Insurers’ liability for civil fines and penalties

The Court of Appeal decision in Safeway v Twigger is very significant for the insurance market

Civil fines and penalties are a “hot topic” in the insurance market. Every aspect of commercial activity is regulated in some way or another, and both the frequency and scope of enforcement actions is increasing. We are now regularly seeing enforcement actions brought by professional bodies, financial regulators, environmental agencies and tax authorities, to name but a few.

These enforcement actions can culminate in penalties, which can run into hundreds of millions of pounds. Companies may increasingly look to pass their liability for penalties into the insurance market, either directly or indirectly.

Direct claims for an indemnity are not fanciful – many policies do not have an express “fines and penalties” exclusion, and the market will be aware of various claims, for example accountants’ firms claiming under their E&O policies for the IRS penalties arising from “tax shelters”.

Even where there is an express “fines and penalties” exclusion, the market is exposed to indirect claims, where companies seek to recover the penalties by suing their directors or professional advisors, opening up their D&O or E&O policies.

A company will not be able to succeed on the direct or indirect claims if the public policy maxim of “ex turpi causa non oritur actio” is triggered. The maxim is therefore taking on an unprecedented importance for the insurance market.

The Ex Turpi Causa Maxim

Put simply, a person cannot recover the damage which is the consequence of his own illegal act. Thus, an arsonist cannot claim on his property insurance, and a fraudster cannot sue his accountant for failing to detect his fraud.

As always, the modern world throws up situations which do not sit easily with the old cases. For example:

- Do breaches of regulatory and administrative law trigger this

RPC comments

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The immediate consequence is where a regulatory penalty is imposed on a company, it might not be able to recover that penalty in a claim for damages from its directors.

This principle also bars an insured from claiming an indemnity for the penalty direct from its insurers. It is true that the FSA had pre-empted this debate as long ago as 2004 when it prohibited authorised firms from insuring themselves against its fines, but this case will be relevant to penalties imposed by any other regulators, including foreign financial regulators such as the SEC or JFSC.

A number of policies – including D&O and PTL
principle in the same way as breaches of the criminal law?

• Should the egregious acts of an employee be attributed to a company, so as to prevent the company from recovering the damage caused by that illegal act?

The Court of Appeal has considered these issues in Safeway v Twigger and its judgment is important to all sectors of the insurance market.

Safeway v Twigger

In 2002-2003, Safeway and other supermarkets shared price information so as to increase the price of milk and other dairy products. The OFT alleged Safeway had breached the prohibition against ‘price fixing’ as contained in the Competition Act 1998. Safeway decided to enter into an “early resolution/fast track” agreement with the OFT, thereby admitting to breaching the law and becoming liable to a penalty in the region of £10.5m.

In September 2008, Safeway sought to recover this sum from the eleven of its former directors and senior employees (the “directors”) responsible for this price fixing conduct. In reality, Safeway was not seeking recovery of the penalty from the directors themselves, but from its D&O insurers.

The Court of Appeal concluded Safeway was as a matter of public policy barred from recovering the penalty from its directors, and in doing so, it has provided answers the two threshold questions (posed above).

What type of conduct triggers the ex turpi causa maxim?

The maxim provides that a person cannot recover the damage caused by his own illegal acts. Having reviewed the earlier authorities, Mr Justice Flaux decided that this maxim applies to all “morally reprehensible” acts.

Having identified the test, Mr Justice Flaux went on to find that price fixing was morally reprehensible. This was so even though the breach can be committed negligently as opposed to intentionally. The court did not give much guidance on what constitutes “morally reprehensible” conduct, except it clearly falls short of “intentional illegality”.

Does the ex turpi causa principle apply to large corporations?

The ex turpi causa principle only applies to a person that has committed morally reprehensible acts. It does not apply to a person who is “merely” vicariously liable for those acts. As a result, whilst a care worker who is liable for abusing children cannot seek an indemnity for their claims, his employer can do so, because its liability for the children’s claims is vicarious and not personal.

Since companies can only act through their employees, their liability is usually vicarious and not personal. Under the common law a company can only be personally liable where (i) the act is committed by someone who is the “guiding mind of that company” (ie the company is a “one man band”) or; (ii) the acts are ratified by the company’s board of directors.

Footnote

1 For the purpose of the appeal, Safeway accepted the conduct triggered the “ex turpi causa” principle, and so this test was not considered further.
These considerations led Mr Justice Flaux to find Safeway had not personally committed these morally reprehensible acts. Safeway was not a "one man band" and the acts were not ratified by Safeway’s board of directors. Since Safeway had not committed these acts personally, he found there was no public policy bar its claim for an indemnity. This logic would suggest the *ex turpi causa* defence would in practice never apply to large corporations.

The Court of Appeal overturned this part of Mr Justice Flaux’s judgment. The court said that Safeway’s liability was personal. It seems the critical factor was the penalty arose by operation of statute, and the OFT could only impose the penalty on the Safeway and only where it – as opposed to the directors – had negligently or intentionally committed price fixing. In those circumstances, Safeway had personally committed these acts and the common law rules of attribution did not apply.

The consequence of the finding that Safeway personally committed these morally reprehensible acts, albeit possibly negligently, was it could not seek to pass these losses on – it could not claim under any insurance policy nor seek a recovery from its directors. This is, of course, the rationale behind the *ex turpi causa* maxim – since the penalty would not be an effective deterrent if Safeway could pass it on to the insurance market (whether directly or indirectly).

**Significance**

In considering the significance of the Court of Appeal’s decision in *Safeway v Twigger*, commentators have focused on the proposition that companies might in future be unable to sue their directors to recover regulatory fines and penalties. But its significance is much wider than this.

The *ex taurpi causa* maxim:

1. is not limited to barring the recovery of fines or penalties: it applies to any damage caused by a person’s illegal and morally reprehensible behaviour. It applies to any loss and also defence costs.

2. is not limited to barring recovery claims against directors: it applies to any recovery claim. It will bar direct claims against insurers. A number of policies – including D&O and PTL policies – explicitly provide coverage for civil fines and penalties “so far as they are insurable by law”, although it is now clear that many of these civil fines and penalties may not in fact be insurable under English law.

3. can apply to companies. Until the Court of Appeal decision, this principle would rarely apply to a company unless it was a “one man band” or the acts were approved by its board of directors. Admittedly, this maxim might have limited applicability to liabilities incurred in the UK, but it might apply more widely to liabilities incurred in different jurisdictions, where liabilities might be more readily be imposed directly onto companies, rather than vicariously.

4. can apply to a wide range of activities - it is not limited to deliberate criminal acts.
Legal Alert continued

The Court of Appeal decision in *Safeway v Twigger* clarifies, widens and strengthens the public policy defence of *ex taepi causa*, with the result that certain direct claims against insurers as well as recovery claims against third parties, who might otherwise be insured, will now be barred. As a result, it is highly significant to the insurance market.