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GOOD NEWS FOR D&O POLICYHOLDERS ON DEFENCE COSTS - AUSTRALIAN POSITION ON BRIDGECORP CLARIFIED

01 February 2017 | Australia
Legal Briefings – By **Mark Darwin**, **Peter Holloway** and **Sophy Woodward**

The NSW Court of Appeal has handed down its much anticipated decision concerning whether parties making a claim against directors and officers can assert a statutory charge over the proceeds of a potentially responsive D&O policy, effectively depriving the directors and officers the ability to access the policy to fund their defence costs.

In the decision handed down on 11 July[1], the Court of Appeal has ruled that even if a statutory charge does apply to the proceeds of a potentially responsive D&O insurance policy, this does not prevent directors and officers insured under the policy from accessing it to fund the defence of claims against them.

The Court of Appeal decision concerns underlying litigation arising out of the collapse of the Great Southern group of companies. The claimants have brought various claims against the company in liquidation as well as against a number of its directors and officers. Based upon the September 2011 decision of the New Zealand High Court, colloquially known as the *'Bridgecorp'* decision, the claimants asserted an entitlement to a charge over all of the proceeds of the D&O policy so that their claims were given priority in the event they succeeded. However, by reason of the charge, the D&O insurers were at risk of having to pay the full policy limit again if they eroded the 'charged proceeds' by agreeing to advance payment of directors' and officers' legal defence costs in the interim.

The first instance New Zealand decision in *Bridgecorp* was overturned by the New Zealand Court of Appeal on 13 February 2013, although the NZ Supreme Court (the highest Court in New Zealand) is yet to hear a further appeal in New Zealand.

In its recent decision the NSW Court of Appeal held that any statutory charge that did apply to an insurance policy only descended over amounts payable in respect of an established liability of the insured parties to third party claimants. Accordingly, until this liability was established (ie after the conclusion of a trial or an award or settlement), the charge was not perfected and therefore could not prevent directors and officers from accessing the policy for defence costs paid under the policies.

The decision will be reassuring to insurers and directors alike, following the uncertainty created by the original New Zealand High Court decision.

BACKGROUND

The Great Southern managed investment scheme collapsed in 2009 triggering actions in Victoria and Western Australia against the company and its directors. The total amount claimed exceeded the limits available under Great Southern's D&O policies.

The claimants asserted that a statutory charge applied to the proceeds payable under the policies, including defence costs payable under the policies, under section 6(1) of the *Law Reform (Miscellaneous Provisions) Act* 1946 NSW (**Reform Act**), which states:

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.

Typically, this legislation was understood to essentially quarantine the proceeds of an insurance policy which covered a company for personal injuries claims from being appropriated by the insured for their own purposes or swallowed up by the creditors, which would have left the injured claimant without compensation. The shareholder in *Bridgecorp* had originally succeeded in proceedings asserting that a similarly worded section of the NZ legislation created a statutory charge for their class action against the company, which then effectively prevented insurers from advancing defence costs to the directors to assist them to defend the very same claim in respect of which it was being asserted a liability arose.

In response to the claimants' assertion of a charge, Great Southern's insurers and directors brought an application in the NSW Court of Appeal to determine, inter alia:

- whether there was sufficient connection to NSW for section 6(1) of the Reform Act to create a charge;

- whether section 6(1) was capable of applying to insurance moneys where the alleged conduct giving rise to the claim happened before the policies were entered into; and

- to the extent that section 6(1) did impose a charge on insurance moneys, whether those insurance monies included defence costs.

DECISION OF THE NSW COURT OF APPEAL

Geographical limits of section 6(1)

The court found that section 6(1) did not apply on the basis that section 6 is directed at claims initiated in NSW courts and the fact that the proceedings were brought outside of NSW resulted in a lack of requisite territorial connection.

Despite this finding, the Court went on to answer the other questions.

Whether a charge applied to claims based on conduct that preceded the policies

The court held that section 6(1) does not create a charge based upon a claim arising from an event that has, or events that have, occurred prior to the inception of the policies.

The court followed the principle in *The Owners-Strata Plan No 50530 v Walter Construction Group (In Liquidation) & Ors* (2007) 14 ANZ Insurance Cases 61,734 that there is nothing to which the charge can attach, or on to which it can descend, unless and until a liability to pay damages or compensation has been determined. The liability is not determined unless and until a determination has been made, by judgment, award or settlement, that the insured is liable.

WHETHER, IF A CHARGE OPERATES, IT APPLIES TO DEFENCE COSTS

The court held that section 6(1) creates a charge in relation to insurance moneys that are, or may become, payable in respect of a liability to pay damages or compensation to third party claimants. Importantly, section 6 does not confer such a right in respect of insurance moneys that are, or may become, payable to an insured otherwise than in respect of a liability to pay damages or compensation.

Critically, the court found that where section 6 imposes a charge**, such a charge would not extend to insurance moneys payable in respect of defence costs, legal representation expenses or costs and expenses** that are paid by insurers in accordance with the policies before judgment is entered or settlement is agreed.

The court noted that the provisions in the policies enabling defence costs to be advanced before indemnity had been determined provided a valuable benefit to the insured. If the charge caught all moneys available under the policy at the time when the charge arose then the insurers could not safely pay defence costs.

Emmett JA and Ball noted:

'There is nothing on the face of s 6 to suggest that it was intended to alter the contractual rights of the parties in such a radical fashion. If the New south Wales Parliament intended s 6 to have such a drastic effect on the contractual rights of an insured, it could be expected to have provided so in express terms' [at 124]

The court also noted that it was possible that the limit under a contract of insurance might be reached as a consequence of the payment of insurance moneys in respect of defence costs and that the insured would not be indemnified in respect of that liability. The court held that there was no reason in principle why a claimant should not be exposed to the same risk.

IMPLICATIONS

The NSW legislation considered in this case is similar to legislation in the ACT and the Northern Territory. The decision therefore should have application to proceedings brought in these States.

Despite the Court of Appeal's decision, some uncertainty remains as to the operation of section 6, and (given that the Court of Appeal found that the NSW legislation was inapplicable) its findings on whether a statutory charge extends to defence costs are persuasive rather than binding. The Court of Appeal noted that '*Section 6 should be repealed altogether or completely redrafted in intelligible form, so as to achieve the objects for which it was enacted'* [at 55].

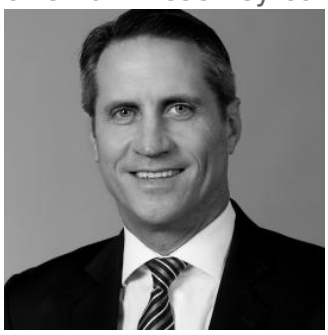
Nonetheless, following the decision (and unless the NZ Supreme Court decides otherwise in the final Bridgecorp appeal or the NSW Court of Appeal's decision is taken to the High Court), it seems likely that D&O insurers will again be comfortable to advance defence costs to director and officer insureds under D&O policies, even if the claimants seek to assert that a statutory charge operates over a D&O policy.

ENDNOTES

1. *Chubb Insurance Company of Australia Ltd v Margaret Moore and others* [2013] NSWCA 212.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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