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STATUTORY CHARGE ON INSURANCE MONIES

Statutory charge on insurance monies - Bridge over the Tasman Sea

In *Steigrad & Ors v BFSL 2007 Limited & Ors* (***Bridgecorp* case**)[1] the High Court of New Zealand ruled that third party claimants have a statutory charge over the whole of the moneys payable under a directors and officers liability insurance policy, and that that charge took priority over any claim b the directors to defence costs. The decision has been regarded with alarm by many in Australia, not least because one of the main reasons why a company might purchase D&O insurance is to provide protection for its directors, including in relation to often substantial legal defence costs. Various responses have been suggested including increasing the total sum insured so that it is more than any likely claim plus defence costs, providing separate limits of indemnity for liability and defence costs or amending cover so that defence costs are payable in addition to the limit of indemnity. Some insurers have responded by restructuring their D&O offering to provide stand alone defence costs insurance policies.

In this article we consider the *Bridgecorp* decision and its implications in Australia and also look at a limitation on the application of the charge where the insurance policy is written on a claims made basis, as most D&O policies are.

The Bridgecorp case

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. The plaintiffs in the case were three of six former directors of companies within the Bridgecorp group. The first and second defendants were companies within the Bridgecorp group. The third defendant was the insurer under the directors and officers liability policy, QBE Insurance (International) Limited.

The limit of indemnity under the relevant policy was $20 million. The policy provided cover in respect of any civil and criminal liability that the directors might incur and cover in respect of defence costs. In addition, the directors held statutory liability insurance (also with QBE) that provided cover for defence costs incurred in respect of claims based on breach of their statutory obligations, up to a limit of $2 million.

The directors faced a number of criminal charges and civil claims, including from the Bridgecorp defendants. When the criminal proceedings commenced, QBE and the directors agreed that the statutory liability policy would be used first to pay the defence costs.

In June 2009 the Bridgecorp defendants advised QBE that they asserted a charge under section 9 of the *Law Reform Act* 1936 (New Zealand) over all monies payable under the D&O policy for amounts they intended to claim from the directors in civil proceedings. QBE advised the directors that it would not make any payments under the D&O policy in respect of defence costs.

By August 2011, the directors' entitlement under the statutory liability policy had been exhausted. For that reason, they needed to resort to the D&O policy to meet ongoing defence costs. Accordingly the directors sought a declaration that section 9 did not prevent QBE from meeting its contractual obligations under the D&O policy to reimburse them for defence costs.

Relevantly, section 9 provides:

> '9. Amount of liability to be charge 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

[1] [2011] NZHC 1037 (15 September 2011)

> 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.
>
> …'

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 the Bridgecorp defendants had not yet quantified their claim against the directors;
- the 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 meet their defence costs because:

- section 9(1) charges 'all insurance money' so that where the level of cover is less than the amount of the notified claim, the entire amount for which cover may be available is subject to the charge;
- if the directors were able to obtain access to funds under the policy to meet their defence costs, the pool of funds available to meet civil claims would be significantly depleted and so would have the effect of defeating the purpose of the statutory charge;
- the wording of section 9(3) makes it clear that the statutory charge has priority over all other charges affecting the insurance money. If the charge takes priority over all other forms of security given by the insured, it is difficult to see how the insured could be in a better position than his or her secured creditors.

The decision is being appealed to the New Zealand Court of Appeal and will be heard together with a similar matter between Chartis as the insurer and the directors of Feltex Carpets who are also being sued in a class action and seek access to the insurance monies to fund defence costs.

Application to reinsurance

Since the decision in the *Bridgecorp* case, the principle has been found to extend to reinsurance disputes. In *Ruscoe and Thorn* v *Canterbury Policyholders*[2] an issue arose as to whether the proceeds of a reinsurance treaty entered into by a now insolvent insurer, Western Pacific Insurance (in liquidation), were available to all insureds and unsecured creditors of the insurer or only to those insureds whose claims had triggered the reinsurance, being insureds who had property damaged in the two Christchurch earthquakes, which would be the case if the charge applied. His Honour Justice France held that section 9 could apply to reinsurance, as it was not expressly excluded from the term 'contract of insurance'. He found that the term 'compensation' in the Act encompassed Western Pacific's obligation to indemnify its insureds and so under section 9 there was a charge on the reinsurance proceeds in favour of the Canterbury Policyholders.

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.

[2] NZ HC (9 December 2011)

The NSW and ACT provisions are almost identical to the New Zealand provision and, according to Lang J, the NSW provision was modelled on the New Zealand one. The ACT 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 charge takes effect in priority to the insured's claim for defence costs. Following the Bridgecorp case, in March 2012 Chartis commenced proceedings in New South Wales to seek a declaration as to whether the claimants in a A$200 million class action in Victoria against the directors of Centro have 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. However the matter was not heard following the settlement of the class action in May.

The implications

If the decision in the *Bridgecorp* case is followed in Australia, its effect may not be limited to those jurisdictions that have equivalent legislation – NSW, the ACT and the Northern Territory. The scope of the NSW provision was to be considered in the Chartis/Centro matter. Is it limited to policies the proper law of which is that of NSW? or to policies entered into in NSW? or is it sufficient if there is a meaningful connection with NSW such as the events giving rise to the claim happening in NSW? As the matter did not proceed, there is no clear answer but no doubt the issue will come before the courts again.

There is no reason for the findings in *Bridgecorp* to be limited to directors and officers liability policies. The legislation makes no distinction between different types of policies so the principle would extend to all policies (including professional indemnity and general liability policies) that provide cover in respect of liability to pay compensation or damages where the charge arises. However there will be some circumstances where the charge will or may not prevent the insurer advancing defence costs.

First, the judge in *Bridgecorp* accepted that the position is likely to be different in circumstances where the amount of the claim is well within the amount of cover available under a policy. In those circumstances the charge could only extend to the likely amount of the claim and its associated costs and the insured might be able to gain access to the policy to meet defence costs.

Secondly, the charge may not arise where the defendant was not the person who 'entered into' the contract of insurance. Although in a different context, when considering the meaning of the words 'entered into' in section 45 of the *Insurance Contracts Act* 1984, the High Court held that that expression should be given its ordinary meaning and so did not include an insured or person entitled to recover the amount of their loss from the insurer who was not a party to the insurance contract. In some circumstances this may assist directors where the policyholder is the corporate entity (although it will depend on the particular wording of the policy) and arguably could assist some insureds under other liability policies, such as employees.

Finally the cases establish the charge will not apply to some claims made or claims made and notified policies if the relevant policy was not in existence at the time the charge was created.

Claims made policies

In the *Owners – Strata Plan No. 50530 v Walter Construction Group Limited (in liquidation) & Ors*[3] in dealing with an application to join the first defendant's insurer, QBE, as an additional defendant pursuant to section 6, the NSW Court of Appeal held that where the insurance contract does not yet exist at the time that the charge arises, which is on the happening of the event that gives rise to the claim, a charge is not created. For section 6 to apply, the contract of insurance must be in existence at the time the event happens. Accordingly, the charge will not apply to some claims made or claims made and notified policies where the event giving rise to the claim happened before the commencement of the policy, although it will apply where the event happens within the policy period.

The charge arises 'on the happening of the event give rise to the claim'. The 'event' is whatever completes the relevant cause of action, which will not always be the act or omission

[3] [2007] NSWCA124

giving rise to the claim. In financial lines matters, the typical causes of action are breach of contract, negligence and misleading or deceptive conduct. In contract, the cause of action is complete on breach so the date of the 'event' is the date of the breach of contract. However, in negligence, the cause of action is not complete until damage is first suffered. While this is easy to determine when the damage is physical, it can be harder in cases of pure economic loss. In claims of misleading or deceptive conduct, the cause of action arises when the damage occurs and the general principles that apply are the same as those for negligence.

The decision in *Walter Construction* followed a long consideration by first instance judges of the same question, including a contrary decision by Lindgren J in the Federal Court that section 6 could apply to policies which post dated the event giving rise to the claim (*FAI General Insurance Co Ltd v McSweeney*[4]). The decision in McSweeney has been said to have been supported by the Full Federal Court's decision in *Macquarie Underwriting Pty Ltd v Permanent Custodians Ltd*.[5] However,[6] in the Macquarie Underwriting case, although the Full Court did grant leave on a claims made policy when the event giving rise to the claim antedated the inception of the policy there is some doubt whether the issue was the subject of argument before the court, because the joint judgment of Allsop and Buchanan JJ does not mention the issue at all and while the third member of the bench, Graham J, thought it arguable that a claim could be sustained in those circumstances he did not refer to relevant authority, including the Court of Appeal's decision in *Walter Constructions*.

June 2012

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[4] [1997] 73 FCR 377

[5] [2007] FAFC60

[6] Perram J noted in *Genworth Financial Mortgage Insurance Pty Ltd v KCRAM Pty Ltd (in liquidation) (No 2)* [2011] FCA1124