BULLETIN

IMPACT ON D&O INSURANCE

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THE BRIDGECORP CASE

The former directors of Bridgecorp face criminal and civil claims arising from the collapse of Bridgecorp finance companies. The receivers and liquidators of those companies have signaled their intention to bring civil proceedings against the directors claiming over $450 million.

The directors of Bridgecorp are currently defending criminal charges brought against them by the Financial Markets Authority (formerly Securities Commission). The defence costs have or are to date been funded under Bridgecorp's Statutory Liability policy although the Limit has almost been exhausted.

THE HIGH COURT RULING

The 15 September 2011 ruling in the High Court under section 9 of the Law Reform Act 1936 concerned a charge placed over the proceeds of the Directors & Officers Liability ("D&O") policy to prevent the directors exhausting the limit of indemnity under the policy through defence costs. The charge secures amounts that they intend to claim in civil proceedings against the directors. This prevents the directors from obtaining payment under the D&O policy to continue funding the legal costs of their defence.

Section 9 of the Law Reform Act provides:

- Where an insured holds a policy that indemnifies the Insured's liability to pay damages or compensation; and
- An event occurs that gives rise to a claim for damages or compensation; then
- The amount claimable becomes a charge over the amounts payable under the policy at the date the claim arose.

This means that charges created by section 9 have priority over all other charges affecting the insurance proceeds, including defence costs.

This ruling appears to clarify that insured's will be left funding their own defences (given the set up of current D&O policies) until such time as all claimants have been settled and appeals exhausted, at which point insured's could seek reimbursement of defence costs (assuming that the policy limit hasn't been exhausted).

The charge can occur even if a civil claim has yet to be made or quantified against the directors, so long as any civil claim is likely to exceed the policy limit. This recognises that quantification of claims can be a long drawn out process that may not occur until well after insured's need to mount defences.

HOW DOES A PROBLEM ARISE WITH D&O POLICIES?

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HOW DOES A PROBLEM ARISE WITH D&O POLICIES?

The Limit of Indemnity for the D&O policies (and some other types of liability policies) issued in our insurance market, is a shared Limit for both legal defence costs and indemnification for claimed loss, making them susceptible to this ruling.

WHERE WE ARE CURRENTLY

We, and insurers are currently looking into the judgement, the effect it has on policy coverage, and how best to provide cover for the insured's defence costs going forward. As you will appreciate, a solution needs to be legally robust. We await the response of each insurer so we can consider how to advise you, our clients. In case you should seek your own legal advice on the effect on your D&O policy, we will willingly engage with your legal advisers in terms of negotiating with insurers on the precise policy contract changes mooted.

WHAT CAN YOU DO NOW?

Our clients are asking various questions about the Bridgecorp ruling including whether or not their policy Limit will be sufficient to cover all potential claims whilst also leaving enough to cover defence costs. Until such time as the insurance market responds, we advise clients to review your current Limit with consideration as to whether it would satisfy all creditors and allow for other potential claimants (e.g. shareholders).

DO NOT RELY ON YOUR STATUTORY LIABILITY POLICY

Lawyers' commentary recently released in relation to the Bridgecorp case has placed an emphasis on Statutory Liability insurance to cover defence costs for statutory prosecutions. A Statutory Liability policy doesn't respond to claims for compensation or damages and therefore would appear to be unable to have a charge put on it. More over the policy only responds to unintentional breaches of statutes. Deliberate breaches, disregard or failure to comply with acts, as well as criminal prosecutions brought under certain acts, are completely excluded.

It would therefore appear that if the prosecution is alleging deliberate or criminal behavior, the policy will not respond unless the insured was acquitted of all charges, still leaving the insured to fund their own defence.

On the other hand many D&O policies only exclude claims for criminal, dishonest, fraudulent and malicious acts or omissions if there is a judgment or other final adjudication to that effect.

WHAT *NOT* TO DO

Finally, some advice we have seen suggests that insured's either structure the notification of a claim to appear as if a civil suit isn't involved or consider delaying notification. This would cause an issue with many duties and conditions imposed on an insured including those around disclosure, acting in good faith and claim conditions pertaining to late notification. This is therefore something we strongly advise against and do not support. Such behavior could render the policy void.

POTENTIAL SOLUTIONS BEING INVESTIGATED BY WILLIS

There are two solutions we see at present as outlined below:

1. Setting up a policy structure whereby a separate Limit is set aside for defence costs that cannot erode a limit separately held for loss.
2. Amending the D&O policy to a costs in addition Limit, whereby a separate Limit is allocated under the policy for defence costs in addition to the main Limit.

The above options have the potential to exhaust insurers' capacity resulting in the need for additional insurers to be used. Where multiple insurers are needed the cost of the policy often pushes up.

The general feeling is that an appeal (in the Bridgecorp case) is maybe likely, due to the wide ranging ramifications of this finding. Any advice we give will be subject to change depending on the outcome of possible later appeals.

CONTACT

For further information, contact your Willis Client Advocate®.