NEW SOUTH WALES BAR ASSOCIATION

SUBMISSION TO REVIEW OF SECTION 6 OF THE *LAW REFORM (MISCELLANEOUS PROVISIONS) ACT 1946* – NEW SOUTH WALES LAW REFORM COMMISSION CONSULTATION PAPER NO 17 "THIRD PARTY CLAIMS ON INSURANCE MONEY"

1. This submission is provided pursuant to the invitation for submissions contained in the New South Wales Law Reform Commission's Consultation Paper No 17 ("the Consultation Paper") issued as part of its reference regarding section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946* ("the 1946 Act").

2. The New South Wales Bar Association recommends that section 6 of the 1946 Act, due to its complexity, be repealed and replaced with a provision similar to section 601AG of the *Corporations Act* 2001 (Cth), with due allowance for the extension of its operation to natural persons as well as corporations. The Bar Association emphasises that section 6 of the 1946 Act serves an important function by enabling claimants to access monies held by an insurance company where the insured may not be able to be located, or is insolvent. There is, therefore, no basis for a repeal of the section without a replacement. There is, however, an urgent need for replacement by a section that is not ambiguous or abstruse.

3. There have been two recent decisions of the NSW Court of Appeal that appear contradictory but suggest that the charge under section 6(1) of the 1946 Act does not extend to an event that occurs before the inception of a "claims made" policy. This is potentially disastrous to claimants who seek damages from professionals who enter into a claims made professional indemnity policy. The decisions are *Registrar-General of New South Wales v LawCover Insurance Pty Ltd* [2014] NSWCA 241 (25 July 2014) per Bathurst CJ, Basten and Meagher JJA ("*Registrar-General*") and *Chubb Insurance Company of Australia Limited v Moore* [2013] NSWCA 212 (11 July 2013) per Bathurst CJ, Beazley P, Macfarlan and Emmett JJA and Ball J ("*Chubb*").

4. In *Chubb*, in their joint judgment Emmett JA and Ball J (Bathurst CJ, Beazley P and Macfarlan JA agreeing) stated at [55]:

> *"The language of section 6 has been described as "undoubtedly opaque and ambiguous" (New South Wales Medical Defence Union v Crawford (1993) 31 NSWLR 469 at 479D). It has also been said that its "ambiguity may be its only clear feature" (McMillan v Mannix (1993) 31 NSWLR 538 at 542B). Section 6 should be repealed altogether or completely redrafted in an intelligible form, so as to achieve the objects for which it was enacted."* (Emphasis added)

The Association supports this observation.

5. The purpose of section 6 of the 1946 Act was summarised in *Chubb* at [52] and [63] as follows:

> *"52. Section 6 of the Reform Act was enacted to address a perceived unfairness that could arise where a person is insured against a liability, that liability arises, the insured obtains a sum from its insurer and then the insured either disappears or fritters away the sum or enters into a collusive arrangement with the insurer. In such situations, even if a claimant obtains a verdict against the insured wrongdoer, he or she may not recover any sum from the insured (see Speech on the Second Reading of the Law Reform (Miscellaneous Provisions) Bill, New South Legislative Council, Parliamentary Debates, 20 March 1946 at 2809)."*
>
> …
>
> *"63. Section 6 seeks to secure the performance of not only the insurer's obligation to pay to the insured insurance moneys that are or may become payable, but also the insured's performance of its obligation to pay damages or compensation to the claim in satisfaction of the insured's liability to the claimant. That is achieved by creating the charge in favour of the claimant over all insurance moneys that are or may become payable in respect of the insured's liability to pay damages or compensation to the claimant. The obligations the performance of which are to be secured by the charge, may be greater or less than the value of the security created by section 6, being the insurance moneys payable under the relevant contract of insurance."*

6. An anomaly in section 6(1) of the 1946 Act was identified in *Registrar-General.* In that matter, the Court of Appeal (Bathurst CJ, Basten and Meagher JJA) dealt with a claim by the registered owner of land who had lost her title through the fault of her brother and his partner. Fraudulent transfers were effected by a solicitor, Mr Yee.

7. Mr Yee had a professional indemnity insurance policy with LawCover Insurance Pty Ltd. This was a claims made and notified policy which would respond to a claim against Mr Yee made after it commenced, even though the events giving rise to the claim pre-dated the commencement of the policy. The commencement of the policy was 1 July 2011. The policy did not indemnify Mr Yee with respect to a claim arising from "any dishonest or fraudulent act or omission" by him. Under section 129(1)(b) of the *Real Property Act 1900* (NSW), the victims of fraud are not entitled to compensation from the statutory fund established under that Act where their loss is a consequence of "any fraudulent, wilful or negligent act or omission by any solicitor" which is compensable under a professional indemnity policy.

8. The Registrar-General required leave to bring proceedings pursuant to section 6(4) of the 1946 Act. Those proceedings were based on the fact that the registered proprietor of the land who had been the victim of the fraud had both a claim and a judgment against Mr

Yee. The claim by the Registrar-General was characterised as a right to enforce the "charge" on insurance moneys created by section 6(1) of the 1946 Act.

9. The lead judgment in *Registrar-General* was delivered by Meagher JA, with whom Bathurst CJ agreed. Basten JA delivered a separate judgment but agreed with the lengthier reasons and orders proposed by Meagher JA. As stated by Basten JA in *Registrar-General* at [10], the charge is in respect of or arose "on the happening of the event giving rise to a claim for damages for compensation" for which the relevant policy provides indemnity. Such a charge cannot arise before the policy granting indemnity came into existence. In making this observation, Basten JA referred to *The Owners Strata Plan 5030 v Walter Construction Group Ltd (in liq)* [2007] NSWCA 124; 14 ANZ Ins Cas 61-734 at [30] ("*Walter Construction*") and *Chubb* at [57]. It follows that section 6 is not engaged in relation to a claims made policy if the events giving rise to the claim occurred before the commencement of the policy. This analysis was not challenged in the appeal as argued in *Registrar-General*.

10. Similar reasoning was applied by Meagher JA in *Registrar-General* at [63] where his Honour reasoned that there was no right to bring an action under section 6(4) of the 1946 Act because there was no statutory charge under section 6(1) due to the fact that the "claims made" policy was not in existence at the time of the happening of the event giving rise to the claim for damages. As the contract of insurance was issued after the liability arose, there was no "charge as aforesaid" for the purposes of section 6(4) of the 1946 Act. This created the unfortunate outcome that the Registrar-General, subrogated to the rights of the defrauded registered proprietor, could not bring an action for the charge against LawCover despite the fact Mr Yee had clearly engaged in conduct that would be met by a "claims made" professional indemnity policy.

11. Therefore, it appears that section 6 of the 1946 Act does not achieve its purpose in the context of a claims made policy if the events giving rise to the claim occurred before the commencement of the policy.

12. Paragraph [57] of the judgment in *Chubb*, which Basten JA referred to in *Registrar-General*, seems, at least when viewed in isolation, to be capable of being read as authority for the proposition that section 6 of the 1946 Act will not apply to a claims made policy where the event occurs before the commencement of the policy. That, however, is, at least *prima facie*, contrary to the reasoning of *Chubb* at [83] and [84]. Paragraph [57] of *Chubb* reads as follows:

> *"The reference in section 6(1) to "the happening of the event giving rise to* ***the claim for*** *damages or compensation" should be construed as a reference to the moment when the liability arises, rather than to a later time when the claim on that liability is made. That is to say, it should be construed as referring to "the happening of the event giving rise to* ***the liability to pay*** *damages or compensation". The charge comes into existence on the happening of the event that gives rise to* ***the liability*** *to pay damages or compensation not when* ***the claim*** *for damages or compensation that the liability may prompt is made.*

> *The claim for damages or compensation will ordinarily be made some time after the liability arises."*

This paragraph does not state, in terms, that section 6 of the 1946 Act will not apply to cause a charge to descend on the insurance monies under a claims made policy where the event occurs before the commencement of the policy. It may, indeed, indicate the contrary.

13. In *Chubb*, a separate question was posed as follows:

> *"Does the fact the Policies indemnify an Insured in respect of a claim for damages or compensation made against the Insured and notified by the Insured to the Plaintiff within the Policy Period render section 6 inapplicable to any insurance moneys that are or may become payable under the Policies?"*

14. The answer at [87] was "No". Notably, the relevant policies for consideration were claims made and notified policies and, as noted at [43], these could meet claims for a wrongful act occurring before or during a "Policy Period" (emphasis added). In *Chubb*, Emmett JA and Ball J stated as follows at [83]:

> *"Whether or not claims made contracts of insurance were in the contemplation of the drafter of section 42 of the Workers Compensation Act 1908 (NZ) is not to the point. The question is whether the language used in section 6, as a matter of English, describes a contract of insurance that happens to be a claims made contract, as well as a contract of insurance that happens to be an occurrence-based contract. The language of section 6(1) is equally apt to describe both kinds of contract, so long as the liability of the insured is to pay damages in respect of which it can be said that an event happened that gave rise to the liability to pay such damages. A contract of insurance against liability will respond whether it is the happening of an event occurring during the period of insurance, or the giving of notice during the period of insurance of a claim in respect of an event, that is the trigger for the right of indemnity under the contract of insurance."*

15. It was further stated in *Chubb* at [84] that there was nothing in the context or text of section 6 to suggest that the general principle described in [83] was inapplicable and that the "reforming object" of section 6 "suggests that the provision should apply to any contract of insurance by which an insured is indemnified against liability to pay any damages or compensation". Indeed, it was stated at [84] that if section 6 were intended to be so limited, "insurers could easily contract out of the effect" of the section by not offering occurrence-based insurance but only claims made insurance.

16. The decision in *Chubb* at [85] referred to the decision of the Court of Appeal in *Walter Construction*. There, the Court of Appeal concluded that a charge under section 6 is not available where the contract of insurance did not come into existence until after the event giving rise to liability. The Court of Appeal in *Chubb* at [85] stated that "[I]f" this proposition is correct, then "section 6 applies in respect of some claims made contacts,

namely where the event occurs and the claim is notified in the same period, but not others, namely where the claim is notified in a subsequent policy period".

17. Whether or not the *Walter Construction* decision is correct was not decided by *Chubb*, which is unfortunate, given that *Walter Construction* was cited by Basten JA in *Registrar-General* in support of the finding that section 6 of the 1946 Act does not create a charge where the claim is notified in a subsequent policy period. The use of the word "If" in *Chubb* to discuss this fundamental anomaly in section 6 of the 1946 Act suggests the matter may be re-argued in the future. That the issue of the application of section 6 of the 1946 Act to claims made policies is not resolved yet by the Court of Appeal is confirmed by the last two sentences of the decision of the Court in *Chubb* at [85] as follows:

> *"It may be an anomaly that section 6 does not apply to all contracts of insurance that provide cover in respect of third party liability claims. However, it is not clear how that anomaly would be cured by restricting further the classes of contract to which section 6 applies."* (note the uncertain language which is a reflection of the opaque language of the section)

18. On a fair reading of *Chubb* at [57] and [84], section 6 of the 1946 Act should not be limited in its application to claims made policies, leaving a broad interpretation of the section consistent with its reformist objective. However, when one reads paragraph [85] and the discussion of *Walter Construction*, if *Walter Construction* is correct then section 6 of the 1946 Act may operate differently in relation to claims made policies depending upon whether the event giving rise to the claim occurred within the period of the policy or not. This confusion does not assist in the advising of clients and has been compounded by the decision of *Registrar-General*. The status of *Registrar-General* is unclear given this is a decision of the Court of Appeal comprised of three members whereas *Chubb* was comprised of five members, including the Chief Justice of NSW and the President of the Court of Appeal.

19. Given the expansion of claims made policies to cover professional liability, this confusion warrants a repeal and replacement of section 6 of the 1946 Act with a plain language provision that achieves the reform objectives of protecting claimants where a defendant has insurance but that insurance cannot be easily accessed by the claimant.

20. It is recommended that a replacement section be introduced which is similar to section 601AG of the *Corporations Act* which provides as follows:

> *"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:*
>
> *(a) the company had a liability to the person; and*
>
> *(b) the insurance contract covered that liability immediately before deregistration."*

21. The two preconditions for the operation of section 601AG are therefore that:

(a) the deregistered company has a liability to the third party;

(b) the insurance contract covered that liability.

It is submitted that these preconditions are more readily understood and applied than the preconditions in section 6(4) of the 1946 Act.

22. Section 601AG of the *Corporations Act* was considered by the Court of Appeal in *Almario v Allianz Australia Workers Compensation (NSW) Insurance Ltd* [2005] NSWCA 19 (24 February 2005) (Hodgson and Ipp JJA, Hunt AJA) ("*Almario*"). The lead judgment of Ipp JA (Hodgson JA and Hunt AJA agreeing) held at [34]-[35] that an insurer can raise against a claimant whatever defences would have been open to the deregistered company (subject, of course, to any qualifications that attach to those defences). It was noted at [37] that section 601AG would be construed as operating in a way akin to section 6 of the 1946 Act, although it was accepted that the wording of section 601AG differs in significant respects from section 6 of the 1946 Act. The basic concept of the two different statutory provisions is the same. The Court of Appeal held at [41] that section 601AG should not be textually construed. Rather, it should be construed so that the opening words read:

> *"A person may recover from the insurer of a company that is deregistered (as if the insurer was the deregistered company) an amount that was payable to the company under the insurance contract…"*

23. Such a construction allows the insurer to raise any defences available to the insured and allows a person claiming under section 601AG to seek from a court (as against the insurer) an extension of any applicable time limits for the commencement of proceedings.

24. The Explanatory Memorandum accompanying the *Company Law Review Bill 1997* that introduced section 601AG was cited in *Almario* at [18] as follows:

> *"At present, a person wishing to make a claim against a deregistered company may need to apply to a court for reinstatement of that company pursuant to an order to bring an action against. The Bill enables a person to proceed directly against the insurer of a company that is deregistered, without seeking the company's reinstatement (Bill section 601AG). Comparable rights have previously been provided in other legislation, for example, section 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW)."*

25. Section 601AG was identified in *Almario* as creating a new cause of action and substitutes the insurer for the insured as a defendant without the complications of seeking to enforce a charge. The complications involved in the question of whether a

claims made policy gives rise to the charge would not arise under section 601AG as they currently do under section 6(1) of the 1946 Act.

26. Given the fact that the intention of section 601AG was to create a corporate insolvency version of section 6 of the 1946 Act, the obvious template for a new section 6 of the 1946 Act is the Commonwealth equivalent. Such an equivalent would allow a claimant to bring an action directly against the insurer for the amount of money and the insured is otherwise liable to pay. This is different from enforcement of a charge. It means the insurer could not only raise the same defences as the insured but also raise a defence that it is not liable to indemnify. The hurdles to such an action being commenced are more readily understood than the hurdles in section 6(4) of the 1946 Act. The replacement section should allow a claimant to bring an action directly against an insurer where the insured, whether corporate or a natural person, cannot be proceeded against due to death, insolvency, bankruptcy or inability to locate. A charge in favour of a claimant should still be imposed on monies payable by the insurer but only in circumstances where a judgment or order has been obtained against the insured but is not satisfied. Such a charge may crystallise on the entry of a judgment or order made by consent or pursuant to a determination by a court or other tribunal of a claim and also crystallise at an arbitration, mediation or other alternative dispute resolution forum. This charge would avoid the claim not being satisfied because the insured "either disappears or fritters away the sum or enters into a collusive arrangement with the insurer": *Chubb* at [52].

27. The proposal to introduce a State equivalent to section 601AG of the *Corporations Act* permitting the claimant to take a direct action against an insurer of a potential tortfeasor (as opposed to enforcing a charge against the insurer) has some analogy in Victoria under s.61(1) of the *Workers Compensation Act 1958* (Vic). Section 6(1) *Workers Compensation Act 1958* is as follows:

> "(1) Where any employer had entered into a contract with any insurers in respect of any liability under this Act to any worker then in the event of the employer becoming insolvent or bankrupt or making a composition or arrangement with his creditors or if the employer is a company in the event of the company having commenced to be wound up the rights of the employer against the insurers as respects that liability shall (notwithstanding anything in the enactments relating to insolvency and the winding up of companies) be transferred to and vest in the worker, and upon such transfer the insurers shall have to same rights and remedies and be subject to the same liabilities as if they were the employer, but so that the insurers shall not be under any greater liability to the worker than they would have been under to the employer."

28. This sub-section allows a worker to bring an action against an insolvent or bankrupt employer's insurer and transfers the rights of the employer as against the insurer to the worker. Leave to proceed against the insurer to enforce a charge is not required. This sub-section also gives the insurer the right to raise the same defences as the employer may have and limits the insurer's liability to that of the employer. This subsection is therefore

similar to the interpretation of section 601AG of the *Corporations Act* as decided in *Almario*. Section 61(1) of the *Workers Compensation Act 1958* has application to both natural and incorporated entities as it refers to an employer who may be "insolvent" (which can only apply to a corporation under the *Corporations Act*) or "bankrupt" (which can only apply to a natural person under the *Bankruptcy Act 1966* (Cth)). This sub-section simplifies the position of the claimant against an insured employer who is unable to be proceeded against due to insolvency or bankruptcy by simply substituting the insurer for the employer and creating a new cause of action. This sub-section shows that a simplified version of section 6 of the 1946 Act can be achieved.

29. For these reasons, the Bar Association recommends that:

(a) section 6 of the 1946 Act be repealed;

(b) a plain language section similar to section 601AG of the *Corporations Act* (Cth), appropriately worded to accommodate the situation of a natural person as the insured, be enacted;

(c) any plain language section include a charge against the insurer equivalent to a sum claimed and payable by the insured with such charge to crystallise on the entry of a judgment or order (whether by consent or imposed by a court or tribunal of competent jurisdiction or made at an arbitration or mediation or other alternative dispute resolution forum) for payment of damages (however defined) against the insured.

18 May 2016