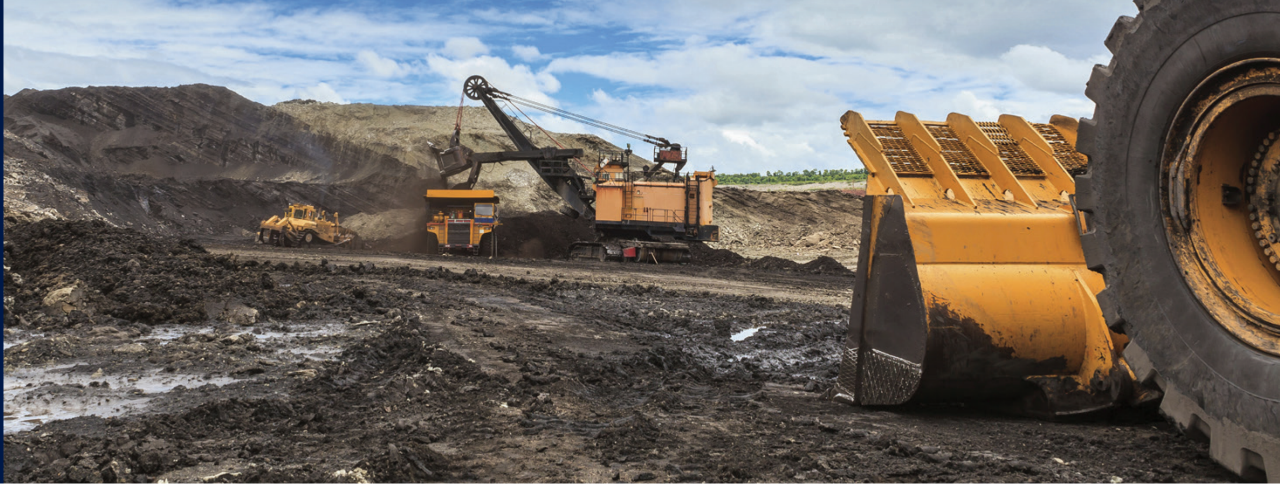
Mining

November 2014

A RAPIDLY EVOLVING LEGAL LANDSCAPE

This Article first appeared in Mining Journal's Anti-Corruption and Compliance Guide 2014 and is reproduced with permission.



Anti-bribery and anti-corruption is an increasingly important issue in the mining and extractive industries. This HFW article focuses on the key recent developments in international anti-corruption laws and assesses their implications for mining companies. We then look at corporate governance and compliance strategies to help manage the risks, and at the types of insurance coverage available. And we examine what exposures remain.

Key developments in international anti-corruption laws

Over recent years there has been a significant increase in the severity of anti-corruption laws and enforcement. The UK Bribery Act 2010 (the Bribery Act) exemplifies this increasing pressure and has been part of a growing trend extending the stringency and scope of anti-corruption enforcement globally.

The Bribery Act entered into force on 1 July 2011, introducing a range of new measures. One of the key provisions addresses the bribing of a foreign public official. The prohibition of this activity is common across all jurisdictions with anti-bribery legislation.

One of the most important developments in the Bribery Act was the introduction of a new offence for a company's failure to prevent bribery. This makes it an offence for a commercial organisation carrying on business in the UK to fail to prevent 'associated persons', including employees, agents, contractors and others providing services to it, from engaging in corrupt activities on its behalf. It is a strict liability offence which means that there is no need to show an intent to bribe on the part of the company. A company is at risk for conduct which it did not sanction and which may have been beyond its control.

Under French law, a similar offence exists where a company fails to prevent bribery by 'associated persons', including their subsidiaries.

The provisions under the US Foreign Corrupt Practices Act (the FCPA) are not as pervasive. For example, the FPCA does not prohibit business-to-business bribery.

However, under the FCPA, a parent company which holds a majority share in a subsidiary, is strictly liable for the failure of that subsidiary to comply with FCPA accounting provisions.

Facilitation payments

The treatment of facilitation payments also varies between jurisdictions. Such payments involve a government official being given money or goods to perform (or to expedite the performance of) an existing duty.

Under UK, French and German law there is no exemption for facilitation payments. However, such payments are currently permitted in the US, Canada and Australia. In these latter jurisdictions, care must be taken to distinguish between lawful facilitation payments and unlawful 'small bribes'. In practice, this can be difficult to do.

US and Australian laws require facilitation payments to be recorded. Strict penalties are placed on companies which fail to comply with these accounting provisions.

Important amendments to the Canadian anti-corruption laws mean that the current exemption for facilitation payments is being phased out. Any company which could have a connection to Canada should prepare for the prohibition coming into effect.

Whilst facilitation payments are generally prohibited under the Bribery Act, a defence is available where such payments are expressly permitted under the receiving jurisdiction's written laws. Local custom is not sufficient. A defence is also available for bona fide hospitality and promotional expenditure which is proportionate and reasonable.

Scope

The extra-territorial reach of anti-corruption laws is also a growing concern for companies. Each jurisdiction applies its anti-corruption laws to its own citizens, residents and domestic companies, including conduct within and outside its territory. The Bribery Act covers offences committed by a person with a 'close connection to the UK'. This extends to include a British overseas citizens and individuals ordinarily resident in the UK.

The US anti-corruption regime is equally far reaching, with the provisions of the FCPA being enforced in cases with little obvious domestic proximity. Indeed, the FCPA only applies to the corruption of foreign public officials and many prosecutions under the FCPA have been brought against non-US companies. It has been argued to be a de facto protectionist measure for the US Government.

Sanctions

Sanctions for the breach of anti-corruption provisions vary depending on jurisdiction. Most commonly they are dealt with through criminal liability and fines which are imposed on companies, directors and individuals. Sanctions can also include asset confiscation, licence revocations or even the prohibition of a company from bidding for future concessions.

US penalties are set at a maximum of 20 years imprisonment and/or fines of up to US$5 million for individuals and US$25 million for companies. In the UK, the fines on conviction of an offence under the Bribery Act are potentially unlimited. Individuals cannot be indemnified by their employer and many of these risks cannot be insured against.

A significant penalty under UK, French and Canadian law is the confiscation of the proceeds of the corrupt act. These provisions target the proceeds received by the company or individual as a result of the bribery. For example, under the UK Proceeds of Crime Act 2002 all revenues from a contract procured by a bribe can be confiscated, not merely the profit.

In addition to these penalties, directors in the UK can be disqualified. These penalties can have a serious financial and reputational impact on the company and on individuals. The stakes under anti-corruption laws are therefore extremely high for those involved.

Defences

While the Bribery Act is strict, it does provide for some important defences. A significant defence exists in relation to the failure to prevent bribery by an associated person if a company can show that it had in place 'adequate procedures' designed to ensure that associated persons did not engage in bribery.

To benefit from this defence companies must ensure that the procedures are appropriate, thorough and up-to-date. Risk assessment is key to this,

Important amendments to the Canadian anti-corruption laws mean that the current exemption for facilitation payments is being phased out.

Mining companies must be aware of the anticorruption regimes of the states in which they operate.

ANTHONY WOOLICH, PARTNER

particularly for companies operating in industries classified as high risk, such as mining, and operating in countries that are vulnerable to corruption.

Australian law allows the defence of having a 'corporate culture' which is compliant with the anti-corruption legislation where an agent is concerned. In contrast, under Canadian law companies have an active obligation to take reasonable steps to stop their representatives from being party to an offence.

Anti-corruption in mining states

Mining companies must be aware of the anti-corruption regimes of the states in which they operate. Many key mining jurisdictions have anti-corruption laws which prohibit the bribery of domestic officials and will hold companies liable for the corrupt conduct. The following case studies illustrate the dangers of these anti-corruption enforcement regimes and the web of litigation that can result.

BSG Resources

In 2010, BSG Resources (BSGR) was awarded a 25-year mining concession in Guinea after its confiscation from Rio Tinto. BSGR then sold the majority stake to Vale for US$2.5 billion. In April 2014, the Guinean government cancelled the licence after an inquiry found BSGR guilty of corruption, alleging that it had offered millions of dollars and shares to Mamadie Touré, the wife of a former Guinean president, to help it to acquire the concession. It was also claimed that the former Guinean mining minister was paid US$200 million for facilitating the grant of the licence.

Despite Guinea not having anti-corruption legislation, BSGR lost its mining rights and has been barred from tendering for the mining concession again. It faced no other sanctions in Guinea apart from the confiscation of the asset and reputational damage.

However, the consequences of the inquiry are ongoing. BSGR is currently engaged in arbitration to prevent Guinea from selling the mining rights Vale is seeking to sue BSGR for its lost stake in the mining rights. Rio Tinto is suing both Vale and BSGR under US law for compensation and damages.

In addition, former BSGR lobbyist in Guinea, Frederic Cilins, was subject to investigation after being recorded offering US$6 million to Ms Touré to destroy evidence. Mr Cilins pleaded guilty to obstruction of justice and was sentenced to two years imprisonment with a US$75,000 fine.

Alcoa

In one of the largest US anti-corruption settlements of its kind, the US based Alcoa Inc (Alcoa) agreed to pay a US$384 million penalty to resolve charges of bribing officials of state controlled Aluminium Bahrain BSC (Alba). Between 1989 and 2009, Alba was one of the largest customers of Alcoa's Australian mining subsidiary. Despite the red flags, the subsidiary retained a consultant to assist in negotiations for the supply of minerals to Alba and Bahraini government officials. Alba brought the proceedings in the US against Alcoa. The consultants had paid bribes to officials through funds generated from commissions they were paid and price mark-ups between the purchase price paid and the sale price to Alba.

The corrupt conduct occurred in Bahrain and the offence was committed by an Australian company. Alcoa was not found to have known about, or acquiesced in, the conduct. Despite this, Alcoa was pursued for violation of the FCPA as the ultimate beneficiary of the conduct. The US SEC found that Alcoa had failed to conduct due diligence or seek to determine whether there was a legitimate business purpose for the consultant and had failed to ensure that the FCPA's accounting provisions were complied with by its subsidiary.

As a result of these events, Alcoa was required to pay US$175 million in disgorgement of ill-gotten gains and US$209 million in criminal fines.

In response to these fines, US regulators advised that it is 'critical that companies assess their supply chains and determine that their business relationships have legitimate purposes'.

Developments in Extractive Industries Transparency Initiative (EITI)

The EITI runs alongside the EU's Transparency and Accounting Directive (the Directives) and has recently been subject to review. The philosophy behind the EITI is that companies should disclose what they pay to Governments to ensure transparency

and accountability in extractive industries, and to ensure that mining states' resources are not squandered.

The EITI was introduced in 2002 to enhance good governance. Its adoption is discretionary and its provisions must be incorporated into the national laws of participant states. Under the EITI, material payments made to and received by governments are published in an EITI report. There is no defined de minimis figure, the criteria for materiality are being developed by multi-stakeholder groups.

In 2013, the EITI broadened its scope considerably to include, in addition to revenue information, details about production volumes, the names of licence holders and information about state-owned oil and gas companies. In line with EU Directives and US Dodd-Frank Act, EITI countries will also now need to disclose payment information by project.

Presently there are 29 EITI compliant countries and 17 candidate countries. The UK, Germany, France and Australia have expressed their intention to implement the EITI. Mining companies incorporated in these countries need to be aware of this development as they may soon be required to comply with the additional obligations under this initiative.

> Under the new rules, listed and large unlisted EU-incorporated companies will have to disclose payments made to governments of €100,000 or more.

EU mandatory disclosure requirements

In June 2013, proposals to make amendments to the EU Directives on transparency requirements were approved.

Under the new rules, listed and large unlisted EU-incorporated companies will have to disclose payments made to governments of €100,000 or more.

Compliance will likely require the investment of significant commercial and administrative resources. Member States must adopt the provisions by July 2015.

Implications for mining companies

In view of these regulatory developments, there are a number of key steps that companies should take.

Mining is classified as one of the highest-risk sectors for corruption, a zero-tolerance approach is therefore required. A culture of compliance needs to start from the top of the organisation. Corrupt business is bad business.

Companies need to ensure that appropriate due diligence is undertaken on all new agents, suppliers, contractors, employees and other entities that the company is dealing with. Appropriate due diligence will also be necessary for subsidiaries and any entities a company is seeking to acquire, to ensure that they too have appropriate anti-corruption policies in place. To afford any real protection, it is vital that these are documented through a full paper trail.

Companies will also need to ensure that employees are properly trained and aware of their obligations. In particular, they need to know what they must do to comply with anti-corruption policies, and when they should seek advice or guidance (red flags). For this reason, it is important to have access to appropriate policies and procedures, giving clear guidance on difficult areas such as facilitation payments, hospitality and whistle blowing.

These measures need to be supported by risk assessments and monitoring on an ongoing basis.

In view of the extended EITI and EU disclosure requirements, companies also need to maintain an appropriate level of reporting. This can add a significant burden on tax and accounting staff. Companies will need to allocate resources and establish mechanisms in order to gather this required data.

In addition, companies should carefully consider anti-bribery clauses in their contracts and ensure that appropriate warranties and restrictions are negotiated.

Companies should also review the wording of confidentiality clauses in their contracts: clauses will need to be drafted to ensure that any confidentiality commitments are subject to statutory disclosure obligations which cannot be derogated from.

Compliance strategies

Establishing a successful compliance strategy is of great importance to companies protecting themselves from the risks of resource development and potential licence and retention issues. A successful compliance strategy is a continuing process, to be reviewed regularly. A compliance strategy cannot be viewed in isolation.

International regulation has had a huge influence on the development of compliance strategies and will continue to do so. As regulations change, better run companies will adapt their compliance strategies accordingly. The United Nations (UN), the Organisation of Economic Co-operation and Development (OECD)



> ...if a good corporate governance structure is not in place, has forced companies to confront the deficiencies in their own compliance strategies to avoid negative and unfair publicity. This is of particular relevance to the mining industry...

and the International Corporate Governance Network (ICGN) are all international organisations that publish guidelines to help provide a structure to a company's corporate governance strategy. The European Commission has also released its own action plan for corporate governance, which includes proposals to improve corporate governance reports, increase disclosures and introduce further initiatives for the development of corporate governance. In addition to the international and European guidelines, national guidelines are also issued to assist domestic companies in establishing their own corporate governance codes. The UK governance code is regularly updated to reflect developments in the corporate governance sphere.

The EITI initiative and the Bribery Act have also been drivers of change in the compliance area. The Bribery Act, although UK specific, has a very wide jurisdictional reach and companies will see the gradual export of UK standards down the contracting and sub-contracting chain. Increasing co-operation between prosecuting authorities, particularly in the UK and the USA, has also influenced the 23 development of compliance strategies. This increased co-operation has seen a crackdown on corrupt payments and other criminal activities.

In addition, efforts to reduce climate change have transformed the compliance strategies of the aviation industry. Their impact is also extending to the shipping industry, and it will not be long before it reaches the extractive industries. So called "climate change governance" has almost become a separate system in its own right.

Hallmarks of good corporate governance

Greater awareness of the problems faced by companies, if a good corporate governance structure is not in place, has forced companies to confront the deficiencies in their own compliance strategies to avoid negative and unfair publicity. This is of particular relevance to the mining industry, where reports of unrest at mine sites and environmental degradation has provoked public outcry at the actions of mining companies.

The hallmark of a good corporate governance strategy is that it will examine risk around the edges of the company's operations so that the long-term success of the company is ensured. A good corporate governance strategy should maintain sound risk management and internal control systems. Companies with good corporate governance perform better in terms of shareholder returns in the longer term than those companies with deficient corporate governance. Good corporate governance needs to be driven from the board level downwards, throughout a company's operations: it should not be developed by risk managers and pushed upwards.

The UK corporate governance code considers that a successful compliance strategy addresses the following key areas: leadership, effectiveness, accountability, remuneration and relations with shareholders. In respect of each of these key areas, the principles of transparency, accountability, fairness and responsibility are emphasised. Fundamentally, good corporate governance is achieved through adequate disclosure that encourages trust and confidence in the company and the management systems in place.

Of particular importance to mining companies is a corporate governance strategy that addresses human rights and development, as mining companies often operate in developing countries where abuses of human rights are unfortunately common. The UN has published principles of business and human rights that provide helpful guidance to companies as to what should be addressed as part of a good corporate governance strategy. A corporate governance code that includes a structure that deals with business ethics, human rights and development provides a solid foundation for companies to operate from.

Due diligence and compliance

It is crucially important for a mining company to undertake a detailed due diligence investigation into the operations of a target entity, as inadequate duediligence investigations could trigger a multitude of issues for the acquiring company. In particular, adequate due diligence will establish the risks that a company may face on resource development and potential liabilities and licence retention issues. The due diligence process is supported by the indemnities and warranties in the acquisition agreement, which also helps to balance the risk that the buyer and seller respectively undertake.

Assessment of risk

The OECD has published a useful report on due diligence guidance for responsible supply chains of minerals from conflict affected and high risk areas. It is important for companies to establish whether a mine is located in a high risk area. Risk can be assessed through an analysis of the circumstances of the proposed acquisition, in addition to an evaluation of the international and domestic law, the recommendations of international organisations for a company's business conduct, government backed tools and a company's internal policies and systems. Failure to assess risk adequately can lead to reputational damage, legal liability and the potential to harm people.

Companies will need to investigate the financials of the seller relating to the mine. This will involve obtaining copies of the seller's accounts, including management accounts.

NICK HUTTON, PARTNER

Technical and commercial due diligence

Primarily, it goes without saying that companies should undertake due diligence to ensure that the mine has sufficient coal or mineral reserves and that the quality of the coal or mineral is satisfactory. Companies need to obtain geological surveys in addition to a qualified person report to confirm this. A full examination of the mine will determine what equipment, machinery and infrastructure are already in place.

The important driver in technical and commercial due diligence is the location of the mine. This will determine to what extent companies can get power and water supplied to it. Companies will need to check, particularly when they are buying out a group, whether the supply contracts automatically continue or whether a re-negotiation is required. Assuming you have got sufficient water and power to run the mine, there is then the question of transporting the mined commodity to the exporting port. This can be particularly problematic where a mine has been in operation for many years, and may have changed hands several times in group reorganisations. If the mined commodity is to be transported by railway to the exporting port, companies may have the right to use the railway, which is typically provided by a third party, but not necessarily so. Companies will also need to establish that they can export their mined commodity, and do not have to wait behind more favoured mine users at the port. The agreements for the operation of the railway and for the operation of the port need to be carefully examined to make sure that the new buyer continues to enjoy the same rights of use as the seller. If the company needs to negotiate new access arrangements or power supply contracts, the company must always be aware of the issue of bribery and facilitation payments in certain countries.

Financial

Companies will need to investigate the financials of the seller relating to the mine. This will involve obtaining copies of the seller's accounts, including management accounts. The buyer will need to assess the key financial parameters of the mine operation. A general cost analysis should be undertaken to evaluate the mine's annual production capacity, mining requirements, sales, FOB average selling price, production cost of sales, stripping ratio, net debt, operating profit, operating margin and EBITDA and so on. The buyer also should analyse the capital expenditure, debts, creditors and financial projections of the seller in addition to looking at its work obligations.

Companies should also obtain all financial documentation and derivatives, financial assurance and bonds (in respect of rehabilitation, environmental and rail/port take or pay), guarantees and security documents. The buyer must raise any discrepancies in the accounts or documents with the seller at pre-contract stage.

Legal

It is just as important that companies undertake a legal and commercial due diligence. This involves obtaining copies of all mining tenements, concessions, licences and permits, in addition to corporate matters including: due incorporation, constitution, share rights and board minutes. Companies will need to check whether consents are required for the transaction, whether there are pre-emption rights and where the root of title is. Rights of pre-emption and options that might affect the purchase will be crucially important to the buyer.



UK companies must be aware of the implications of the Bribery Act in terms of investment in extractive industry projects around the world, but also more widely the question of compliance with EU, US and Australian financial sanctions.

It is also important that companies analyse the seller's material contracts, insurance policies and lease agreements to ensure that there is no ongoing litigation, disputes or liabilities outstanding under the contracts. In particular, the buyer must ensure that the seller has all the requisite environmental licences – for example, waste water disposal – as failure to obtain adequate environment licenses can lead to delays and fines. It can also lead to adverse publicity for the mining company, as environmental issues are a global concern.

Local legal and social engagement

The importance of the local community, and due diligence on the local community, has become increasingly important to mining companies. As corporations have grown and the extractive industry has expanded, civil society groups have become more aware of mining companies' business.

Companies need to be certain of access to the land and this goes to a detailed investigation into the root of title and the necessary permits and consents required for the continued operation of the mine. Claims by indigenous people need to be considered not only from the legal point of view but from the social responsibility angle too. This is particularly relevant in areas of conflict and high risk. Companies must ensure that the acquisition of a mine does not facilitate, contribute to, profit from or assist with any form of degrading or inhuman treatment, torture, or any form of compulsory labour. To help prevent this from occurring, companies should employ competent local advisers to guide companies through the whole process, including establishing native root of title and ensuring regulatory compliance. It is important that companies also do their due diligence on the local advisers to be employed – making sure that the local advisers are legitimate and have come to the deal with clean hands is crucial.

It is our experience that in certain countries, typically those following a civil code rather than a common law legal system, the law can be imprecise and quite often some provisions of the law conflict with other provisions. For example, the forestry law might prevent the stripping of the top soil, which the mining law and the concessions and the permits may all allow. Furthermore, where there are different levels of government, particularly in developing countries, companies can find themselves embroiled in disputes between the different levels on who can grant particular permits. This can lead to uncertainty about whether a mine has the right operating permits to continue on a sale. This sort of issue tends to arise around a change of control and there is increased sensitivity to avoiding any form of inducement.

Compliance advice to companies

UK companies must be aware of the implications of the Bribery Act in terms of investment in extractive industry projects around the world, but also more widely the question of compliance with EU, US and Australian financial sanctions. Understanding the risks and challenges involved, implementing a comprehensive compliance strategy, keeping abreast of changes in regulation, and obtaining adequate insurance and reinsurance cover, will help to protect a company from the increasing risks mining companies face.

Insurance coverage

Insurance is an important tool in the risk manager's armoury, which together with a company's internal compliance procedures forms part of a risk management programme aimed at minimising not just the risk of claims, investigations and fines, but also their financial consequences.

Increased globalisation of industry, particularly in industrial sectors operating in emerging markets such as the mining sector, has significantly increased the issues risk managers need to consider when formulating a risk management programme. For example, when focussing on insurance architecture (the structure of a company's insurances), the imperative must be not only on contract certainty but also contract quality to ensure the insurances respond as intended, providing the cover required in the geographical locations the business operates in.

Pre-claims/investigations insurance considerations

The complexities caused by cross-border business operations to global insurance programmes can require sophisticated solutions to ensure that the different regulatory jurisdictions and laws are taken into account. A failure to have the correct local insurances in place can lead to draconian consequences on companies and their directors and officers.


Creating an effective risk management programme requires a host of internal guidelines and policies to ensure that a company and its directors stay on the right side of the law. From an insurance perspective, procedures are needed across all the business units to ensure that if investigations or claims (or circumstances) arise, they can be notified to insurers within the terms and conditions of the relevant insurance policies. In formulating such procedures the following should be considered:

1. What and when matters are required to be notified. This will depend upon the different triggers in the insurance policies, for example whether circumstances are required to be notified or just claims. Also, in what time frame – immediately, as soon as practicable, or within a set time limit?

2. Quick flow of information is required as well as an ability to capture evidence quickly, not only for notification purposes but also to support the insurance claim and, where necessary, to ensure preventative action can be taken to limit liability.

3. Claims protocols should be agreed with insurance brokers to ensure that there is clarity on the reporting lines in the event of a claim or investigation. How conflicts are managed will need to be considered. Investigations and claims could involve the company and multiple directors.

4. In relation to directors and officers insurance, those that are covered by the insurance should be informed of the scope of cover and who they report to in order to notify circumstances or claims. The cover may provide emergency contact numbers for directors to obtain urgent legal advice. A protocol will be needed so that insureds understand the situations in which such advice can be sought.

Insurance cover

When focusing on anti-corruption and ways of mitigating financial loss or the consequences of investigations and/or claims, there are three main insurances: errors and omissions (E&O) insurance; directors and officers (D&O) insurance and crime insurance. Whilst a number of other insurance products are important from a compliance perspective, such as cyber insurance, we focus hereon these three key insurance products.

1. E&O insurance, in its basic form, provides cover for third party claims and the legal expenses associated with defending such claims. In addition, cover for investigation costs which indemnify or pay for the legal advice/representation received by the company during formal investigations is usually included.

2. D&O insurance provides cover to directors and officers of companies for third-party liabilities and the associated legal defence costs. It also provides cover for legal expenses incurred on formal investigations involving directors and/or officers.

3. Crime insurance, unlike E&O and D&O insurance, are first party insurance policies indemnifying the company where it has suffered a loss at the hands of an employee's or third party's dishonesty or fraud.

...there are three main insurances: errors and omissions (E&O) insurance; directors and officers (D&O) insurance and crime insurance.

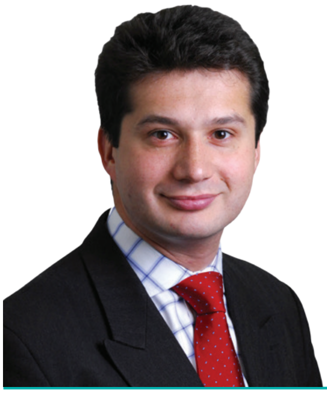
Each of these insurances has its own nuances.

E&O insurance

When considering the scope of cover, there are a number of issues to be aware of:

1. Investigation costs. Historically, investigation costs were sub-limited, although this is becoming less common. Investigations, particularly across jurisdictions, can be expensive, so careful consideration should be given to the limits of cover. Just as important are the triggers for this cover. Typically, insurance policies only indemnify legal costs incurred in relation to a "formal" investigation, as opposed to "informal" investigations. At what point the right to an indemnity is triggered can be a grey area. Consideration needs to be given to the formulation of the investigation costs cover to ensure that it is understood at what point legal costs are indemnified.

2. Mitigation costs cover. This is not a cover automatically provided in E&O policies. This extension provides a company with an indemnity for reasonable fees, costs and expenses incurred as a direct result of action taken to prevent, limit or mitigate a company's exposure to damages. Without such cover an E&O policy will not necessarily indemnify the legal costs incurred in undertaking such preventative action.



...provides an indemnity to the company in situations where the company is permitted to indemnify directors or officers for legal representation or advice costs. In addition, where the company is not permitted to indemnify a director or officer for such costs, the policy provides an indemnity for such legal advice/ representation costs.

GHRAHAM DENNY, PARTNER

3. Contractual liability. Insuring clauses in E&O policies usually require the claim to be for a civil liability for the policy to respond. What constitutes a civil liability is usually defined within the policy. It does not include contractual liability and there are specific exclusions for this, for example, excluding "loss resulting from any claim or for legal liability assumed by the Assured under the specific terms, conditions or warranties of any contract, unless such liability would nevertheless have attached by law in the absence of such term, condition or warranty." Usually, third party claims allege breaches of concurrent duties in tort as well as contract. In such cases, an E&O policy would respond; however, where the claim is purely contractual in nature it is unlikely that the policy will not respond.

4. Restitution/unjust enrichment. E&O insurance indemnifies the company for compensatory liabilities owed to a third party. Claims for restitution or unjust enrichment are not considered to be compensatory claims but rather claims for a return of monies to which the company was not entitled in the first place. Restitution and unjust enrichment claims are normally excluded under E&O policies.

5. Fines and penalties. These are usually excluded from cover on the basis of public policy and common law. For those businesses that operate in multiple jurisdictions and are at the mercy of different legal systems, we have seen insurance wordings broadening to allow the indemnification of fines and penalties to the extent they are "permitted by law". This leaves open the possibility of receiving an indemnity in respect of a fine or penalty where a jurisdiction's legal system permits this.

D&O Insurance

D&O insurance, in its basic form, provides an indemnity to the company in situations where the company is permitted to indemnify directors or officers for legal representation or advice costs. In addition, where the company is not permitted to indemnify a director or officer for such costs, the policy provides an indemnity for such legal advice/representation costs.

We have seen an increasing trend of greater regulation and co-operation between regulators, whether nationally or internationally, and a drive for transparency in business operations as well as directors'/employees' conduct. D&O insurance is therefore becoming increasingly important:

1. Insuring clauses often require a claim or investigation to arise from a wrongful act by a director or officer. What constitutes a wrongful act will be defined in the policy and can differ between policies. This can have a significant effect on the scope of cover.

2. Aggregate limit. D&O limits are written on an aggregate limit basis and so the limits reduce the more calls there are on the policy during the policy period. It is therefore extremely important to ensure that the right specialist legal advice is obtained at the outset to make the best use of the available limit.

3. Definition of directors and officers. The larger the group of insureds, the greater the risk of the policy limits eroding. This definition can

vary between jurisdictions. For example, in Argentina an officer is translated as a "functionary" and this can result in a large selection of employees potentially being covered who were not intended to be. Other coverage issues to be considered are whether senior executives or non-executive directors should have ring-fenced limits of cover.

4. Professional services exclusion. This exclusion is usually drafted broadly in D&O policies incorporating language to ensure the cover excludes claims "arising from or attributable to or in connection with" the performance or failure to perform professional services "by or on behalf of" any director or officer. This exclusion frequently causes difficulties for those directors or officers implicated in corruption or bribery where it could be argued that the paying of the bribe was done "in connection with" the performance of his employment or services. In such cases, it is unlikely that the D&O policy would provide cover.

5. Dishonesty/fraud. D&O policies contain dishonesty and fraud exclusions and it is usual for these to provide defence costs cover up to a final determination of dishonesty or fraud. It is important to ensure this is the case and that the exclusion does not take effect earlier, for instance on a determination of fraud or dishonesty, as this affects the scope of the cover significantly.

6. Consideration also should be given to the scope of the extradition cover available.

Crime insurance

The level of cover available from crime policies varies depending upon the insured's requirements. In addition to employee dishonesty, it is possible to extend cover to include loss suffered from forged instruments, computer and telephonic misuse, physical loss of property and extortion. The policies can also cover acts of third parties as well as collusion between employees and third parties. Issues to be aware of in relation to crime policies, include:

1. Loss. Cover is usually provided for direct financial loss which is normally defined in the policies. It will usually include: direct financial loss to the company; claims preparation costs; legal fees and costs associated with the verification and reconstitution or removal of electronic data.

2. Improper financial gain or intent to cause loss. It is often a condition that the act which has caused the loss must be committed with the intent either to make an improper financial gain or cause loss to the company.

3. Proof of loss. Policies usually require the insured to provide insurers with a Proof of Loss setting out: all the facts leading to the loss, the amount of the loss and the supporting documentation in order to prove the loss suffered. The requirement and time limits (often 6 months) for providing the Proof of Loss are usually drafted as a condition precedent in the policy. Confusion can occur as to when exactly time starts to run and the exact date on which the Proof of Loss is due. This should always be agreed with insurers as early as possible in the claim process and extensions sought well in advance if more time is needed.

Building an effective risk management programme to limit risk to companies and directors is not straightforward. The issues discussed above are but a few of the insurance matters that fall for consideration. It does help to explain the increasing prominence and responsibilities placed on risk managers and general counsel in companies. In addition, it explains the increasing reliance on external legal counsel to help guide companies on risk management issues, including insurance architecture development and stress testing, as well as providing specialist defence and advisory services in the event of investigations and/or litigation.

For further information, please contact Anthony Woolich, Partner, on +44 (0)20 7264 8033 or anthony.woolich@hfw.com, or Nick Hutton, Partner, on +44 (0)20 7264 8254 or nick.hutton@hfw.com, or Graham Denny, Partner, on +44 (0)20 7264 8387 or graham.denny@hfw.com, or your usual contact at HFW.



Lawyers for international commerce

hfw.com

São Paulo London Paris Brussels Geneva Piraeus Dubai Shanghai Hong Kong Singapore Melbourne Sydney Perth