Insurance/ Reinsurance

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DIRECTORS' DEFENCE COSTS: BRIDGECORP DECISION OVERTURNED

In our November 2011 briefing, we advised that a New Zealand High Court decision (*Steigrad v Bridgecorp*[1]) raised the spectre that "combined limit" D&O policies in New Zealand and in Australian States & Territories with equivalent legislation may not make funds available for defence costs in certain circumstances where the amount claimed against the directors exceeds the policy limits.

This high profile decision has now been overturned by the New Zealand Court of Appeal in a judgment[2] that will provide some comfort to directors and officers (and other professionals insured under defence costs-inclusive liability policies) that they should be able to access their cover for defence costs.

However, it is likely that the Court of Appeal's decision will be appealed to the Supreme Court and it remains uncertain as to how this issue will be determined by the Australian Courts, which have not yet considered the issue - for the time being, arrangements that have been put in place for provision of separate policies, or separate limits of indemnity within a single policy, for defence costs and third party liability should be maintained.

Background

New Zealand and certain Australian States & Territories (New South Wales, Northern Territory and Australian Capital Territory) have long-standing legislation[3] designed to protect victims of parties who die or become insolvent, by which the proceeds of liability policies entered into by the latter are deemed "charged" upon the happening of an event which gives rise to a claim upon the insured person.

Steigrad v Bridgecorp arose from the collapse of the property company, Bridgecorp Ltd, with net debts in excess of NZ$450 million. The High Court had to consider whether s.9 operated so as to make the NZ$20 million D&O policy limit subject to a statutory charge in favour of the Bridgecorp receivers, in such a way that the policy funds could not be advanced to meet the directors' criminal defence costs.

1. *Steigrad v BFSL 2007 Ltd & Ors*, HC Auckland CIV-2011-404-611, 15 September 2011.
2. *Steigrad v BFSL 2007 Ltd & Ors* [2012] NZCA 604.
3. Section 9 of the *NZ Law Reform Act 1936*, which is substantially mirrored in NSW by the *Law Reform (Miscellaneous Provisions) Act 1946*, Section 6, in ACT by the Civil Law (Wrongs) Act 2002 s.206 and in NT by section 26 of *Law Reform (Miscellaneous Provisions) Act*.

The High Court held that the charge under s.9 descended upon all proceeds of the D&O policy, in respect of the directors' potential liability to pay damages to Bridgecorp for breaches of duty. The charge prevented the directors from having access to the D&O policy to meet their defence costs. Once the insurer (QBE) had been notified of the charge, its obligation to keep the insurance funds 'intact' applied, regardless of the merits of the claims brought against the directors.

Court of Appeal judgment

On 20 December 2012, the Court of Appeal overturned the High Court decision holding that the director (Steigrad) is entitled to indemnity for his defence costs, immediately after they are incurred on two interrelated grounds:

- s.9 does not apply to insurance monies payable for defence costs, even where such cover is combined with third-party liability cover and made subject to a single limit of liability.
- s.9 has limited effect and is not intended to rewrite or interfere with a director's contractual rights as to cover and reimbursement for defence costs.

The Court of Appeal held that the director's liability to pay defence costs, and the insurer's liability to reimburse the director, will arise independently of and, in most cases, precede the insurer's liability, if any, to indemnify the director on the primary claim. Accordingly, s.9 cannot apply, because Bridgecorp is not entitled to a statutory charge over insurance money lawfully payable by the insurer to the director to reimburse his existing liability to pay defence costs, as opposed to a contingent liability for damages or compensation payable to Bridgecorp.

The Court of Appeal also held that the effect of the High Court decision is to deny the director his contractual right to reimbursement of defence costs, as and when they are incurred, and that this result is inconsistent with the text, purpose and policy of s.9. The Court held that s.9 is limited to granting a charge in favour of a third party over "all insurance money" that an insurer is liable to pay in discharge of the insured's liability to that party, and its terms cannot operate to interfere with or suspend the performance of mutual contractual rights and obligations relating to another liability.

A second proceeding[4] brought by the directors of Feltex, a carpet manufacturer which in 2006 was placed into receivership and then liquidation, was heard and determined at the same time, with the Court of Appeal holding that the respondent/claimant is not entitled under s.9 to charge money payable by the insurer (Chartis) to the directors in reimbursement of their defence costs incurred in defending claims brought against them by the respondent and others.

4. *Chartis Insurance New Zealand Ltd & T.E.C Saunders v E.M. Houghton* CA 842/2011.

Comment

Following the High Court decision, steps have been taken by insurers and directors to "ring fence" defence costs policy proceeds from claims that may be made against the directors by regulators, shareholders, and creditors (including liquidators). Our November 2011 briefing provided some guidance as to how this might be achieved.

The successful appeal will provide some comfort to directors, officers and other professionals that they should be able to access their cover for defence costs, even where provision has not been made for separate policies, or separate limits on indemnity within a single policy, for defence costs and third party liability.

The lawyers acting for the receivers of Bridgecorp have, however, indicated that a further appeal to the New Zealand Supreme Court is likely. Also, this issue has not yet been (but will be) considered by the Australian Courts. In the circumstances, we recommend that arrangements put in place to "ring fence" defence costs policy proceeds be maintained.

For more information, please contact Richard Jowett, Partner, on +61 (0)3 8601 4521 or richard.jowett@hfw.com, or Andrew Dunn, Partner, on +61 (0)2 9320 4603 or andrew.dunn@hfw.com, or John Barlow, Partner, on +44 (0)20 7264 8188 or john.barlow@hfw.com, or Brendan McCashin, Associate, on +61 (0)3 8601 4527 or brendan.mccashin@hfw.com, or your usual HFW contact.

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
United Kingdom
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888