

Landmark Decision Drives D&O Change

On the 15th September 2011 Justice Lang of the High Court of Auckland issued his decision in the case of **Steigrad & Ors v BFSL 2007 Limited & Ors (the "Bridgecorp Case")**.

The Court looked at what would happen when directors wanted their Directors & Officers insurance policy to pay for their legal defence when, at the same time, potential claimants wanted the money set aside in the event they could successfully establish a liability claim against the directors.

The court decided that if a claimant had a 'charge' over the insurance money available under a D&O policy then the insurance company could not pay the directors' defence costs. A claimant could establish a 'charge' over the insurance money using the provisions of Section 9 of the Law Reform Act 1936. Insurance companies are now faced with deciding if, and how, they can pay defence costs under a D&O policy to insured directors and/or officers.

Lumley's position

Lumley is addressing this problem by amending our D&O primary policies to ring-fence defence costs to ensure that, in the event of a Section 9 'charge', we can legally defend claims brought against our insured directors and officers.



Background

The Bridgecorp Group ("Bridgecorp") was a group of finance companies that borrowed money from investors to fund developments in New Zealand, Australia and Fiji. On 2 July 2007 Bridgecorp was placed into receivership, owing investors nearly \$500 million.

The plaintiffs in this case were three of the directors of Bridgecorp (Peter Steigrad, Bruce Davidson and Gary Urwin). The first and second defendants in the case were the companies in the Bridgecorp Group that are all in receivership and/or liquidation. The third defendant was QBE Insurance (International) Limited.

The plaintiffs faced a number of criminal and civil actions following the collapse of the Bridgecorp business. In addition to the actions already underway, the liquidators and receivers have advised the directors that they intend to bring civil proceedings against them, alleging mismanagement of the company. They intend on seeking more than \$450 million. Further to this, the Australian arm of Bridgecorp (also in liquidation) has also advised it intends to bring a civil action against the directors.

Until the decision the directors had been funding their defence against the criminal actions from a Statutory Liability policy. This policy had a limit of \$2 million, which is now exhausted. As a result the

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directors sought to invoke the provisions of the D&O policy to obtain further funding. This D&O policy had been held with QBE since 1996 with an indemnity limit of \$20 million.

On 12 June 2009 the liquidators and receivers advised QBE that they were asserting a 'charge' over the monies payable under the D&O policy for the amounts that they intended to claim from the directors in the civil proceedings. They claimed that the 'charge' arose through Section 9 of the Law Reform Act 1936.

As a result QBE advised the directors it would not pay any defence costs under the D&O policy. The directors asked the court to declare that the 'charge' under Section 9 does not prevent QBE from paying defence costs.

Section 9 of the Law Reform Act 1936

Section 9 of the Law Reform Act 1936 creates a 'charge' in favour of a claimant over insurance monies where they have a claim against an insured.

The Court made the following points in relation to Section 9 of the Law Reform Act 1936:

1. It was enacted in response to issues that arose within the context of claims for personal injury.
2. The purpose of the Act is to ensure claimants' entitlements are not frustrated by allowing them direct access to the insurance funds.
3. The section has particular application where an insured is insolvent because it means the insurance monies cannot be pooled to meet general debts and must be kept for claimants.

4. The legislation does not mean a claimant has wider rights than the insured would have otherwise had.
5. It creates a procedure by which a claimant can enforce existing rights.
6. The 'charge' is also designed to stop:
 - An insured (the director or officer) using insurance funds for purposes other than satisfying a claim
 - An insured entering into a corrupt bargain with the insurer to frustrate a claimant's ability to gain access to the insurance funds

The court's view of the 'charge'?

In terms of the 'charge' that is created over the insurance fund, the court stated that:

1. It comes into existence well before the liability is officially declared to exist (i.e. even before an actual claim has been made). All that is required is an event giving rise to a claim for damages or compensation. The 'charge' in this case arose when Bridgecorp collapsed.
2. Quantum does not need to be determined for the 'charge' to come into existence.
3. The 'charge' applies to both money that is payable and will become payable. This means the 'charge' exists even when indemnity under the policy has not been confirmed.
4. If an insurer pays a claim without notice of the 'charge' then that payment is still valid. Further, where the insurer shows there is no cover then no 'charge' exists.

Does the existence of the 'charge' prevent the directors accessing their defence funds?

In determining the answer to this question the following comments from the court were pivotal:

- The court agreed in principle with the defendants' submission that if the directors could access the insurance funds for their defence, then the funds available for the claimants would be significantly reduced.
- There is a legal authority to support the proposition that the payment of defence costs should not be allowed to reduce the pool of funds that would otherwise have been available to meet claims in respect of which a 'charge' has arisen. This means that an insurer has to make sure the entire limit of indemnity is available to a claimant.
- The wording of Section 9 does not contain a mechanism that would enable funds to be released to meet the insurer's other obligations under the D&O policy.
- In this case the quantum of the claim far exceeds the limit of indemnity (i.e. in this case the potential claim was in excess of \$450 million and the D&O policy limit was \$20 million).

If QBE were to pay defence costs these payments would not reduce the liability QBE has to meet the claimant's 'charge'. QBE would be paying the defence costs voluntarily outside the sum insured under the D&O policy.

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So what does this mean?

To date there is no news of an appeal. So until there is either a new case or a law change there is the potential that a claimant can issue a 'charge' over the full limit of indemnity in a liability claim, thereby preventing an insurer from advancing defence costs or making payments in general.

The court did acknowledge that where the amount of the claim is well within the amount of cover available under the policy then the 'charge' would only extend to the likely amount of the claim and its associated costs.

What is the solution?

The reality is that the court has effectively determined how a D&O policy could operate, possibly resulting in some insureds feeling that a fundamental aspect of the cover has been diminished.

One solution is to create an immediate amendment to the D&O policy ensuring that the defence costs are essentially 'ring-fenced' in the event of a claim where the insurance funds are threatened by a Section 9 action.

By specifically endorsing the policy it would make it clear the 'defence costs' do not form the insurance funds for a claim of 'damages or compensation'.

Lumley will make this amendment for its current clients to provide cover should they find themselves in the same position as the Bridgecorp directors.

Lumley is addressing this problem by amending our D&O primary policies to ring-fence defence costs to ensure that, in the event of a Section 9 'charge', we can legally defend claims brought against our insured directors and officers.

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If you have any questions, please call Lumley Liability on 0800 111 888 and ask to discuss this cover with one of our experts.

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