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Chartis' response to Bridgecorp decision

Chartis in Australia, a market leader in Directors' & Officers' insurance (D&O) is pleased to provide an overview of the complexities introduced by the recent *Bridgecorp*¹ decision in New Zealand and to introduce our D&O Gold Costs and Expenses Policy in response to this decision.

Chartis in Australia has developed the D&O Gold Costs & Expenses Policy as a companion policy to our existing D&O Gold product suite to provide certainty on costs and expenses where the policy becomes subject to a charge. We recognise that all our stakeholders have been giving careful consideration to how best to respond to the vulnerabilities identified in the *Bridgecorp* decision and we value and appreciate the feedback.

The *Bridgecorp* decision

The *Bridgecorp* decision concerned a dispute over whether former directors of the Bridgecorp companies could obtain an advancement of their defence costs under their D&O policy issued by QBE. The directors faced third party civil claims that were potentially in excess of the limit of the D&O policy. The D&O policy, like most D&O policies within the insurance market, aggregated cover for liability and defence costs.

The court found that where the potential quantum for civil compensation exceeded the policy limit, a charge would prevent the advancement of defence costs under the policy.

What are the issues?

1. Inability to Advance Defence Costs

As the entire limit could be required to meet an award of damages and compensation in respect of the potential civil claims, the court ruled that the whole "insurance fund" was subject to a statutory charge in favour of the civil claimants. The D&O cover could therefore not be used to meet the directors' defence costs.

This aspect of the ruling affects all liability insurance providing coverage for civil compensation in which Defence Costs are within the aggregate limit.

¹ Steigrad v BFSL 2007 Limited, 15 September 2011, Lang J

2. *Compensation Frustrated*

In addition, the analysis of the law that underlies the *Bridgecorp* decision has highlighted that the relevant law may also be interpreted so that when there are either multiple claims and/or multiple claimants, an insurer may be precluded from making compensation payments until all claims have been resolved.

In D&O, this may be felt most acutely in Representative Actions (also referred to as a Class Action), where not all of the potential plaintiffs are captured within the class. The result may be that the insurer would be unable to pay any of the plaintiffs until they can settle with each and every prospective plaintiff (including those who have not pursued the insured), and to determine the order of payment to the plaintiffs on the basis who was 'wronged' first.

Establishing such a quantum (particularly if some of the plaintiffs' have not yet litigated) along with determining when the relevant 'event' occurred for each individual could take many years. In the interim, the insured would be required to pay any settlement/judgment and await reimbursement from the insurer.

This aspect of the law impacts all liability policies that provide cover for civil compensation, irrespective of whether the Defence Costs are within or in addition to the limit.

Does *Bridgecorp* apply in Australia?

Whilst the law in New South Wales², the Australian Capital Territory³ and the Northern Territory⁴ is almost identical to that in New Zealand, it is unclear whether an Australian court would arrive at the same decision as New Zealand. The New Zealand decision is not a precedent in Australia and would, at best, be treated as persuasive to the court in making their decision.

There have been no similar cases in Australia over the past 65 years.

Should a similar matter arise in Australia, legal opinion varies widely on whether the Australian courts would arrive at the same conclusion as Justice Lang in *Bridgecorp*. The views of leading Australian lawyers vary widely, with a number bullish at the prospects of leading the court to an alternate view to the judge in *Bridgecorp*, whilst others are equally bearish.

Since the New Zealand and Australian laws were first introduced in the 1930s, 40s and 50s, there has been divergence in the law between the two countries. Wide ranging Australian Federal insurance law has been introduced, including the Insurance Contracts Act⁵, which now has the State law arguably playing a secondary role in the regulation of insurance. In addition, Australian case law has diverged from that in New Zealand, and this case law may limit the scope of the relevant laws.

An example of case law reducing the effective scope in Australia is the *Walters Construction case*⁶ which determines that for the New South Wales law to apply to claims made insurance, the 'event' needs to occur during the policy period. The 'event' is determined by the courts as the 'crystallisation

² section 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (New South Wales)

³ section 206 Civil Wrongs Act 2002 (ACT), previously sections 25 to 28 of the Law Reform (Miscellaneous Provisions) Act 1955 (ACT)

⁴ sections 26 to 29 of the Law Reform (Miscellaneous Provisions) Act 1956 (Northern Territory)

⁵ Insurance Contract Act 1984

⁶ *Strata Plan No 50530 v Walter Construction Group Limited* (2007) 14 ANZ Ins Cas 61-734

of the loss'. Given that claims made insurance typically reacts to claims the insured became aware of, rather than with reference to when the event occurred, a significant number of claims would not be subject to charge.

Leading lawyers also note that Australian courts resist interpreting legislation that leads to absurdity or frustration. Rather, they will seek an understanding of the context in which the legislation was enacted to seek a sensible interpretation that meets the drafter's intent.

What is Chartis in Australia's approach to existing claims?

Whilst we note the *Bridgecorp* decision with interest, there has been no such case in Australia and we continue to advance defence costs as per the policy provisions.

We will vigorously defend our insureds and meet our contractual responsibilities.

Chartis will only revise this position in Australia to the extent that there is further adverse development in the legal environment relating to how we can advance defence costs.

What is the long-term solution?

Chartis in Australia is an active member of the Insurance Council of Australia (ICA) and will continue to support the ICA and other interested bodies to seek repeal or clarification of this state legislation. While the state laws were introduced to provide consumer protection, the state law appears redundant given significant headway has since been achieved at a Federal level⁷.

As there is some doubt as to whether the *Bridgecorp* decision will be appealed, Chartis in New Zealand is pursuing an alternate matter that could be considered by the Court of Appeal to obtain clarity and to address many of the concerns that the *Bridgecorp* matter has raised.

Whilst the media and legal coverage to date focuses upon protecting the defence costs for D&Os, judicial or legislative repeal or clarification is the only viable solution available to deal with the payment of compensation in multiple claims and multiple claimants scenarios outlined in the 'Compensation Frustrated' above.

What is the short-term solution?

We recognise that *Bridgecorp* has added another layer of uncertainty to an industry that strives to provide certainty to its clients. For those clients that are seeking the comfort of having an additional level of protection, Chartis in Australia is now able to offer to the market a policy response to this legal development.

D&O Gold Costs & Expenses Policy

The D&O Gold Costs & Expenses Policy provides a dedicated limit for defence costs that will be triggered should the existing D&O program be subject to a charge that prevents the policy from advancing defence costs. It is sold as an optional accompaniment to our D&O Gold product suite.

⁷ Refer to 'Reflections on Section 6' by Justice R D Giles, Chief Justice of the Commercial Division of the Supreme Court of New South Wales

We believe that this approach is a sound solution as it provides the client with both certainty and flexibility in the placement of their D&O program:

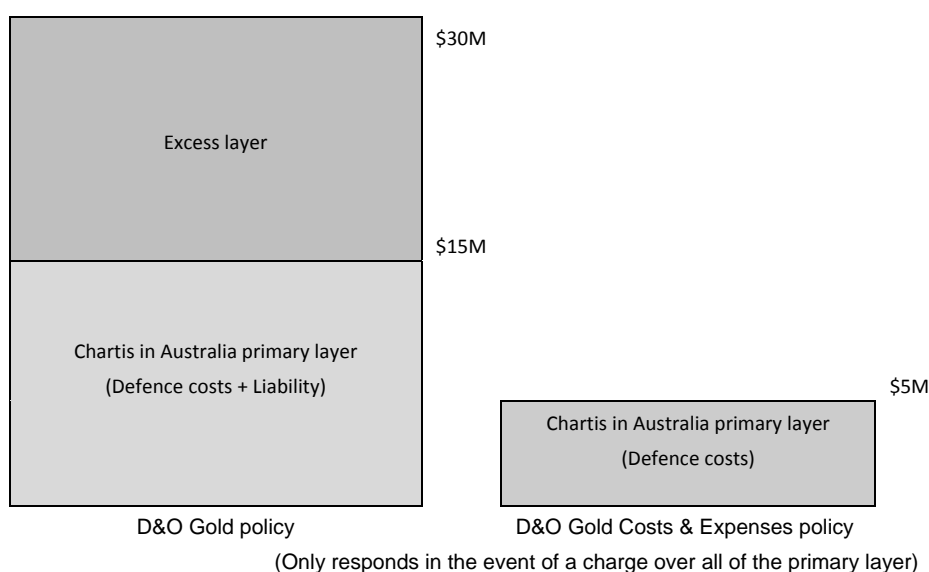
- Where there is no charge, the existing D&O program can respond as usual;
- Where the charge is significantly lower than the primary limit of liability under the existing D&O program, that primary limit can still respond to the extent there are amounts not subject to the charge;
- Where the whole primary limit in the existing D&O program is subject to a charge (therefore precluding payment), directors can access Costs & Expenses under the new D&O Gold Costs & Expenses policy;
- It is a separate policy wording that is intended to reduce the likelihood that the D&O Gold Costs & Expenses policy would be subject to a charge: if the additional defence costs are within the same policy wording (including by endorsement), it *may* be contested that the defence costs also fall within the ambit of "...all insurance monies..." contemplated in the Australian law;
- The policy will react to a charge under the three Australian State laws and the New Zealand law;
- The drafting facilitate ease of placing excess layers where the client wishes to build a more substantial limit;
- The D&O Gold Costs & Expenses policy seamlessly reacts when charge applies: there is no need for the insured to seek a court order to confirm the existence of the charge;
- The policy responds to Directors & Officers, Company Reimbursement and/or Securities Entity cover – a charge can apply irrespective of whether the Company or the Directors are the defendant and irrespective of whether the Company is insolvent or not.
- The Cost & Expenses Policy aligns with our D&O Gold suite of policies, and not only protects the availability of Defence Costs, but also provides Investigation Costs, Extradition Costs, Bail Bond and Civil Bond Premium, Prosecution Costs, Asset and Liberty Expenses and Public Relations Expenses;
- A single retention is payable under both policies in regards to a Related Claim or Circumstances;
- If costs and expenses need to be advanced under the new D&O Gold Costs & Expenses policy but it later transpires that the existing D&O tower could have responded (for example, the charge is lifted or discharged or is not as large as the insurer initially thought), there is a mechanism for the D&O Gold Costs & Expenses program to be reimbursed to allow the separate defence costs cover to be reinstated in the event of a second claim.

Our response means that minimal changes need to be made to insureds' existing D&O Gold programs (including excess layers) and provides a simple solution for insureds to revert to the original structure if the *Bridgecorp* decision is reversed.

How will it work?

We have outlined over the following pages three examples of how our solution would work in practice. As per the above position, Chartis in Australia continues to advance defence costs on claims. However, these examples assume that there has been an adverse change in the Australian legal environment and that insurers are assessing any new claim/circumstance to determine whether a charge applies. These are hypothetical examples only and should not be relied upon to predict the outcome of any claim, or in place of careful review of the policy wording:

Hypothetical Program Structure



Scenario 1:

- Third party claim for \$6m
- Chartis in Australia pays defence costs out of the remaining \$9m of the primary D&O Gold Policy
- \$1m defence costs incurred
- Third party claim settled at \$5m
- Chartis in Australia pays out \$6m under the D&O Gold Policy
- Neither the Excess layer nor D&O Gold Costs & Expenses policy pay

Scenario 2:

- Third party claim for \$30m
- A charge exists over the entire primary layer
- D&O Gold Costs & Expenses policy is made available to the insured
- \$3 million defence costs paid under D&O Gold Costs & Expenses policy
- Third party claim settled at \$20m, including an adverse costs award
- Chartis in Australia pays out \$15m for damages under the D&O Gold Policy
- Excess layer pays \$5m for damages under the original tower
- Excess layer reimburses Chartis in Australia \$3m for payments made under D&O Gold Costs & Expenses policy

Scenario 3:

- A Regulator begins investigating the insured and seeks to freeze the assets of one insured
- Third party claim on a related matter is brought for \$30m
- A charge exists over the entire primary layer
- D&O Gold Costs & Expenses policy is made available to the insured
- \$1m is expended in Investigation Costs and Asset & Liberty Expenses under the D&O Gold Costs & Expenses policy
- The Insureds succeed in respect of the regulatory matter
- \$3 million defence costs incurred under D&O Gold Costs & Expenses policy
- The Civil Claim finally determined to be \$30m
- Chartis in Australia pays out \$15m for damages under the original tower
- Excess layer pays \$15m for damages under the original tower
- As the D&O Gold Policy and the Excess is exhausted, the D&O Gold Costs & Expenses policy also ceases

How will Chartis manage capacity so as to issue the D&O Gold Costs & Expenses Policy?

Chartis will manage its exposure due to the aggregation of capacity between the D&O Gold policy and the D&O Gold Costs and Expenses Policy. In many cases, we will seek to provide an additional \$5m capacity for the D&O Gold Costs & Expenses Policy, but this is dependent upon the nature of the risk, the cover and the current capacity deployed.

On those occasions where we already deploy our full capacity, we are happy to discuss the appropriate capacity allocation between the policies.

What should you do next?

We are able to provide this option immediately to our D&O Gold AB (02-09) clients, and we are following shortly with the D&O Gold ABC (09-09), Company Securities Insurance (02-09) and Investment Managers Insurance (04-11).

Please note that Chartis in Australia is offering this solution for those insureds who have a concern regarding the advancement of defence costs raised by the *Bridgecorp* decision and wish to protect themselves against the possibility of being left in the same position as the directors in that case.

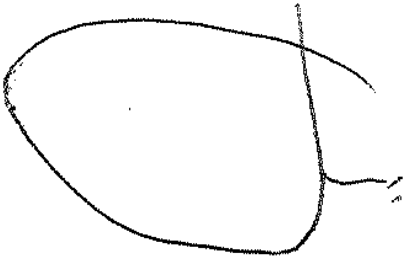
Chartis in Australia will continue to work with the insurance industry and other appropriate bodies to seek a permanent solution through legislative and judicial means.

Chartis in Australia continues to take an innovative approach to liability insurance. Our experience and global network enable us to evaluate trends, develop new responses to emerging issues, and stay ahead of the game. We are pleased to continue working with director groups, insurance and legal advisers to shape appropriate offerings in response to the major issues of the day.

We hope that this overview has been helpful. Please remember that it is for your information only and should not be treated as advice. Should you require advice on these issues, we recommend that you consult your professional advisor.

If you wish to pursue the D&O Gold Costs & Expenses policy, please speak to any Chartis in Australia Financial Lines underwriter, or feel free to contact me directly. We pride ourselves on understanding and dealing with these complex issues and are always pleased to discuss.

Regards

A handwritten signature in black ink, appearing to read 'Jeremy Scott-Mackenzie'. The signature is stylized with a large, rounded initial 'J' and a long, sweeping horizontal stroke that extends to the right.

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