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BRIDGECORP APPEAL ALLOWED

In the *Bridgecorp* case[1] the High Court of New Zealand ruled that third party claimants have a statutory charge (under section 9 of the *Law Reform Act* 1936 (NZ)) over all monies payable under a directors and officers liability insurance policy, and that that charge took priority over any claim by the directors to defence costs. In a judgment handed down on 20 December 2012[2], the New Zealand Court of Appeal overturned that decision and held that:

- section 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
- section 9 has limited effect and is not intended to rewrite or interfere with contractual rights as to cover and reimbursement.

The appeal was heard together with a similar matter[3] between Chartis as the insurer and the directors of Feltex Carpets who are also been sued in a class action and seek access to the insurance monies to fund defence costs. The appeals were heard together on the premise that there were no material differences between the relevant policies. Accordingly, the Court of Appeal focused on the Bridgecorp policy wording without reference to the Chartis/Feltex policy.

Background

The Bridgecorp Group was a group of finance companies that borrowed money from the public to fund property developments in New Zealand, Australia and Fiji. The group collapsed in July 2007 owing investors nearly $500 million. Mr Steigrad and several of his fellow directors were convicted of offences under the *Securities Act* 1978 (NZ). They now face claims brought against them by Bridgecorp companies, on the basis that they breached duties which they owed to the companies as directors.

Bridgecorp held a directors and officers liability policy with QBE Insurance (International) Limited. Mr Steigrad and his fellow directors made claims under the D&O policy for reimbursement of defence costs. In June 2009 Bridgecorp advised QBE that they asserted a charge over all monies payable under the D&O policy under section 9 of the *Law Reform Act* 1936 (NZ). QBE advised the directors that it would not make any payments under the D&O policy in respect of defence costs.

The judgment at first instance

Relevantly, section 9 provides:

> '9. Amount of liability to be charged on insurance money payable against that liability.
>
> (1) if any person (hereinafter in this Part of this Act referred to as the insured) has, whether before or after the passing of this Act, 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.'

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[1] *Steigrad & Ors v BFSL 2007 Limited & Ors* [2011] NZHC 1037 (15 September 2011).

[2] *Steigrad v BFSL 2007 Limited & Ors* [2012] NZCA 604.

[3] *Chartis Insurance New Zealand Limited & Saunders & Ors v Houghton*.

In considering the nature of the charge under section 9, his Honour Justice Lang concluded that:

- it is clear that the charge comes into existence well before liability is declared to exist by a court or other tribunal of competent jurisdiction;
- the fact that the quantum of the claim has yet to be determined will not prevent a charge from coming into existence, so that it did not matter that Bridgecorp have not yet quantified their claim against the directors;
- a charge applies to both insurance monies that are payable and to that which may become payable so that it can arise notwithstanding the fact that the insurer has not yet accepted the claim and/or where the insured has not established that the claim is covered by the policy.

His Honour found that the charge prevented the directors from having access to the D&O policy to fund their defence costs.

The judgment on appeal

The New Zealand Court of Appeal (O'Regan P, Arnold and Harrison JJ in a joint judgment) allowed the appeal on two interrelated grounds:

- section 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
- section 9 has limited effect and is not intended to rewrite or interfere with contractual rights as to cover and reimbursement.

Defence costs

The D&O policy provided cover for 'loss' which was defined as all sums that a director became legally liable to pay including defence costs. The policy provided that if cover had been confirmed in writing, QBE would advance defence costs as and when they were incurred and that if cover had not been confirmed in writing, then QBE was obliged to advance reasonable defence costs up to a specified limit. QBE had not confirmed cover, but nor had it declined indemnity.

The Court of Appeal found that the policy recognised two distinct types of payment constituting 'loss' for which a director may be become legally liable. The first is payment of damages or compensation in satisfaction of a claim by a third party, such as Bridgecorp. The second, but separate, loss is costs incurred in defending the claim. The court said:

> 'Thus, while the two losses might arise from one claim on account of the same wrongful act, Mr Steigrad is independently entitled to indemnity for his defence costs immediately after they are incurred. Subject to conditions as to reasonableness, his right is absolute. Defence costs are defined as those incurred in defending the primary claim.
> Mr Steigrad's liability to pay defence costs and QBE's liability to reimburse him will necessarily arise independently of and precedes the insurer's liability, if any, to indemnify him on the primary claim, at least in circumstances where liability on the primary claim is not admitted immediately. 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.'

The court found that Bridgecorp is not entitled to a statutory charge over insurance money lawfully payable by QBE to Mr Steigrad to reimburse his existing liability to pay defence costs as opposed to a contingent liability for damages payable to Bridgecorp.

Interference with contractual rights

The court noted that the effect of the judgment at first instance was to deny the directors their contractual right to reimbursement of defence costs as and when they are incurred. They found that this result is inconsistent with the text, purpose and policy of section 9.

The court noted that section 9 was enacted to remedy two problems:

- first, where a third party had a valid claim against a person who had relevant liability insurance, the third party could not require that the insurance monies be paid to him or her directly. So if, for example, the insured became insolvent, the monies would go into the insolvent's estate and become available for distribution to the insured's creditors as a class. The third party simply became another of the insured's creditors;
- second, it was possible for the insurance monies to be reduced in amount, or even diverted entirely from meeting the insured's liability to the third party, by a variation to the policy made after the event that gave rise to the third party's claim.

The Court of Appeal found that the terms of the statutory provision cannot operate to interfere with or suspend the performance of mutual contractual rights and obligations relating to another liability. The purpose of section 9 was not to rewrite the bargain struck between the parties to the insurance contract. Instead it provides a mechanism whereby a third party claimant can access direct funds which an insurer is liable to pay its insured to meet the insured's liability to that third party.

The court concluded that the statutory charge does not prevent QBE from meeting its obligation to the directors to reimburse defence costs.

The Australian position

There are equivalent provisions to section 9 of the New Zealand Act in New South Wales (section 6 *Law Reform (Miscellaneous Provisions) Act* 1946, the Australian Capital Territory (section 206 *Civil Law (Wrongs) Act* 2002) and the Northern Territory (section 26 *Law Reform (Miscellaneous Provisions) Act*) but not in the other states of Australia.

The NSW and ACT provisions are almost identical to the New Zealand provision. The NT provision is not the same but very similar.

Perhaps surprisingly, given the age of the legislation, the courts in Australia have not yet considered the question of whether the statutory charge takes effect in priority to the insured's claim for defence costs. Following the judgment at first instance in *Bridgecorp*, in March 2012, Chartis commenced proceedings in New South Wales to seek a declaration as to whether the claimants in a $200 million class action in Victoria against the directors of Centro had priority (because of a charge under section 6) to the proceeds of a D&O insurance policy over the claims of the directors for payment of their defence costs. The matter was fast-tracked to the Court of Appeal but was not heard because the class action settled. Similar proceedings by the D&O insurers of Great Southern (whose directors also face a class action) are listed for hearing by the New South Wales Court of Appeal on 29 January 2013.

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