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Insurance Law Case Note

Steigrad v BFSL 2007 Limited: Defence costs precluded by statutory charge over insurance monies.

A decision in this matter was handed down by the New Zealand High Court on 15 September 2011 that may have significant ramifications in Australia.

The Facts

The case concerned the collapse of the Bridgecorp Group (which comprised various finance companies) in July 2007 owing investors almost \$500M.

The plaintiffs were former directors of the Bridgecorp Group and they faced a number of criminal and civil claims. The defendants, the "Bridgecorp defendants" were companies within the Bridgecorp group that were all in liquidation and/or receivership. The defendants intended to commence civil proceedings against the directors alleging breach of statutory and common law duties to the company. The civil proceedings were stayed pending disposition of criminal law proceedings.

The Policies

The directors were the beneficiaries of a Directors and Officers ("D&O") policy with QBE. The policy had a limit of indemnity of \$20M, significantly less than the value of the various claims which were expected to be brought against the directors. The policy provided cover for defence costs incurred by the directors. The directors also had an additional policy which provided cover solely for defence costs incurred due to a breach of their statutory obligations (the Statutory Liability or "SL policy"). This policy had a limit of indemnity of \$2M.

When the criminal proceedings were initiated, the directors agreed to first use the SL policy to fund their defence costs, and to divide the \$2M limit of indemnity equally between all directors. By 1 August 2011, the majority of directors had exhausted their entitlement under the SL policy, and had to resort to the D&O policy in order to meet ongoing defence costs.

Fast Facts

The New Zealand High Court has found an assertion by a claimant of a statutory charge over all insurance monies operated to prevent the insured from accessing the insurance monies to defend themselves.

The effect of this was the directors were denied their defence costs under their own D&O policy (because the entire limit of indemnity was likely to be exhausted by the claim).

Warning: The mechanism by which this was able to occur, exists in Australia. We have similar legislation in some states. For example, in NSW section 6 of the Law Reform (Miscellaneous Provisions) Act 1946 NSW creates the same type of charge. Where there are patently insufficient monies in the policy to cover the loss, insureds can by this case, lose their entitlement to up front payment of defence costs.

The Bridgecorp Defendants – Statutory Charge

The Bridgecorp defendants advised QBE that they intended to assert a charge over the monies payable under the D&O policy for the amounts that they intended to claim from the directors in the civil proceedings. They asserted that the charge arose pursuant to Section 9 of the *Law Reform Act 1936* ("the Act"), which creates a charge in favour of a claimant over monies that may be payable under an insurance policy.

What QBE Did

QBE ceased making payments under the D&O policy, and the directors sought a declaration that Section 9 of the Act did not prevent QBE from advancing defence costs in accordance with the D&O policy.

The Legislation

Section 9 of the Act operates in a similar manner to Section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW). Section 9(1) provides that:

If any person (hereinafter ... referred to as the insured) has ... entered into a contract of insurance by which he is indemnified against liability to pay damages or compensation, the amount of his liability shall, on the happening of the event giving rise to the claim for damages or compensation, and notwithstanding that the amount of such liability may not then have been determined, be a charge on all insurance money that is, or may become payable in respect of that liability.

Lang J noted that this section provided a procedural mechanism to ensure that a claimant can, in appropriate circumstances, gain direct access to insurance monies that would have been available to the insured. He found that the charge came into existence well before liability is declared to exist by a court. Further, the fact that the quantum of the claim has yet to be determined will not prevent a charge from coming into existence. Accordingly, in the present case, it did not matter that the Bridgecorp defendants had not yet quantified their claim against the directors. Additionally, the charge applied to both insurance money that was payable, and to that which may become payable.

The Decision

Lang J considered that the authorities on Section 9, and the authorities to which he was referred on Section 6 of the NSW Act were of limited assistance. Accordingly, it was necessary to decide the case by having regard to the nature of the charge, and the purpose of Section 9. In this regard he noted that the charge in favour of the Bridgecorp defendants remained conditional upon the occurrence of two events before it will be fixed and enforceable by them against QBE – first, the defendants would need to establish that the directors were liable to them for a quantified sum, secondly, it would need to be established that the directors were entitled to cover in respect of their liability to the Bridgecorp defendants. This would not however determine whether the charge prevented the directors from having access to the D&O policy to meet their defence costs.

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In determining this issue, Lang J found that the claim by the Bridgecorp defendants was for a sum significantly greater than the amount of cover available under the D&O policy. As such, QBE were bound to keep the insurance fund intact for the benefit of the Bridgecorp defendants and any other civil claimants (the position could be different where the amount of the claim was well within the amount of cover under the policy). As such, if QBE made any payment to the directors, it would still have to restore the pool of funds available to meet the defendants' claim and would therefore make any such payment "as a volunteer".

Lang J noted that this could have harsh consequences for directors, however this finding was in accordance with the object and purpose of Section 9, and as such, the directors could not have access to the D&O policy in this case to meet their defence costs.

Consequences for Insurers and Insureds

Bearing in mind the similarities between Section 9, and Section 6 of the NSW Act, this decision could have significant ramifications in NSW, not just in respect of D&O policies, but also public liability and professional indemnity policies which frequently have defence costs extensions.

Consideration will need to be given to this, particularly because insureds who do not have access to money from an insurance policy for defence costs may not have sufficient personal funds to adequately defend a matter – leaving an insurer potentially exposed for the entire limit of indemnity, or else making a commercial decision to make a "voluntary" payment to insureds for defence costs to enable a robust defence to be run.

Some solutions going forward may be:

1. Insureds could be offered SL policies purely to cover their defence costs.
2. Insureds could be offered separate coverage under their D&O or other policies with separate limits of indemnity for damages and defence costs.
3. Policies with much higher coverage may be required.

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