Grant Thornton

Western Pacific Insurance Limited (in Liquidation)

Report to Creditors dated 21 December 2011

Contents

Matters leading up to this report

We refer all creditors to our last report issued in October 2011 and provide the following update on progress of the liquidation

Appointment

On 1 April 2011, the Shareholders by Special Resolution appointed David Ian Ruscoe and Simon John Thorn, of Grant Thornton New Zealand Limited, as Joint and Several Liquidators of Western Pacific Insurance Limited ("the Company").

Policy cancellation

All policies/contracts of insurance issued by the company were cancelled effective 21 April 2011.

Accordingly, all policyholders are advised to arrange alternative cover where possible and to act as prudent uninsured in the event alternate insurance cannot be secured.

Claims

The claims department remains in operation and all claims for losses incurred prior to the cancellation of all policies should be notified to the claims department for assessment.

The claims department can be contacted on (09) 365 1642 or claims@westenpacins.com.

Reinsurance

The company's reinsurance treaties have been retained by payment of the initial premiums for the 2011 year totalling approximately $430,000. The balance of premium due for the 2011 year treaties is a further $2m and it is expected the reinsurers will offset this amount from reinsurance recoveries in respect of each treaty where premium remains payable. It is estimated recoveries totalling $34 million may be available from reinsurance.

Debtors and unremitted premiums

We are continuing with efforts to recover significant unremitted premiums held by brokers, which are due in accordance with the brokerage agreements entered into between the brokers and the company.

Claims summary

The following is an update on the claims position along with an estimate of the reinsurance recovery at the time of writing this report.

We expect there will be a shortfall of funds available for claims and also expect that the quantum of claims may increase as assessment of same is completed.

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Claims – Sept 2010 Earthquake	14,118,590
Claims – Feb 2011 Earthquake	32,496,009
Other New Zealand claims	1,246,975
Australian based claims	13,556,151
Pacific and other claims	2,014,381
Estimated total claims	**63,432,106**
Reinsurance recovery estimate – Sept 2010 Earthquake	13,391,527
Reinsurance recovery estimate – Feb 2011 Earthquake	21,174,919
Reinsurance recovery estimate – Other	1,944,018
Estimated total reinsurance recovery	**36,510,464**
Reinsurance premiums due	**2,675,405**
Estimated claims shortfall	**24,246,237**

Meeting of creditors

As outlined in our previous report, the company has limited funds and we do not believe convening a meeting of creditors at this stage is in the best interests of creditors. In this regard, we note that the cost of convening and holding a meeting is likely to be considerable as creditors are scattered throughout both New Zealand and the wider Asia Pacific region. Rather, we encourage all creditors with queries to contact the claims department or us directly.

Entitlement to Reinsurance Proceeds

Application to Court for Directions

As reported previously, we expect to receive an estimated $34 million from the company's reinsurers in respect of claims made by policy holders for loss arising out of the two main earthquakes in Christchurch, New Zealand on 4 September 2010 and 22 February 2011.

We explained that there was some uncertainty as to who was entitled to those reinsurance proceeds and that we have applied to the Court for directions on behalf of all creditors of the Company as to whether:

- We can pay out those reinsurance monies to all creditors of the company and not just those policy holders who have claimed for loss arising out of the two earthquakes ("Canterbury Policy Holders").

- We can repay from those reinsurance monies any funders who have advanced money to Western Pacific to pay premiums due on the reinsurance treaties or who may advance money to pay loss adjustors to assess claims.

- We can pay from those reinsurance monies our fees and expenses and remuneration if there are no other funds available to us to pay these costs.

The Court appointed Jared Ormsby to represent Canterbury Policy Holders.

Judgement

Our application was heard in the High Court at Wellington on 3 November 2011.

The judgment, a copy of which is attached in full, provides that the above mentioned reinsurance proceeds are charged in favour of the Canterbury Policy Holders pursuant to section 9 of the Law Reform Act 1936.

What does this mean for creditors?

The decision of the Court means that the Company will not receive the above mentioned reinsurance proceeds and therefore there is likely to be no funds available for creditors of the Company including those policy holders with claims unrelated to the two earthquakes.

If the reinsurance proceeds were available for all creditors of the Company, a return of approximately 50 cents in the dollar would be available before costs assuming total claims were $68m (refer above total insurance claims, excluding ordinary unsecured creditors, is presently greater than $63m).

Right of Appeal

We have sought legal advice on the merits of appealing the judgment of the High Court.

As you may recall from our reports to creditors on 7 June 2011 and 26 August 2011, our initial legal advice was that Canterbury Policy Holders may have a right to claim against the specific funds received from reinsurers for each earthquake, but a level of uncertainty about this meant that it was necessary to seek directions from the Court.

In preparing for the Court hearing on behalf of all creditors of the Company, our legal advisors took the view that there are reasonably sound arguments that Parliament did not contemplate that section 9 of the Law Reform Act 1936 would apply to reinsurance in the circumstances present in this case.

Our legal advice is that the Judge may have made errors of law in reaching his decision, which makes the judgment susceptible to being overturned on appeal and that they regard the prospects of success as being fair.

Funding requirements

The practicalities of actually running an appeal given the proceeds of reinsurance are effectively quarantined from the liquidation under the recent judgement mean that to do so we will require funding.

The liquidation presently has limited funds. It is unlikely, given that the Court has found that the reinsurance proceeds are charged in favour of Canterbury Policy Holders, that we will be able to meet the costs of an appeal from those reinsurance proceeds (as we have been allowed to do in respect of the application to the High Court). Accordingly, creditors who would benefit from a successful appeal are being asked to consider funding such action.

It is estimated the costs of an appeal may exceed $75,000 before GST and disbursements. These costs are comprised of the following:

- Legal costs estimated at $40,000
- Liquidators' costs estimated at costs $25,000
- Security for costs estimated at $10,000 (this amount may be required to cover costs awarded to Canterbury Policy Holders for defending the proceedings should the appeal ultimately be unsuccessful).

Should the appeal be successful, it is possible the Canterbury Policy Holders would appeal this decision to the Supreme Court resulting in further costs.

We ask that all creditors willing to fund an appeal contact us in writing no later than Friday, 20 January 2012 as proceedings for an appeal must be filed by 27 January 2012.

Other Matters

Next report
We expect to provide you with a further report in February 2012.

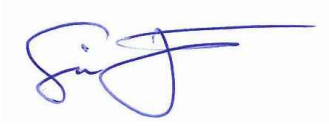
Contact details
Please forward general enquiries to westernpac@nz.gt.com and we will respond as soon as possible.

For any claims enquiries please call (09) 365 1642 or forward to claims@westenpacins.com.

Further information
Further information including correspondence to date and documents relating to recent Court judgement are available on our website www.grantthornton.co.nz.

Disclaimer
The statements and opinions expressed in this report have been made in good faith, and on the basis that all information that we have relied upon is true and accurate in all material respects. In preparing this report we have relied upon, and have not necessarily independently verified, the information and explanations provided to us and we express no opinion as to the accuracy or completeness of that information, other than to note that our investigations are ongoing.

The contents of this report are based on the information available to us at the date of this report. If we become aware of any additional information not known to us at the date of this report, we reserve the right, but shall not be obliged to, review or update this report.



David Ruscoe
Liquidator

Simon Thorn
Liquidator

Appendix 1 – Judgement of Simon France J (CIV 2011-485-1535)

IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV 2011-485-1535

IN THE MATTER OF	the Companies Act 1993
AND	
IN THE MATTER OF	the Liquidation of Western Pacific Insurance Limited (In Liquidation)
AND	
IN THE MATTER OF	an application by DAVID IAN RUSCOE and SIMON JOHN THORN of Grant Thornton New Zealand Limited as joint and several Liquidators of Western Pacific Insurance Limited (In Liquidation)
BETWEEN	D I RUSCOE AND S J THORN Applicants
AND	CANTERBURY POLICY HOLDERS First Respondents

Hearing: 3 November 2011

Counsel: F B Barton and V M Heward for Applicants
J V Ormsby for First Respondents
J Toebes for Interveners

Judgment: 9 December 2011

JUDGMENT OF SIMON FRANCE J

Introduction

[1] This is an application by the liquidators of Western Pacific Insurance Limited for directions. Western Pacific went into voluntary liquidation on 1 April this year. As at the date of this hearing there are unsettled claims totalling around $60 million. Two thirds of the value of those claims relate to claims arising from the two Christchurch earthquakes.

[2] Western Pacific had reinsurance arrangements. One such arrangement was an annually renewed treaty relating to property insurance. It had two limbs – risk and catastrophe. The risk limb dealt with reinsurance of individual claims, and the catastrophe limb dealt with loss stemming from a group of claims relating to the same incident. The reinsured – i.e. Western Pacific – has the choice as to which section of the treaty to allocate a particular claim.

[3] Claims resulting from the two Christchurch earthquakes have triggered the catastrophe section of the reinsurance treaty for both 2010 and 2011. The 2010 policy covered Western Pacific to a maximum of $20 million; the 2011 version was limited to $15 million. In each year there is an excess or retention of $1 million, meaning there is $33 million available to the liquidators. The treaties provided that the money would be payable even if the reinsured became insolvent, and so had not actually paid out on the triggering claims. This is recognised by the reinsurers and there is no issue about the $33 million being available to the liquidators.

[4] The issue the Court is asked to determine is whether that $33 million is available to all claimants and unsecured creditors, or just to those whose claims triggered the reinsurance. The liquidators contend the money is available to all. The role of respondent has been taken by the Canterbury Policy Holders. They contend that s 9(1) of the Law Reform Act 1936 applies so as to give them a first charge over the proceeds of reinsurance. They are supported by the interveners, being three of the major banks which hold mortgages over the subject property.[1]

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[1] ANZ National Bank Limited; Kiwibank Limited; Rabobank NZ Limited.

[5] Section 9(1) of the Law Reform Act 1936 provides:

> **9 Amount of liability to be charge on insurance money payable against that liability**
>
> (1) If any person (hereinafter in this Part of this Act referred to as the insured) has, whether before or after the passing of this Act, entered into a contract of insurance by which he is indemnified against liability to pay any damages or compensation, the amount of his liability shall, on the happening of the event giving rise to the claim for damages or compensation, and notwithstanding that the amount of such liability may not then have been determined, be a charge on all insurance money that is or may become payable in respect of that liability.

[6] The analysis for which the policy holders contend is:

• Any person	=	Western Pacific
• Contract of insurance	=	the reinsurance treaties
• Liability to pay damages or compensation	=	the money Western Pacific must pay to the original insured for damage suffered to their buildings

[7] The primary point of dispute is whether it can be said that the reinsurance policies indemnify Western Pacific as regards a liability Western Pacific has:

> to pay damages or compensation.

[8] The liquidators submit that this aspect of s 9 is not met because:

(a) the liability of Western Pacific to the original insured under a general policy is not a liability to pay damages or compensation;

(b) reinsurance is reinsurance of the original subject matter and not an insurance of Western Pacific's liability in relation to the policy.

[9] As regards the first point, I agree that it is not correct to describe Western Pacific's obligation under the original policy as being an obligation to pay damages. That would more accurately describe a situation where Western Pacific

was in breach of its contractual obligation. However, compensation seems a readily applicable term.[2]

[10] The liquidators read the section as if it says liability to pay compensation for a wrong, thereby limiting the scope of the section to situations where the insured has caused an injury to a third party. Support for s 9 being limited in scope could be found in the judgment of Blanchard J, writing for the Court in *Ludgater Holdings Ltd v Gerling Australia Insurance Co Pty Ltd*.[3] That case involved a conflict of laws issue, but in describing s 9 his Honour observed:

> [1] The issue on this appeal is whether a New Zealand statutory provision, which gives someone who has suffered injury or damage the right to make a direct claim against the insurer of the person who caused the injury or damage, can apply in circumstances where the insured and the insurer were Australian companies, the insurance policy was arranged between them in that country and the insured has gone into liquidation there.

[11] There is no dispute here, however, as to what the usual role or use of s 9 has been.[4] The issue here is whether the section can apply to a different situation, namely reinsurance. In that regard, all the section talks of is a liability to pay compensation, and I do not consider it is stretching that word to see it as applicable to the present situation. Western Pacific has agreed to indemnify its policyholders for loss they suffer within the terms of the original policy. That is, I consider, an obligation to compensate them. The reinsurance treaties have been triggered by Western Pacific's liability to pay compensation to the Canterbury Policy Holders, and s 9 says those policy holders have a charge over the money.

[12] There is no doubt that compensation could have a narrower meaning which excluded the liability under the original policy. For example, Black's Law Dictionary describes compensation as: [5]

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2 I have been assisted in consideration of this topic by a conference paper presented by M Quinlan – "Commentary on HIH Casualty and General Insurance Ltd (in liquidation) v Wallace and Ors", (London, 28 March 2007) and R Cameron "Reinsurance and the Australian Context" (2001) 12(3) Insurance Law Journal 199.

3 *Ludgater Holdings Ltd v Gerling Australia Insurance Co Pty Ltd* [2010] 3 NZLR 713, at [1] (SC).

4 The history of s 9 is discussed by the Law Commission in Report 46 – Some Insurance Law Problems, Part 5.

5 Ninth Ed, West Publishing 2009, B Garner 2009.

> payment of damages or other act that a court orders to be done by a person who has caused injury to another.

[13] However, a less technical meaning of the term usually involves the concept of "to make up for, or counterbalance".[6] That comfortably describes Western Pacific's situation as regards its policy holders.

[14] In terms of other factors that might influence the interpretation of s 9, Mr Barton refers to the practical difficulties that arise in a reinsurance situation. First, most individual policy holders who have suffered loss could not bring an action on their own, because their individual loss has not triggered the reinsurance. It is the pooling of the claims by the reinsured company that triggers the reinsurance. Next, the original insured would face the hurdle of the excess or retention that applies before the catastrophe reinsurance is triggered. And finally, most reinsurance will involve several individual reinsurers, who will be based in different jurisdictions.

[15] The response to these points must be that they are indeed practical difficulties, but they are not insurmountable conceptually. The fact that in a particular case it may be difficult or uneconomic to pursue a group action under s 9 does not mean s 9 should be interpreted so as to remove the option. Further, and more importantly, the issues do not arise here where the reinsurers accept their liability and arrangements are in place for the $33 million to be paid. Accordingly, I am of the view that on its plain terms s 9 can apply to this reinsurance situation.

[16] The second proposition relied on by the liquidators is an argument that s 9 is limited to liability insurance, and reinsurance is not a form of liability insurance so s 9 cannot apply. However, once one decides that the plain wording of s 9 fits the situation of the Canterbury Policy Holders, I do not consider a general proposition that s 9 does not apply to reinsurance advances matters.[7]

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6 Garner Dictionary of Legal Usage, 3rd Ed, OUP 2011; The New Zealand Oxford Dictionary, OUP 2005.

7 The Australian Capital Territory also enacted this provision.

[17] In *Charter Reinsurance Co Ltd v Fagan* Lord Mustill viewed the issue of the nature of reinsurance as being open, observing:[8]

> This is not the place to discuss the question, perhaps not yet finally resolved, whether there can be cases where a contract of reinsurance is an insurance of the reinsured's liability under the inward policy or whether it is always an insurance on the original subject matter, the liability of the reinsured serving merely to give him an insurable interest.

[18] Further, none of those discussions of the nature of reinsurance involved consideration of the different issue of whether s 9 applied to a reinsurance policy. Most of the decisions relied upon are decisions of the English Courts and it is instructive that the English legislation – the Third Parties (Rights Against Insurers) Act 1930, and now 2010 – has always expressly excluded reinsurance from its ambit. Yet when New Zealand enacted s 9, and likewise in New South Wales,[9] the respective legislatures did not carry over that part of the legislation. Reinsurance was not expressly excluded. Standard principles of statutory interpretation would accord weight both to the apparent belief that it was necessary to expressly exclude reinsurance from the ambit of the Act, and to the decision of the New Zealand Parliament not to do so.

[19] Although the issue has never arisen directly in New South Wales under its identical provision to s 9 of our Act, there has existed in Australia complementary legislation, the treatment of which is instructive. Section 292(5) of the Companies Act 1961 provided:[10]

> Where the company is under a contract of insurance (entered into before the commencement of the winding up) insured against liability to third parties, then if any such liability is incurred by the company (either before or after the commencement of the winding up) and an amount in respect of that liability is or has been received by the company or the liquidator from the insurer the amount shall, after deducting any expenses of or incidental to getting in such amount, be paid by the liquidator to the third party in respect of whom the liability was incurred to the extent necessary to discharge that liability or any part of that liability remaining undischarged in priority to all payments in respect of the debts referred to in subsection (1) of this section.

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8 *Charter Reinsurance Co Ltd v Fagan* 1997 AC 313 at [385].
9 Law Reform Miscellaneous Provisions Act (NSW) 1946.
10 This was uniform legislation enacted by each state.

[20] In *Re Dominion Insurance Co of Australia Limited*,[11] Needham J interpreted this provision as applying to a reinsurance situation. In that case Dominion Insurance had gone into voluntary liquidation. The reinsurance arrangements were quota share policies. The Court held that the money received under these policies from the reinsurer was held by the liquidator for the individual claimant in priority to other creditors. In the course of that decision it was held both that the term "contract of insurance" included reinsurance, and that the express liability to a third party was not limited to tortious liability. Weight was also placed on the fact that the English Act specifically excluded reinsurance, an exclusion that had not been carried over to the Australian uniform companies legislation.

[21] Likewise, in *Re Palmdale Insurance Limited (No. 3)*,[12] Crockett J, sitting in a different jurisdiction, applied s 295(2) to reinsurance money from two types of reinsurance treaty – a proportional reinsurance treaty where the reinsurer had taken over a fixed proportion of the underlying policy, and an excess loss treaty which appears to have had similar arrangements to the treaties in issue here.

[22] The uniform companies legislation that had been adopted by the various states, and which was applied in these two cases to a reinsurance situation, was eventually superseded by the Corporations Act 1989 (Commonwealth) and now the Corporations Act 2001 (Commonwealth). Section 562 of the 2001 Act is largely in similar terms to s 292(5) of the uniform acts, but has an important addition:

> **Application of proceeds of contracts of insurance**
>
> (1) Where a company is, under a contract of insurance (*not being a contract of reinsurance*) entered into before the relevant date, insured against liability to third parties, then, if such a liability is incurred by the company (whether before or after the relevant date) and an amount in respect of that liability has been or is received by the company or the liquidator from the insurer, the amount must, after deducting any expenses of or incidental to getting in that amount, be paid by the liquidator to the third party in respect of whom the liability was incurred to the extent necessary to discharge that liability, or any part of that liability remaining undischarged, in priority to all payments in respect of the debts mentioned in section 556. (emphasis added)

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11 *Re Dominion Insurance Co of Australia Limited* [1980] 1 NSWLR 271.
12 *Re Palmdale Insurance Limited (No. 3)* [1986] VR 439 (Victoria).

[23] It can be seen that in the first line that reinsurance has now been expressly excluded. This is consistent with the English model, but also with a pattern of needing to expressly say so if reinsurance is to be taken outside the scope of the legislation. Further, s 562A was later added. It provides separately that in a situation such as the present the money is available to all creditors. However, the Court is then given a discretion to adjust the allocation formula in relation to a particular claimant to what would be just and equitable in the circumstances. This discretion seems to be aimed at situations, for example, where the original insured had made reinsurance a condition of entering into the original policy. In such circumstances it could be seen as unjust that the original insured receives only a pro-rata allocation of the reinsurance money.

[24] What emerges from this cursory overview is the point already made that the tendency is to deal expressly with reinsurance if there is to be a special rule. And second, that there are competing policy perspectives that are properly for the legislature to resolve. [13] What can be said is that if the wording of s 9 on its face seems to apply to the Canterbury Policy Holders, as I consider it does, there is nothing in the legislative history that would support an alternative interpretation, and indeed the opposite is true.

Conclusion

[25] Pursuant to my interpretation of s 9, I hold that Western Pacific had entered into a contract of insurance that indemnified it against liability to pay compensation to its policy holders on the happening of an event, which in this case is the Christchurch earthquake of 2010, and then of 2011. As such, the amount of the liability on the original policies is a charge on the reinsurance money that has become payable in respect of that liability.

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[13] Reference is again made to the Law Commission Report, and its reform suggestions. Reinsurance is not one of the topics discussed, but the Commission does discuss the correctness of s 9 giving the injured party priority over the creditors in insolvency situations.

Other matters

[26] Counsel were agreed that draft orders would be provided once a decision was issued. One unusual aspect should be noted for the record. When the liquidators were appointed, premiums were due on the reinsurance. The liquidators approached the three banks who are the interveners in these proceedings, and they provided the money to pay the premiums. The sum in issue is around $340,000. The orders will, by consent, give priority to the repayment of this sum. It is also agreed that the liquidators expenses in relation to realising and managing the $33 million are properly recoverable.

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Simon France J

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