

# FOCUS

## INSURANCE & REINSURANCE



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## MIND THE GAP: DIRECTOR INDEMNIFIED FOR COSTS OF OWN ACTION

Companies typically indemnify their directors for third-party claims made against them for liability arising from the performance of their duties as directors. However, a recent New South Wales Supreme Court decision suggests that some companies may be providing a broader indemnity than they realise. Partner Dean Carrigan and Senior Associate Mark Lindfield discuss the implications that this key finding may have on the potential gap between the indemnity a company gives to its directors and the terms of its directors' and officers' liability insurance.

A court decision suggests some companies may be providing a broader indemnity to directors than intended

### BACKGROUND

Nicholas Whitlam was director of National Roads and Motorists' Association Limited (**NRMA**) from 1995 to 2002 and was its president from 1996 to 2002. He was also chairman of its subsidiary, NRMA Insurance Limited, which is now known as Insurance Australia Group Limited.

These two companies were, prior to 2000, mutual organisations that together comprised the NRMA Group.

Between 1994 and 2000, the NRMA Group considered various proposals to demutualise. In March 2001, Mr Whitlam was interviewed by the Nine Network's *Sunday* program about the demutualisation. Mr Whitlam consulted with

NRMA about the question of whether to provide the interview and ultimately took part in the interview with NRMA's consent.

On several occasions between March and December 2001, Nine broadcast excerpts of that interview in stories that were capable of conveying defamatory imputations of Mr Whitlam.

In March 2001, a *Sunday* reporter was interviewed by Sydney radio station 2GB about the first of these broadcasts. This radio interview also conveyed defamatory imputations of Mr Whitlam.

Mr Whitlam did not immediately commence defamation proceedings against Nine, but was kept informed of the status of proceedings that



were commenced by NRMA Limited in July 2001. However, Mr Whitlam did immediately commence defamation proceedings against 2GB and these proceedings were settled in May 2002 when the radio station agreed to apologise to Mr Whitlam and pay almost all of his legal costs.

Mr Whitlam eventually commenced defamation proceedings against Nine in December 2002, but those proceedings were discontinued four months later.

## DEEDS OF INDEMNITY

In November 1999, Mr Whitlam and NRMA had executed a deed by which NRMA confirmed the basis upon which Mr Whitlam was entitled to indemnity, insurance and access to documents while serving as an officer of NRMA Group companies.

The parties executed a second deed in August 2002 to reflect the demutualisation of NRMA Group and the enactment of the *Corporations Act 2001* (Cth).

The important issue highlighted by this case is the need for companies to ensure that the indemnities that they provide to their officers are aligned with their own directors' and officers' insurance.

In August 2002, Mr Whitlam requested that NRMA reimburse him for legal costs that he had incurred in defending proceedings commenced by the Australian Securities and Investments Commission (**ASIC**) for alleged breaches of director's duties (in which ASIC had been successful at first instance, but in which Mr Whitlam had successfully appealed to the New South Wales Court of Appeal).

At the same time, Mr Whitlam sought from NRMA an indemnity for compensation and legal costs incurred 'in respect of causes of action in defamation arising as a consequence of numerous defamatory publications' concerning his role as director and president of NRMA.

The claim for compensation was later described by his solicitors as being a claim for indemnity for 'damage to his reputation and consequential loss of earning capacity, which would otherwise be compensable from those directly responsible for it.'

Despite this, and several further requests, in December 2004 NRMA eventually declined to indemnify Mr Whitlam.

## THE PROCEEDINGS

Mr Whitlam commenced proceedings against NRMA, in which the issues were limited so that the only relief sought was a declaration and orders that NRMA was liable to indemnify him for:

- the costs reasonably incurred in the proceedings against 2GB;
- the costs reasonably incurred in the discontinued proceedings against Nine; and
- the costs he may reasonably incur in bringing defamation proceedings against Nine.

NRMA denied that it was liable to Mr Whitlam because the indemnities sought were not liabilities that arose from a third-party claim against Mr Whitlam for his acts or omissions as an officer of NRMA and the deeds of indemnity were obviously intended to respond only to such liabilities.

Justice Bergin, in the Supreme Court of New South Wales, handed down her decision on 3 August 2006.

## WHICH DEED APPLIES?

The deeds executed by Mr Whitlam and NRMA in 1999 and 2002 conferred a 'full indemnity' to Mr Whitlam for all liabilities incurred by Mr Whitlam as an officer of an NRMA Group company, including costs incurred in defending proceedings in which judgment was given in Mr Whitlam's favour and in which the court grants relief to Mr Whitlam under the corporations legislation.

Both deeds excluded any indemnity for a liability arising from 'a lack of good faith, wilful misconduct, gross negligence, reckless misbehaviour or fraud'.



Both deeds also excluded any indemnity for a liability to the NRMA Group, except one that was permitted by section 241(3) of the *Corporations Law* (under the 1999 deed) or one that was permitted by ss 199A(2) or 199A(3) of the Corporations Act (under the 2002 deed).

NRMA argued that Mr Whitlam's entitlement to indemnity should be construed by reference to the 1999 deed only and that the indemnity being sought was prohibited by s241(3) of the Corporations Law.

Mr Whitlam argued that, even if the indemnity was prohibited under the 1999 deed, the 2002 deed should apply and the claim for indemnity was not prohibited by that deed.

Justice Bergin found that, as a matter of construction, the 2002 deed was intended to replace the 1999 deed and, therefore, the question was whether the indemnity being sought was prohibited by that deed.

## DEFENDING A CLAIM CAN INCLUDE INITIATING PROCEEDINGS

Justice Bergin found that by incurring costs in bringing defamation proceedings against Nine, Mr Whitlam had taken steps in defending a claim and that this was a liability for which the 2002 deed provided an indemnity.

Her Honour found that nothing in s199A of the Corporations Act prohibited an indemnity for costs incurred in pursuing a defamation action. Further, Mr Whitlam was found to have been defamed in the performance of his duties as an officer of NRMA, being his authorised interview with Nine.

The indemnity conferred by the 2002 deed was very broad and the court found that the only pre-requisite to indemnification by NRMA was that Mr Whitlam incurred 'loss, liability, cost, charge or expense ... as an officer' of NRMA. This pre-requisite was satisfied because Mr Whitlam incurred a liability by giving an interview to Nine with NRMA's authority and in his capacity as an officer of NRMA (not in his personal capacity).

The indemnity for those costs was to be limited to cases in which Mr Whitlam was vindicated by obtaining an apology, a settlement or verdict and judgment. Here, Mr Whitlam had discontinued his action against Nine and obtained an apology from 2GB.

Justice Bergin found that Mr Whitlam was entitled to indemnity for the costs incurred in the 2GB proceedings and also for the Nine proceedings because Mr Whitlam's discontinuance was reasonable in the circumstances.

However, Mr Whitlam's ultimate entitlement to indemnity for costs incurred in the proceedings against Nine could not be determined until the outcome of Mr Whitlam's proposed further proceedings against Nine (the conduct of which NRMA would be entitled to assume).

## COMMENT

It has been suggested that this case has ramifications for companies, their insurers and their shareholders. This is true, but it is important to recognise that this decision ultimately turned on the wording of very broad indemnities provided by a company to its officers through deeds of indemnity, insurance and access.

The indemnities were broader than the company intended because the court found that they included not only actions brought against the officer, but also actions commenced by the officer when defending allegations (in this case, defamatory imputations) made against them in their capacity as an officer.

The important issue highlighted by this case is the need for companies to ensure that the indemnities that they provide to their officers are aligned with their own directors' and officers' (**D&O**) insurance.

Alternatively, companies must at least be aware of the existence of any gaps between their D&O insurance cover and the indemnities given to their officers.

Conventional D&O policies provide two types of cover: firstly to, or on behalf of, the company in respect of liabilities that the company incurs when indemnifying a director or officer, when permitted or required to do so by law; and secondly to, or on behalf of, the insured director or officer for all liabilities for which the insured person is not indemnified by the company.

Typically, a D&O insurance policy will not provide cover for actions commenced by an officer against a third party because such policies are generally expressed as providing cover for claims made by third parties against officers in their capacity as officers of the company.

However, this may not be true in all cases and regard must be had to the particular terms and cover provided by each policy to identify what gaps, if any, exist between the insurance policy and the indemnity provided by the company to its officers.

Gaps in cover may exist for a number of reasons, such as officers not being prepared to carry out their functions without very broad indemnities to which the insurance may not respond.

However, if companies are not at least aware of those gaps in their D&O insurance cover then they expose themselves to the risk of liabilities to officers and directors which are not covered by insurance.



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