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CORPORATE AND PROFESSIONAL INDEMNITY INSURANCE

ADVANCEMENT OF DEFENCE COSTS

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A: Introduction

1 It is trite to observe that liability insurance policies issued by insurers to insureds in Australia, routinely provide both 'claim' cover and 'defence costs' cover.

2 That is, when a claim by a third party claimant is made against an insured of a type covered by a particular species of insurance contract – such as a public liability claim, or a product liability claim, or a professional indemnity claim, or a directors and officers liability claim – then the insurance policy should ordinarily indemnify the insured against:

2.1 its liability (if any) to the third party for the claim; and

2.2 its reasonable costs of defending the claim.

3 From an insured's perspective, when a third party claim is made against it both aspects of the insurance cover are of considerable importance.

4 Additionally, there are situations where a third party claim has yet to be made against an insured (and possibly never will be made), but an insured has been subject to regulatory investigation or scrutiny, and the insured prudently requires expensive legal representation in response to such investigation. In these situations, the availability of defence cost cover (or 'investigation cost' cover) becomes a very important feature of a relevant insurance policy.

5 The purpose of this paper is to address some topical issues relating to the insuring of defence costs, focusing on:

- Who is going to pay to defend the case?
- How is defence cost advancement being dealt with by the leading insurers?
- Developments in case law.

6 At the outset, it should be noted that the most prominent development in relation to an insurer's contractual obligation to advance defence costs to an insured arises out of the *Bridgecorp*[1] litigation in New Zealand. I will discuss the *Bridgecorp Case* in Part E of this paper. Before doing so, however, I thought I should set the scene by reviewing more generally in Part B of the paper an insurer's defence cost and investigation cost obligations, by considering in Part C some specific defence cost advancement issues which arise where a policy contains a 'final adjudication' clause, and by discussing the question of defence cost allocation in Part D.

B: Advancement of defence costs – generally

Differing types of defence cost cover

7 There are a variety of different types of defence and investigation cost cover available in the Australian insurance market.

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[1] Being the first instance decision of *Steigrad & Ors v BFSL Limited, Bridgecorp Limited & Ors* reported at [2011] NZHC 1037 (15 September 2011) and the Court of Appeal decision of the same name reported at [2012] NZCA 604.

8 I am not an insurance broker, and my purpose is not to survey and comment on the different covers, but instead to highlight some legal issues which arise from their practical application in various contexts.

9 That said, a brief review of some of the different types of insurance cover available in this area may be useful.

10 Without being exhaustive, from my observation the insurance industry in Australia routinely offers insureds various 'defence cost' options such as the following:

- the choice of a policy which provides claim and defence cost cover, or a policy which provides 'stand alone' legal expenses cover only;
- a policy which provides claim and defence cost cover inclusive of the indemnity limit. Typically, directors and officers liability policies ('D&O' policies) are of this nature;
- a policy which provides claim and defence cost cover, with the latter in addition to the indemnity limit. Typically generic professional indemnity and public liability policies are of this nature;
- a policy which confines the legal expenses cover to costs of defending a claim, but does not provide broader 'investigation cost' cover. Public liability policies and many but not all professional indemnity policies are of this nature;
- a policy which provides broad legal expenses cover, to encompass not only the insured's cost of defending third party compensation claims against it, but also the insured's costs of investigation expenses, the defence of regulatory claims, and even the defence of criminal claims. D&O policies often provide this sort of cover, and certain financial lines professional indemnity policies for very large financial institutions do likewise;
- policies where the advancement of defence cost cover is discretionary for an insurer (or discretionary unless indemnity is extended by the insurer);
- policies where the advancement of defence cost cover by the insurer is mandatory, unless the insurer is successfully able to deny indemnity under the policy;
- policies where an insurer is obliged to advance defence cost funding to an insured even if the underlying claim against the insured is one which asserts fraud, unless and until the fraud has been established by final adjudication against the insured.

11 No doubt many other variations are possible, and the availability and extent of defence cost insurance would no doubt fluctuate as different types of insurance product become available in the market, or as market conditions for the selling of insurance soften or harden.

12 As a commercial matter, when an insured is purchasing insurance cover, the answer to the question 'Who is going to pay to defend the case' is one which the insured would need to consider prospectively, in conjunction with the insured's broker. After the cover has been purchased, and a specific claim circumstance eventuates, the answer to the question of who will pay to defend the case will turn upon a close reading of the insurance policy under consideration, and the application of the provisions of that insurance policy to the precise factual situation thrown up by the underlying claim.

13 In this paper I will not review the different permutations of outcome that may hypothetically arise when a particular request for defence cost advancement is made under a particular type of insurance policy. But in very general terms the insurance coverage response will tend to turn on whether:

- The defence costs are reasonable?
- The policy provides coverage for defence costs inclusive of or in addition to the limit of indemnity?
- The insurer has a discretion or obligation to advance defence costs pending a decision on indemnity?

- The policy covers investigation and similar costs, as well as pure defence costs?
- The policy contains a 'final adjudication' clause?
- Indemnity would be available under the insurance policy for the claim against the insured?

A recent example – *BOQ Ltd v Chartis*

14 At this point, it is probably as well to illustrate the general principles that apply to the advancement of defence costs by a consideration of a specific reported case. The case I have chosen for this purpose is the decision of Jackson J of the Supreme Court of Queensland in the recent matter of *Bank of Queensland Ltd v Chartis Aust Insurance Ltd*[2]. As well as being the most recent authority of which I am aware on the issue of defence cost advancement under an insurance policy, the judgment also conveniently discusses a number of earlier authorities on the point.

Facts

15 The facts of the case are as follows:

15.1 The BOQ and an insurer, Chartis, were parties to a professional services liability insurance policy.

15.2 Under the policy Chartis agreed to pay on behalf of the BOQ all loss and defence costs resulting from a claim first made against the insured during the policy period for a wrongful act as defined. The insured's indemnity entitlement under the policy was also, of course, subject to a number of conditions and exclusions in the policy, including those referred to below.

15.3 In 2010 proceedings were commenced against the BOQ in the Federal Court of Australia by ASIC and Barry and Deanna Doyle. Mr & Mrs Doyle had previously borrowed money from the BOQ by way of loan agreement, secured by mortgage over their residential property. The Doyles had used these loan monies in significant part to fund a leveraged investment in various investment funds recommended by the failed financial advisory firm, Storm Financial Limited.

15.4 The causes of action asserted by the Doyles against the BOQ were essentially threefold. In essence it was asserted that:

(i) in making the loans to the Doyles, the BOQ had breached express terms of the various loan agreements;

(ii) the conduct of the BOQ in respect of each loan was unconscionable; and

(iii) in respect of the loan agreements, the BOQ was a "linked credit provider" with Storm pursuant to section 73 of the *Trade Practices Act*, and was therefore liable for various breaches of duty by Storm.

16 The BOQ notified the ASIC and Doyle claim to Chartis under the policy, and sought from the insurer indemnity for any liability the BOQ might have in respect of the claim (which liability to ASIC and the Doyles the BOQ denied), and the advancement of defence costs under clause 6.6 of the policy.

17 The following provisions of the insurance policy were of particular relevance to the insurance position:

17.1 The insuring agreement in clause 1, which provided:

'The Insurer shall pay on behalf of each Insured all Loss and Defence Costs resulting from any Claim first made during the Policy Period for any Wrongful Act.'

[2] [2012] QSC 319, 3 December 2012; (2013) 17 ANZ Insurance Cases 61-953

17.2 Clause 3.8 of the policy, headed 'Wrongdoing', which provided that:

'The insurer shall not be liable to make any payment for Loss ... arising out of, based upon or attributable to any Wrongdoing committed by any Insured provided that:

(iv) this exclusion shall only apply if it is established through a judgment or other final adjudication adverse to the Insured against whom the Claim is made, or any admission by an Insured that the Wrongdoing did in fact occur.'

17.3 The definition of 'Wrongdoing', which was stated to mean fraudulent, dishonest, criminal, malicious or wilful act, error or omission.

17.4 Clause 3.9 of the policy, headed 'Lender's Liability Exclusion', which provided that:

'The insurer shall not be liable to make any payment for Loss ... arising out of, based upon or attributable to any actual or alleged:

(i) loan, lease or extension of credit except to the extent such Claim arises out of a Wrongful Act in the administration of such loan, lease or extension of credit'

17.5 Clause 6.6 of the Policy, headed 'Advance Payment of Insured Defence Costs', which provided:

'Except to the extent the Insurer has denied indemnity for any Claim, the Insurer shall advance Defence Costs in excess of the Retention, if applicable, promptly after sufficiently detailed invoices for those costs are received by the Insurer.

The Insurer may not refuse to advance Defence Costs by reason only that the Insurer considers that conduct referred to in the 'Wrongdoing' Exclusion has occurred, until such time as there is an admission by the Insured, or, a judgment, award or other finding by a court, tribunal or arbitrator with jurisdiction to finally determine the matter (including the outcome of any appeal in relation to such judgment, award or other finding) which establishes the foregoing.

The Policyholder shall reimburse the Insurer for any payments which are ultimately determined not to be covered by the policy.'

18 Chartis considered that the Lenders' Liability Exclusion in clause 3.9 of the policy operated to exclude from cover the BOQ's request in respect of the ASIC and Doyle claim, both in relation to the request by the insured for indemnity for the claim, and in relation to the request for the advancement of defence costs. Accordingly, the insurer denied indemnity.

19 The BOQ disputed the indemnity denial, and commenced proceedings against the insurer is the Supreme Court of Queensland. In the proceedings the insured sought from the Court various declarations, including:

19.1 a declaration that Chartis is obliged to indemnify the insured under the policy for any loss it may have in respect of the ASIC and Doyle proceedings; and

19.2 a declaration that Chartis is obliged to indemnify the insured under the policy for its reasonable costs of defending the said proceedings.

20 For the purposes of this paper, I am mainly interested in the defence cost issue, but the way in which that issue was resolved cannot really be understood without an overview of the claim issue.

<u>The claim issue</u>

21 Chartis in essence advanced two arguments in opposition to the BOQ's application for a declaration of indemnity entitlement for any loss it may have in relation to the ASIC and Doyle claim.

22 <u>First</u>, the insurer asserted that the Lenders Liability Exclusion clearly applied, because the claim by ASIC and Doyle against the BOQ was sufficiently causally related to the various loan agreements as to arise out of a loan, and hence activate the exclusion.

The insured disputed this assertion, and instead maintained that the claim was either insufficiently connected with the loans to activate the exclusion, or the claim arose from the 'administration' of a loan (and was therefore said to be within the exception of the exclusion).

23 Secondly, and in the alternative, the insurer argued that the declaration sought by the BOQ was entirely hypothetical and lacking in utility, because unless and until the insured's liability to ASIC and the Doyles was established by judgment or settlement, the BOQ had not suffered any loss within the meaning of the policy, and there could be no liability in the insurer to pay a loss which had not occurred (and may never occur). In addition, even if the BOQ were liable for the claim, it was argued that the quantum of such liability was undetermined, and it might be that the claim would fall below the insured's deductible, or even fall above the insurer's coverage layer. In any of these circumstances, factual matters which by necessity must occur in the future (if at all) would point to the impossibility of any declaration of indemnity entitlement being made at this time.

24 Jackson J of the Supreme Court of Queensland found in favour of Chartis on the second argument, and therefore refused to determine the first argument. His Honour held that until the facts underlying the BOQ's liability (including whether there be such a liability)) to ASIC and the Doyles had been established by evidence or agreement, it would be entirely hypothetical and lacking in utility for the Court to make the declaration sought. Further, the application of the exclusion could not be ascertained unless and until the facts were established. Cases cited by the judge to support this stance included *Bass v Perpetual Trustee Co Ltd*[3]*; QBE Insurance (Aust) Ltd v Tropical Reef Shipyard Pty Ltd*[4]*;* and *Kings College v Allianz Australia Ltd*[5].

25 Hence, the Court effectively found that it would ordinarily be inappropriate to determine the liability of an insurer to an insured in respect of a claim, in advance of the determination of the liability of the insured to the claimant.[6]

The defence cost issue

26 In the alternative, the BOQ had in effect submitted that if the Court were unwilling at this stage to make a declaration of indemnity entitlement in respect of the ASIC and Doyle claim, it ought make a declaration that the insurer advance defence costs in respect of such claim.

27 The claim for the advancement of defence costs was made by the insured in reliance on clause 6.6 of the policy (quoted above). In response, Chartis submitted that:

27.1 by the express terms of the clause, it was only obliged to advance defence costs under clause 6.6 of the policy '*except to the extent the Insurer has denied indemnity for any Claim'*. And, because Chartis had denied indemnity, then clause 6.6 was not activated, and it was therefore not obliged to advance costs to the insured;

27.2 in any event, its indemnity denial based on clause 3.9 was valid, and hence there could be no defence costs liability in the insurer in relation to the ASIC and Doyle claim against the insured, because there was no indemnity obligation of the insurer for the claim.

28 In response, the BOQ asserted:

28.1 that the insurer's obligation to pay or advance defence costs under the policy was not affected by the exclusions in section 3 of the policy. This was because the exclusions – including exclusion 3.9 – were only stated to apply to 'Loss' and not 'Defence Costs' (see the wording of clause 3.9 at paragraph 17.4 above). Hence, Chartis would have to pay defence costs even if claim cover for

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[3] (1999) 198 CLR 334

[4] [2009] FCAFC 161

[5] [2004] 1 QD R 394

[6] Also see *AMP Fire and General Insurance Company Ltd v Dixon* [1982] VR 833, cited in support of this proposition.

the ASIC and Doyle proceeding were excluded, and therefore Chartis should make advance payment in respect of such defence costs;

28.2 alternatively, that clause 6.6 required the insurer to advance defence costs until final adjudication of a dishonesty or fraud claim against the insured, and it would be incongruous for the insurer to be able to refuse to advance defence costs where a much lesser species of wrongful act had been asserted against the insurer. So, clause 6.6 should be construed as requiring defence cost advancement until final disposition of any claim against the insured;

28.3 alternatively, the only ground advanced by the insurer to deny liability under the policy was the Lender's Liability Exclusion in clause 3.9, and this ground of denial was wrongly based, and therefore defence costs should be advanced.

29 Jackson J found that, despite some infelicity in the wording of the policy, the argument by the BOQ in subparagraph 28.1 above was wrong. In other words, despite the fact that the policy only referred to 'Loss', and not additionally to 'Defence Costs' in the introduction to the exclusion clauses, the judge found that if Chartis were entitled to deny indemnity to the BOQ for a claim – for instance on the basis of clause 3.9 – then the insurer would not be obliged to pay defence costs either: see paragraph 74 of the judgment. In reaching this conclusion, Jackson J in effect followed a series of cases to similar effect[7], and also expressly sought to apply the decisions of the High Court of Australia on the proper approach to the construction of commercial contracts (in *McCann v Switzerland Insurance Australia Ltd*[8] and *Australian Broadcasting Commission v Australasian Performing Rights Association Ltd*[9]), namely:

> *'that the construction to be preferred is one that gives a business-like interpretation or that "[i]nterpreting a commercial document requires attention to the language used by the parties, the commercial circumstances which the document addresses, and the objects which it is intended to secure". The appropriate resolution of potential inconsistency within a commercial contract is to be undertaken in a way that seeks "to render [the relevant parts of the text] all harmonious one with another", in the context of the policy as a whole.'*

30 Jackson J further found that the alternative argument of the BOQ in paragraph 28.2 above was also ill-founded. That is, the mere fact that, the insurer would not be able to rely on the Wrongdoing (fraud and dishonesty) exclusion in clause 3.8 of the policy to refuse to advance defence costs if a fraud or dishonesty claim had been made against the insured until final adjudication of such a claim, does not mean that the insurer could not deny indemnity on some other valid ground and refuse to advance defence costs forthwith. So, in this case the insurer has purported to deny coverage forthwith on the basis of the Lenders' Liability Exclusion in clause 3.9, and nothing in clause 6.6 would prevent the insurer from doing so and refusing to advance defence costs.

31 This, then, left for determination the validity of the insurer's denial of indemnity and refusal to advance defence costs on the basis of clause 3.9 itself. However, for the reasons mentioned above, Jackson J had already found that he could not rule on the application of this exclusion until the BOQ's liability (if any) in the ASIC and Doyle matter had been established; and for the same reason he refused to make the declaration sought by the insured in relation to the advancement of defence cost funding.

32 So, the result of the case was that – despite the 'Advance Payment of Insured Defence Costs' clause in the policy, or perhaps because of it - the insurer was not required to advance defence costs to the insured in the case in question, because the insurer had purported to deny indemnity under the policy, and the validity of that denial could not

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[7] *McCarthy & Ors v St Paul International Insurance Co Ltd* (2007) FCR 402 and *Major Engineering Pty Ltd v CGU Insurance Ltd* (2011) 282 ALR 363.

[8] (2000) 203 CLR 579

[9] (1973) 129 CLR 99

be judicially resolved until the insured's liability in the underlying claim had been determined.

33 In a sense, this result seems to give the insurer a unilateral right to refuse defence cost advancement – at least in the policy in question and in the factual circumstances under consideration – until the underlying claim against the insured has been resolved. The irony is that it is in respect of such underlying claim that the insured would no doubt wish to have the benefit of defence cost advancement.

C: Final adjudication clauses

What is a final adjudication clause?

34 The type of defence cost advancement issue revealed by the case of *Bank of Queensland Ltd v Chartis Aust Insurance Ltd* had previously led some insurers, in respect of some types of claim and in respect of some types of insurance policy, to make more expansive defence cost advancement promises.

35 In certain classes of insurance – particularly D&O insurance and financial lines professional indemnity insurance – it is reasonably common at present to find policies which oblige an insurer to advance defence cost funding to an insured in respect of a claim which alleges serious wrongdoing against that insured, even though the allegation, if true, would disentitle the insured to coverage under the policy, until the wrongdoing had been established by 'final adjudication' of a Court or Tribunal.

36 Such 'final adjudication' clauses typically apply where the alleged wrongdoing by the insured involves fraud or dishonesty. So, where an insurance policy imposes on an insurer a 'defence cost advancement until final adjudication' obligation, it can be seen that the policy would provide very generous defence cost cover to the insured.

37 An example of a 'defence cost advancement' clause coupled with a 'final adjudication' clause can be seen in the *Bank of Queensland v Chartis Case*: see the clauses at subparagraphs 17.2 and 17.5 above. Another sample clause is set out below:

> *'Defence Cost Advancement*
>
> *The Insurer shall, prior to the final disposition of any **Claim** covered by this Policy, advance **Defence Costs** or **Investigation Costs** to the Insured. Any such advancement shall be repaid to the Insurer by the **Insured**, if and to the extent it is determined that such **Defence Costs** or **Investigation Costs** are not insured under this **Policy.***
>
> *Dishonesty Exclusion*
>
> *The Insurer shall not be liable for **Loss** in respect of any **Claim** arising from or in respect of any fraudulent act or omission, or any wilful violation or breach of any law or regulation or by-law by an **Insured,** provided that this exclusion shall not apply, including for the avoidance of doubt to the Insurer's obligation to advance **Defence Costs** or **Investigation Costs** until a final adjudication in any proceeding establishes such a fraudulent act, omission, wilful violation or breach*.'

38 The clause set out above provides for obligatory defence cost advancement prior to final adjudication. Other clauses sometimes provide discretionary cover only. The difference between the two types of defence cost cover is starkly revealed in the differing outcomes of the *Rich and Wilkie Cases*, discussed below. These cases also reveal the limits inherent in even the broadest types of defence cost coverage.

Rich and Wilkie Cases

39 The leading cases in Australia on the proper interpretation and application of 'final adjudication' clauses in insurance policies, are the decisions of the High Court in *Wilkie v Gordian Runoff Ltd*[10] and *Rich v CGU Insurance Ltd*[11], and the decision of the NSW

[10] (2005) 221 CLR 522

[11] (2005) 214 ALR 370

Court of Appeal in the *Rich Case*[12]. It is worthwhile reviewing the differing way in which these decisions answer the question: Who is going to pay to defend the case?

40 Mr Wilkie was an executive of the failed Australian insurance company, FAI General Insurance. After the insolvency of FAI, he was prosecuted with various offences alleging that he knowingly failed to act honestly in the provision of information to FAI's auditors. Mr Rich was an executive of the failed telecommunications company, One.Tel Ltd. After the insolvency of One-Tel, he was the subject of proceedings brought by ASIC, alleging serious wrong-doing by Mr Rich as a director and officer of that company.[13]

41 Mr Wilkie had the benefit of a Directors and Officers Liability Insurance Policy issued by GIO Insurance. Mr Rich had the benefit of such coverage from CGU Insurance. Although the policies were differently worded – and significantly so, as indicated by the differing results of each case – both policies contained dishonesty exclusions which could only be relied on by the insurers in the event of 'final adjudication' (although the policy issued by GIO Insurance also permitted the exclusion to operate if dishonesty had been admitted by the insured). The policies also both had clauses providing for the advancement of defence costs by each insurer; although crucially, the policy issued by GIO Insurance in respect of Mr Wilkie effectively provided that such advancement was mandatory, whereas the policy issued by CGU Insurance in respect of Mr Rich only provided for advancement of costs at the insurer's absolute discretion.

42 Whilst the underlying claims against Messrs Wilkie and Rich were entirely unrelated, the claims by each on their different Directors & Officers Liability Insurance policies bore a degree of similarity in terms of issues raised and tactical positions adopted; and the matters were effectively heard in tandem in the High Court. Amongst other things:

(a) Both insureds sought the advancement of defence costs from their respective insurer to fund the defence of the underlying proceedings against them;

(b) Each insurer sought to deny indemnity under the policies, including in relation to defence costs, on the ground of alleged fraud or dishonesty by the insureds (which the insureds vigorously denied). CGU additionally sought to avoid the policy it issued to Mr Rich on the ground of fraudulent non-disclosure (but GIO Insurance did not seem to raise a non-disclosure case);

(c) Both insureds sought to circumvent the indemnity and advancement denials by commencing separate proceedings against their insurers, and seeking to have those proceedings determined in advance of the underlying claims. Further, each insured argued that their insurer could not seek a final adjudication of dishonesty or fraud against them in the insurance proceedings, and was obliged to advance defence costs until such adjudication was determined in the underlying litigation.

43 In the result, the High Court found that Mr Wilkie was entitled to the advancement of defence costs from his insurer, because there had as yet been no final adjudication of dishonesty enlivening the exclusion, and the advancement obligation in the GIO Policy was mandatory; whereas Mr Rich was not so entitled, even though there had been no final adjudication of dishonesty in his case either, because CGU had a discretion to advance defence costs, and was not under a mandatory obligation to do so.

44 The following general propositions as to the proper interpretation of 'final adjudication' clauses in Dishonesty Exclusions may be derived from the *Wilkie* and *Rich Cases* in the High Court, and the *Silbermann Case* in the Court of Appeal:

(a) First, an insurer may, itself, seek a final adjudication of fraud by an insured, in insurance coverage proceedings by or against the insurer. The argument advanced by both Messrs Wilkie and Rich that such an adjudication could not

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[12] Reported as *Silbermann V CGU Insurance; Rich v CGU Insurance; Greaves V CGU Insurance* [2003] NSWCA 203.

[13] Mr Rich subsequently successfully defended the proceedings brought by ASIC: see judgment of Austin J of 18 November 2009 in the Supreme Court of NSW. Mr Wilkie also successfully defended the criminal prosecutions against him, and was acquitted by jury at trial in the Supreme Court of New South Wales.

occur in proceedings involving the insurer was rejected by the Courts below, and the High Court did not grant special leave to appeal from that finding;

(b) Secondly, in making a decision to plead fraud against an insured so as to enliven the 'final adjudication' proviso of the Dishonesty Exclusion, an Insurer would need to do so in good faith. As stated by Hodgson JA in the Court of Appeal in *Silbermann*:

'*In my opinion, the obligation of good faith means that the insurer can rely on any defence only if it has reasonable grounds to do so; and generally this would require legal advice given on the basis of full instructions as to facts and evidence known to the insurer. Of course, because of privilege, the insured and the Court will not generally be able to put that to the test, so to some extent this must depend upon the integrity of the insurer. Otherwise, the only real sanction is the possibility of striking out defences which are shown to have no reasonable chance of success.'*

(c) Thirdly, if the only coverage defence advanced by the insurer is the alleged fraud or dishonesty of the Insured said to enliven an exclusion, and where the relevant insurance policy contains a mandatory obligation on the insurer to advance defence costs until a final adjudication of such fraud or dishonesty has been established in proceedings, then the insurer will be obliged to advance: see *Wilkie's Case* in the High Court[14]. It is clear, then, that in Australia notions of public policy do not prevent insurers from agreeing to advance defence costs to an insured accused of fraud (at least where that fraud is denied or not admitted by the Insured). Where the insurance policy only provides a discretion in the insurer as to the advancement of defence costs, and the insurer declines as a matter of discretion to advance, then the policy does not oblige the advancement of defence costs by the insurer: see *Rich's Case*.

(d) Fourthly, if an insurer has other coverage defence available in addition to the Dishonesty Exclusion, then the insurer may in good faith raise such defences, and refuse to advance defence costs on the strength of the other defences. In the *Rich Case*, CGU Insurance had purported to avoid the policy for fraudulent non-disclosure by the insured, such non-disclosure covering similar factual issues to those said to enliven the Dishonesty Exclusion. The Court of Appeal considered such a non-disclosure defence was not precluded by the Dishonesty Exclusion itself, and would (if established) afford a separate basis for denial of defence cost funding entirely distinct from the Dishonesty Exclusion, and not constrained by the 'final adjudication' proviso. The High Court seemed to endorse this approach.[15] In the *BOQ v Chartis Case* as discussed above, an insurer was permitted to refuse to advance defence costs because of the asserted availability of an exclusion in a policy entirely unrelated to the fraud and dishonesty exclusion[16]. In the case of Rich *and Silbermann*, Hodgson JA summarised the principles as follows:

'*1. If the only defence is ... [the Dishonesty Exclusion] ..., then until there is a judgment, the insurer is plainly in breach if it does not pay Defence Costs once they have been incurred and paid (subject to reasonableness questions).*

2. However, whether or not such payment would be ordered is subject to discretions concerning the granting of an appropriate summary judgment and discretions concerning the timing of hearing of issues.

3. If there are other reasonable defences, and the issues raised by those defences are intertwined with the issues under ... [the Dishonesty Exclusion] ..., then

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[14] But note the comments of Hodgson JA in *Silbermann's Case* in the Court of Appeal. If the insurer has sufficiently strong evidence of fraud by the insured, then even where the Defence Cost advancement obligation in the policy is mandatory, it seems the insurer could still refuse to advance where it was able to resist an application by the insured for summary judgment on the basis of strong evidence of fraud by the insured; and the insurer may also then seek an expedited adjudication of fraud in the coverage proceedings: see at paragraph 52.

[15] See at paragraphs 8 and 9 in *Rich's Case*.

[16] And it should be remembered that the underlying claim in the *BOQ v Chartis Case* did not involve any allegation of fraud or dishonesty whatsoever.

generally there is no way in which the insured can compel the funding of its defence in advance of a final determination of the insurance proceedings.

4. If there are other reasonable defences, and the issues raised by those defences are severable from issues under ... [the Dishonesty Exclusion] ..., then there will be case management questions and other discretionary questions which will arise in determining whether issues are severed, and if so when and in what order they are heard.

5. I would add also that there may be a further question of case management, as to whether a dishonesty allegation brought by third parties should or should not be heard together with the ... [Dishonesty Exclusion] ... defence raised by the Insurer. If ... [the Dishonesty Exclusion] ... is the only defence and there is a summary judgment relating to Defence Costs paid during the period until that defence may be established, then the insured would be funded in relation to the combined hearing.'

Impact of the *Corporations Act*

45 At paragraph 44(c) of this paper I have stated that it is implicitly clear from the *Rich and Wilkie Cases* that notions of public policy in Australia do not prevent the advancement of defence costs by an insurer to an insured in relation to a fraud claim, prior to a final adjudication of fraud adverse to the insured (at least where the insured had not admitted the impugned conduct).

46 This position would also seem to be consistent with the provisions of Division 1 of Part 2D.2 of the *Corporations Act 2001 (Cwth)*, a copy of which is **attached**, in relation to defence cost advancement by insurers to directors and officers of a company.

47 It will be recalled that the abovementioned Division of the *Act* contains various restrictions against a company indemnifying a director or officer against such person's liabilities to the company owed in their capacity as a director or officer of the company, and against the provision of insurance cover for such liabilities. I note:

(a) Section 199A(1) of the *Act* prohibits a company from exempting a director or officer from liabilities owed to the company by that person as a director or officer of the company. Section 199A(2) similarly prohibits a company from indemnifying a director or officer against such liabilities, whether by agreement or by making a payment for or on behalf of such person.

(b) However, the prohibitions in ss.199A(1) and (2) <u>do not apply</u> to an indemnity to a director or officer of a company against legal costs of resisting a claim of breach of duty owed by the director or officer to the company, save where the person is found to have a liability to the company: see section 199A(3).

(c) Section 199B of the *Act* prohibits a company from paying a premium for a contract insuring a director or officer of the company against a liability (<u>other than one for legal costs</u>) arising out of conduct involving a wilful breach of duty in relation to the company; or a contravention of sections 182 or 183 of the *Corporations Act*.

(d) Section 199C provides that '*Anything that purports to indemnify or insure a person against a liability, or exempt them from a liability, is void to the extent that it contravenes section 199A or 199B.'*

48 So, it seems that a 'defence cost advancement until final adjudication clause' in a D&O policy of the type set out in paragraph 37 above, would also comply with the indemnity and insurance restrictions in the *Corporations Act*.

What if an insured has admitted fraud?

49 It can be seen from the above discussion that a 'Wilkie'-style insurance policy – with a mandatory defence cost advancement obligation on the insurer until the insured's fraud or dishonesty be established by final adjudication – would generally result in the insurer having to fund the insured's defence (unless other legitimate coverage defences were available to the insurer). But what would be the position, in a hypothetical case, if the insured had frankly admitted its own fraud to the insurer? Could the insured still

insist on the funding of its defence, because there had been as yet no final adjudication?

50 Many 'final adjudication' clauses do not expressly deal with this situation. (Although the insurance policy in the *Wilkie Case* did do so. In fact, it provided that the Dishonesty Exclusion would apply when there had been either a final adjudication or admission of fraud.[17])

51 However, it seems to me that, should an insured admit fraud or dishonesty, various insurance law or public policy doctrines would operate so as to preclude the insurer from funding the insured's defence, even if a final adjudication of fraud or dishonesty had not yet occurred.[18] These would include:

51.1 a possible implied term in the insurance policy;

51.2 public policy doctrines;

51.3 statutory good faith principles.

Implied term analysis

52 At first instance in the *Silbermann and Rich Case*[19], the judgment of the trial judge, McClellan J, records the following submission from the insurer regarding an asserted implied term in an insurance contract precluding an insured from being covered for his or her own fraud:

> '*The construction advanced by the plaintiffs is contrary to the 'fundamental principle of all insurance law that the insured is debarred by an implied term from recovering on the policy if he intentionally caused the loss or event upon which the insurance moneys were expressed to be payable'. Fire & All Risk Insurance Co Ltd v Powell (1966) VR 513 at 517. CGU emphasises the fact that in this hearing, the plaintiffs accept that the questions 'should be decided upon the assumption that the matters pleaded against each plaintiff are true'... On that basis, it is submitted that the payment pursuant to the policy is 'brought about by or which involves' the relevant ... [Dishonesty Exclusion] ... conduct and the construction advanced by the plaintiffs is contrary to and undermines that fundamental principle. A construction, which subverts public policy, ought not readily be adopted*.'[20]

53 Such an implied term, if found to exist in an insurance contract, would in my view afford a ground for an insurer to refuse to advance defence costs where an insured had admitted dishonesty (but a final adjudication to this effect had not yet occurred). In the *Silbermann and Rich Case*, however, there was no admission by the insureds of fraud or dishonesty; and instead there was a vigorous denial of any wrongdoing by them. So, the factual basis of the implied term submission was not sustained.

54 In the event, then, it was not necessary for the trial judge in the *Silbermann and Rich Case* to rule expressly on the implied term submission, and the matter does not seem specifically to have been addressed in the Court of Appeal. The submission was also irrelevant to the arguments advanced in the High Court.

55 Nonetheless, in my opinion, the submission is a powerful one, and given the right factual basis (such as an admission of fraud or dishonesty by an insured in a specific case) might apply to any attempt by an insured person under a D&O policy to argue that an insurer had precluded itself from asserting the insured's own fraud in answer to a claim for indemnity (including in relation to advancement of defence costs for admitted fraudulent conduct by the insured).

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[17] Also see the dishonesty (or 'Wrongdoing') exclusion in the *BOQ v Chartis Case* at paragraph 17.2 above, which also permits the insurer to rely on the dishonesty exclusion prior to final adjudication where there has been an admission.

[18] There is an argument that a final adjudication would occur if an insured had made such a frank admission of fraud or dishonesty. But if the policy were to define 'final adjudication' as requiring some pronouncement by a Court or Tribunal, then an *extra curial* admission might not be sufficient to satisfy this definition.

[19] [2002] NSWSC 1195

[20] At paragraph 36

Public policy considerations

56 Aside from any implied term analysis, conventional principles of public policy support the proposition that the law will not permit an insured to profit from his, her or its own crime. In my opinion, these principles would prevent an insured from obtaining defence cost advancement – under even the most liberal coverage terms – where the insured has admitted to the insurer its own fraud or dishonesty in relation to the matter in issue.

57 This topic is addressed in general terms (not expressly directed to defence cost issues) in the *CCH Insurance Reporter* as follows:[21]

> '*The most important aspect of illegality in the insurance context involves public policy considerations. Two maxims are relevant in this context: ex turpi causa non oritur actio (no action can arise from a wrongful cause) and no one may profit from his or her own crime (although the latter may merely be a particular application of the former). Thus where a claim is made under a contract of insurance, the insured may not be entitled to indemnity if the loss results from his or her own illegal acts or occurs while he or she is engaged in an illegal act.*
>
> *The principle was expressed by Sir Samuel Evans P in The Estate of Crippen (1911) P 108 at p 112 as follows:*
>
> > *'It is clear law that no person can obtain or enforce any rights resulting to him from his own crime, neither can his representative claiming under him obtain or enforce any such rights. The human mind revolts at the very idea that any other doctrine could be possible in our system of jurisprudence.'*
>
> *In WH Smith v Clinton (1908) 99 LT 840, indemnity granted by a publisher against libel was held to be unenforceable, at least where the libel was intentional and thus criminal...*
>
> *It would seem that the commission of the illegal act must be deliberate. Kennedy J said in Burrows v Rhodes (1899) 1 QB 816 at pp 828-829 that if the act of the party seeking indemnity was unlawful but "was done in honest ignorance of the particular circumstances which constituted unlawfulness", the action for indemnity may be maintained.*
>
> *Similarly, in Geismar v Sun Alliance and London Insurance Ltd...Talbot J thought different considerations would apply in cases of "unintentional importation or of innocent possession of uncustomed goods".'*

58 In a similar vein, in *HIH Casualty and General Insurance Ltd & Ors v Chase Manhattan Bank & Ors*[22], the House of Lords considered a similar issue of insurance policy interpretation and public policy in the Film Finance Litigation.

59 Briefly, in the *Chase Manhattan Case* an insurer had issued a complex insurance policy covering a Bank against certain types of financial loss to which the Bank was potentially exposed as a result of its financing of various motion picture productions. The insurance was arranged by a Broker, and when the film productions were financially unsuccessful, the Bank made a claim on the policy. The insurer denied indemnity, including on the basis of alleged innocent and fraudulent non-disclosure by the Bank's agent (the Broker). The Bank said that the insurance policy contained a "Truth of Statements" clause, pursuant to which the insurer agreed to waive any right or remedy in relation to non-disclosure, whether innocent or fraudulent.

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[21] At paragraph 18-485

[22] [2003] 1 All ER (Comm) 349

60 On a demurrer, the preliminary point was heard as to whether the insurer could deny indemnity for fraudulent non-disclosure (assuming the Broker had been fraudulent). The House of Lords found that the Insurer could deny the claim, if it could prove fraudulent non-disclosure. The arguments before the Lords included:

(a) An interpretation argument. The House of Lords found that, on its proper construction, the "Truth of Statements" clause only waived innocent non-disclosure and not fraudulent non-disclosure. On the interpretation argument, it was found that a written contract would not be interpreted as exculpating a party from its own (or its agent's) fraud, unless clear and express words were used to that effect. Hence, the terms of the insurance contract did not prevent the insurer from denying cover to the Bank in this case, if the insurer could prove fraudulent non-disclosure by the Bank or its agent.

(b) An argument as to whether public policy prevents an insurer from prospectively waiving fraudulent non-disclosure by an insured. The Lords all agreed that such a clause would not be valid. For example, Lord Scott found:

> '*On the question of whether a contractual clause exonerating a party from liability for misrepresentations or non-disclosures covers fraudulent misrepresentations or dishonest non-disclosures, two lines of argument become relevant and both have to be addressed by your Lordships in this appeal. The first line of argument proposes a rule of public policy. A party cannot be allowed to benefit from his own fraud or from the fraud of his alter ego. So, if an exclusion clause on its true construction purports to cover such fraud, it cannot, on public policy grounds, be permitted to have that effect.*
>
> *I would, for my part, be content to accept the need for and the existence of such a rule. If the Truth in Statements clause in the present case had contained a phrase expressed to exonerate Chase from any liability for fraudulent misrepresentations by itself, Chase could not have relied on the phrase to bar action based on its own fraudulent misrepresentation*.' [23]

61 In my opinion, the public policy rule confirmed by the House of Lords in the *Chase Manhattan Case* would be good law in Australia. Thus, if an insurer had issued a very liberal defence cost advancement/final adjudication clause, but the insured had frankly admitted its own fraud, I consider public policy would preclude the insurer from advancing costs (even though a final adjudication of fraud or dishonesty had not yet occurred).

Good faith

62 Additionally, section 13 of the *Insurance Contracts Act (Cth) 1984* implies a term of utmost good faith into all insurance contracts covered by the *Act*. It seems to me that there may also be scope for an insurer to invoke section 13 to refuse to advance defence costs in circumstances such as those we have discussed above.

D: Allocation

63 It sometimes happens that an insurer will have an admitted obligation to advance defence costs to a person insured under a relevant contract of insurance, but an issue will arise whether the insurer is able to apportion or allocate these costs for particular purposes, thereby reducing the quantum of the insurer's costs liability. This might arise in a number of different contexts. For example:

63.1 the insured's liability, or putative liability, to the claimant may greatly exceed the limit of indemnity of the insurance contract, and the insurer may wish to allocate or apportion the defence cost obligation commensurately;

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[23] On our reading, the House of Lords in the *Chase Manhattan Case* differed on whether a contract could exclude liability for fraud of an agent. Lord Scott thought it could; Lord Hobhouse thought it could not; the other Lords did not decide the point.

63.2 an uninsured party may benefit from the defence costs expended by the insurer on behalf of the insured, and the insurer may wish there to be some allocation or apportionment fairly to reflect this circumstance; or

63.3 an insured may be faced with claims for covered and uncovered loss, and the insurer may wish there to be some allocation or apportionment fairly to reflect this circumstance.

64 Each of these scenarios gives rise to an issue of allocation, and whether it is permissible in a particular situation for an insurer to reduce its defence cost obligation to an insured.

Claim amount v indemnity limit allocation

65 As one might expect, the entitlement of an insurer to allocate defence costs will turn upon the application of the terms and conditions of the insurance policy in question to the particular situation in each case in which the allocation issue arises.

66 In relation to the situation posed in paragraph 63.1 above – where the claim greatly exceeds the indemnity limit of the policy – a proportionate allocation of defence costs would typically be achieved by a specific clause in the insurance contract.

67 Such a clause may be along the following lines:

> '*Defence cost allocation*
>
> *The Insurer agrees to pay, in addition to the limit of indemnity, the reasonable defence costs incurred by or on behalf of the Insured in defending, investigating or monitoring a claim the subject on an indemnity obligation under the policy. However, if the Insured's liability arising from the claim exceeds the limit of indemnity, the Insurer is only liable to pay the same proportion of the defence costs as the amount that the limit of indemnity bears to the amount of the Insured's liability in respect of the claim.'*

68 I have not encountered any reported decision regarding the efficacy of a defence cost allocation clause such as the one set out above. I can see no reason why such a clause would not be enforceable. With the hypothetical clause above, I suppose a practical issue that might arise is that the allocation proportion could not be ascertained until the outcome of the claim had been determined (because it would only be at that stage the parties would be likely to know the amount of the Insured's liability). This would likely result in any defence cost allocation being conducted *post facto* and after the defence costs had been incurred and advanced. If the contracting parties wished to make clear that a defence cost allocation should take place at an earlier time, then the clause might need some refinement (say, for example, to specify that the allocation should be undertaken by reference to the limit of indemnity in comparison to the particularised quantum of the claim).

Insured v uninsured allocation

69 In relation to the situations posed in paragraphs 63.2 and 63.3 above – where an uninsured person may seek to benefit from insured defence costs, or where an insured person may seek to have their costs paid by the insurer in respect of uninsured or uncovered loss - various complexities may arise, and there has been some litigation on point. The leading cases on this topic are the decisions of the Privy Council in *New Zealand Forest Products Limited v New Zealand Insurance Co Limited*[24] and the decision of the New South Wales Court of Appeal in *Vero Insurance v Baycorp Advantage*[25].

70 In Vero Insurance v Baycorp Advantage the relevant facts were:

70.1 Vero had issued a D&O policy to Baycorp (or its predecessor entities), which indemnified the directors and officers of Baycorp (or the predecessor entities)

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[24] (1997) 1 WLR 1237

[25] [2004] NSWCA 390

against their liability to third persons for breach of duty as directors and officers, and which also indemnified them for their defence costs.

70.2 Baycorp (using this term to include references to the relevant predecessor companies) was not insured under the policy for any liability it may have to such third persons, or for its costs of defending a claim against it. However, it was insured against its obligation to indemnify the directors or officers for their liability or defence costs.

70.3 Baycorp was, amongst other things, a company which specialised in the assessment of the credit history and creditworthiness of applicants for finance, and maintained various databases and the like which contained information about this topic.

70.4 Three claims were subsequently made against Baycorp and various of the officers of Baycorp by certain claimants. In essence, a number of these claimants asserted that the credit information about them was inaccurate, and sought damages from Baycorp and certain of its officers in this regard.

70.5 Baycorp and the officers appointed the one firm of lawyers to defend them in the matter. Significant defence costs were incurred in the joint defence of the claim, and a compromise settlement of the matter was subsequently effected.

71 When the claims were made, the insured officers of Baycorp sought indemnity from Vero under the D&O policy in respect of their potential liability to the claimants and their costs of defending the claims against them. Vero made an indemnity decision in favour of the insureds, but did not exercise its rights under the policy to conduct the defence of the claims. Consequent upon the settlement of the claims, the Baycorp officers sought payment from Vero of the whole of the settlement amount (with no deduction to reflect any share that should be borne by Baycorp); and there was a similar demand made regarding defence costs.

72 The settlement allocation issue does not presently concern us (because I have only been asked to address defence cost issues in this paper). But the Court of Appeal (Giles, Tobias and McColl JJA) overturned the decision of the primary judge (Einstein J) and found that the whole of the settlement sum was to be paid by Baycorp. This was because, on the proper construction of the settlement deed in the case as between the claimants, Baycorp and the officers, the promise to pay was made only by Baycorp, and there was no promise by the officers to pay all or any part of that sum. So, no part of the settlement sum was payable by the officers, and therefore nothing had to be paid by the insurer in this respect.

73 However, the position regarding defence costs was somewhat different. As mentioned, the one firm of lawyers acted for Baycorp and the officers, and very significant defence costs were incurred. It appears that bills were not rendered in such a way as made easily apparent what portion of costs had been incurred defending the officers, and what costs related to the defence of the corporate defendant. The Court appointed a referee, who found that the aggregate defence costs incurred in respect of the three claims could be apportioned into three categories:

73.1 defence costs relating solely and exclusively to the corporate defendant (Baycorp);

73.2 defence costs relating solely and exclusively to the officers; and

73.3 common costs, relating to the defence of both corporate defendant and the officers.

74 The primary judge and the Court of Appeal had no difficulty in accepting that costs in category (a) would not be covered by the D&O policy, and costs in category (b) would be covered. But the argument centred on a very large quantum of costs – in excess of $5million – which fell into the 'common costs' category. The executives argued that all of this category of cost fell within the defence costs obligation of Vero under the D&O policy. Vero argued that this was not so. It said:

74.1 first, that as a matter of construction of the defence cost clauses of the policy, only costs that were solely incurred for the benefit of the insured executives fell within cover; and

74.2 secondly, in any event there was an allocation clause in Claims Condition 6 of the policy, which had the effect of apportioning the 'common costs' as between insured and uninsured parties on a 'fair and proper' basis.

75 The primary judge and the judges of the Court of Appeal found for the insured officers on both arguments, and ordered Vero to pay all of the common costs, even though the relevantly uninsured corporate defendant benefitted from those costs. To understand the principles involved, it is worthwhile examining the approach of the Court in relation to both arguments.

First argument

76 In relation to the first argument, the judges essentially followed the earlier decision of the Privy Council in the *New Zealand Forest Products Limited Case* on a similar allocation issue.

77 Einstein J dealt with the matter as follows:

> *'53 RSA's ... [now Vero] ... obligation is to pay "defence costs" which means "all reasonable legal and experts' fees, costs, charges and expenses ... incurred ... in defending, investigating, monitoring or settling [the] claim". RSA is obliged to pay any of the fees, costs, charges and expenses paid to Mallesons which are so characterised.*
>
> *54 It is, I accept, apparent from the pleadings before the Victorian Supreme Court that the factual aspects of the allegations made by the Price parties in the proceedings were common to all relevant defendants. The claim by the plaintiffs is that* virtually all *of Mallesons' fees, costs, charges and expenses were incurred in meeting the allegations of fact relied upon by the Price parties to make out the causes of action pleaded against the officers, and in addressing the legal implications which flow from those facts. All such costs are said to have been incurred in defending, investigating, monitoring or settling the claim (against the officers). [Precisely which costs were so incurred is the subject of separate question 4 which will be determined by a referee.]*
>
> *55 The effect of the definition of "defence costs" and "claim" is, as I accept, that costs which relate exclusively to the defence of the corporate defendants will not be defence costs. The referee will quantify the amount of the costs in this category and they will be excluded from the amount of defence costs.*
>
> *56 The matter may be viewed as follows. Had the officers been sued alone, there would not be any dispute about RSA's obligation to pay all reasonable costs incurred in defending the proceedings. Nor is there any dispute that the corporate defendants received a benefit from the costs being incurred, namely defence of the claims against them. RSA appears to contend that it is relieved of all or part of its obligation to pay defence costs because the corporate defendants received a benefit from the costs incurred.*
>
> *57 There is nothing in the language of the insuring clauses, automatic extension 1(a) or the definitions of "loss" and "defence costs" which as it seems to me, reveals an intention to cut back RSA's obligation to pay defence costs simply because an uninsured corporate defendant also benefits from those costs being incurred. In particular, the definition of "defence costs" does not refer to costs incurred* solely *in defending, investigating, monitoring or settling a claim, nor does*

> *it contain an exclusion for costs from which an uninsured corporation benefits. Such words could of course have been added if that is what was intended.*
>
> *58 On the contrary, the language of the policy is plainly expansive and inclusive: RSA is obliged to pay "all" reasonable legal and experts' fees, costs, charges and expenses ...'*

78 The Court of Appeal agreed with Einstein J's approach.

79 Hence, as a matter of construction of the defence cost obligation in the policy, the insurer was obliged to pay all of the reasonable costs incurred in defending the claim against the insured officers, even though the uninsured corporate defendant benefitted from such payment. In particular, on the wording of the relevant defence cost clause (which is a fairly typically wording in this respect), there was no requirement that the costs be incurred *solely* for the benefit of the insured. As mentioned, this approach was consistent with previous authority, including of the Privy Council.

Second argument

80 The second argument advanced by the insurer in the *Baycorp Case* concerned a specific allocation clause in the Vero policy. Presumably, this clause had been inserted with the intent – at least from the insurer's perspective – of permitting an allocation of defence costs between insured and uninsured parties in a situation such as arose in the case in question. However, the primary judge and the judges of the Court of Appeal all found that the allocation clause in question was unenforceable, and did not achieve this intended outcome.

81 In my view, the reason for the approach adopted by the Court turned on the particular wording of the allocation clause under examination. I do not consider that the *Baycorp Case* would prevent defence cost allocation where a clause was appropriately worded.

82 The allocation problem for the insurer in *Baycorp* can be seem from a perusal of the terms of the allocation provision in Claims Condition 6 of the D&O policy in that case. The clause relevantly read as follows:

> *'In the event that ...(b) both an Insured Person and others (including the Insured Entity) are a party to the proceedings or demand to which a Claim relates, then the Insureds and the Insurer will agree on a fair and proper allocation of damages, interest, claimant's costs and expenses and Defence Costs between Loss covered by this Policy and Loss not covered by this Policy'*

83 Einstein J found that the above clause was unenforceable because it was merely an agreement to agree. The Court of Appeal approved His Honour's findings on this point.

84 The relevant principles are set out in the primary judge's judgment as follows:

> *'64 In my view Claims Condition 6 is unenforceable as an agreement to agree and is therefore void for uncertainty. ...*
>
> *65 If either of the two prescribed alternative conditions is satisfied, the claims condition 6 provides that the parties "will agree on a fair and proper allocation of damages, interest, claimant's costs and expenses and defence costs between loss covered by this policy and loss not covered by this policy."*
>
> *66 No allocation is specified other than the "fair and proper" allocation which results from the parties' further agreement (if any).*
>
> *67 The only obligation expressly imposed upon the parties by claims condition 6 is to agree. It is a pure agreement to agree of the type which is unenforceable as an incomplete agreement:* Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd *(1982) 149 CLR 600 at 604.*
>
> *68 None of the elements which sometimes save agreements to agree are present in claims condition 6:*
>
> - *absolutely no machinery is specified for determination of a "fair and proper allocation" – it is left entirely to the parties' further agreement;*

- *no third party is specified to determine the allocation (*cf Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd*);*
- *there is no provision for arbitration in the specific case of failure to agree on a fair and proper allocation (*cf Booker Industries Pty Ltd v Wilson Parking (Qld) Pty Ltd *);*
- *there is no provision for arbitration in the general case of any question, dispute or difference between parties (*cf Queensland Electricity Generating Board v New Hope Collieries Pty Ltd *(1989) 1 Lloyd's Rep 205); and*
- *the matter upon which further agreement is required is the essential element of claims condition 6 (ie, "a fair and proper allocation"), not a subsidiary, non-essential or mechanical matter (such as the identity of a third party to determine the allocation).*

69 Further , the parties are required to agree upon a subjective matter ("a fair and proper allocation"):

- *"allocation" requires judgment, balance and discretion;*
- *when used in the context of an allocation, "fair" is a subjective term – what might be considered fair in the judgment of one party might not be considered fair by the other;*
- *"proper" is a subjective term - what might be considered proper by one party might not be considered proper by the other; and*
- *use of the indefinite article shows that there may be a range of allocations which may satisfy the criteria of "fair and proper":* Holt v Cox (1994) 15 ACSR 313 at 336 *(Santow J)'*

85 At paragraphs 70 to 78 of the judgment, Einstein elaborates the above reasons, and further highlights the deficiencies in the allocation clause in issue.

86 The result, then, of *Vero Insurance v Baycorp Advantage* was a victory for the insurer on the settlement payment issue, but a victory for the insured officers on the defence cost funding and allocation point. However, it seems clear from the judgments that the case does not place anything in the nature of a blanket prohibition on defence cost allocation. From an insurer's perspective the trick, however, is to ensure that the defence cost allocation clause is sufficiently drafted so as to avoid uncertainty or incompleteness. And the drafting clues to achieve a valid allocation clause may be derived from the various matters canvassed in the above-quoted passage from the first instance judgment of Einstein J.

What are leading insurers doing with cost allocation clauses?

87 As mentioned previously, I am not an insurance broker. Accordingly, I am not qualified to comment on the variety of defence cost allocation clauses currently in use in the insurance market in Australia, or the differing approaches which various insurers commercially adopt to the issue of defence cost allocation.

88 Where indemnity has been extended to an insured, some insurers seem to utilise their contractual power to conduct the defence of the claim against their insureds to appoint defence counsel and to require that they act exclusively for the insured. At a practical level, this would solve the problem of uninsured persons also being represented by the same defence counsel, and effectively obtaining a 'free' defence funded by the insurer. However, this approach is not as readily available where indemnity has been reserved; and nor would it seem to work as well in instances where there is only the one party entitled to insurance cover, but common costs are expended defending covered and uncovered loss.

89 Other insurers have taken up the drafting tips in the *Baycorp Case*, and have far more elaborate allocation clauses. These clauses often spell out a formula to determine the content of a 'fair and equitable' allocation, and provide for expert determination of any dispute.

90 Some insurers, in at least some classes of insurance, have gone so far as expressly to cover common defence costs incurred for insured and uninsured exposures – but presumably such expansive cover would come at some additional premium to compensate the insurer for the increased costs exposure.

E: Advancement of defence costs – *Bridgecorp Case*

91 And so we come to a consideration of the *Bridgecorp* litigation in New Zealand. As mentioned at the beginning of this paper, the *Bridgecorp Case* is currently the most topical issue regarding defence cost advancement, with important ramifications for the questions I have been asked to address:

- Who is going to pay to defend the case?
- How is defence cost advancement being dealt with by the leading insurers?
- What are the developments in case law?

92 The result of the first instance decision in *Bridgecorp* (since reversed on appeal) was that certain insured directors were found not to be entitled to the advancement of defence costs from their D&O insurer – despite the insurer's contractual promise of defence cost advancement – because of a statutory charge over the sum insured by the D&O policy asserted by a third party claimant.

93 This outcome was of considerable surprise, and seemed to deprive insured directors and officers of a considerable part of the benefit they thought they were obtaining from their D&O insurance cover. For those interested in this area of insurance, *Bridgecorp* give rise to a number of issues including:

93.1 the correctness of the decision, and whether and how it would be applied in Australia?

93.2 assuming the case was correctly decided, the delineation of the circumstances in which it would have application?

93.3 how the insurance industry has reacted to the decision, in terms of policy drafting or new insurance products, designed to overcome any Bridgecorp-like impediment to defence cost advancement.

94 As mentioned, the first instance decision in *Bridgecorp* was subsequently (and recently) overruled, but it is understood there is to be a further appeal to New Zealand's highest court. So the status of the decision as a matter of New Zealand law remains uncertain. Uncertainty also surrounds the reception in Australia of the principles addressed in the case, so a detailed review of *Bridgecorp* would seem justified from an Australian perspective.

Facts of Bridgecorp

95 Briefly, the facts of the *Bridgecorp Case* were:

95.1 Bridgecorp comprised a group of finance companies which collapsed in 2007, owing investors in New Zealand and Australia almost NZ$500million.

95.2 Criminal proceedings had been brought against Bridgecorp's directors in New Zealand. The directors had also been notified by the receivers that Bridgecorp would bring civil proceedings against them for recovery of more than NZ$450million.

95.3 QBE had issued a D&O policy to Bridgecorp and its directors and officers. The policy indemnified the directors for civil liability as a result of claims against them for wrongful acts, and also for defence costs (for defending both civil and criminal proceedings). There was a combined policy limit of NZ$20million, which did not differentiate between liabilities arising from wrongful acts or defence costs. (This drafting approach – where defence costs were inclusive of the policy limit, and the policy did not segregate between claim and defence costs - was historically the case with many D&O policies).

95.4 The Bridgecorp directors sought defence cost funding under the QBE policy in respect of the criminal proceedings. However, in 2009 the Bridgecorp receivers

had written to QBE stating that they intended to pursue the directors in civil proceedings for sums in excess of the policy limit, and claiming a charge over all monies payable under the D&O policy pursuant to section 9 of the *Law Reform Act 1936 (NZ)*.

96 Section 9 of the New Zealand Act relevantly reads as follows:

> ***'9 Amount of liability to be charge on insurance money payable against that liability***
>
> *(1) 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 any 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.*
>
> *(2) ...*
>
> *(3) Every charge created by this section shall have priority over all other charges affecting the said insurance money, and where the same insurance money is subject to 2 or more charges by virtue of this Part of this Act those charges shall have priority between themselves in the order of the dates of the events out of which the liability arose, or, if such charges arise out of events happening on the same date, they shall rank equally between themselves.*
>
> *(4) Every such charge as aforesaid shall be enforceable by way of an action against the insurer in the same way and in the same Court as if the action were an action to recover damages from the insured; and in respect of any such action and of the judgment given therein the parties shall, to the extent of the charge, have the same rights and liabilities, and the Court shall have the same powers, as if the action were against the insured:*
>
> *Provided that, except where the provisions of subsection (2) of this section apply, no such action shall be commenced in any Court except with the leave of that Court.*
>
> *(5) ...*
>
> *(6) Any payment made by an insurer under the contract of insurance without actual notice of the existence of any such charge shall to the extent of that payment be a valid discharge to the insurer, notwithstanding anything in this Part of this Act contained.*
>
> *(7) No insurer shall be liable under this Part of this Act for any sum beyond limits fixed by the contract of insurance between himself and the insured.'*

97 Section 9 of the New Zealand Act is identical to similar legislation creating charges over insurance money in New South Wales[26] and, I understand, the Australian Capital Territory and the Northern Territory. I understand that the other Australian jurisdictions, including the Commonwealth and the other States, do not have legislation creating an equivalent statutory insurance charge.

98 Given the receivers' assertion of the charge, QBE would not advance defence costs to the Bridgecorp directors unless they and Bridgecorp would agree on allocation. To resolve this issue, the directors (or some of them) brought proceedings in the New Zealand Court seeking a declaration that they were entitled to be paid defence cost funding under the D&O policy, despite the asserted charge in favour of Bridgecorp.

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[26] see section 6 of the *Law Reform (Miscellaneous Provisions)Act 1946 (NSW)*, a copy of which is **attached**.

First instance decision of Lang J

99 In a judgment delivered on 15 September 2011 in Auckland, Lang J of the High Court of New Zealand found against the directors. That is, the judge found Bridgecorp had the benefit of a conditional charge over the whole of the insurance money created by section 9 of the *Law Reform Act*, which prevented the directors from having access to the D&O policy to meet their defence costs.

100 As I read the judgment, Lang J seems to have found that:

100.1 Because the directors were insured against liability under the D&O policy issued by QBE, and because Bridgecorp had a liability claim against the directors, then a conditional charge had been created by section 9 in favour of Bridgecorp over the insurance money payable by QBE under the policy. The charge was conditional because the directors' liability to Bridgecorp was yet to be determined, and because QBE's liability to the directors under the policy was also to be determined (see parargaphs 28,53 and 54 of the judgment).

100.2 The charge in favour of Bridgecorp arose at the time the Group collapsed (paragraph 26).

100.3 If the directors were permitted to recover defence costs under the D&O policy, the amount available to Bridgecorp would be significantly reduced, and hence '*the charge under s 9 will be rendered largely ineffective'*(paragraph 39). This would be inconsistent with authority (paragraph 46), and the object and purpose of section 9 (paragraph 58). (This consequence arose because defence cost funding was inclusive of the limit of cover under the policy, and because the policy did not independently assign separate limits to claim cover and costs cover.)

100.4 Because Bridgecorp's claim against the directors in this case far exceeded the amount of cover under the D&O policy, '*QBE is now bound to keep the insurance fund intact for the benefit of the Bridgecorp defendants and any other civil claimants who might have priority*' (paragraph 56), and '*any payment that QBE might now make under the policy must be for the purpose of satisfying any liability that the directors might have to civil claimants*' (paragraph 57). So, if QBE made any payment to the directors it would do so as a volunteer.

100.5 And sub-section (6) would not assist QBE, because it is aware of Bridgecorp's charge (paragraph 50).

101 Accordingly, Lang J found that the directors were not entitled to have their defence costs paid by QBE under the policy, despite the express contractual promise by the insurer to advance such payments.

102 The *Bridgecorp* first instance judgment has given rise to much debate and discussion in both New Zealand and Australia.

103 On a practical level, if correct, the decision would severely curtail an insured's entitlement to defence cost advancement, where a claimant had asserted the benefit of a statutory charge, and where the insured's defence cost entitlement under the insurance policy was inclusive of costs and un-segregated as between claim cover and defence cost cover. In effect, the insurance contract would be rewritten in these circumstances, with the insured to be deprived of a contractual promise to have its defence costs paid by the insurer.

104 On a legal level, and with respect to the judge, it seems to me that Lang J does not provide any adequate reason for such a rewriting of the insurance contract. It may be asked hypothetically, why should an insurer be relived of its contractual promise to advance defence costs to an insured, simply because a third party claimant has asserted a charge? On what basis could an insurer resist a claim by the insured for breach of contract, if the insurer were to refuse to advance costs because of the claimed charge? Or, to be more precise, what provisions within s 9 would produce this outcome? Further, Lang J does not seem to have addressed in the judgment the possible effect of ss. 9(4) or 9(7) of the *Act*.

105 As set out above, section 9(4) provides that an insurer, such as QBE in the *Bridgecorp Case*, would have the same rights and liabilities in relation to an action by a third party claimant to enforce a section 9 charge, as if the action were by the insured. And if QBE had already paid defence costs to the insured legitimately under the insurance contract, why would this not be available as a defence to any section 9 claim by the third party (to the extent of the defence cost payments)?

106 And section 9(7) provides that no insurer shall be liable for a statutory charge '*for any sum beyond the limits fixed by the contract of insurance between himself and the insured.'* If this means that the terms of the insurance contract are paramount (as opposed, for example, to meaning simply that the sum insured under the policy cannot be exceeded), then how could the first instance result in *Bridgecorp* be correct?

Court of Appeal decision

107 Perhaps unsurprisingly, the decision of Lang J in *Bridgecorp* was the subject of an appeal. On 20 December 2012 the New Zealand Court of Appeal, comprising O'Reagan P and Arnold and Harrison JJA, unanimously overturned the first instance decision.

108 The appellate judges were extremely critical of Lang J's judgment, and did not feel obliged directly to address the first instance reasoning. At paragraph 17 of the appellate judgment they stated:

> '*It is unnecessary for us to recite Lang J's reasoning separately at this stage. That is because the grounds which we regard as decisive were nor addressed in his judgment in the way that they are dealt with here. Instead we shall refer to Lang J's judgment where it is relevant to our reasoning*.'

109 Whilst, with respect, I consider the decision of the Court of Appeal to be correct, I feel it is unfortunate that the appellate bench did not directly expose what they considered to be the flaws in the first instance decision. It seems to me that the two judgments are somewhat akin to ships passing in the night, and the precise error (assuming there to be error) in Lang J's analysis is not, to my mind, clearly revealed.

110 At paragraphs 18 and 19 of their judgment the Court of Appeal summarised their approach as follows:

> *'18. We will determine Mr Steigrad's appeal according to the settled approach of applying the plain words of s 9 to the relevant circumstances and policy provisions. Previous decisions given in different insurance contexts will be of limited assistance to our analysis.*
>
> *19. In our judgment Mr Steigrad's appeal must succeed on two interrelated grounds:*
>
> *(a) s 9 does not by its terms apply to insurance monies payable in respect of defence costs, even where such cover is combined with third party liability cover and made subject to a single limit of liability; and*
>
> *(b) s 9 has limited effect and is not intended to rewrite or interfere with contractual rights as to cover and reimbursement.'*

111 Ground (a) involves the undoubtedly correct observation that any section 9 charge does not attach to defence cost cover, but only to the liability component of the insurance cover. The Court of Appeal then argue that this means the charge can only attach to so much of the sum insured under the policy as has not been consumed by defence costs at the time the charge crystallises: see paragraphs 26 and 27 of the judgment. (The charge descends on the insurance money in favour of the third party claimant on the happening of the event giving rise to the third party's claim for damages against the insured. But the charge is only conditional at that time, and would only crystallise when the insured's liability to the third party was established: see paragraphs 26 and 45 of the appellate judgment.)

112 But why should this be the consequence of the statutory charge not including defence costs? Lang J did not seem to labour under the misapprehension that the charge included such costs. It seems to me the fact that the charge can only attach to the insurance money that is or may be payable in respect of the insured's liability to the

third party, does not – of itself – inevitably mean that an insurance indemnity limit can be eroded by defence cost payments until such time as the already created charge has crystallised. To my mind, some additional reasoning is needed to refute Lang J's conclusion that the whole of the indemnity limit is preserved for the purposes of the conditional charge, than the mere observation that defence costs cannot be included within the charge.

113 Ground (b) involves an exercise in statutory interpretation by the Court of Appeal, and clearly exposes the Court's rationale for overturning the first instance judgment. The appellate judges set out to examine the '*text, purpose and policy of s 9*' and find at paragraph 36 of the judgment that:

> '*The statutory provision 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. Its terms cannot operate to interfere with or suspend the performance of mutual contractual rights and obligations relating to another liability*'.
>
> (Our emphasis)

114 Earlier in the judgment the Court of Appeal acknowledged the benefit to both insured and insurer of the defence cost provisions of the policy, stating:

> '*Plainly these provisions are included for the parties' mutual benefit because, as a result of incurring defence costs, Mr Steigrad may never incur a liability to Bridgecorp. In those circumstances, QBE will have no liability to Bridgecorp but will still be liable in respect of Mr Steigrad's defence costs*.'

115 The Court of Appeal, then, place considerable emphasis on the mutual benefit to insurer and insured of the defence cost provisions in the relevant insurance policy; and refuse to discern any legislative intention to interfere with those contractual rights to the detriment of the contracting parties. Hence, if there were no legislative intent to rewrite the terms of the insurance policy, nothing in section 9 should prevent the insurer from complying with its contractual promise to the insured directors regarding the advancement of defence costs. The Court finds, at paragraph 38:

> '*In practical terms, the High Court declaration means that QBE's inability to discharge its contractual obligation in relation to defence costs is likely to compromise Mr Steigrad's ability to fund and defend Bridgecorp's claim to his best ability. Effectively, it places defence costs outside the limit of indemnity provided under the policy, so that the insurer would be obliged to take on an additional cost burden if it wished to ensure that the third party claims were defended appropriately.'*

116 Whilst I respectfully agree with this reasoning, it does not really directly address the alternative legislative intent as discerned by Lang J, and exposed at some considerable length in the first instance judgment. Lang J discerned in the legislation and reading speeches a very clear intent by Parliament to enhance and protect the position of a third party claimant to access liability insurance monies, and for this to override the general law rights of the original contracting parties. So why is it that the legislative intent discerned by the Court of Appeal (not to interfere with contractual rights) trumps the intent discerned by Lang J (to protect third party claimants)?

Further appeal?

117 I understand that a further appeal has been lodged to New Zealand's ultimate appellate body, the Supreme Court. I would feel more confident about the outcome if the Court of Appeal's judgment had dealt more directly with the first instance judgment, and addressed Lang J's reasoning in a more explicit manner. It seems to me the 'legislative intention' point would have been considerably bolstered by reference to ss. 9(4) and 9(7), and perhaps these aspects will be more fully ventilated before the Supreme Court.

118 In any event, it seems that the impact in New Zealand of the section 9 statutory charge on an insured's defence cost advancement rights has been significantly

ameliorated by the decision of the Court of Appeal in *Bridgecorp*, but until the Supreme Court has finally resolved the issue, the position must remain uncertain.

Relevance to Australia

119 What, then, is the position in Australia? Does the *Bridgecorp Case* have any impact on the questions:

119.1 Who is going to pay to defend the case?

119.2 How is defence cost advancement being dealt with by the leading insurers?

Legal objections to Bridgecorp

120 As to legal considerations in Australia relating to defence cost advancement in respect of 'Bridgecorp'-style policies, a number of observations may be made. These include the following:

120.1 First, and obviously enough, *Bridgecorp* is a New Zealand case, and therefore is not binding on an Australian Court. Further, and as mentioned, I understand the decision of the Court of Appeal is, itself, the subject of an appeal to New Zealand's ultimate appellate body. Hence, the effect of the decision, even as a matter of New Zealand law, remains uncertain. That said, the Court of Appeal has overturned in emphatic fashion the first instance decision of Lang J, and in my respectful opinion the appellate decision is correct (although, as I have already indicated, I feel the judgment would be bolstered by reference to additional matters not expressly addressed by the Court).

120.2 Secondly, before the Court of Appeal's decision in *Bridgecorp* was delivered, there was a reasonably strong view in Australia that the decision of Lang J was not good law. In particular, many Australian commentators considered it unsatisfactory for insured directors to have their express contractual or other rights to defence cost funding under an insurance contract defeated by the statutory charge in favour of non-insured claimants. There was (and is) a view that sub-sections (4) and (7) of section 9 (and its Australian equivalents) should be interpreted so as to prevent this outcome. Put another way, there is a view in Australia that the existence of a statutory charge would not and could not excuse an insurer from performing its contractual promise to advance defence costs to a director, and therefore the charge could not defeat express insurance indemnity rights, and ss. 9(4) and (7) of the *Act* would ensure this outcome. This view would no doubt be bolstered by the very strong findings by the New Zealand Court of Appeal on legislative intent, but perhaps the findings of the New Zealand Court might be more secure if based on ss. 9(4) and (7).

120.3 Thirdly, there is a view that unless and until a civil liability claimant were expressly to assert the charge and notify the insurer of it (as Bridgecorp did), then the Insurer may safely pay defence costs without such payments being considered voluntary.

120.4 Fourthly, there is a view that a statutory charge cannot be enforced by legal action as long as there is a '*perfectly good common law defendant'* (see *Oswald v Bailey* per Kirby P). However, the availability of a '*perfectly good common law defendant*' merely prevents the charge from being enforced directly against the insurer. It does not prevent the existence of the charge.

120.5 Fifthly, there are Australian authorities concerning the NSW statutory charge, which hold that the charge cannot be created where the happening of the event giving rise to the claim for damages or compensation occurs before the relevant contract of insurance incepted: see *The Owners – Strata Plan No 50530 v Walter Construction Group Ltd*.[27]

120.6 Finally, and significantly from an Australian perspective, there is the crucial issue of territorial jurisdiction in relation to any asserted charge over insurance monies. That is, in each case an issue would arise whether the relevant

[27] (2007) 14 ANZ Insurance Cases 61-734; [2007] NSWCA 124

insurance policy in question, and the factual matters relevant to the third party's damages claim against the insured, and the factual matters relevant to the existence of the asserted charge, sufficiently would be within the territorial reach of any of the Australian jurisdictions that have legislative provisions creating charges over insurance money. As mentioned, only New South Wales and the two Australian Territories have a legislative equivalent of section 9 of the New Zealand Act. The Commonwealth and the other Australian States do not have similar legislation creating statutory charges over insurance monies. So, even if the decision of Lang J were good law in Australia, in any case that involved territorial connections outside New South Wales or the Territories, the jurisdictional issue would become of crucial significance. The issue would be whether, in any particular case, the relevant insurance policy in question, or the claim, had connection with any Australian jurisdiction with section 9-style legislation sufficient to enliven the charge?

The *Chartis Case*

121 A number of the legal issues listed above were ventilated in New South Wales in the case of *Chartis Australia Insurance Limited v Kirby & Ors*[28].

122 The *Chartis Case* involved the *Centro Class Actions*, which were a series of related Class Actions conducted in the Victorian Registry of the Federal Court of Australia. Centro had been a significant publicly listed company, headquartered in Victoria but with significant interests in shopping malls and other retail developments throughout Australia and overseas. Centro ultimately encountered financial difficulties, in part arising from the GFC, and many of its investors suffered significant losses from their investments in the company. A number of Class Actions were subsequently commenced on behalf of various groups of Centro investors, including Mr Kirby.

123 In one of the Class Actions, Mr Kirby and others sued various directors or officers of Centro for alleged breach of duty (and also sued the Centro auditor). A trial of the Class Actions was conducted in 2012 before Gordon J in the Federal Court in Victoria.

124 Chartis had issued a D&O policy to Centro and its directors and officers. Under the D&O policy, Chartis had an obligation to advance defence costs to the relevant directors and officers in relation to the Class Actions, and had been doing so. The D&O policy was otherwise relevantly similar to the Bridgecorp policy (this is, it provided that defence cost cover was inclusive of the sum insured under the policy, and it did not segregate claim cover from defence cost cover). So, to the extent that defence cost payments could lawfully be made under the policy, the indemnity limit available to the Class Action Claimants would be eroded (and less could be recovered by them under the policy, if they were to succeed in the Class Action Claims).

125 In an attempt to preserve the insurance asset for the benefit to the Class Action Claimants, shortly before the commencement of the trial of the Centro Class Action in March 2012, Mr Kirby and others asserted a 'Bridgecorp'-style charge over the proceeds of the D&O policy. They also asserted that the insurer could not make defence cost payments to the Centro directors and officers under the policy, if to do so would erode the insurance fund the subject of the charge.

126 In asserting the benefit of a statutory charge over the Centro D&O policy, Mr Kirby *et al* were, in essence, claiming that:

126.1 The decision of Lang J at first instance in *Bridgecorp* was good law in Australia, and operates to prevent defence cost advancement in similar situations, involving similar policy wordings; and

126.2 Even though Centro was a company headquartered in Victoria, and even though the Chartis D&O policy was negotiated and entered in Victoria, and even though Victoria does not have any relevant insurance charge legislation equivalent to section 9 of the New Zealand Act, nonetheless the Centro Claimants could assert the benefit of equivalent New South Wales legislation to found the

[28] Court of Appeal, matter no. 115213 of 2012.

existence of the asserted charge (this legislation being section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946 NSW*).

127 Chartis commenced proceedings in the Supreme Court of New South Wales to obtain a judicial ruling on the matter. Given the importance of the issues, both in relation to the *Bridgecorp* point and the jurisdictional/territorial aspect, the matter was removed to a specially constituted Court of Appeal. On the day appointed for the hearing of the matter before the Court of Appeal, it was announced that the Centro Class Actions had settled, and hence the Court of Appeal decided the case now lacked any practical utility, and the hearing was vacated.

128 Thus, in terms of legal authority, we still do not have any judicial resolution in Australia of the correctness of the first instance decision in *Bridgecorp*, or its application where insureds, claims, and insurance contracts have significant territorial connection outside the 'charging' jurisdictions of New South Wales, the ACT and the Northern Territory.

129 So, if you encounter a Bridgecorp-style policy and defence cost advancement claim in Australia, the issue of who is going to pay to defend the case remains unresolved.

Practical aspects

130 I have been asked to address the topic: How is defence cost advancement being dealt with by the leading insurers?

131 In relation to Bridgecorp-style policies and claim situations, one answer seems to be that they are seeking a suitable vehicle to have the issue judicially resolved. The first attempt, being the *Chartis v Kirby Case*, managed to get all the runners to the barrier, but them the race was cancelled. No doubt another test case is in the offing.

132 In relation to new insurance policies, it seems that many insurers are resolving the matter prospectively, by offering to issue 'stand-alone' defence cost policies. Clearly, the defence cost advancement problems revealed in the first instance decision in *Bridgecorp*, even if it be good law now that it has been overruled by the New Zealand Court of Appeal, can be avoided if defence costs are covered in separate policies to claim cover, or if there are separate limits in the one policy for both types of cover, or if defence costs are provided in addition to the claim cover limit. Any of these policy drafting techniques should resolve or avoid a 'Bridgecorp' defence cost problem, although additional insurance premiums would no doubt be sought as the drafting solutions to *Bridgecorp* would involve insurers accepting additional defence cost exposures.

F: Conclusion

133 In this paper I have endeavoured to address some of the topical insurance law issues which arise in the area of defence cost advancement.

134 The topics I have selected to discuss are probably those which I have had occasion to consider on a professional level in recent times. No doubt there may be other topical issues which I have not covered.

135 If you need to consider any of the topics I have covered – such as final adjudication clauses, *Bridgecorp*-style issues, or allocation issues – you will no doubt form your own views on the issues which arise. I hope my general comments as outlined above may serve at least to refer you to some of the cases, and to address some of the issues albeit in a preliminary and hypothetical manner.

March 2013

This article was prepared by Paul O'Brien, Director.

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DISCLAIMER

Law Reform (Miscellaneous Provisions) Act 1946 No 33

6 Amount of liability to be charge on insurance moneys payable against that liability

(1) If any person (hereinafter in this Part referred to as the insured) has, whether before or after the commencement of this Act, entered into a contract of insurance by which the person is indemnified against liability to pay any damages or compensation, the amount of the person's 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 moneys that are or may become payable in respect of that liability.

(2) If, on the happening of the event giving rise to any claim for damages or compensation as aforesaid, the insured (being a corporation) is being wound up, or if any subsequent winding-up of the insured (being a corporation) is deemed to have commenced not later than the happening of that event, the provisions of subsection (1) shall apply notwithstanding the winding-up.

(3) Every charge created by this section shall have priority over all other charges affecting the said insurance moneys, and where the same insurance moneys are subject to two or more charges by virtue of this Part those charges shall have priority between themselves in the order of the dates of the events out of which the liability arose, or, if such charges arise out of events happening on the same date, they shall rank equally between themselves.

(4) Every such charge as aforesaid shall be enforceable by way of an action against the insurer in the same way and in the same court as if the action were an action to recover damages or compensation from the insured; and in respect of any such action and of the judgment given therein the parties shall, to the extent of the charge, have the same rights and liabilities, and the court shall have the same powers, as if the action were against the insured:

Provided that, except where the provisions of subsection (2) apply, no such action shall be commenced in any court except with the leave of that court. Leave shall not be granted in any case where the court is satisfied that the insurer is entitled under the terms of the contract of insurance to disclaim liability, and that any proceedings, including arbitration proceedings, necessary to establish that the insurer is so entitled to disclaim, have been taken.

(5) Such an action may be brought although judgment has been already recovered against the insured for damages or compensation in respect of the same matter.

(6) Any payment made by the insurer under the contract of insurance without actual notice of the existence of any such charge shall to the extent of that payment be a valid discharge to the insurer, notwithstanding anything in this Part contained.

(7) No insurer shall be liable under this Part for any greater sum than that fixed by the contract of insurance between the insurer and the insured.

(8) Nothing in this section shall affect the operation of any of the provisions of the *Workers Compensation Act 1987* or the *Motor Vehicles (Third Party Insurance) Act 1942*.

(9) Despite subsection (8), this section applies in relation to a policy of workers compensation insurance entered into by an employer (whether entered into before or after the commencement of this subsection), where the employer:

(a) being a natural person, has died, or is permanently resident outside the Commonwealth and its Territories, or cannot after due inquiry and search be found, or

(b) being a corporation (other than a company that has commenced to be wound up), has ceased to exist, or

(c) being a company, corporation, society, association or other body (other than a company that has commenced to be wound up), was at the time when it commenced to employ workers to which the policy relates incorporated outside the Commonwealth and its Territories and registered as a foreign company under the laws of any State or Territory and is not so registered under any such law, or

(d) being a company, is in the course of being wound up.

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Corporations Act 2001

Part 2D.2 - Restrictions on indemnities, insurance and termination payments

DIVISION 1 - INDEMNITIES AND INSURANCE FOR OFFICERS AND AUDITORS

Indemnification and exemption of officer or auditor

199A (1) Exemptions not allowed A company or a related body corporate must not exempt a person (whether directly or through an interposed entity) from a liability to the company incurred as an officer or auditor of the company.

199A (2) When indemnity for liability (other than for legal costs) not allowed A company or a related body corporate must not indemnify a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against any of the following liabilities incurred as an officer or auditor of the company;

(a) a liability owed to the company or a related body corporate;

(b) a liability for a pecuniary penalty order under section 1317G or a compensation order under section 1317H or 1317HA;

(c) a liability that is owed to someone other than the company or a related body corporate and did not arise out of conduct in good faith.

This subsection does not apply to a liability for legal costs.

199A (3) When indemnity for legal costs not allowed A company or related body corporate must not indemnify a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against legal costs incurred in defending an action for a liability incurred as an officer or auditor of the company if the costs are incurred:

(a) in defending or resisting proceedings in which the person is found to have a liability for which they could not be indemnified under subsection (2); or

(b) in defending or resisting criminal proceedings in which the person is found guilty; or

(c) in defending or resisting proceedings brought by ASIC or a liquidator for a court order if the grounds for making the order are found by the court to have been established; or

(d) in connection with proceedings for relief to the person under this Act in which the Court denies the relief.

Paragraph (c) does not apply to costs incurred in responding to actions taken by ASIC or a liquidator as part of an investigation before commencing proceedings for the court order.

199A (4) [Outcome of proceedings] For the purposes of subsection (3), the outcome of proceedings is the outcome of the proceedings and any appeal in relation to the proceedings.

Insurance premiums for certain liabilities of director, secretary, other officer or auditor

199B (1) [Insurance premiums for certain liabilities] A company or a related body corporate must not pay, or agree to pay, a premium for a contract insuring a person who is or has been an officer or auditor of the company against a liability (other than one for legal costs) arising out of:

(a) conduct involving a wilful breach of duty in relation to the company; or

(b) a contravention of section 182 or 183.

This section applies to a premium whether it is paid directly or through an interposed entity.

199B (2) [Strict liability offence] An offence based on subsection (1) is an offence of strict liability.

Certain indemnities, exemptions, payments and agreements not authorised and certain documents void.

199C (1) [Unlawful acts] Sections 199A and 199B do not authorise anything that would otherwise be unlawful.

199C (2) [Void indemnities] Anything that purports to indemnify or insure a person against a liability, or exempt them from a liability, is void to the extent that it contravenes section 199A or 199B.