

IN THE HIGH COURT OF NEW ZEALAND  
AUCKLAND REGISTRY

CIV-2011-404-611

BETWEEN PETER DAVID STEIGRAD, BRUCE  
NELSON DAVIDSON AND GARY  
KENNETH URWIN  
Plaintiffs

AND BFSL 2007 LIMITED, BNL 2007  
LIMITED, B2B BROKERS LIMITED  
AND OTHERS  
First Defendants

AND BRIDGECORP LIMITED AND  
BRIDGECORP MANAGEMENT  
SERVICES LIMITED (BOTH IN  
RECEIVERSHIP AND LIQUIDATION)  
Second Defendants

AND QBE INSURANCE (INTERNATIONAL)  
LIMITED  
Third Defendant

Hearing: 25 and 26 August 2011

Appearances: B Keene QC and J Little for plaintiffs  
M Tingey and D J Friar for first defendants and receivers of second  
defendants  
A Challis for third defendant

Judgment: 15 September 2011

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**JUDGMENT OF LANG J**

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*This judgment was delivered by me on 15 September 2011 at 11.30 am, pursuant to  
Rule 11.5 of the High Court Rules.*

*Registrar/Deputy Registrar*

*Date .....*

[1] The Bridgecorp group was comprised of finance companies that borrowed money from the investing public to fund property developments in New Zealand, Australia and Fiji. The group collapsed and was placed in receivership from 2 July 2007, owing investors nearly \$500 million.

[2] The plaintiffs, Mr Steigrad, Mr Davidson and Mr Urwin ("the directors"), are three of six former directors of companies within the Bridgecorp group. The other directors are Mr Roest, Mr Petricevic and Mr O'Sullivan. The first and second defendants ("the Bridgecorp defendants") are companies within the Bridgecorp group that are all in receivership and/or liquidation.

[3] Although Mr Urwin is named as a plaintiff, his counsel has received no instructions from him for some time. At the commencement of the trial I granted Mr Keene leave to withdraw as counsel for Mr Urwin. As a consequence, only Mr Steigrad and Mr Davidson proceeded to trial.

[4] The directors face numerous criminal and civil claims following the collapse of the Bridgecorp group. These include civil and criminal proceedings that the Securities Commission has instituted. The criminal proceedings are based on allegations that the directors made false statements in prospectuses, extension certificates and investment statements that the Bridgecorp companies issued to prospective investors. The trial was due to commence in this Court on 5 September 2011, but has now been delayed until 10 October 2011 because of difficulties encountered by some of the accused in obtaining legal representation. The civil proceedings have been stayed pending disposition of the criminal proceedings.

[5] In addition, the Bridgecorp defendants have advised the directors that they intend to institute civil proceedings against them. The proceedings will allege that the directors managed the Bridgecorp defendants in a manner that breached their statutory and common law duties to the companies. The Bridgecorp defendants will seek orders requiring the directors to pay the Bridgecorp defendants more than \$450 million.

[6] Bridgecorp companies incorporated in Australia have also indicated that they intend to issue civil proceedings against the directors seeking compensation for breach of common law and statutory duties under the Australian companies legislation.

[7] The Bridgecorp companies have held a directors and officers insurance policy (the "D & O" policy) with QBE, the third defendant, since 1996. The current limit of indemnity under the D & O policy is \$20 million. In broad terms, the policy indemnifies the directors in respect of any civil and criminal liability that they might incur as a result of their acts or omissions as directors. It also provides cover in respect of any costs that they might incur in defending civil and criminal proceedings seeking to establish such liability ("defence costs").

[8] In addition to the D & O policy, the directors took out insurance in 2000 providing them with cover for defence costs incurred in respect of claims based on breach of their statutory obligations ("the SL policy"). Thereafter, the directors renewed and received quotes from QBE in respect of the two policies simultaneously. When the Bridgecorp group collapsed, the directors held SL cover up to a limit of \$2 million. This, and the D & O policy cover, was for "any one claim and in the aggregate".

[9] When the criminal proceedings commenced, QBE and the directors agreed that they would resort first to the SL policy to pay the associated defence costs. They also agreed that the \$2 million indemnity limit under the SL policy would be divided equally between the five directors. By 1 August 2011, all of the directors other than Mr Urwin had exhausted their entitlement under the SL policy. For that reason they now need to resort to the D & O policy in order to meet ongoing defence costs in relation to all proceedings.

[10] The directors estimate that further defence costs through to the end of the trial will amount to approximately \$3 million. This does not include the costs of any appeals that may follow the criminal trial, nor does it include future costs and/or liability arising out of the civil proceedings.

[11] On 12 June 2009, the Bridgecorp defendants advised QBE that they assert a charge over monies payable under the D & O insurance policy for amounts they intended to claim from the directors in civil proceedings. They claimed that the charge arose by virtue of s 9 of the Law Reform Act 1936 (“the Act), which creates a charge in favour of a claimant over monies that may be payable under any insurance policy held by the person against whom the claim is made. This prompted QBE to advise the directors that it would not make any payments under the D & O policy in respect of defence costs until the directors and Bridgecorp defendants agreed on the allocation of funds under the D & O policy.

[12] Given that the parties cannot reach such an agreement, the directors now seek a declaration that s 9 of the Act does not prevent QBE from meeting its contractual obligation under the D & O policy to reimburse them for defence costs. By way of counter-claim, the Bridgecorp defendants contend that, if s 9 does not prevent QBE from reimbursing the directors for defence costs, the policy nevertheless limits the amount that QBE is liable to pay for defence costs to \$500,000.<sup>1</sup>

[13] QBE was not originally a party to the proceeding. It was content to leave the issue of the charge to be litigated between the directors and the Bridgecorp defendants. It was subsequently added as a party because it had a direct interest in the Bridgecorp defendants’ counterclaim.

#### **The terms of the D & O policy**

[14] Relevantly, cl 1.0 of the D & O policy provides:

[S]ubject to the terms of this Policy QBE agrees to pay on behalf of:

- a) Each Insured Person any loss for which they do not receive payment by way of indemnity from the Insured Company; and
- b) The Insured Company any loss for which it grants indemnity to any Insured Person as permitted or required by law

On account of any claim of a Wrongful Act first made against any Insured Person individually or otherwise during the Period of Insurance and notified to QBE during the Period of Insurance or within 60 days after its expiry or, if exercised, during the Extended Reporting Period.

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<sup>1</sup> Under clause 4.17 of the policy; see [18].

[15] Clause 2.0 of the policy defines a “Wrongful Act” as:

- (a) any actual or alleged:
- Breach of duty;
  - Breach of trust;
  - Neglect;
  - Act, error or omission;
  - Mis-statement or misleading statement;
  - Breach of warranty or expressed authority;

Made, committed, attempted or allegedly made, committed or attempted by any Insured Person, individually or otherwise, in the course of his or her duties to the Insured Company. A Wrongful Act also includes any matter claimed against any Insured Person solely by reason of his or her serving the Insured Company.

All causally connected Wrongful Acts shall be deemed one Wrongful Act.

[16] “Loss” is defined in cl 2.0 of the policy as:

All sums that the Insured Person becomes legally liable to pay on account of all claims made against the Insured Person for any Wrongful Act to which this insurance applies, including but not limited to Defence Costs.

[17] Clause 2.0 also defines “Defence Costs” as meaning:

Costs incurred by QBE or with its consent (which will not be unreasonably withheld) in:

- a) The investigation and defence or settlement of any claim to which this insurance applies, including the threat or intimation of any such claim;
- b) The Insured Persons’ attendance and representation (including preparation) at any investigation, prosecution, inquiry, commission, examination, administrative proceeding or regulatory proceeding in connection with any claim to which this insurance applies;
- c) The investigation and defence or settlement of an civil or criminal action in connection with any claim to which this insurance applies;
- d) The investigation of any circumstances from which a claim to which this insurance applies may arise.

Defence Costs include the cost of any appeal, attachment or similar bond but do not include the regular or overtime wages, salaries or fees of any director or employee of the Insured Company.

[18] Clause 4.17 permits QBE to make progress payments of defence costs. It provides:

**PROGRESS PAYMENT OF DEFENCE COSTS**

If cover has not been confirmed in writing by QBE, QBE will advance all reasonable Defence Costs as and when they are incurred provided that:

- (a) the amount so advanced will be limited to 20% of the Limit of Indemnity of \$500,000, whichever is the less, unless QBE agrees in writing to advance a greater amount; and
- (b) no Defence Costs other than those incurred with the prior written consent of QBE shall be payable hereunder, such consent not to be unreasonably withheld.

**The charge created by s 9 of the Law Reform Act 1936**

[19] Section 9 provides:

**9 Amount of liability to be charge on insurance money payable against that liability**

- (1) If any person (hereinafter in this Part of this Act referred to as the insured) has, whether before or after the passing of this Act, entered into a contract of insurance by which he is indemnified against liability to pay any damages or compensation, the amount of his liability shall, on the happening of the event giving rise to the claim for damages or compensation, and notwithstanding that the amount of such liability may not then have been determined, be a charge on all insurance money that is or may become payable in respect of that liability.
- (2) If, on the happening of the event giving rise to any claim for damages or compensation as aforesaid, the insured has died insolvent or is bankrupt or, in the case of a corporation, is being wound up, or if any subsequent bankruptcy or winding up of the insured is deemed to have commenced not later than the happening of that event, the provisions of the last preceding subsection shall apply notwithstanding the insolvency, bankruptcy, or winding up of the insured.
- (3) Every charge created by this section shall have priority over all other charges affecting the said insurance money, and where the same insurance money is subject to 2 or more charges by virtue of this Part of this Act those charges shall have priority between themselves in the order of the dates of the events out of which the liability arose, or, if such charges arise out of events happening on the same date, they shall rank equally between themselves.
- (4) Every such charge as aforesaid shall be enforceable by way of an action against the insurer in the same way and in the same Court as if the action were an action to recover damages or compensation from

the insured; and in respect of any such action and of the judgment given therein the parties shall, to the extent of the charge, have the same rights and liabilities, and the Court shall have the same powers, as if the action were against the insured:

Provided that, except where the provisions of subsection (2) of this section apply, no such action shall be commenced in any Court except with the leave of that Court.

- (5) Such an action may be brought although judgment has been already recovered against the insured for damages or compensation in respect of the same matter.
- (6) Any payment made by an insurer under the contract of insurance without actual notice of the existence of any such charge shall to the extent of that payment be a valid discharge to the insurer, notwithstanding anything in this Part of this Act contained.
- (7) No insurer shall be liable under this Part of this Act for any sum beyond the limits fixed by the contract of insurance between himself and the insured.

#### *The purpose of a charge under s 9*

[20] There are numerous cases in Australia and New Zealand that discuss the purpose and history of s 9 and its Australian equivalent.<sup>2</sup> Such provisions were enacted in response to issues that arose within the context of claims for personal injuries. In *Ludgater Holdings Ltd v Gerling Australia Insurance Co Pty Ltd*, the Supreme Court observed:<sup>3</sup>

The section and its predecessor responded to the obvious unfairness in the denial by the common law of priority for an injured plaintiff's claim to insurance proceeds received by or payable to an insolvent insured defendant.

[21] Section 6 of the New South Wales Law Reform (Miscellaneous Provisions) Act 1946 was modelled on s 9 of the New Zealand legislation and Kirby P described its purpose as follows:<sup>4</sup>

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<sup>2</sup> *National Insurance Company of New Zealand Ltd v Wilson* [1941] NZLR 639 (SC); *Pattinson v General Accident, Fire, and Life Assurance Corporation Ltd* [1941] NZLR 1029 (SC); *Oswald v Bailey* (1987) 11 NSWLR 715 (SC); *Grimson v Aviation & General (Underwriting) Agents Pty Ltd* (1991) 25 NSWLR 422; *McMillan v Mannix* (1993) 31 NSWLR 538 (CA); *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd* [1994] 1 NZLR 11 (CA); *Bailey v New South Wales Medical Defence Union Ltd* (1995) 184 CLR 399 (HCA); *Ludgater Holdings Ltd v Gerling Australia Insurance Co Pty Ltd* [2010] 3 NZLR 713 (SC); *Trustees Executors Ltd v QBE Insurance (International) Ltd* [2010] NZCA 608 (CA); *Body Corporate No 195843 v North Shore City Council (The Grange)* [2011] 2 NZLR 222 (CA).

<sup>3</sup> *Ludgater* at [17].

<sup>4</sup> *Grimson* at 424.

Clearly, the purpose of allowing direct access to the insurance fund notionally created at the moment of the cause of action by the descent of the statutory (charge) is to ensure that enforcement of the plaintiff's entitlements is not frustrated, as otherwise it would be...

[22] To similar effect, Ellis J recently described the purpose of the section in this way:<sup>5</sup>

As the title of the Law Reform Act makes clear, the object of s 9 is reformatory. The purpose, obvious on the face of the provision, is to provide a means of redress against the insurer of a person responsible for an event giving rise to a claim for damages or compensation (the insured) in circumstances where proceedings against the insured cannot be maintained.

[23] Section 9 has particular application where the insured is insolvent, because it removes the monies payable under the insurance policy from the pool of funds available to meet debts owing to the other creditors of the insured.<sup>6</sup> The section does not, however, provide a claimant with wider rights against the insured than it would otherwise have. Rather, it provides a procedural mechanism to ensure that a claimant can, in appropriate circumstances, gain direct access to insurance monies that would have been available to the insured. Richardson J made this clear in *FAI General Insurance v Blundell*, when he said:<sup>7</sup>

First, s 9 is a procedural provision. The claimant does not become entitled to recover a greater sum than that already recoverable. It merely makes available to the claimant a more effective procedure for enforcing existing rights.

[24] The charge that the section creates is also designed to prevent an insured from receiving and disbursing the proceeds of an insurance claim for purposes other than satisfying the claim in respect of which the insurer made the payment.<sup>8</sup> Further, it prevents an insured from entering into a corrupt bargain with the insurer that would frustrate a claimant's ability to gain access to the monies payable under a policy held by the insured.<sup>9</sup> Using the present case as an example, it would prevent the directors from entering into an arrangement with QBE under which QBE paid the

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<sup>5</sup> *The Grange* at [17].

<sup>6</sup> In *Ludgater* at [21] the Supreme Court said that s 9 "is plainly intended to operate primarily when the insured is insolvent, and it alters the priority of claims against the assets of such an insured."

<sup>7</sup> *FAI (NZ) General Insurance Co Ltd* at 17.

<sup>8</sup> *McMillan* at 547.

<sup>9</sup> *Ibid.*

directors a sum of money in return for a discharge from any further liability to indemnify them under the policy.

*The nature of the charge*

[25] Section 9 does not specify the nature and effect of the charge that it creates. There is also surprisingly little discussion of these issues in the reported authorities. Some conclusions can, however, be drawn from the wording used in the section.

[26] First, it is clear that the charge comes into existence well before liability is declared to exist by a court or other tribunal of competent jurisdiction. This follows from the fact that the charge arises “on the happening of the event giving rise to the claim for damages or compensation”. This does not mean the date upon which the claimant’s cause of action arose. Rather, it means the date of the event giving rise to the claim.<sup>10</sup> In the present case, any charge in favour of the Bridgecorp defendants arose at the time that the Bridgecorp group collapsed.<sup>11</sup>

[27] Second, the fact that the quantum of the claim has yet to be determined will not prevent a charge from coming into existence. This flows from the fact that s 9(1) provides that the charge operates “notwithstanding that the amount of such liability may not then have been determined”. As a result, it does not matter in the present case that the Bridgecorp defendants have not yet quantified their claim against the directors.

[28] Third, the charge applies both to insurance money that is payable and to that which may become payable.<sup>12</sup> This means that it can arise notwithstanding the fact that the insurer has not yet accepted the claim, and/or where the insured has not established that the claim is covered by the insurance policy. In the present case, QBE has not yet confirmed that the directors are subject to cover under the D & O policy, and it is unlikely to make that decision until after the criminal proceedings,

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<sup>10</sup> *Independent Wool Dumpers Pty Limited v American International Underwriters (NZ) Limited* HC Auckland CL 22/92 17 November 1992 at 13.

<sup>11</sup> The date upon which the charge came into existence may be important in determining the respective priorities of competing charges. In that event s 9(3) provides that priority is determined according to the order of the dates of the events out of which liability arose.

<sup>12</sup> Law Reform Act 1936, s 9(6).

including any appeals, have been finally determined. That fact does not, however, prevent the charge from taking effect. The charge will apply to the extent that monies may become payable under the D & O policy in the future.

[29] The effect of the charge in this context was explained by Gummow and McHugh JJ in *Bailey v New South Wales Medical Defence Union Limited* as follows:<sup>13</sup>

The phrase in s 6(1), “insurance moneys that ... may become payable”, is apt to deal with the situation where, whilst the charge has descended, there is as yet no sum which could be identified as presently payable by the insurer to the insured. In such a case, the statutory charge operates, by loose analogy to an agreement for a charge on after-acquired property, upon such moneys as and when they do become payable. ...

[30] Fourth, there are clearly limits to the scope and application of the charge. This follows from the fact that any payment made by an insurer without actual notice of the existence of the charge will, to the extent of the payment, constitute a valid discharge of the insurer’s obligations under the policy.<sup>14</sup> In addition, where the insurer establishes that it is entitled to disclaim liability under the policy or where there is a vitiating factor in its formation, no charge will exist.<sup>15</sup> In that sense the charge has been described as being conditional.<sup>16</sup>

[31] One of the predecessors to s 9, s 10 of the Motor-vehicles Insurance (Third-party Risks) Act 1928, was cast in terms similar to s 9 of the Act. It provided:

In the event of an owner dying insolvent or making a composition or arrangement with his creditors, or, if the owner is a body corporate, in the event of proceedings being commenced for winding-up that body corporate, after the happening of an accident giving rise to a claim for damages in respect of which the owner is indemnified by a contract of insurance under this Act or in the event of an owner being bankrupt at the time of such accident or thereafter become bankrupt, the amount of the owner’s liability, whether already determined or not, shall be a charge on all insurance-moneys which are or may become payable in accordance with this Act in respect of that liability, or which would be or become payable in respect thereof had no such insolvency, bankruptcy, composition, arrangement, or winding-up taken place.

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<sup>13</sup> *Bailey v New South Wales Medical Defence Union Ltd* (1995) 184 CLR 399 (HCA) at 449.

<sup>14</sup> S 9(6).

<sup>15</sup> *Bailey* at 449.

<sup>16</sup> *FAI* at 14.

[32] In *Findlater v Public Trustee*, Blair J described the nature and effect of s 10 as follows:<sup>17</sup>

As [the negligence of the insured] has not yet been established the amount of this charge is not fixed, but the charge though indefinite as to amount becomes fixed as soon as liability on [the part of the insured] is established. Until it becomes fixed and there is only a possible liability the charge is in the nature of a floating charge liable to become fixed with its priority preserved as from the date of the accident.

[33] I am not sure, with respect, that the term “floating charge” is particularly apt to describe the charge that s 9 creates. That term implies that the person whose assets are subject to the charge may continue to deal those assets until the charge becomes fixed. For reasons that follow, that is not necessarily so in the case of a charge created by s 9.

[34] Moreover, the charge can only be described as floating in the sense that it cannot attach to an identified portion of the insurance cover until quantum has been determined. Even then, however, the charge does not become fixed as it would, for example, in the case of a floating contractual charge that has crystallised through the occurrence of an event specified in the contract. Before monies will become payable under the policy, the insured must still establish, or the insurer must concede, entitlement to cover under the policy. Until that point the charge remains conditional, and cannot properly be said to have become fixed. Its priority as against other charges is, however, protected by s 9(3).

**Does the existence of a charge under s 9 prevent the directors from having access to the D & O policy to meet their defence costs?**

[35] Counsel referred me to numerous authorities in which the effect of s 9 is discussed.<sup>18</sup> I consider that only three of these are sufficiently on point to warrant discussion.

[36] The earliest is *National Insurance Company of New Zealand Limited v Wilson*.<sup>19</sup> In that case an employer took out an insurance policy providing indemnity

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<sup>17</sup> *Findlater v Public Trustee* [1931] GLR 291 (QLD SC) at 293.

<sup>18</sup> Principally those listed in above n 2.

in respect of claims by his employees. An extension to the policy increased cover from £1000 to £2000 “inclusive of costs”. An employee successfully sued the employer in negligence in relation to injuries that the employee had sustained whilst working for the employer. The insurer took over the defence of the claim on behalf of the employer, and incurred legal costs of £260 in doing so.

[37] The jury awarded the employee damages in the sum of £4000. When the insurer paid out under the policy, it deducted the costs that it had incurred in defending the claim. The employee subsequently assigned his rights under the policy to a third party, who sued the insurer to recover the sum it had deducted.

[38] Johnston J held that the insurer was not entitled to deduct its costs from the amount that it paid out under the policy. His reasoning was as follows:<sup>20</sup>

Where, however, the liability undertaken is limited to a certain amount inclusive of costs, the insurer is clearly liable not only for the compensation found due on account of the injuries received, but for the costs to which the [insured] has become liable to his employee, so long as the insurer’s limit of liability is not exceeded. Consequently, the costs insured against must be the costs the employee is entitled to recover from the insured, the indemnity being expressly to cover a liability due to employee by employer. Costs not coming within the ambit of this description cannot form part of the indemnity fund. If it were not so, the insurer could whittle down its liability to the insured by unnecessary and extravagant litigation, and, in the long run, the employee would lose the security for compensation he would otherwise enjoy by virtue of the policy.

[39] Counsel for the Bridgecorp defendants submits that the same result will follow in the present case if the directors are permitted to recover defence costs under the policy. He argues that the reimbursement of defence costs will significantly reduce the amount available under the D & O policy for civil claimants such as his clients. As a result, the charge under s 9 will be rendered largely ineffective.

[40] I agree in general terms with that submission. The facts in *National Insurance* were, however, very different to those in the present case. The issue in that case related to whether the insurer could deduct its own costs from the amount

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<sup>19</sup> *National Insurance Company of New Zealand Ltd v Wilson* [1941] NZLR 639 (SC).

<sup>20</sup> At 645.

that it was required to pay the insured after the insured had been found liable to his employee. The case turned on the particular wording used in the policy. These points of distinction mean that the case is of limited assistance.

[41] The next case to consider is 9 in this context was *Pattinson v General Accident Fire and Life Assurance Corporation Limited*.<sup>21</sup> In that case, an insurer had issued a comprehensive motor vehicle policy that provided indemnity for any compensation awarded against the insured in respect of personal injuries sustained by passengers travelling in his motor vehicle. The indemnity extended to “legal costs incurred with the written consent of the [insurer] in defending any action at law which may be brought against the insured in respect of any claim for which the [insurer] may be liable” under the policy. The policy also provided that the total liability of the insurer was not to exceed £2000.

[42] The insured was subsequently sued by the widow of a man who had died whilst travelling as a passenger in his motor vehicle. The vehicle was being driven by the insured’s son, who was a minor. Judgment was entered against the insured for a sum exceeding the maximum amount payable under the policy.

[43] The insurer accepted liability, but when it paid out under the policy it deducted the aggregate amount of three sets of legal costs that had been incurred with its consent. Costs had been paid to the solicitors who had acted for the insured, and to the solicitors who had been instructed to act on behalf of the insurer in relation to the claim. The third set of costs was paid to a barrister who had been appointed *guardian ad litem* of the insured’s son, and had represented him at trial. The claimant sued the insurer to recover the full amount payable under the policy.

[44] During the trial the insurer, “properly” in Myers CJ’s opinion, abandoned its defence so far as it related to the deductions relating to legal costs. Myers CJ went on to say:<sup>22</sup>

The costs incurred ...were indeed incurred with the written consent of the corporation, and, I think it may probably be said, under an express or at least an implied undertaking by the corporation to pay them. However that may

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<sup>21</sup> *Pattinson v General Accident Fire and Life Assurance Corporation Ltd* [1941] NZLR 1029.

<sup>22</sup> At 1038.

be, and although the total liability of the corporation under the policy may be limited to £2,000, I cannot think, reading s 9 of the Law Reform Act 1936 and the insurance policy together, that either the insured or the corporation is entitled to pay his, its, or their legal costs at the expense of the injured person or his representatives to whom a charge is given upon the insurance moneys by s 9 of the Act. In this case the corporation has chosen to pay the three sets of costs to its own solicitors and the solicitors for the [insured and his son]. It was not bound to undertake absolutely the payment of the costs of the solicitors for the [insured and his son], and, if it chose to do so, and the amount to which the plaintiff became entitled as against the insured is £2,000 or more, the corporation must bear the costs itself. *A fortiori* is this so, so far as the costs of the corporation's own solicitors are concerned. That result follows from what I understand to be the effect of Johnston, J's judgment in the *National Insurance Co* case, with which I agree. It is for these reasons that in my opinion the claim by the corporation to deduct the three items aggregating £290 7s. 10. was rightly abandoned, and the plaintiff is entitled to recover the sum.

[45] Counsel for the Bridgecorp defendants relied on the reasoning in *Pattinson* as providing support for his submission that the charge under s 9 prevents an insurer from paying out defence costs. Counsel for the directors conceded that it assisted the Bridgecorp defendants, but submitted that *Pattinson* was factually different because it concerned a situation in which the insurer consented to legal costs being incurred when it was not contractually obliged to meet those costs. In the present case, QBE cannot unreasonably withhold its consent to the directors incurring costs in defending the criminal proceedings.<sup>23</sup>

[46] Notwithstanding this factual distinction, *Pattinson* is authority for the proposition that the payment of defence costs should not reduce the pool of funds that would otherwise have been available to meet claims in respect of which a charge has arisen. As counsel for the Bridgecorp defendants pointed out, *Pattinson* was decided 70 years ago. It does not appear to have been the subject of criticism at any level, and was cited with apparent approval by both the High Court of Australia in *Bailey v New South Wales Medical Defence Union Limited*<sup>24</sup> and by our Supreme Court in *Ludgater*.<sup>25</sup>

[47] The third case is *Bailey*, which involved detailed consideration of the New South Wales equivalent to s 9. In that case, a patient sued his doctor for

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<sup>23</sup> See the meaning of "defence costs" in cl. 2.0 set out above at [17].

<sup>24</sup> *Bailey* at 443.

<sup>25</sup> *Ludgater* n 28 at 728.

compensation in respect of injuries he had sustained whilst being treated by the doctor. The insurer responded by purporting to retrospectively amend its articles of association so as to give it the power to unilaterally terminate any grant of indemnity in its sole discretion. It then refused to provide indemnity in respect of the claim. The High Court of Australia was required to decide whether the insurer was entitled to amend its articles of association given the fact that the statutory charge had already descended. It ultimately determined that the insurer was not entitled to unilaterally vary, discharge or otherwise qualify the terms of the insurance contract in those circumstances.

[48] Counsel for both the directors and the Bridgecorp defendants contended that the following passage from the joint judgment of McHugh and Gummow JJ was of particular relevance in the present context.<sup>26</sup>

However, once the charge has descended on the happening of the event giving rise to the claim for damages or compensation, **no mutual or unilateral action of insurer or insured which is taken otherwise than under or pursuant to the contract of insurance or the general law as it operates upon the contract may vary, discharge or otherwise qualify or abrogate the contract of insurance so as to deny to the claimant what otherwise would be the fruits of enforcement of the charge by action taken under s 6(4) against the insurer.** The contract of insurance is that as it stood when the charge descended. **Nor, after the charge has descended, is it open to the insurer to rely upon a payment made under the contract to the insured,** unless the payment was made without actual notice of the existence of the claimant's charge (s 6(6)). In these ways the position of the claimant is protected.

... the conclusion reached on the first branch of the case has the consequence that the steps in question were taken unilaterally by the [insurer] and not under or in pursuance of the contract of insurance between the [insurer] and [the insured]. Accordingly, they were ineffective to deprive the charge which had arisen in 1974 of its operation upon the insurance moneys that, under the contract of insurance as so construed, are payable to the [insured].

(Emphasis added)

[49] Counsel for the directors submitted that the words "otherwise than under or pursuant to the contract of insurance" in the first sentence are significant, because they suggest that actions taken in accordance with the terms of the policy as they stood at the time the charge descended will be given effect. This obviously favours the argument for which the directors contend.

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<sup>26</sup> *Bailey* at 449.

[50] The Bridgecorp defendants countered this argument by pointing out that the penultimate sentence in the same paragraph makes it clear that, once the charge descends, the insurer cannot rely upon any payment made to the insured under the contract unless the insurer has no notice of the existence of the charge. QBE now has notice of their charge, so it is no longer able to rely upon payments to the directors as discharging its obligations under the policy.

[51] It is important to remember that the issue that the High Court of Australia was required to consider in *Bailey* was whether the insurer could unilaterally vary a policy so as to avoid indemnifying the insured in respect of damages or compensation for which the insured might be found liable. The issue of defence costs never arose. McHugh and Gummow JJ may therefore have intended the sentence upon which the Bridgecorp defendants rely to refer only to payments made by the insurer in respect of the liability of the insured to third parties for damages or compensation. I accept, however, that the wording used in the sentence is sufficiently wide to capture all payments made to the insured after the charge descends.

[52] The authorities are therefore of limited assistance in determining the issue that arises in the present case. For that reason it is necessary to decide the issue having regard to the nature of the charge and the purpose of s 9.

[53] As already indicated, I consider that the charge in favour of the Bridgecorp defendants remains conditional upon the occurrence of two events before it will be fixed and enforceable by them against QBE. First, the Bridgecorp defendants will need to establish that the directors are liable to them for a quantified sum. Second, they or the directors will need to establish that the directors are entitled to cover in respect of their liability to the Bridgecorp defendants. This could occur in several different ways. First, QBE could accept the claim for cover. Second, the directors could establish their entitlement to cover, through proceedings filed in this Court if necessary. Third, the Bridgecorp defendants could seek to obtain judgment directly against QBE under s 9(4) of the Act.

[54] The fact that the charge is conditional does not, however, determine the critical issue of whether it prevents the directors from having access to the D & O policy to meet their defence costs.

[55] Several factors are relevant to this issue. First, s 9(1) charges “all insurance money” that is or may become payable in respect of liability to pay damages or compensation. The use of those words suggests that, where the level of cover is less than the amount of a notified claim, the entire amount for which cover may be available is subject to the charge. The section does not contain any mechanism that would enable funds to be released to meet the insurer’s other obligations under the policy.

[56] In the present case the claim by the Bridgecorp defendants is for a sum significantly greater than the amount of cover available under the D & O policy. As a result, QBE is now bound to keep the insurance fund intact for the benefit of the Bridgecorp defendants and any other civil claimants who might have priority over them by virtue of s 9(3). The position is likely to be different in circumstances where the amount of the claim is well within the amount of cover available under a policy. In those circumstances the charge could only extend to the likely amount of the claim and its associated costs. The insured may therefore be able to gain access to the policy to meet defence costs.

[57] It follows that any payment that QBE might now make under the policy must be for the purpose of satisfying any liability that the directors might have to civil claimants. As the passage from *Bailey* set out above demonstrates, any payment that QBE might make for another purpose will not deprive the charge of its operation on the insurance moneys.<sup>27</sup> QBE would therefore be liable to restore the amount of any such payment to the pool of money available under the policy to meet the Bridgecorp defendants’ claim. In effect, if QBE was now to make a payment towards defence costs, it would do so as a volunteer. It is therefore likely to find itself in the same position as the insurer in *Pattinson*.

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<sup>27</sup> At [48].

[58] Secondly, although this result may be harsh for the directors, it is clearly in accordance with the object and purpose of s 9. If the directors are able to obtain access to funds under the policy to meet their defence costs, the pool of funds available to meet civil claims will be significantly depleted. The interpretation for which the directors contend therefore has the effect of defeating the purpose of the statutory charge.

[59] Finally, the wording of s 9(3) makes it clear that the statutory charge has priority over all other charges affecting the insurance money. In *Ludgater*, the Supreme Court noted that the charge has priority over any general charge given by the insured, including charges given under a general security agreement and general floating charges granted by the insured prior to the introduction of the Personal Property Securities Act 1999.<sup>28</sup> If the charge takes priority over all other forms of security given by the insured, it is difficult to see how the insured could be in a better position than his or her secured creditors.

[60] Taken together, these factors persuade me that the charge prevents the directors from having access to the D & O policy to meet their defence costs.

[61] In reaching that view, 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.

[62] The outcome is partly a consequence, however, of the fact that the Bridgecorp companies elected to take out an insurance policy that provided cover for both defence costs and claims for damages and compensation. This left the directors in a vulnerable position once they began to face large civil claims. As counsel for the Bridgecorp defendants points out, the directors could have taken out an SL policy providing greater cover for defence costs than the policy that they ultimately elected

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<sup>28</sup> *Ludgater* at [17].

to take out. The Bridgecorp defendants have always accepted that monies payable under the SL policy are not susceptible to a charge under s 9.

[63] The outcome in the present case is also a direct consequence of the statutory regime that the Act introduced nearly 80 years ago. When it passed the Act, Parliament may not have envisaged all of the consequences that it would ultimately produce. If it had foreseen the outcome of the present case, however, it is almost certain that Parliament would have viewed it as being consistent with the type of outcome that it intended s 9 to produce.

### **Result**

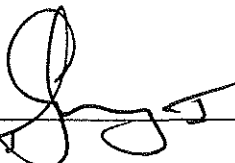
[64] I make a declaration that the charge under s 9 of the Act in respect of the claim to be brought by the Bridgecorp defendants prevents the directors from having access to the D & O policy to meet their defence costs.

[65] My conclusion on this point means that it is not necessary to consider the Bridgecorp defendants' counterclaim.

### **Costs**

[66] Counsel have asked that I reserve the issue of costs. My tentative view is that the Bridgecorp defendants should have costs against the directors on a category 2B basis, together with disbursements as fixed by the Registrar. Given that QBE's presence was only rendered necessary by the counterclaim, I tend to the view that the directors should not be required to meet QBE's costs, and that it should be left to meet its own costs.

[67] If counsel cannot reach agreement regarding any issue as to costs, counsel for the Bridgecorp defendants is to file and serve a memorandum of not more than seven pages in length within 21 days of the date of delivery of this judgment. Counsel for the directors is then to file and serve a memorandum in response within 14 days thereafter, and any reply memorandum is to be filed and served seven days after that. I will then deal with the issue of costs on the papers.

  
Lang

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