

Directors & Officers Liability Insurance – *Steigrad* Supreme Court Ruling

Introduction

A recent ruling by the Supreme Court (*Steigrad and others v BFSL 2007 Limited and others*) has reversed the Court of Appeal's earlier decision. This means that third party claimants now have priority over all monies payable under insurance policies which pay damages or compensation and where the single Limit pays both Loss and Defence Costs.

Background

High Court Decision (15 September 2011)

The High Court ruled that the former Bridgecorp directors could not access their Directors and Officers Liability Insurance policy to fund their defence in respect of proceedings which have been brought against them by the Securities Commission or in respect of any proceeding which "may" be brought against them by the receivers and liquidators at Bridgecorp.

On behalf of the Bridgecorp companies (in receiverships), the receivers and liquidators asserted a charge over the proceeds of the Directors & Officers Liability Insurance policy under section 9 of the Law Reform Act 1936. The High Court held that once a charge has arisen, which has the potential to exceed the policy Limit, then the Insurer is prohibited from advancing Defence Costs as the Limit is unable to be depleted. The Limit must remain available to the claimants to the extent necessary to meet such liability as is eventually established against the directors.

Steigrad and others appealed the High Court Decision.

A section 9 charge was also asserted over the Feltex Carpets Ltd Prospectus Liability Policy and the Feltex directors and their Insurer applied to the High Court for a Declaration that section 9 did not prevent the Insurer from paying the directors' reasonable defence costs. This application was moved to the Court of Appeal to be heard with the *Steigrad* Appeal.

Court of Appeal Decision (20 December 2012)

The Court of Appeal overturned the High Court Decision in December 2012.

The Court of Appeal Judges found that the appeal succeeded on the basis that:

- a charge cannot interfere with the insurer's contractual duty to pay defence costs; and
- is not intended to rewrite the insurance policy.

The Bridgecorp Receivers and Eric Houghton (in the *Feltex* matter) successfully sought leave to appeal the Decision in the Supreme Court.

Supreme Court Ruling (23 December 2013)

By a majority of 3 to 2, the Supreme Court reversed the Court of Appeal's decision which means that third party claimants have priority over all monies payable under insurance policies (which pay damages or compensation) where the Insurance Limit pays both Loss and Defence Costs. This means that in practice an insurer considers that they are unable to advance Defence Costs once a charge has been asserted which has the potential to exceed the policy Limit.

The ruling confirmed that a statutory charge under section 9 arises on the happening of the event giving rise to the claim and secures the full amount of liability to the third party claimant as eventually established through judgment on, or settlement of, the claim (subject to policy limits).

Insurance Implications

Directors & Officers Liability

If you have not already purchased a separate Defence Costs policy or ring fenced a Defence Costs Limit under your Directors & Officers Liability Insurance policy it is imperative that you do so to ensure your insurer is able to advance Defence Costs.

Other Liability Policies

The need for a separate Defence Costs policy or a ring fenced Defence Costs Limit is not limited to Directors & Officers Liability Insurance. It also applies to the following insurance policies including Management Liability Package Policies and the Errors & Omissions section under an I.T. Policy (unless the policy pays Defence Costs in addition to the Limit):

- Professional Indemnity;
- Trustees Liability;
- Associations Liability;
- Employers Liability;
- Prospectus Liability;
- Employment Disputes Liability.



When considering arranging a separate Defence Costs cover, consideration should be given as to who is the Insured. For instance with regard to Professional Indemnity, the Insured is usually a company rather than an individual. If a company, then the company's balance sheet may be able to fund the Defence Costs until final outcome of the proceedings is known and, provided the Limit is not exhausted, then the Insurer will be able to reimburse the Defence Costs at that point.

Statutory Liability

There is a possibility that Statutory Liability insurance policies are also susceptible to a section 9 charge as reparations orders *may* be considered compensatory in nature.

Statutory Liability policies pay defence costs and fines & penalties for unintentional breaches of certain NZ legislation arising out of proceedings brought by statutory authorities or enforcement agencies and reparation orders imposed by the Court upon conviction of an Insured for an offence under the Health & Safety in Employment Act 1992.

When considering arranging a separate Defence Costs cover, consideration should be given as to the size of the Limit you currently purchase and whether the activities you / your company undertakes has a high health & safety exposure.

We recommend that you also review your Statutory Liability Insurance policy and consider purchasing a higher Limit and/or separate defence costs cover due to the above and the impending changes to the Health & Safety legislation.

Insurer solutions

There is a range of policy structure options which vary depending on your Insurer. The solution options are as follows:

- ▶ Ring fenced Defence Costs Limit within your current insurance policy;
- ▶ Separate Defence Costs Policy which applies to Directors & Officers Liability only;
- ▶ Separate Defence Costs Policy which can apply to all your Liability Insurance Policies (with the exception of Public Liability);
- ▶ Defence Costs paid in addition to the Limit of Liability.

The complex liability programmes with multiple layers are structured on an individual case by case basis with the relevant insurers.

Defence Costs Limit / Statutory Liability

We encourage clients to consider taking their own legal advice, especially in determining an appropriate defence costs limit. It should be noted that in the one proceeding, Steigrad and others exhausted \$2m in pre-trial costs and estimated that they required \$4m for the costs of the trial.

We recommend that clients review their Liability Insurance limits with your Aon broker to determine the best way forward.