Mitigating Risk through D&O Insurance: Assessing the Role of Illegality Defence and Corporate Attribution

Dr Samet Caliskan*

1. Introduction

Directors' wrongful conduct in this article can be defined as illegal behaviour that exposes the company to a number of risks in the long term whereas it can be financially beneficial in the short term. Given that these risks are likely to harm the interests of stakeholders, the company may seek to mitigate them through insurance by bringing a direct claim against the insurer or indirect claim against its directors.

Although there exist a number of policy coverages provided to the company and its directors under Directors and Officers Liability Insurance (hereafter D&O insurance)[1], the extent to which insurance provides recovery to the company is limited. This leaves the company unable to mitigate some of the risks arising from the operational deficiencies of its business and behavioural shortcomings of its directors.

The question that arises at this point is how these limitations operate. In order to determine the cover available under D&O insurance for the directors' wrongful conduct, different approaches are adopted by different jurisdictions. For example, Civil law jurisdictions establish these limitations though introducing insurance Codes whereas this aim is achieved in Common law jurisdictions by considering public policy.[2] The defence of public policy is usually raised to preclude the insured from being indemnified the loss suffered, because of illegality on their part.

* Assistant Professor of Law, Mus Alparslan University, Mus, Turkey. BA (Gazi), LLM (CWRU), PhD (Newcastle). The author can be contacted at s.caliskan@alparslan.edu.tr

[1] D&O insurance provides coverage categorised as Personal Coverage (Side A), Corporate Reimbursement Cover (Side B), Entity Cover (Side C).

[2] Chris Parsons, 'Managerial Liability, Risk and Insurance: An International View' (2001) 3(1) I.C.C.L.J. 1, 8.

The application of public policy operates through a range of doctrines, including the doctrine known as the maxim of the illegality defence (hereafter 'maxim'). In order to protect public policy, the maxim sets limits to the risks that may be managed through insurance.[3] Therefore, the approach of the maxim is important in terms of determining whether the insured is able to mitigate the risk through insurance. Although the maxim does not always automatically render the policy void, it debars the insured from recovering the loss arising from particular acts based on the considerations of public policy.[4]

In this regard, it is crucial to analyse how the maxim operates in insurance law in terms of determining how far the insurance mitigates the risk upon the insured company. In a literal sense, the company is unlikely to be personally liable as it cannot physically involve itself in any action. However, the law of insurance interacts with the doctrine of corporate attribution, which attributes the acts of directors and their liability to the entity of the company. Hence, the company can be found personally liable for the acts of its directors, and its claim under the insurance policy for recovery can fail through the joint operation of the doctrine of attribution and the maxim.

This article investigates how this triangular relationship between liability insurance, the maxim and the doctrine of corporate attribution operate together in the context of D&O insurance and the impact this has on the ability of the company to mitigate the risk through insurance. In this regard, it considers how risk distribution is achieved between the three actors of the D&O insurance, namely the company, the directors and the insurer. If the liability arising from directors' behaviour is determined as the personal liability of the company through the principle of corporate attribution, the question arises whether its insurance contract is tainted with illegality and it becomes unenforceable.

2. The Illegality Principle and Liability Insurance

Having policy coverage does not guarantee that all types of risk to which the insured is subjected can be covered by insurance, as there are certain limitations. Although the insured is aware of this, he/she may still claim to recover any loss he/she has suffered under his/her policy. In that case, the insurer may defend itself by raising the maxim to prevent the insured from

[3] Digby C. Jess, *The Insurance of Commercial Risks: Law and Practice* (3rd edn. Sweet Maxwell, 2001) 466-472.
[4] ibid, 467.

recovering the loss. Based on the considerations of public policy, the maxim also places certain restrictions on the market coverage of insurance, so there are certain types of risk and loss for which a person or company cannot obtain coverage.

Before liability insurance was introduced to the insurance market, there were serious concerns regarding the morality of providing policy coverage for the personal liability of the wrongdoer. Tunc described this as follows:

> [A]t the beginning of the nineteenth century, liability insurance would have been unthinkable. It would have been considered as immoral to take out an insurance against the consequences of civil liability as to take out one against the consequences of criminal liability.[5]

The foundation that underpins this concern was that such a policy would cause a moral hazard, as removing liability from the wrongdoing insured might encourage him/her to become involved in further wrongdoing. Although this approach has softened significantly, and there is liability insurance which engages with every aspects of life, limitations have been placed through the maxim, so that such concerns about liability insurance are minimized.

The application of the maxim arises “where the insured has deliberately infringed the law to procure or keep the insured goods [and] public policy will prevent his recovery for their loss or damage under the policy, for otherwise the court would be assisting the insured to derive a profit from his illegal acts”.[6] The operation of the maxim, therefore, is to “set limits to the distribution of risks and losses”.[7] This explains how close the relationship between liability insurance and the maxim is, since it has a significant role in determining the recoverability of loss in the context of insurance.

The crucial question here concerns when the maxim is triggered to prevent the insured from relying on insurance. The application of the maxim differs, depending on the nature of the act with which the insured is engaged, and the involvement of third-party interests. In some cases, recovery can still be provided by insurance if there is a third-party victim, even though the

[5] Andre Tunc, ‘An Historical and Geographical Survey of the Law of Tort’ in Viktor Knapp (ed.) *International Encyclopaedia of Comparative Law* (International Association of Legal Science Volume 11, 1983) 50.
[6] n 3, 337.
[7] Rob Merkin and Jenny Steele, *Insurance and the Law of Obligations* (1st edn. Oxford, 2013) 331.

insured is personally liable and even if allowing him/her to recover would be contrary to public policy. In this situation, the court may not consider the rationales of public policy as restrictions, for the sake of protecting the interests of third parties.

The maxim was applied to a case involving the recovery of a loss in the corporate context by the Court of Appeal in *Safeway Stores Ltd v Twigger*.[8] In that case, the company brought a claim against its directors to recover the loss it has suffered due to fines imposed by the Office of Fair Trading because of their anti-competitive behaviour. Despite the fact that the company did not bring a direct claim against the insurer to recover the loss, it did bring an indirect claim against its wrongdoing directors with the intention of pursuing D&O insurance. Based on the maxim, the company was prevented from passing on its personal liability to directors, and this automatically prevented the recovery of the loss from insurance.

In the next section, the application of the maxim in general liability insurance and particular D&O insurance will be examined.

3. How Public Policy Restricts Cover

As noted above, since the invention of liability insurance as a tool to spread risk liability and loss, the issue of moral hazard as a consequence of allowing the wrongdoer to be indemnified has always been a concern. Public policy has frequently been invoked to determine whether the liability of the insured can appropriately be 'removed' by insurance. The role of public policy in the concept of liability insurance is similar to its general role as it seeks to prevent the wrongdoing insured from recovering the loss he/she has suffered as a consequence of his/her own wrongdoing from insurance. This was emphasised by Mance J in *Total Graphics Ltd v AGF Insurance Ltd Hence*[9] when it was stated that "public policy creates a personal disability to recover".[10] Even though the true basis of public policy is not very clear, the objectives of deterrence through punishment and not allowing the wrongdoer to benefit from his/her own wrongdoing are the bases that have been commonly suggested.[11]

[8] [2010] EWCA Civ 1472.
[9] [1997] 1 Lloyd's Rep 599.
[10] ibid, para [606].
[11] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn. Sweet&Maxwell, 2017) para [5.080].

Nevertheless, the importance of the role of public policy on the subject of insurance has not been truly assessed, as “most of the decisions of the courts-contain little or no discussion of the effect of public policy upon insurance arrangements”.[12] However, its implications for the insurance arrangements are “profound”[13] in respect of the claims brought against the insured by third parties or the claims brought by the insured under the insurance policy to recover the loss. Interestingly, “the public policy rules for tort claims and for insurance indemnity claims are derived from the same sources”.[14]

There is a process that the court goes through when determining whether public policy would be violated if the claimant was to be allowed to recover.[15] This process consists of three steps. Firstly, the court determines the gravity of the illegal conduct to see whether the wrongdoing of the claimant is intentional or negligent. Secondly, the court asks whether allowing the insurance contract to be enforced would encourage a future commitment to illegal conduct. Lastly, the court considers the negative effect of not awarding a recovery not only on victims but also on society. These three steps show that the determination is based on balancing the twin protections of the rationales of public policy and the interests of third-party victims.

When a claim is brought before the court by the insured under the insurance policy, the initial approach of the court would be to allow the insurance contract to be enforced. However, when it considers the other issues, such as protection of public policy by not allowing the insured to benefit from his/her own illegality, and protecting the interests of other innocent parties, it may retreat from this approach. This consequently gives rise to a requirement that risks covered by insurance should be consistent with the rationales of public policy. The logic behind this approach is that insurance should not offend the public conscience.[16]

It is commonly known that the maxim prevents illegal transactions from being enforced, but it is crucial to ask, “where does that leave the parties?”.[17] There are two approaches to this issue. The first seeks to put the parties in the position that they would have been in if the transaction had not occurred by seeking to reverse the consequences of the transaction. This is the approach

[12] n 7, 333.
[13] ibid.
[14] ibid, 335.
[15] Ray Hodgin, *Insurance Law: Text and Materials* (2nd edn. Covendish, 2002) 144.
[16] D S Hansell, *Introduction to Insurance* (2nd edn. Lloyd’s of London Press, 1999) 15.
[17] Lord Sumption, ‘Reflections on the Law of Illegality’ (2012) 20 Restitution Law Review 1, 3.

adopted by French law.[18] The second approach basically seeks to disable the right-holder from seeking a remedy and usually "leaves the loss to lie where it falls", which is to say that "the past consequences of the transaction are left undisturbed".[19] This is the approach adopted by English law. The logic of this approach is based on the historical condemnation in English law of the idea of providing aid to a wrongdoer, as inconsistent with the purpose of promoting the dignity of the courts.[20]

This rigid rule in England, however, has become more flexible over the years. For example, although insuring a person for his/her legal liability for harming others and insuring the risk of losing business profit due to fire used to be seen as immoral and wrong, these two types of insurance have now become very important insurance sectors.[21] This issue was described by Roche J in *James v British General Ins Co Ltd*,[22] when it was noted that "the principles of public policy, which I suppose are only a branch of the principles of ethics, are themselves unchanging, but their applications may be infinitely various from time to time and from place to place".[23]

The application of public policy in insurance law is usually based on the question whether insurance protects the third-party victim or the insured. This is because, if the protection of the victim third party is considered, the court is less concerned about deterrence for the sake of protecting the victim. In the contrary scenario, if allowing the insured to recover the loss is the primary consideration, public policy is strictly applied to prevent the wrongdoing insured from recovery.

Such considerations are also valid for the context of D&O insurance. This insurance is a type of optional liability insurance which aims to protect the insured directors and company, and public policy is frequently raised in D&O insurance cases, bringing rigid exclusions to policy coverage. In general terms, "the primary insuring words will refer to claims for actual or alleged breach of contract, misstatement, breach of trust, breach of duty, act, neglect, error, omission,

[18] ibid.
[19] ibid, 3-4.
[20] ibid.
[21] n 16, 15.
[22] [1927] 2 KB 311.
[23] ibid, [322].

breach of warranty of authority or wrongful trading";[24] however, D&O insurance contracts contain a number of exclusions.

According to Merkin, these exclusions can be separated into two categories.[25] The first category is based on the insurance policy term that excludes certain legal liabilities arising from deliberate, wilful, or wrongful acts, fraud, dishonesty, criminal activity, wrongful trading, and intentional insider dealing.[26] In the second category, regardless of whether there are other exclusions expressly stated along these lines, public policy may restrict the types of wrongful act for which recovery is possible. Deliberate criminal acts and intentional acts causing a loss to the third party can be the examples of such exclusions.

Although these exclusions should be assessed under the two different categories[27], the basis that underlies all of them is arguably the same, which is protecting public policy. The exclusions based on the insurance policy in the first category still rely on public policy because preventing an insured director who deliberately caused loss from bringing a claim by relying upon their own illegal act is the main rationale underlying public policy.[28] Thus, public policy can be considered as the major obstacle that limits the ability of directors to seek indemnification through insurance.

Considerations of public policy also arise when the company intends to obtain policy coverage and brings a claim against its D&O insurance for the loss it has suffered due to its directors' wrongful conduct. Regulatory loss, reputational loss, and insolvency loss are types of loss that the market will not usually cover fully. In addition, loss from punitive damages is a type of loss for which coverage is rarely provided.[29] Policy coverage is available to purchase for the loss of compensatory damages, but the company is unlikely to recover such loss from D&O insurance when it is found personally liable for directors' behaviour. It is typically prevented

---

[24] n 3, 228.
[25] n 11, para [21.154].
[26] In spite of these preclusions of D&O insurance, defence cost is still available for directors to recover from insurance. ibid.
[27] D&O insurance also contains a number of other exclusions, depending on the wordings, that may include for instance exclusions for prior and pending litigation, notified circumstances, etc.
[28] See Robert Merkin, 'Motor and Other Liability Insurance' in Robert Merkin (ed), *Insurance Law: An Introduction* (1st edn. Informa, 2007) 275, 282.
[29] For an in-depth analysis of the types of losses a company might suffer due to the wrongful conduct of its directors and available coverages, see Samet Caliskan, 'Managing the Risk of Directors' Wrongful Conduct through D&O Insurance' (2019) 132 The Journal of British Insurance Law Association

from transferring the risk of loss to directors or their insurance, because this would contravene the objectives of public policy.[30]

There are two objectives of public policy that are often referred in case law. These are deterrence and the ‘no benefit’ rule.

3.1 Maintaining Deterrence

The first rationale, deterrence, aims to prevent an insured person convicted of illegal conduct from relying on his/her own illegality to recover the loss he/she suffered from the insurer. The punishment deters not only the wrongdoer but also other potential wrongdoers from carrying out illegal acts in future. This rationale is very important when determining the availability of recovery to the insured because, as Clarke stated, “non-enforcement of insurance is said to help to deter crime”.[31] This point was also emphasised by Bugra and Merkin, who stated that the “loss of the entirety of an insurance claim where part of it is fraudulent is simply one means to achieve the aim of deterrence”.[32]

The well-known example of the application of this rule in liability insurance is *Gray v Barr*.[33] In this case, Barr (B) suspected that his wife was having an affair with Gray (G) and he went to G’s home with a loaded shotgun, which fired accidently, and G was killed. G’s widow brought a damages claim against B for his manslaughter, and it was awarded. B claimed a recovery under his insurance policy for the loss he suffered resulting from his liability to the widow. The court held that he could not recover such a loss from the insurer as his insurance policy only covered accidents, and manslaughter was not regarded as an accident. Salmon LJ indicated that,

> Crimes of violence, particularly when committed with loaded guns, are amongst the worst curses of this age. It is very much in the public interest that they should be deterred… no one who threatens unlawful violence with a loaded gun should be allowed to enforce a claim

[30] ibid.
[31] Malcolm A. Clarke, *The Law of Insurance Contracts* (5th edn. Informa, 2006) 759.
[32] Aysegul Bugra and Rob Merkin, ‘“Fraud” and Fraudulent Claims’ (2012) 125 The Journal of the British Insurance Law Association 3, 9.
[33] *Gray v Barr* [1971] 2 QB 554.

> for indemnity against any liability he may incur as a result of having so acted. I do not intend to lay down any wider proposition.[34]

Although the intention of the defendant was only to frighten the victim rather than kill him, he was still found guilty of manslaughter as he had carried a gun to the victim's house, making his act deliberate and wilful. The judgment can be regarded as a message to deter the wrongdoing insured and other insureds who might carry a gun, as they would have no recourse of recovery from insurance.[35] Therefore, the court considered "the necessity of deterring him and others from doing the same thing again, to reform him and, in cases such as this, to make him and others more careful in their dealings".[36] The logic behind this approach is that providing recovery for such a criminal or tortious act "would be productive of great evil if the courts were to encourage such an engagement as this and thereby hold out inducement to the propagation of illegal and unfounded charges".[37]

The deterrence objective of public policy is also a major consideration in D&O insurance. It can be a significant barrier that limits the company's ability to recover loss caused by wrongful conduct from insurance, if it is found personally liable for the act of its directors. In this case, the court typically considers that allowing the company to recover the loss would undermine the deterrence objective of public policy, and it should rather be punished by depriving it from recovery. This objective was one of the underlying reasons the Court of Appeal referred to in the judgment of *Safeway*. Since the company was found personally liable and the court was aware of the fact that it was seeking to recover the loss from the insurer, the company's claim against its directors was rejected. Pill LJ argued that:

> Only if the undertaking itself bears the responsibilities and meets the consequences of their non-observance are the public protected. A deterrent effect is contemplated and the obligation to provide effective preventive measures is upon the undertaking itself.[38]

---

[34] ibid, para [581].
[35] n 7, 357.
[36] *Askey v. Golden Wine Co Ltd* (1948) 64 TLR 379 [380].
[37] *Shackell v Rosier* (1836) 2 Bing NC 634 para [648] *per* Park J.
[38] n 8, para [44].

It was considered that if the company was to be allowed to recover the loss from insurance, it and other companies would be encouraged to become involved in further illegal behaviour to increase their value.

3.2 The Rule of No Benefit

The rule of no benefit is the second objective of public policy: it aims to prevent the wrongdoing insured from profiting from his/her own illegality. This rationale is also the second basis that underlies the non-enforcement of an insurance policy. There are two considerations that underpin this public policy rationale. The first is that compensating the claimant for his own illegality would damage 'public notions of the fair distribution of resources'.[39] The second is that "preserv[ing] the dignity of the courts and the reputations of the legal system" by not "enforc[ing] any right in law under the insurance".[40]

This objective of public policy was mentioned by Lord Macmillan in *Beresford v. Royal Insurance Co. Ltd*[41] in reference to the fact that it is a principle of public policy that "no Court ought to assist a criminal to derive benefit from his crime".[42] In addition, Pearson L.J. in *Hardy v. Motor Insurers Bureau*[43] opined that,

> There is a principle of public policy that an insured person cannot recover an indemnity from his insurers in respect of the consequences of the insured person's own intentional criminal act. If he were allowed to do so, he would be reaping the fruits of his own crime and profiting by his own wrong, and that is contrary to public policy.[44]

This objective was also the reason underlying the judgement in *Geismar v. Sun Alliance and London Insurance Ltd*.[45] In this case, the claimant imported items of jewellery without paying the required excise duty. The items of jewellery were stolen from his house and he sought to recover the loss from the insurer. The claim was rejected, and Talbot J stated that, "where there is a deliberate breach of the law I do not think that the court ought to assist the plaintiff to

---

[39] *Gray v Thames Trains* [2009] UKHL 33 [51].
[40] n 7, 338.
[41] [1938] A.C. 586.
[42] ibid, para [603].
[43] [1964] 2 Q.B. 745, CA.
[44] ibid, para [762].
[45] [1977] Q.B. 383.

derive a profit from it, even though it is sought indirectly through an indemnity under an insurance policy".[46]

The rule has also been mentioned in D&O insurance cases. In *Safeway*, the company was considered as a wrongdoer in seeking to benefit from its illegality, and it was prevented from going after its directors and their insurance, as it would be contrary to the 'rule of no benefit' if the company had been allowed to recover. Although there was no direct reference to this rationale, the court indirectly considered it while the deterrence objective was emphasised because the court was aware that allowing the company to recover the loss would allow it to benefit from its illegality, thus undermining the integrity of the court.

To sum up, in order to determine the availability of policy coverage for loss under D&O insurance, the maxim relies on public policy and its two rationales of deterrence and the no benefit rule. These are usually the underlying bases which bar the wrongdoing insured from recovery. These policy objectives also form the basis upon which the company is also barred from recovery for the losses arising from the wrongful conduct of directors, if it is found personally liable through corporate attribution, and it is the latter which will be examined in the next section.

4. The Doctrine of Corporate Attribution

Besides the applications of the maxim to the company's claim, there is another principle that may have an impact on the company's ability to recover loss from insurance. The doctrine of corporate attribution attributes the directors' act or intention onto the company, which is consequently held personally liable. As a result, the company can claim recovery from the wrongdoing directors or their insurance as long as it is not found personally liable. In support of this, Merkin and Steele stated that,

> An organisation which faces liability for the acts of an employee or agent may seek indemnification from tortfeasor or insurers unless the employee/ agent is the alter ego of the organisation, or the organisation has condoned or participated in the conduct of the employee/ agent.[47]

[46] ibid, para [395].
[47] n 7, 334-335.

The underlying foundation of this approach is again the deterrence and no benefit rationales of public policy, which seek to prevent any wrongdoer personally liable for his/her own act from recovery. Such prevention may make sense in principle, but it may cause harsh consequences in terms of the ability of the company to protect the long-term interests of its stakeholders.

The main issue that arises in this regard is that directors are equipped with great power to direct the company's affairs, and for this reason they are usually seen as the "managing agent" of the company.[48] With very limited exception, they are usually considered the mind of the company and their liability is likely to be attributed to it even though they do not act as part of the board.

This issue can be seen in *Safeway.* Although there were a number of considerations regarding how UK competition law viewed the company as the primary wrongdoer in this case, the reasoning of the doctrine of attribution influenced the court's approach and the company was consequently precluded from recovery based on its perceived personal liability.

In this respect, the doctrine of corporate attribution can be considered the first step to analysing the ability of the company to recover the loss from insurance, because when the company is found personally liable for the acts of directors, recovery will be precluded based on public policy. Bugra and Merkin argued that, "if the controller of a company deliberately sets fire to the company's property, the doctrine of attribution will treat the acts of the controller as if they were the acts of the company, thereby depriving other shareholders of the benefits of the policy".[49] This is because the company is considered personally liable for the acts of its directors, and the deterrence and no benefit rule of public policy would be undermined if it were allowed to recover the loss.

This argument can be challenged by pointing to the judgement of the Supreme Court in *Jetivia SA and Another v. Bilta (UK) Ltd (in liquidation) and Others.*[50] In this case, the court found the company not personally liable despite the fact that the directors, who were involved in fraud, were the directing mind and will of the company. This was because the fraud was perpetrated on the company. As a result, the company was allowed to recover the loss from its

[48] *Re Faure Electric Accumulator Co.* (1888) 40 Ch. D. 141 [151]
[49] n 32, 10.
[50] [2015] UKSC 23.

directors and other defendants. This may be considered as opening the door to the company being able to recover the loss from insurance.

However, this outcome is based on the fraud exception, which is not applicable for a case that involves directors' wrongful conduct. Such behaviour usually involves a tort perpetrated on a third party or regulatory infringements which are usually attributed to the company. Therefore, the outcome of the case may not be considered a reference for a company's ability to recover the loss caused by directors' wrongful conduct from insurance.

Contrary to this argument, Davidson opined that the application of attribution for liability purposes and the application of attribution for insurance purposes may differ. This is because although dishonesty, fraud or an omission undertaken by a single director would be attributed to the company for liability purposes, this situation will not validate the attribution of the liability to the company for insurance purposes, unless all the directors of the company are collectively involved.[51] He asserted that there will be a number of cases in which the conduct is attributed to a company for liability purposes, whereas the same conduct is not to be attributed to it for insurance purposes.[52] This argument, however, is not without serious drawbacks in terms of the company's ability to mitigate the risks of wrongful conduct.

Firstly, such an application of attribution may be valid when the company brings a direct claim against the insurer to recover the loss; however, the company may not be able to obtain policy coverage for regulatory loss, loss of punitive damages, insolvency loss, and reputational loss caused by directors' wrongful conduct[53]. When the loss arises from the imposition of compensatory damages, the company is not able to bring an indirect claim against its directors' insurance because, under the attribution rules, it is personally liable for the loss caused by the directors' wrongful conduct to the third-party claimant. Indeed, following the third-party claim, the personal liability on the parts of the company and directors must be initially determined before the claim can be brought against insurance. The company is likely to be regarded as being involved in the conduct personally, and it would be prevented from recovery by the maxim.

[51] Nicholas Davidson, 'A Sideways Look at Stone & Rolls' (2010) 26(2) Professional Negligence 66, 69-70.
[52] ibid.
[53] n 29.

Secondly, even assuming that the fraud perpetrated by the directors on the third party was not to be attributed to the company for insurance purposes, this would not mean that the company can recover the loss it has suffered from directors' insurance, as the basis of the claim would be directors' fraud, and this is commonly excluded in D&O insurance. The insurer would reject the claim.

Thirdly, again even assuming that the recovery were available, the company would still not be able to mitigate through insurance all types of risk and recover all types of loss caused by directors' wrongful conduct. Regulatory loss, reputational loss, and insolvency loss would still remain with the company because they are not covered.

In a nutshell, the personal liability of the company, determined by the doctrine of corporate attribution, combines with the application of the maxim to defeat claims brought by a company against its directors with the intention of recovering under their D&O insurance. Consequently, the maxim and the doctrine of corporate attribution prevent the protection of the long-term interests of stakeholders, as their joint operation impairs the ability of the company to mitigate the risk of losses caused by directors' wrongful conduct.

5. A More Nuanced Approach

In order to develop the law in a much more nuanced way, the cases of *Bilta*, *Lancashire County Council, Hounga v Allen,*[54] and *Patel (Respondent) v Mirza (Appellant)*[55] can be taken as references. In respect of the application of corporate attribution in D&O insurance, the approach adopted by the court in *Bilta* may underlie the foundation of a distinctive approach which should be adopted when the company brings a claim for the loss caused by directors' wrongful conduct. This is because the outcome of the case illustrates the court's recognition of how harmful directors' behaviour was for the company. A similar approach which recognises individual accountability and allows the company to recover loss could be introduced in D&O insurance by establishing a policy consideration for stakeholder protection against the adverse consequences of directorial actions.

[54] [2012] EWCA Civ 609; [2014] UKSC 47

[55] [2013] EWCH 1892; [2014] EWCA Civ 1047; [2016] UKSC 42.

In addition, the unavailability of policy coverage to companies is usually determined by the maxim, which relies purely on the rationales of public policy. The question that arises is whether there should be a different application of the maxim in the concept of D&O insurance, rather than providing an automatic response to the company's claims. The maxim could also have different application in D&O insurance by taking into account specific policy considerations, such as the protection of the long-term interests of stakeholders against directorial actions.

In respect of the suggested application of the maxim in D&O insurance, *Patel* could be taken as a reference to develop a different way in which the maxim applies to a company's claim. In this case, the court took the development initiated in *Hounga* further and departed from previous case law, which solely relied on public policy considerations, and widened the scope of the maxim to other policy considerations underlying the unjust enrichment law. This more nuanced approach can therefore form the foundation of the way in which the maxim applies in D&O insurance to company claims for losses arising from directors' wrongful conduct, in recognition of stakeholder protection.

This widened policy consideration was also seen in *Lancashire County Council*. Although this is unusual, the Council obtained a policy which explicitly covered loss arising from punitive damages. In addition, as a response to the claim for punitive damages by the Council, the court considered the negative consequences of preventing the Council from recovery upon the public and allowed the Council to recover. The case is therefore a significant development as the Council was not only allowed to obtain policy coverage for punitive damages, it was also able to recover the loss caused by such damages. The court took into account other policy considerations, such as the possible higher taxes that the public would have to pay, rather than giving an automatic response that the recovery for punitive damages is never available based on the maxim. When it is considered that the recovery for loss of punitive damages is not available to companies and they may not even arguably obtain policy coverage for such a loss, *Lancashire County Council* could be the foundation of a new approach that takes into account other policy considerations such as stakeholder protection when the company demands policy coverage or brings a claim for punitive damages.

6. Concluding Remarks

The article has examined the underlying reasons why a company may not obtain policy coverage for losses arising from its directors' wrongful conduct when seeking to protect the long-term interests of its stakeholders. It outlined the foundations of the illegality principle and the doctrine of corporate attribution and how they operate in the context of insurance. The conclusion reached is that the illegality principle and the doctrine of attribution are very significant when determining the availability of policy coverage to the company. The company is not able to mitigate the risks of wrongful conduct through insurance due to the narrow approach taken by courts when applying these principles.

The application of the maxim in corporate cases does not differ from its application in cases that involve individuals. It prevents the company from obtaining policy coverage for itself and recovery from D&O insurance without considering other considerations, such as the impairment of the long-term interests of stakeholders by directorial actions. This may be because of the 'imprecise' nature of the maxim.[56] It is applied for the purpose of protecting public policy, but this prevents the company from mitigating the risks of directors' wrongful conduct through insurance. It can therefore be argued that "denials of insurance coverage based on broad principles and exhortations to public policy gradually but surely fail".[57]

In order to determine the availability of policy coverage, the sole reliance on public policy considerations may cause other considerations to be disregarded. In respect of the company's claims, the doctrine of corporate attribution likewise does not differ in its application for insurance purposes compared with the way it is applied more generally. This gives rise to the question of whether these principles should have different applications in the context of D&O insurance.

This illustrates the inadequacy of insurance law in terms of recognising the serious negative consequences of directors' wrongful conduct upon the long-term interests of stakeholders. It is submitted that stakeholder protection should be a consideration when a company seeks to obtain policy coverage or brings a claim for losses caused by directors' wrongful conduct under its D&O insurance. This is based on the fact that different types of insurance use difference

[56] n 7, 329.
[57] Tom Baker, 'Liability Insurance at Tort-Crime Boundary' in David M Engel and Michael McCann (eds), *Fault Lines – Tort Law as a Cultural Practice* (Stanford University Press, 2009) 66, 68.

criteria to determine the availability of coverage for particular loss, and therefore D&O insurance should be developed in such a way as to widen the considerations regarding the relationship between the company and directors. In order to do so, it is suggested that the approaches of the courts in the cases of *Bilta*, *Lancashire*, *Hounga*, and *Patel* should be taken into account.