COMPREHENSIVELY YACHTS
HFW YACHTING INDUSTRY BRIEFING

As the northern hemisphere's summer season begins and the rush of pre-season work slows down, we have found time to put pen to paper to bring you the latest edition of Comprehensively Yachts, which we hope you find full of thought-provoking topics and analysis.

In light of the growing adoption of sustainable technology in yachting, including Feadship's recently launched 60m Project 713, which will harness solar energy and has the capacity to also run on non-fossil hydrogenated vegetable oil, and Project 821, the world's first hydrogen fuel-cell superyacht, we take a look at what may be the next frontier in yacht propulsion: nuclear power.

Next, we consider the Cayman Islands' new Merchant Shipping Act 2024 and the revised Red Ensign Group Code, before our London employment team revisit a UK employment tribunal case of significant relevance for the employment of yacht crew.

Given the importance of Swiss manufacturing to the yachting industry, it is not uncommon to encounter Swiss law contracts, and we have therefore asked our colleagues in Geneva provide a summary of why arbitration in Switzerland maintains such popularity.

Our usual sanctions update follows, before we finish off with a focus on fraud, the changes with the new UK legislation and what you can do to stay one step ahead.

We hope you enjoy this edition and please do keep in touch. If there is anything you would like us to discuss in forthcoming editions, please do let us know.

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Nuclear-Powered Yachts: A Viable Option Towards Achieving Net-Zero Emissions?

Imagine a very large yacht capable of cruising the world non-stop without refuelling or requiring an expensive chase boat. Could this become a reality?

Nuclear is not new technology

In 1953, US President Eisenhower announced the "*Atoms for Peace*" nuclear programme, and the following decades saw the development and operation of several global experimental nuclear merchant vessels, including the *American NS Savannah*, *German Otto Hahn* and *Japanese Mutsu*.

Beyond these examples, larger scale production of civilian nuclear vessels failed to emerge. However, the push for the yachting industry to decarbonise and forge a path toward net-zero greenhouse gas (GHG) emissions, along with the potential technical efficiencies and onboard space savings promised by nuclear propulsion, has given the subject a new lease of life.

Emerging nuclear developments

UK Government climate change proposals recognise nuclear propulsion as a means of reducing maritime GHG emissions and are encouraging its development and adoption. The UK's Department for Energy Security and Net Zero recently launched £20 billion and £157 million funding grants for the design and build of a Small Modular Reactor along with other nuclear technology projects, including those engaged in "*advanced nuclear business development*".

Outside the UK, classification society American Bureau of Shipping and Herbert Engineering Corp. published a joint study into advanced nuclear reactors onboard commercial ships[1]. The study concluded that two Lead-Cooled Fast Reactors could power a ship for its entire 25-year lifespan while simultaneously delivering increased carrying capacity and operational speed.

The development of Molten Salt Reactors, where nuclear fuel (Thorium) is suspended in coolant (molten liquid salt) may bring greater operating efficiencies at higher temperatures, yet with reduced risk of over-pressurisation, smaller waste streams and the ability to refuel without shutting down reactors. A number of concepts are being developed in this field, including Ulstein Thor[2].

Financial viability

Disproportionate running costs contributed to decommissioning of earlier nuclear vessels, and remain a concern today, as do the large upfront investment costs. However, new approaches, including the standardisation of reactors and leasing rather than purchasing them could reduce costs. Further, their operation might be simplified and adoption encouraged by manufacturers retaining responsibility for the in-life maintenance, repair and replacement of reactors via 'plug and play/pay" arrangements. Such an approach should ensure the highest standards are maintained and allow the relevant authorities to maintain oversight of reactors in service. When repairs or fuel changes are required, licenced shipyards could remove 'old' reactors and plug in 'new' reactors. High upfront reactor leasing costs (compared to alternative fuels) are offset by significantly reduced running and refuelling costs.

Insurance

Nuclear power plant operators are strictly liable for nuclear damage and many countries require compulsory third-party liability insurance. Damage caused by nuclear fuel, nuclear waste or combustion of nuclear fuel is excluded from most marine insurance policies, including P&I cover. Consequently, it is currently effectively impossible to insure civilian nuclear vessels on commercial terms. However, several insurers in the London market are alive to the issue and are considering the position, with the potential for appropriate cover growing.

Regulatory challenges

Chapter VIII of the International Convention for the Safety of Life at Sea (**SOLAS**)[3] and the Safety Code for Nuclear Ships (res. A.491. XII) (**Nuclear Code**)[4] specify nuclear vessel design, operation, safety and decommissioning criteria. In the UK, these are supplemented and transposed by national legislation in the form of the Merchant Shipping (Nuclear Ships) Regulations[5] (the **UK Nuclear Ships Regulations**) and MGN 679(M) Nuclear Ships[6] (the **MGN**).

Theoretically, there is no reason why yachts built to the same regulations could not operate and be classed in a manner similar to commercial vessels. Under UK legislation, a nuclear-powered yacht must comply with the following requirements:

- MCA approved safety assessment prior to construction, ensuring no unreasonable radiation or other hazards (regulation 7 of Merchant Shipping Regulations).
- A Quality Assurance Program covering the yacht's lifecycle from design to decommissioning (MCA approval precondition) (regulation 28 of Merchant Shipping Regulations).
- Detailed operating manual carried onboard, including all operational information required for normal operating and emergency conditions (regulation 14 of Merchant Shipping Regulations).
- Compliance with the Radiation (Emergency Preparedness and Public Information) Regulations 2019 when the yacht is moored and undertaking ionising radiation work (section 7.3 MGN).

1 https://news.cision.com/american-bureau-of-shipping/r/groundbreaking-abs-study-explores-potential-of-commercial-nuclear-propulsion,c3810211
2 https://ulstein.com/news/thorium-powered-ulstein-thor
3 https://library.arcticportal.org/1696/1/SOLAS_consolidated_edition2004.pdf
4 https://wwwcdn.imo.org/localresources/en/KnowledgeCentre/IndexofIMOResolutions/AssemblyDocuments/A.491(12).pdf
5 https://www.legislation.gov.uk/uksi/2022/1169/contents/made
6 https://www.gov.uk/government/publications/mgn-679-nuclear-ships/mgn-679-m-nuclear-ships

“As with all new technology, legislation often lags behind. If Molten Salt Reactors become commonplace, regulatory requirements may develop further to accommodate nuclear yachts.”

- A non UK-flagged nuclear yacht intending to call at a UK port must provide a safety assessment 12 months before arrival in UK waters (regulation 13(5) of Merchant Shipping Regulations).
- Non-compliance with the UK Nuclear Ships Regulations constitutes a criminal offence punishable by fines or possible imprisonment (regulation 31 of Merchant Shipping Regulations).

Whilst it might be possible to build a nuclear yacht in accordance with the regulations, there remain obstacles to the adoption of the technology.

The Convention on Limitation of Liability for Maritime Claims 1976[7] explicitly excludes nuclear ships from its scope (article 3) and it is therefore important to note that an owner of a nuclear yacht could face unlimited liability in the event of an incident.

Furthermore, the Vienna Convention on Civil Liability for Nuclear Damage 1963[8] applies strict and exclusive liability for operators of nuclear installations. The handling and disposal of nuclear waste, as well as the export of nuclear materials, is also strictly regulated.

Finally, port states and flag states will need to implement regulations for nuclear vessels. The UN Convention on the Law of the Sea (**UNCLOS**)[9] explicitly requires nuclear-powered ships and ships carrying nuclear substances to “*carry documents and observe special precautionary measures*” when passing through territorial seas of port states (UNCLOS article 23).

As with all new technology, legislation often lags behind. If Molten Salt Reactors become commonplace, regulatory requirements may develop further to accommodate nuclear yachts.

Practical requirements and safety concerns

In addition, the perception of nuclear technology remains to be tackled. A generally negative public perception of the technology, which is likely shared by many would be yacht owners and charter guests, will prevail until ‘new’ Small Modular Reactors for use on vessels are sufficiently advanced and can be distinguished from earlier commercial reactors and associated risks.

Safety will be paramount. Specially trained crew and engineers will be required. Crew training requirements specified in the UK Nuclear Ships Regulations include basic principles of nuclear energy, structure and performance of nuclear ships, basic principles of radiation hazards and radiological protection, and emergency actions.

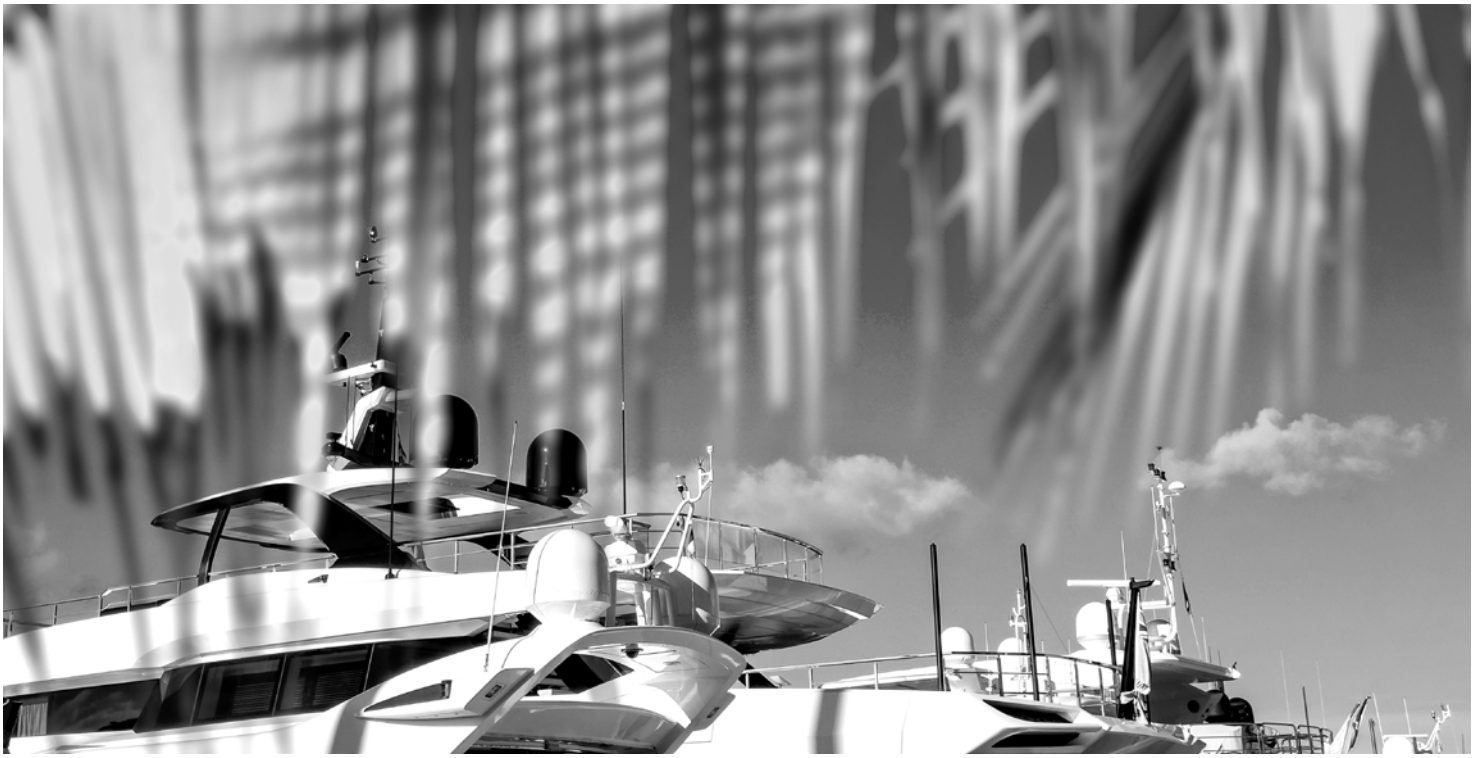
Safe salvage, repair and decommissioning of nuclear vessels will necessitate specialist knowledge and equipment compliant with the Nuclear Code, requiring consideration at the design stage.

Conclusion

The international community foresaw and adopted regulations for nuclear vessels decades ago, and the recent UK Nuclear Ships Regulations have brought those regulations into the 21st century. The legal framework therefore already exists for the construction and operation of nuclear merchant vessels, and small regulatory amends could allow Small Modular Reactors to be fitted to yachts. The extra space created by a smaller powerplant and absence of fuel tanks opens up significant opportunities for yacht designers.

Nuclear propulsion and its use onboard yachts will face challenges, primarily around safety and

7 https://portal.royalbureau.com/wp-content/uploads/2018/07/ConventiononLimitationofLiabilityforMaritimeClaimsLLMCconsolidated_1976_llmc_prot_1996.pdf
8 https://www.iaea.org/sites/default/files/infcirc500.pdf
9 https://www.un.org/depts/los/convention_agreements/texts/unclos/unclos_e.pdf



perception, yet the technology makes it a credible contender for future adoption by those owners seeking to reduce both carbon footprint and operating expenditure.

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A New Merchant Shipping Act For Cayman

The Cayman Islands Merchant Shipping Act 2024 (the **2024 Act**)[10] came into force on 11 March 2024 with the aim of bringing the Cayman Islands' maritime legislation in line with current international standards.

Whilst the 2024 Act replaces and fundamentally redrafts its predecessor, it is materially similar on most of the key provisions. For instance, there have been no significant changes to provisions relating to the registration of vessels and mortgages. The most noteworthy change to catch the attention of the yachting industry is the requirement under the 2024 Act that all Cayman-flagged vessels, including private yachts, must have written contracts of employment for all crew members working onboard.

Whilst having written contracts of employment is not new for most yachts, the 2024 Act also details certain minimum criteria which the contracts must include, including: wage structure and method of payment, entitlement to repatriation and medical expenses, entitlement to leave, required notice periods and the governing law. The Cayman Island Shipping Registry will not individually review contracts but will be monitoring compliance with these new rules. Those failing to comply with the new rules will be subject to penalties, including, on summary conviction, to a fine of up to KYD 20,000.

The 2024 Act also improves protection for seafarers by giving the Maritime Labour Convention 2006[11] and The Standards of Training, Certification and Watchkeeping Convention 1978 (as amended)[12] the force of law in the Cayman Islands and including provisions requiring the supply of adequate free food and water to seafarers employed on Cayman Islands-flagged vessels. Other noteworthy changes include amendments to the provisions relating to liability for pollution and wreck removal such that they now directly cross-refer to the applicable international conventions and protocols (e.g. the Athens Convention[13], the Bunkers Convention[14] and the Wreck Removal Convention[15], to name but a few). Furthermore, the tonnage regulations have been updated to give the International Convention on Tonnage Measurement of Ships 1969 (as amended)[16] the force of law in the Cayman Islands.

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Revised Red Ensign Group Code

The latest revision to the Red Ensign Group Yacht Code (the **2024 Code**)[17] will come into force in July 2024. The 2024 Code is the first significant

10 https://www.cishipping.com/sites/default/files/lawsregulations/MerchantShippingAct%2C2024.pdf
11 https://www.ilo.org/sites/default/files/wcmsp5/groups/public/@ed_norm/@normes/documents/normativeinstrument/wcms_090250.pdf
12 The Standards of Training, Certification and Watchkeeping Convention 1978
13 https://www.imo.org/en/About/Conventions/Pages/Athens-Convention-relating-to-the-Carriage-of-Passengers-and-their-Luggage-by-Sea-(PAL).aspx
14 https://www.imo.org/en/About/Conventions/Pages/International-Convention-on-Civil-Liability-for-Bunker-Oil-Pollution-Damage-(BUNKER).aspx
15 https://www.imo.org/en/About/Conventions/Pages/Nairobi-International-Convention-on-the-Removal-of-Wrecks.aspx
16 https://www.imo.org/en/About/Conventions/Pages/International-Convention-on-Tonnage-Measurement-of-Ships.aspx
17 https://www.redensigngroup.org/media/yzlbtkyi/reg-yc-july-2024-edition-part-a.pdf

revision of the Red Ensign Group Yacht Code since 2019. The aim of the 2024 Code is to ensure that the Red Ensign Code accords with current international standards and guidance from the IMO and supports technological developments in the yacht industry. For example, it includes new guidance on battery systems, emergency training, over-side working systems, installation of fire appliances and petrol storage. The 2024 Code also contains provisions designed to support the adoption of alternative fuels for vessels as the industry moves towards more sustainable and environmentally friendly practices.

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Swiss Law and Arbitration

Whilst English law remains predominant, if you are dealing directly with German and Swiss manufacturers of goods – be they engineering systems or luxury goods – the chances are you will have encountered a contract subject to Swiss law. HFW's Geneva office regularly advises on Swiss law contracts, including for the sale and distribution of goods and services.

Many of these contracts provide for arbitration in Switzerland, which might at first glance be unnerving for those used to dealing with English law and London arbitration. However, Switzerland is, of course, neutral and its law can be relied upon for predictable outcomes and a business-friendly approach.

Switzerland itself has a long-standing reputation as being a popular and arbitration-friendly jurisdiction. On an annual basis, Zurich and Geneva combined host more International Chamber of Commerce arbitration hearings than London, together with a large number of arbitration hearings held under other rules, including those of the Swiss Arbitration Centre.

Under Swiss law, tribunals have wide powers to order interim or conservatory measures, with enforcement requested in other jurisdictions in the event of non-compliance. Swiss arbitration awards are readily enforceable against organisations outside of Switzerland and foreign awards are equally readily enforceable in Switzerland, which has been a signatory of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (known as the New York convention)[18] since 1965.

If you are required to enter into a contract governed by Swiss law and / or with arbitration in Switzerland, whilst the arbitration laws and provisions may not be familiar to you, this should not be an automatic cause for concern, but we would recommend you take advice from a suitably qualified and experienced lawyer before you do so.

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The Long Reach of UK Employment Law

In a landmark case with significant implications for yacht and crew management companies, the UK's Employment Appeal Tribunal (**EAT**) recently held that they did have grounds to hear an unfair dismissal and discrimination claim from a crew member working on board a yacht, notwithstanding the fact that the

18 https://legal.un.org/avl/pdf/ha/crefaa/crefaa_e.pdf

yacht never entered UK waters whilst the crew member was on board.[19]

Facts

Lindsay Gordon was employed by Yacht Management Company Limited (**YMC**) as second stewardess on board MY Alamshar. At no point during Gordon's employment did the yacht enter UK waters and YMC, which was registered in and managed payroll out of Guernsey and kept its management and HR functions in France, did not carry on any business in the UK.

Gordon travelled from her home in Aberdeen to join the yacht in Germany and she took her annual leave in Mallorca. All of Gordon's travel to and from the yacht was paid for by YMC. Gordon's employment contract stated that her place of work was on the yacht on voyages worldwide. The contract was governed by the law of England and Wales, and subject to the exclusive jurisdiction of the courts of England and Wales.

Gordon brought claims under the Employment Rights Act 1996 (**ERA**)[20] and the Equality Act 2010 (**EqA**)[21] after she was dismissed, purportedly because YMC had decided to make the role of Second Stewardess redundant.

Judgment

The EAT upheld the decision of the Scottish Employment Tribunal (the **Tribunal**) (against which YMC had appealed) that it had jurisdiction to hear Gordon's claims of unfair dismissal under the ERA and claims under the EqA.

It is an established principle of UK employment law that peripatetic employees who work in multiple jurisdictions will be protected from unfair dismissal under the ERA if their "*base*" is in Great Britain. An employee's base is normally where the employee begins and ends a "*tour of duty*"[22]. When determining an employee's base, the Tribunal must consider the entire factual matrix, including how the contract operated in practice overall (rather than simply looking at the place of work clause).

In this case, the parties had agreed that Gordon "*commenced and ended all of [her] tours of duty in a location [outside] Great Britain*".

Despite this, the EAT agreed with the Tribunal that "tours of duty" was not synonymous with "duties under the contract" which the Tribunal had concluded began and ended at Gordon's home in Aberdeen, where she commenced her journeys to join the yacht and returned to after her tours of duty finished.

The EAT held that the Tribunal had correctly employed the multi-factor analysis to determine Gordon's base. The other relevant factors were:

- The bank account into which her salary was paid was located in Great Britain.
- She accounted to HMRC for tax as a Scottish resident.
- The governing law of the contract was England and Wales and the courts of England and Wales had exclusive jurisdiction to settle disputes or claims in connection with the contract (the Tribunal disregarded the existence of Scots law and noted that the law of unfair dismissal is the same under English and Scots law).
- Her redundancy pay was calculated based on UK law.
- YMC were responsible for all travel expenses between her home and the yacht.
- Payment of her contractual annual salary commenced the day before she began her travel to join the yacht in Germany.

The EAT emphasised a distinction between whether the Tribunal was the appropriate forum to hear the dispute (international jurisdiction) and the territorial reach of the statutes (territorial jurisdiction), noting that international jurisdiction was not examined in this case.

Comment

It is not a new concept that a seafarer will benefit from UK employment rights if their base is in Great Britain, and that base need not be the port where they join the vessel (a cruise ship master was previously found to be based at either Heathrow or Gatwick airport, the locations from where he flew to join the ship at ports worldwide)[23].

The aspect of this case which may be concerning for those employing international seafarers, is that an employee's home can be their base for employment law purposes. However, this is a decision of the UK EAT and courts in other jurisdictions will not necessarily follow the same reasoning.

Even in the UK, each case will be fact specific, as any tribunal will be required to undertake a multi-factor analysis to determine a seafarer's base.

Had the Tribunal examined the issue of international jurisdiction, it may have reached a different conclusion. In another recent case, *Stena Drilling PTE Ltd v Smith*, the EAT overturned a tribunal's decision that it had jurisdiction to hear unfair dismissal and discrimination claims bought by a seafarer working on a UK-flagged vessel operating in international waters, as that tribunal had failed to distinguish between international jurisdiction and the territorial reach of the ERA and EqA.[24]

In the *Stena Drilling* case, the EAT confirmed that an employer may be sued by the employee:

(a) in the courts for the part of the UK in which the employer is domiciled;

(b) in the courts for the place in the UK where the employee habitually carried out their work or last did so; or

(c) if the employee does not habitually carry out their work in any one part of the UK or any one overseas country, in the courts for the place in the UK where the business which engaged the employee is situated.

19 https://assets.publishing.service.gov.uk/media/65f020cbff1170000196158fd/Yacht_Management_Company_Ltd_v_Ms_Lindsay_Gordon__2024__EAT_33.pdf
20 https://www.legislation.gov.uk/ukpga/1996/18/contents
21 https://www.legislation.gov.uk/ukpga/2010/15/contents
22 *Lawson v Serco* [2006] UKHL 3
23 *Windstar Management Services Limited v Harris* [2016] ICR 847
24 [2024] EAT 57

As Stena Drilling was not domiciled in the UK, nor did the employee habitually work in the UK, the case was remitted back to the tribunal to re-consider the matter of international jurisdiction and, in particular, whether the role of a UK registered group company (which was the claimant's point of contact during recruitment and for HR matters) meant that international jurisdiction was conferred by (c) above.

Gordon's case will now proceed to a full hearing in relation to her dismissal unless the parties reach an out of court settlement in the meantime.

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Sanctions Update

In our December edition of Comprehensively Yachts, we provided an update on the yachts PHI, AMADEA and ALFA NERO, each of which have faced action due to their alleged Russian connections.

With the press reporting the planned sale of ROYAL ROMANCE by Ukraine's Asset Recovery and Management Agency (**ARMA**), it will be interesting to see whether the proposed sale by auction proceeds, whether it is contested if it does proceed, and whether any such sale spurs other countries into action, several of which are bearing the heavy weight of running costs for sanctioned yachts.

ROYAL ROMANCE is owned by Viktor Medvedchuk (an ally of Vladimir Putin, and the pro-Russian leader of the Ukrainian For Life party), and his ownership of the yacht does not appear to have been disputed, unlike some of the yachts we mention below.

In May 2024, ARMA appointed a Dutch auction house to sell the yacht, although the appointment fell through a few days later. It is currently reported that discussions are now ongoing with US based Boathouse Auctions. ARMA appears committed to this course, having stated its intent to use the proceeds from the yacht's sale to fund the Ukrainian war effort by funding the purchase of Ukrainian defence bonds

However, understandably, there are questions about how effective the transfer of title to Ukraine was as a matter of law. The yacht was not originally seized by Ukraine but rather by the Croatian authorities. The Croatian Foreign and European Affairs Ministry transferred ownership of the yacht to ARMA. In most jurisdictions, the authorities have limited, if any, ability to confiscate and sell sanctioned property in this way. It is therefore realistic to think that the process is open to legal challenge and this, together with the yacht's history, may prove disconcerting for many would be buyers.

As covered in our previous edition, AMADEA's ownership remains contested, with Eduard Khudainatov maintaining he is the true beneficial owner, as opposed to sanctioned Suleiman Kerimov. With the US Federal Government reportedly spending over US$7 million a year in upkeep for the yacht, in addition to the cost of its current shipyard maintenance period in the Port of Everett, Washington, the recent US court decision to deny the US government permission to sell the yacht whilst the ownership battle continues will have been a blow.

ALFA NERO appears no closer to a sale, as the legal action against the Government of Antigua and Barbuda by the daughter of the sanctioned Russian billionaire Andrey Guryev, Yulia Guryeva-Motlokhov, continues. With an application by the Government of Antigua and Barbuda to strike out the proceedings having been dismissed, full proceedings with regard to ownership are due to commence in September 2024. Despite Yulia Guryeva-Motlokhov having herself recently been designated as subject to UK sanctions, it is not thought that this will directly affect the ongoing litigation, as Antigua, an independent sovereign nation, is not bound to apply UK sanctions.

Finally, we return to the yacht PHI, which in December 2023 we reported continued to be detained in London by the UK authorities after a failed action against their decision to detain it. PHI's owner, Sergei Naumenko, was unsuccessful in suing the UK government for the yacht's release in the English High Court in July 2023, despite the High Court acknowledging the significant interference with Naumenko's property rights.

This decision was challenged in the English Court of Appeal earlier this year. There were six grounds of appeal, the main ones being:

- Proportionality – the Court of Appeal held that the High Court judge had correctly directed himself on the law.
- Improper purpose – the Court of Appeal held that the terms of the legislation were clear, and it was sufficient for the exercise of that power that the individual was connected with Russia. The court further found that sanctioning wealthy Russians could ultimately impact "tacit support" for Putin's regime.
- Failure to state grounds – the Court of Appeal held that while the government was not required to give reasons for the detention, it had in any event done so by explaining that the detention was a result of Naumenko's ownership.
- Irrelevant considerations – while the Court of Appeal reprimanded Grant Shapps MP (Secretary of State at the relevant time), for inaccuracies in his public statements about Naumenko, it was held that the statements themselves made no difference to the legality of the detention.
- Proper purpose of Regulation 57D[25] – the Court of Appeal held that Regulation 57D (the UK sanction against Russia, which permits detentions in respect of ships owned by "persons connected with Russia") could apply to any vessel, not simply those which were involved in global trade.

Accordingly, the Court of Appeal found, again, in favour of the UK government.

25 https://www.legislation.gov.uk/uksi/2019/855/regulation/57D?view=plain

This ruling is the latest in a series of sanctions wins for the UK government. Of key importance to the yachting industry is the emphasis placed by the Court of Appeal on the UK government's ability to detain all manner of vessels which sail in UK waters, provided there is a link between the owner and Russia. The UK, EU and US governments are also increasingly focused on vessel ownership, with accusations of sham structures becoming more prevalent.

This may result in further detentions going forwards. However, as outlined above, the difficulties and costs encountered by authorities in maintaining and selling detained or seized yachts make this an extremely complicated path to embark upon, and some authorities may think twice before detaining further yachts.

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Focus on Fraud

An industry rife with opportunity

The allure of, and money involved in, yachting attracts many, including fraudsters. Against that backdrop, we discuss the new anti-fraud legislation in the UK and how that may impact upon the yachting industry.

The long-awaited Economic Crime and Corporate Transparency Act (**ECCTA**)[26] recently received Royal Assent and is part of a package of measures designed to clamp down on fraud in the UK and beyond including provisions making it easier to successfully prosecute businesses mixed up in a fraud.

Key changes under ECCTA include: 1) a new failure to prevent fraud offence which will come into effect later this year; and 2) a new law for attributing corporate liability.

The new law has potential implications for all businesses in the yachting industry including, without limitation, family offices, yacht brokers, yacht managers, yacht-owning companies, crew, marine insurers, lawyers and other service providers, as well as their Directors' and Officers' (**D&O**) liability insurance.

Failure to prevent fraud offence

The failure to prevent fraud offence works in a similar way to the failure to prevent bribery offence under the UK's Bribery Act, but instead deals with fraud. It is a new strict liability offence which covers the core fraud offences found in the Fraud Act 2006[27] (such as fraud by false representation, omission, or abuse of position) and those in the Theft Act 1968[28] (false accounting and false statements made by company directors). In a nutshell, if an employee, agent or another providing a service to the business commits fraud in relation to the business, then the business will be liable for failing to prevent it. Offences covered under the failure to prevent offence are extensive, and include aiding, abetting, counselling or procuring the commission of a fraud offence. The offence will only apply to those businesses constituting 'large organisations', where a person associated with such a business commits a relevant fraud offence intending to benefit (directly or indirectly) the business or any person or entity the associated person provides services to on behalf of the business.

26 https://www.legislation.gov.uk/ukpga/2023/56
27 https://www.legislation.gov.uk/ukpga/2006/35/contents
28 Theft Act 1968 (www.legislation.gov.uk)

Two of the three criteria below must be met in the financial year that precedes the year of the fraud offence, for a business to constitute a 'large organisation' and thus the 'failure to prevent fraud' offence to apply. The business must have more than:

- 250 employees; and/or
- more than £36 million in turnover; and/or
- more than £18 million in total assets.

The failure to prevent fraud offence will also apply to parent companies who fall within the 'large organisation' definition if they satisfy **two or more** of the following criteria in the financial year preceding the year in which the offence is committed:

- more than 250 aggregate employees; and/or
- an aggregate turnover of over £36 million net (or £43.2 million gross); and/or
- an aggregate balance sheet of over £18 million net (or £21.6 million gross).

The failure to prevent fraud offence will also apply extraterritorially, meaning that organisations located outside the UK can be prosecuted if their employee commits fraud under UK law or the victims are in the UK, *even if* the employee is based outside of the UK.

Even if a business is not itself large enough to meet these thresholds, it is likely to be impacted by the new laws as larger organisations they work with start to cascade down increased compliance requirements as a result of the new laws, in order to comply with their own reasonable procedures defence, described below.

Reasonable prevention procedures

Under the new law the relevant organisation will have a defence if it can show that it had reasonable prevention procedures in place, or if it can show it was not reasonable to expect the organisation to have prevention procedures in place to prevent the fraud from occurring.

The offence will not come into force until guidance has been published by the Ministry of Justice on what constitutes reasonable prevention procedures, although this is expected soon. In the meantime, we recommend businesses revisit their existing anti-fraud measures in the wake of this new law. Insurers may seek information as to an insured's procedures in this area when considering the risk in relation to their D&O and broader management liability policies.

Attributing corporate liability for misconduct of senior managers

The expansion of corporate criminal liability under ECCTA for certain economic crimes perpetrated by senior managers came into force on 26 December 2023.

ECCTA section 196(4) defines a 'senior manager' as an individual who plays a significant role in the making of decisions about how the whole or substantial part of the activities of a body corporate or partnership are to be managed or organised, or who actually manages or organises the whole or a substantial part of those activities.

This new law fundamentally lowers the bar for prosecuting authorities to secure convictions against companies for economic crimes. Under Section 196(1) of ECCTA, where a senior manager acting within the actual or apparent scope of their authority commits a relevant offence, the organisation will also be found guilty of the offence.

Accordingly, the conduct of senior managers will be an increasing focus for law enforcement and there is likely to be pressure for law enforcement agencies to use the new law after years of complaining that the legislative enforcement tools didn't exist.

Wider implications

With the increased risk of claims, against both individual senior managers and the corporate entity itself, we recommend businesses review their existing anti-fraud measures to ensure compliance with the new law and to prevent fraud.

We also recommend checking the extent of cover under existing D&O and/or management liability insurance policy wordings. Consider whether all individuals who fall within the ECCTA definition of 'senior manager' are covered, and whether the level of policy coverage remains appropriate. This is an especially important method of risk management for smaller organisations which will benefit greatly from having in place adequate D&O cover.

Although D&O insurance will commonly exclude claims arising from fraud, dishonesty, or acts/omissions that are intentional or deliberate, insurance cover for defence or investigation costs may be available if it can be proven that the defence was successful, and no fraud was established. Clearly, this will depend on the exact policy wording and circumstances.

It will also be necessary to consider how any cover provided in respect of the entity itself responds to ECCTA generally. The prevention of fraud offence involves a form of strict liability, and it will be essential to carefully evaluate the application of any exclusions and/or the illegality principle when determining insurance coverage in such circumstances.

We recommend all businesses, regardless of size, conduct self-assessments and engage with their support networks to ensure that up-to-date anti-fraud policies and procedures are in place, and that the new risks and implications for senior managers are adequately identified and mitigated in light of ECCTA.

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