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NSW Law Reform Commission
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Dear Ms Gough

SECTION 6 OF LAW REFORM (MISCELLANEOUS PROVISIONS) ACT 1946

The Insurance Council of Australia[1] (Insurance Council) appreciates the opportunity to provide its views in response to the NSW Law Reform Commission's consultation paper (the Paper) reviewing section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946* (the Act).

The Insurance Council strongly supports Option 4 that section 6 be repealed. As the Paper made clear, section 6 has long been a source of judicial concern. The New Zealand High Court's (NZHC) 2012 decision in the *Bridgecorp*[2] case reignited debate in Australia about the relevance of section 6 and created significant uncertainty about the operation of liability insurance policies; particularly Directors' and Officers' (D&O) liability policies.

The NZHC (confirmed by the Supreme Court of New Zealand's decision[3] in 2013) concluded that section 9 of the *Law Reform Act 1936* (NZ), upon which section 6 of the Act was modelled, prevents directors and officers from accessing an insurance policy to fund their defence costs. In *Chubb v Moore*[4], the New South Wales Court of Appeal (NSWCA) arrived at the opposite conclusion. While clearly the NSWCA decision has greater value as precedent in Australia, in the absence of a decision by the High Court of Australia, the consequences of section 6 have not been definitively settled.

One of the core value propositions of D&O liability policies, and similar professional indemnity or financial lines policies, is that they provide protection for companies and individuals in meeting the costs of investigations and defending claims. The uncertainty created by the reasoning in the New Zealand *Bridgecorp* cases is of major concern to insureds and insurers, as it unnecessarily questions the operation of those policies.

If the *Bridgecorp* interpretation were adopted in Australia, there would potentially be serious implications for all parties. For instance, an insured may well, depending of the specifics of the case, be obliged to fund their own defence which could lead to serious financial hardship

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. March 2016 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $43.8 billion per annum and has total assets of $118.5 billion. The industry employs approximately 60,000 people and on average pays out about $124.2 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

[2] *Steigrad & Ors v BFSL 2007 Ltd & Ors* [2011] NZHC 1037, Justice Lang.
[3] *BFSL 2007 Ltd v Steigrad* [2013] NZSC 156.
[4] *Chubb Insurance Company of Australia Limited v Moore* [2013] NSW CA 212.

and/or an inability to defend a claim. Claimants may also be severely impacted in the event of competing statutory charges from multiple claims, as these charges may effectively 'freeze' the policy (possibly over many years) pending the resolution of competing claims.

While insurers have restructured D&O liability policies in order to avoid the consequences of the Bridgecorp reasoning, insurers are unable to address the uncertainties flowing from deficiencies in the section's drafting.

In considering the case for repeal, it is necessary to assess the contemporary relevance of section 6. It was suggested by the Attorney General in 1946, at the time section 6 was passed, that its purpose was to protect third parties against fly by night insureds and collusive insurers[5]. However, as emphasised in the Paper, section 6 was enacted 70 years ago, in the different legislative and insurance environment of the 1940s. Critically, since section 6 was enacted in 1946, the Commonwealth has established a strong and comprehensive regime of insurance regulation.

Changes in insurance law and more rigorous regulatory supervision, combined with modern insurance practices, effectively preclude conspiracies between a defendant and insurer or any malpractice from a defendant. Because of this, we submit that section 6 is no longer relevant, as the risks to which it was enacted to address in 1946 no longer exist in today's environment. Apart from the Australian Capital Territory and Northern Territory, no other Australian jurisdiction has considered it necessary to introduce an equivalent of section 6.

Indeed, if any clear material gap was identified in the Commonwealth's provisions, given that the focus on responsibility for insurance regulation is now at the national level, it would be appropriate for this to be addressed by the Commonwealth Government; it would seem inappropriate to retain section 6 for any substitutive purposes, as it does not offer the same breadth of coverage and consistency as Commonwealth legislation. The fact that *Chubb v Moore* was brought in NSW demonstrates that the existence of section 6 encourages 'forum shopping' in order to assert a charge unavailable in other jurisdictions.

For all these reasons the Insurance Council would strongly support the repeal of section 6. There is no apparent contemporary rationale for its provisions and, as the Paper points out, redrafting section 6 may inadvertently change the law and may lead to unintended consequences. The Attachment provides additional information that supports our position.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director and CEO

[5] Justice RD Giles Reflections on Section 6, Insurance Law Journal7 (1996), p.4.

INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT

REASONS WHY SECTION 6 SHOULD BE REPEALED

The *Bridgecorp* and *Chubb v Moore* cases

The Supreme Court of New Zealand's (SCNZ) judgment on 23 December 2013 in *BFSL 2007 Ltd v Steigrad* [2013] NZSC 156 (*Bridgecorp*) set aside the New Zealand Court of Appeal's decision[6] of 20 December 2012.

The SCNZ concluded that where there was insufficient insurance cover to meet both third party claims and a director's or officer's defence costs, an insurer could only meet the latter at the 'peril' of falling foul of the statutory charge created pursuant to section 9 of the *Law Reform Act 1936* (NZ).

Defence costs did not fall within the scope of the charge, and the existence of the charge could significantly impact upon the contractual right of a director or officer to be advanced or reimbursed for those costs. While the SCNZ did not decide whether an insurer could refuse to pay defence costs, as that question was not directly before it, it suggested that an insurer was entitled to be 'cautious' about payment of defence costs when faced with a claim subject to the charge.

On 11 July 2013, a five judge bench of the New South Wales Court of Appeal (NSWCA) in *Chubb Insurance Company of Australia Limited v Moore* [2013] NSW CA 212[7] (*Chubb v Moore*) considered issues similar to those in *Bridgecorp*. The decision is useful in that it clarifies that an insurer is not prevented from advancing defence costs to an insured. The decision states (paragraph 124):

> *"There is nothing on the face of s 6 to suggest that it was intended to alter the contractual rights of the parties in such a radical fashion. If the New South Wales Parliament intended s 6 to have such a drastic effect on the contractual rights of an insured, it could be expected to have provided so in express terms."*

However, in line with the Insurance Council's own view, the NSWCA observed in relation to section 6 (paragraph 55):

> *"Section 6 should be repealed altogether or completely redrafted in an intelligible form, so as to achieve the objects for which it was enacted."*

We understand that, rather than the approach taken in New Zealand, the Australian position on section 6 of the Act, and the equivalent Australian Capital Territory and Northern Territory law provisions, would remain as determined by the NSWCA interpretation. Although helpful, the *Chubb v Moore* judgment may be subject to appeal, with the NSWCA observing that this question is not without its difficulties and the answer is "*certainly not without doubt*" (paragraph 205).

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[6] *Steigrad & Ors v BFSL 2007 Ltd & Ors* [2012] NZCA 604, President O'Regan, Justices Arnold and Harrison. The New Zealand Court of Appeal held that the statutory charge created by section 9 of the *Law Reform Act 1936* (New Zealand) did not prevent the directors from having recourse to their D&O policy for cover for their defence costs.

[7] *Chubb Insurance Company of Australia Limited v Moore* [2013] NSWCA 212, Chief Justice Bathurst, President Beazley, Justices of Appeal Macfarlan and Emmett and Justice Ball. The NSWCA found that the statutory charge created by s6 of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) does not prevent an insurer from advancing defence costs to an insured.

Operation of liability insurance

As mentioned earlier, the New Zealand decisions in the *Bridgecorp* case reignited debate about the relevance of section 6 and created significant uncertainty about the operation and therefore commercial value of liability insurance policies.

This particularly applies to Directors' and Officers' (D&O) liability policies, which would not have been in contemplation at the time when section 6 was first considered or adopted by New South Wales. Section 6 was adopted in the 1940s in the context of personal injury liability policies and not in respect of complex policies dealing with financial risk.

The conflicting case law between New Zealand and Australia means that it remains uncertain whether section 6 of the Act operates so that parties making a claim can assert a statutory charge over the proceeds which would prevent directors and officers from accessing the policy to fund their defence costs before judgment is handed down.

A decision based on the NZSC's reasoning would undermine the commercial value and intention of D&O liability insurance policies, which is to provide protection for companies and individuals in meeting the costs of investigations and defending claims. Such an outcome would impact a broad range of liability insurances, not only D&O liability, but also: public liability; professional indemnity; and other domestic policies providing liability cover.

The consequence for an insured is that they would be obliged to personally fund their own defence which, in many cases, would lead to financial difficulty or indeed the inability to defend the claim at all. Directors would need to carefully reconsider 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.

Importantly, there would also be serious implications for claimants. 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 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. Negotiated settlements and early resolution of disputes (such as disputes lodged with the Financial Ombudsman Service) could be frustrated; indeed, this would be an undesirable outcome for consumers seeking to avail themselves of a no-cost external dispute resolution service as an alternative to costly court proceedings.

Some insurers have tried to address the uncertainty by restructuring policies to preserve the commercial value and intention of those policies. Using D&O liability policies as an example, some insurers offer a separate limit of liability in a policy for defence costs that is intended to provide coverage for defence costs where a plaintiff makes a section 6 claim.

However, insurers are unable to adequately address the inherent complications created by section 6. We agree with the Paper that industry attempts at addressing the uncertainty do not provide the best outcome – it is a poor situation where insureds and insurers have to reengineer policies proven to be satisfactory simply to avoid the potential inappropriate application of a redundant provision.

Effective Commonwealth Protections

The Insurance Council submits that effective protection for third party claimants is available at the Commonwealth level. We are not aware of any consumer detriment in those States where an equivalent section 6 does not operate.

Since section 6 was enacted in 1946, the Commonwealth Government has established a strong and comprehensive regime of insurance regulation. There are three Commonwealth Acts that deal with the issues of accessing insurance money, as pointed out in the Paper: the *Insurance Contracts Act 1984*; the *Bankruptcy Act 1966*; and the *Corporations Act 2001*.

With respect to the *Insurance Contracts Act 1984*, the Insurance Council emphasises that attention should be given to the 2013 reforms under the *Insurance Contracts Amendment Act 2013* (Cth). These amendments provide explicit rights to consumers who are third party beneficiaries. The *Insurance Contracts Act 1984* provides, for example, that:

- individuals who have rights under a contract of insurance ('third party beneficiaries') but who are not the insured, have access to particular rights and obligations currently held by insureds;
- third parties with damages claims against an insured or third party beneficiary who has died or cannot be found may recover directly against the insurer; and
- ASIC will have powers to bring representative actions on behalf of third party beneficiaries.

Justice Giles pointed out[8] that third party matters were considered when framing the *Insurance Contracts Act 1984*, giving rise to section 51 of that Act, which sets out the rights of a third party to recover against an insurer in circumstances where the insurer has died, or cannot be found, after reasonable inquiry.

Further to that, consideration should be given to the fact that the behaviour of insurance companies in the administration of their insurance policies and claims handling is now overseen by the Australian Securities and Investments Commission (established in 1991) and the Australian Prudential Regulation Authority (established in 1998).

The Insurance Council notes that the Paper has described 'some uncertainty' about the scope and operation of the Commonwealth provisions and is concerned that they 'do not offer the breadth of coverage' that section 6 does. However, while there may be a theoretical deficiency, the Insurance Council is unaware of any real life situation where section 6 would offer the only remedy available to a consumer.

It is important, in considering the overall merit of section 6, to note that it has been problematic to interpret and apply. For this reason alone, as also highlighted in the Paper, there has been significant criticism of section 6 by Australian courts; notably, the NSWCA[9] called for section 6 to be *"repealed altogether or completely redrafted in an intelligible form*". In addition, Justice Kirby[10] characterised section 6 as "*undoubtedly opaque and ambiguous*" and observed that "*ambiguity may be its only clear feature*".

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[8] Justice RD Giles, Op.cit., p.6.
[9] *Chubb Insurance Company of Australia Ltd v Moore* [2013] NSWCA 212 [5], [55].
[10] *New South Wales Medical Defence Union v Crawford* (1993) 31 NSWLR 469, 479; *McMillan v Mannix* (1993) 31 NSWLR 538, 542.

As noted earlier however, if any clear gap were to be identified in the regulatory regime applying to insurance, it would be appropriate for this to be addressed at the Commonwealth level.

New South Wales legislation
Supplementing the protections at the Commonwealth level, there are similar protections in New South Wales, both in workers compensation – *Workers Compensation Act 1987* (NSW) – and motor accidents – *Motor Accidents Act 1988* (NSW), as outlined in the Paper.

Contemporary Market Practices

Modern insurance practices also contribute to effectively preclude the development of conspiracies between a defendant and insurer or any malpractice on the part of defendants in collecting insurance moneys by way of indemnity for a liability they do not discharge.

Contemporary liability insurance policy wordings are usually structured in a way that the obligation of the insurer is to discharge the liability by payment to the ultimate claimant; they are not structured in a manner that would involve the insurer paying the insured unless the insured had previously discharged the obligation to the claimant.