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S6 of the *Law Reform (Miscellaneous Provisions) Act 1946* - Its wings are clipped.

Insurance Update

The long awaited decision of whether there is a charge over D & O defence costs was handed down yesterday in *Chubb Insurance Company of Australia Limited v Moore* [2013] NSWCA 212.

The NSW Court of Appeal found that a claimant's charge under s6 of the *Law Reform (Miscellaneous Provisions)* Act 1946 over D & O policies does not extend to costs spent in the defence of a claim.

Chubb v Moore confirms that Australia will not follow *Steigard v BFSL 2007 Ltd* [2011] NZHC 1037, colloquially know as the *Bridgecorp* decision, which is based on similarly worded legislature.

The NSW Court of Appeal decision was presided over by a 5 judge bench, which is indicative of the importance of the decision. The reasoning of the Court is interesting and in depth, with the ultimate findings being based on a number of individual questions. This note looks at some of those questions of particular interest to insurers and insureds

The New Zealand Bridgecorp decisions

The *Bridgecorp* decision caused quite a stir through the insurance industry in 2011. The Court found that there was a risk attaching to paying defence costs under a D & O policy in defending a claim against directors costs, despite those costs being expressly covered under the terms of the policy, by virtue of the operation of s9 of the *Law Reform Act 1936* (NZ). The Court found that s9 of the NZ Act created

Who does this affect?

- Insurers
- Directors & officers
- Creditors

Article Highlights

- The NSW Court of Appeal has found that a claimant's charge under s6 of the Law Reform (Miscellaneous Provisions) Act 1946, over Director and Officer insurance policies, does not descend over the policy to, in effect, prevent payment of defence costs.
- Insurers are entitled to make indemnity payments to D&O Insureds to cover defence costs incurred in defending claims, despite the fact that this may ultimately erode the insurance moneys available to meet a s6 charge ultimately held over a subsequently found liability.

a statutory charge in favour of claimants on all insurance money that is or may become payable under a contract of insurance which indemnifies a person against liability to pay damages or compensation.

The trial judge commented that:

> "I *am conscious that it produces some unsatisfactory consequences. In particular,* ***it means that the charge prevents the directors from being able to resort to the D & O policy to meet their defence costs even though the Bridgecorp defendants have not yet filed a claim against them*** *and may not do so for some considerable time. That result may seem unfair given the fact that the Bridgecorp companies took the policy out at least in part for that specific purpose." [Emphasis added]*

Some hope of change appeared when, in December 2012, Bridgecorp was overturned by the New Zealand Court of Appeal in *Steigrad v BFSL 2007 Ltd* [2012] NZCA 604 (**Bridgecorp Appeal**). In brief summary the NZ Court of Appeal overturned the primary Court's decision for two reasons, namely:

- Section 9 did not apply to insurance monies payable for defence costs, even where such cover is combined with third-party liability cover and made subject to a single limit of liability;
- Section 9 is largely procedural in nature, and cannot operate to interfere with the contractual relationship between an insurer and an insured with regards to a separate liability (i.e. as between a liability to pay defence costs to one party and to pay another party for a claim).

But this was not the end of the matter in New Zealand. On 15 April 2013, leave was granted for the matter to be appealed to the New Zealand Supreme Court (New Zealand's highest Court). The appeal is still to be heard.

There was concern amongst the Australian insurance community and insureds that the 'unsatisfactory consequences' identified in *Bridgecorp* may find their way into Australian law because NSW, the ACT and the NT all have similarly worded legislation to the NZ Act.

Facts of the case

Following the collapse of Great Southern Limited and its subsidiaries (**Great Southern**), several proceedings have commenced in the Supreme Court of Victoria (**the PDS Proceedings**) and the Supreme Court of WA (**the Transform Proceedings**). In both those proceedings, the plaintiffs claim damages from former directors and executives of Great Southern, alleging various contraventions of the Corporations Act, the ASIC Act and the Fair Trading Acts of Victoria and Western Australia. In both the PDS and Transform Proceedings, the plaintiffs have invoked s6 of the *Law Reform (Miscellaneous Provisions)* Act 1946, which is drafted in similar terms to s9 of the NZ Act. The plaintiffs in both proceedings claim that s6 affords them priority over legal expenses incurred by the directors and executives of Great Southern in defending those proceedings.

Article Highlights (cont)

- Section 6 of the Law Reform (Miscellaneous Provisions) Act 1946 will not create a charge where the events giving rise to a liability occurred prior to the commencement of an insurance policy. Accordingly, there will be times where claims made insurance policies avoid the operation of s6.

In response, the insurers behind the D & O policy of the directors and officers in the Great Southern proceedings (**Insurers**), issued proceedings in *Chubb v Moore* to address this priority issue. The Insurers asked the Court to consider whether s6 of the NSW Act affords priority to the plaintiffs in the PDS and Transform Proceedings over the moneys that may be payable under the policies.

The decision

Defence Costs

The Court accepted that the charge created by s6 attached to, or descended upon, not only insurance moneys that are payable, but to all insurance moneys that may become payable. As per the Walter Construction Case (discussed below), the charge arises on the happening of the event giving rise to the claim, and at that time the charge affects all insurance moneys that are or may become payable in respect of the claim. The plaintiffs in the Transform and PDS Proceedings claimed that this included defence costs of the directors and executives, the payment of which erodes cover under the Policy which might otherwise be charged by a claimant. The first instance decision in *Bridgecorp* was relied upon.

The Court however, did not agree and preferred the decision in the *Bridgecorp Appeal*. The Court said that s6 only conferred a right to insurance moneys payable in respect of a liability. It said that defence costs could not be considered such a liability, but rather the insured's contractual right to seek indemnity from its insurer in respect of loss or outgoing. The Court said that the charge was not expressed so as to catch all moneys that might be payable under a contract of insurance. The Court said it did not matter whether the insurance policy had separate limits of indemnity for third party claim liabilities and defence costs or just one. The Court said there was no intention by the legislature to interfere with the insured's and insurer's contractual relationship in respect of defence costs.

The Court recognised that it was clearly possible that the limit of an insurance policy might be entirely eroded by defence cost payments, leaving nothing to meet a liability subsequently found against the insured. The insured faces the risk of having to answer a liability personally when the limit is eroded. The claimant faces the risk of having to enforce a liability against an insured personally, who may or may not have the funds sufficient to meet the liability.

The Court said there was no reason in principal why a claimant should not be exposed to such a risk and that the claimant should not be in a more favourable position than the insured is in respect of the insured's contractual right of indemnity under the contract of insurance. The Court said:

> *"An insured should not be required to wait until after the question of its liability to a claimant has been determined before it can be indemnified for such costs. It would be quite anomalous for an insured, who successfully defends a claim by a claimant, to be compelled to wait until after that successful defence before being reimbursed for what could be very substantial legal costs incurred in defending the claim".*

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Accordingly, the Court found that the Insurers were entitled to pay the Great Southern directors' and executives' defence costs in the Transform and PDS Proceedings, prior to judgment or settlement occurring, despite that this may erode the total amount of insurance money available to meet any liability in the future.

Territorial connection to NSW legislation

One question before the Court was whether s6 of the NSW Act applied to the Transform Proceedings and PDS Proceedings, which were commenced in WA and Victoria respectively, jurisdictions which do not have their own legislative version of s6 of the NSW Act. That question was made difficult by the Principal Policy of insurance which contained a term that it was governed by 'the law of Australia', but several of the Excess Policies sitting behind the Principal Policy made specific choices of law, the majority nominating NSW law.

An additional complication was that Great Southern and the insureds are predominantly based in Western Australia and conducted business from Western Australia. Further, the Principal Policy and Excess Policies were said to have been predominantly negotiated in Western Australia through the insurance broker Aon, who were based in Western Australia. The events that gave rise to the claims in both proceedings were also said to have occurred in Western Australia.

Ultimately the Court said s6 of the NSW Act should not be limited to contracts nominating the Law of NSW, and that neither the place where an event occurred that gave rise to liability or the particular law behind a claim for damages or compensation, was a determinative factor as to the territorial application of s6.

The Court said that the focus should be on the fundamental purpose behind s6; to protect claimants who have obtained judgment or settlement, or who are entitled to obtain a judgment, and to secure the payment of that judgment or settlement when the defendant is insured from moneys that would otherwise be payable to the insured in respect of that judgment or settlement. The Court saw s6 as a procedural mechanism by which that fundamental purpose was achieved.

The Court decided that the preferable approach was to treat s6 as applying to all claims brought in a court of NSW, and not applying to a claim brought in a court that is not a court of NSW. This meant that s6 did not apply to the Transform and PDS Proceedings as neither were brought in a NSW Court. The Court acknowledged that this finding was not without difficulties and that its answer was not without doubt.

A difficulty that may arise from this decision is that parties may forum shop.

Relevant Event Prior to Inception of Policy

The Court rejected the Insurers' argument that s6 only applied to occurrence based contracts of insurance and not to claims made contracts (such as the policy in question). The Court said there was nothing in the Act to support this argument.

The Court then considered whether a s6 charge was available where the contract of insurance did not come into existence until after the event triggering the operation of s6.

If the answer was no, the Court noted that this meant that s6 would apply to some claims made contracts, namely, where the event occurs and the claim is notified in the same policy period, but not others, namely, where the claim is notified in a subsequent policy period.

An earlier NSW Court of Appeal case, *The Owners – Strata Plan No 50530 v Walter Construction Group Limited (In Liquidation) & Ors [2007] NSWCA 124* (**the Walter Construction Case**) had answered this question in the negative. In this case the Court found that s6 speaks as at the moment after the contract of insurance is entered into, and at subsequent moments throughout the period of the contract of insurance up to the time of the happening of the relevant event.

The Court in *Chubb v Moore* was not entirely enamoured with the reasoning in the Walter Construction Case, but ultimately found that the Walter Construction Case was not 'plainly wrong', such that it must be followed as precedent. The result was that the PDS Proceedings did not attract the operation of s6 because the alleged conduct of the Insured giving rise to the claim for damages or compensation happened before the inception of the Policy.

Implications of the decision

The NSW Court of Appeal has answered the question that has permeated through the Insurance industry since *Bridgecorp* was handed down in 2011; will the 'unsatisfactory consequences' cross the Tasman? Australian claimants cannot use s6 to claim a charge over D&O insurance policy moneys that might be used as defence costs prior to the entry of judgment or settlement. Accordingly insurers may pay defence costs without risk.

Directors and officers will welcome this decision at a time when it seemed that the main commercial purpose of a D&O policy (to fund the defence of claims) was under threat.

The insurance industry should however remain vigilant. The possibility of an appeal to the High Court still remains and Bridgecorp is yet to have its final day in court in New Zealand. The s6 charge continues to be available for liabilities other than defence costs and the Court's comments on territorial issues raise the spectre of forum shopping.

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