D&O ruling calms fears

CLYDE & CO

The decision of the Auckland High Court in *Steigrad v BFSL 2007 Ltd (Bridgecorp)* in September 2012 caused shockwaves throughout the Australian and New Zealand directors' and officers' (D&O) markets. That decision has recently been overturned.

Bridgecorp Group collapsed in 2007 and was placed into receivership, owing investors NZ$500m ($421.6m). Receivers asserted claims against various Bridgecorp directors for alleged breaches of their duties. The directors were also subject to criminal prosecution and wanted to access the NZ$20m cover provided under their D&O policy to defend that case.

To preserve the funds available under the policy, the receivers asserted a charge over any insurance proceeds that may be payable in relation to the receiver's claim, pursuant to s9 of the Law Reform Act 1936 (NZ).

The court was asked to determine whether such a charge prevented the directors from obtaining reimbursement under the policy for their defence costs. It concluded any payments by the insurer towards the directors' defence costs would not reduce the sum subject to any charge.

This meant, effectively, any payment by the insurer would be made as a volunteer and it would still remain liable to pay the full indemnity sum to the third-party claimants.

The decision led some insurers to restructure their D&O policies (to ensure directors have access to funds for defence costs) and the creation of entirely new D&O "companion policies".

The appeal, handed down in December 2012, overturns the High Court's decision primarily on the grounds that s9 of the Law Reform Act does not apply to insurance monies payable in respect of defence costs, even where such cover is combined with third-party liability cover and subject to a single limit of liability.

Importantly, the court held: "There was no suggestion, if there had been separate defence costs and third-party liability policies, s9 would have applied to the defence costs policy. Combining the two forms of cover – defence costs and third-party liability – in a single policy with separate sums insured would not affect this outcome.

"In our view, combining the two forms of cover in a single policy subject to a single sum insured does not change the analysis either. There is a single, aggregated fund from which the two distinct liabilities can be met. The charge attaches to the balance that is available to meet third-party claims after any defence costs liability has been met."

The court also concluded the intention of s9 is not to interfere with contractual rights as to cover and reimbursement.

Importantly, however, the court held the appeal would have succeeded on the primary ground alone.

The decision confirms (in New Zealand at least) a s9 charge cannot be used to deprive a director from seeking reimbursement for his defence costs under a D&O policy for amounts that are distinct from a third-party liability owed (or potentially owed).

$500m
Amount Bridgecorp owed investors when it went into receivership in 2007

$20m
Cover that was provided under Bridgecorp's D&O policy

In short, the decision places insureds and insurers back in the position they most probably thought they were in before *Bridgecorp*.

The appeal decision is likely to be welcomed as providing some certainty as to how the law operates and how D&O protection should be structured.

We also anticipate renewed discussion about the language to be used in D&O products and whether it is still necessary for directors to take out separate defence costs cover. ■

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