

Article: The Third Parties (Rights Against Insurers) Act 2010

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When my mother was starting school aged 5 years old, The Third Parties (Rights Against Insurers) Act 1930 was passed. Although she took little notice of it at the time, what it sought to do was to give a direct right to a claimant to recover from a defendant's liability insurers when the defendant/insured was insolvent.

At 85 my mother is similarly disinterested in The Third Parties (Rights Against Insurers) Act 2010, which received the Royal Assent on 25th March 2010 and which will repeal and therefore replace the 1930 Act. So, not a "once in a life time" change, but after 80 years well over due as so much has changed in insolvency law since the 1930s.

The 1930 Act

Put simply where a party incurred a liability to another (the claimant) and took out insurance to cover that liability, but became insolvent before insurers paid out to the claimant, then under general legal principles the insurance monies would form an asset in the insolvency. The claimant would therefore be lucky to receive even part of the payment as he would rank as an unsecured creditor along with other similar creditors in the insolvency.

The 1930 Act changed this by transferring the insured's rights under the policy to the claimant.

Reforms made by the 2010 Act

Under the 1930 Act a third party could not issue proceedings against an insurer without first obtaining Judgement against the insured. This could involve lengthy delays and expense whilst those proceedings were taking place. The 2010 Act removes this requirement and allows a third party claimant to issue proceedings directly against the insurer. In those proceedings both the liability of the insured to the claimant and the extent of the cover afforded will be decided in the same proceedings.

Under the 1930 Act if an insured was defunct and had been struck off the Companies Register the claimant had first to take proceedings to restore the

company to the Register of Companies in order to be able to commence proceedings against it. The 2010 Act removes the need for the third party to sue the insured and also removes the need to first restore the defunct company.

Another problem with the 1930 Act was that the claimant might not know the precise terms and the extent of the liability cover taken out by the now defunct insured party. The claimant would have to commence proceedings against the defunct party and then progress those proceedings to the stage of discovery of documents before he could make an informed decision about whether to go ahead and obtain a Judgement against the insured in order to then pursue a claim against the insurer.

The 2010 Act gives the claimant rights to information about the insurance policy so allowing him to make an informed decision at an early stage about the rights which are transferred to him and therefore decide whether to commence or continue litigation.

Under the 1930 Act rights transferred to the claimant would be subject to any defences which the insurers could use against the insured. The 2010 Act retains this scheme however it introduces three new exceptions where claimants are not prevented from enforcing their rights.

The 2010 updates the law to reflect changes in insolvency law since 1930. A provision is included which provides for rights to be transferred to a

claimant where an insured is facing financial difficulties and enters into certain voluntary procedures and makes an agreement/ composition with his or her creditors.

The 2010 Act

Section 1 sets out when a statutory transfer of rights occurs and specifies when the third party may enforce those rights. When the insured becomes subject to one of a number of procedures (listed in Sections 4,6 & 7 of the Act) then by virtue of section 1(3) the third party may bring proceedings to enforce rights against the insurers without first having to establish the insured liability.

Section 2 provides the mechanisms to enable a third party to bring proceedings against the insurers without first establishing the fact and amount of the insured liability. So when a third party claims that by virtue of the transfer of rights in Section 1 to have a right to claim under the insurance, but he has not established the insured's liability to him, then the third party may bring proceedings against the insurer for a declaration:

- a. that the insured was liable to him;
- b. that the insurers are therefore liable to him.

In this way, in one set of proceedings, both the insured's liability and insurer's liability to indemnify are resolved.

Section 2(4) provides that where proceedings are brought, an insurer may rely on a defence on which the insured could have relied if the proceedings had been brought against the insured.

Section 2(6) gives the Court the power to give appropriate Judgements. In many cases this will be a Judgement for a particular sum of money, however if argument on the amount of liability is to be postponed then Judgement can be granted for damages to be assessed either by a later Court or by Arbitration.

The procedures referred to in Section 2 – in other words when the right to sue insurers directly occurs – are set out in Sections 4,5 & 6.

Section 4 relates to individuals, Section 5 to individuals who die insolvent and Section 6 corporate bodies.

Section 6 provides that the right to sue the insurer direct occurs when the corporate body has not only been dissolved, but also widens the Act to other situations. A full list appears in section 6(1) and (2) and includes a voluntary arrangement/ compromise agreement with creditors, an administration order where a receiver or manager has been appointed, where a company has voluntarily wound itself up and where a liquidator has been appointed. In each case reference is made to these circumstances as they appear in the Companies Act 2006.

Section 8 provides that a third party does not receive a right to recover from the insurer any amount in excess of the insured liability.

Section 9 states that rights transferred to the third party are subject to all defences which the insurer could use against the insured. However three exceptions to this are introduced by the Act. Firstly, if after the transfer of rights the third party satisfies a requirement under the insurance policy to meet a particular condition imposed on the insured, the insurer will not be able to rely on the non performance of the policy condition. Secondly, if the insured has been dissolved and is therefore unable to fulfil a condition requiring the insured to provide the insurer with information and/or assistance then the insurer cannot rely on that breach. The third exception relates to 'pay to be paid' clauses and is considered separately below.

The Fanti and Padre Island

Section 9(5) and (6) deal with the pay first or 'pay to be paid' clauses in liability insurances. Whilst subsection 5 makes such clauses invalid, subsection 6 preserves the rule in the Fanti and Padre Island in cases involving a contract of marine insurance, except now in relation to death or personal injury claims. 'Contract of marine insurance' has the meaning given in s.1 of the Marine Insurance Act 1906.

Section 10 preserves the rights of an insurer to deduct money owed to it by the insured from the monies payable to the third party. So if the insured has not paid all premiums in relation to the insured policy the insurers can deduct the unpaid premiums when paying the third party's claim.

Schedule 1: Information and Disclosure for Third Parties

Of great practical significance, Section 11 introduces Schedule 1 which contains the right of the third party to obtain information about the insurance policy. Originally it was arguable that the 1930 Act did not give rise to any rights to obtain any information until the liability of the insured had been established. However, the Court of Appeal held in *OT Computers Limited (in Administration)* (2004) that a third party could make a request for information under section 2 of the 1930 Act before the insured's liability had been established. The 2010 Act takes this further with the aim of enabling the third party, at an early stage, to make an informed decision on whether or not to commence or continue with litigation.

Under the Schedule, if a person believes on reasonable grounds that another has incurred liability to him and that person is subject to one of the bankruptcy or similar procedures in articles 4, 5 & 6, then he may by notice in writing request information from the defendant as follows:-

Whether there is a contract of insurance that covers the proposed liability or might reasonably be regarded as covering it and if there is such a contract:

- Who the insurer is.
- What the terms of the insurance are.
- Whether the insurer has claimed not to be liable under the insurance.
- Whether there are or have been any proceedings between the insurer and the insured in relation to the supposed liability and if so details of those proceedings.
- If the contract sets a limit on the fund available to meet claims and sums have already been paid, then how much of it has been paid in respect of other liabilities.

Further and importantly under Paragraph 1 (2) if the claimant reasonably believes another person is able to provide information then he might serve a similar notice on the other person. So brokers and other persons holding information about the policy may find that they are served with notices.

Paragraph 2 outlines what a person receiving a notice requesting information under paragraph 1 needs to do. Subparagraph (1) provides that the person must, within 28 days of receiving the notice, provide

the claimant requesting the information with that information or if unable to provide the information notify the claimant who has requested the information why it cannot be provided.

Subparagraph (2) provides that where a document is no longer in the control of the person who has received the notice (but at one time the document was under his/her control) and the person knows or believes that it is now under another person's control, then he is required to provide whatever particulars he can as to the nature of the information and the identity of the person who now has the document. Again, this has to be done within 28 days of the receipt of the notice.

Paragraphs 3 and 4 provide similar mechanisms in relation to defunct bodies. One of the purposes of the Act is to remove the need for third parties to restore a defunct body to the register of companies in order to initiate proceedings against it. Paragraphs 3 and 4 remove the need to restore a defunct body to the register in order to obtain information from that body as they allow the third party to request information directly from persons related to the defunct body. These persons are described at paragraph 3(2) and include those who were employees or officers of the body immediately before the transfer of rights, any insolvency practitioner in relation to the defunct body or any person acting as an official receiver in relation to the winding up of the body.

Although proceedings against the defunct body need not be initiated before a notice is sent, the notice requesting information must be accompanied by some particulars of claim in relation to the proceedings.

Paragraph 4 imposes the same duties on the persons receiving the notice as would be imposed by the Court had the defunct body been restored to the register and orders for standard disclosure of documents been made.

Paragraph 5 prevents the insurance contract from being drafted so as to nullify the effects of Schedule 1.

Limitation

Section 12 sets out rules governing when an action to enforce rights transferred by the Act will be time barred. If a third party has issued proceedings against the insured in time then the third party will

not be time bared from issuing fresh proceedings against the insurers for a declaration that the insurer is bound to indemnify the insured.

Jurisdiction

Section 13 concerns jurisdiction within the United Kingdom. It covers cases in which the third party is domiciled in one part of the UK and the insurer in another. It provides the third party with the choice to issue proceedings either in his own place of domicile or that of the insurer regardless of any contrary provision within the insurance contract.

Section 15 provides that the Act does not apply where the liability incurred is itself a liability by an insurer under a contract of insurance. The effect of this section is that the Act does not apply to reinsurance.

Section 17 prevents an insurance contract from being drafted so as to nullify the effect of the Act. Any provision in an insurance contract which purports to avoid the effect of the Act will have no effect.

Summary

The Act therefore provides a direct right of action against insurers which arises in many more circumstances than the rights in the 1930 Act which were confined to insolvencies.

The direct right and the rights to obtain information about the insurance arrangements of the insured allow third party claimants to take a reasoned decision on whether to pursue a (transferred rights) claim against the insurer without having first to incur the expense of restoring a defunct company to the companies register and then running proceedings against that insured perhaps up to discovery/disclosure of documents.

In relation to marine insurance 'the pay to be paid' clause is still valid so that a P&I Club's position under the Fanti and Padre Island Rule is preserved. There is then no direct right of action against P&I

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Clubs – as there is in Scandinavia and other countries, except now in relation to death and personal injury claims.

The right to information requires a "reasonable belief" on the part of the third party claimant. The class of persons who may be requested to provide information is widened to enable the third party to request information from any person that he or she reasonably believes could provide the information. This will include (amongst others) insurers, brokers and other persons authorised to hold policy information.

How is a Liability Insurer affected by the Act?

Liability insurers may firstly find themselves having to reply within a relatively short time scale (28 days) to notices requiring information about their policies where the insured is in any one of a number of financial difficulties.

Secondly they will then face proceedings being issued directly against them by claimants and in those proceedings will have to muster any defences which the insured could raise against the claimant as well as any defences which the insurer could raise against the insured.

How will the Act affect the position of the Subrogated Insurer?

His position is improved where a defendant is in one of the financial difficulties listed in the Act because he will be able to quickly establish the extent of the liability cover that the defendant had (by serving a notice) on one of a number of people and then decide whether to step into the shoes of the defendant and sue the liability insurer direct.

The Act now having received the Royal Assent will come into force on a date prescribed by the Secretary of State, so in the very near future –so if you have read this far you are ahead of the ball game!

Tony Thomas - 23/04/2010

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