

International Corporate Rescue



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CASE REVIEW SECTION

AIG Australia Limited v Kaboko Mining Limited [2019] FCAFC 96

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Synopsis

In *AIG Australia Limited v Kaboko Mining Limited* [2019] FCAFC 96 the Full Federal Court of Australia was required to consider whether an insolvency exclusion clause in a directors' and officers' ('D&O') policy precluded a claim for indemnity by former directors and officers. Upon construing the exclusion clause by reference to the D&O policy definitions, the Court held that their indemnification under the policy was not excluded on the basis that the alleged breaches of duties by the former directors and officers were not founded upon any allegation of insolvency. The decision is a timely reminder of the importance of considering the appropriate formulation of claims against directors or officers of insolvent companies, particularly where an insolvency exclusion may apply.

Introduction

Kaboko Pty Limited ('Kaboko') entered into agreements with Noble Resources Limited ('Noble') to sell manganese ore extracted from mines in Zambia. Under the agreements Noble would advance USD10 million to Kaboko in two tranches to be used for specified purposes. Around two years after the agreements were entered into, Noble alleged Kaboko was in default of the agreements as Kaboko had sold manganese to third parties without its consent, used the advanced funds for purposes other than the specified purposes and failed to keep proper financial records. Noble issued a demand for repayment of the amounts owing, and when Kaboko failed to pay, Noble appointed receivers to Kaboko. Shortly thereafter Kaboko appointed administrators pursuant to s 436A of the *Corporations Act 2001* (Cth). Subsequent to entering into a deed of company arrangement, the administrators brought proceedings against the former directors and officers, seeking damages, being the amounts owed to Noble for the unpaid advances.

The facts

In September 2016, Kaboko commenced proceedings against four of its former directors and officers ('Former Officers') for breaching their duties to act with due

care and diligence in managing the affairs of the company and to act in good faith in the best interests of the company. The Former Officers sought indemnity from AIG Australia Limited ('AIG') pursuant to their D&O policy. AIG declined to indemnify the Former Officers relying on the insolvency exclusion endorsed on the policy. This was because AIG alleged that the breach of duties by the Former Officers led to the company's state of insolvency. Relevantly, the proceedings did not allege the Former Officers were guilty of insolvent trading.

The insolvency exclusion contained in the policy stated:

'[AIG] shall not be liable under any Cover or Extension for any Loss in connection with any Claim arising out of, based upon or attributable to the actual or alleged insolvency of [Kaboko] or any actual or alleged liability of [Kaboko] to pay any or all of its debts as and when they fall due.'

Justice McKerracher in *Kaboko Mining Limited v Van Heerden (No 3)* [2018] FCA 2055 rejected AIG's argument, taking into account the commercial purpose of the D&O policy and the 'mischief' sought to be excluded by the insolvency exclusion.

Issues

The Full Federal Court identified that the key question was whether it was the subject matter of the Claim that must have the requisite link to insolvency, or whether that link can be established where, by reason of the circumstances that led to the Claim being brought, it can be said that the Claim arises out of, is based upon or is attributable to the insolvency.

The judgment

In reaching its decision, the Court focused on the use of the defined terms 'Loss' and 'Claim' in the exclusion clause and acknowledged the following three significant points as to those definitions [at 44]:

1. the definition of Loss itself incorporated the term Claim;

2. the definition of Claim was concerned with the occurrence of an event, not the reasons why that event occurred; and
3. to the extent the definition of Claim referred to a demand or a proceeding, it referred to a demand or proceeding 'for a specified act, error or omission'.

Parties' interpretations of the insolvency exclusion

AIG submitted that the exclusion applied where there was any loss in connection with any claim arising out of, based upon or attributable to the specified insolvency event. Therefore AIG argued it was able to rely on the insolvency exclusion in circumstances where there was the requisite insolvency connection with the bringing of the claim or the nature of the loss for which indemnity was sought (at [38]). In so doing, AIG argued that the proceedings had been brought because of the insolvency of Kaboko as there would have been no proceedings had Kaboko repaid Noble for the advances made.

For Kaboko it was submitted that the exclusion only applied if insolvency was one of the underlying facts, that, if established, would justify the claim or loss claimed. As such, for the insolvency exclusion to apply, the merits of the claim itself or the causal link for the loss claimed must depend upon demonstrating the insolvency of Kaboko.

The Court's decision

In dismissing AIG's appeal the Court held that for the purposes of this insolvency exclusion, a Claim does not arise out of, is not based upon and is not attributable to insolvency unless the subject matter of the Claim has that character.

The Court reasoned the exclusion could not apply on the basis that Kaboko's insolvency motivated or led to bringing the Claim, for reasons including:

- there was no language in the definition of 'Claim' or in the insolvency exclusion that directs attention to the reasons why the Claim was brought;
- there is no commercial rationale for the extent of coverage to be dependent upon the motivations behind bringing the Claim;
- to accept AIG's argument, there would need to be an objective or subjective inquiry into the state of mind of those bringing the Claim – which would likely result in complexity in other cases; and
- the words used in the insolvency exclusion, especially 'arising out of' and 'based upon' indicate a focus on the subject matter of the Claim, not the motivations behind bringing the Claim.

Ultimately, the Full Court found that Kaboko's claim against the Former Officers was not founded upon any allegation of insolvency, and could be advanced irrespective of whether Kaboko was in administration. Accordingly, it could not be said that the breaches were of a character that they arise out of, are based upon or are attributable to Kaboko's insolvency.

Comment

The decision confirms that the reasons and motivation for commencing proceedings are irrelevant in determining the scope of insolvency exclusions in D&O policies and, such exclusions will not automatically apply to claims against former directors and officers of insolvent companies. In relying primarily on a close consideration of the policy wording rather than commercial considerations, the judgment demonstrates the Court's objective approach to the construction of insolvency exclusions, specifically in D&O policies. Moving forward, parties seeking to bring claims against former directors and officers of an insolvent company should closely consider the way in which they formulate those claims and the potential interaction with any insolvency exclusion.

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