STATE LEGAL CONFERENCE

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S.6 LAW REFORM MISCELLANEOUS PROVISIONS ACT 1946 and CHUBB INSURANCE COMPANY OF AUSTRALIA LTD V. MOORE [2013] NSWSC 212

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1. As everyone in this room knows s.6 created "a new right with an associated remedy to enforce it … by it's own force, the statute, in circumstances where it applies, creates, on the happening of the event giving rise to a claim or damages for compensation, a charge on all insurance monies which are then payable in respect of the liability against which the insured is indemnified and on all such insurance monies that may become payable in respect of that liability."[1]

2. Where it applies s.6 gives a third party claimant direct access to the insurer, and insurance monies, to secure satisfaction of the claimant's entitlement to damages or compensation when ascertained by judgment, award or settlement. The right, is, of course, subject to the terms of the policy as they stood upon the happening of the event giving rise to the claim for damages or compensation "notwithstanding that the amount of such liability may not then have been determined"[2].

3. As I have said, the charge is subject to the terms of the policy[3], not only as to the monetary limit of indemnity but also as to the rights of the insurer conferred by the contract of insurance or general law. These rights include the general law right to rescind for non-disclosure, where it still exists, or the right to avoid in certain cases of non-disclosure and

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[1] *Bailey v. New South Wales Medical Defence Union Ltd* (1995) 184 CLR 399 at 446 per McHugh and Gummow JJ; with whom Brennan CJ, Deane and Dawson JJ agreed (415).

[2] S.6(1).

[3] S.6(7).

misrepresentation conferred by s.28 *Insurance Contracts Act 1984* (Cth). The statute does not affect the entitlement of the insurer to deny where liability to indemnity does not arise because of the failure of the insured to observe, or comply with, a condition precedent to the liability of the insurer[4]. Nor will the statutory charge deny the insurer the benefit or advantage of an express exception from cover contained in the policy. In both these categories of case, there will be no insurance monies which are, or might become, payable in terms of s.6(1)[5].

Legislative Context

4. As is well known s.6 is derived from s.9 *Law Reform Act 1936* (NZ), indeed they are identical down to subsection (7). The local example makes specific provision for local statutory insurance in subsections (8) and (9). Within the Commonwealth of Australia, only the Australian Capital Territory[6] and the Northern Territory[7] have followed suit.

5. There are other legislative provisions providing for direct access to insurance monies by a person who is not a party to the contract of insurance: ss. 59(2) and 162 *Workers Compensation Act 1987* (NSW), ss. 23 and 113 *Motor Accidents Compensation Act 1999* (NSW), ss.48 and 51 *Insurance Contracts Act 1984* (Cth) and s.601AG *Corporations Act 2001* (Cth) provide examples.

6. I have not undertaken a thorough review of the literature, but my firm impression is that none of these other provisions have attracted anything like the stringent criticism from judges and commentators directed at s.6. Nonetheless, it is also my impression that s.6 remains the provision most frequently utilised by claimants seeking to proceed directly against an insurer rather than the insured. Perhaps contempt

[4] *MacMillan v. Mannix* (1993) 31 NSW LR 538; VACC Insurance Ltd v. BP Insurance Ltd (1999) 47 NSWLR 716.
[5] *MacMillan; Bailey* at 449.
[6] *Civil Law (Wrongs) Act 2002* (ACT) (ss. 206, 209).
[7] *Law Reform (Miscellaneous Provisions) Act 1955* (NT) ss. 26 – 29.

breeds familiarity. In *Chubb,* to which I will return in a moment, Emmett JA and Ball J, who wrote the judgment in which the other members of a five-judge Bench agreed, noting previous criticism, remarked[8] that s.6 "should be repealed altogether or completely redrafted in an intelligible form, so as to achieve the objects for which it is enacted". Other criticisms include a description of its language as "undoubtedly opaque and ambiguous";[9] and "ambiguity may be its only clear feature".[10]

7. These criticisms go back a long way. Writing extra-curially R.D. Giles J, when Chief Judge of the Commercial Division, called for a reconsideration of s.6 extending, I infer, to it's repeal and replacement with "a less confusing provision"[11]. His Honour was reviewing the legal position in the aftermath of the High Court decision in *Bailey* .

The purpose of s.6

8. Emmett JA and Ball J[12] identified the purpose of s.6 in the following terms:

> 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 (Citations omitted)

9. In his article, Giles J doubted whether such considerations were founded in reality in the modern age. And it may be that it is the procedural efficiency of s.6 which appeals to practitioners more than the reality of the risk of premature disgorgement of the insurance monies depriving an innocent claimant of his or her just desserts. However, the unusual facts in *Bailey* demonstrate that in hard cases

[8] Chubb at [55].
[9] NSW Medical Defence Union v. Crawford (1993) 31 NSWLR 469 at 479D.
[10] MacMillan at 542B.
[11] R.D. Giles *Reflections on s.6* (1996) 7ILJ 152.
[12] Chubb at [52].

attempts may be made even by apparently reputable insurers to avoid liability after the event. And, premature disgorgement was at the heart of one of the key issues decided in *Chubb* to which I will now turn.

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10. I will not tarry long over the facts in *Chubb*. It is sufficient for present purposes to say that the question to be determined by the New South Wales Court of Appeal related to whether s.6 applied for the benefit of different categories of claimant in interstate proceedings arising out of the collapse of Great Southern Limited and it's subsidiaries. There were proceedings in the Supreme Court of Western Australia and the Supreme Court of Victoria. The principle place of business of the Great Southern Group was Western Australia, although it was engaged in commercial activities in various parts of Australia. The commercial activities had no special connection with New South Wales. All of the defendants in the various proceedings were insured under various policies issued by a number of insurers. The policies extended to cover the liability of former directors and executives of companies in the Group. Each of the policies was a claims made and notified contract of insurance. As you will appreciate, such a policy responds to a claim for a liability made against the insured during the policy period, and notified to the relevant insurer during the policy period.[13] The solicitors for the various claimants notified the insurers by letter of their assertion of the existence of a charge in favour of the clients by the operation of s.6. The purpose of this letter was to claim priority pursuant to s.6 for the purpose of ss.6(3) and (6). The particular significance of this is that the policies, subject to a single monetary limit of cover, indemnified the insureds against third party liability, and for defence costs and legal representation expenses. The concern of the claimants was to assert priority over legal expenses incurred by the defendants in defending the various proceedings.

[13] Chubb at [28]

11. The insurers commenced proceedings in the Commercial List of the Equity Division of the Supreme Court of New South Wales. The principal relief sought was a declaration to the effect that upon it's proper construction there can be no charge under s.6 on any insurance monies that are or may become payable by any of the insurers under any of the policies in respect of the entitlements of the claimants in the various Great Southern proceedings. By order of the Commercial List Judge, certain controversial questions were removed to the Court of Appeal for determination as separate questions under the rules on the basis of an agreed statement of facts.

12. I will not set out the questions in full. They can be found at [66] and [207] of the judgment. The issues to which they in substance relate are: the territorial reach of s.6, bearing in mind the litigation was in Victoria and Western Australia; does s.6 apply to claims made policies; if so, does it create a charge arising from an event that precedes the inception of the policy; does the statutory charge extend to insurance monies payable to the insured in respect of defence costs paid in accordance with the policy before judgment, award or settlement; will payment to one claimant constitute valid discharge if made prior to judgment settlement in respect of other claims, and; did the solicitors letters put the insurers on actual notice of the existence of the statutory charge for the purpose of s.6(6).

13. The third and fourth questions have previously arisen and been answered by the Court of Appeal. That this is so, explains why a five-judge bench was convened to decide the case.

14. Of particular interest is that the answer given to the fourth question whether payment of defence costs prior to judgment or settlement were exclusive of the charge differs from the answer given to the same question by the Supreme Court of New Zealand in *BFSL 2007 Limited and Bridgecorp Limited v. Steigrad* [2013] NZSC 156. The judgment in

Chubb was delivered on the 11th of July 2013 and in part followed the reasoning of the New Zealand Court of Appeal in *Steigrad v. BFSL 2007 Limited* [2012] NZCA 604 at [25][14]. The judgment of the Supreme Court of New Zealand, overruling its Court of Appeal, was given on the 23rd of December 2013. I will come back to this.

The first question - Territoriality

15. The New South Wales Court of Appeal answered the first question last. As a matter of construction, the Court identified the relevant territorial connection with the State of New South Wales for the purpose of the operation of s.6 "as applying to all claims brought in a court of New South Wales, and as not applying to a claim brought in a court that is not a court of New South Wales"[15]. Emmett JA and Ball JA held that the fundamental legislative purpose behind s.6 is to protect claimants who have obtained a judgment or settlement, or who are entitled to obtain a judgment, and to secure the payment of that judgment or settlement when the defendant is insured for monies that would otherwise be payable to the insured in respect of that judgment or settlement. Their Honours inferred that the legislature intended to protect any claimant "who properly brings a claim in New South Wales, even where that claim is governed" by the law of some other place[16]. Their Honours were of the view that the statutory cause of action created by s.6(4) was the "hinge, or central concern, of s.6". They took this as indicating that the Section is "focused" on New South Wales courts. It was not obvious to them as a matter of construction that the New South Wales Parliament intended to protect claimants who sued elsewhere even if the law of New South Wales was the proper law of the contract of insurance.[17]

[14] See Chubb [120].
[15] Chubb at [204].
[16] Chub [202].
[17] Chubb [203].

16. In making this decision, their Honours rejected the argument of the insurers that s.6 applies only where three conditions are satisfied:

- The event giving rise to a claim for damages occurs in New South Wales; and
- The claim for damages is governed by New South Wales law; and
- The law with the closest and most real connection with the contract of insurance is New South Wales.

They also rejected the arguments of at least one group of claimants that one only of the five following connections alone would be sufficient to attract the operation of the section wherever the claim was heard:

- The law governing the claim is the law of New South Wales;
- The event giving rise to the claim for damages occurred in New South Wales;
- The proper law of the contract of insurance is the law of New South Wales;
- The contract of insurance has it's closest and its most real connection with New South Wales;
- The *situs* of the contract of insurance is New South Wales.

It must be said that the answer provided by their Honours has the great advantage of simplicity and clarity. The approach contended for by the insurers was unnecessarily restrictive and left the reach and operation of the Section too much to the terms of the policy. The arguments of the claimants would have left the question of reach in a cloud of uncertainty.

The Application of s.6 to claims made policies.

17. At [83] Emmett JA and Ball J said:

> The question is whether the language used in s 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 s 6(1) is equally apt to describe both kinds of contract, so long as the liability of the insured to pay damages is one 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.

Their Honours held that the generality of the language used and the reforming object of s.6 suggested that the provision should apply to any contract of insurance by which an insurer is indemnified against liability to pay any damages or compensation. It's remedial purpose was not limited to occurrence based policies. That the New South Wales legislature in 1946 may not have had claims made policies in its contemplation when enacting the legislation was not to the point. Legislation should be interpreted as ambulatory or in the sense of always speaking. Their Honours stressed the insured is not indemnified against a claim, but only against his or it's own liability to pay damages in respect of a claim.

Event giving rise to the claim occurring prior to the inception of the Claims made Policy

18. This topic is familiar territory for insurance lawyers. Claims made policies are particularly common in the area of the liability of professionals, such as engineers, architects, doctors, accountants and, of course, lawyers. Leaving doctors to one side, the liability of professionals will often fall into the category of pure economic loss. The plaintiff who loses his claim for damages for personal injury because of the negligence of his lawyers has a claim for damages for economic loss. The purchaser who buys a property at overvalue in reliance upon the report of an engineer has a claim for economic loss, and so on.

19. Policies of professional indemnity insurance are usually expressed to enure for the current year only. They are not renewed from year to year. A new policy is "incepted" at the commencement of each policy year.

20. A cause of action for pure economic loss does not accrue until economic loss is actually suffered. Accordingly, the act or omission constituting professional negligence may occur during the currency of one policy; the cause of action may accrue during the currency of a second policy; and the claim may not be made until the currency of yet a third. For the purpose of the discussion, I will leave to one side the complexities that may arise where the professional appreciates his or her mistake during the currency of the first or second policy and notifies the insurer accordingly, and whether that makes any difference legally.

21. Emmett JA and Ball J referred to the identification of two competing constructions of s. 6 summarised by Lindgren J in *FAI General Insurance Limited v. McSweeney*[18] that inform the question. The complexities and subtleties are fully explained at Chubb [88] - [104]. Essentially, the first alternative is that s.6 speaks from the inception of the contract of insurance and during its currency. The indemnity, of course, runs during that same period.

22. The second alternative is that s.6 speaks at the time of adjudication. On this approach, in part, the charge created by s.6 would be viewed as a floating charge in respect of insurance monies that may become payable, and do in fact become payable, at a later date. It is immaterial that the insurance monies become payable pursuant to an insurance contract entered into after the relevant date.

[18] (1997) 73 FCR 379 at 415.

23. As is well known, the New South Wales Court of Appeal preferred the first alternative in *Strata Plan No. 50530 v. Walter Construction Group Limited*[19]. Hodgson JA who delivered the leading judgment referred to the extreme difficulty of discerning a legislative intention that "there would be something called a charge in existence at a time when there was 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". In context, the property is the insurance policy, and the person against whom rights could be asserted is the insurer who issued it. The words in s.6 "may become payable" are apt only to refer to cases where an amount may become payable under an existing insurance policy, but have not yet been assessed so remain contingent. His Honour thought that Lindgren J's second alternative allowing the question to be considered on the day of adjudication did not sit with the essential feature of the statutory charge that it descends "upon the happening of the event giving rise to the claim for damages".

24. One may discern a leaning towards Lindgren J's second alternative on the part of Emmett JA and Ball J, but notwithstanding the constitution of a five-judge bench, their Honours were not persuaded that Hodgson JA's analysis was "plainly wrong" and accordingly declined to overrule or depart from it. In this regard, their Honours faithfully observed the doctrine of judicial precedent even as it applies to intermediate courts of appeal.

25. It may be that in answering these last two questions relating to claims made policies their Honours gave with one hand and took away with the other. However that may be, one can say that the approach of Hodgson JA in the *Walter Construction* case is now entrenched. It is difficult to conceive of any departure from it by the Court of Appeal in the future. Whether Lindgren J's preferred view might reassert itself

[19] (2007) 14 ANZ IC 61 - 734.

must depend upon future judgment from the High Court of Australia. Having said that, it may be that legal ingenuity is not yet exhausted. The river may be both deep and wide, but there may yet be room for negotiating it within the strictures of Hodgson JA's approach.

Defence Costs and Multiple Claims

26. For insurers, not only in respect of directors and office holder policies, the most crucial question arising is whether payment of approved defence costs operates in valid partial discharge of the statutory charge. It is on this point that the New South Wales Court of Appeal and the Supreme Court of New Zealand differ. Emmett JA and Ball J approached this question at [117] - [124]. It must be said that their Honours took a grammatical approach to the construction of s.6(1) to conclude that the statutory charge would not extend to insurance monies payable in respect of defence costs, legal representation expenses or costs and expenses that are paid by the insurers in accordance with the policies before judgment is entered or settlement is agreed. At [121] - [122] their Honours said:

> It is unquestionably the purpose of s 6 to ensure that insurance moneys that are payable to an insured **in respect of liability to a claimant** are not depleted to the prejudice of the claimant. Nevetheless, there is nothing to suggest that the purpose of s 6 is to prevent insurance moneys being paid to discharge **other** obligations that an insurer may have to an insured under a contract of insurance.
>
> Importantly, if s 6 were construed as catching all moneys available at the time when the charge arises, that would alter the contractual rights between insurer and insured. In the present case, each insured under the Primary Policy has a contractual right to be advanced defence costs within 30 days of receipt of an invoice from defence counsel. That right exists even if the right to indemnity under the Primary Policy has not yet been determined. The Primary Policy contains a provision permitting the Insurer to recover amounts so advanced in the event that it is ultimately determined that the Primary Policy does not respond to the claim in question.

27. Their Honours continued that if the charge caught all monies payable under the Policy at the time when the charge arose the insurers could not safely pay the defence costs if there was any possibility that the ultimate liability of the insured might exceed the amount available to meet that liability at any time. Their Honours stressed the insured's contractual right to the payment of defence costs and were unable to find any intention expressed in the words of the section suggesting that the contractual rights of the insurer and the insured were to be altered in so radical a fashion. Their Honours acknowledge that it is possible that the monetary limit under a contract of insurance might be reached as a consequence of the payment of insurance monies in respect of defence costs. At [133] their Honours expressed the view that there was no reason in principle why a claimant should not be exposed to the risk that all monies payable under the policy at the time of judgment or settlement have been fully expended. It is at this point that the majority in the Supreme Court of New Zealand depart.

28. As I have already said, the decision of the New Zealand Court of Appeal in *Stiegrad* proceeded on much the same reasoning in this regard as the New South Wales Court of Appeal subsequently expressed. The decision in the Supreme Court was a majority 3 to 2 decision. Elias CJ and Glazebrook J (Anderson J agreeing) constituted the majority, McGrath and Gault JJ dissented.

29. The majority expressed the issue in the following pithy terms[20]:

> the issue in these appeals is whether the statutory charge in s 9 allows payments to be made under the insurance policy for defence costs before liability with regard to the charged claims is decided by way of settlement or judgment, where to do so would deplete the sum available to meet the claim with regard to the eventual liability to the third party.

[20] Stiegrad [22].

30. Their Honours, it must be said, in answering the question took a purposive rather than grammatical approach to interpretation. Their Honours acknowledged that the charge only attaches to the insurance money that is or may become payable in respect of the insured's liability to pay damages or compensation[21]. Their Honours reviewed the decision in Chubb at [43] to [47]. Although the language of the provisions is identical a more expansive purpose was discerned in the language of the New Zealand legislation. At [53] their Honours decided that:

> … the effect of s 9(3) is to put the risk on the insurer, up to the limit fixed by the contract of insurance, if it does not observe the statutory charge and pays out under the provisions of the insurance policy unequally where there are claims arising out of the same events giving rise to the claim for damages or compensation, pays out rival claimants arising from events later than those of another statutory charge holder or pays out claims under the policy (such as defence costs) which are not protected by the statutory charge.

Their Honours went on to say that statutory charge "protects the third party claimant and prevents performance of the defence costs obligation without risk to the insured". This may mean that the insurer and insured made a poor bargain because the policy had not been properly drawn overlooking the effect of the statutory charge. Their Honours said an insurer may be entitled to be cautious about meeting the defence costs claim where a third party claim, of which it has notice and which may exceed the insurance limit remains outstanding.

31. Their Honours also noticed that an indirect effect of permitting an insurer and it's insured to wholly deplete the insurance monies by payment of defence costs would be to require the "charge holder" to pay not only its own costs in enforcing the charge, but also the debtors costs in its unsuccessful defence of the enforcement proceedings. This would be an exceptional outcome.

[21] Stiegrad [36].

32. As can be seen, the New Zealand Court took the view that the insurer ought to wear the risk, whereas in New South Wales, the charge holder is exposed to this risk.

Multiple Claims and Notice

33. Payment to one claimant to whom the insured is adjudged liable is a valid discharge if made before judgment award or settlement in relation to other claimants. In dealing with the operation of s.6(6) the Court of Appeal said at [140]:

> … it is sufficient, for the purposes of s 6(6), that an insurer have actual notice of the circumstances that, by the operation of s 6(1), give rise to the charge.

The effect of s.6, of course, is any payment made without notice under the policy is a valid discharge to the insurer notwithstanding the charge created by s.6(1). One wonders in the context of a claims made policy whether notification of circumstances might have some relevance as to whether the policy in force at that time can be affected by the statutory charge. I will leave this question unanswered.

Final Observations

34. The difference between the New South Wales Court of Appeal and the New Zealand Supreme Court in relation to payment of defence costs is to say the least, interesting, especially as in part, and certainly not wholly, Emmett JA and Ball J adopted the reasoning of the New Zealand Court of Appeal.

35. As an addendum it should be pointed out that an application for special leave to appeal to the High Court of Australia was lodged by the unsuccessful defendants in *Chubb*. It was supposed to be heard on the 14th of March 2014, but has been "stood over". One might have

thought that the differences of opinion across the ditch may have given the application better than usual prospects of success. However, that difference is concerned with only one, albeit important, issue. The third party claimants in *Chubb* doubtless have more than one thorny question to conjure with. If this special leave application does not proceed, it may be quite some time before a similar case makes its way for consideration by the High Court.

Appendix s6 law Reform (Miscellaneous Provisions) Act 1946

6. Amount of liability to be charge on insurance moneys payable against that liability

(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 the person is indemnified against liability to pay any damages or compensation, the amount of the person's liability shall on the happening of the event giving rise to the claim for damages or compensation, and notwithstanding 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.

(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 subsection (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 moneys, and where the same insurance moneys 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 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 subsection (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.

(5) Such an action may be brought although judgment has been already recovered against the insured for damages or compensation in respect of 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 the insurer and the insured.

(8) Nothing in this section shall affect the operation of any of the provisions of the *Workers Compensation Act 1987* or the *Motor Vehicles (Third Party Insurance) Act 1942*.

(9) Despite subsection (8), this section applies in relation to a policy of workers compensation insurance entered into by an employer (whether entered into before or after the commencement of this subsection), where the employer:

(a) being a natural person, has died, or is permanently resident outside the Commonwealth and its Territories, or cannot after due inquiry and search be found, or

(b) being a corporation (other than a company that has commenced to be wound up), has ceased to exist, or

(c) being a company, corporation, society, association or other body (other than a company that has commenced to be wound up), was at the time when it commenced to employ workers to which the policy relates incorporated outside the Commonwealth and its Territories and registered as a foreign company under the laws of any State or Territory and is not so registered under any such law, or

(d) being a company, is in the course of being wound up.