NIBA
National Insurance Brokers Association.

New South Wales Law Reform Commission
GPO Box 21
Sydney NSW 2000

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

National Insurance Brokers Association of Australia (NIBA) submission on Consultation Paper 17: Third party claims on insurance money: review of s 6 of the Law Reform (Miscellaneous Provisions) Act 1946

ABOUT NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents over 300 member firms and over 2000 individual Qualified Practising Insurance Brokers (QPIBS) throughout Australia.

Brokers handle almost 90% of the commercial insurance transacted in Australia, and play a major role in insurance distribution, handling an estimated $18 billion in premiums annually and placing around half of Australia's total insurance business. Insurance brokers also place substantial insurance business into overseas markets for large and special risks.

Over a number of years NIBA has been a driving force for change in the Australian insurance broking industry. It has supported financial services reforms, encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 325 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on Risk Insurance products.

NIBA is grateful for the opportunity to provide is feedback on this issue which has a significant effect on the insurance industry.

ABOUT INSURANCE BROKERS

The traditional role of insurance brokers is to:

- assist customers to assess and manage their risks, and provide advice on what insurance is appropriate for the customer's needs;
- assist customers to arrange and acquire insurance; and
- assist the customer in relation to any claim that may be made by them under the insurance.

In doing the above the insurance broker acts on behalf of the customer as their agent. Insurance brokers offer many benefits to customers and consumers:

- assistance with selecting and arranging appropriate, tailored insurance policies and packages
- detailed technical expertise including knowledge of prices, terms and conditions, benefits and pitfalls of the wide range of insurance policies on the market;

- assistance in interpreting, arranging and completing insurance documentation;
- experience in predicting, managing and reducing risks; and
- assistance with claims and a higher success rate with settlements (about 10 per cent higher than claims made without a broker).

In limited cases insurance brokers may act as agent of the insurer not the insured but where such a relationship exists the customer is clearly advised up front.

EXECUTIVE SUMMARY

NIBA believes change is required in relation to section 6. A lack of clarity creates inefficiency in the insurance system for all involved.

Whether it should be repealed or amended to clarify Government's position on the relevant issues identified should depend on identification of whether it continues to serve any useful purpose and to the extent it does, whether its continued existence (albeit clarified) is justified on a cost benefit analysis.

As to what changes are appropriate, NIBA sets out its view on the main issues identified below.

KEY PROBLEMS WITH SECTION 6

Directors and Officers/Access to defense costs issue

As noted in the Consultation Paper, the application of section 6 to directors' and officers' insurance policies is unclear, especially in relation to whether the charge on "all insurance money that is or may become payable" affects the ability of directors and officers to access insurance money to meet ongoing defence legal costs.

This would also have a significant impact on public liability, professional indemnity and domestic policies providing liability cover such as comprehensive motor and home policies (except those specifically excluded by legislation).

Whilst all these liability insurances cover different exposures they have a common intention – to protect the insured against third party claims including the payment of defence costs and damages.

In *Chubb Insurance Company of Australia v Moore (***Chubb***)*, the Court of Appeal confirmed that s 6 did not prevent an insurer from discharging its obligations to an insured to meet legal costs, which is the opposite conclusion the New Zealand Supreme Court came to in *Steigrad & Ors vs Bridgecorp Limited & Ors*[1] (**Bridgecorp**).

Although this judgement is helpful, many of the NSW Court of Appeal findings do not provide binding precedent.

This has created widespread apprehension and could have two potentially serious implications in the event that the courts departed from the judgement in *Chubb Insurance Company of Australia v Moore:*

[1] HC AK CIV-2011-404-611 [2011] NZHC 1037

- Firstly, in event of one or more claims exceeding the available policy limit, an insurer may be prevented from advancing money to the insured for the defence of legal proceedings (in respect of a claim) in accordance with the terms of the policy.

  This is contrary to the fundamental intention of such policies which is to protect the insured (not the third party claimant).

  In such a situation, the insured would be obliged to fund their own defence which, in many cases, would lead to financial difficulty or indeed the inability to defend the claim at all. In the case of D&O insurance, directors and officers may therefore be required to personally fund defence costs. We understand that directors are reconsidering whether they can afford to serve on Boards given the personal financial exposure they may incur in defending legal actions brought against them in their corporate capacity, pending potential reimbursement from the insurer.

- Secondly, in the event that two or more claims together exceed the available policy limit, competing charges, the ranking of charges, and uncertainty about the magnitude of the charges have the serious potential for insurance payments to be subject to protracted delays while these issues are resolved. Such delays would impact not only the insurer and the insured but also claimants as the competing statutory charges created over all the insurance monies may effectively “freeze” the policy pending the resolution of all ”competing” claims. It is likely that such delays would be protracted (possibly over many years) and the outcomes would be uncertain.

To safely avoid the risk if a contrary view being taken by the High Court, separate policies covering defence costs would need to be negotiated. Whilst this may be possible for certain companies, persons and policies it is not a practical solution for all affected persons and all policies.

For example:

- some companies and persons may not be able to afford the separate coverage, especially where they have already paid for cover that provides the cover as part of the overall limit of liability;
- some persons may never become aware of the issue and risk and thus will do nothing;
- it is not practical to split home policies in this manner without significantly increasing the cost of such insurance.

The issue is causes confusion and apprehension, especially in the corporate market place and in relation to professional indemnity and Directors and Officers insurance.

The risk that defence costs may not be available under existing policies causes some directors and officers to query whether to serve in such roles given the risks.

NIBA believes the position regarding the above issues need to be settled, either by way of clarification or amendment of the relevant section after undertaking a cost benefit analysis of the relevant options. NIBA supports the position of the Court of Appeal.

Claims made and notified policies prior event issue

In Chubb, the Court of Appeal confirmed that s 6 applies to claims made and notified policies, but despite misgivings, also confirmed previous authorities that s 6 does not apply to events that took place before such a policy commenced.

Until the High Court determines the issue, there is still uncertainty as to whether or not a s6(1) charge could arise in circumstances where a claims made and notified policy (with a retroactive date) was entered into after the occurrence of the event giving rise to a claim.

NIBA supports any change that clarifies this uncertainty.

Liability for pure economic loss issue

Questions have been raised about the application of the expression "happening of the event giving rise to the claim for damages or compensation" to cases of pure economic loss.

NIBA supports any change that clarifies this uncertainty.

Contracts of reinsurance issue

There is uncertainty over whether s 6 covers situations where an insured cannot proceed against or recover from an insurer and, instead, seeks to recover from the insurer's reinsurer. The argument is that since the reinsurance indemnifies the reinsured "against liability to pay any damages or Compensation" it is caught by s 6.

NIBA supports any change that clarifies this uncertainty.

Limitation periods issue

The Court of Appeal in Chubb has held that the remedy established under s6(4) is, "subject only to other subsections, assimilated to a cause of action against an insured" so that "[t]ime commences to run at the same time as the cause of action in tort or contract accrues to the claimant against the insured", and "[t]ime ceases to run ... when proceedings are brought against the insured or the insurer, whichever comes first".

Prior to this decision, there were three differing interpretations of the commencement of the limitation period:

i) It commences at the same time as the limitation period for proceedings against the insured, such that if proceedings against the insured would be statute barred, so would the proceedings against the insurer. This was the view of the NSW Court of Appeal in *Grimson v Aviation and General (Underwriting) Agents Pty Ltd*[2] and *McMillan v Mannix*[3].

[2] *Grimson v Aviation and General (Underwriting) Agents Pty Ltd* (1991) 25 NSWLR 422.
[3] *McMillan v Mannix* (1993) 31 NSWLR 538.

ii) It only begins to run from the time that leave is granted with the view that proceedings under s6 are to enforce a charge and the granting of leave under section 6(4) is itself an element of the cause of action. This was the majority view in the NSW Court of Appeal decision in *Medical Defence Union Ltd v Crawford*[4] and Northern Territory Court of Appeal decision in *Ceric v CE Health Underwriting Insurance (Australia) Pty Ltd*[5].

iii) The limitation period for proceedings against the insurer and insured commence together, but time cesses to run in favour of the insurer once proceedings are commenced against the insurer. The Chubb Court of Appeal view.

In the absence of the High Court determining the issue, there is still uncertainty for insurers and insureds.

NIBA supports any change that clarifies this uncertainty.

Failure to obtain leave issue

The NSW Court of Appeal has held that failure to obtain leave to commence an action to enforce a charge under s6(1), invalidates any action taken and prevents any action being revived by retrospective leave. This conclusion continues to be applied in NSW despite some misgivings in other judgments (including in the High Court) and contrary authority from the Northern Territory Court of Appeal.

NIBA supports any change that clarifies this uncertainty.

The insurer's right to disclaim liability issue

Ss6(4) of the Act provides a prohibition to the grant of leave where the court is satisfied that the insurer is entitled to disclaim liability and any proceedings necessary to establish the entitlement to disclaim has been taken. Whether there is an entitlement by the insurer to disclaim liability is difficult and the test for a grant of leave is whether the applicant has shown 'an arguable case of liability against the insured'. This result is that although leave may be granted on this basis, the insurer may still be entitled to subsequently disclaim liability with the result that the insurer is drawn into unnecessary and expensive litigation.

This position has been criticised as allowing an "indolent, or malevolent, insured" to thwart a plaintiff's attempts to recover from an insurer. Other examples of potentially problematic terms which may be found in insurance policies include where the insured's right to be indemnified arises only if a plaintiff obtains judgment against the insured, and where the insurer may avoid the contract if the insured discloses to a third party that the insured has liability insurance cover and the terms of that cover.

NIBA notes that Section 28 and 54 of the Insurance Contracts Act (**ICA**), which respectively provide for remedies for non-disclosure and misrepresentation and remedies generally, both contain proportionality tests which may reduce an insurer's liability to nil. S6 of the Act has the effect of dragging an insurer into complex and expensive litigation, where the end result may be that the insurer is not liable or can reduce its liability.

[4] *Medical Defence Union v Crawford* (1993) 31 NSWLR 469.
[5] *Ceric v CE Health Underwriting Insurance (Australia) Pty Ltd* (1994) 99 NTR.

NIBA supports the current approach in ss6(4) however is happy to consider any amendments that address any valid forms of misconduct which should be avoided weighing up these protections against the issue raised in the previous paragraph.

Priority between charges where there are multiple plaintiffs issue

Ss6(3) has different provisions depending on whether the events giving rise to the liability occurred on the same or on different days.

The provisions relating to proportional distribution may operate unfairly and the different provisions create practical difficulties where there are multiple claimants making separate claims under one policy on the same day and where the sum insured would not be enough to satisfy all the claims.

NIBA supports any change that clarifies this uncertainty and achieves a fair result.

Where the person covered is not the person who entered the contract issue

Section 48 of the ICA provides that persons who are not parties to the insurance contract, but are specified or referred to in the contract, have rights to claim against the insurer.

A question arises as to whether such persons are 'indemnified' for the purposes of s6, that is, can a third party claimant assert a charge over the insurance contract in circumstances where the 'insured' is a party specified or referred to in the contract, but not a named insured?

Given the High Court of Australia decision in *Zurich Australia Insurance Ltd v Metals & Minerals Insurance Pte Ltd & Ors*[6] the better view may be that the person indemnified as referred to in s 6 of the Act is a party to the contract of insurance, and not a mere beneficiary of the benefit of the contract, especially given the words in s6(1) that the person 'entered into a contract of insurance'.

NIBA supports any change that clarifies this issue.

Territoriality issue

The Court of Appeal has recently confirmed that s6 applies to an action that a plaintiff brings against an insured in a NSW court, however, it did not do this "without doubt", questioning, in particular, how the section might apply under cross-vesting arrangements. Recent Federal Court authority suggests that s6 may apply to proceedings brought in the NSW registry of the Federal Court.

NIBA supports any change that clarifies this issue.

Corporate Insolvency issue

[6] *Zurich Australia Insurance Ltd v Metals & Minerals Insurance Pte Ltd & Ors* [2009] HCA 50.

There is a question whether ss6(2) (which deals with any claims while the insured corporation is being wound up or is deemed to be wound up) continues to operate since the referral of corporations power to the Commonwealth in 2001.

NIBA supports any change that clarifies this issue.

Workers Compensation and Motor Accidents issue

A question arises about the extent to which ss6(8) is needed to preserve the effect of NSW workers compensation and motor accidents legislation. Particular issues about the interaction with workers compensation legislation include:

- The application of ss6(9). This subsection was added in 1998 to overcome a Court of Appeal decision. In that decision the Court held that s 6 does not apply to workers compensation insurance policies.

- The interaction of the timing provisions in ss6(1) with s51AB of the Workers Compensation Act 1987 (NSW) which, in occupational disease cases, makes the last liability insurer liable to indemnify an employer.

The necessity for these issues to be addressed will depend on the final outcome.

Compromise Issue

Where an insurer on notice of a claim being made against the insured, denies indemnity but subsequently enters into a compromise with the insured, what happens where the claimant subsequently asserts a charge over the monies payable under the policy? Would the claimant be bound by the compromise or would the insurer be bound to pay the amount the subject of the claim to which the charge attaches up to the amount insured under the policy?

The operation of s6 in relation to the above is uncertain and should be clarified.

PROPOSED OPTIONS FOR REFORM

Reform Option 1:

Do nothing, on the basis that the section continues to be useful and that relevant High Court and NSW Court of Appeal decisions sufficiently clarify its operation

NIBA does not believe this a valid option given the lack of clarity regarding the issues noted above.

A lack of clarity creates uncertainty for insurance brokers and their clients and inefficiencies in the insurance system that ultimately create unnecessary extra costs for those involved.

Insurance brokers are being put to considerable expense in having to:

- form views on the above issues; and
- develop procedures to seek to manage these complex issues.

This applies whether the insurance broker acts for the insured, third party beneficiaries, the insurer or third party claimant.

Reform Option 2:

Retain the thrust and structure of the section but clarify areas of uncertainty, for example:

- ***clarify that s 6 does not affect other obligations under an insurance contract, such as the obligation to meet legal costs; for example, directors' and officers' defence costs;***
- ***clarify how s 6 applies to claims made and insurance policies;***
- ***clarify that, for the purposes of the limitation period that applies to a plaintiff's claim against an insurer, time ceases to run against the plaintiff once proceedings are issued against the insured defendant; and***
- ***clarify whether s 6 applies to contracts of reinsurance.***

NIBA is happy to consider appropriate changes to s6 that address the areas of uncertainty identified above, assuming that the view is formed by relevant stakeholders that the evils the section was intended to address justify its continued existence on a cost benefit analysis.

NIBA is not aware of any recent evidence of the identified evils or where section 6 has been used to address such an issue.

NIBA notes that apart from NSW, the Australian Capital Territory and the Northern Territory, no other jurisdiction has deemed it necessary to have similar protection in place.

Given the current robust regulatory regime applicable to insurers in Australia and current market practices, it would be unusual for an insurer not to make payments directly to a third party claimant once liability was established.

In addition:

- the NSW Supreme court rules allow a third party to commence proceedings against an insurer directly in circumstances of the insured's death or insolvency;
- Similar rights apply in relation to individual insureds under section 51 of the Insurance Contracts Act and section 117 of the bankruptcy Act 1966 (Cth);
- section 562 of the Corporations Act give claimants the right to proceed directly against an insurer where the corporate insured becomes insolvent; and
- section 601AG of the Corporations Act deals with deregistered companies.

Reform Option 3:

Retain the thrust and structure of the section while reforming areas were s 6 has been criticised as problematic or inadequate, for example:

- ***to provide that the person who has "entered into the contract of insurance" includes, for the purposes of s 6(1), the person on whose behalf such a contract has been entered into;***
- ***to provide for priorities between charges where there is more than one plaintiff;***
- ***to provide that the insurer should not be entitled to deny liability because the insured has not complied with an obligation in relation to the claim - an approach that is consistent with s 54 of the Insurance Contracts Act 1984 (Cth);***
- ***to provide that a plaintiff should be entitled to fulfil any conditions of a policy such as the payment of an excess or notifying the insurer of a "policyholder event'; and***
- ***to tighten the leave requirements on the basis that, where plaintiffs are unsuccessful, an insurer will be disadvantaged by not being fully indemnified in costs; and to limit the operation of s6 to liability for personal injury, to the exclusion of property damage and pure economic loss.***

NIBA supports such an approach where the relevant change is shown to achieve a fair and balanced result. For example, NIBA would have concerns with a blanket prohibition on the insurer being entitled to deny liability because the insured has not complied with an obligation in relation to the claim. In some cases such a right is a fair and reasonable result.

Reform Option 4:

Repeal s 6 and leave the field to existing (or revised) Commonwealth provisions and existing State workers compensation and motor accidents regimes - effectively the position in every other State – on the basis that those provisions and regimes and the common law sufficiently address the need for a direct remedy against insurers, and/or that current insurance practices and regulation means that the risks to which s 6 was directed in 1946 no longer exist.

NIBA would support such an approach where the view is formed by relevant stakeholders that the evils the section was intended to address do not justify its continued existence on a cost benefit analysis.

Reform Option 5:

Retain the thrust of the s 6, but rewrite it in a contemporary drafting style, while addressing the clarifications discussed above

Where amendment is considered justified by relevant stakeholders, NIBA supports such an approach over the clarification of the existing wording, in order to make the section clearer for all concerned.

NIBA would appreciate the opportunity to meet and discuss this important issue further.

Thank you for the opportunity to provide these brief comments.

Dallas Booth
Chief Executive Officer
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National Insurance Brokers' Association of Australia