



## With the best intentions...

BY MICHAEL LEA

Few are likely to have celebrated when Sarbanes-Oxley marked its fifth anniversary recently. Companies on both sides of the Atlantic have chafed against the time and expense employed in meeting the legislation's exacting requirements. So much so that earlier this year companies ranging from British Airways to ICI took the opportunity to beat the retreat in the US by jettisoning their listing there and deregistering with the Securities and Exchange Commission (SEC).

Sarbox can be summed up as good intentions turned sour. Certainly a stiff dose of medicine was needed to ensure that, in the wake of Enron and WorldCom, companies cleaned up

their act. But some consequences were unintended, such as enabling London to challenge New York as the world's premier financial centre, thanks to the UK's more relaxed regulatory regime.

Nor is it the first time that the outcome has diverged from the aim – witness the Private Securities Litigation Reform Act of 1995, which was intended to deter the more frivolous lawsuits brought against company directors. Any short-lived success was swiftly erased; plaintiff law firms raised their game and improved the standard of suits – and the average settlement value was pushed higher.

The post-Sarbox era has accelerated this trend. Since 2002, breaches of duty by a director have become more easily identifiable. While the legislation has encouraged individuals to play by the rules, the financial consequences when they fail to do so have been catastrophic. Last year, the average settlement value in D&O lawsuits in the US was a record \$45m, or more than double the figure of the mid-90s. The figure included four settlements in excess of \$1bn and seven more that exceeded \$500m. The average for 2007 is again on course to exceed \$40m.

These values have been over a period in which the US economy has proved buoyant and produced fewer disgruntled shareholders. The rather tougher era now underway suggests more individuals will be taking aim at directors who are seen as having failed to perform adequately. Delisting may not always provide an escape hatch; it is unlikely to shield BA from class actions in the US arising from fines imposed on the airline for alleged price fixing, for example.

### Who would be a director?

On this side of the Atlantic, UK company

directors may also be asking themselves whether their prestige and remuneration still compensate the potential liabilities. The impact of the incoming Companies Act 2006 – which started to come into force in January but won't be fully implemented until October 2008 – is as yet unknown, but most anticipate it will result in a heavier burden of duty.

These fears are principally focused on two changes. First is the codifying of directors' fiduciary duties and their duties of skill and care. Second is the revised mechanism for shareholder actions, which will make derivative actions easier for individuals who are outside the company but claim to be acting on its behalf. The latter could be used by pressure groups seeking to draw attention to their cause. Potential examples include environmentalists who could use only a modest shareholding to launch an action against airports operator BAA or animal liberationists attempting to prevent medical research groups from continuing animal testing.

The Act imposes a set of criteria that directors must consider in reaching a business decision. Some believe these are no more onerous than those already set out in common law. What is different is that directors must keep clear records to evidence that their decisions take into account the impact on the companies stakeholders, who include employees, customers, suppliers, the environment and the public at large. Mere verbal assurances will no longer be enough.

The Corporate Manslaughter Act promises to further increase the number of occasions when a company or its individual directors are found guilty of criminal neglect.

However, the impact of these changes on the D&O market are likely to be limited. Policy ►►

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forms have already broadened the definition of a 'wrongful act', so radical wording changes are not expected to result.

#### **The good news is...**

Given the difficulty for insurers in anticipating how tougher corporate governance will affect litigation trends, the response of the D&O insurance market tends to be passive or reactive,

rather than innovative.

The good news is that the market conditions, which hardened in the wake of the dotcom boom/bust have been much more favourable in the past four years. The recent credit crunch may well mean the days of these 'soft market' conditions are numbered, but premium rates are currently favourable and policy forms offer broader coverage. AIG, the D&O market's

biggest player, relaunched its policy form last year and revised D&O products have since followed from Liberty International, Chubb, XL Insurance Axis, CNA and Allianz. ■

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