



Insuring the cost of prosecutions and regulatory investigations

An investigation by a regulator or criminal prosecution can be a significant strain on a business' resources and involve considerable expense. For many companies, insurance is available to mitigate some of the financial burden. However, it is important to understand the limitations of such cover. This briefing provides an overview of the types of insurance available to cover the cost of defending prosecutions and dealing with regulatory investigations and proceedings.

What cover is available?

Depending on the nature of the investigation or prosecution, cover may be available under directors' and officers' liability, professional indemnity or trustee liability insurance. Some businesses may also have cover under their general business insurance or stand-alone legal expenses insurance.

Such cover will typically provide indemnity for the costs incurred in defending or challenging claims or findings made against the company or its officers, but will usually not cover fines or penalties which might be imposed as a result of a prosecution or regulatory proceedings. Criminal fines and penalties can never be indemnified by an insurance policy and civil fines and penalties are often expressly excluded by the policy terms, or cover prohibited by the relevant regulator. Public policy may also prevent the recovery of such penalties, although the scope of this public policy rule can be uncertain in the civil context.

A key point to consider in relation to coverage is at what point in the prosecution or investigation coverage is triggered. Often a policy will require formal proceedings to be initiated or for a person to be called in for an interview before any cover becomes available. Companies will often incur considerable expense in dealing with the matter before that point and in many cases those costs are unlikely to be covered.

In addition, proceedings can be lengthy and it is therefore important to have cover that pays costs as they are incurred. This allows the policyholder to keep defending the case without having to foot the bill and then recover from the insurer at the end.

Defending prosecutions

What is covered?

Cover relating to the defence of prosecutions will usually include legal costs and expenses arising out of any alleged act or omission of the policyholder, directors or its employees, which leads to prosecution in a court of criminal jurisdiction. This can include a range of offences including offences under unfair trading laws, health and safety issues including manslaughter, tax and environmental laws.

The policy may also cover the cost of appealing or defending an appeal against conviction, sentence or judgment of the relevant court or tribunal.

What is not covered?

Policy wording can vary widely and care should be taken to understand what is (and, importantly, what is not) covered.

Certain general and specific exclusions will be contained in the policy wording, in which circumstances the insurer will not be obliged to pay out on the policy. In relation to defending prosecutions, these exclusions are likely to include losses or fines arising from dishonesty as well as the amount of any fine or penalty imposed in the event that the policyholder is found to be liable.

In the event that the prosecution leads to a conviction, it is possible that the insurer may be able to claw back some or all of the costs paid out to date. In the majority of cases, the policy will only provide for claw back in the event that the individual being prosecuted is found to have acted dishonestly or fraudulently or have engaged in criminal conduct. Arguably, however, insurers may be able to recover payments made under the common law whether or not the policy provides for claw back. Whether such sums are recoverable is a matter for the court, although many insurers do not actively seek to pursue repayments.

Cover for defence costs will often also be excluded in the event that the individual being prosecuted pleads guilty. There may be some coverage available for ongoing challenges to the level

of fines or penalties imposed following a guilty plea, but this depends on the policy wording.

Regulatory proceedings

The cost of defending formal administrative or regulatory proceedings, for example those initiated by the Health and Safety Executive, the Office of Fair Trading or the FCA (for financial services firms), are often insured. The cost of dealing with these sorts of proceedings can be considerable.

However, often costs are incurred well before formal regulatory proceedings are started. For example, many financial services firms incur costs of dealing with FCA investigations without cover being triggered under their relevant policies because no proceedings have been brought.

Dealing with investigations

Investigations leading to prosecution/regulatory proceedings

Although there will usually be cover for the cost of defending a prosecution or regulatory proceeding, often there is no cover for expense incurred in dealing with the prosecutor's or regulator's initial investigations. There may be some limited cover at this stage, for example, for required attendance at regulatory interviews.

However, insurers should still be notified of any initial investigations. Some insurers may agree to reimburse such expenses if they are incurred with the insurer's prior written consent. Where an insurer believes that a well-constructed legal response to an initial investigation will reduce the chances of prosecution or formal regulatory action (and hence coverage being required under the policy), it may well be interested in reducing overall costs by providing support at the early stage.

HMRC investigations

HMRC has the ability to carry out investigations into a company's tax affairs and to initiate proceedings in both civil and criminal law. These investigations, however extensive, are likely to be time consuming and even in cases where the investigation finds no fault, the cost of complying with an investigation or appealing a decision of HMRC can be very high.

There may be provision under one of a company's policies to cover these costs.

What is covered?

Precisely which costs are covered will depend on the policy wording.

Many policies will distinguish between a "Full" HMRC investigation, in which an extensive examination of the company's tax affairs are considered, and an "Aspect" HMRC investigation, in which the investigation is restricted to certain aspects of the company's tax affairs. In both cases, cover is

likely to be triggered once the formal investigation is initiated. Costs incurred prior to that point are unlikely to be recoverable.

Bespoke insurance policies can also be taken out to cover the cost of dealing with tax enquiries. Such policies provide a wider degree of coverage, not only for costs associated with Full and Aspect investigations but also covering other HMRC enquiries such as those relating to Employer Compliance, VAT and IR35.

What is not covered?

As with all insurance policies, certain general and specific exclusions will apply in relation to HMRC investigations. Policies will exclude cover in cases where a finding of fraud or other criminal conduct.

Whereas in the case of a prosecution or regulatory investigation, costs are likely to be covered up to the point at which fraudulent or criminal conduct is determined (at which point the insurer may attempt to claw back the sums paid), tax protection may not be available even at the investigation stage where fraud or criminal conduct is alleged. Costs associated with an investigation launched by either HMRC's Special Civil Investigations (Fraud and Avoidance) or Criminal Investigations teams may be specifically excluded by many policies.

Claims barred on public policy grounds: the "ex turpi causa" principle

In addition to the exclusions contained in the policy wording, insurance cover will be rendered unenforceable if to pay out on the policy would be against public policy. The maxim *ex turpi causa oritur actio* prevents a person who commits an unlawful act from seeking indemnity against the liability which resulted from that act.

In practice, this means that in cases where the policyholder has been found to have acted dishonestly, fraudulently or otherwise unlawfully they are likely to be barred from recovering in respect of their liability on the insurance policy. This includes claims which would otherwise be covered by the policy as well as those which are also likely to be excluded by the policy wording in any event.

The application of the rule will vary with the circumstances. It is likely to apply in criminal cases. In addition, a recent Court of Appeal decision confirmed that *ex turpi causa* can apply in cases of regulatory fines and penalties for conduct which does not amount to intentional wrongdoing. The circumstances in which a regulatory breach will be treated as equivalent to a criminal offence, however, was not expressly considered and this remains a grey area.

Conclusion and practical tips

In the case of a prosecution or regulatory investigation, the policyholder's own defence costs are likely to be covered by

the policy at least up until determination. In the case of an HMRC investigation, costs incurred in enabling the investigation to take place will probably also be covered. The precise costs recoverable under the policy may be wider than this and may also include costs incurred by other parties and the costs of making an appeal.

It's important to have a good understanding of the extent of cover and exclusions. A wide range of cover is available, so it's a good idea to speak to your broker about the options available to your business.

Contact

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