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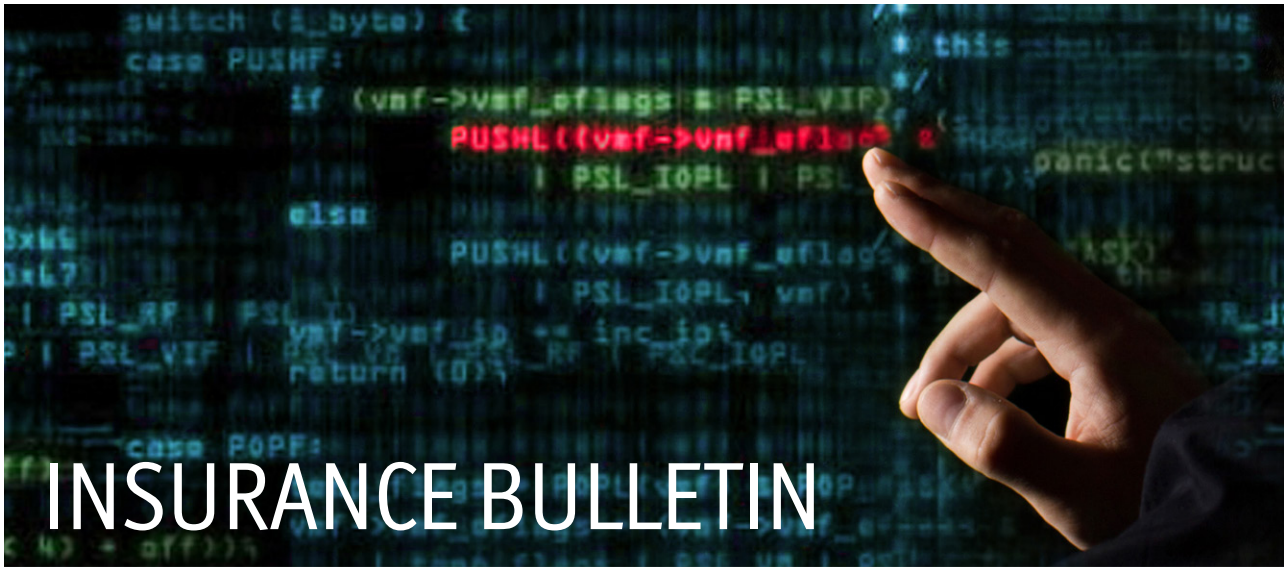

INSURANCE BULLETIN





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1. Regulation and legislation

UK: What should the role of government be in managing cyber risks?

The cyber insurance market has made substantial progress in recent years in developing products and insurance-backed services to help their clients manage their exposure to "cyber risks", ranging from theft of client data or intellectual property to the paralysation of critical business systems.

The industry's progress in this regard is the result of its having worked with insureds, in many sectors, to develop products to meet their needs. However, this has been a challenging process, not least because the threat evolves so quickly.

Whilst the products that the industry is now offering are, in some respects, quite sophisticated, serious doubts remain as to whether it can afford to offer cover for the most serious cyber risks, such as a massive accumulation or aggregation of losses arising out of disruption of critical infrastructure or coordinated attacks on or failures of cloud providers.

Furthermore, in some cyber insurance markets, there may be a tension between insurers' desire to work with their insureds to engender strong risk management on the one hand, and the insured's desire to lay off its cyber risk at a lower cost than it would incur to upgrade critical systems to harden them against cyber attacks.

In the light of these concerns, some market participants have renewed calls for the government to provide a backstop, similar to those in place for terrorism risks. They argue that the potential magnitude of some cyber risks and the potential for significant accumulations of losses present risks so great that they cannot be absorbed by the capital of insureds and insurers alone.

If a government backstop is implemented, it must be implemented properly, so as to allow the industry to do what is does best whilst still ensuring that the security of the economy is adequately protected.

There is obvious force in these arguments. However, others in the market are more circumspect, arguing that the case has yet to be made as regards the necessity for a government backstop.

It is suggested that cyber does pose risk of a magnitude that is potentially greater than the capacity the existing cyber market can absorb. However, critics of the government backstop proposal are probably right that the nature and scope of such potential cyber catastrophes must be analysed and articulated more cogently before the case for a government backstop is made out. Further, that, if a government backstop is implemented, it must be implemented properly, so as to allow the industry to do what is does best whilst still ensuring that the security of the economy is adequately protected.

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2. Court cases and arbitration

England & Wales: *Denso Manufacturing UK Limited v Great Lakes Reinsurance (UK) PLC* – ATE Insurance Considered

This case arose from an underlying claim by a company called Mploy against Denso, which resulted in an adverse costs order against Mploy.

Mploy went into liquidation and its rights under an ATE insurance policy were assigned to Denso under the Third Parties (Rights against Insurers) Act 1930. Denso offered to accept £210,000 in respect of its costs on the basis that it would seek detailed assessment in the absence of response. Mploy's liquidators failed to pass this offer onto the ATE insurers for two months. They also failed to pass on two subsequent chasers, notify insurers that detailed assessment had been commenced or to respond to the offer, which resulted in Denso obtaining a costs order for £300,000. The interesting issues in this case concern the court's consideration of the conditions precedent in the policy.

The insurers refused to indemnify Denso, relying on the following breaches of contract:

- There had been a breach of a condition precedent requiring Mploy to cooperate in claims and provide information. Specifically, the policy required the insured to *"advise [insurers] in writing as soon as an offer to settle... is made"*.
- There had been a breach of a condition precedent to pay premium.
- Cover was excluded by the application of five separate exclusions in the policy.

Denso denied that the conditions requiring the insured to cooperate and to provide information were conditions precedent to liability or that it had breached them. Rather, it argued, the clauses in question were general statements of expectation requiring cooperation. The judge rejected this argument, finding that clauses of this type were *"commercially vital"* to this kind of policy. The judge also held that Mploy had indeed breached the condition precedent by failing to pass on the offer for two months, failing to pass on the chasers and failing to notify the insurers that detailed assessment had been commenced.

As to point 2, the policy provided that premium was to be paid in the event that the insured was successful or partially successful in the proceedings. In this case, Mploy had been awarded damages of £34,000, having rejected a Part 36 offer of £600,000, hence the adverse costs order. The judge held that the definition of success in the policy made no reference to costs liability exceeding the damages award, and on that basis Mploy had been partially successful. However, the judge went on to find that the requirement to pay premium was not a condition precedent, and in any event, insurers had not properly demanded the payment of premium. They were therefore not entitled to deny the claim by reason of a breach of this condition.

The judge also found in favour of the insurers in relation to their arguments on two policy exclusions, which excluded cover for costs incurred or increased as a result of the insured's failure to (a) mitigate its liability or (b) cooperate with insurers. These exclusions acted as backstop to the conditions precedent described above.

Whilst the Insurance Act 2015 has sought to soften the impact of certain classes of clauses where a breach is not causally related to a loss, it is important to note that section 11 of the Act does not apply to clauses such as those dealt with by this case, which do not *"tend to reduce the risk of... loss"*.

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England and Wales: can claimants be forced to reveal who their litigation funders are and what their ATE policies say? - The RBS Rights Issue Litigation[1]

It will come as no surprise to many that the court has needed to determine another application in this high stakes/high cost litigation.

The issue on this occasion: when can the Court order a claimant to name its litigation funders and give details of its, arguably privileged, ATE cover for the purposes of a defendant's threatened security for costs application?

The answer is an important one for parties, insurers, and their advisors who are, or may yet be, involved on either side of funded litigation.

Background

Some 27,000 institutional and individual investors have been pursuing RBS and a number of its directors for breaches of s.90 FSMA 2000 concerning alleged misleading statements and critical omissions in a pre-financial crash Rights Issue Prospectus. The losses claimed have previously been estimated at £1.2 billion. While a number of claimant groups settled their claims last

1 [2017] EWHC 463 (Ch) 9 March 2017, full copy of the judgment can be found here: http://www.bailii.org/ew/cases/EWHC/Ch/2017/463.html

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December, a trial on liability for the remainder is listed this May.

Somewhat unsurprisingly for complex and high value litigation, the legal costs are sizeable: the defendants have incurred more than £100 million and estimate that a further £25 million will be incurred to the end of the liability trial. The claimants' costs are significantly lower at an amount in excess of £20 million, although CFA terms may increase that number if they are successful.

The application

In preparing to make an application for security for costs, apparently prompted by changes in circumstances and inconsistent statements about the sufficiency of ATE cover, the RBS

defendants applied for (a) disclosure of the names and addresses of the claimants' litigation funders and (b) either a copy of any applicable ATE policy, or confirmation that the claimants would not rely on policy terms for the purposes of defending an application for security.

The defendants argued that such information was a necessary precursor to considering whether it was worth applying for security for costs and justifiable on grounds of 'efficient case management' and a 'cards on the table' approach. The claimants contended that the defendants' application for disclosure was premature and unnecessary because any subsequent application for security for costs would be bound to fail. They further contended that the ATE policy was not relevant to any substantive issue and, moreover, legally privileged.

There was no substantial dispute between the parties about the jurisdiction of the court to order disclosure of funder details. Submissions therefore focused on whether the court should exercise its discretion to order such disclosure where a future security for costs application was uncertain and, according to the claimants, had no real prospects of success.

In relation to the claimants' ATE policy/policies, the defendants argued that disclosure would enable them to decide once and for all whether to pursue the application for security and avoid a potentially pointless and expensive application. The claimants relied in particular on the decision in *Ocensa Pipeline Group Litigation*[2] in which the Senior Master concluded that (i) the court had no jurisdiction to order disclosure of an ATE policy, records of its negotiation, or earlier drafts; and (b) as the ATE materials had been created for the dominant purpose of litigation and were likely to reflect legal advice on prospects and tactics, they were all privileged such that the court could not compel their production.

Decision

While Mr Justice Hildyard concluded that the prospective application for security would face *"difficult hurdles"* and was not something that he would encourage, it was not something that was so unrealistic or hopeless that the defendants should be prevented from trying. He therefore ordered the claimants to name their funders, but hoped that it might discourage an application for security which, he warned, should be carefully circumscribed if it was made.

The Judge did not agree that the court's general case management jurisdiction to order disclosure of ATE information was so limited but accepted that ATE policies would not usually be susceptible to ordinary disclosure applications under CPR Part 18 although there may be exceptions. The Judge also did not agree with the views expressed by the Senior Master in *Ocensa* in relation to privilege on that basis that his characterisation of the ATE materials was too broadly stated: in the Judge's view it was unlikely that an ATE policy would be privileged except to the extent that its parts allowed a reader to work out what legal advice had been given. In spite of these conclusions, the Judge was not prepared to exercise his case management discretion in favour of the defendants, expressing concern that ATE policy disclosure would lead to disproportionately costly collateral issues concerning ATE policy terms and scope and that *"it is better to save costs than rely on compensation for costs in a costs order"*.

Comment

There are a number of potential points for parties, their insurers, and their advisors, to consider as a result of this recent judgment:

- It may now be more difficult to withhold ATE policies in their entirety as of right on grounds of privilege.
- Parties and their advisors may need to reconsider with ATE insurers what is included in their ATE policies.
- Those seeking litigation funding may want to give some thought to their choice of funder in case they would be susceptible to an order for security for costs which could, in turn, have a negative impact on the conduct and success of the claims.
- Parties seeking funding and their advisors should continue to put in place from the outset mechanisms for preserving privileged information which might otherwise be susceptible to an application for disclosure.

This RBS decision also resonates with the recent decision of the New South Wales Court of Appeal in the *Hastie* case (see article below) in which the Australian court considered whether funding agreements are privileged

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2 [2010] EWHC 1643 (QB)

Australia: *Hastie Group Ltd (In Liq.) v Moore*

Privilege – post Hastie

The New South Wales Court of Appeal decision in *Hastie Group (In Liq.) v Moore*[1] underlines the view that disclosure of the mere existence of privileged documents to third parties will not necessarily waive privilege.

Key facts

The liquidators of Hastie Group Ltd (In Liq.) (Hastie) had obtained orders extending the time for service of a statement of claim alleging professional negligence against Hastie's Auditor, Deloitte (Auditor), between 2008 and 2010.

In doing so, the liquidator had sworn an affidavit in support which referred to an expert report provided in confidence to a potential litigation funder (Report).

The Auditor served notices to produce the Report and Hastie resisted on the basis of client legal privilege.

The New South Wales Supreme Court decision

The judge held that the Auditor was entitled to inspect the Report on the basis that it was not privileged, or alternatively, that privilege had been impliedly waived.

The judge also held that litigation funding agreements did not automatically attract privilege under s119 of the Evidence Act 1995 (NSW), as communications between liquidators and litigation funders involved *"a relationship under which legal professional services may be later provided"* and were not actual legal advice per se.

Although the Report may have appeared relevant to the proceedings generally, this was not enough to waive privilege.

The Court of Appeal decision

On appeal, the following two key points were considered:

1 Whether the Report was privileged; and if so

2 Whether privilege had been waived.

In allowing the appeal, a 2:1 majority of Court of Appeal held that the Report was privileged because both the liquidator and the Auditor accepted that the engagement letter attaching the Report was privileged. It rejected the Auditor's submission that, if privilege existed, it belonged to the liquidator as agent of Hastie. It also rejected the view that the litigation funding agreement did not attract privilege. However, it reaffirmed the principle that whether or not a litigation funding agreement attracts privilege is a question of fact and depends on the reasons for its creation.

The majority also held that the Report was merely referred to in an affidavit and the confidential disclosure of it to a litigation funder was not a waiver of privilege as its contents were not relied upon in the affidavit. Although the Report may have appeared relevant to the proceedings generally, this was not enough to waive privilege.

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1 [2016] NSWCA 305

hfw 3. Market developments

International: Insurers and litigation funders face growing challenge from the prospect of increased class actions globally

Insurers and litigation funders operating outside the US have not to date faced the same challenges as their US counterparts in relation to class actions. This of course is because mass-tort actions have traditionally been a peculiarity of the US legal landscape, being much less common in other jurisdictions.

However, the development of legal mechanisms for class actions, or collective redress as it is referred to in the EU, is progressing – both at an EU level and at a national level, inside the EEA and in other jurisdictions, such as Australia, Canada and in Asia (Thailand) – all of which have recently implemented or are implementing legal frameworks to enable class actions.

The drive to implement this legal reform is being driven by a desire to enable

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actions by groups of investors and by the fact that, in some jurisdictions, such actions are made more feasible by the availability of litigation funding.

Whilst questions remain as to whether class actions, in practice, provide enough benefit for the individuals comprising the claimant class as compared with the lawyers running the actions, these developments undoubtedly present both opportunities and challenges for insurers and litigation funders.

D&O insurers and liability insurers in particular can expect to face greater exposures, in the light of potential class actions. This may of course also translate into greater demand for their products.

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4. HFW publications and events

England: HFW attending Practical Law Insurance Law Forum 2017

On 23 March, Richard Spiller (Partner, London) and William Reddie (Associate, London) will be attending the Practical Law Insurance Law Forum 2017

Lawyers for international commerce hfw.com