Direct Tel: 02 8267 0955
Direct Fax: 02 9261 3318

Maurice Blackburn Lawyers Since 1919

Maurice Blackburn Pty Limited
ABN 21 105 657 949
Level 32, 201 Elizabeth Street, Sydney NSW 200
T 02 8267 0955
F (02 9261 3318

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New South Wales Law Reform Commission

By email: nsw_lrc@agd.nsw.gov.au

Submission regarding Section 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW)

1. Introduction

1.1 Maurice Blackburn is a leading Plaintiff law firm practicing across a range of specialisations including personal injuries, class actions, insurance claims and financial services disputes. We thank the New South Wales Law Reform Commission for the opportunity to provide this submission on Consultation Paper 17, "*Third party claims on insurance money: review of the Law Reform (Miscellaneous Provisions) Act 1946*" ("Consultation paper").

1.2 Through our work, we have seen too often the difficulty claimants can face in bringing claims for a variety of reasons, including because a potential Defendant is insolvent. An example is the many financial catastrophes associated with the Global Financial Crisis. That is of course an unfair situation for a claimant who has suffered an injury or financial loss already, and then faces further challenge in even bringing their claim for compensation.

1.3 The purpose of *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) ("section 6") is to allow claimants the right to bring an action directly against an insurer that has insured the potential Defendant against liability. The reason that companies and individuals hold indemnity insurance is so that in the event they are liable to a claimant, there are funds available to meet that claimant's compensation claim. Accordingly, in practice, insurers are usually the ones that pay the compensation claimants receive, even when an action has been brought directly against the Defendant that acted unlawfully.

1.4 It is therefore of the utmost importance that claimants are able to recover directly against an insurer if for some reason (usually due to the Defendant's insolvency), they cannot recover directly from the Defendant. The right conferred by section 6 is pivotal to this. However, the current drafting of section 6 does leave room for interpretation to the detriment of claimants. We have recommended on that basis that while section 6 definitely be retained, it be redrafted is a way that is clearer and more fair to claimants, and specifically to clarify the relevant limitation period; confirm the section applies to "claims made" and "claims notified" policies; confirm the section applies to economic loss claims; and, to provide a mechanism for discovering the identity of the insurer, which is the usually the first challenge a claimant faces.

2. Executive summary

2.1 We support the option proposed (at 1.38 points 2 and 5) of the Consultation paper, to retain the thrust of section 6 but redraft it to be clearer.

2.2 We propose the following specific provisions be included:

1) The limitation period applicable to section 6 is as articulated in *Kinzett v McCourt*[1]: time commences to run from the date it would ordinarily commence under each cause of action pleaded, but it ceases to run when the claimant brings proceedings against the individual or entity ("the insured"), or the insurer. The provision should specify that if multiple causes of action are alleged by the claimant against insured (e.g. breach of contract and negligence), the limitation period is that which would apply to each cause of action.[2]

2) Confirmation that section 6 applies to "claims made" and "claims notified" policies. To achieve that purpose, it should provide that if the relevant "event", e.g. a breach of professional retainer, which triggers liability occurred prior to the inception of the policy, the insurer will still be liable under the terms of that policy, if it would otherwise be liable.

3) Confirmation that section 6 applies to pure economic loss claims.

4) A formal mechanism for discovery of the identity of an insurer.

2.3 While we note that redrafting section 6 may affect the existing law, the current law is in many respects unsatisfactory and we consider that preferable to retaining its current form where further interpretation may dilute the remedial spirit of the legislation.

3. Background to proposals

3.1 As identified in the Consultation paper, section 6 is relevant to situations where a claimant has a cause of action against the insured person or entity that has entered a contract of insurance against liability with an insurer, such as a professional indemnity insurance policy. Ordinarily, the claimant would only have recourse against the insured, because the doctrine of privity would prevent the claimant from enforcing an insurance contract he or she was not party to. However, section 6 creates a statutory charge over insurance moneys "*that are or may become payable*" in respect to the insured's liability to the claimant "*on the happening of the event giving rise to the claim for damages or compensation*", whether or not such liability has been determined or admitted (section 6(1)). The charge can be enforced against the insurer by the claimant as though that action was against the insured, with the Court's leave (section 6(4)).

3.2 In the usual course, claimants will pursue their claims directly against the insured. For example, someone making a claim against his or her financial adviser would bring proceedings against the financial adviser's Australian Financial Services Licensee ("AFSL"), which is required to hold professional indemnity insurance.

[1] As decided in (1999) 46 NSWLR 32.
[2] This is to prevent any reliance by an insurer on the case of *Perpetual Trustees Victoria Ltd v Malouf* [2012] NSWSC 1119 ("*Malouf*") in claims involving allegations of contract and negligence.

However, reliance on section 6 may be necessary in circumstances where proceedings cannot be brought or maintained against the insured, usually because they or it is in administration or liquidation, a bankrupt, or there are other concerns about recovery of insurance proceeds due to the insured's impecunity or recalcitrance.

3.3 Such situations are common in the field of financial services, particularly against the background of the Global Financial Crisis, with several high profile examples of large-scale company failures, such as Storm Financial, Trio Capital, Gunns and Great Southern. Only recently, the AFSL entity Wealthsure Pty Ltd was placed in liquidation after a raft of claims was made against it involving allegations of, inter alia, negligence and breaches of statute by its Authorised Representatives. Claimants who are yet to obtain judgment against the insolvent insured face considerable difficulty in exercising their rights against the insurer without recourse to section 6. While the *Corporations Act 2001* (Cth)[3] permits a claimant to bring proceedings against the insurer of a deregistered company, that entitlement does not extend to situations where a company is insolvent but still being wound up. Further, while section 51 of the *Insurance Contract Act 1984* (Cth) also permits a claimant to bring proceedings against an insurer where the insured has died or cannot be found after reasonable inquiry, it does not appear to apply to companies so is of limited utility in the professional indemnity context.

3.4 Claimants are also restricted in terms of bringing or maintaining actions against companies being wound up, generally requiring the Court's leave.[4] The bar for obtaining leave to proceed under section 6 is significantly easier to meet than under the *Corporations Act*.[5] For claimants who are unable to proceed against the company and therefore obtain judgment, they become just one of many contingent creditors. Where particularly when the insured has incurred a number of liabilities. Even with judgment, a claimant will be paid in accordance with the distribution of funds determined at the end of the winding up process. While sections 562 and 562A of the *Corporations Act* require a liquidator of an insured to apply insurance and reinsurance proceeds for the benefit of third party beneficiaries rather than for general distribution amongst creditors, this protection is restricted to liquidation, and there is also no specific provision regarding priority of claims.

3.5 Claimants are also limited in pursuing claims against individuals in bankruptcy. Similarly to the *Corporations Act*, section 117 of the *Bankruptcy Act*[6] requires that the Trustee in Bankruptcy pay any insurance proceeds received by the bankrupt in respect to a third party claimant out to that claimant. However, that provision does not provide any right to pursue a claim directly against the bankrupt's insurer. Given that section 60 of the *Bankruptcy Act* requires that the Trustee in Bankruptcy give consent to proceed in an action against an undischarged bankrupt, a claimant is likely to face difficulty in being able to pursue their claim in the first place.

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[3] ("*Corporations Act*") section 601AG.

[4] *Corporations Act* sections 440D and 500 require the consent of the administrator or leave of the Court to proceed against a company in administration, or the leave of the Court to proceed against a company in liquidation, respectively. The bar for leave under these sections is high: see for example and in respect to applications under s 500(2) of the *Corporations Act*, *Oceanic Life Ltd v Insurance and Retirement Services (in liq)* (1993) 2 Tas R (NC) N23 per Zeeman J)

[5] Section 6 only requires that the claimant "establish an arguable case to proceed against the insurer": *A review of s 6 of the Law Reform (Miscellaneous Provisions) Act 1947 (NSW)*, Carolyn Coventry (2007) 18 ILJ 212, page 3, citing *Schipp v Cameron* (1995) 8 ANZ Ins Cas 61-256 and *Hall v Adventure Training Systems Pty Ltd* (2006) ANZ Ins Cas 61-673; cf *Energize Fitness Pty Ltd v Vero Insurance Ltd* [2012] NSWCA which suggested that a claimant also needed to show that the facts that supported an arguable case also provided grounds for legal relief.

[6] *1966* (Cth) ("*Bankruptcy Act*").

3.6 A claimant who wishes to pursue his or her claim against the insured when they or it is being wound up or they are bankrupt, faces considerable difficulty and potential risk of being unable to obtain or enforce judgment, or recover moneys after all creditors and other claimants are paid out. In contrast, recourse by relying on section 6 could potentially allow a claimant to access insurance proceeds direct against the insurer, and provide priority to them in obtaining any insurance proceeds. Section 6(3) provides that each charge created under the section has priority over other charges affecting the insurance money. In respect to multiple charges under section 6, they have priority according to the date of the event from which liability arose.

3.7 Section 6 is therefore an important and beneficial piece of legislation, and in the absence of such a statutory right, claimants may be unable to recover damages from the insured. This is reflected in comments of the Australian Law Reform Commission, "*[any] prejudice [to the insurer] must be weighed against the injustice suffered by an innocent third party who is unable to recover his loss even though the insurer has been paid a premium and is liable to pay money in respect to that loss."*[7] The potential for injustice is illustrated by the case of *Henderson v Gray & Winter*[8], a case heard in Victoria (where there is no equivalent provision to section 6) involving an action by claimants against their former solicitors. Their solicitors settled their professional indemnity claim against their insurer for a sum of money before the claimants' proceedings were heard. It was held that the solicitors were entitled to retain the insurance proceeds, notwithstanding those proceeds would probably be exhausted in the course of the solicitors defending the claims, potentially meaning that the claimants would not be able to access any insurance proceeds.

3.8 However, the current drafting of section 6 leaves much room for interpretation, particularly because it has not been examined in detail by the High Court of Australia.[9] The potential for inconsistent and disadvantageous results is evident in a number of cases (particularly *Malouf*, below) where claimants have been unable to rely on section 6 because the "event" that gave rise to the claim occurred before the policy came into force. That is of particular significance in the field of professional indemnity insurance, where "claims made" and "claims made and notified" policies are ubiquitous.

3.9 *Malouf* related to a negligence claim in 2004 against a solicitor (Mr Charles Goldberg), regarding advice given to the claimant in respect to a property lending scheme. Perpetual Trustees brought proceedings against the claimant and his parents in respect to a loan it provided the claimant in funding his investment scheme, and they cross claimed against Mr Goldberg. Their claim was of professional negligence, and for damages flowing from the breach of Mr Goldberg's duties to them.

3.10 Mr Goldberg was an insured person for the purposes of a policy held by the entity Law Cover Insurance Pty Ltd ("LawCover"), which covered claims made against solicitors who had ceased to practice, as Mr Goldberg had by that time. The cross claim was served on Mr Goldberg on 14 March 2007, and the LawCover policy covered claims "first made" during the period 1 July 2006 – 30 June 2007.

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[7] Report 20, *Insurance Contracts* (tabled December 1982), paragraph 340

[8] (unreported, Vic SC, Eames J, 20 October 1995, BC9501003)

[9] Section 6 has been called ambiguous and open to interpretation; see for example, Kirby J in *New South Wales Medical Defence Union Ltd v Crawford & Bailey (as executrix of the Estate of Bailey)* (1993) 31 NSWLR 469 at 479; Giles JA in *The Owners Strata Plan 5030 v Walter Construction Group Pty Ltd (in Liq) & Ors* [2007] NSWCA 124 at [7] . the only High Court case to consider section 6, *Bailey v New South Wales Medical Defence Union Ltd* (1995) 183 CLR 399 did not specifically address many of the issues raised below, and nor did it contain any substantial interpretation of section 6 in totality.

3.11 The question for the Court to decide in respect to section 6 was the relevant date of the "event" for the purposes of the "*happening of the event giving rise to the claim for damages*". While it has been settled that the date of the "event" was the date a cause of action was completed,[10] there was dispute over when that was. The claimant's contention was that it was 6 October 2006, when the last property sold (the date he alleged that the cause of action accrued in negligence), whereas LawCover contended the event happened on the date the contract was breached, which was in 2004. Justice Davies agreed with LawCover and held that the "event" for the purposes of section 6 occurred in 2004, well before the date the insurance policy came into force.

3.12 Pleadings against professionals (such as financial advisers, other entities operating under the auspices of the *Corporations Act 2001* (Cth)), accountants and solicitors) are often framed on multiple bases. For instance, a pleading against a financial adviser will generally allege breach of contract, negligence, and breach of the *Corporations Act* and *Australian Securities and Investments Commission Act 2001* (Cth). But the difficulties arising from *Malouf* cannot be avoided by careful drafting of pleadings. There, the claim was pleaded as one in negligence rather than contract, but the Court nevertheless decided it was essentially a contractual dispute and the cause of action was completed as at the date the contract was breached, notwithstanding any alternative or further claim in negligence only being completed when loss was ascertainable.[11] *Malouf* emphasises the inadequacy of section 6: it fails to afford a claimant a right of direct recourse against the insurer for a negligence claim, regardless of whether there is an indemnity policy as at the date of the losses caused by the negligence which would ordinarily respond if the insured was to claim upon it.

4. Proposal 1: Limitation periods

4.1 The effect of *Malouf* is to ignore that a Plaintiff will often have multiple causes of action, and despite the beneficial intention of section 6, the precedent may lead to unfair results for claimants. The availability of multiple causes of action is of paramount importance not only in terms of establishing any damages claim but because of the operation of limitation dates. A claimant's cause of action in contract commences to run from the date of the breach of the contract,[12] which in financial advice claims is the date the advice is received. In many, if not most such claims, claimants are not aware that they have suffered loss until a much later time, which may be after the statutory time limits in respect to contract have already expired.

4.2 In claims involving investments, claimants will often also naturally attempt to ride out losses and see if the performance of their funds will improve over time. Unfortunately they may only decide to bring a claim once they are already time-barred in contract, although they may still have suffered claimable losses on the basis that their cause of action in negligence and under statute did not start to run until they suffered actual, not just prospective loss.[13]

4.3 But following *Malouf*, it appears that in cases involving allegations of negligent advice, Courts will find that the date of the relevant event is the date of cause of

[10] See for example, *The Owners Strata Plan 5030 v Walter Construction Group Pty Ltd (in Liq) & Ors* [2007] NSWCA 124 at [24]
[11] Davies J did not consider *Sciacca v ACE Insurance Ltd* [2011] NSWSC 798, where it was held that the cause of action completed when actual loss occurred. In that case, the Court in that case did not seem to consider it was a contractual dispute, despite it relating to financial advice. The claimant was grated leave under section 6.
[12] *Limitation Act 1969* (NSW) s 14(1).
[13] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 530 and 531.

action in contract completed, which would be when the advice was given. That is inconsistent with the law that would apply if a claimant brought their action against the insured, which is an unwelcome development. Furthermore, it is likely to lead to many potential claimants being statute barred from recovering damages.

4.4 Section 6 should therefore be redrafted to clarify that the "event" (as it is currently conceptualised) is referrable to the date each cause of action that is *pleaded* first accrued. We otherwise propose that the current law in respect to section 6 limitation periods be enumerated in the legislation.

5. Proposal 2: "Claims made" and "claims made and notified" policies

5.1 Despite it being now settled that section 6 does apply to "claims made" and "claims made and notified" policies,[14] the effect of *Malouf* (and other decisions made before it[15]) is to practically restrict the availability of section 6 in such claims. "Claims made" or "claims made and notified" policies are those that respond as at the time the claim is made to the Insurer, or the Insurer is notified or otherwise becomes aware of the circumstances giving rise to the claim. That is to be contrasted with "occurrence" policies which were conventional at the time section 6 was drafted, and which typically respond as at the date liability arises, regardless of when the claim is made.

5.2 "Claims made" are typically only in force for one year (as shown by the policy in *Malouf*), and will only respond to claims that are made, notified or the insured become aware of in that year, even if the event giving rise to liability occurred many years prior, depending upon the precise wording of the policy. They are advantageous to insurers because they allow it to close its book of claims after that particular policy expires, assured that most, if not all claims payable under the policy are accounted for. It would be expected that insurers will continue to prefer these policies to "occurrence" policies.

5.3 In *Chubb*, the Court was critical of judicial precedent that if the event occurred prior to the policy inception, leave ought not be granted, and noted it was an "anomaly" in respect to "claims made" and "claims made and notified" policies.[16] The Court seemed to prefer the Federal Court precedent (which diverges from Supreme Court precedent such as in *Malouf*) and in particular the construction of section 6 espoused by Lindgren J that to achieve its purpose, it ought to be construed that the charge created by section 6 is to be given effect as at the time of adjudication, not when the event occurred.[17] However, the Court in *Chubb* was not prepared to overrule the Supreme Court precedent to the contrary.

5.4 The current law is therefore unsatisfactory: unless the event occurs and the claim is made in the policy period, then a claimant will not be able to exercise the right conferred under section 6. This disadvantages claimants seeking to access insurance proceeds relating to professional indemnity policies given those claims typically involve an "event" that occurs before the claimant is aware they have suffered loss. This is an unfair result for such claimants: if the policy responds to their claim in circumstances where the event that triggered the insured's liability occurred before the policy was in force, then there is no reason that they should be prevented from relying on the statutory charge created by section 6. Section 6 should therefore be redrafted to resolve this issue.

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[14] *Chubb* at [83].
[15] See, eg, *The Owners Strata Plan 5030 v Walter Construction Group Pty Ltd (in Liq) & Ors* [2007] NSWCA 124.
[16] *Chubb* at [85].
[17] *Chubb* at [90]; *FAI General Insurance Limited v McSweeney* (1997) 73 FCR 379 at 415.

6. Proposal 3: Economic loss claims

6.1 *Chubb* concerned a pure economic loss claim flowing from a failed investment scheme. The Court noted (as detailed above with reference to financial services negligence) that often in economic loss claims generally, an "event" may occur which attracts liability, but loss only be suffered many years later.[18] The Court suggested but expressed no conclusion that because of the temporal limits of section 6, economic loss claims could be excluded.

6.2 It would be patently unfair to exclude such claims. In practice, it is not just commercial parties who bring pure economic loss claims, but also people who have invested and lost large amounts of money or property – too often, their entire savings, their superannuation and even their homes – or who may face losing their homes or being made bankrupt because of unmanageable levels of debt. Where the individual or entity that provided the service or advice is bankrupt or being wound up, claimants should be entitled to rely on recourse through the charge provided by section 6.

7. Proposal 4: discovery of identity of an insurer

7.1 One of the most significant impediments in practice to bringing a claim under section 6 is identifying the relevant insurer. The principle of privity of contract means that a claimant is generally not entitled to information regarding a policy of insurance to which they are not a party, but merely a potential beneficiary. In our experience, insurers are well aware of the challenge claimants face in ascertaining their identities for the purposes of claiming directly against them, or even simply to provide advice on whether insurance may respond to their claim, and are reticent to provide any assistance to claimants. Additionally, in our experience and absent a Court order, it is difficult to obtain information regarding an insolvent insured's insurance from their or its Trustee in Bankruptcy, Liquidator or Administrators. A Court order is both costly and difficult to obtain given the limitations on Court action which apply as discussed above in respect to bankruptcy and corporate winding up). Claimants therefore face a Catch-22: to bring or maintain costly actions, they generally need to show there is responsive insurance, but they are unable to take any of the usual steps (such as subpoenas, discovery or Notices to Product) ordinarily available to assess whether there is in fact responsive insurance.

7.2 We therefore propose a statutory regime be incorporated into legislation that would allow claimants to discover the identity of an insurer for the purposes of bringing a claim under section 6. This could take the form of an exception to the automatic stay of proceedings under the Bankruptcy Act and Corporations Act to allow claimants to seek a Court order compelling provision of the relevant insurance policy, or a simplified and directed preliminary discovery process.[19]

7.3 Alternatively, another option would be a register of professional indemnity policies, although that may outside the scope of section 6.

[18] [141]
[19] See rule 5.3 of the *Uniform Civil Procedure Rules 2005* (NSW).

MAURICE BLACKBURN LAWYERS

Josh Mennen
Principal
MAURICE BLACKBURN
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