THIRD PARTY CLAIMS ON INSURANCE FUNDS: THE CHARGE IS OVER

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Introduction

1. In the normal course a claim by a third party against an insured wrongdoer proceeds directly against that wrongdoer. The defence of the claim is generally conducted by the insurer pursuant to the terms of the policy and the insurer meets any settlement or judgment.
2. Difficulties arise when, for some reason, a claimant is unable to proceed in an action against a wrongdoer. This can be for many reasons such as death, insolvency, company deregistration, inability to serve process or even an unwillingness to participate in the proceedings.
3. Various procedures are available to deal with the above circumstances, including third party claimants suing insurers directly for recovery of damages.
4. Until recently the most common method attempted by a claimant in New South Wales to access insurance monies directly was through section 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (LR (MP) Act). The section attracted substantial criticism and reliance on section 6 caused many difficulties.
5. On 1 June 2017 the Civil Liability (Third Party Claims Against Insurers) Act 2017 (the Act) commenced operation. The Act repealed s 6 of the LR (MP) Act and introduced new rules for third party claimants to sue insurers directly.
6. It was often overlooked, however, that section 6 was not the only available method for a direct third party claim against an insurer. A direct claim was, and is, permitted in certain circumstances under the Insurance Contracts

Act and the Corporations Act. These provisions are unaffected by the operation of Civil Liability (Third Party Claims Against Insurers) Act.

Section 51 Insurance Contracts Act

7. This section is relevantly in the following terms:

(1) If:

(a) the insured or any third party beneficiary under a contract of liability insurance is liable in damages to another person; and

(b) the contract provides insurance cover in respect of the liability; and

(c) the insured or third party beneficiary has died or cannot, after reasonable inquiry, be found;

then the other person may recover from the insurer an amount equal to the insurer's liability under the contract in respect of the liability of the insured or third party beneficiary.

8. The section was amended in 2014 to extend to claims against a third party beneficiary under an insurance policy, in addition to an insured.
9. Subsection (2) provides that a payment under subsection (1) is a discharge of the insurer's liability under the insurance contract and the liability of the insured or beneficiary under the policy to the claimant.
10. There is no requirement of leave with section 51. In some instances, the section has been interpreted as requiring a finding of liability for damages prior to the action against the insurer being brought[1]. However, such an interpretation is counter intuitive and the section has largely been used by claimants to sue an insurer in lieu of the wrongdoer in applicable circumstances.
11. In any action brought under section 51 an insurer is able to deny liability on the basis that the insurance policy does not respond to the claim.

[1] *Vollstedt v Calibre Enterprises P/L* (1999) 10 ANZ Ins Cas 61-440 per Beach J (Vic Supreme Court)

Section 601AG Corporations Act

12. This section provides for recovery directly from an insurer by a claimant in the event that the insured wrongdoer is a deregistered company, in the following terms:

> *A person may recover from the insurer of a company that is deregistered an amount that was payable to the company under the insurance contract if:*
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> *(a) the company had a liability to the person; and*
>
> *(b) the insurance contract covered that liability immediately before deregistration.*

13. This provision allows a claimant to proceed directly against the insurer, rather than the more cumbersome procedure of having to bring separate proceedings to reinstate the company.

Insolvency Provisions

14. Section 117 of the Bankruptcy Act 1966 and section 562 of the Corporations Act 2001 apply when the insured defendant is in either personal or corporate insolvency.
15. Section 117 of the *Bankruptcy Act* 1966 (Cth) provides that where a bankrupt is or was insured against liabilities to third parties and a liability against which he or she was so insured has been incurred (whether before or after he or she became a bankrupt), the "*right of the bankrupt to indemnity under the policy vests in the trustee and any amount received by the trustee from the insurer under the policy in respect of the liability shall, if the liability has not been satisfied, be paid in full forthwith to the third party to whom it was incurred"*.
16. Section 562 of the *Corporations Act* 2001 (Cth) provides that, where a company is insured against liability to third parties, under a contract of insurance, entered into before it is wound up, then, if such a liability is incurred by the company (whether before or after the winding up) and an

amount in respect of that liability has been or is received by the company or the liquidator from the insurer, the amount shall, after deducting any expenses of and incidental to getting that amount, be paid by the liquidator to the third party in respect of whom the liability was incurred in priority to all payments in respect of debts mentioned in s 556. Expenses are to be deducted. Payment is to made to the extent necessary to discharge the liability.

17. The provisions do not permit a direct recovery of damages against the insurer so that potentially two actions are required – first in respect of the principal claim and secondly against the insurer.

Section 6 LR (MP) Act

18. Section 6(1) provided that if an insured had entered into a contract of insurance by which the insured was indemnified against liability to pay any damages or compensation, the amount of the insured's liability would, on the happening of the event giving rise to the claim for damages or compensation, and not withstanding that the amount of such liability may not then have been determined, be a charge on all insurance moneys that are or may become payable in respect of that liability.
19. Section 6(4) provided that every charge created by the section was 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 would, 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.
20. The section also stipulated that:

> *"no such action could be commenced in any court except with the leave of that court. Leave shall not be granted in any case where the court is satisfied that the insurer is entitled under the terms of the contract of insurance to disclaim liability, and that any*

proceedings, including arbitration proceedings, necessary to establish that the insurer is so entitled to disclaim, have been taken."

21. The principal difficulties in respect of section arose due to the mechanism of the creation of a charge. These difficulties and other problems arising in respect of the operation of section 6 included the following:

    i. It had very limited application to "*claims made*" policies, effectively meaning it could rarely be used in professional negligence cases. The issue was that s 6 created a charge on the happening of the event giving rise to the liability. This time is usually well before the time that a claim has been brought. If the policy that was responsive to the claim was not in force at the time of the event there was nothing for the charge to attach itself to.[2] There was no apparent public policy justification to exclude such policies from the operation of s 6. It could not have been intended by the Legislature and it is doubtful that claims made policies had a significant presence in the Australian market as at 1946.

    ii. There was concern as to how section 6 operated in respect of claims for pure economic loss. The issue, acknowledged by the Court of Appeal in *Chubb Insurance Company Of Australia v Moore*, was whether the occurrence of the damage was the event giving rise to the claim for damages or compensation or whether it was the earlier act or omission that was the cause of the damage.[3]

    iii. There were potential injustices and difficulties if there was more than 1 claim against an insured in a policy year and limited indemnity in respect of those claims. Under s 6(3) where the same insurance moneys are subject to two or more charges under s 6 they were to have priority as between themselves in the order of

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[2] see *Owners Strata-Plan 50530 v Walter Construction Group (in liq)* [2007] NSWCA 124 [29]-[35], subsequently followed in a number of cases including, with some reservation, *Chubb Insurance Company Of Australia v Moore* [2013] NSWCA 212 [57], [88] – [104]

[3] at [141], per Emmett JA and Ball J, "*It is not, however, necessary to resolve these questions in the context of the present case.*"

the dates of the events out of which the liability arose. If they arise out of events happening on the same date, they were to rank equally among themselves. This would give rise to the practical difficulty that any proportionate distribution could only occur once all claims have been determined or resolved.

iv. There was uncertainty as to whether section 6 applied to reinsurance contracts.

v. Section 6 only applied to cases where the defendant was a party to the insurance contract. It did not extend to circumstances where a defendant was entitled to indemnity under a policy but was not the party who had "*entered into the policy of insurance*"[4].

22. Other areas of contention that had arisen but which were largely resolved were whether s 6 interfered with:

    i. an insured's entitlement under a directors and officer's liability policy for the advancement of defence costs prior to any judgment or settlement [5], and

    ii. the applicable limitation period.[6]

Civil Liability (Third Party Claims Against Insurers) Act 2017

23. In February 2016 the NSW Law Reform Commission (NSW LRC) was asked to review and report on the operation of section 6 of the LR (MP) Act.

24. In November 2016 the NSW LRC produced its report[7].

25. The Act is a consequence of the report.

26. The heart of the Act is contained in sections 4 and 5.

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[4] *Robinson v Vogelsang (No 1)* [2015] NSWSC 1670 [13-[18]

[5] The Court of Appeal in *Chubb v Moore*, declining to follow the decision of the NZ High Court in *Steigrad &Ors v BFSL 2007 Ltd, Steigrad v Bridgecorp* [2011] NZHC 1037, held s 6 did not prevent the advancement of defence costs prior to judgment or settlement

[6] The Court of Appeal in *Kinzett v McCourt* [1999] NSWCA 7 determined that time begins to run at the same time as it is accrued against the insured and ceases to run when proceedings are first brought, whether against insured or insurer

[7] Report no 143

27. Section 4, under the heading *"Claimant may recover from insurer in certain circumstances"* provides as follows:

(1) If an insured person has an insured liability to a person (the claimant), the claimant may, subject to this Act, recover the amount of the insured liability from the insurer in proceedings before a court.

(2) The amount of the insured liability is the amount of indemnity (if any) payable pursuant to the terms of the contract of insurance in respect of the insured person's liability to the claimant.

(3) In proceedings brought by a claimant against an insurer under this section, the insurer stands in the place of the insured person as if the proceedings were proceedings to recover damages, compensation or costs from the insured person. Accordingly (but subject to this Act), the parties have the same rights and liabilities, and the court has the same powers, as if the proceedings were proceedings brought against the insured person.

(4) This section does not entitle a claimant to recover any amount from a re-insurer under a contract or arrangement for re-insurance.

28. An "*insured person*" is defined to mean *"a person who is, in respect of a liability to a third party, entitled to indemnity pursuant to the terms of a contract of insurance, and includes a person who is not a party to the contract of insurance but is specified or referred to in the contract, whether by name or otherwise, as a person to whom the benefit of the insurance cover provided by the contract extends."*[8]

29. An "*insured liability*" *"means a liability in respect of which an insured person is entitled to be indemnified by the insurer."*

30. Liability is defined to mean a "*liability to pay damages, compensation or costs"*.

31. Section 5 provides that leave is required in any action under the Act:

[8] the definitions are contained in section 3 of the Act

(1) Proceedings may not be brought, or continued, against an insurer under section 4 except by leave of the court in which the proceedings are to be, or have been, commenced.

(2) An application for leave may be made before or after proceedings under section 4 have been commenced.

(3) Subject to subsection (4), the court may grant or refuse the claimant's application for leave.

(4) Leave must be refused if the insurer can establish that it is entitled to disclaim liability under the contract of insurance or under any Act or law.

32. Subsection (2) provides that the leave application may be brought after proceedings have been commenced. This provides a safeguard in circumstances where for limitation or other issues proceedings must be commenced in a hurry. In such circumstances a plaintiff can sue the insurer directly and subsequently bring the leave application in order to maintain the proceedings.
33. Section 6 of the Act provides that proceedings against an insurer under the Act are subject to the same limitation period as applicable to the claim against the "*insured person*".
34. The insurer is entitled to rely on any defence in respect of its liability to indemnify under the policy or that the insured person would have been able to rely on in defence of the action: section 7.
35. Section 8 of the Act provides that a judgment or order against an insured person does not prevent a claimant from proceeding against an insurer under section 4, save to the extent that the judgment or order has been satisfied.
36. Section 9 provides that a payment made by the insurer to a claimant under the Act in respect of an insured liability discharges, to the extent of the payment, the liability of the insurer to indemnify the insured party pursuant to the contract of insurance.
37. Section 10 provides a safeguard to claimants in respect of arrangements entered into by insurers and insured persons. It provides that a claimant's

right to recover from an insurer under the Act is not affected by such arrangements:

An insurer's liability to a claimant under this Act is not reduced, discharged or otherwise affected by:

(a) any compromise or settlement between the insurer and the insured person in respect of the insured liability, or

(b) any payment by the insurer to the insured person in respect of the insured liability unless and to the extent that the amount of the payment is or has been paid by the insured person to the claimant in respect of the insured liability.

38. Insurers should be aware of the risk, therefore, that if a settlement in a disputed claim for indemnity is reached with an insured on the basis of a payment to the insured, there remains a risk that they can ultimately be pursued by a claimant if there is a shortfall in the claimant's recovery from the defendant.
39. Although section 6 of the LR (MP) Act is repealed, section 12 of the Act provides that section 6 continues to apply (as if it had not been repealed) to actions brought against insurers under that section prior to the commencement of the Act.

When will orders under sections 4 and 5 be made?

40. There is nothing in section 4 or section 5 that prescribes the circumstances in which an action under the Act can be brought. For example, there is no stipulation that the insured person must be unable to be proceeded against for any reason.
41. Can, therefore, the Act be relied on in any circumstances to sue an insurer directly even where there is no difficulty in proceeding against the insured person?
42. It is relevant to consider the available extraneous materials comprising the Explanatory Note to the Bill, the second reading speech and NSW LRC Report 143.

43. The Explanatory Note and second reading speech make plain that the Act represents an implementation of all the recommendations of the NSW LRC report. Indeed this is apparent from the content of the Act which is in relevantly identical terms to the draft proposed amendment to the LR (MP) Act contained in the report.
44. However it is also apparent from the content of the report that the authors intended to limit the application of the Act to those circumstances where it is required. As much is clear from recommendation 1 of the report:

> *If a defendant (being a natural person or a corporation):*
> *(a) has a liability to a plaintiff to pay any damages or compensation*
> *(b) was insured (directly or as a third party) by an insurance contract that would have covered that liability, and*
> *(c) has for any reason failed or is unable to meet the liability in whole or in part then the plaintiff should be able to recover from the insurer the amount the insurer would have paid to the defendant under the insurance contract in respect of the defendant's liability to the plaintiff.*

45. As noted above, section 5 of the Act requires a party to seek leave to proceed against an insurer.
46. Subject to the proviso that leave may not be granted if the insurer can establish that it is entitled to deny indemnity, section 5 in broad terms states that the Court "***may*** *grant or refuse the claimant's application for leave"*. This indicates a discretion although the Act provides no specific guidance as to the matters that will be relevant in the exercise of the discretion.
47. As to how this discretion, described by the NSW LRC as being "*at large*" subject to sub section (4), is to be exercised the report states:

> *"It is our intention that the court's general discretion to grant leave will continue to be exercised under these proposed provisions in the same way that it is exercised under the existing s6.*"[9]

[9] at 4.25

48. Consistent with the NSW LRC report it is reasonable to expect that Courts will apply the same discretionary considerations that were applied in respect of section 6.[10]
49. In broad terms, therefore, a claimant in an application for leave will be required to establish:
    i. An arguable case on liability against the insured party,
    ii. An arguable case that the insurer's policy will respond to the claim, and
    iii. A real possibility that the claimant will be unable to enforce any judgment obtained against the insured party.[11]
50. As regards this latter issue the report states that the "*new provisions are framed to capture all possible scenarios of a defendant's inability or failure to meet the relevant liability"*.[12]

Cases So Far…

51. As yet, there appear to be no published cases in which orders have been made under the Act.
52. There are two cases in which the Act has been referred to.
53. *Mohamad Alameddine v Nizar Alameddine t/as On Call Tree Services and Gardening Maintenance*[13] concerned a notice of motion originally brought under s 6 of the *LR(MP) Act*. The motion had not been determined by the time the Act commenced operation and therefore it was necessary for the applicant to amend the motion to seek orders under the Act. The respondent to the motion opposes the orders on the basis that the action will be statute barred, in reliance on section 6 of the Act. The matter was adjourned to allow the plaintiff to put on evidence on the *Limitation Act* issue.

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[10] this is also consistent with the observations of Yates J in *Petersen Superannuation Fund P/L v Bank Of Queensland Limited* [2017] FCA 699, see below
[11] Leave was not granted under s 6 if there was "*a perfectly good common law defendant available*": *Tzaidas v Child* [2004] 61 NSWLR 18 at [50].
[12] see 4.19
[13] [2017] NSWSC 938

54. *Petersen Superannuation Fund Pty Ltd v Bank of Queensland Limited*[14] concerned a security for costs application in a representative action. The respondent to the application argued that the existence of an insurance policy and, in particular the prospect of the insurer being sued directly under the Act, was a factor against an order for security for costs.

55. This argument was unsuccessful, Yates J observing that as the insurer was a foreign company the ability to seek leave to sue it directly did not improve the applicant's prospects of enforcement.[15]

56. In his judgment, Yates J reviewed the Act and made the following comments in relation to the exercise of discretion:

> *"Whilst in terms unconfined (other than for the consequence required by s 5(4)), the exercise of discretion must be directed to the purpose for which it is conferred. I proceed on the basis that the purpose of s 5(1) is materially the same as the purpose for which, under the proviso to s 6 of the LR(MP) Act, leave was also required, namely to ensure that insurers are not exposed to "unnecessary" or "inappropriate" claims (Oswald v Bailey (1987) 11 NSWLR 715 at 717F-G) or "unwarranted" claims (Tzaidas v Child (2014) 61 NSWLR 18; [2004] NSWCA 252 at [17] and [107]).*"[16]

57. The analysis by Yates J in respect of the exercise of the discretion is not thorough, and nor did it need to be, however it is consistent with the notion that the discretion will be applied with the same considerations as it was under s 6.

Ambiguities (mostly) Solved

58. The principal ambiguities and historical problems produced by section 6 have been largely resolved by the new Act:

- The Act applies to all liability policies including claims made,
- There is no difficulty with claims for pure economic loss,

[14] [2017] FCA 699
[15] see [110]-[113]
[16] at [104]

- The Act expressly does not apply to reinsurance contracts,
- There is no ambiguity as regards an insured's entitlement to defence costs in advance of resolution of claim,
- Limitation period of underlying claim applies,
- The Act applies where the "insured" is not a party to the policy of insurance.

59. As there is no charge there is no formal issue of priorities of competing charges, however there is still scope for injustice and difficulties where there is more than one plaintiff and only a limited indemnity available. The Act is silent on the issue. The NSW LRC report takes the matter no further than saying it "*see[s] no reason to depart from the general rule that the earlier claim takes priority*".[17]
60. Other than "*first in best dressed*" it appears there is no solution provided to the potential problem and claimants and their advisors should be conscious of this if there is a concern as to the amount of indemnity available in the context of potential claims by multiple claimants.
61. Further, by "*earlier claim*" do we mean earlier claim to accrue (which was the s 6(3) criteria) or earlier claim finalised? This is a potentially significant matter which will need to be determined.

Conclusion

62. The new Act commenced operation on 1 June 2017 and repealed s 6 of the LR (MP) Act[18].
63. Other provisions such as s 51 of the Insurance Contracts Act and s 601AG of the Corporations Act continue to apply.
64. Leave is required to proceed under the Act and the Court has a discretion save that it cannot grant leave if the insurer can establish it is entitled to deny indemnity.

[17] 4.16
[18] subject to its transitional application

65. It appears likely that the discretionary considerations will be the same as those that applied in respect of section 6.
66. The new Act successfully deals with the principal ambiguities and problems that were caused by s 6 of the LR (MP) Act[19].
67. Unlike s 6 the new Act is reasonably user friendly. As yet there are no equivalents in other states and it would not be surprising to see parties "*forum shopping*" where possible in order to enjoy the benefit of the new legislation.

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[19] subject to concern as to how claims from multiple claimants with a limited amount of indemnity will be dealt with