Kennedys

Legal advice in black and white

24 February 2017

London Market Brief

Welcome to the latest edition of London Market brief.

Headlines in this edition include:

- Proper Increasing cyber-attacks on insurers and their customers
- Security procedures pending EU data protection regulations
- Regulatory issues posed by crewless merchant ships
- Liability issues following a new air cargo agreement
- Legal innovations and the insurance industry
- Proper construction of a notification condition precedent
- Impact on D&O policies following fraud investigation in Brazil
- Denied passenger boarding claims and US entry requirements
- The hazards of combining fine art and luxury yachts

As always, we hope you enjoy reading this edition and welcome your feedback.

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Cyber attacks are on the increase, but who is the real victim?

The 2016 annual Crime Survey of England and Wales concluded that more than 5.5 million cyber offences now take place each year, which accounts for almost 50% of crime in England and Wales.

According to telecommunications specialists, Beaming, British firms were each subjected to an average of almost 230,000 cyber attacks in 2016. In addition, the average volume of attacks hitting individual company firewalls passed the 1,000 per day mark for the first time in November 2016. So what options do insurers and their customers have if an attack is successfully executed?

Man in the middle

Take the following situation: an insured company deals in foreign currency exchange and liaises with its customers via registered and verified email addresses. The insured receives instructions from a customer's registered email address to transfer its funds to a third party's account in say, Spain. The insured actions the request, but it is subsequently discovered that their customer's email account had been hacked and a fraudster had sent the email instructions from the legitimate email account (known as a 'man in the middle' attack). The customer is unaware of the transaction until he discovers that his money is not where it should be. In that scenario, the insured has simply followed instructions, believing them to be from their client, but the client is left out of pocket.

Liability

Putting to one side arguments that the insured's verification procedures could have been more stringent in the above example, who is liable to compensate the client?

An insured, be it a company or a financial institution, will look to its cyber insurers. However, the majority of policies currently offered will only provide cover in circumstances where the insured's own computer systems or data have been manipulated or attacked. Equally, although some financial loss policies will cover electronic crime, many do not specifically cover phishing attacks - again limiting cover to manipulation of computer systems by a third either party or an employee. The result can be a gap in cover.

Alternatively, the financial institution's financial loss policies may respond under professional negligence cover - on the basis that, if an insured does not compensate a client for the missing funds, a negligence claim would follow (on the basis that the insured did not take adequate steps to protect the client's money).

The situation is slightly different where money is obtained fraudulently from a client of a firm of solicitors who receives an email purporting to be from their solicitor advising of a change to their firm's client account details. The Solicitors' Accounts Rules oblige a solicitor to account to the client for the shortfall and, as such, professional indemnity insurers may find themselves indemnifying their insureds - despite technically no negligent or wrongful act having taken place.

Landmark decision?

On 9 January 2017, The Telegraph reported an incident involving TSB Bank. A Mr Burton had purchased a motor home for £3,400 via eBay in 2014. He transferred the money to the vendor's TSB account via Paypal and was told that the vehicle would be delivered within four days. The motor home never appeared and the vendor's contact number no longer existed.

Mr Burton reported the issue to his bank, Barclays. The bank advised that there was nothing it could do. The money had been siphoned from the TSB account as soon as it was paid in. Mr Burton complained to the Financial Ombudsman, which held that TSB was not at fault. Mr Burton contacted the police, who advised that the vendor's TSB account had been opened using false identity details. The Ombudsman maintained its rejection of the complaint and it was only when Mr Burton contacted Telegraph Money that TSB agreed to refund Mr Burton.

A changing tide?

Other victims may try to rely on this outcome in support of their own positions. Whether or not Mr Burton's outcome is truly "landmark" waits to be seen. The adverse publicity here is likely to have influenced the bank's decision to exercise its discretion to compensate Mr Burton. However, this decision could represent a shift in banks' attitudes where they do not do everything they can to prevent fraudsters setting up bank accounts.

Comment

In order to try to limit their potential exposure to cyber attacks, both insurers and their customers should ensure that:

- They have appropriate firewalls in place to prevent hackers accessing internal systems.
- Staff are fully trained to identify and respond to possible fraudulent communications and phishing attempts.
- They have appropriate insurance cover specifically designed to cover cybercrime.

Underwriters should also consider whether their financial and professional indemnity policies are inadvertently exposed to losses arising from these kind of cyber attacks, and if so, appropriate exclusions should be included.

If the worst happens and an insurer or insured is targeted, the action taken on identifying the issue is crucial.

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EU data protection: this time it's personal

New EU General Data Protection Regulations (GDPR) were agreed at the end of last year, and are set to replace current UK Data Protection Act 1998 laws from 28 May 2018.

The new rules are designed to strengthen the rights individuals have over their data, and simplify the regulatory environment to provide further clarity and legal certainty for businesses.

Since the current data protection rules were put in place in 1998, we have seen a transformation in the threat faced by companies from cyber hackers and associated data breaches. The high profile attack against Yahoo provides a recent example. This could be one of the largest cybersecurity breaches ever, and Yahoo recently confirmed that the hack may have compromised data associated with up to one billion user accounts.

With the increasing occurrence of such attacks and larger amounts of personal data held online, the new data protection rules are key for businesses to safeguard their customers' personal data.

EU regulations in a post-Brexit UK

The GDPR will apply to any company that handles EU citizens' data and imposes restrictions on the transfer of personal data outside the EU, to ensure that the level of protection of individuals' data is not undermined. Where a company is based outside the EU, but handles EU citizens' personal data, the European Commission will determine whether that country is able to ensure an "adequate level of protection" for the data, before any transfers of data can be made.

Once the UK leaves the EU, such a consideration will have to be made in regards to UK businesses which hold personal data of EU citizens. A "safe" rating for the UK will not be automatic, and will depend on whether the UK agrees to implement equivalent data protection laws in 2018.

Sanctions

Under the new rules, businesses will not only need to comply with the regulations, but must also demonstrate their compliance (Article 5(2)). Non-compliance with the GDPR will attract heavy fines of up to 4% of a company's global turnover or €20 million – whichever is higher.

The rules state that calculating the fine of up to 4% will be based on "annual turnover of the preceding financial year", although no guidance is given on

whether the preceding year relates to the date of the breach or to the date the breach is disclosed.

Take a recent example where a large multinational company has suffered a data breach as a result of the cyber-attacks on Yahoo. Yahoo has confirmed that names, phone numbers, passwords and email addresses were stolen, but no bank and payment data was taken. If the GDPR was current law, as Yahoo failed to report the exposure within 72 hours, they would have faced massive fines. If we take 2015 as the year of the data breach, Yahoo could have been fined up to €188 million. Either way, these fines are demonstrative of the need for businesses to take a very careful approach to data security.

New regulations – key changes

Businesses will face joint liability with their data management partners. This is a key tenet of the reforms. At present, only the data controller is liable for a data breach. The GDPR extends liability to include providers of outsourced operations (data processors). Given the deterrent nature of the fines that could be imposed, businesses are likely to want to manage their outsourced operations very closely.

Further, any breaches must be reported to the relevant supervisory authority within 72 hours. Failure to do so can result in a fine of up to €10 million or 2% of global turnover.

Impact on the market

Until the Commission makes a decision on whether the UK is "safe" for the transfer of data, EU companies will have to consider whether they are able to transfer personal data to the UK. In anticipation of these considerations, companies should ensure they have appropriate security procedures in place to prevent loss of data by the time the legislation comes into force in early 2018.

The existing market may wish to review the level of premium in light of the dramatic increase in penalties, or in the alternative consider a cap on the level of an indemnity. Consider the impact of the imposition of an EDPR fine on a company such as Yahoo. Rather than facing the current maximum fine of £500,000, if the data breach had taken place under the EDPR, it could risk receiving fines within the range referred to above. We believe that insureds will have no choice but to seek some form of cover.

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Ghost ships

The carrier shall be bound, before and at the beginning of the voyage, to exercise due diligence to…properly man...the ship…

Unlike the 'Flying Dutchman', crewless, drone or 'ghost ships', may be calling into ports sooner than we imagine.

Whether remotely operated, or fully autonomous, crewless merchant ships are on the horizon, and while there are no shortage of justifications and tech sector is prepared, legal and regulatory hurdles still need to be navigated, and marine insurers should keep watch.

Automation

Automation in marine transport is not a new concept. Merchant ships already rely on hundreds of integrated control systems and automated sensor technologies to manage propulsion, support navigation and communications, operate safety systems, and manage cargo loading and discharge.

Around 150 years ago a normal cargo ship had about 250 crew members on-board, and numbers have declined ever since. These days little more than a 'skeleton' crew of 10 to 15 man the helms of the world's largest ships.

In the last couple of years the world's leading marine technology and innovation companies have focussed their attention on turning that skeleton crew into ghosts, developing concept designs and prototypes for completely crewless ships.

Developments

In late 2014, international certification body and classification society, DNV GL, developed a concept design for a 60 metre long, unmanned, fully battery powered, zero-emission, shortsea vessel - code named the 'ReVolt'.

This was followed by a three year research project by the European funded, 'Maritime Unmanned Navigation through Intelligence in Networks' (MUNIN) group, which released its final report earlier this year.

A most noteworthy project is the Rolls-Royce led 'Advanced Autonomous Waterborne Applications' initiative (AAWA), which in 2016 released its futuristic vision of land based control centres where captains remotely control more than 10 vessels at a time with the aid of interactive smart screens, voice recognition systems, holograms and surveillance drones, to monitor what is happening both on board and around the ship.

But this is only the beginning. We are already moving well past simply ‘floating’ the ideas of the future. Actual sea trials of larger unmanned ships are due to commence soon. Finnish maritime industries are establishing an ecosystem for autonomous marine transport aimed at creating autonomous marine transport systems in the Baltic Sea by 2025. Further, Norwegian maritime authorities have entered into an agreement to define a designated area for sea trials and testing of autonomous ships in Trondheim Fjord, with some companies close commencing sea trials for what they say will be the first unmanned and fully-automated offshore ship to enter service in 2018.

Justifications

The two primary drivers of crewless ships are safety and costs.

First, most accidents at sea are caused by human error. On average, 1 vessel sinks every 4 days. This has a significant toll on human life with it being estimated that between 2,000 and 6,000 mariners die at sea each year. Removing the crew all but eradicates this problem. Additionally, removing the crew, removes the possibility of hostages in piracy situations.

Second, the expense incurred to crew a large cargo ship equates to approximately 44% of the cost of running the entire vessel. The removal of a crew eliminates the need for accommodation, heating and plumbing aboard these ships, in turn providing greater capacity to carry cargo. Further, removing the crew allows vessels carrying non-urgent cargo to ‘slow steam’, reducing cruising speeds to reduce greenhouse emissions. This not only has a clear benefit in fuel economy, with it being estimated that a 30% reduction in speed can save a bulk carrier around 50% in fuel, but would not be possible if a crew were on-board.

Regulatory Issues

The greatest barriers for these crewless ships are not technological, nor do they lack reason, rather it is the legal and regulatory framework that poses the greatest challenge, a reality shared by driverless cars and pilotless aircraft.

Compliance with current international marine regulations remains questionable. To date no international legal marine instrument has addressed the legalities of crewless ships. It is important to consider how, if at all, these vessels could comply with current maritime regulations such as SOLAS, COLREGs, STCW, and MARPOL, to name a few. The primary issue with these crewless ships is the ‘manning’ requirement, whether express or implicit in many of these regulations.

Expressly, for example, chapter V, regulation 14 of SOLAS, which regulates minimum safety standards in the construction, equipment and operation of ships, provides that a ship must be sufficiently and efficiently manned, and stipulates that minimum safe manning levels should be implemented aboard ships. Regulation

33 provides an obligation on the master of a ship to offer aid to other ships in distress, where it can do so, and regulation 24 requires that it must be possible to switch to manual steering with the assistance of a helmsmen. It is difficult to imagine how an unmanned ship would be able to provide assistance to a human operated ship in distress.

At least impliedly, the COLREGs, the 'rules of the road' on the high seas, require ships to be manned requiring, at rule 5, that a ship must maintain a proper lookout by sight and hearing so as have a full appraisal of the risks of collision. Similar issues are found in the STCW, which set out minimum standards relating to watch-keeping.

Further, under most sea carriage conventions, the carrier is obliged to "properly man, equip and supply the ship", in order for the vessel to be considered seaworthy.

Crewless ships that do not comply with current legal frameworks pose significant issues for insurers, brokers and their insureds. To the extent manning denotes seaworthiness, an unseaworthy ship is ineligible for insurance.

The difficulties posed by current regulatory frameworks are hurdles, not walls. After all, 'sufficient', 'efficient', or 'proper' manning may be no manning at all. In the case of semi-autonomous vessels, the obligations may be fulfilled by remote skilled operators, with any obligation to keep a proper lookout being met by sophisticated camera and audio sensory technologies, arguably superior than any human eye or ear.

Of course the more interconnected and automated a ship is, the more exposure to cyber security concerns. The possibility of cyber piracy, damage or delay through cyber disruption must be borne in mind, when presently the majority of marine insurance policies include cyber-attack exclusion clauses. Like any risk, however, the risk of a cyber intrusion will never be eradicated, only minimised. This risk mitigation occurs both on the technological side, but also through appropriate marine insurance.

Overcoming technological and regulatory hurdles demands a collaborative approach. As technology develops, so must marine insurance. Even if the ships are crewless, marine insurers must ensure their posts are manned, and continue to keep watch.

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Incoming air cargo agreement could buffet airline insurers

The recent announcement by the International Federation of Freight Forwarders (FIATA) and the International Air Transport Association (IATA) of a new air cargo agreement and subsequent signing of a co-operation agreement is intended to herald a new era in the relationship between freight forwarders and airlines.

The new relationship will see the end of the IATA airline-controlled Cargo Agency Programme and Conference in favour of the establishment of a new shared cargo programme called the IATA FIATA Air Cargo Programme (IFACP).

The new programme means forwarders and airlines are intended to sit as equals in acknowledgment of a shift from forwarders' traditional cargo-selling agent role to their evolving principal-to-principal relationship with airlines, while together they define and establish new operating procedures in the cargo business. Roll-out of the new programme will commence next year in Canada with the expectation the IFACP will be fully operational in 2018.

With more than 80% of transactions now performed by forwarders acting as principals, the move to principal relationships is anticipated to "diminish liability issues and reduce the risk of legal challenge going forward", while reducing airline forwarder conflict said to be caused by ambiguous roles and terms.

Under the old agency relationship, the role of the forwarder has often been subject to legal scrutiny, particularly when issues arise as to the capacity in which a forwarder was acting in relation to a particular element or task associated with carriage. This IATA agent "dual capacity" has always been legally perplexing and, over time, has become more difficult to manage particularly from a legal liability perspective.

Clarifying liability

Another stated objective of the IFACP is to clarify the realm of legal liability between carriers and forwarders. Issues have often arisen, particularly concerning when the carriage by air commences or whether notices of complaint to the airline may be delivered to the forwarder in its capacity as agent of the carrier.

Whether these issues will be definitively resolved under the new programme will continue to depend heavily on the manner in which air waybill documentation is recorded, the true facts and circumstances associated with each contract of carriage and claim, the actual role performed by the forwarder and, not insignificantly, on what a shipper understood or was told about the carriage and its logistics.

Under IFACP, forwarders acting as principals and their consignments will be governed by the same rules of contract formation as "true shipper" consignments. For example, the carriage by air and an air carrier's convention liability for loss, damage or delay to cargo is not intended to commence until cargo is received by the airline or its ground handling agent.

In addition to legal issues, which will remain dependent on the particulars and logistics of carriage, the newly recognised role of the forwarder as principal brings with it the reality of forwarders' increased customer bargaining power vis-à-vis airlines, particularly with regard to cargo legal liability, claims, and payments.

With FIATA forwarders currently comprising a significant (if not the most important) segment of commercially valuable customer for airlines, traditional approaches to cargo liability and even convention applicability may well be at risk as airlines are, as a commercial imperative, forced by forwarders to approach claims from a commercial or customer relations standpoint rather than from a pure legal one.

With forwarders increasingly controlling shipper-consignee relationships and airlines' increasing distance from originating shippers or ultimate consignees, forwarders are increasingly settling claims directly with their shipping customers without prior reference to airlines or to convention principles of legal liability, then exerting pressure on airlines to reimburse them irrespective of valid legal defences to liability or limitation of liability.

To complicate matters, the new relationship makes it increasingly difficult for carriers to verify claims and damages directly with a forwarder's client unless the forwarder provides that information.

Forwarders increasingly threaten to (and do) shift business from carrier to carrier unless carriers pay full claimed amounts without reference to applicable law or limitation. It is not difficult to anticipate that commercial imperative and preservation of key customer relationships will likely override airline legal considerations in handling cargo claims.

Difficult decisions

Decisions must be made as to whether and how airlines will deal with (read pay) and account for payments in the absence of any legal liability and in excess of limits of liability with the knowledge that such ex gratia payments will directly affect carrier revenue and profit, as well as recoverability from underwriters if the cargo policy is applicable to a particular claim.

Air waybill deductibles aside, it is a well-settled principle of insurance enshrined in the policy that underwriters are obligated only to indemnify amounts that their insureds are legally liable to pay.

In addition to the fundamental question of whether the convention and its liability limits will remain relevant considerations in cargo claims, airlines will need to consider the effect of ex gratia payments on indemnities to which they may otherwise be entitled from other responsible parties.

Historically, IATA-based ground handling agreements or road carriage contracts allow service providers to limit liability in accordance with applicable convention limits. Voluntary payments may therefore impinge on issues related to contribution and indemnity.

This article was first published by Insurance Day on 22 November 2016.

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Legal innovations and the insurance industry

There has been a profound shift in the provision and delivery of legal services to the insurance industry within the last ten years. The introduction of government driven, online claims portals and medical reporting criteria for the majority of personal injury cases has forced a reduction in the proportion of those claims heading into litigation.

Such a seismic shift should have seen a correspondingly dramatic change in the way that lawyers offer legal services to the insurance industry.

In spite of exciting opportunities to modernise, many lawyers still seek to differentiate product defiantly and depressingly purely on price, notwithstanding that there are a plethora of new technologies that lawyers should be investigating for their clients' benefit. Artificial Intelligence and its application to the delivery of legal services; and insurers' push towards solutions built on coding, such as Blockchain, are but two possibilities.

In 2009, I wrote an article focused on innovation. I argued then that clients regard the instruction of their own lawyers as 'a distress purchase'. Lawyers who have continued to set their pricing models based on ever-increasing claims volumes or greater levels of attritional work are, therefore, rather missing the point, and missing it by some distance. As a consequence, they face in 2017, a very significant risk in the wake of the current whiplash consultation, which promises to eradicate huge swathes of the litigation upon which the solvency of such businesses depends.

The intervening years

In 2009, external investment in law firms was coming. It's moot whether such investment was a success for clients. Very little external investment appears to have been truly directed at innovation for the benefit of clients, rather than for the benefit of the lawyers receiving that investment.

Claims numbers have continued to rise, and litigation numbers generally seem to have stabilised, often for the wrong reasons. As one client has recently said to me, "there will always be such a thing as good litigation". However, I understand that some lawyers require clients to guarantee litigation numbers. Such clients are compelled to become addicted to their lawyers, while those same lawyers race to the bottom on service and price.

To offer value, innovative legal solutions for the insurance industry must help claims teams to reduce their reliance on lawyers and to break the addiction.

The way forward?

Therefore, a modern law firm must offer innovative ways to cure clients of their traditional addiction on lawyers.

Insurers are now developing their thinking far more quickly than the lawyers who profess to advise them. For example, On-Demand Insurance built on AI coding and the work being carried out by insurers, based around Blockchain, should also be changing lawyers' understanding of the insurance market.

LJ Briggs, in his report on the reform of the structure of civil courts, has proposed a world in which citizens can secure justice through innovation, technology, and a greatly reduced reliance on the legal profession. Rather than fighting that inevitability, how much better would it be for the legal profession to create the innovations that ensure access to justice for the disadvantaged?

I work with a group of visionary people who have designed a range of products to meet a 21st century insurance market that empowers clients with the means to make their own legal decisions. I have also seen the future in the form of KLAiM, a virtual lawyer that does away with insurance clients' need to instruct a lawyer at all in many injury cases.

Such innovations support the core principle that legal innovation must help clients only to use a lawyer when they really need one.

This article was first published by Insurance Post on 6 January 2017.

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Notification: Court considers the meaning of "as soon as possible" and "likely to give rise to a claim"

***Maccaferri Limited v Zurich Insurance PLC* [2015]**

In this case, the Commercial Court provided useful guidance on the proper construction of a notification condition precedent in a public and product liability policy.

The case is also notable as the Court rejected the insurer's argument that a duty of inquiry should be placed on the insured.

Background

An employee suffered a serious eye injury at work whilst using a Spenax gun. The employee sued his employer who, in turn, sued the Insured, Maccaferri Limited, who had hired the gun to the employer.

The employee's accident occurred on 22 September 2011. The Insured received a solicitor's letter almost two years later, on 18 July 2013, informing it that a claim was to be brought against it by the employer. The Insured notified its public and product liability insurer, Zurich a few days later on 22 July 2013.

The Insurer declined to provide an indemnity on the basis that the Insured had failed to comply with a condition precedent relating to notification which said:

"The Insured shall give notice in writing to the Insurer as soon as possible after the occurrence of any event likely to give rise to a claim with full particulars thereof."

The Insurer argued that the Insured should have given notice by October 2011 (shortly after the accident occurred) or by June 2012.

The Insurer also argued that the use of the words "as soon as possible" indicated that the obligation to notify arises when an Insured could with reasonable diligence discover that an event was likely to give rise to a claim. The Insurer argued that this wording put an obligation on the Insured to proactively investigate whether a claim was likely, which the Insured here had failed to do.

Decision

In both instances, the Court (Mr Justice Knowles) rejected the Insurer's arguments and found for the Insured. The Insurer was therefore obliged to indemnity the Insured.

Mr Justice Knowles held that the notification requirement of an event “likely to give rise to a claim” meant that there needed to be at least a “fifty percent chance that a claim against the Claimant would eventuate”. The Court held that the wording was merely a reference to the promptness with which notice should be given and did not indicate an implied duty of reasonable inquiry. Mr Justice Knowles held that there was “no room…for…a continuing or “rolling assessment” of claims being made against the Insured.

Applying the terms of the policy to the facts of the case, Mr Justice Knowles held that at the time of the accident, there had not been at least a 50% chance that a claim against the Insured would eventuate; it had only been a possibility. The accident could have been as a result of the fault of the gun, the fault in the use or no fault at all. The Court also found that the reference to the likely involvement of the Health & Safety Executive or forensic testing on the gun did not indicate that there was anything more than a possibility of a claim. The Court broadly accepted that a claim might still have been likely if it were a bad or vexatious claim, but this would depend upon the facts and did not aid the Insurer here.

Comment

This decision serves as a useful reminder for both insurers and policyholders that it is important to set out notice provisions in detail so as not to leave room for interpretation in the event of a dispute. This is particularly crucial when notifications are expressed to be a condition precedent, where any failure to comply means that the insurer can legitimately refuse a claim.

Parties must also consider carefully what wording to use in a notification clause. It is possible that this case may have been decided differently if the Insured was obliged to notify an event which “may give rise to a claim” as opposed to an event which was “likely to give rise to a claim” or a “circumstance” as opposed to an “event”.

This case will provide some comfort to policyholders when they are faced with an event where causation is not immediately ascertainable - there is no duty on a policyholder to proactively investigate. However, it will be interesting to see how the Court intends to reconcile this with the new duty of fair presentation under the Insurance Act 2015. This new duty will require policyholders to present every material circumstance which would influence the judgement of a prudent insurer or put the prudent insurer on notice when assessing a risk.

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Operation Greenfield: a new watermark post-Lava Jato?

Towards the end of 2016, news broke of a Brazilian Federal Police investigation designated *Operation Greenfield*, a major fraud investigation that the Brazilian press has labelled the “new Lava Jato”.

The scale and potential ripple effects of this operation throughout the (re)insurance industry, particularly in D&O programmes, make Greenfield undoubtedly interesting. However, it will be even more fascinating to see how the investigation develops and how it interacts with the evolving Brazilian legal system, in the wake of the Lava Jato investigation.

Investigation

Greenfield is the code word that the Brazilian Federal Police has used for the initial stages of the investigation that is focused on Brazil’s four largest state-run pension funds:

- Funcef - pension fund of the state-run bank Caixa Economica Federal
- Previ - pension fund of the state-run bank Banco do Brasil
- Postalis - pension fund of the postal service Correios
- Petros - pension fund of Petrobras.

Other private pension funds are also under investigation, as well as the private banks Bradesco and Banco Santander Brasil, and the fund manager Rio Bravo Investimentos.

After the targeted pension funds suffered many years of successive losses, and following a parliamentary inquiry filed in August 2015, the Brazilian Federal Police and the Public Prosecutor began to analyze whether these losses were connected with a potentially fraudulent scheme.

The Federal Police alleged evidence of “organized criminal activity” between senior business executives, pension fund managers, asset rating companies, and private equity funds.

The alleged scheme involved:

- High-level directors of the pension funds
- Auditing companies that issued reports about the financial health of the invested entities

- Directors of the (Fundos de Investimentos em Participações - special funds launched by private and publically traded companies) (FIPs)

- The invested companies.

The total losses arising out of the scheme are estimated at BRL$6.6 billion (US$2.6 billion) between the four pension funds.

Impact on (re)insurers of D&O policies

Almost every D&O policy has a provision stating that the (re)insurer will advance/indemnify the insured for the costs the insured may incur in defending a legal action brought against them. At the same time, every D&O policy has an exclusion for the wilful wrongful acts committed by the insured. However, barring an insured's confession, this exclusion may only be applied once a final, un-appealable judgment has been rendered against the insured.

If the defendant insured is found guilty, then the policy provides that the (re)insurer has the right to have the advanced defence costs reimbursed. However, this provision has largely gone untested and it is not known how effective it really is.

This limitation on the application of the wilful misconduct exclusion is mandated by law, usually constitutionally, so that the policy complies with the presumption of innocence.

Interaction with Brazilian legal system

The Brazilian legal system is three-tiered, and in some cases, there is the option to appeal to a fourth level, the Superior Federal Tribunal, Brazil's highest court. According to the provisions of most D&O policies, the wilful misconduct exclusion may only be applied when the defendant insured has exhausted every possible legal recourse. One can imagine how expensive legal fees incurred can get whilst the defendant insured navigates the many levels of the Brazilian legal system.

However, in the light of the Lava Jato investigation, a new trend in Brazilian jurisprudence leaves room for (re)insurers to apply the wilful misconduct exclusion before the defendant insured goes through every level of the Brazilian judicial system.

Multiple discussions have been had on the subject and, on 17 February 2016, the Superior Federal Tribunal issued a polemic decision holding that penal sentences rendered by second instance courts may be executed before a final and un-appealable decision.

Further solidifying this new trend, on 5 October 2016, the Superior Federal Tribunal ruled that the presumption of innocence is not absolute, and therefore, a decision rendered by second instance courts could be executed, even if the defendant still has the right to appeal to higher courts.

Further complicating matters for (re)insurers is Brazilian law's tenuous notion of reasonableness when it comes to defence costs. It is a given that most, if not all, D&O policies will cover the insured's reasonable defence costs. However, in Brazil, the notion of reasonableness is heavily skewed towards the insured; so much so that SUSEP, the Brazilian Insurance Superintendence, in its Circular No. 541 of 14 October 2016, completely removed the qualitative term "reasonable" from its definition of defence costs.

Comment

Many in the industry have already categorized Lava Jato as a watermark event in Latin America's insurance industry, particularly in the relatively young and still-developing D&O market.

With over US$2.6 billion in losses suffered by these pension funds and 353 individuals and institutions implicated, the ripple effects of Operation Greenfield may be felt just as strongly.

It remains to be seen whether applicable policies for this first major "post-Lava Jato" event will reflect any lessons learned.

Read the full version of this article (PDF, 75KB)
http://www.kennedyslaw.com/files/Uploads/Documents/Miami%20office/Kennedys_Greenfield%20II%20(full%20analysis).pdf

Passenger denied boarding: will you be Trumped?

Is there a defence for airlines in the event of denied boarding claims under European Regulation EC261/2004 (the Regulation), as a consequence of misunderstanding the changing US entry requirements?

Executive decision

On 27 January 2017, Donald J. Trump, US President, issued an executive order changing the requirements for entering into the US.

Section 3(c) of the executive order states that:

> "…immigrant and nonimmigrant entry into the United States of aliens from countries referred to in section 217(a)(12) of the INA, 8 USC 1187(a)(12), would be detrimental to the interests of the United States, and I hereby suspend entry…of such persons… (excluding those foreign nationals travelling on diplomatic visas, North Atlantic Treaty Organization visas, C-2 visas for travel to the United Nations and G-1, G-2, G-3 and G-4 visas)."

Specifically, entry was suspended for nationals from seven countries. These countries being: Iraq, Syria, Iran, Libya, Somalia, Sudan and Yemen.

While the legality, application and enforcement of the executive order remains an ever 'moving feast', various information, advice and cautions have been provided to both airlines and passengers regarding travel into the US.

The UK government's current advice [correct at 9 February 2017] states: "British passport holders, including British nationals who hold dual nationality with these countries, aren't affected by these measures. However, British dual nationals of one of the seven countries must apply for a visa rather than travel under the Visa Waiver Programme."

Confusion

Underlining the confusion surrounding the effect of the executive order, press stories, allegedly based on information from the UK Foreign Office state that the executive order:

Only applies to those individuals travelling from either Iraq, Syria, Iran, Libya, Somalia, Sudan, and Yemen to the US.

Does not apply to UK nationals (even if non-UK born and born in the banned seven countries) travelling from either Iraq, Syria, Iran, Libya, Somalia, Sudan, and Yemen to the US.

Does not apply to a dual nationality citizen of either Iraq, Syria, Iran, Libya, Somalia, Sudan, and Yemen travelling to the US from another county (not from the banned seven countries).

May apply to dual nationality citizens travelling from one of the seven countries to the US.

Given the immediate impact to the aviation industry, on 30 January, IATA made a statement on the US executive order on Travel. It stated that:

> "The EO was issued without prior coordination or warning, causing confusion among both airlines and travellers. It also placed additional burdens on airlines to comply with unclear requirements, to bear implementation costs and to face potential penalties for non-compliance."

Impact for airlines

Essentially there are two broad risks that airlines may face as a result of the 'travel ban':

The incorrect denied boarding of passengers who are incorrectly determined to be affected by the 'travel ban' and therefore the resulting compensation claim from the passenger.

The carriage of passengers incorrectly where nationality and/or travel documents are subject to the 'travel ban' and the financial penalty imposed on the airlines as a result of their carriage to the US in breach of the 'travel ban'.

In respect of the first risk identified, the Regulation imposes certain obligations.

The Regulation will be relevant to all airlines departing from the EU and to EU carriers departing for the EU, perhaps with passengers intending to transit through airports situated in EU Member States.

Article 4(3) deals with the obligations of the airline to compensate and assist passengers who are denied boarding against their will. Compensation is fixed under the Regulation.

However, although Article 1(1)(j) confirms that "denied boarding" means "a refusal to carry passengers on a flight, although they have presented themselves for boarding, under the conditions laid down in Article 3(2)", there is an exception "where there are reasonable grounds to deny them boarding, such a reasons of health, safety or security, or inadequate travel documentation".

If airlines err on the side of caution (given the mixed messages, confusion, insufficient detail and changing nature of the 'travel ban') and deny boarding

incorrectly, could a claim for denied boarding compensation be successfully defended on the basis that there were “reasonable grounds” to deny the passenger boarding?

Reasonable grounds in English law

In essence, may the confusion, insufficient detail, and changing nature of the ‘travel ban’ constitute “reasonable grounds”? We will consider this question in the context of English law.

It is arguable that the precise nature, application and enforcement of the ‘travel ban’ has not been communicated in detail. There was a lack of co-ordination or warning that the ‘travel ban’ was to be implemented by the US, and subsequent ‘clarifications’ issued by the Department for Homeland Security have made for a confusing situation of itself. In addition, the day-to-day position in respect of the nature, application and enforcement (and even legality) of the ‘travel ban’ is changing and it is clearly difficult to understand with absolute clarity what travel restrictions apply to which passengers.

Given the high likelihood that passengers will be denied boarding in the mistaken belief that they are ineligible for entry to the US, the question arises whether an airline, which mistakenly denies boarding to a passenger in such circumstances, will be entitled to rely on the “reasonable grounds” defence to a claim for compensation under the Regulation.

The concept of “reasonable grounds” has been the object of judicial consideration in England and Wales in the context of striking out statements of case. In that context, if the statement of case discloses no reasonable grounds for bringing or defending the claim it may be struck out by the court. In this context the court maintains its discretion, and case management powers, to determine whether there are “reasonable grounds”.

However, a statement of case will have no reasonable grounds where it discloses no facts indicating what the claim is about, or the facts are incoherent or, where coherent, and if true, disclose no legally recognisable claim. On this basis, the threshold for “reasonable grounds” is relatively low, with a coherent decision, based on facts which could support the decision, being sufficient.

In other contexts, “reasonable grounds” has been held to mean that it is necessary to demonstrate actual knowledge of relevant facts which provided the grounds for a relevant belief, established by evidence. Accordingly evidence would need to be adduced from the agent who denied boarding as to the basis of that decision (i.e. a belief, based on relevant facts that the passenger would not be permitted to enter the US).

Comment

If an airline (in defence to a claim for compensation under the Regulation) can evidence that a decision to deny boarding was taken based on facts sufficient to meet the “reasonable belief” requirements and the position of the passenger (with regard to nationality and/or travel documents), even if mistaken, the airline should benefit from the “reasonable grounds” defence.

While there is no guarantee that any individual judge will apply the same “reasonable grounds” test in the context of a denied boarding claim under the Regulation, the body of judicial consideration of the phrase in the context of strike out applications, gives some optimism that a defence on this basis may be successful.

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Legal advice in black and white

Fine art and luxury yachts: plain sailing for insurers?

The UK luxury yacht market is booming. The fall in the value of sterling has made purchasing yachts from UK sellers even more attractive to overseas buyers. The fine art market is similarly buoyant, delivering growth rates outstripping other assets.

All this should be good news for builders, designers, banks, brokers, and specialist yacht and high net worth (HNW) insurers. But, when fine art and luxury yachts combine, there are some hazards to navigate.

Aggregation

Hull values alone far exceed many commercial vessels. The 92 million Aquarius, delivered in 2016 and owned by avid fine art collector Steve Wynn, has a reported value of US$215 million. Combine this with fine art and other toys with which high-end yachts can now come and aggregate values can reach the US$500 million mark, in respect of a single yacht.

Mr Wynn's previous 67 million Aquarius had a value of around US$75 million, but several of his artworks are worth substantially more – in 2008, he famously put his elbow through a Picasso he was about to sell for US$139 million. Where the value of the art substantially exceeds the value of the yacht, insurers may not be willing or able to take on the additional fine art exposure; and the marine risk may be difficult to add to the fine art cover.

Recent marine market casualties such as Tianjin have highlighted the need to focus on wider aggregation issues which, for yacht insurers, will consist of exposures in marinas, particularly to fires, weather events and pollution, or for racing events and regattas.

Additional risks

Fine art afloat is subject to specific risks, such as water damage, sinking, collision damage and piracy, to which it would not be subject ashore. Special precautions are required to ensure the art can withstand swell, and rolling and pitching of the vessel at sea. Sunlight, humidity and temperature fluctuations can easily damage artworks and pose particular problems afloat because the art will change geographical location as well as its position relative to the sun.

Valuations

Just as with fine art, the valuation of yachts is highly subjective and often problematic. Comparators can be difficult to find. Vessels may well be unique. Second-hand values can fluctuate considerably, depending on what other yachts are available on the market at the same time.

Getting valuations right is crucial. In 2015, an insured failed to recover a total loss claim by declaring a value of €12 million when the yacht was up for sale at €8 million. Not every over-valuation will amount to a misrepresentation and, now that the Insurance Act 2015 is in force, the insurer's remedy for any misrepresentation will be proportionate, so it is more likely that claims will have to be paid (at least in part).

Compensation for late payment of claims

The yacht and HNW market prides itself on claims service excellence. Disputes between insurers and their insureds are rare. The pressure to make quick claims settlements will only increase. Insurers need to be alive to the potential exposure to pay damages for late payment of claims. As from 4 May 2017, s.13A of the Insurance Act 2015 implies a term into every contract of insurance that the insurer must pay claims within a reasonable time. What is reasonable will depend on the circumstances of each case.

Contracting out of the term is not permissible as against consumer insureds, which will catch many yacht, fine art and HNW policies. That may encourage more insurers to make use of provisions - such as those in the American R12 form - which require the insured to file a sworn proof of loss within 90 days of the event giving rise to a claim. The reasonable time to pay a claim cannot start prior to filing of such a proof. If the policy terms make filing the proof in time a pre-condition of liability, a failure to do so may give insurers a complete defence to a claim.

Recoveries

Subrogated recoveries for yacht and fine art claims are seldom straightforward. What is required by way of policy indemnity may far exceed what any responsible party would be liable for in law.

Owners of ships can usually limit their liability by reference to the tonnage of the ship. Recourse against yacht builders and equipment manufacturers is often limited to the cost of replacement parts, and exclusions of consequential loss are commonplace.

Until recently, the English courts have given such exclusions a very narrow interpretation.

A decision in a recent shipbuilding case (*Star Polaris LLC v HHIC-Phil Inc.* [2016]) bucked the trend and could see the start of a return to a more commercial interpretation in these contracts. This will benefit shipyards and their liability insurers, by greatly limiting the scope of financial loss recovery available to yacht insurers for defect claims.

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Legal advice in black and white

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