IN THE SUPREME COURT OF NEW ZEALAND

SC 19/2013
[2013] NZSC 156

BETWEEN	BFSL 2007 LIMITED & ORS (IN LIQUIDATION) First Appellants
	BRIDGECORP LIMITED & BRIDGECORP MANAGEMENT SERVICES LTD (BOTH IN RECEIVERSHIP AND LIQUIDATION) Second Appellants
AND	PETER DAVID STEIGRAD Respondent

SC 21/2013

BETWEEN	ERIC MESERVE HOUGHTON Appellant
AND	AIG INSURANCE NEW ZEALAND LIMITED (FORMERLY CHARTIS INSURANCE NEW ZEALAND LIMITED) First Respondent
	T E C SAUNDERS, S J MAGILL, J M FEENEY, P THOMAS, C E HORROCKS & P D HUNTER Second Respondents

Hearing: 17 October 2013

Court: Elias CJ, McGrath, Glazebrook, Gault and Anderson JJ

Counsel: M J Tingey and D J Friar for First and Second Appellants in SC 19/2013
B P Keene QC and J F Anderson for the Respondent in SC 19/2013
A J Forbes QC and P A B Mills for Appellant in SC 21/2013
M G Ring QC and B J Burt for First Respondent in SC 21/2013
A R Galbraith QC and A E Ferguson for Second Respondents in SC 21/2013
C T Patterson for Intervener G K Urwin in SC 19/2013

Judgment: 23 December 2013

JUDGMENT OF THE COURT

A **The appeals are allowed. The Court of Appeal's declaration in SC 21/2013 is set aside.**

B **The respondent is to pay costs of $25,000 to the appellants in SC 19/2013 plus usual disbursements (to be set by the Registrar, if necessary). We certify for two counsel.**

C **The respondents are to pay, jointly and severally, costs of $25,000 to the appellants in SC 21/2013 (to be set by the Registrar, if necessary). We certify for two counsel.**

REASONS

ELIAS CJ AND GLAZEBROOK J

(Given by Glazebrook J)

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Background

[1] Section 9(1) of the Law Reform Act 1936 imposes a statutory charge on insurance money payable to an insured to indemnify the insured for damages or compensation payable to third party claimants. The issue in these appeals is the nature and effect of such a charge and in particular:

(a) whether the charge secures whatever is eventually held to be the full amount of the insured's liability to the third party claimant (subject to any insurance policy limit), with no payments under the policy able to be made that would deplete the insurance money available to meet the third party claim if it is established; or

(b) whether the charge secures the insurance money that remains at the time of judgment on, or settlement of, the third party claim against the insured, allowing in the meantime the payment of other sums that fall due for payment under the policy, even if that depletes the sum available to meet the third party claim.

[2] The insurance policies at issue in these appeals concern directors' liability insurance taken out on behalf of the directors of the Bridgecorp group of companies (Bridgecorp)[1] and those of Feltex Carpets Ltd (Feltex).[2] The insurance policies in

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1 SC 19/2013.
2 SC 21/2013.

both cases covered not only claims for losses resulting from breaches of duty as directors but also the costs of defending any actions brought against the directors. The limits of indemnity provided under the policies constituted combined policy limits, which applied to the aggregate of liability to third parties and defence costs.

[3] Mr Steigrad was a director of the Bridgecorp group of companies. The receivers of Bridgecorp have brought a claim against the directors, including Mr Steigrad, seeking to recover funds for the members of the public who invested in Bridgecorp. These claims exceed by a wide margin the policy limit in the relevant insurance policy with QBE Insurance (International) Ltd (QBE) held by Bridgecorp.

[4] Mr Houghton bought shares in Feltex when it was floated in 2004. He has brought an action against a number of parties involved with the share issue, including the directors of Feltex.[3] He is suing on his own behalf and in a representative capacity for other shareholders.[4] Again, the aggregate amount of the claims exceeds the policy limit under the policy with AIG Insurance New Zealand Ltd (AIG).

[5] The appellants in both appeals contend for the interpretation set out at [1](a), meaning that defence costs are not able to be paid under the policy if to do so would deplete the funds available to meet the directors' liability as eventually established in the relevant proceedings. That interpretation was held to be correct by the High Court in the Bridgecorp proceedings.[5]

[6] The respondents argue for the interpretation set out at [1](b). They maintain that s 9 was not designed to interfere with the contract between the directors and their insurers and therefore that, until liability is established under the third party claim, payments for defence costs may be made as they fall due under the policies.

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3 The second respondents in SC 21/2013 are some of those directors.
4 Under High Court Rule 4.24.
5 *Steigrad v BFSL 2007 Ltd* (2011) 16 ANZ Insurance Cases 61-910 (HC) (Lang J) [*Steigrad* (HC)] at [58] and [60].

The respondents' interpretation was upheld on appeal in both the Bridgecorp and Houghton cases by the Court of Appeal.[6]

[7] Leave to appeal to this Court was granted on 15 April 2013 on the question of whether the Court of Appeal interpreted s 9 of the Law Reform Act correctly.[7]

[8] For the reasons given in what follows, we allow the appeals. In short, we consider that the scheme, the text, the caselaw and the legislative history of s 9 make it clear that the statutory charge attaches at the time of the occurrence of the event giving rise to the claim for compensation or damages in respect of the liability to third parties which is covered by the policy. Reimbursement to the directors of their defence costs is not within the statutory charge.

[9] It is immaterial under the statute that the contractual obligation to pay the directors' defence costs arises when the costs are incurred and that liability on the claim for damages is not yet determined or payable. The effect of the charge is that payments on the contractual obligation to meet the directors' defence costs can be met only at the peril of the insurer when there is insufficient insurance cover under the limit of the policy to meet both insurance obligations.

Further background

The Bridgecorp appeal

[10] Mr Steigrad, along with several co-directors,[8] is being sued for damages in excess of $340 million on the basis that they breached duties owed to the Bridgecorp companies in their capacity as directors causing the companies loss. They have been convicted of offences under the Securities Act 1978 for breach of statutory duties.

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6 *Steigrad v BFSL 2007 Ltd* [2013] 2 NZLR 100 (O'Regan P, Arnold and Harrison JJ) [*Steigrad* (CA)] at [36], [43] and [45]. The Court of Appeal judgment addressed both the Bridgecorp and Houghton appeals. The judgment was originally given as [2012] NZCA 604 which was then reported in [2013] 2 NZLR 100 but the judgment was later reissued as [2013] NZCA 253 to correct an error in the costs order. See the procedural history of the Bridgecorp appeal below at [10]–[16] and that of the Houghton appeal below at [17]–[20].

7 *BFSL 2007 Ltd v Steigrad* [2013] NZSC 32.

8 The plaintiffs in the High Court, Messrs Steigrad, Davidson and Urwin (the intervenor in the Supreme Court), are three of six former directors of companies within the Bridgecorp group. The other former directors are Messrs Roest, Petricevic and O'Sullivan. See *Steigrad* (HC), above n 5, at [2].

[11] There were two relevant insurance policies taken out by Bridgecorp with QBE. One was a statutory liability policy, which provided cover for the costs of defending claims based on breaches of statutory duty. The limit of the policy was $2 million and it was exhausted in the defence of the Securities Act proceedings. It is common ground that monies payable under the statutory liability policy are not susceptible to a charge under s 9.[9]

[12] The second policy is that which is in issue in these proceedings. It is a Directors and Officers Liability and Company Reimbursement Insurance Policy (the QBE policy) with a limit of indemnity of $20 million.[10] Under the policy, the directors are entitled to be indemnified against any liability arising out of their acts or omissions as directors.[11] The policy also provides for payment of defence costs paid either by the insurer in defending a claim covered by the policy or by the directors.[12] QBE must give its written consent to the incurrence of such costs, which shall not be unreasonably withheld.[13] Neither QBE nor the insured is required to contest a claim unless mutually agreed legal counsel advises that it should be contested.[14]

[13] The QBE policy provides that QBE will advance defence costs as and when those costs are incurred if QBE has given its prior written consent.[15] The amount recoverable for defence costs is presumptively capped, unless QBE consents in

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9 *Steigrad* (HC), above n 5, at [62].

10 The schedule to the Directors and Officers Liability and Company Reimbursement Insurance Policy (QBE policy) stated that the limit of indemnity was $20 million for "any one claim and in the aggregate".

11 Clause 1 of the QBE policy covered liability for claims for "wrongful" acts brought against any insured person individually or otherwise. Clause 2.0 defined "insured person" as including the directors of Bridgecorp and Bridgecorp as the insured company. Clause 2.0 further defined "wrongful act" as meaning any actual or alleged breach of duty; breach of trust; neglect; act, error or omission; misstatement or misleading statement; breach of warranty or breach of authority committed in the course of an insured person's duties to the insured company.

12 Clause 4.17.

13 Clause 4.17(b).

14 Clause 4.6.

15 Clause 4.17.

writing to advance a greater amount.[16] Claims arising from third party claims are payable under the policy at the time legal liability is established against an insured.[17]

[14] Bridgecorp gave QBE notice of its claims against the directors on 12 June 2009, specifically providing QBE with notice of the statutory charge under s 9. QBE then advised the directors, on 17 June 2009, that it would make no further payments towards defence costs pending agreement with Bridgecorp on the allocation of the proceeds of the policy. The directors had initially relied on the statutory liability policy to cover the costs of the criminal proceedings, but, after they had exhausted their entitlement under that policy, the directors sought indemnity under the QBE policy to meet ongoing defence costs in both the criminal and civil proceedings.[18]

[15] Mr Steigrad and two other directors[19] then applied to the High Court for a declaration that they were entitled to reimbursement of their defence costs. In the High Court, Lang J held that the s 9 charge prevented the disbursement of insurance moneys in payment of defence costs following notification of the existence of the charge.[20]

[16] The Court of Appeal reversed that decision on the basis that the statutory charge had "not crystallised" and would not do so until Mr Steigrad's liability was established.[21] Until then it remained "contingent".[22] The only liability that had "crystallised" was the obligation to pay the defence costs.[23] Section 9 was held not to apply "because Bridgecorp is not entitled to a statutory charge over insurance

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16 Clause 4.17(a). Without prior written consent, the amount that QBE would pay for defence costs was presumptively capped at 20 per cent of the limit of indemnity or $500,000, whichever was less, unless QBE agreed to pay a higher amount.

17 Under cl 1.0, QBE agreed to indemnify an insured person for "[l]oss" on account of any claim for a wrongful act brought against an insured person. "Loss" was defined in cl 2.0 as including "all sums that the Insured Person becomes legally liable to pay" as a result of successful claims made by third parties against the insured person.

18 *Steigrad* (HC), above n 5, at [9].

19 As noted at above n 8, Messrs Steigrad, Davidson and Urwin were the plaintiffs in the High Court proceedings. However, counsel for Mr Urwin was permitted to withdraw from the trial as he had not received instructions from Mr Urwin for some time. As a result, only Messrs Steigrad and Davidson proceeded to trial. See *Steigrad* (HC), above n 5, at [3].

20 *Steigrad* (HC), above n 5, at [54]–[60].

21 *Steigrad* (CA), above n 6, at [45].

22 At [45].

23 At [45].

money lawfully payable by QBE to Mr Steigrad".[24] The Court of Appeal quashed the declaration made by the High Court 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 [Directors and Officers] policy to meet their defence costs."[25]

The Houghton appeal

[17] Feltex was floated in 2004. Receivers were appointed on 22 September 2006 and the company was liquidated on 13 December 2006. In February 2008 Mr Houghton initiated proceedings against a number of parties, including those who were directors in May 2004. He sues in a representative capacity on behalf of himself and other shareholders who purchased shares in the initial public offering. He and the shareholders he represents are claiming some $180 million in damages.

[18] In July 2004 Chartis Insurance New Zealand Ltd (now AIG) issued a Prospectus Liability Insurance Policy (the AIG policy). We understand that the policy limit under the AIG policy is $50 million. On 25 October 2011, Mr Houghton gave notice to AIG of the statutory charge in relation to his representative claim for damages.

[19] The AIG policy sets out the order of priority for payments of claims under the policy. Generally speaking it provides that the insurer will pay out claims in the order in which they are presented to the insurer.[26] The insurer, unless it has denied indemnity and subject to the limit of the policy, will advance to the insured, defence costs incurred in respect of any securities claim before final resolution of that claim.[27] Prior written consent must be obtained for the incurrence of defence costs but that consent must not be unreasonably withheld.[28] If a dispute arises about whether an insured should be required to contest any legal proceedings, then the insured can request that the opinion of a lawyer (to be mutually agreed upon by both the insured and the insurer) be sought to advise whether such proceedings should be

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24 At [26].
25 At [54], referring to *Steigrad* (HC), above n 5, at [64].
26 Clause 5.10 of the Prospectus Liability Insurance Policy (the AIG policy).
27 Clause 5.7.
28 Clause 5.6.

contested or should be settled.[29] Claims, with regard to liability to third parties, are able to be made upon judgment or settlement of any claim.[30]

[20] AIG and some of the directors of Feltex applied for a declaration in the High Court that s 9 did not prevent AIG from paying the directors' reasonable defence costs under the policy. The application was removed into the Court of Appeal to be heard with Mr Steigrad's appeal in the Bridgecorp case.[31] The Court of Appeal made the following declaration in favour of the directors and AIG:[32]

> Mr Houghton is not presently entitled pursuant to s 9 of the Law Reform Act 1936 to charge money payable to Chartis to Mr Saunders and his co-insured pursuant to a policy of prospectus liability insurance policy in reimbursement of their defence costs incurred in defending a claim or claims brought against them by Mr Houghton and others.

Structure of the judgment

[21] Under the terms of the insurance policies at issue in this case, claims for defence costs become payable to the insured as they are incurred (in the case of the Bridgecorp QBE policy) or in the order that claims are presented to the insurer (in the case of the Houghton AIG policy). Defence costs will be incurred before any claim for the associated third party liability is made. This is because, under both policies, claims with regard to third party liabilities are only able to be made when liability on the particular claim is established by judgment or settlement.

[22] As noted above, the issue in these appeals is whether the statutory charge in s 9 allows payments to be made under the insurance policy for defence costs before liability with regard to the charged claims is decided by way of settlement or judgment, where to do so would deplete the sum available to meet the claim with regard to the eventual liability to the third party.

[23] We propose to examine this question by first analysing the wording of the legislation. We then consider the nature of the statutory charge by analogy with the

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29 Clause 5.11.

30 Clause 2.10 defines loss as, among other things, "legal costs and expenses awarded against the **Insured** but only in connection with a covered judgment or settlement" (emphasis in original).

31 *American Home Assurance Co trading as Chartis v Houghton* HC Auckland CIV-2011-404-7152, 2 December 2011.

32 *Steigrad* (CA), above n 6, at [57].

nature of charges that existed at the time the legislation was passed, before moving to consider the caselaw and the legislative history. Finally, we discuss the policy issues that have been raised.

The legislation

[24] Section 9 of the Law Reform Act provides as follows:

> **9. Amount of liability to be charge on insurance moneys payable against that liability–**
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> (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.
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> (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.

[25] In summary, by s 9(1), a statutory charge is imposed in respect of any liability of an insured to pay damages or compensation over "all insurance money that is or may become payable in respect of that liability." The charge arises "on the happening of the event giving rise to the claim for damages or compensation" and applies "notwithstanding that the amount of such liability may not then have been determined" It is common ground that no charge arises with regard to defence costs as they are not a "liability to pay any damages or compensation."

[26] Under s 9(3) charges created under s 9(1) have "priority over all other charges affecting the said insurance money." Where however "the same insurance money" is "subject to 2 or more charges by virtue of this Part", the statutory charges "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."

[27] Charges under s 9(1) are enforceable by 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", as provided by s 9(4). Such actions may be brought even if judgment has already been recovered in respect of the same matter, under s 9(5).

[28] Under s 9(6), before an insurer has notice of the existence of a charge, "[a]ny payment made by an insurer under the contract of insurance shall to the extent of that payment be a valid discharge to the insurer."

[29] The insurer, by s 9(7), is not liable under the Act "for any sum beyond the limits fixed by the contract of insurance between himself and the insured." That places a cap on the liability of the insurer.

[30] We now discuss the most significant subsections of s 9 in more detail.

Wording of s 9(1)

[31] Section 9(1) refers to a contract of insurance whereby an insured is "indemnified against liability to pay any damages or compensation" to a third party. The "amount of his [or her] liability" (a reference back to the liability to the third party) shall "be a charge on all insurance money that is or may become payable in respect of that liability." That charge arises "on the happening of the event giving rise to the claim for damages or compensation."

[32] The words "that liability" in the phrase "be a charge on all insurance money that is or may become payable in respect of that liability" at the end of s 9(1) refer to the liability to the third party and not to the insurer's liability to the insured. That is clear not only from the use of the word "liability" but also from the fact that the words "that liability" refer back to the words "such liability" in the phrase used just above, which provides that the charge arises notwithstanding the fact that "such liability" may not yet have been determined. This is in turn clearly a reference back to liability under the third party claim.

[33] If the claim is ultimately successful, the liability of the insured to the third party dates back to the time of the event giving rise to the claim. The insured's liability to the third party does not arise at the time the amount is ascertained or agreed. This suggests that the charge arises immediately and covers the full amount of the eventual liability.

[34] Under s 9(1) the charge attaches not only to insurance money that is payable but also to insurance money that "may become payable in respect of that liability." It also arises "notwithstanding that the amount of such liability may not then have been determined." Section 9(1) therefore recognises that, on the happening of the event

giving rise to the claim for damages or compensation, the amount of the liability to the third party may not yet be ascertained.

[35] All the above provides strong textual support for the proposition that the charge arises at the time the event giving rise to the liability occurs and that it secures whatever the full amount of the liability (if any) to the third party ultimately turns out to be.

[36] Of course the charge only attaches to the "insurance money that is or may become payable in respect of that liability". This means that, if the claim is for more than the insurance limit, then the charge will be limited to the amount of insurance money that is available. This follows from the wording of s 9(1) itself (as the insurance money available cannot be more than the limit in the policy) but is in any event made clear by s 9(7).

[37] The position of the respondents is that, in addition, the fact that the charge arises over "all insurance money that is or may become payable in respect of that liability" means that the available insurance money is ascertained at the time of judgment or settlement and therefore that payments can be made under the insurance policy up to the time the liability to the third party is ascertained. In their submission, the charge only attaches to the available insurance proceeds at the time of judgment on, or settlement of, the claim.

[38] We do not consider this to be the correct interpretation of s 9(1), even if that subsection is interpreted in isolation from the rest of the section. We refer, in particular, to the way the subsection scans, as set out above at [25] above and to the concentration in s 9 on the liability to the third party (and not on when a claim on the policy can be made). When s 9(1) is interpreted in the context of s 9 as a whole, this further reinforces our view as to the proper interpretation of s 9(1).

Section 9(3) – priorities

[39] Section 9(3) sets out the priority of the statutory charges created under the Act. It provides that every charge "created by this section" (and a statutory charge is

"created" under s 9(1), on the happening of the event giving rise to the claim) has priority over all other charges affecting the same insurance money.

[40] This is not limited to charges under s 9 of the Act. It therefore gives all statutory s 9 charges priority over all other charges (including charges created outside the Act over the insurance proceeds). There is nothing in the wording of the subsection to suggest that this priority is limited to insolvency situations.

[41] Section 9(3) also concerns priority between statutory charges. It provides that they have priority according to the order of the dates of the events out of which the liability arose and that they rank equally between themselves if they happened on the same date.

[42] On its wording, this would appear to displace any contractual provisions as to priority of claims. It also changes the normal priority rules at common law with regard to rival claims. The common law approach has been labelled a "dash for cash."[33]

[43] It is submitted by the respondents, however, that s 9 was not designed to override the contractual obligations between the insurer and the insured as to the payment of defence costs. They refer in support of their position to the decision of the New South Wales Court of Appeal in *Chubb Insurance Co of Australia Ltd v Moore* on a provision that is in all relevant respects identical to s 9.[34] The New

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[33] In *Cox v Bankside Members Agency Ltd* [1995] 2 Lloyd's Rep 437 (CA) at 465, Saville LJ referred to the "dash for cash" rule of priority "where some litigants have sought to be the first to get to judgment, in the hope that they can thereby scoop the particular pool available to them and not be defeated by the claims of other litigants to the same fund." This rule of chronological priority has also been known as "first past the post" or "first come, first served": at 456 per Bingham MR. The United Kingdom Supreme Court recently affirmed *Cox v Bankside Members Agency Ltd* in *Teal Assurance Co Ltd v R Berkley Insurance (Europe) Ltd* [2013] UKSC 57, [2013] 4 All ER 643 at [17], by saying that "[t]he ascertainment, by agreement, judgment or award, of the insured's liability gives rise to the claim under the insurance, which exhausts the insurance either entirely or [to the extent of the claim]". The Court said that the claim had to fall within the scope of the policy and the insured may need to fulfil certain procedural requirements regarding notification to the insurer as a condition of recovery: at [17].

[34] *Chubb Insurance Co of Australia Ltd v Moore* [2013] NSWCA 212, (2013) 302 ALR 101. The judgment for the New South Wales Court of Appeal was given by Emmett JA and Ball J, with whom Bathurst CJ, Beazley P and Macfarlan JA agreed. *Chubb* was delivered on 11 July 2013, after both *Steigrad* (HC), above n 5, which was delivered on 15 September 2011; and *Steigrad* (CA), above n 6, which was delivered on 20 December 2012. Both the High Court and Court of Appeal decisions in *Steigrad* were cited in *Chubb*.

South Wales provision is s 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW). In *Chubb*, under the policy at issue, an insured was entitled to be indemnified against any loss.[35] There was (as in the policies at issue in these appeals) a combined policy limit for both defence costs and claims with regard to liability to third parties.[36]

[44] The New South Wales Court of Appeal held that there was nothing to suggest that the purpose of the New South Wales equivalent of s 9 was to prevent insurance money being paid to discharge other obligations that an insurer may have to an insured under a contract of insurance.[37] The New South Wales equivalent of s 9 could not provide a defence to the contractual right to be paid defence costs. There was nothing to suggest that it was intended to alter the contractual rights of the parties in such a radical fashion.[38] It was held that a charge under the New South Wales equivalent of s 9 does not extend to defence costs payable before judgment on the third party claim. Nor does it apply to competing third party claims that become payable before judgment or settlement is achieved on a claim.[39]

[45] With regard to competing claims, the Court commented that, where the indemnity concerns an obligation to satisfy a judgment, award or settlement, the right to the indemnity arises at the time when the liability is established and the insured is entitled to sue on the indemnity and to recover the amount, subject to policy limits.[40] The fact that other claims have been or may be brought does not alter the insured's right to indemnity in respect of the liability that has been determined.[41]

[46] The Court then commented that, if the New South Wales equivalent of s 9 caught all money available at the time when the charge arises, an insurer could not safely pay the first ascertained claim if the second claim might exceed the amount of the limit that would then remain, unless it could be satisfied that the first ascertained

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35 At [126].
36 At [42]–[43].
37 At [121].
38 At [124].
39 At [135].
40 At [126].
41 At [126].

claim has priority under the equivalent of s 9(3).[42] This, the Court said, would mean that the effect of the New South Wales equivalent of s 9 would be "by a side wind, to alter the rights of the contracting parties."[43]

[47] The Court did recognise that, if priority is given only in respect of moneys that have become payable as a result of judgment, award or settlement, the circumstances in which there may be competing claims to those moneys will be limited.[44] On that Court's interpretation, competing claims would generally only arise where judgment is obtained in favour of a number of claimants whose claims arise out of the same or similar facts.[45] The Court considered that the New South Wales equivalent of s 9(3) was not rendered otiose by the interpretation it favoured. The fact that, on that interpretation, the circumstances in which the priority rules may operate are limited was not a reason for rejecting the interpretation.[46]

[48] It seems to us inherently unlikely that the purpose of s 9(3) in New Zealand was as narrow. The respondents did not, however, seek to argue that *Chubb* was correct on the issue of rival claims. Their submission is that, while s 9(3) changes the priority and overrides the contract with regard to rival claims, this does not apply to defence costs as they are not covered by s 9(3) because this provision is concerned solely with ordering priority between rival claims.[47]

[49] But, as the argument of the respondents is that s 9 was not designed to interfere with insurance policies and that payments can be made as they fall due under the relevant insurance policy, then it is difficult to see why, if that argument is correct, this does not apply to payments of rival claims under the policy, where the policy provides that they fall due for payment.

[50] The respondents' argument would lead to the result that uncharged claims for defence costs would rank above any statutory charges and presumably also above all

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42 At [127].
43 At [127].
44 At [130].
45 At [130].
46 At [130].
47 This submission is accepted by McGrath J in his judgment at [179].

charges over the insurance money given outside the Act.[48] The respondents submit that this is because defence costs are first party cover which is to be distinguished from third party cover, to which s 9 applies.[49] We accept that there is a difference between first and third party cover. This does not change the fact that defence costs are uncharged.

[51] Defence costs are not only uncharged, however; they are also incurred after the charge under s 9(1) arises or "has descended."[50] As pointed out by Mr Tingey for Bridgecorp, there is no existing liability to pay defence costs at the date the charge under s 9(1) is created. Defence costs at that point are merely liabilities that may arise in the future, should it be decided to defend the claim.

[52] Further, it would not be usual for a charge holder to have to pay not only its own costs in enforcing the charge but also the debtor's costs in its unsuccessful defence of enforcement proceedings. The respondents' argument, however, would effectively require the statutory charge holder to do this. On their argument, the available insurance funds would be able to be depleted by the payment of defence costs in defending the third party claim (and, in fact, could also be depleted by the payment of defence costs in another unrelated claim if they were incurred before the third party claim was finalised).[51]

[53] Taking all the above into account, we consider that the effect of s 9(3) is to put the risk on the insurer, up to the limit fixed by the contract of insurance, if it does not observe the statutory charge and pays out under the provisions of the insurance policy unequally where there are claims arising out of the same events giving rise to the claim for damages or compensation, pays out rival claimants arising from events

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48 As indicated above at [40], s 9(3) gives priority for the statutory charges over charges created outside of the Act.

49 See DK Derrington and RS Ashton *The Law of Liability Insurance* (3rd ed, Lexis Nexis Butterworths, Chatswood (NSW), 2013) vol 2 at [13-142].

50 To use the terminology in *Bailey v New South Wales Medical Defence Union Ltd* (1995) 184 CLR 399. In that case, McHugh and Gummow JJ discussed the New South Wales equivalent of s 9 in detail. Brennan CJ, Deane and Dawson JJ expressed their agreement (at 415) with McHugh and Gummow JJ's view of the effect of the provision.

51 As noted above at [14], when the Bridgecorp directors had exhausted their entitlement to the payment of defence costs under the statutory liability policy, they sought indemnity under the QBE policy to meet ongoing defence costs in both the criminal and civil proceedings.

later than those of another statutory charge holder or pays out claims under the policy (such as defence costs) which are not protected by the statutory charge.

[54] A statutory charge (and the risk to the insurer) may be displaced to allow payments to be made without apportionment or abatement in respect of claims for damages or compensation for events arising earlier in time than events giving rise to other claims for damages or compensation where both are covered by statutory charges under s 9(1).

Section 9(4) – direct right of action for third parties

[55] Section 9 creates not only a statutory charge in relation to third party claims, but it also, in s 9(4), gives a direct right of action for third parties against the insurer to enforce the charge "as if the action were an action to recover damages or compensation from the insured" except in cases of death, insolvency, bankruptcy or winding up,[52] with the leave of the court. Leave is likely to be granted provided that there is an arguable case and a real possibility that the insured will not be able to meet any judgment which is obtained.[53]

[56] In any action to enforce the charge and in respect of the judgment on any such action, the parties are deemed, to the extent of the charge (and note, not to the extent of the available insurance money) to have the same "rights and liabilities" and the court to have the same powers "as if the action were against the insured."

[57] The action to enforce the charge therefore is equated to an action against the insured. As any liability of the insured, if upheld, dates back to the time of the event giving rise to the claim, this is another important textual indication that the charge is considered to arise (or descend), and that the available insurance money is to be ascertained, at the time liability under the claim would arise for the insured (on the happening of the event giving rise to the claim) and not when the amount is finally ascertained.

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52 In terms of the proviso to s 9(4) where the provisions of s 9(2) apply.

53 Derrington and Ashton, above n 49, vol 2 at [13-149]. See also *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd* [1994] 1 NZLR 11 (CA) at 15–16, citing *Campbell v Mutual Life and Citizens Fire and General Insurance Co (New Zealand) Ltd* [1971] NZLR 240 (SC). See also the Law Commission's summary of *FAI* and *Campbell* in Law Commission *Some Insurance Law Problems* (NZLC R46, 1998) at [106].

[58] Further, any judgment under s 9(4) against the insurer to enforce the charge will, on the terms of s 9(4), be a judgment for the amount of the damages or compensation that would be awarded against the insured. This follows from the fact that the action is equated to "an action to recover damages or compensation from the insured," that the insurer is deemed to have the same "liabilities" as the insured (albeit to the extent of the charge) and the court the "same powers" as if the action were against the insured.

[59] The judgment cannot of course be for more than is covered by the charge. That is clear from the fact that it is the charge that is enforceable by way of direct action and the judgment is only given "to the extent of the charge." This means that the liability of the insurer is reduced by any payments made before notice of the charge under s 9(6) and is subject to the insurance policy limits under s 9(7).

[60] There is no provision that it is reduced by any other payments made after notice of the charge is given, whether under the contract of insurance or otherwise. This is unsurprising. It would add an undue level of complexity to a proceeding if, before issuing judgment, a judge had to inquire what remains of the insurance money at that time (and presumably verify whether any payments that had been made were in fact properly made under the policy).

[61] As a general point, it is unlikely that Parliament would have envisaged a reversal of the ordinary cost rules in litigation.[54] Under the normal rules, the party who succeeds receives a proportion of its costs and the losing party bears its own costs. If the respondents' submission is correct, payment of the insurance company's defence costs (if covered by the policy) would be allowed to deplete the insurance money available to a successful third party, thus in substance requiring the claimant to fund the insurance company's unsuccessful defence.

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[54] It is well-established that a fundamental principle applying to the determination of costs is that costs follow the event: this rule applied in 1936. The party who fails with respect to an appeal should pay costs to the party who succeeds: *Manukau Golf Club Inc v Shoye Venture Ltd* [2012] NZSC 109, [2013] 1 NZLR 305 at [7]–[8], citing *Glaister v Amalgamated Dairies Ltd* [2004] 2 NZLR 606 (CA) at [9]; and *Cates v Glass* [1920] NZLR 37 (CA).

Section 9(6) – payments made under the contract of insurance

[62] If payments are able to be made with impunity under the contract of insurance, despite the existence of a statutory charge, then it seems to us that there would be no need at all for s 9(6).

[63] The respondents submit, however, that we should adopt the interpretation of the New South Wales Court of Appeal in *Chubb*. The s 9(6) protection was seen by that Court as limited to two situations. The first is where amendments to the contract have been made after the event. The second relates to payments to the insured with regard to the third party liability. The Court said that:[55]

> … it would not be open to the insurer, after that time, to rely upon a payment made to the insured under the contract of insurance in respect of a liability to a claimant, unless the payment was made without actual notice of the existence of the charge in favour of the claimant.

[64] The Court considered that payments under the policy that did not relate to the liability of the insured to the third party (such as defence costs and rival claims) could be paid as they fell due under the contract. The New South Wales Court of Appeal said:[56]

> It is unquestionably the purpose of s 6 to ensure that insurance moneys that are payable to an insured *in respect of liability to a claimant* are not depleted to the prejudice of the claimant. Nevertheless, there is nothing to suggest that the purpose of s 6 is to prevent insurance moneys being paid to discharge *other* obligations that an insurer may have to an insured under a contract of insurance."

The "other" obligations that an insurer may have to an insured under an insurance policy include "defence costs."[57]

[65] McGrath J, in his judgment, also suggests that the purpose of s 9(6) was to restrict the freedom the insurer would otherwise have to pay to the insured money in respect of the liability to the third party as a result of a compromise between the

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55 *Chubb*, above n 34, at [131].

56 At [121] (emphasis in original).

57 At [122]. Presumably this reasoning applies to rival claims as well: see [127]–[129] and [135]; and our discussion above at [46].

insured and insurer, thus leaving the third party claimant with no recourse against the insurance company as the claim will already have been satisfied.[58]

[66] This interpretation requires reading words into s 9(6). The legislation refers to "[a]ny payment made by an insurer under the contract of insurance." It does not refer to "any payment made by an insurer under the contract of insurance *which relates to the liability to the statutory charge holder.*" If such a qualification to the broad working of s 9(6) had been intended, then one would have expected it to be made explicitly.

[67] We do not consider that it is legitimate to add those words in because they accord with an inferred intention of Parliament as McGrath J does. As will be apparent when we discuss the legislative history of s 9, there is very little contemporary material from which to infer purpose at the time the legislation was passed. Further, in 1936, Parliament may well have expected the courts to apply a literal interpretation to the words used.[59] Even now, our task is to interpret text in light of purpose and not to override text to accord with the perceived purpose of Parliament.[60]

[68] The narrow interpretation of the New South Wales equivalent of s 9(6) does not seem to have been the view of McHugh and Gummow JJ in *Bailey*.[61] They said the subsection had the effect that "after the charge has descended, it is [not] 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."[62] They thus referred to all payments and not just to payments in respect of a liability to a claimant. The charge was said to have "descended on the happening of the event giving rise to the claim for damages or compensation."[63] McHugh and Gummow JJ

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58 See McGrath J's judgment at [178].

59 Burrows and Carter say that the literal approach had by no means disappeared even in the 1960s: JF Burrows and RI Carter *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 198–199. citing DAS Ward "A Criticism of the Interpretation of Statutes in the New Zealand Courts" [1963] NZLJ 293.

60 Under s 5(1) of the Interpretation Act 1999.

61 *Bailey*, above n 50.

62 At 450 per McHugh and Gummow JJ.

63 At 450 per McHugh and Gummow JJ.

commented that the equivalent of s 9(6) is one of the ways in which the position of the third party claimant is protected.

[69] McGrath J also places significance on the fact that s 9(6) is not phrased as a positive obligation to preserve enough insurance money to satisfy the charge.[64] We do not consider that there was any need to do so. The charge already secures the amount (whatever it turns out to be) of the third party claim from the date of incurrence of the event under s 9(1). Section 9(3) sets out the priority between claims. Judgment under s 9(4) can be obtained against the insurer for the amount of any claim. If those subsections are integrated in this way, then s 9(6), phrased as it is, would have been necessary to release the insurer from liability with regard to sums paid out in breach of the charge when it had no notice of the charge.

Nature of the statutory charge

[70] Parliament used the term "charge" in s 9. It is thus useful to consider the nature of the charges that existed at the time the legislation was passed, as that is the background against which the term "charge" was used.[65] We do agree, however, with McGrath J that the nature of the s 9 charge is to be ascertained from the wording of the provision. As we discuss above, the wording of the provision aligns with the interpretation contended for by the appellants.

[71] The first point is that the s 9(1) charge, on whatever interpretation is favoured, will be a charge over future property in all cases where judgment on, or settlement of, a third party claim has not yet occurred. The common law did not recognise a security over future property unless there was a new act done by the grantor after he or she acquired the property that indicated his or her intention that the property should pass under the security.[66] Equity, however, did recognise a charge over future property. An equitable interest would therefore attach to the

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64 See McGrath J's judgment below at [177].

65 In *FAI General Insurance Co Ltd v McSweeney* (1997) 73 FCR 379 (FCA) at 411, Lindgren J suggested that the statutory charge could be "conceived of as partaking of the nature of a floating charge which becomes fixed once there are moneys payable in respect of the liability in question".

66 *Lunn v Thornton* (1845) 1 CB 379 at 388, 135 ER 587 at 590. See also Peter Blanchard and Michael Gedye *The Law of Company Receiverships in Australia and New Zealand* (2nd ed, Butterworths, Wellington, 1994) at [1.04].

property as soon as the debtor acquired the collateral.[67] Such a charge could be either floating or fixed, or a combination of both, depending on the terms of the agreement.[68]

[72] If the statutory charge is analogous to a fixed charge over whatever the amount of the claim might turn out to be (subject to the maximum payable under the policy), then the answer would be clear. No payment could be made under the insurance policy, except to the extent that the payment comes out of funds over and above the amount of the insured's liability to the third party as eventually ascertained.[69]

[73] On the other hand, a floating charge is a charge over future property within the description of the charge instrument until the debtor company's[70] power to manage his or her assets is brought to an end by the debtor going into bankruptcy, receivership or liquidation or upon the occurrence of some other event specified in the charge instrument. At such a time the charge would crystallise, fastening in specie on property within the description in the charge instrument in which the debtor company then had, or subsequently acquired, an interest. Up until the time of crystallisation, a floating charge is an immediate, albeit unattached, security interest.[71]

[74] In the meantime, the debtor would remain "free, within such limitations as may be contained in the contract between the [debtor] and the lender or implied at law, to deal in the assets and pass to those with whom it deals a title which is not encumbered by the floating charge."[72] The ability to continue normal trading, however, is on the assumption that the entity remains a going concern. A floating charge at common law will crystallise as a matter of law on the occurrence of any

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67 *Holroyd v Marshall* (1862) 10 HL Cas 191, 11 ER 999. Michael Gedye, Ronald CC Cuming and Roderick J Wood *Personal Property Securities in New Zealand* (Brookers, Wellington, 2002) at [43.1].

68 Blanchard and Gedye, above n 66, at [1.09].

69 Blanchard and Gedye, above n 66, at [1.02].

70 Generally, an individual cannot give a floating charge: see RJ Scragg "Floating Charge" in Andrew Borrowdale (ed) *Butterworths Commercial Law in New Zealand* (Butterworths of New Zealand Ltd, Wellington, 1996) 607 at 607 and Louise Gullifer (ed) *Goode on Legal Problems of Credit and Security* (4th ed, Sweet & Maxwell, London, 2008) at [4-01].

71 *Goode on Legal Problems of Credit and Security*, above n 70, at 125–126.

72 Blanchard and Gedye, above n 66, at [1.02].

event that is incompatible with the continuance of the entity trading as a going concern.[73]

[75] In these cases, the Court of Appeal held that the statutory charge crystallises upon judgment on the third party claim,[74] (or upon settlement of that claim[75]). This was on the basis that it is only at that point that there is any right of indemnification for the insured. The same reasoning is expressed in the New South Wales Court of Appeal decision in *Chubb*.[76]

[76] There is, however, nothing in the wording of s 9 to specify that the charge crystallises on judgment or settlement. Nor is there even anything explicitly in the legislation to specify that it crystallises on the insolvency of the insured. If the statutory charge was intended to be analogous to a floating charge, then one would have expected the legislature to set out the crystallisation events (including insolvency) explicitly. This is particularly the case as it is common ground that at least one of the purposes of the legislation was to avoid insurance proceeds falling into the general pool for creditors.[77]

[77] The only explicit mention of timing in relation to the charge is that it arises "on the happening of the event giving rise to the claim for damages or compensation."[78] Also significant is the fact that it arises "notwithstanding that the amount of liability may not then have been determined".[79] Further, there is no indication in s 9 that the insurer is free to make payments from the fund after the s 9(1) charge descends even when to do so (because of the policy limits involved) would diminish the amount available to meet the third party claim. Quite to the

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73 *Goode on Legal Problems of Credit and Security*, above n 70, at 153–154.

74 *Steigrad* (CA), above n 6, at [45].

75 Both the insurance policies in this case contemplate settlement of a third party claim with the consent of the insurer.

76 *Chubb*, above n 34, at [118]–[119]. The New South Wales Court of Appeal cited *Steigrad* (CA) for the proposition that the statutory charge was concerned with moneys payable "in respect of that liability," meaning the liability of the insured to pay damages or compensation to the claimant. They said that the charge was not expressed to catch all moneys that might be payable under the insurance contract: *Chubb*, above n 34, at [120], citing *Steigrad* (CA), above n 6, at [25].

77 See the unanimous comments of this Court in *Ludgater Holdings Ltd v Gerling Australia Insurance Co Pty Ltd* [2010] NZSC 49, [2010] 3 NZLR 713 at [14] and [21].

78 Law Reform Act, s 9(1).

79 Section 9(1).

contrary. Section 9(6) makes it clear that it is only payments made from the insurance fund without notice of the charge that will be a valid discharge. While we do not suggest that in every case the inverse of a statutory statement is true, in this case we consider that the exception in s 9(6) supports our view that the s 9 charge is not analogous to a floating charge and that payments that risk depleting the amount available to meet the liability to a third party claimant are not allowable. If the statutory charge were analogous to a floating charge, there would be no need for s 9(6).[80]

Prior caselaw

[78] The case of *Pattinson v General Accident, Fire, and Life Insurance Corp Ltd* concerned a motor vehicle insurance policy which provided indemnity for any personal injury liability incurred by the vehicle owner to passengers travelling in his or her vehicle.[81] The indemnity was later extended to include "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.[82]

[79] Myers CJ said that neither the insurance company nor the insured were entitled to payment of their legal costs at the expense of the statutory charge. The Chief Justice stated that:[83]

> … I cannot think, reading s 9 of the Law Reform Act, 1936, and the insurance policy together, that either the insured or the [insurer] 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.

[80] Although these comments were made in the face of a concession to that effect, this concession was made only after full argument.[84] The terms of the insurance policy in that case were, in fact, contrary to what the Court of Appeal

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80 At least on our interpretation of the subsection: see above at [62]–[69].
81 *Pattinson v General Accident, Fire, and Life Insurance Corp Ltd* [1941] NZLR 1029 (SC).
82 At 1031.
83 At 1038.
84 See the comments of Myers CJ at 1037.

said,[85] very similar to the contract in these cases. The insurer in *Pattinson* had to consent to the costs being incurred but presumably (as in these cases) that consent could not be unreasonably withheld.[86]

[81] The insurer in *Pattinson* was not a volunteer (despite the comments of Myers CJ referred to by McGrath J).[87] Plainly defence costs were no more of a choice for the insurer in that case than they are in these cases. We consider that Myers CJ was referring to the fact that the insurer could always choose to pay the defence costs but that would have to be out of its own funds if the amount of the eventual judgment (the charged amount) exceeds the insurance limit.

[82] A similar result was reached in *National Insurance Co of New Zealand Ltd v Wilson*[88] in 1941, although in that case this was done by interpreting the term "costs" as including only costs that an employee would be entitled to recover from the employer.[89] Costs incurred by the employer in defending the claim were held not to fall within the ambit of the policy and could not be deducted. Johnston J noted that, if this were not so, the insurer could whittle down its liability by excessive and drawn out litigation. In the long run, this would reduce the security that such a policy was intended to provide to employees.[90]

[83] There are three points to make in relation to *Pattinson* (and to a lesser extent *National Insurance*). The first is that the parties in the cases at hand should have been aware of those decisions. If they had wanted to be sure of being able to pay out defence costs in priority to the third party claimants, they should have ensured that the insurance limit was higher or provided for a separate pool of insurance for defence costs.

[84] The second point is that *Pattinson* is a decision that has stood for a long time seemingly without challenge. It was also decided shortly after the legislation was

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85 *Steigrad* (CA), above n 6, at [32].
86 The QBE policy requires consent, as does the AIG policy.
87 See McGrath J's judgment below at [188].
88 *National Insurance Co of New Zealand, Ltd v Wilson* [1941] NZLR 639 (SC).
89 At 645.
90 At 645.

passed and in the same legal and social setting. It therefore is a good guide to what was thought at the time to be the purpose of the legislation.

[85] The third point is that the legislature, if it did not consider that *Pattinson* accorded with the purpose of the legislation, has had a long time to correct the situation by amending the legislation.

Legislative history

The predecessor provisions

[86] The predecessor provisions to s 9 of the Law Reform Act were s 42 of the Workers' Compensation Act 1908, s 48 of the Workers' Compensation Act 1922 and s 10 of the Motor-vehicles Insurance (Third-party Risks) Act 1928.

[87] The purpose of the Workers' Compensation Bill 1907 was to consolidate existing legislation dealing with workers' compensation[91] and, in particular, to simplify the procedure for employees to sue their employers for workplace-related accidents.[92] The Attorney-General commented in the second reading of the Bill in the Legislative Council that every step taken in the Bill was a "step in favour of the worker".[93] He continued:[94]

> A complete charge is given to him over the property of the employer, so that it is almost impossible, or, at any rate, cases will very rarely occur in which the worker fails to get the compensation awarded.

[88] It is unclear whether this was a reference to the charge over insurance moneys. A similar charge provision over insurance moneys was carried forward to the 1922 Act but nothing was said about that issue in the debates on that Act.

[89] As to the Motor-vehicles Insurance (Third-party Risks) Act, the Attorney-General said that the main feature of the Bill was to ensure that every vehicle automatically carried insurance for the benefit of anyone injured through negligence

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91 Workers' Compensation Bill 1907 (explanatory memorandum) at i.

92 See the Minister of Labour's comments during the debates in the House of Representatives: (6 October 1908) 145 NZPD 940.

93 (9 October 1908) 145 NZPD 1073.

94 (9 October 1908) 145 NZPD 1073.

in the control of a vehicle.[95] The insurance was to attach to the car, rather than the car's owner, so that an injured party would be able to get compensation even if the person driving the car was not the owner.[96] The insurance was to cover damages and costs, which appears to be a reference to costs of the third party.[97]

[90] The Attorney-General said that the purpose of cl 10 (the statutory charge provision) was to ensure that a third party with a claim against an insured wrongdoer would not miss out on obtaining compensation simply because the insured person became bankrupt or died. The Attorney-General referred to an English case and said that the purpose of cl 10 was to reverse this ruling so that the insurance money would go to the third party rather than creditors generally:[98]

> Clause 10 deals with the legal position which may arise in the case of death or insolvency of the owner, and provides in such a case of death or insolvency the liability would be a charge on the insurance moneys. In other words, if the owner happened to become bankrupt the insurance moneys will necessarily go to the injured party, and not to the Official Assignee. It has been held in England that, where the owner happened to become bankrupt, the insurance company was liable to pay the moneys over to the Official Assignee as the legal representative of the owner; consequently the moneys became available for the creditors instead of going to the injured party. This provision negatives that rule of law; without it the moneys would go to the representatives of the owner – in this case the Official Assignee – and would become the property of the creditors rather than that of the injured party. That, of course, is a purely legal or technical point, but it is in the interests of the injured party.

[91] The Attorney-General did not name the English case he was referring to but this was likely a reference either to *Re Harrington Motor Co, Ltd, ex parte Chaplin* or *Hood's Trustees v Southern Union General Insurance Co of Australasia, Ltd*.[99]

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95 (27 September 1928) 219 NZPD 590.

96 (27 September 1928) 219 NZPD 591.

97 See s 6(1) and (2). Section 6(1) provides that, on the payment on the insurance premium in respect of a motor vehicle, the insurance company nominated by the vehicle's owner would be deemed to have contracted to indemnify the insured owner from liability "to pay damages (inclusive of costs)" on account of death or injury caused by the use of the vehicle. "Costs" in s 6(1) was linked to "damages," which suggests that "costs" was meant to refer to costs payable by an insured to a successful third party claimant. Section 6(2) capped the liability of an insurance company at a certain amount depending on how many claimants there were. Section 6(2) provided that the amounts specified were "inclusive of all costs incidental to any such claim or claims". Presumably the reference to "costs" in s 6(2) was meant to be read consistently with "costs" in s 6(1).

98 (27 September 1928) 219 NZPD 601.

99 *Re Harrington Motor Co, Ltd, ex parte Chaplin* [1928] Ch 105 (CA); and *Hood's Trustees v Southern Union General Insurance Co of Australasia, Ltd* [1928] Ch 793 (CA). Two years later, a New Zealand decision applied those decisions: *Smith v Horlor* [1930] NZLR 537 (SC).

The decision in *Re Harrington Motor Co* was to the effect that the proceeds of an insurance policy taken out by an insured company, by then in liquidation, were to be shared between all unsecured creditors (including the third party claimant) pari passu. Under *Hood's Trustees*, the claimant fared even worse. It was held that the third party claimant could not even share pari passu with other unsecured creditors as there had been no judgment establishing liability before the bankruptcy. At the time, an unliquidated claim in tort did not give a right to claim in bankruptcy.[100]

[92] McElroy and Gresson summarised the effect of s 10 of the Motor-vehicles Insurance (Third-party) Risks Act and s 48 of the Workers' Compensation Act in their text as follows:[101]

> This Part [a reference to s 9] of the Law Reform Act, 1936, concerns insurance-moneys, and is an extension and consolidation of s. 48 of the Workers' Compensation Act, 1922, and of s. 10 of the Motor-vehicles Insurance (Third-party Risks) Act, 1928, under which the amount of the insured's liability – that is, his liability to pay compensation or damages … in respect of a particular accident to which these statutes applied – was a first charge on all insurance-moneys payable in respect of that accident, whether this amount had been determined or not, in the event of –
>
> (i) The employer or motor vehicle owner dying insolvent or making a composition or arrangement with his creditors.
>
> (ii) Proceedings being commenced for winding-up, if the employer or motor-vehicle owner was a body corporate.
>
> (iii) An employer becoming bankrupt, or a motor vehicle owner being bankrupt at the time of the accident or thereafter becoming bankrupt.

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100 That was the case in New Zealand also at the time: s 98(1) of the Bankruptcy Act 1908. Section 98(1) provided that "[d]emands in the nature of unliquidated damages arising otherwise than by reason of a contract, promise, or breach of trust shall not be provable in bankruptcy". Louise Affleck explains that "[i]n the case of an insolvent company, assets were distributed to creditors able to file proofs of debt and the company was dissolved [under the Companies Act 1933, s 220], so the continuation of proceedings against an insolvent company was pointless": Louise Affleck "Section 9 of the Law Reform Act 1936 – the legislative background" (1995) 25 VUWLR 433 at 434. "The rules preventing claims for unliquidated damages arising from a tort were amended when the Insolvency Act 1967 was introduced": Affleck at 439. Section 87(1) of the Insolvency Act provided that generally "all debts and liabilities, present or future, certain or contingent, to which the bankrupt is subject at the time of his adjudication, or to which he becomes subject before his discharge by reason of any obligation incurred before the time of his adjudication, shall be debts provable in bankruptcy". "The amended rules continue[d] to apply to companies in liquidation": Affleck at 439, citing the Companies Act 1955, s 307; and the Companies Act 1993, s 302. "Further, prior to 1936, claims for unliquidated damages could not be pursued if the tortfeasor died": Affleck at 435.

101 RG McElroy and TA Gresson *The Law Reform Act, 1936* (Butterworth and Co, Wellington, 1937) at 30.

[93] In a case decided under the Motor-vehicles Insurance (Third-party) Risks Act, the charge was said to be in the nature of a floating charge liable to become fixed as soon as liability for the accident was established. However, it was said that, once the charge became fixed, it did so "with its priority preserved as from the date of the accident."[102]

[94] It has been said that these predecessor provisions contained an element of social insurance, understandable in the context of the society at the time. There was no state controlled accident compensation scheme or comprehensive social welfare system. Suffering death or injury could thus seriously affect the economic well-being of third parties who suffered injury and that of their dependents.[103]

The Law Reform Act

[95] On the introduction of the Law Reform Act, the Hon Rex Mason MP said that s 9 consolidated previous provisions and made them of general application.[104] These existing provisions, he said, created a lien on insurance moneys by injured claimants. Rather than extending these specific provisions to the Deaths By Accidents Compensation Act 1908, the Hon Rex Mason said that the law draftsman had "thought it better to consolidate them all and make a general rule."[105]

[96] The only significant change for our purposes made from the predecessor provisions to s 9 was to bring forward the date the statutory charge arose to the date of the event giving rise for the claim. Under the predecessor legislation[106] the charge

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102 *Findlater v Public Trustee and Queensland Insurance Co* [1931] GLR 291 (SC) at 298 per Blair J.

103 Affleck, above n 100, at 437–438.

104 (17 September 1936) 247 NZPD 237.

105 (17 September 1936) 247 NZPD 237.

106 Under s 42(1) of the Workers' Compensation Act 1908, the statutory charge arose "in the event of the employer dying insolvent, or becoming bankrupt, … or, if the employer is a body corporate, in the event of that body corporate having commenced to be wound up". This wording was carried into s 48(1) of the Workers' Compensation Act 1922. The same wording was modified in s 10(1) of the Motor-vehicles Insurance (Third-party Risks) Act, where the charge arose "[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 [the Motor-vehicles (Third-party Risks) Act]".

arose on bankruptcy or winding up.[107] It was not explained in the parliamentary materials why the change in the time that the charge arises was made (although the fact that there was a change in timing was noted in the debates).[108]

[97] It has been suggested that this change was made because the policy behind this legislation (to ensure that the third party received the insurance moneys even if the insured subsequently became insolvent) was not totally effective in achieving its purpose. Affeck says that "[p]rovided the insured was not insolvent, he or she could receive the insurance money due under the policy and use it for other purposes."[109] However, as noted above, no explanation was given in Parliament for why the timing for the creation of the statutory charge was changed.

[98] By contrast, in New South Wales, 10 years later, the concern that the insured may deal with the insurance money to the detriment of the third party claimant seemed to be the main focus of the explanation given for the introduction of the New South Wales equivalent of s 9. The New South Wales Attorney-General emphasised two problems that the Law Reform (Miscellaneous Provisions) Bill aimed to solve. The first problem arose when an injured person obtained judgment against the insured wrongdoer but the insured, after receiving the insurance money, simply disappeared without the money ever reaching the injured person. The second problem arose where an insured and his or her insurer entered into a collusive arrangement so as to deprive a third party of the "fruits" of a judgment obtained against the insured. The Attorney-General said during the first reading of the Bill:[110]

> Coming to the last clause of the bill, in this State to-day, except in regard to workers' compensation and motor vehicles (third party) insurance, it is possible for an injured person to obtain a judgment against an insured person and yet be deprived of the fruits of that judgment, because there is nothing in the law to prevent the insured person collecting his insurance money and just disappearing. Similarly, there is nothing to prevent an insured person, when sued, going to his insurance company and releasing it from its liability to

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107 The issue of the death of an insured was dealt with by s 3 of the Law Reform Act 1936 as enacted. Section 3 prevented the third party's cause of action against the insured from being extinguished and s 9 prevented the insurer's liability from being extinguished. Previously (before 1936) death ended both the liability of the insured and the insurer: Affleck, above n 100, at 437 and fn 24, citing *Jorgensen v Findlater* [1931] GLR 403 (SC) at 407.

108 (18 September 1936) 247 NZPD 254.

109 Affleck, above n 100, at 437.

110 (5 March 1946) 79 NSWPD 2456.

him on payment to him of a lump sum which he immediately dissipates or makes away with.

Discussion

[99] It is significant that the claims that were drawn to the attention of Parliament at the time that s 9 and its predecessors were being debated were claims for personal injury or death. In relation to such claims, given the link to human suffering and also the social cost of injury or death, it may be thought that the protection of the claimant with regard to insurance money was paramount. That uncharged claims (such as defence costs) could diminish the money available for injured persons would, it might be thought, not fit in with this policy aim.[111]

[100] It is also significant that motor vehicle liability insurance was made compulsory when the Motor-vehicles Insurance (Third-party Risks) Act was enacted in 1928.[112] It would have undermined Parliament's intention in making liability insurance cover compulsory if money subject to such a charge could be diverted from a liability insurance fund to be used for purposes other than paying that liability. The wording used in s 10 of that Act is largely identical to that of s 9. Notably s 10(1) provided that the charge "shall be a charge on all insurance-moneys which are or may become payable in accordance with this Act in respect of that liability."

[101] We accept that care must be taken in assuming that wording used in previous legislation is intended to have the same meaning when consolidated or re-enacted in a different context.[113] Section 9 was clearly intended to apply to forms of insurance that are not compulsory. Even accepting that, however, it would be odd for the same words in a charging provision to create an entirely different type of charge from that created under the predecessor legislation.

[102] If Parliament had intended a different type of charge to be created (that is, one that allowed payments to continue to be made under a policy, despite the result

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111 See the comments in *National Insurance Co of New Zealand, Ltd v Wilson*, above n 88, about the requirement of an insurer to keep the insurance money intact: at 644.

112 Motor-vehicles Insurance (Third-party Risks) Act, s 3.

113 Francis Bennion *Bennion on Statutory Interpretation: A Code* (5th ed, LexisNexis, London, 2008) at 607.

being the depletion of funds available to meet the claim), one would have expected it to have made this clear. For example, as discussed above, it could have done this by stipulating a crystallising event or confirming explicitly that the insurer could continue to make payments under the policy in the ordinary course of business and despite the risk of the policy limit being breached.[114] It is significant in this regard that the explanatory note to the Law Reform Bill 1936 states that s 9 "makes the charge apply immediately on the happening of the event giving rise to the claim".[115] There is no reference to later crystallisation.

[103] The structure of s 10 of the Motor-vehicles Insurance (Third-party Risks) Act is very similar to s 9. As noted above, the statutory charge in s 10 arose only on bankruptcy (or winding up). It is unlikely that, in an insolvency situation, Parliament would have thought that uncharged claims would escape the s 10 charge and be paid to the general run of creditors because judgment had not yet been obtained on the third party claim.

[104] Against the background of the Motor-vehicles Insurance (Third-party Risks) Act, where the statutory charge must have been intended to operate when it was created to secure the amount of the claim when established (up to the insurance limit), it would be odd if the statutory charge under s 9(1), albeit arising on the happening of the event giving rise to the claim, secured nothing until judgment (or at least did not prevent payments being made on the policy until judgment, including after insolvency which, because of the policy limit, would deplete the funds available to meet a third party claim).

General policy arguments

[105] Given that the origins of s 9 and its predecessor provisions relate to personal injury claims and the preservation of insurance money to meet those claims, this points very strongly to an interpretation of s 9 which does not allow available insurance moneys to be depleted so as to deprive third party claimants of the benefit of their statutory charges.

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114 See above at [76].

115 Law Reform Bill 1936 (37-1) (explanatory memorandum) at ii.

[106] It is true that the insurance policies at issue in these appeals arise in a different context and are voluntary. Nevertheless, the amounts able to be claimed under the policies form part of the assets of the insured and a policy that ensures they go towards meeting the liability of the insured to a third party is understandable. Indeed, the practice, at least in Australia, with regard to liability insurance is for insurers to arrange to pay third parties directly and it would be unusual for an insurer to pay the insured unless satisfied that the insured had already paid the third party.[116]

[107] As we have said earlier, allowing defence costs to diminish the sum available to third parties is tantamount to requiring third party claimants to fund an unsuccessful defence, which would normally not occur under ordinary court cost rules. The fact that insurance for defence costs is covered in the same policy as the liability insurance does not obviously point to the displacement of those normal costs rules, absent clear statutory language.

[108] The respondents submit that there are policy reasons for ensuring that claims are paid out when they fall due and that it cannot have been intended that a claim could "tie up" insurance proceeds until judgment or settlement in cases where there is a risk that the insurance policy limit may be breached.

[109] This concern remains, however, even on the respondents' argument. The respondents accept that s 9(3) does create priority rules for rival claims.[117] This means that a claim risks "tying up" insurance proceeds with regard to all claims arising later in time. There is no obvious reason why defence costs should not be in a similar position (and in fact, given ordinary costs rules, the logic for defence costs not to be paid out where to do so would be to deplete the funds available for claimants is even stronger).

[110] The answer to the respondents' concern may be that, provided the policy limit suffices to cover all claims as well as defence costs where there is a combined policy limit, then the statutory charges will not "tie up" insurance proceeds. Even where a

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116 Letter from the Insurance Council of Australia to the New South Wales Attorney-General's Department "Law Reform (Miscellaneous Provisions Act 1946: Repeal of Section 6" (5 March 2012) at 3.

117 Contrary to the view expressed in *Chubb*, above n 34; see discussion above at [45]–[48].

policy limit would be exceeded, if a clearly inflated or unmeritorious claim is made, then the insurer would be able to advance defence costs and pay rival claims, as the charge only covers the amount of the eventual judgment, albeit this would be at the risk of the insurer.

[111] The respondents next submit that to find in favour of the appellants could inhibit their access to justice. We do not accept this submission. An insured would only be deprived of the ability to mount a defence if he or she had no other funds available for a defence and where no lawyer would act on a contingency basis. Further, an insurer may well have an incentive to fund a good defence out of its own funds as that would reduce the insurer's exposure under the policy.

[112] Further, it is significant that it is only if the claim is unsuccessfully defended that defence costs will not be paid. If the defence is successful, then defence costs will be paid, provided they are within the policy limits and there are no other claims that are the subject of a s 9 charge.

[113] It seems to us that most of the difficulties put forward by the respondents (and the related policy issues) arise only in circumstances where the limit on a policy is going to be reached without being able to meet both defence costs and the claims. There is much to be said for the argument made on behalf of the third party claimants that the difficulties arise in those cases because the insurance cover was not sufficient and because of the combined policy limit. While it is relatively common, although not universal, to have combined limits for directors' liability insurance policies,[118] a combined limit is not necessarily the norm for other policies.[119]

[114] Legislation to protect third party claimants with regard to insurance proceeds is common. Different jurisdictions have come to different solutions to the

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118 Derrington and Ashton, above n 49, at [11–250]. See also Neil Campbell "Insurance Law" [2012] NZ L Rev 353 at 359.

119 Derrington and Ashton, above n 49, at [9–141]. See also Robert Merkin *Colinvaux's Law of Insurance* (9th ed, Sweet & Maxwell, London, 2010) at [20–047] and John Birds, Ben Lynch and Simon Milnes *MacGillivray on Insurance Law* (12th ed, Sweet & Maxwell, London, 2012) at [23-060]–[23-061].

difficulties that can arise, particularly in insolvency situations.[120] There have been criticisms made of the balance struck with regard to a number of these provisions. Further, with regard to provisions similar to s 9, issues have been raised over various difficulties of interpretation, including limitation periods and their application to claims made policies.[121] Difficulties have also been raised with the interpretation of the provision reached by the High Court (and in this judgment).[122] If it is considered that a different balance should be struck between the rights of third party claimants, the insured and insurers, however, then this is for Parliament.[123]

Conclusion

[115] The statutory charge under s 9(1) secures the full amount of the eventual liability to the third party claimant and arises immediately on the event giving rise to the claim. Unless the indemnity for defence costs is within the statutory charge (which it is common ground it is not and which would not allow in any event payment out in priority to the related claim since they arise out of the same events, requiring equality of treatment), then the payment of defence costs is at the risk of the insurer because of the statutory charge for the claims.

[116] The fact that the insured's liability for defence costs is established (so that they become payable by the insured) before liability is established on the claims for damages or compensation is irrelevant. The scheme of s 9 is that the charge (which

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120 See discussion in Deidre Willmott "Third party claims against insurers: the case for uniform national reform" (2003) 15 ILJ 1 and Matthew Ellis "Give Vic s 6: An argument for the expansion of third party access to proceeds of insurance in Victoria" (2008) 19 ILJ 1. In the United Kingdom, in 2001, the United Kingdom Law Commission and the Scottish Law Commission published a report recommending reform of the Third Parties (Rights against Insurers) Act 1930 (UK). The Law Commissions' recommendations led to the enactment of the Third Parties (Rights against Insurers) Act 2010 (UK). See United Kingdom Law Commission and the Scottish Law Commission *Third Parties – Rights Against Insurers* (Law Com No 272 and Scot Law Com No 184, 2001); and United Kingdom Law Commission "Third Parties (Rights against Insurers)" <www.lawcommission.justice.gov.uk>.

121 See, for example, RD Giles "Reflections on s 6" (1996) 7 ILJ 1.

122 See, for example, Campbell, above n 118.

123 In 1998, the Law Commission recommended that pt 3 of the Law Reform Act (which includes s 9) be replaced and substituted with a new set of provisions: see Law Commission, above n 53, at [112]. The recommendations included abolishing the concept of a statutory charge and allowing a third party to sue an insurer directly only where an insured is insolvent. Where there are competing claims to insurance money and the policy limit would be exceeded, it was recommended that claims would abate proportionately to their amounts. These recommendations have not been adopted by Parliament.

puts the risk on the insurer in respect of payments under the contract) has effect "on the happening of the event giving rise to the claim for damages or compensation."

[117] These unusual cases arise because the policies in issue have made the defence costs the subject of cover in a policy that also covers the third-party liability that gives rise to the defence costs. As a result, the statutory charge protects the third party claimant and prevents performance of the defence cost obligation without risk to the insurer. This means that the insurer and the insured have made a poor bargain because the policy has not been properly drawn, overlooking the effect of the statutory charge.

[118] The result is that the indemnity for defence costs does not get around the charge and is not effective to displace the usual risk taken on by an insurer who has to calculate the risk in defending a claim on behalf of an insured or in funding the insured's defence. The contractual obligation with regard to the payment of defence costs does not mean it can keep paying out defence costs if that would undermine the statutory charge.

Result and costs

[119] The appeals are allowed. The Court of Appeal's declaration in SC 21/2013 is set aside.[124]

[120] The statutory charge under s 9(1) arises on the happening of the event giving rise to the claim and secures the full amount of the liability to a third party claimant as eventually established through judgment on, or settlement of, the claim (subject to policy limits).

[121] An insurer may be entitled to be cautious about meeting a defence cost claim where a third party claim, of which it has notice and which exceeds the insurance limit, remains outstanding. We prefer, however, to leave the question of whether an insurer would be entitled to refuse to pay defence costs where there was a risk the

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[124] *Steigrad* (CA), above n 6, at [57].

policy limit may be exceeded to a case where that is clearly in issue. We thus do not reinstate the declaration made by the High Court in SC 19/2013.

[122] If further clarification is required with regard to whether payments may be made under the policies at issue in this case before settlement or judgment on the appellants' claims, the parties should apply to the High Court to deal with this point.

[123] Costs of $25,000 are awarded to the appellants in SC 19/2013 plus usual disbursements (to be set by the Registrar if necessary), payable by the respondent. We certify for two counsel.

[124] Costs of $25,000 are awarded to the appellant in SC 21/2013 plus usual disbursements (to be set by the Registrar if necessary), payable jointly and severally by the respondents. We certify for two counsel.

McGRATH AND GAULT JJ

(Given by McGrath J)

Introduction

[125] These two appeals concern the scope of the statutory charge which comes into existence when a person, who is the subject of a claim for liability to pay compensation or damages, is insured under a policy which provides indemnity against such liability. Under s 9 of the Law Reform Act 1936, on the happening of the event that gives rise to the insured person's liability, a charge arises over all insurance moneys then payable, or which later become payable, in respect of the liability to pay damages or compensation. The section was enacted to enable a claimant who establishes the liability of the insured person in these circumstances to recover directly from the insurer the insurance money that otherwise would be payable to the insured. It overcomes the inability of the claimant under the common law to get direct access to the insurance proceeds. This had given rise to difficulties for claimants, particularly where the insured was, or became insolvent.

Background

Bridgecorp's appeal

[126] The first appeal has its origins in the collapse on 2 July 2007 of the Bridgecorp group of companies, owing investors around $500 million. The appellants are the receivers and liquidators of Bridgecorp, who have sued the respondents, Mr Davidson, Mr Steigrad and Mr Urwin, formerly directors of companies in the group, claiming that they acted in breach of their statutory and common law duties as directors. Acting effectively on behalf of the companies' investors, Bridgecorp is seeking damages from the directors in excess of $340 million. The respondents have already faced criminal proceedings in relation to acts or omissions as directors, in which each respondent was convicted of offences under the Securities Act 1978.

[127] From 1996, Bridgecorp held two insurance policies with QBE Insurance (International) Limited. One (the "D & O" policy) insured directors of Bridgecorp

against civil and criminal liability arising from the discharge of their roles as directors. Cover under that policy also extended to costs incurred by the directors in defending proceedings brought to establish such liability. The total limit of the indemnity under the policy at the time of the collapse was $20 million. The other insurance policy (the "SL" policy) provided cover for defence costs incurred by directors in respect of claims brought against them which alleged that they were in breach of their statutory obligations. The limit of indemnity under that policy was $2 million.

[128] Defence costs incurred by the respondents in defending the criminal proceedings exhausted the limit under the SL policy and they sought access to the D & O policy to cover defence costs in relation to the civil and criminal proceedings. But, on 12 June 2009, the receivers and liquidators of Bridgecorp notified QBE Insurance of their claim that a charge under s 9 existed over all moneys payable under the D & O insurance policy. QBE Insurance then refused to make any payments for defence costs under the D & O policy, pending agreement with Bridgecorp on the allocation of the proceeds of the policy between the two heads of cover.

Mr Houghton's appeal

[129] The second appeal is brought by Mr Houghton, a representative plaintiff, against the former directors of Feltex Carpets Ltd. In 2006, Feltex was placed in receivership and subsequently in liquidation. Feltex had raised $250 million in 2004 from a share issue, on the basis of a prospectus and investment statement. At that time, Feltex took out with Chartis Insurance NZ Limited a prospectus liability insurance policy providing cover for the company's directors in respect of securities claims. The cover was for "losses" which by definition extended to defence costs incurred in relation to such claims.

[130] Mr Houghton was a member of the public who had subscribed for shares. He has brought a claim against the former directors of Feltex. His statement of claim alleges that the Feltex prospectus contained untrue statements. At the time that the parties' submissions were filed in this Court, he represented some 3,700 shareholders

claiming some $180 million in damages.[125] The respondents who were the directors of Feltex at the relevant time were Mr Saunders, Mr Magill, Mr Feeney, Mr Thomas, Mr Horrocks and Mr Hunter.

The judgments of the High Court and Court of Appeal

[131] The directors who are respondents in Bridgecorp's proceeding applied to the High Court for a declaration that the charge over insurance moneys under s 9 does not prevent QBE Insurance from reimbursing them for their costs of defending the proceeding, under the terms of the policy.

[132] In the High Court, Lang J found that when the charge in favour of Bridgecorp came into existence, it was conditional on the occurrence of two further events before it became fixed and enforceable against QBE Insurance.[126] First, Bridgecorp needed to establish that the directors were liable to them for a quantified sum. Secondly, the directors (or Bridgecorp) needed to establish that the directors were entitled to cover under the policy.[127]

[133] The conditional nature of the charge was not determinative of the critical issue, however, which was whether, as soon as the charge came into existence, it prevented the directors from having access to cover under the D & O Policy to meet their costs of defending the Bridgecorp claim. Lang J decided that in charging "all insurance money" that is or may become payable in respect of liability to pay damages, the statutory language suggested that, if the level of cover was less than the amount of a notified claim, the entire amount for which cover might be available under the policy was subject to the charge.[128] That in fact was the position and the insurer was required to keep the insurance fund intact for the benefit of Bridgecorp and others who might have priority entitlements under s 9(3).[129] QBE Insurance was accordingly confined to making payments under the policy to those which would satisfy any liability the directors might have to the civil claimants.[130]

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125 Including interest and costs.
126 *Steigrad v BFSL 2007 Ltd* (2011) 16 ANZ Insurance Cases 61-910 (HC) (Lang J) [*Steigrad* (HC)].
127 At [53].
128 At [55].
129 At [56].
130 At [57].

[134] In reaching this conclusion the Judge was influenced by his view that this outcome was in accord with the object and purpose of s 9. Allowing the insured directors access to funds under the policy to meet defence costs would lead to the balance of funds eventually available for Bridgecorp being significantly depleted.[131] Accordingly, Lang J held: [132]

> … 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.

The directors appealed.

[135] Following delivery of the High Court's judgment in the Bridgecorp proceeding, Mr Houghton notified Chartis that he and the other shareholders he represents claimed a charge under s 9(1) over the proceeds of the Chartis prospectus liability insurance policy. Chartis and the former directors of Feltex issued a proceeding against Mr Houghton seeking a declaration that the operation of the statutory charge did not preclude Chartis from paying reasonable defence costs under the policy. This proceeding was transferred to the Court of Appeal, where it was heard in conjunction with the appeal by the Bridgecorp directors against the High Court's judgment.

[136] The Court of Appeal allowed the directors' appeal against the High Court judgment in favour of Bridgecorp and made the declaration sought by the Feltex directors in Mr Houghton's proceeding, holding that:[133]

> (a) s 9 does not by its terms apply to insurance monies payable in respect of defence costs, even where such cover is combined with third party liability cover and made the subject to a single limit of liability; and
>
> (b) s 9 has limited effect and is not intended to rewrite or interfere with contractual rights as to cover and reimbursement.

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131 At [58].

132 At [64].

133 *Steigrad v BFSL 2007 Ltd* [2013] 2 NZLR 100 (O'Regan P, Arnold and Harrison JJ). The judgment was originally given as [2012] NZCA 604 which was then reported in [2013] 2 NZLR 100 but the judgment was later reissued as [2013] NZCA 253 to correct an error in the costs order.

[137] In relation to the first of these reasons, the Court of Appeal saw it as significant that the contract of insurance with QBE Insurance indemnified the directors of Bridgecorp against two liabilities: their liability to pay damages or compensation to Bridgecorp, and their liability to pay defence costs incurred in defending the Bridgecorp claim. The Court of Appeal reasoned that all insurance money payable "*in respect of*" the directors' liability meant payable "towards satisfying" or "relating to" that liability. The insurance money to which the directors were contractually entitled was payable in respect of their defence costs and not in respect of their liability to pay damages or compensation. It was not charged by s 9(1).[134]

[138] The second basis for the Court's decision was its view that s 9 does not rewrite the bargain struck by the parties.[135] The section is limited to granting a charge over insurance money that an insurer is liable to pay in discharge of the insured's liability to a third party; it does not interfere with the performance of contractual rights and obligations relating to another liability, such as defence costs.[136]

[139] The Court of Appeal accordingly declared that:[137]

> … where, by the terms of a liability policy, the insurer has agreed that:
>
> (1) it will provide to the insured an indemnity against legal liabilities and against defence costs; and
>
> (2) its maximum amount payable under the policy is a single aggregate limit, inclusive of both the amount of any legal liabilities and of all defence costs,
>
> the amount of the insurance money charged pursuant to s 9(1) of the Law Reform Act 1936 in favour of a claimant against the insured is the balance of the policy limit at the date when the insurer is required under the policy to discharge its promise to the insured to provide indemnity against the insured's legal liability to the claimant (subject to s 9(3) in relation to prior charges); …

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134 At [25].
135 At [38].
136 At [36].
137 At [44].

Section 9 of the Law Reform Act 1936

[140] Under the common law, a claim could not be brought directly against the insurer of the person who the claimant sought to hold liable. Where an insured person became insolvent before liability to the claimant was established and the judgment enforced, the liability policy proceeds fell into a pool of funds to be distributed pro-rata to all creditors including the claimant. This was despite the fact that the policy only existed to fund the insured for the purpose of meeting its liability to the claimant. It was to remedy the injustice perceived in decisions applying this approach[138] that s 9 was passed. Section 9 of the Law Reform Act (like its predecessors, which are discussed below) counteracts the common law rule by giving the claimant a statutory charge over a sum that the liable insured person would otherwise be entitled to recover from his insurer.

[141] It is convenient at this point to set out s 9 in full and to outline briefly how it operates:

> **9 Amount of liability to be charge on insurance money payable against that liability**
>
> (1) If any person (hereinafter in this Part of the 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.

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[138] As demonstrated in the later decision *In re Harrington Motor Co, Ltd, ex parte Chaplin* [1928] 1 Ch 105 (CA) in which the Court of Appeal confirmed the common law rule with regret. See also *Hood's Trustees v Southern Union General Insurance Co of Australasia Ltd* [1928] 1 Ch 793 (CA).

(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.

[142] It is helpful to consider the operation of s 9 against the background of the three relationships on which it impacts.[139] The first of these relationships is between the third party claimant and the insured. It arises in these cases from the claims against the insured directors for damages on account of their alleged breaches of duties owed to the companies. This relationship is regulated by the substantive law applicable to the claim against the insured. The second relationship is between the insured directors and the insurer. It is governed by their insurance contract under which, subject to the policy's terms, the insurer must indemnify the directors for their liability to the claimants. In the present cases, the directors are also entitled to

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[139] See *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd* [1994] 1 NZLR 11 (CA) at 17 per Richardson J.

cover for their costs of defending the claim for liability, within the overall limitation of cover.

[143] The third relationship, one created by s 9, is between the claimants and the insurer. It arises "on the happening of the event giving rise to the claim for damages or compensation". At this point s 9(1) creates a charge, in favour of a third party claimant, over "all insurance money that is or may become payable in respect of that liability", being an insured person's "liability to pay any damages or compensation" to that third party.

[144] The charge will usually come into existence prior to both a claim for liability against the insured person being made and determined, and the liability of the insurer under the policy being accepted, or otherwise established, and quantified.[140] The statute recognises this prospective feature of the charge in providing that it applies to insurance money that "is payable or may become payable". In a situation where the charge is over money which may become payable, although in terms of s 9 it exists, the full operation of the charge is conditional on the acceptance or establishment of the insurer's liability under the policy and its quantification.[141] The charge will only fully operate on such money if and when a quantified sum becomes payable.[142]

[145] On coming into existence, however, the charge immediately confers certain protection on claimants. Section 9(2) provides that if, at the time the event creating liability happens, the insured is insolvent, or any subsequent bankruptcy or winding up is deemed to have commenced before the event happened, s 9(1) nevertheless applies. As well, s 9(3) confers priority of a charge under s 9(1) over all other charges affecting insurance money.

[146] The claimant is also given, by s 9(4), the right to enforce the charge directly against the insurer, in the same way as if it were an action to recover damages or compensation from the insured. The common law's insistence on adherence to the doctrine of privity of contract would otherwise prevent a third party from requiring

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140 *Steigrad* (HC), above n 126, at [26]; and *Bailey v New South Wales Medical Defence Union Ltd* [1995] 184 CLR 399 at 449.

141 *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd*, above n 139, at [19] per Hardie Boys J.

142 *Bailey*, above n 140, at 449.

that any insurance money be paid to him or her. But, to the extent of the charge, the parties to such an action have the same rights and liabilities and the courts the same powers as if the action were against the insured.[143] Privity of contract is, accordingly, procedurally and substantially modified.

[147] The effect of s 9 is to create a new relationship, between claimant and insurer where previously none existed. This relationship is akin to the contractual relationship that already existed between insured and insurer, in so far as it relates to indemnity for liability to pay damages or compensation. The insurer is placed in the same position as the insured for the purposes of the claim by a third party. As Richardson J said in *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd*:[144]

> That reflects the policy of the section that the plaintiff should be in no better or worse position if seeking to proceed against the insurer than if proceeding against the insured.

And, under s 9(5), such a direct action against the insurer is not precluded where the claimant has earlier obtained judgment against the insured.

[148] On the other hand, s 9 also protects the position of the insurer. An action by the claimant against the insurer under s 9(4) can in most cases only be brought with leave of the court. The insurer, under s 9(7), cannot be held liable to the claimant beyond the limits fixed by its contract of insurance with the insured. Section 9(6) provides that any payment made by the insurer under the contract of insurance, without actual notice of the existence of a charge shall, to the extent of that payment be a valid discharge of the insurer's liability under the policy.

The issue

[149] In each of these appeals, the event giving rise to the third party's claim against the insured directors, and accordingly to a charge under s 9(1), is the collapse of the relevant company. The central issue in these appeals concerns the effect of the charge once it is brought into existence upon the occurrence of that event. It

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143 This provision of course also gives protection to the insurer.

144 *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd*, above n 139, at 17.

ultimately turns on the meaning of the key phrase in s 9(1): "a charge on all insurance money that is or may become payable in respect of that liability", being the liability of the insured to pay "any damages or compensation". The issue is not when the charge arises, for it is common ground that it arises on the occurrence of the event giving rise to the insured's liability. The issue rather concerns the nature and the effect of the charge and in particular: to what does it attach?

[150] The terms of the insurance policies in the present cases provide that the directors, as well as having the right to indemnity for their liability, have cover for defence and investigation costs for the purpose of such defence. The insurer in each case is required to indemnify against defence costs incurred by the insured with the consent of the insurer. The policy terms state that such consent will not be unreasonably withheld. This cover under the policy enables the insurer and the insured to protect their mutual interests by investigating the claim and by disputing either or both liability and quantum of damages. The extent to which the statutory charge overrides provisions to pay defence costs is a question about the degree to which the relationship between the claimant and the insurer modifies the contractual relationship of insurer and insured.

[151] Bridgecorp and Mr Houghton contend that s 9 prevents the insurers from making payments to the directors, on account of the cover provided by the policies, for their defence costs. This argument would interpret the "insurance money that is or may become payable in respect of" the directors' prospective liability as including money payable under the policy to reimburse the directors for their defence costs. If this meaning is upheld, all insurance moneys up to the limit of the policy will be affected by the charge and available to the claimants to the extent necessary to meet such liability as they eventually establish against the directors. This interpretation was favoured by the High Court.

[152] The directors' response is that the claimants' charges secure the money payable under the policy after the insurers have met concurrent obligations to the directors to provide cover for their defence costs. This submission confines the "insurance money that is or may become payable in respect of" the directors' liability to what eventually is established to be payable by the insurer, under the

policy, once liability is accepted and quantified and any further payments made to the insured under the terms of the policy, such as defence costs, have been met. If this interpretation is correct, the sum that will be available to the claimants will be net of defence costs. This is the meaning that was preferred by the Court of Appeal.

[153] In resolving the issue raised by the present appeals, the text of s 9 should not be considered in isolation. As required by s 5(1) of the Interpretation Act 1999, the meaning of s 9 must be ascertained "from its text in light of its purpose". Regard must also be had to the statutory context. Older Acts are frequently the subject of disorganised composition.[145] That was the case with the predecessor of s 9, the text of which was largely carried through in 1936 to the current provision. Section 9 is, as a result, not easy to understand. Qualifications and provisos interrupt the flow of its complex text. Its subsections do not follow a clear sequence (especially s 9(6)). There is extensive use of cross-reference (for example, "any claim for damages or compensation as aforesaid", "that liability" and "the said insurance money"). But even more importantly, s 9 is drafted in a highly compressed way and in very general terms. These characteristics make it particularly important, in ascertaining its meaning, to read the very general language of s 9 in light of its purpose and having regard to its statutory context.

Legislative history

[154] Ascertaining the purpose of the phrase in s 9(1) requires consideration of its legislative history. The first provision in New Zealand legislation for a charge over insurance moneys that indemnified the insured person for liability to a third party appeared in the Workers' Compensation Act 1900.[146] A more elaborate provision appeared in s 42 of the Workers' Compensation Act 1908. That section applied where an employer entered into a contract with an insurer for an indemnity in respect of any liability to pay compensation or damages to a worker. It only created a charge over the insurance money in the event that the employer died insolvent, became bankrupt, made a composition or arrangement with creditors or, in the case of a

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145 FAR Bennion *Bennion on Statutory Interpretation: A Code* (5th ed, LexisNexis, London, 2008) at 410.

146 Workers' Compensation for Accidents Act 1900, s 17.

company, was wound up.[147] Section 42 was re-enacted in s 48 of the Workers' Compensation Act 1922.

[155] In 1928 liability insurance cover for injury resulting from motor vehicle accidents became compulsory.[148] Insurance money payable for such liability was made the subject of a charge in favour of the injured plaintiff under the Motor-vehicles Insurance (Third-party Risks) Act 1928.[149] Section 10 of the 1928 Act applied, like the 1908 Act, where an insured owner of a vehicle who was liable to a third party died insolvent, was or became bankrupt, made a composition or arrangement with creditors or, being a body corporate, was the subject of winding up proceedings. In such cases, s 10 gave the third party a charge over the insurance money payable whether or not that liability was determinate.[150] Speaking at the second reading of the Motor-vehicles Insurance (Third-party Risks) Bill, the Attorney-General, the Hon Mr FJ Rolleston MP, explained that s 10 would negative the common law rule that would see insurance moneys distributed amongst all creditors of a bankrupt insured instead of going to the third party claimant.[151] The courts interpreted s 10 consistently with this purpose. In *Jorgensen v Findlater*, Myers CJ described the object of s 10 as being "to create a charge in respect of any existing liability that there may be and to prevent the injustice that was shewn to exist in such cases as *In Re Harrington Motor Company Co, Ltd, Ex parte Chaplin*".[152]

[156] Section 9 is modelled on s 42 of the Workers' Compensation Act 1908 and, as we have indicated, reflects the drafting style of those times. Many of the provisions of s 9 are substantially the same as those which first appeared in s 42. In two respects, however, s 9 is broader in scope than its predecessors. The section extended the scope of the statutory charge over the proceeds of liability insurance policies to apply to all contracts of insurance indemnifying an insured against "liability to pay any damages or compensation". The earlier more specific statutory

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147 Workers' Compensation Act 1908, s 42(1).
148 Motor-vehicles Insurance (Third-party Risks) Act 1938, s 3.
149 Section 10.
150 Section 10(1).
151 (27 September 1928) 219 NZPD 601.
152 *Jorgensen v Findlater* [1931] GLR 403 (SC) at 407, referring to *In re Harrington Motor Co, Ltd, ex parte Chaplin*, above n 138.

provisions applicable to workers' compensation and motor vehicle accidents were repealed. As well, the circumstances creating the charge were not limited to where the insured is bankrupt or being wound up. Section 9 does, however, have particular application in the insolvency context because it removes money from the pool of funds to be distributed to other creditors, preserving it for a successful claimant.

[157] In moving the committal of the Law Reform Bill 1936 in the House of Representatives the Attorney-General, the Hon HGR Mason MP, said:[153]

> Part III simply consolidates some existing provisions, which provide that where there is wrong perpetrated by a person who is insured the injured person can have a lien on the insurance-moneys. That already exists, in the law in respect of the Workers' Compensation Act, and also there are provisions in the Motor-vehicles Insurance (Third-party Risks) Act in relation to the matter. There was no provision of that sort in regard to the Deaths by Accidents Compensation Act, and instead of making a third provision the Law Draftsman thought it better to consolidate them all and make a general rule, which he has done in Part III, to cover all cases of that description.

He later reiterated:[154]

> It simply expresses the existing legislation as to liens, but in general terms, so as to apply to all Acts.

[158] The measure was supported for the Opposition by Mr Bodkin MP who observed that the Bill contained no new principles being written into the statute law for the first time. The principles had been accepted in the 1928 Act and Part III of the Bill did no more than consolidate those principles.[155]

[159] These references to the 1936 measure being a consolidating one, albeit extending charges over the proceeds of liability insurance policies to apply more generally, indicates that the purpose of s 9 was not to make wider inroads on the rights of insurers and insured under contracts of insurance than those which had been provided for in earlier statutory provisions in workers' compensation and accident

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153 (17 September 1936) 247 NZPD 237.
154 (17 September 1936) 247 NZPD 238.
155 (17 September 1936) 247 NZPD 240.

damages insurance money. This perception of the purpose of the 1936 Act finds support in observations of a textbook published in 1937:[156]

> This Part of the Law Reform Act, 1936, concerns insurance-moneys, and is an extension and consolidation of s. 48 of the Workers' Compensation Act, 1922, and of s. 10 of the Motor-vehicles Insurance (Third Party Risks) Act, 1928, under which the amount of the insured's liability–that is, his liability to pay compensation … in respect of a particular accident to which these statutes applied– was a first charge on all insurance-moneys payable in respect of that accident, whether this amount had been already determined or not, in the event of–
>
> (i) The employer or motor-vehicle owner dying insolvent or making a composition or arrangement with his creditors.
>
> (ii) Proceedings being commenced for winding-up, if the employer or motor-vehicle owner was a body corporate.
>
> (iii) An employer becoming bankrupt, or a motor-vehicle owner being bankrupt at the time of the accident or thereafter becoming bankrupt.
>
> The previously existing law thus protected the worker and the injured party in a motor accident against the insured's insolvency, bankruptcy, composition, arrangement, or winding-up.

The purpose of s 9

[160] In *Ludgater Holdings Ltd v Gerling Australasia Insurance Co Pty Ltd* this Court saw the purpose of s 9 in similar terms to that indicated by its legislative history:[157]

> The section and a 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.

[161] Later the Court added that:[158]

> … the section is plainly intended to operate primarily when an insured is insolvent and alters the priority of claims against an asset of such an insured …

[162] The appellants in the present case, however, contend that s 9 has a wider purpose which they say is focussed on the protection of the claimant and not the

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156 RG McElroy and TA Gresson *The Law Reform Act, 1936* (Butterworths, Wellington, 1937) at 30.

157 *Ludgater Holdings Ltd v Gerling Australasia Insurance Co Pty Ltd* [2010] NZSC 49, [2010] 3 NZLR 713 at [14] (footnote omitted).

158 At [21].

insured. Mr Tingey for Bridgecorp referred to the views of Kirby P on the equivalent New South Wales section. In his dissenting judgment in *McMillan v Mannix*, his Honour said:[159]

> Put simply, the scheme of the Act is the protection of the complainant. It is not, as such, the protection of the insurer and the insured.

[163] Earlier in the same judgment Kirby P said:[160]

> That the section was a creative legislative reform is not in doubt. Such a bold statutory provision ought not be rendered impotent, or frustrated in the achievement of its object, by the adoption of a narrow or restrictive interpretation.

[164] Kirby P repeated these views in *Grimson v Aviation and General (Underwriting) Agents Pty Ltd*:[161]

> The Court has previously held that the section should not be construed narrowly but should receive a construction, supported by the words, which achieves the purpose of Parliament of protecting those who are intended to have its benefit … . 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 … .

[165] It is important to take a purposive approach in the interpretation of s 9 but ascertaining its purpose requires a proper identification of the injustices that prompted the reform and which the section sought to ameliorate.[162] The legislative history traversed above indicates that the purpose in 1936 was the narrower one identified by this Court in *Ludgater*. While the purpose of s 9 was to remedy the perceived injustices of the common law and to protect the interests of third party claimants, this was to be achieved in a limited way. It was confined to providing a means for ensuring that the financial circumstances of the insured would not prevent payment of insurance moneys being made to the third party who had established the insured person's liability.

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159 *McMillan v Mannix* (1993) 31 NSWLR 538 (NSWCA) at 544.

160 At 543.

161 *Grimson v Aviation and General (Underwriting) Agents Pty Ltd* (1991) 25 NSWLR 422 (NSWCA) at 424 (citations omitted).

162 Compare the view of the House of Lords in *Bradley v Eagle Star Insurance* [1989] 1 AC 957 (HL) at 968 per Lord Brandon.

The meaning of s 9(1)

[166] The meaning of the critical phrase in s 9(1) – "a charge on all insurance money that is or may become payable in respect of that liability" – must be ascertained from the text, considered in light of this purpose.

[167] At the hearing, emphasis was placed by Mr Ring QC, for Chartis, on the significance of the phrase "in respect of" in s 9(1). Although regularly used by legal drafters, the phrase "in respect of" does not, in itself, have a precise legal meaning. It is used to convey that there is a necessary relationship between two stipulated subject matters that the phrase connects. It is in the context of its use in any text, in particular the nature of the two subjects that are linked by the phrase, that guidance is to be derived as to the sort of relationship that Parliament considered should exist.[163]

[168] In s 9(1), the two subject matters that "in respect of" establishes a relationship between are, first, "all insurance money that is or may become payable" and, second, "that liability". Read independently of the required relationship, the first subject is all money which the insured is entitled to receive or have paid on his or her behalf, under the terms of the policy. The language naturally includes payments by the insurer on account of liability, defence costs and any other payments provided for by the policy. The latter subject is the insured's "liability to pay any damages or compensation". As a matter of ordinary meaning, the relationship between these subjects requires that the scope of the charge is limited to that insurance money payable (the first subject of "in respect of") which is sufficiently connected to the liability that is the second subject. The charge does not attach to "all insurance money that is or may become payable" under the terms of the policy, but only to that insurance money that can be said to be payable "in respect of" the insured's liability to pay damages or compensation. So read, the relationship with the insured's liability qualifies the scope of the money payable under s 9(1).

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[163] The judgments delivered in the Court of Appeal in *Phonographic Performances (NZ) Ltd v Lion Breweries Ltd* [1979] 2 NZLR 252 (CA) provide a helpful illustration of the application of "in respect of" to a statutory text in the context of a "payment".

[169] The natural place to look to ascertain what money "is or may become payable in respect of that liability" is to the terms of the insurance policy that provide indemnity for that purpose in the particular case. The whole of s 9(1) is concerned with a charge over proceeds of insurance policies that indemnify an insured for his or her liability to meet a claim by a third party for damages or compensation and it is the terms of the policy that spell out the relationship between the insurer's obligation to advance insurance money and the insured's liability for damages or compensation. As Johnston J observed in an early case on s 9:[164]

> While this section does, I think, impose on the insurer an obligation to keep intact the amount of its liability to the insured, whatever it may be, so that the insured man is protected, it does not, I think, fix the amount of the insurer's liability to the insured. To find the amount one must go to the contract of indemnity. It is true that the liability of the insured may be greater as in this case than the amount for which the insurer has indemnified him, and the total amount of the insurer's liability is made a charge on all insurance-moneys payable to him. But although the amount for which the charge can be made may exceed the insurer's liability, the liability is not measured by the charge. Subsection 7 makes sure of this, providing that no insurer shall be liable under that part of the Act for any sum beyond the limits fixed by the contract of insurance between himself and the insured. To find out, therefore, the amount payable by the insurer, resort must be had to the contract of insurance, and to it alone.

[170] The terms of the policy may limit the insurance money that is payable to the insured as indemnity for its liability to pay damages or compensation to a third party. The most obvious way in which this occurs is by providing for a limit on the amount of the insurer's liability. But the sum payable by the insurer in respect of any claim under the policy may also be limited by the operation of other terms of the policy providing, for example, for the insurer to make payments to the insured in relation to other costs and liabilities, such as costs incurred in defending a claim by a third party.

[171] The judgment of Elias CJ and Glazebrook J[165] characterises payment of the directors' defence costs as payment of charged moneys. We see it as being payment of moneys due before the charge becomes fully operational in accordance with the insured's contractual rights at that time. The terms of the policy which provide that defence costs are payable before liability and quantum are established, operate, in

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164 *National Insurance Company of New Zealand, Ltd v Wilson* [1941] NZLR 639 (SC) at 644.

165 With which Anderson J agrees.

effect, as a limit upon the money that ultimately will be payable to the insured as indemnity for its liability to the third party.

[172] Thus, reading s 9(1) as a whole, there is a charge over the money that would, in the absence of s 9 and in the normal course of the operation of the policy according to all its terms, be or become payable by the insurer to the insured as indemnity against the insured's liability to the claimant. The charge does not extend to other money available under the policy but which is not ultimately ascertained to be payable to the insured in respect of its liability for damages or compensation. The charge accordingly becomes fully operational once an amount is, or has become, payable by the insurer to the insured, for example, by judgment establishing the insured's liability and acceptance by the insurer of cover under the policy. In this way, the charge operates fully only in respect of actual liability on the part of the insured to the third party (and the insurer to the insured),[166] and not, contrary to the view of the majority, on the basis of a claim, which may or may not ultimately prove to be successful.

[173] This meaning is consistent with the view we take of the purpose of the provision, already discussed. The purpose of s 9 was to provide a mechanism to ensure that the money that would otherwise be paid to the insured was instead made available to claimants and not dissipated by the insured or paid to its general creditors. The legislative history gives no indication of a wider protective concern that would further intrude on the contractual rights of the insurer and insured under the policy. In particular, there is no indication that s 9 requires there to be a charge in favour of the claimant over money other than that which will become available in the normal course to meet a liability of the insured to pay damages to that person.[167] The claimant does not, by virtue of the charge under s 9, become entitled to a greater sum than that to which the insured would have a right under the policy.[168]

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166 As Blair J observed in *Findlater v Public Trustee and Queensland Insurance Co* [1931] GLR 291 (SC) at 293 in respect of the antecedent provision in s 10 of the Motor-vehicles Insurance (Third-party Risks) Act, money is not payable in respect of a liability until that liability is established. Until then there is only a "possible liability" and the charge is not fully operational.

167 In this respect, we agree with the analysis in *Chubb Insurance Co of Australasia Ltd v Moore* [2013] NSWCA 212, (2013) 302 ALR 101 at [119]–[120] per Emmett JA and Ball J (with whom Bathurst CJ, Beazley P and Macfarlan JA joined).

168 *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd*, above n 139, at 17 per Richardson J.

[174] This is also consistent with Australian authority. Section s 9 has been adopted with little change in New South Wales and other jurisdictions.[169] The decision of the High Court of Australia in *Bailey v New South Wales Medical Defence Union Ltd* makes clear that the contract of insurance to which resort must be had to ascertain the scope of the charge is that which existed at the happening of the event giving rise to liability. In *Bailey*, McHugh and Gummow JJ were concerned with the effect of s 6(6) of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW), the equivalent provision to s 9(7). After pointing out the stipulation that no insurer shall be liable beyond the limits fixed by the insurance contract, their Honours said that this referred to the contract indemnifying the insured at the time of the event giving rise to the claim in terms of s 9(1) and not that contract as subsequently varied by the insurer and insured. They added:[170]

> That is not to say that the contract may not, at the time the charge arises, contain provisions conferring rights which, in the events which have already happened or which later happen, are exercisable by the insurer against the insured. But those rights, whenever exercised, draw their life from the contract at the time when the charge descended not from any subsequent variation or replacement of that contract.

[175] On this interpretation of s 9(1), the charge also protects claimants by preventing the insurer and the insured from acting in a way that would frustrate the claimant's access to the moneys payable under the policy. Recently, the Full Court of the Court of Appeal of New South Wales stated in *Chubb Insurance Co of Australasia Ltd v Moore*:[171]

> Thus, once the charge has arisen, upon the happening of the event that gives rise to the liability for damages or compensation, no mutual or unilateral action by either the insurer or the insured, which is taken otherwise than under 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 a claimant what otherwise would be the fruits of enforcement of the charge by action taken under s 6(4) against the insurer.

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169 In s 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW).

170 *Bailey*, above n 140, at 448 per McHugh and Gummow JJ, with whom Brennan CJ, Deane and Dawson JJ agreed as to the effect of s 6 of the Law Reform (Miscellaneous Provisions) Act (NSW).

171 *Chubb*, above n 166, at [131] per Emmett JA and Ball J.

For example, the insurer and the insured are precluded from bargaining for discharge of the indemnity obligation by some lesser amount, and from varying the policy by agreement.

The statutory context

[176] The appellants, however, contend that this meaning is contradicted by s 9(6) of the Act which reads:

> (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.

The submission is that s 9(6) must be read as implicitly stipulating that any payment under the contract by an insurer *with* notice of the existence of the charge, is not a valid discharge. Mr Tingey pointed out that in *Bailey*, McHugh and Gummow JJ said:[172]

> 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.

[177] This argument is based on the premise that full force must be given to the prohibition that is the inverse of the statutory language in s 9(6). In some cases, the inverse proposition will be correct, for example, where, as in *Bailey*, the only payments that may be made under the policy are those in respect of the insured's liability to pay compensation or damages. The generality of their Honours' statement in *Bailey* is also explained by the fact that the exact scope of s 6(6) was not at issue in that case. Logic does not, however, require that the inverse of every statement is also necessarily true in all circumstances. Somewhat closer attention to Parliament's intended meaning of the words it used in s 9(6) is required in the circumstances giving rise to the present appeals.

[178] The generality of the phrase in s 9(6), "Any payment made by an insurer under the contract of insurance", is symptomatic of the age and origins of s 9 and, as

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[172] *Bailey*, above n 140, at 450 per McHugh and Gummow JJ.

already explained, an overly literal approach to the text will not be helpful. Those words should be read, in light of their context and consistent with the purpose of s 9, as confined to payments connected with the insurer's indemnity for the insured's liability to the claimant. Section 9(6) is concerned with restricting the freedom the insurer would otherwise have to pay to the insured money in respect of the liability, for example, as a result of a compromise.[173] It is not concerned with interrupting the operation of other terms of the insurance policy. It is inconsistent with Parliament's purpose to read s 9(6) as having that meaning.

[179] Nor does s 9(3) assist the appellants. Section 9(3) gives a charge created by s 9 "priority over all other charges affecting the said insurance money", being insurance money payable in respect of the insured's liability for damages or compensation. It applies as between charges arising under s 9 itself and any other charges given by the insured, such as those given by a general security agreement or a specific charge over the right of the insured to recover from the insurer.[174] As well, s 9(3) applies to competing charges that arise under s 9(1), altering both the common law[175] and any policy terms that prioritise the payment of such claims, for example, according to when judgment is obtained. Payments under the policy in respect of the insured's liability to third parties must be made in accordance with the priority set out in s 9(3): claims are to be paid according to the order of the dates on which the events giving rise to liability occurred, ranking equally where the claims arose on the same date. The priority of a charge is preserved from the time of the event giving rise to liability.[176] To this extent, we disagree with the decision in *Chubb* that s 9(3) allows third party claims to be paid in the order in which judgment or settlement is achieved.[177] We understand the majority to be of the same view.

[180] But the pre-existing contractual entitlement of the insured as a party to the insurance policy, to the payment of insurance money in respect of defence costs does

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173 Neil Campbell "Insurance Law" [2012] NZ L Rev 353 at 361.

174 *Ludgater Holdings Ltd v Gerling Australasia Insurance Co Pty Ltd*, above n 157, at [17].

175 The common law "dash for cash" approach is explained above at n 33 of the reasons of Elias CJ and Glazebrook J.

176 As was the case under s 10 of the Motor-vehicles Insurance (Third-party Risks) Act: see *Findlater v Public Trustee and Queensland Insurance Co*, above n 165.

177 See above at [46]–[50] of the reasons of Elias CJ and Glazebrook J.

not constitute a "charge" over insurance money.[178] Section 9(3) therefore does not give a charge under s 9(1) a priority over payments to be made as ordinary incidents of the operation of the policies in relation to other liabilities. The priority rule in s 9(3) accordingly does not alter the operation of any policy terms that may allow payments to be made by the insurer to the insured in respect of defence costs (or some other liability) before any money becomes payable or is paid in respect of the insured's liability to a third party. Such policy terms continue to apply, operating as a limit on the money that will become payable in respect of the charged claim, as we have indicated.[179]

[181] Interpreted in this way, s 9(3) protects the position of a claimant, consistently with the purpose of s 9. It gives a s 9 charge priority over the secured interests of creditors and prevents the insurer from reducing the money that may be payable to a claimant by making payments to an insured in relation to subsequent liabilities. It does not, however, prevent the insurer from making payments to meet other obligations under the policy.[180]

[182] Section 9(4) is not concerned with the scope of the charge that ultimately will determine the amount that may be claimed in proceedings against the insurer. Its text provides no assistance on that issue.

[183] Section 9(7) is an indication, in the statutory context, that supports this interpretation of s 9(1). Payment of defence costs by the insurer facilitates defences against unmeritorious claims of liability of the insured and claims for excessive amounts of damages or compensation. In doing so it helps ensure the integrity of the operation of the insurance policy. To allow these rights to be negated would be inconsistent with s 9(7) which provides that no insurer is to be liable beyond the limits fixed by the contract of insurance.

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178 See DK Derrington and RS Ashton *The Law of Liability Insurance* (3rd ed, LexisNexis Butterworths, Chatswood (NSW), 2013) vol 2 at [13]–[142].

179 See above at 170.

180 Campbell, above n 172, at 361.

Wider commercial context

[184] Unlike the majority,[181] we do not see the different forms of charges that existed in 1936 as relevant context in interpreting s 9. As Mr Galbraith QC, counsel for the directors in the *Houghton* proceedings, submitted, the charge under s 9 is sui generis: its nature and scope is best ascertained from the text of the statute read in light of its purpose and its statutory context.

Pattinson v General Accident, Fire, and Life Assurance Corp Ltd

[185] For completeness we add that we do not accept that the judgment of Myers CJ in *Pattinson v General Accident, Fire, and Life Assurance Corp Ltd*[182] materially assists the appellants. That judgment is often cited for the proposition that s 9 imposes a charge on the insurance money which accrues on the happening of the event giving rise to the claim for damages or compensation,[183] which is not in issue in this case. The appellants, however, seek to rely on Myers CJ's decision that the insurers in that case had "rightly abandoned" their claim to deduct solicitors' costs from the sum of insurance money paid to the claimant.

[186] In *Pattinson*, Myers CJ decided that, reading the applicable insurance policy and s 9 together, the insured or insurer was not entitled to pay its legal costs at the expense of the third party for whose benefit a charge exists over the insurance moneys. The insurer was "not bound to undertake absolutely the payment of the costs of the solicitors" and, if it chose to do so, the insurer would have to bear the costs itself.[184] It is not, however, clear whether Myers CJ's decision was based on his interpretation of the insurance policy, or on the effect of the s 9 charge on the policy.

[187] If Myers CJ's decision was based on the terms of the applicable policy, it can be distinguished from the present appeals. Mr Forbes QC submitted on behalf of Mr Houghton that the terms of the Chartis policy did not impose any obligation on the insurer to pay the insured's defence costs. We disagree. The policies applicable to

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181 See above at [70]–[77] of the reasons of Elias CJ and Glazebrook J.
182 *Pattinson v General Accident, Fire, and Life Assurance Corp Ltd* [1941] NZLR 1029 (SC).
183 See for example, *Bailey*, above n 140, at 443 per McHugh and Gummow JJ.
184 *Pattinson*, above n 182, at 1039.

both of the present appeals require each insurer to indemnify the insured in respect of defence costs incurred with the insurer's consent, which must not be unreasonably withheld. This imposes on the insurers an obligation to consent to, and provide cover for, defence costs unless it is reasonable to refuse to do so.[185]

[188] If, on the other hand, Myers CJ reasoned that the effect of s 9 was to charge all insurance moneys up to the limit of indemnity, thereby rendering the insurer a volunteer in respect of defence costs, we disagree. As well, as the argument in relation to the solicitors' costs had been abandoned, Myers CJ's comments were obiter.

[189] In contrast with *Pattinson*, the New South Wales Court of Appeal in *Chubb* has reached the same conclusion on this point as we have. The Full Court was there required to decide whether the charge imposed by s 6 of the Law Reform (Miscellaneous Provisions) Act (NSW) extended to defence costs that are paid by an insurer in accordance with a policy before judgment is obtained or settlement agreed in respect of the third party's claim for damages or compensation. The Court said:[186]

> [121] The [third party claimants] rely on the proposition that s 6 is intended to ensure that insurance moneys are not depleted to the prejudice of a claimant. However, stating the purpose in those terms glosses over an important distinction. It is unquestionably the purpose of s 6 to ensure that insurance moneys that are payable to an insured *in respect of liability to a claimant* are not depleted to the prejudice of the claimant. Nevertheless, there is nothing to suggest that the purpose of s 6 is to prevent insurance moneys being paid to discharge *other* obligations that an insurer may have to an insured under a contract of insurance.
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> [122] Importantly, if s 6 were construed as catching all moneys available at the time when the charge arises, that would alter the contractual rights between insurer and insured. In the present case, each insured under the [insurance policy] has a contractual right to be advanced defence costs within 30 days of receipt of an invoice from defence counsel. That right exists even if the right to indemnity under the [insurance policy] has not yet been determined. The [insurance policy] contains a provision permitting the Insurer to recover amounts so advanced in the event that it is ultimately determined that the [insurance policy] does not respond to the claim in question.

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185 The insurers are also free to consent to defence costs even where it would be reasonable to withhold consent, in which case they are obliged to provide cover.

186 *Chubb*, above n 167 (emphasis in original).

> [123] Those provisions provide a valuable benefit to the insureds. They ensure that the insureds are not placed in the invidious position of having insufficient resources to defend major claims while the insurers consider the question of indemnity. If the charge caught all moneys available under the [insurance policy] at the time when the charge arose, and s 6 applied, [the insurers] could not safely pay defence costs, if there were any possibility that the ultimate liability of the insured might exceed the amount available to meet that liability at that time. There would then be a real question as to what would happen.
>
> [124] The insured would have a contractual right to be paid defence costs and could bring an action to enforce that right. It would be extraordinary if the effect of s 6 were to provide [the insurers] with a defence to such an action, on the basis that they might, at some time in the future, be liable, by the operation of s 6(4), to pay to the [claimants] the moneys that would otherwise have been paid in defence costs. There is nothing on the face of s 6 to suggest that it was intended to alter the contractual rights of the parties in such a radical fashion. If the New South Wales Parliament intended s 6 to have such a drastic effect on the contractual rights of an insured, it could be expected to have provided so in express terms.

Conclusion

[190] We have had the opportunity to consider in draft the judgment of Elias CJ and Glazebrook J, with which Anderson J agrees, and now state our essential differences. We are in agreement with the majority that the charge under s 9 arises on occurrence of the event giving rise to the insured's liability. We do not agree with the majority's conclusion that the charge secures the full amount of the eventual liability of the insured.

[191] If, as the appellants contend and the majority accept, the insurance money charged was what was available within the policy limit when the event giving rise to liability of the claimant took place, that would interfere with the ability of the insured and insurer to defend third party's claims. That would be a major interference with the rights of insurer and insured under the policy that formed part of their bargain. There is no indication that Parliament had in mind such an interference with the contractual position and the passages cited above from *Chubb* support this view.

[192] We have concluded that the text of s 9, its purpose and statutory context all support reading the phrase "all insurance money that is or may become payable in

respect of that liability" as the insurance money that would, in the ordinary course of events and in accordance with the policy, be payable to the insured as indemnity for the insured's liability for damages or compensation. Money which "is or may become payable" does not mean money which is, at the time the charge arises, available to indemnify the insured for its liability. It rather means the money ultimately ascertained to be payable to the insured. What is so payable is limited by the terms of the policy. The limitations include, but are not confined to, the contractual limit on cover. Other terms of a policy may permit payments in relation to other liabilities or costs of the insured, such as defence costs. Following the event that creates the charge, these terms of the policy will continue to operate until what is payable is determined, at which point the charge operates fully on the insurance money payable in respect of the insured's liability for damages or compensation.

[193] Under the policies applicable to the present appeals, payments in respect of defence costs may be made prior to liability and quantum being agreed or established, at which point what is "payable" in terms of s 9(1) has been determined. It is that sum which is charged. Prior to that time, the directors are entitled to be paid reasonable defence costs incurred as a contractual right that is not affected by the charge until it is fully operational. This accordingly allows each insured, in conjunction with the insurer, to defend the claim and meet its costs in doing so. Defence costs claimed and paid under the policy must be reasonable, a limitation that the courts, if called on, will monitor.

[194] So interpreted, the statutory relationship between the insurer and the third party claimant, created when the charge arises, provides a measure of protection to that claimant without unduly interfering with the contractual relationship between the insurer and the insured.

[195] For these reasons we are satisfied that the judgment of the Court of Appeal and the declaration it made were correct. Accordingly we would dismiss the appeal.

ANDERSON J

[196] I agree with the analysis and result of the judgment given by Glazebrook J for her and the Chief Justice, in light of which I add the following. It is plain to my mind that the legislation is intended to benefit a claimant, not the insured and, in terms of fiscal reality, the insurer. The question is, who carries the risk of being wrong? I think it is obvious that the legislation puts the risk on the insurer/insured. Suppose that the insurer/insured successfully defends the claim, then there is no loss to the claimant in respect of the insurance policy. But suppose that the insurer/insured defends unsuccessfully. Could the legislative intent be that, although meritorious, the claimant should, in effect, underwrite the failed attempt of the claimant's opponent? I think not. In my opinion, the risk of failure passes to the insurer/insured, who, if they consider the claim is worth defending, must defend at their own risk. I would allow the appeals and agree with the costs orders.

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