Insurance/
Reinsurance

March
2013

INSURANCE/ REINSURANCE BULLETIN

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

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*.

holman fenwick willan hfw

the Bridgecorp receivers, in such a way that the policy funds could not be advanced to meet the directors' criminal defence costs. 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.

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.

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

Mitigating costs in liability policies

Ace European Group & Ors v Standard Life Assurance Limited [2012] EWCA Civ 1713

It is common for liability policies to indemnify the assured in respect of mitigation costs, which are typically defined as costs incurred by the assured in taking action to avoid or reduce third party claims of a type which would have been covered under the policy. The rationale is that the insurer benefits from action taken to avoid or reduce claims and the assured is therefore entitled to be indemnified in respect of the cost of such action.

In this case, the Court of Appeal held that, where an assured has incurred mitigation costs for the dual purpose of (i) reducing or avoiding third party claims of a type covered under the policy; and (ii) avoiding or reducing a separate risk not covered under the policy (in this case damage to the assured's brand), there is no need to apportion the mitigation costs between the two purposes and the assured may instead recover such mitigation costs in full, the principle of apportionment having no application in the context of liability claims.

The appellant SL faced the prospect of multiple claims arising out of the marketing and operation of one of its investment funds (the Fund). In order to avoid and reduce such claims, and to reduce further damage to the SL brand, SL made a lump sum payment into the Fund to restore its value, as well as making certain compensation payments, amounting to a total "cash injection" of approximately £100 million. SL sought to recover the cash injection as mitigation costs from its insurers, who denied liability.

Having been ordered at first instance to indemnify SL in respect of the cash injection, insurers appealed on the issue of apportionment. Insurers argued that, by analogy with the apportionment rules which apply to marine sue and labour claims, the mitigation costs should be apportioned between those referable to the avoidance or reduction of insured third party claims and those referable to the avoidance or reduction of uninsured damage to the SL brand. On the basis that the avoided third party claims were estimated to amount to approximately £1,000,000, whereas the avoided damage to the SL brand was estimated to be worth £3,000,000, insurers argued that they should only be liable for 25% of the mitigation costs.

In rejecting the appeal, Lord Justice Tomlinson ultimately decided that insurers' arguments were untenable as a matter of construction of the policy. The first instance judge had found that the cash injection met all of the necessary criteria to satisfy the definition of mitigation costs in the policy. They were therefore costs which the insurers had undertaken to pay and any apportionment of the them would involve insurers failing to honour their promise to indemnify SL for mitigation costs.

Lord Justice Tomlinson went on to explain that, in any case, the rationale underlying the principle of apportionment (that is, underinsurance of the property insured) has no place in liability insurance and that it would be irrational and unprincipled to attempt to introduce it.

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Jurisdiction and contract certainty

Howden North America Inc v ACE European Group Ltd [2012] EWCA Civ 1624

The London Market Group has identified governing law and jurisdiction as being one of the key areas to be dealt with in order to achieve contract certainty. This case is an illustration of the issues that can arise when policies do not make express provision in this regard.

As reported in our October 2012 Bulletin, this case concerns an application by certain London Market insurers for permission to serve a Claim Form out of the jurisdiction on their insured, a US-based engineering company (H). H notified insurers of certain asbestos-related claims brought by third parties, in response to which insurers sought declaratory relief in England against H as to the meaning of their policies. H had previously commenced related proceedings before the Pennsylvania court and argued that, in view of this, insurers' claim for declaratory relief was not of sufficient utility to justify service out.

At first instance, H's application failed, Field J holding that there was sufficient utility in respect of the declaration sought, on the grounds that: (i) there remained a real prospect that English law would be held by the Pennsylvania court to be the governing law, in which event the Pennsylvania court would find the judgment of the English court to be of considerable assistance (the assistance ground); and (ii) the declarations sought would, if made, be useful in resisting enforcement in England of a judgment in Pennsylvania that ignored the express or implied choice of law of the parties (the enforcement ground). H appealed these conclusions as to utility.

The Court of Appeal allowed H's appeal and set aside Field J's order granting permission to serve out. As to the assistance ground, the court held that: (i) Field J had overstated the likelihood of English law being found to be the governing law; (ii) even if English law was found to be the governing law, the Pennsylvania court would be able to receive, understand and evaluate such evidence of English law as the parties may wish to put before it; and, moreover, (iii) there was no evidence that the Pennsylvania court wished to be assisted by the English court's views and the idea that the English court should give its unsolicited judgment as "advice" in such circumstances was both presumptuous and condescending, smacking of unacceptable hubris.

As to the enforcement ground, the court held that mounting a kind of "pre-emptive strike" to obtain an English court's judgment on certain limited declarations for no other reason than to lay the ground for a defence to enforcement of a foreign judgment on the ground that it is contrary to a pre-existing English judgment is, at least on the facts of this case, not a "useful" exercise of the English court's jurisdiction.

Although insurers' position was that that they were not trying to get more favourable treatment by proceeding in England, the issue of law and jurisdiction was crucial because in Pennsylvania, exposure to a hazardous condition is sufficient to trigger liability, whereas this is not so under English law. Similarly, under English law, the relevant trigger must occur within the policy period, but this is not the case in Pennsylvania. The illustrates the particular importance of law and jurisdiction provisions in policies responding to perils such as third party asbestos claims, to which differing approaches may be adopted by the courts of different jurisdictions, with potentially serious consequences for insurers and reinsurers.

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Basis of contract clause

The decision in *Genesis Housing Association v Liberty Syndicate Management Ltd* serves as a reminder that the courts will interpret "basis of contract clauses" in proposal forms and the resulting warranties strictly, and that inaccuracies will release the insurers from the date of breach.

The proposal form in relation to a policy, signed by Time and Tide (Bedford) (TTB) on behalf of the insured (G), wrongly stated the identity of the builder as Time and Tide Construction (TTC) instead of TTB. It declared that the insured had answered questions *"to the best of...knowledge and belief...and this proposal and the statements made therein shall form the basis of the contract".*

A key issue was whether the facts disclosed in the proposal form absolutely warranted as to their truth, or whether they merely had to be to the best of the proposer's knowledge and belief. The court found that G (a company) knew/should have known the identity of the builder, and the information in the proposal could therefore not have been *"to the best of [G's] knowledge and belief"*. The court therefore ruled that G had no claim under the policy because it was, *"albeit innocently, in breach of warranty in that the statement made by it in the proposal form to the effect that the builder was or was to be TTC was within its knowledge and belief incorrect".*

In previous cases involving individuals as opposed to companies, the insured had claimed

the burden of showing its knowledge and belief was discharged by honesty.

The law on basis of contract clauses will change in relation to consumers when the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDR) comes into force, expected in 2013. The expectation of the individual will be brought in line with the approach currently taken by the Financial Ombudsman Service. This will modify the consumer's duty of utmost good faith by removing the obligation to disclose all material facts. The consumer would no longer be required to volunteer information but only to respond honestly and with reasonable care to questions asked.

However, whilst there is a greater burden on the knowledge of a corporate entity compared to a consumer, the CIDR does not define what constitutes a misrepresentation. Under common law a misrepresentation is a representation that is either inaccurate or incomplete. On that basis, if the same test and facts in *Genesis* were applied to an individual, it is difficult to see how a court could not reach the same conclusion in that the individual ought to reasonably have known the representation was inaccurate.

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Loss of hire

Sealion Shipping Ltd v Valiant Insurance Co [2012] EWHC 50 (Comm), [2012] EWCA Civ 1625

This case concerns a loss of hire claim by the owners of a support vessel used in connection with drilling operations in the Gulf of Mexico.

The vessel was capable of dynamic positioning, enabling her to maintain her position above a wellhead, with the aid of computer controlled rotating bow and stern thrusters. She suffered three separate and technically unconnected breakdowns. The vessel was returned to service 82 days after the initial breakdown. Since the vessel had been placed off-hire, owners pursued a claim under their loss of hire policy.

Under the loss of hire policy, the daily sum insured was US$70,000, limited to 30 days each accident or series thereof arising out of one event, subject to a 21 day excess in respect of machinery breakdown. There was no dispute that the breakdowns were machinery breakdowns.

The policy also included an Inchmaree clause which provided cover for loss or damage caused by, amongst other things, the negligence of the master and officers etc. *"provided such loss or damage has not resulted from want of due diligence by the Assured, Owners or Managers".*

At first instance

Insurers denied the claim on three main grounds: (1) misrepresentation/ non-disclosure (2) want of due diligence under the Inchmaree clause and (3) the fact that each breakdown was a separate event incurring an excess of 21 days, and since no single breakdown was responsible for more than 21 days loss of hire, no claim was payable.

1. The alleged non-disclosures/ misrepresentations were threefold:

- Firstly, the information section of the policy stated that there had been *"one hull claim on the vessel"*. The Court accepted that this statement was inaccurate because there had been two hull claims on the vessel, but found that the disclosure of one hull claim does not make the other hull claim material. The materiality of the hull claims was linked to the extent to which they caused loss of hire.

- Secondly, the information section in the policy stated that *"apart from scheduled dry-dockings and a few hours off-hire now and again, the vessel has not experienced any significant off-hire period"*. The vessel had in fact experienced approximately ten days off-hire in 2004. The Court held that ten days' loss of hire experienced in 2004 compared to a 21-day excess under the 2008 policy was not material. It was not a particularly long period of off-hire, it was nearly four years previous to the placing of the policy, it did not result in a claim, and it did not come close to the excess period.

- Thirdly, the underwriter was informed by the broker that the vessel had *"an excellent hull record and that there had been*

no major business interruption". In spite of the points made above, the Judge held this statement to be true, since it was a statement of the brokers' opinion and was made in good faith (see S.20(5) of the Marine Insurance Act 1906).

The Judge also found that insurers failed on inducement. The Court was not satisfied that the senior underwriter, who was not in Court to give evidence, would have proceeded any differently had he been told of the two hull claims or of the ten days off-hire in 2004.

2. Want of due diligence: In order to bring the owner out of cover under the Inchmaree clause, the burden of proof was on insurers to show a want of due diligence by the assured and the question for the Court was what is the standard of care in this context, recklessness or negligence. The Court held that the standard was one of negligence and that want of due diligence is a lack of reasonable care, however since owners had appointed competent specialist engineers and were entitled to rely on their conclusions and recommendations (even if incorrect), the Court found there to have been no negligence.

3. Three breakdown events: The Court accepted that although there was a circumstantial link, there was no technical cause and effect between the three breakdown events and there were therefore three separate "occurrences". On this basis it would follow that an excess of 21 days would apply in respect of each loss. However, on this occasion, the owner was entitled to treat the entire 82 days off-hire as being consequent upon the original breakdown, even though other work may have been undertaken during that time.

The Court of Appeal

This case was appealed on the aggregation point only. The appeal was made on three grounds: (1) causation (2) construction and (3) the 'Ferdinand Retzlaff' point (being a case from 1972).

1. Causation: Insurers submitted that the first occurrence had been overtaken by the second occurrence, which it was accepted had arisen out of the owner's election to use the opportunity and advantage of access arising from the first breakdown to undertake work that gave rise to the second occurrence. The Court of Appeal were not persuaded that the Judge was wrong in the essentially factual conclusion he reached. The work that led to the second breakdown was closely and reasonably related to owner's efforts to mitigate and it was entirely reasonable for owners to undertake the work they did which resulted in the second breakdown. There was therefore no break in causation between the first breakdown and owner's entitlement to full indemnity, in spite of there being two operative causes.

2. Construction: Insurers submitted that the construction of the policy called for the application of three excess periods one for each occurrence, and since the three occurrences were treated as three separate events under the H&M cover, it would be odd if the LOH cover were treated differently. The Court disagreed holding that owners had satisfied the contractual threshold in respect of the first occurrence and there was therefore no need to take into account the excess periods which would have been applicable to the second and third occurrences. The Court did not decide on the H&M issue.

3. The 'Ferdinand Retzlaff' point: Insurers submitted they were under no liability in respect of the second occurrence because owners had suffered no loss of hire, given that they undertook their own work at the same time, thus saving time and earning capacity later. Although this point was academic, the Court held that for insurers to succeed it would be necessary to read into the policy a requirement that owners give credit for time saved later, that there was no express provision to this effect and that there were good reasons for not construing the policy as containing a requirement to give credit.

Comments

This case is of interest because:

1. It provides guidance on the requirements of materiality and inducement and the difficulties of succeeding in an avoidance action, especially where the main underwriter does not give evidence.

2. It helps delineate a statement of fact from a statement of opinion under s20(5) of the MIA.

3. It will be welcomed by hull insurers as it provides clarity as to the standard of care required in connection with the due diligence provison in the Inchmaree clause.

4. It shows how causation can bear on the issue of the aggregation of losses for the purpose of applying policy deductibles.

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Enforcing Commercial Court judgments in the DIFC; and *vice versa*

Background

Founded in 2002 and open for business since 2004, the Dubai International Financial Centre (DIFC) is a 110 acre on shore financial hub in Dubai, UAE. A number of the large, international reinsurers have set up in the DIFC.

The DIFC is part of the UAE, but is an independent jurisdiction under the UAE Constitution and has its own civil and commercial laws. These are written in English and default to English law.

The DIFC Courts were established in 2004 and operate as common law courts dealing with commercial and civil disputes either connected with the DIFC, or (since 2011) over which the parties have agreed that the DIFC Court should have jurisdiction.

The DIFC Court has recently published a memorandum of guidance (the Memorandum) jointly with the Commercial Court of England & Wales (being the specialist court that typically deals with large and complicated financial and business disputes).

These courts are therefore suited to dealing with large value, complex cross-border disputes typical of re/insurance.

The Memorandum sets out the procedures for the reciprocal enforcement of money judgments made by the Commercial Court and DIFC Courts. A money judgment is simply a judgment under which one person is required to pay a sum to another person. The Memorandum therefore provides some clarity as to how money judgments will be mutually recognised and enforced.

The Memorandum

The Memorandum explains that in order to be enforced in the other court, a DIFC Court judgment or a Commercial Court judgment must satisfy the following requirements.

1. It must be final and conclusive (it may be "final and conclusive" even if it is subject to appeal).

2. Cannot be in respect of certain types of judgment, namely one relating to the payment of a penalty, for example the payment of taxes or fines.

3. The Court making the judgment must have had jurisdiction to determine the dispute. As to this question, the "enforcing" court will generally consider that the other court had the required jurisdiction if the person against whom the judgment was made (i) was present in the jurisdiction when the proceedings were commenced; or (ii) was the claimant or counterclaimant; or (iii), submitted to the courts jurisdiction; or (iv) agreed before commencement and in respect of the subject matter of the proceedings to submit to the court's jurisdiction.

If the above three requirements are fulfilled there are only limited grounds on which the judgment can be challenged, including where the judgment was obtained by fraud, where it is contrary to public policy, or where the proceedings were conducted in a manner contrary to natural justice. The enforcing court will not re-examine the merits of the other court's judgment.

Although the Memorandum does not change any existing laws and is not binding on judges of either court, it clarifies the arrangement between the courts and provides a strong indication of the courts' supportive approach to each other's judgments, which in turn provides some clarity for businesses dealing with parties in the two jurisdictions.

Finally, there is currently no treaty in place between the UAE and the UK under which each other's judgments can be enforced; this includes the DIFC Courts. The Memorandum described above sets out a procedure based on the

fact that the DIFC Courts and the Commercial Court are both common law courts. Whilst a system has been established whereby DIFC Court judgments can be enforced in Dubai, it remains to be seen whether a Commercial Court judgment (or indeed any common law judgment) can be enforced in Dubai via the DIFC Court using the process described in the Memorandum.

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News

Geoffrey Conlin, who is a Senior Associate in the London office, has re-located to São Paulo, Brazil, from 15 February 2013, to assist in the development of HFW's insurance and reinsurance practice in the Latin America region. Geoffrey specialises in resolving complex, cross-border claims arising from property, marine, energy (onshore and offshore), oil and gas, powergen, casualty, liability and D&O risks. He also advises on the drafting of policy wordings and related matters. Geoffrey has acted on cases in all major jurisdictions in Latin America. He has an MA Hons in Spanish and Portuguese.

Twin Towers – how many events?

HFW recently acted for RiverStone, the successful party in the High Court appeal of an arbitration award regarding whether, for reinsurance aggregation purposes, the attacks on the World Trade Center amounted to one or two "events". This is the first public English decision on this issue and it should help put an end to any remaining uncertainty in the reinsurance market. Please see our client briefing for further details: http://www.hfw.com/Twin-Towers-Feb-13

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Conferences & Events

Lillehammer Energy Claims Conference
Norway
(6-8 March 2013)
Attending: Jonathan Bruce

Mining Claims Seminar
HFW, Friary Court, London
(19 March 2013)
Presenting: Rebecca Hopkirk, Toby Savage, Paul Wordley, Nigel Wick and Jonathan Bruce

Airmic Exhibition 2013
Brighton
(10-12 June 2013)
Attending: Costas Frangeskides, Nick Hughes and Graham Denny

If you are interested in receiving more information about these events, please contact events@hfw.com

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