definition of a bribe as a financial or other advantage intended to induce or reward the "improper performance" of a person's function or activity where, very broadly, any personal benefit to the recipient could create a conflict between his own interests and the interests of those he is supposed to be serving. Anyone with a "close connection" with the UK (e.g. a British citizen or long-term resident) can be prosecuted here wherever the alleged bribe took place and the act expressly excludes any appeal to local custom or practice (in, for example, a country where backhanders are accepted as the norm) by way of defence.

Alarmists suggested the definition was sufficient to criminalise the entire machinery of corporate hospitality, but the guidance published by the Ministry of Justice on 31 March 2011 emphasises that this was never the government's intention. It confirms (as various informed sources had been saying for some time) that "reasonable and proportionate" expenditure is unlikely to engage the attention of the Serious



Fraud Office or the Director of Public Prosecutions. Even so, the fact that a payment is reasonable and proportionate will not prevent a prosecution if there is positive evidence that the payer intended to induce improper performance, and commercial organisations will still need to set criteria for hospitality payments in their anti-bribery procedures.

The act's second key innovation is introducing the separate offence of "bribing a Foreign Public Official [FPO]". This offence is committed where a person offers or provides a financial or other advantage intending to influence the FPO and to obtain or retain business or an advantage in business (unless the FPO is permitted or required by the local written law to be influenced by the inducement). What is distinctive about this new offence is that, in contrast to the general offence, the prosecution does not have to show any intention to induce improper performance. The benefit, coupled with the intended advantage, is enough. This has been criticised as sweeping and draconian.

The guidance explains that the requirement of an intention of improper performance was excluded because, in countries where corruption is rife, it would be very difficult for prosecutors to prove what a local official's functions were. It was preferable therefore to define the offence broadly rather than risk stymieing justifiable prosecutions because of evidential difficulties. Nonetheless, it says, the act is only intended to bite where actual or intended improper performance arises and the prosecution would need to show a "sufficient connection" between the payment and the intended advantage.

Another effect of the formulation of this offence is that it catches facilitation payments – payments made to officials to ensure they perform, or perform more

quickly, steps that they are in fact under a duty to carry out in any event. The guidance accepts that in many places small bribes to facilitate government action are a fact of life that cannot be eradicated without a culture shift. However, it makes no attempt to limit the act's application to such payments. Rather, the expectation is that businesses' procedures will provide for such payments to be challenged and resisted. Facilitation payments obtained by extortion are not excluded from the ambit of the act, but as the guidance points out, an individual who makes a payment under pressure may well have a defence of duress. Beyond that, it will be a matter of prosecutorial discretion.

Adequate procedures

In order to defend a prosecution under the act, organisations will have to show that they had in place "adequate" anti-bribery procedures. What does this mean? The act itself is silent. The guidance offers six principles that a business can adopt to shape its procedures:

- proportionality: procedures are to be "proportionate" to the risks an organisation faces and the nature, scale and complexity of its activities;
- top level involvement: the board and senior management will embrace the philosophy and promote the procedures;
- assessment of an organisation's nature and its exposure to bribery risks;
- due diligence should be conducted on business partners, including investigation of their track record and their own anti-corruption standards;
- effective communication of the procedures, including staff training; and ongoing monitoring and improvement.

As the guidance is at pains to point out, the act's intention is not to criminalise ethically run organisations that face



isolated instances of bribery. But the flip side is that such organisations will need to have adequate anti-corruption procedures in place. Failure to do so will place businesses at serious risk, as the penalty for a corporate offence is an unlimited fine, and the indications are that the courts will be prepared to consider fining a guilty company into extinction if it is perceived to represent an ongoing corruption risk.

A comparative analysis

How does the act compare with anti-corruption regimes in other jurisdictions where (re)insurance is a major industry or emerging force? The following table has been compiled from data and information collated by the global anti-corruption coalition Transparency International:

The US Foreign Corrupt Practices Act (FCPA) was previously considered to be one of the most stringent pieces of anti-corruption legislation in the world. However, in some respects the Bribery Act 2010 goes much further.

Country	OECD signatory? [*]	Adequacy of legal provisions	Adequacy of enforcement measures
Brazil	Yes	Significant inadequacies, e.g. no criminal liability except in case of environmental crimes. The only sanction applicable to companies found guilty of corruption is ineligibility to participate in bids for government contracts. Corporations not held responsible for subsidiaries, joint ventures and other agents	Police have insufficient manpower, training, equipment and motivation to fight bribery and related crimes
China	No	Signed and ratified UN Convention against Corruption (requires signatories to criminalise foreign bribery) but not yet enacted legislation. Lacks centralised anti-corruption legal framework	No foreign bribery enforcement system. Domestic bribery enforcement system inadequate, e.g. lack of training for investigators
France	Yes	Several inadequacies, e.g. short duration of statute of limitation (3 years for all corruption offences)	Key weaknesses include inadequate resources. Fines not always enforced
UK	Yes	Bribery Act “greatly improves” legal framework for foreign bribery prosecutions	Enforcement system “improved considerably” in recent years and will be strengthened by Bribery Act
US	Yes	No significant inadequacies	No significant inadequacies

^{*} OECD Convention on the Bribery of Foreign Public Officials in International Business Transactions

For example, in contrast to the FCPA, the Bribery Act applies to both public and private sector corruption. Unlike the FCPA, it makes companies criminally liable for the acts of third parties, including employees and joint ventures. It is also worth noting that the FCPA exempts “facilitating” payments from criminal and civil sanctions for corruption. Many developed countries, including G8 members, have significantly less strict regimes than the UK – and the enforcement procedures are often inadequate.

Sanctions regimes

Perhaps it is unfair to cite international trade sanctions as an example of government taking a heavy-handed approach to regulation. After all, it is not difficult to understand the rationale for such measures. However, ensuring compliance is becoming increasingly burdensome.

It is outside the scope of this White Paper to consider in detail all the provisions under the various UN, US and EU sanctions that may affect the insurance and reinsurance industries. These continue to proliferate; at the time of writing, sanctions had recently been introduced in response to the developing situations in Libya and Syria. We will focus here on the impact of the EU sanctions against Iran.

The latest sanctions (at the time of writing) are contained in Council Regulation (EU) No 961/2010. The regulation entered into force on 27 October 2010. The sanctions imposed are far wider in scope than those previously in place against Iran and contain specific provisions relating to the provision of insurance and reinsurance to Iranian entities. Article 26 provides that: “1. It shall be prohibited:

- (a) to provide insurance or reinsurance to:
 - (i) Iran or its government, and its public



- bodies, corporations and agencies;
 - (ii) an Iranian person, entity or body other than a natural person; or
 - (iii) a natural person or a legal person, entity or body when acting on behalf or at the direction of a legal person, entity or body referred to in (i) or (ii).
- (b) to participate, knowingly and intentionally, in activities, the object or effect of which is to circumvent the prohibition in point (a)."

Article 26(4) of the regulation "prohibits the extension or renewal of insurance and reinsurance agreements concluded before the entry into force of this regulation, but... it does not prohibit compliance with agreements concluded before that date".

Issues for (re)insurers and brokers

The regulation gives rise to a number of issues for (re)insurers and brokers. For example, Article 26 prohibits the extension or renewal of (re)insurance agreements concluded before 27 October 2010 but expressly does not prohibit compliance with those concluded before that date. In some cases, however, the terms of the contract agreed prior to 27 October 2010 may oblige a (re)insurer to accept additional risks incepting after that date. Is this permitted? This issue was addressed, in part, by the Court of Appeal's decision in *Arash Shipping v Groupama* [2011] EWCA Civ 620. Groupama (and the following market) provided hull and machinery risks insurance to Arash Shipping, operator of the National Iranian Tanker Company. The policy incepted in May 2010 (pre-regulation) and was for a 12-month period. It contained a clause giving insurers the right to cancel where "the Assured has exposed or may, in the opinion of the Insurer, expose the Insurer to the risk of

being or becoming subject to or in breach of any sanction... in respect of Iran..." There was also a "Review Clause" providing for automatic renewal on unaltered terms provided the "Credit Balance" was below a specified threshold.

In April 2011 (post-regulation), Groupama served notice of cancellation and some of the other insurers did likewise. Arash issued proceedings requiring Groupama itself and as representative of the other cancelling insurers to comply with the Review Clause.

There were two questions for the court. Firstly, was the extension prohibited by Article 26(4) (Issue 1)? Secondly, was Groupama entitled to serve its notice and was the notice effective (Issue 2)? At first instance Mr Justice Burton had answered both in the affirmative.

As to Issue 2, the Court of Appeal held that Groupama was entitled to give notice as long as it exercised its discretion in good faith and on grounds that could not be challenged for "Wednesbury unreasonableness" (i.e. so unreasonable that no reasonable person acting reasonably could have made the decision). It was impossible, said the court, to accept that Groupama could not reasonably have formed the opinion that the extension would expose it to the relevant risk, one factor being that HM Treasury had advised it did not consider automatic renewal to be permitted under Article 26(4). The court's clear conclusion on Issue 2 rendered Issue 1 academic.

A number of points arise from this decision. Firstly, it is important to note that not all sanctions clauses operate by vesting in the insurer a right to cancel, wise though that seems to be. Others in use appear only to suspend performance – an approach less likely to provide certainty for the parties, which is a consideration that the Court of Appeal noted as important.



Secondly, Groupama was sued both in its own right and as a representative of the following insurers. The court made it clear that it was for each insurer to serve its own notice of cancellation. The validity of any such notice may depend on their individual opinion as to whether they were exposed to the relevant risk. Finally, the court refused to entertain Arash's contention that Issue 1, even if now academic, should be determined since it was of general concern to the insurance market. Lord Justice Tomlinson did, however, indicate his preliminary view that Burton J had been correct to hold that Article 26(4) prohibited any extension or renewal of insurance contracts in existence prior to the regulation being implemented.

Practical steps

In addition to the use of sanctions clauses, there are additional practical steps that (re)insurers should take to protect themselves against the risk of being found in breach of the regulation. For example:

- due diligence should be carried out both prior to and during the life of the contract. Prior to inception, (re)insurers should make enquiries to ensure that they are not (re)insuring persons or entities that are prohibited under international sanctions legislation. Post-inception, controls and checks should be in place to ensure that claims payments and return premiums are not paid to sanctioned persons/entities;
- by devising and implementing specific sanctions compliance policies; and
- by training staff.

The knowledge defence in Article 32(2) of the regulation protects (re)insurers, provided they have carried out their due diligence requirements properly. Article 32(2) states the prohibitions will "not give rise to liability of any kind on the part of

the natural or legal persons or entities concerned if they did not know, and had no reasonable cause to suspect, that their actions would infringe these prohibitions".

Compliance with international trade sanctions is a significant issue for all commercial organisations and the (re)insurance industry is no exception. The complexity involved should not be underestimated and the cost can be significant.

However, the cost of non-compliance can be even greater; breach of the raft of regulations in place may result in risk enforcement action or prosecution, hefty fines and reputational damage.

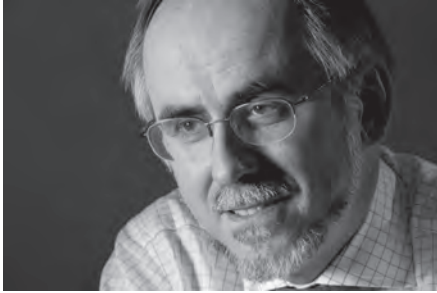
Conclusion

Business, and society as a whole, would not function without regulation. However, it is a question of balance. UK businesses – including insurers, reinsurers and broking firms – are arguably subject to some of the world's most stringent and most actively enforced regulatory regimes. The burden of complying with an ever-expanding legislative and regulatory framework is significant, both in terms of management time and cost. This potentially has a deleterious effect on the competitiveness of UK businesses in foreign jurisdictions, and particularly in emerging markets. It is perhaps no coincidence that the axis of the (re)insurance industry is gradually turning away from London, the US and Bermuda and towards the Asia-Pacific region, where regulation is generally less extensive and certainly less enthusiastically enforced.

It is understandable, even laudable, that governments should want to provide consumer protection and market stability, to combat corruption and promote transparency and competition. But perhaps the message from (re)insurers industry would be "don't kill us off in the process!"

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As a member of the Insurance Business Group Andrew Ottley has in-depth experience of professional liability claims across a range of professions including accountants, architects and engineers, insurance brokers, and surveyors, but most notably solicitors. This emphasis has in turn led to involvement in risk management, anti-money laundering and other regulatory areas.

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Recent cases include Standard Life Assurance Limited v Oak Dedicated Limited & Others, relating to Financial Institutions liability cover and involving the aggregation of third party claims, policy construction and broker negligence.

He also has experience in reinsurance, directors and officers' cover and policy drafting.



Michelle Linderman joined Ince in 1997 and was seconded to the Hong Kong office in 2001. After returning to London in 2004 she became a partner in 2007.

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