

Insurance Newsletter

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Insurance Law Update

Section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946 (NSW)* and “Claims Made and Notified Policies” – Latest Developments

Background

What happens if a claimant wants to sue a professional indemnity insurer directly? For one reason or another, there may be no viable middleman – i.e. the insured.

In New South Wales, a popular solution is to seek leave to proceed against the insurer under Section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946 (NSW)*. Mirror legislation has been passed in the Northern^[1] and Australian Capital Territories^[2] but nowhere else in the Australian Commonwealth^[3].

The *Law Reform (Miscellaneous Provisions) Act 1946 (NSW)* became law on 21 May 1946^[4]. It is a little convoluted but the gist of Section 6 is, in certain circumstances, to place a statutory charge on insurance proceeds that may be available to meet a claim and preserve those proceeds for the benefit of the claimant.

Section 6 provides as follows:

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

- (2) If, on the happening of the event giving rise to any claim for damages or compensation as aforesaid, the insured (being a corporation) is being wound up, or if any subsequent winding-up of the insured (being a corporation) is deemed to have commenced not later than the happening of that event, the provisions of sub section (1) shall apply notwithstanding the winding-up.
- (3) Every charge created by this section shall have priority over all other charges affecting the said insurance monies, and where the same insurance monies are subject to two or more charges by virtue of this Part those charges shall have priority between themselves in the order of the dates of the events out of which the liability arose, or, if such charges arise out of the events happening on the same date, they shall rank equally between themselves.
- (4) **Every such charge as aforesaid shall be 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 shall, 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:

Provided that, except where the provisions of sub section (2) apply, **no such action shall 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.



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- (5) Such an action may be brought although judgment has been already recovered against the insured for damages or compensation in respect to the same matter.
- (6) Any payment made by the insurer under the contract of insurance without actual notice of the existence of any such charge shall to the extent of that payment be a valid discharge to the insurer, notwithstanding anything in this Part contained.
- (7) No insurer shall be liable under this Part for any greater sum than that fixed by the contract of insurance between itself and the insured.
- (8) Nothing in this section shall affect the operation of any provisions of the *Workers Compensation Act 1987* or the *Motor Vehicles (Third Party Insurance) Act 1942*.

The highlighted words capture the Section's gist.

At the time the New South Wales and Territory legislation was passed, the typical professional indemnity policy was "event" based. That meant that it was the happening of an "event" during a policy's period of insurance which activated or "triggered" that policy. Those who drafted section 6 adopted the same concept as the trigger for the creation of the "charge" about which section 6 speaks. Sub-section 6(1) refers to "the happening of the event giving rise to the claim for damages or compensation". The idea was that the policy and statutory charge would be triggered at the same point in time.

"Claims made and notified" policies are a relatively recent development.

It is not the happening of an event which triggers a "claims made and notified" policy. It is the making of the claim against the insured (even if the event occurred before the policy's inception) and its notification to the insurer which activate or "trigger" that type of policy.

The introduction and subsequent popularity of "claims made and notified" policies created a tension with the operation of section 6 because the statutory trigger and the policy trigger were no longer both focussed on the happening of the event and would not, therefore, always occur at the same time. In fact it was possible that the statutory trigger might occur (and the charge therefore arise) before the inception of the policy and, therefore, at a time when there were no insurance proceeds to which the charge could attach.

Notwithstanding this mismatch in timing, applications were made under section 6(4) to proceed against insurers of "claims made and notified" policies. As a result, different views emerged about whether a statutory charge which arose before a "claims made and notified" policy's inception could attach to the proceeds available under that policy.

For example in *Manettas v Underwriters at Lloyd's*^[5], Cole J of the Supreme Court of New South Wales observed:

"If at the relevant time there is no insurance policy even a fictional charge cannot attach to non-existent insurance monies. If at that time there is no policy, there cannot be any insurance monies "that are or may become payable" in respect of that liability under any then existing policy. The section does not say that a charge affixes in respect of insurance monies which "are or may become payable" under policies of insurance which may be written in the future."

Lindgren J expressed a different view in *FAI v McSweeney*^[6] where he said:-

"Sub-section 6 (1) speaks as at the time of adjudication. As at that time, the insured has entered into a contract of insurance by which the insured "is indemnified [at the time of the adjudication] against any liability to pay damages or compensation". The expression, "shall be a charge" does not convey a future tense but is prescriptive of a legal result to which courts must give effect. The charge which the section creates exists on and from the Event. The charge is a fixed charge in the case where insurance moneys are payable at the time of the Event and a floating charge in respect of insurance moneys that may become payable, and do in fact become payable, at a later date. In relation to the latter, it is immaterial that the insurance moneys become payable pursuant to an insurance contract entered into after the Event: once insurance moneys have in fact become payable in respect of the liability, the charge fixes upon them.

I have, with respect, reached the opposite conclusion to that reached by Cole J in Manettas. I favour the ... construction referred to above."

This dispute as to which view should prevail, was resolved by NSW Court of Appeal in *Owners – Strata Plan No. 50530 v Walter Construction Group Limited (In Liquidation)*^[7] where the Court of Appeal unanimously held that a charge did not arise where the event happened before the inception of the relevant policy. Hodgson JA (with whom Giles and Tobias JJA agreed) said, amongst other things

It is common ground, as well as being asserted by the High Court in Bailey^[8],



that under s 6(1) the “charge” must arise, if at all, on the happening of the “event” giving rise to the claim against the insured, and not at some later time. That being so, if there is to be any charge in any cases where that event (whatever completes the cause of action against the insured) occurs before any contract of insurance is made, it would have to be a “charge” arising where there is no property or even potential property to which it could apply, and not even any identifiable insurer with whom such property, if and when it came into existence, might be associated. It would thus be a “charge” without having even as much substance as a contract to give a charge on after-acquired property, where there is at least a person against whom a contractual right exists pursuant to which (assuming the contract is specifically enforceable) an equitable charge can arise if and when the property is acquired.

It is true that the charge under s 6(1) is something created by statute, which does not have to conform to pre-existing general law categories; but it is difficult in the extreme to read s 6(1) as disclosing a legislative intention that there be something called a charge in existence at a time when there is no property to which it could attach, and no person against whom any rights could be asserted to have a charge attached to property if and when the property comes into existence. (It would be otherwise if there were, at the time of the event, a contract between the insured and the insurer for claims-made insurance to be given for some future period: in those circumstances, I think a charge would arise.)

Since *Walter*, further applications have been made under section 6(4) for leave to proceed against insurers directly in which this issue of a mismatch in timing has arisen. How has *Walter* been applied?

Recent Cases

The first judgment is the judgment of Justice McCallum in *Perpetual Trustees Victoria Limited v Malouf*^[9]. This case concerned a borrower’s failure to repay a loan. A solicitor who had allegedly advised the borrower’s parents in respect of the loan could not be found and so steps were being taken to pursue a claim against the lawyer’s

professional indemnity insurers directly.

McCallum J recognised the competing views about the operation of section 6 but was bound by the Court of Appeal’s decision in *Walter* to accept that as a matter of principle section 6 did not give rise to a charge where the relevant event happened before the inception of the relevant contract of insurance. But that left two issues to be resolved:

1. When was a claim first made against the insured lawyer; and
2. When did the event giving rise to the claim against the insured lawyer occur?

The court was satisfied that no claim was made against the insured before 1 July 2006. So the policy which responded to the claim was the policy which commenced on that date.

The evidence before the court demonstrated that by 30 June 2006 it was reasonably ascertainable that there would be a shortfall in the value of the security supporting the repayment of the lender. Accordingly, by that time at the latest, any loss suffered by the plaintiffs due to the conduct of the insured had “happened”.

The event did not happen during the relevant policy period. The application to proceed directly against the insurers was therefore dismissed.

La Trobe Capital & Mortgage Corporation Limited v Ace Insurance Limited^[10] concerned an application to proceed against an insured valuer’s professional indemnity insurer. Here it was discovered that a valuation provided by the insured materially exceeded the property’s worth. An application was made to proceed directly against the valuer’s professional indemnity insurer.

The Court found that it was not until the property had been passed in at an amount significantly less than the valuation and the amount lent against it, that the event “happened”. Unlike *Malouf* the court found that the event happened during the policy period and that that policy had therefore been triggered.

Leave to proceed against the insurer was granted.

The final decision is *Provident Capital Limited v Gould*^[11]. This was an application to proceed against a lawyer’s professional

indemnity insurer where the insured lawyer had made representations about his client’s financial standing.

The professional indemnity insurer resisted the application on two grounds. Firstly the policy was not on foot at the time the liability of the insured “happened”. Secondly, the insurer argued that its insured’s conduct triggered a dishonesty exclusion which would ultimately prevent the policy from responding to this particular claim.

The Court granted the claimant leave to proceed against the insurer.

Firstly, it concluded that it was arguable that the damages suffered by the plaintiff first happened during the policy period.

Secondly it concluded that resolving any question about the application of the dishonesty exclusion was a matter for the trial judge.

Summary

The following is a summary of the position as it currently stands:-

- In some jurisdictions, a claimant may, with the leave of the court, proceed directly against an insured’s professional indemnity insurer.
- A claimant must obtain the court’s leave.
- The court will not grant leave where the court is satisfied that the insurer is entitled to deny indemnity and has commenced separate proceedings to establish that entitlement.
- The court will not grant leave where the relevant event (i.e. the event creating the charge) happened before the relevant policy’s inception.
- The courts consider the ‘happening’ to be the moment when the cause of action is completed.
- While the insurer is entitled to rely against the claimant on any defences which it had against its insured (e.g. the application of a particular exclusion), the availability of those defences will usually be left for the trial judge.



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TressCox 'Insurance Contracts Act' Seminar Series 2010

We are delighted to invite you to attend the TressCox 'Insurance Contracts Act' Seminar Series for 2010.

These seminars will provide you with a practical overview of the *Insurance Contracts Act* and its application, including a review of Sections 40 and 54; insights into the duty of utmost good faith; duty of disclosure; expiry, renewal and cancellations; subrogation and contribution between insurers.

To launch the series, Alistair Little, head of the TressCox Sydney, Litigation Division, will provide an overview of the Insurance Contracts Act, its application and the role of ASIC in the wake of the GFC.

These seminars will provide you with insights into the recent developments in the insurance sector, as well as an opportunity to network with industry colleagues.



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Click here to RSVP!

To RSVP for the first seminar in Sydney on Tuesday 23 March 2010 click [here](#).

Alternatively, please RSVP direct to Emma Gordon at emma_gordon@tresscox.com.au or telephone 02 9228 9340.

All seminars are hosted at 5:30pm in our respective TressCox offices:

SYD - Level 20, 135 King Street, Sydney

MEL - Level 9, 469 La Trobe Street, Melbourne

Save the dates for the following seminars!

Seminar Part I

Date: SYD - Tuesday 23 March 2010
MEL - To be advised

Topic: *The Insurance Contracts Act, its application and the role of ASIC.*

Seminar Part II

Date: SYD - Tuesday 25 May 2010
MEL - To be advised

Topic: *The duty of utmost good faith.*

Seminar Part III

Date: SYD - Tuesday 27 July 2010
MEL - To be advised

Topic: *Duty of disclosures, consequences of breaches of duty of disclosure or misrepresentation of prior known claims exclusions.*

Seminar Part IV

Date: SYD - Tuesday 21 September 2010
MEL - To be advised

Topic: *Particular terms and conditions of contracts of insurance. Sections 40 & 54 of the Insurance Contracts Act including fraudulent claims.*

Seminar Part V

Date: SYD - Tuesday 23 November 2010
MEL - To be advised

Topic: *Expiry, renewal and cancellations, subrogation and contribution between insurers.*

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[1] Section 26- 28 Law Reform (Miscellaneous Provisions) Act 1956 (NT)

[2] Section 25-26 Law Reform (Miscellaneous Provisions) Act 1955 (ACT) (now Section 206 of the Civil Law (Wrongs) Act).

[3] The Corporations Act includes provisions (562 and 601AG) which are expressed differently but whose purpose is to protect the insurance asset in certain circumstances. Section 51 of the Insurance Contracts Act 1994 (Cth) also provides a means to access an insured's professional indemnity policy directly where the insured has died or cannot be found. Importantly neither the Corporations Act nor the Insurance Contracts Act talks about a charge arising so the tension in the application of the New South Wales and Territory legislation does not arise.

[4] Since its passing, the New South Wales Act has been amended on a number of occasions but not in a way that is immediately relevant.

[5] (1993) 7 ANZ Insurance Cases 61-180

[6] (1997) 10 ANZ Insurance Cases 61-400

[7] (2007) 14 ANZ Insurance Cases 61-734

[8] (1995) 184 CLR 399

[9] [2008] NSWSC 834

[10] [2008] NSWSC1303

[11] [2009] NSWSC 1458