The Law Commission
and
The Scottish Law Commission

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THIRD PARTIES – RIGHTS AGAINST INSURERS

Presented to the Parliament of the United Kingdom by the Lord High Chancellor by Command of Her Majesty
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THIRD PARTIES – RIGHTS AGAINST INSURERS

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ABBREVIATIONS

In this Report the following abbreviations are used:

"1930 Act"	Third Parties (Rights against Insurers) Act 1930
"1998 Regulations"	The Employers' Liability (Compulsory Insurance) Regulations 1998
"ABI"	Association of British Insurers
"Brussels Convention"	The EC Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters 1968
"CA 1985"	Companies Act 1985
"Consultation paper"	Third Parties (Rights against Insurers) Act 1930 (1998) Law Com No 152; Scot Law Com No 104
"*Cork Report*"	Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558
"CPR"	Civil Procedure Rules
"CVA"	Company Voluntary Arrangement
"DETR"	Department of the Environment, Transport and Regions
"Draft Bill"	The draft Bill in Appendix A, implementing the recommendations of this report
"DTI"	Department of Trade and Industry
"EU"	European Union
"FSMA 2000"	Financial Services and Markets Act 2000
"GATS"	General Agreement on Trade in Services
"GISC"	General Insurance Standards Council
"IA 1986"	Insolvency Act 1986
"IMO"	International Maritime Organisation
"IPO 1994"	Insolvent Partnerships Order 1994
"IPO Orders"	Orders made under IPO 1994
"IVA"	Individual Voluntary Arrangement
"LCD"	Lord Chancellor's Department
"LLP"	Limited Liability Partnership
"LLPA 2000"	Limited Liability Partnerships Act 2000
"LLPR 2000"	Limited Liability Partnerships Regulations 2000
"Office-holder"	The person in charge of an insolvency procedure
"PPB"	Policyholders Protection Board
"UN"	United Nations
"UNCITRAL"	United Nations Commission on International Trade Law
"WTO"	World Trade Organisation

THE LAW COMMISSION
AND
THE SCOTTISH LAW COMMISSION

Item 9 of the Law Commission's Seventh Programme of Law Reform: Third Parties' Rights Against Insurers

THIRD PARTIES – RIGHTS AGAINST INSURERS

To the Right Honourable the Lord Irvine of Lairg, Lord High Chancellor of Great Britain, and the Scottish Ministers

PART 1
INTRODUCTION

THE 1930 ACT

1.1 The scheme of the Third Parties (Rights against Insurers) Act 1930[1] is to give a person who is owed money a direct claim against an insurer of the debt. In this report we refer to the person who is owed money as the "third party", the person who owes the money as the "insured" and the insurer of the debt as the "insurer". The 1930 Act performs its function by effecting what we shall refer to as a "statutory transfer" of certain of the insured's rights under the insurance policy to the third party.[2]

1.2 One of the circumstances in which the 1930 Act effects a statutory transfer is if the insured is declared insolvent. If it did not, the third party would not receive all the insurance proceeds. Instead, these would be treated as an asset of the insured and would be distributed pro rata under insolvency legislation to the general creditors, of whom the third party would be one. As a result, the third party would be likely to recover at most only a small proportion of the insurance proceeds. The balance would increase the dividends of the other creditors.[3]

1.3 In the absence of the 1930 Act, the third party might also be disadvantaged if the insured's freedom of action was lost for some reason other than insolvency. For example, a corporate insured might be wound up while solvent or might become subject to a receivership.[4] The 1930 Act aims to relieve the third party of the

[1] Referred to in this report as the "1930 Act".

[2] Section 1(1).

[3] This was the situation before the 1930 Act was passed. See *In re Harrington Motor Co. Ltd ex parte Chaplin* [1928] 1 Ch 105; *Hood's Trustees v Southern Union General Insurance Co. of Australasia* [1928] 1 Ch 793.

[4] The long title to the 1930 Act is "An Act to confer on third parties rights against insurers of third-party risks in the event of the insured becoming insolvent, *and in certain other events.*" (emphasis added).

potentially serious delay and expense involved in dealing with such an insured by effecting a statutory transfer. Commenting on the rationale for the 1930 Act's operation in such circumstances, Bingham LJ said:

> The legislative intention was, I think, that ... the provisions of the 1930 Act should apply upon an insured losing the effective power to enforce its own rights and dispose of its own assets.[5]

1.4 As we pointed out in our consultation paper,[6] direct claims under the 1930 Act are now made by third parties under a wide range of insurance policies.[7] In addition to its use in court and arbitration proceedings brought by third parties against insurers, the 1930 Act lies behind many claims settled without recourse to litigation. By disentangling insured debts from insolvency procedures, the 1930 Act plays an important commercial role. It is also worth noting that third parties who use the 1930 Act are often vulnerable members of society - for example, injured former employees of defunct companies.[8]

THE NEED FOR REFORM

1.5 Unfortunately, the 1930 Act does not work as well as it should. Its basic operation in the context of insolvency has provoked criticism over a number of years from academics, lawyers, the judiciary and litigants.[9] Owing to the way the 1930 Act has been applied by the courts, third parties are often not assisted by it at all or are unnecessarily required to expend substantial time and money enforcing their rights.

1.6 A number of respondents to the Law Commission's consultation paper on privity of contract[10] argued that the 1930 Act should be amended. As we explained in the subsequent report,[11] such proposals raise significantly different issues from those we were then considering. Accordingly, we were pleased to be asked to

5 *The Fanti and The Padre Island* [1989] 1 Lloyd's Rep 239 at p 247 in a passage approved on appeal by Lord Goff of Chievely [1991] 2 AC 1 at p 38.

6 Third Parties (Rights against Insurers) Act 1930 (1998) Law Com No 152; Scot Law Com No 104, referred to in this report as the "consultation paper".

7 Consultation paper, paras 2.8-2.11.

8 See the consultation paper, Appendix C, for statistics from the Association of British Insurers indicating that around 30% of litigation relating to the 1930 Act related to claims against employers.

9 See, in particular, Jonathan Goodliffe "What is left of the Third Parties (Rights against Insurers) Act 1930?" [1993] JBL 590, Sir Jonathan Mance "Insolvency at Sea" [1995] LMCLQ 34, Professor Robert Merkin "Liability insurance - the rights of third parties" [1997] P & I Int 178 and Robert Purves "Claims Against Insolvent Insureds" [1998] CFILR 98.

10 Privity of Contract: Contracts for the Benefit of Third Parties (1991) Law Com No 121.

11 Privity of Contract: Contracts for the Benefit of Third Parties (1996) Law Com No 242; Cm 3329, para 12.20.

examine, as a separate exercise, the operation of the 1930 Act in the light of current law and the market practices of the insurance industry.[12]

1.7 Respondents to our consultation paper, published in 1998, overwhelmingly confirmed that the deficiencies of the 1930 Act were not merely theoretical but caused real hardship. In addition, it became clear, both from consultees' responses and from our further work, that the 1930 Act is seriously out of date in a number of ways. The drive towards clarifying and improving insolvency law which began with the publication of the *Cork Report* in 1982,[13] and which resulted in the Insolvency Act 1985, the Insolvency Act 1986 ("IA 1986") and most recently the Insolvency Act 2000, has added significantly to the range of circumstances of the kind to which Bingham LJ was referring, in which an insured may lose effective control of its rights and assets.[14] Although the 1930 Act has been periodically updated,[15] some developments in insolvency law have been ignored[16] and others have not been properly addressed.[17] In this report we consider these shortcomings.

1.8 It is possible that, in England, third parties may in the future derive some benefit from the Contracts (Rights of Third Parties) Act 1999.[18] If the insurance contract in question is drafted so that it complies with the requirements of that Act, the third party may be able to enforce some of its terms. But there is no obvious reason for insurers to draft third party liability insurance contracts in this way and we are not aware of any cases in which this has been done.[19] Even were such a contract to come about, this would not necessarily improve the third party's position from that under the 1930 Act. In particular, it would not improve the third party's ability to obtain information about the insurance position;[20] nor

[12] Our original terms of reference are set out in the Law Commission's Sixth Programme of Law Reform (1995) Law Com No 234 and the Scottish Law Commission's Fifth Programme of Law Reform (1997) Scot Law Com No 159.

[13] Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558.

[14] See para 1.3 above.

[15] See para 2.6 below.

[16] For example, the application of insolvency procedures to partnerships by the Insolvent Partnerships Order 1994 ("IPO 1994"). See paras 2.26-2.29 below.

[17] For example, the procedures for company and voluntary arrangements in the Insolvency Act 1986. See Part 6 below.

[18] Which was enacted largely in the terms of the draft Bill included in Privity of Contract: Contracts for the Benefit of Third Parties (1996) Law Com No 242; Cm 3329.

[19] The 1999 Act may, by contrast, have an important effect in the context of reinsurance contracts with "cut-through" clauses by allowing direct claims by the insured against the reinsurer. As we explain in para 2.45 below, reinsurance is outside the scope of the 1930 Act and that of the draft Bill. For a review of the likely relevance of the 1999 Act to insurance law generally, see Professor Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and its implications for commercial contracts" [2000] 4 LMCLQ 540 and Anthony Menzies, "Rights of third parties against insurers" 30 November 2000, *Insurance Day*, p 6.

[20] See paras 4.5-4.10 below.

would it necessarily remove the requirement that the third party establish the insured's liability before becoming entitled to proceed against the insurer.[21] The need for fresh legislation to deal with these two problems, and the others which we identify in this report, is, in our view, as strong as ever.

PRINCIPAL REFORM RECOMMENDATIONS

1.9 The draft Bill appended to this report would, if enacted, remedy the problems which have prevented the 1930 Act from working well in the past and accommodate recent developments in the fields of insurance and insolvency. By removing the need for multiple sets of proceedings, it would also reduce costs for both litigants and the courts. We set out briefly below the principal reforms in the draft Bill.

Third party entitled to a remedy in one set of proceedings[22]

1.10 The third party cannot issue proceedings against the insurer under the 1930 Act without first establishing the existence and amount of the insured's liability. This may require the third party to issue a number of separate sets of proceedings.

1.11 The draft Bill would give the third party a right to issue proceedings against the insurer before the liability of the insured has been established. The third party would then establish the existence and amount of the insured's liability in those proceedings.

Third party not required to sue the insured[23]

1.12 Under the 1930 Act, if the insured is a dissolved company which has been struck off the register of companies, the third party may first have to take proceedings to restore it to the register in order to be able to sue it.

1.13 The third party would not have to do this under the draft Bill under which it would not be necessary for the third party to proceed against the insured at all.

Third party would have improved rights to insurance information[24]

1.14 Although the 1930 Act gives the third party a right to obtain information about the insurance policy, in practice that right is often worthless. The main difficulties are:

(1) It has been held by the courts that a right to information does not arise until the liability of the insured is established.[25] This may not be until some time after the insured's insolvency. Until then, the third party may

[21] See paras 3.4-3.10 below.

[22] See Part 3 below.

[23] See Part 3 below.

[24] See Part 4 below.

[25] *Woolwich Building Society v Taylor* [1995] 1 BCLC 132.

have to conduct litigation in ignorance of whether any rights have been transferred by the 1930 Act or, if they have, whether they are of any value. As a result, time and money may be wasted pursuing a worthless claim or a worthwhile claim may be abandoned in the belief that there would be no funds to pay a judgment.

(2) Even after the third party's right to obtain information arises, the third party is only able to exercise it against a limited list of people. These may not include the person who in fact has the information, for example an insurance broker.

(3) It is unclear what information the third party is entitled to receive and the information provided in accordance with the 1930 Act may omit critical details.

1.15 The draft Bill would remedy these deficiencies. In relation to the particular problems highlighted in the previous paragraph:

(1) A person who believed on reasonable grounds that he had received a transfer of rights under the draft Bill would be entitled to obtain information about those rights so as to enable a sensible decision to be taken on whether to pursue or continue litigation.

(2) The draft Bill would entitle the third party to require the information from anyone in control of it.

(3) The draft Bill specifies the information which would have to be provided to a third party exercising rights under the draft Bill.

Developments in company and insolvency law reflected[26]

1.16 There are a number of surprising omissions from the list of circumstances in which the 1930 Act effects a statutory transfer. For example, no transfer is effected if the insured is struck off the register of companies under section 652 or section 652A of the Companies Act 1985 ("CA 1985") and no mention is made of the orders which may be made against an insolvent partnership.[27]

1.17 The draft Bill takes account of the wide variety of procedures to which individuals, companies and other bodies may now be subjected and which might adversely affect a third party. It also contains a power of amendment which would enable the Secretary of State to ensure that a new Act could be updated without the need for fresh primary legislation.

[26] See Part 2 below.

[27] Under the IPO 1994.

Voluntary procedures properly catered for[28]

1.18 Since the publication of the consultation paper, two reported cases[29] have raised serious concerns over the interaction between the 1930 Act and "voluntary arrangements".[30] The value of the third party's claim against the insurer may be reduced by such an arrangement. The third party may only be able to avoid such a result by making, and involving other creditors in, expensive and time consuming applications to court. Similar problems arise in cases in which the insured enters into other forms of voluntary procedure falling short of a formal bankruptcy or winding-up.

1.19 The draft Bill contains provisions which prevent these problems from arising. Under the draft Bill, a third party with rights against an insurer would not be bound by a voluntary procedure to the extent of those rights.

Legal expenses and health insurance covered[31]

1.20 In *Tarbuck v Avon Insurance plc*,[32] it was held that the 1930 Act does not enable a solicitor with unpaid fees to claim directly on the legal expenses insurance of an insolvent client. The same reasoning appears to apply to health insurance or car repairs insurance. In *Tarbuck*, Toulson J remarked that this result was unfortunate and called for reform.

1.21 Under the draft Bill this restriction would no longer apply. A third party would be able to make a direct claim against an insurer even if the insurance covered liabilities voluntarily incurred by the insured to the third party.

Insurers' rights to rely on some technical defences removed[33]

1.22 Under the 1930 Act, a third party's claim may fail because the insurer successfully relies on the defence that the insured did not give notice of the claim, even where the third party had personally told the insurer of the claim within the prescribed period.

1.23 This would not be possible under the draft Bill. If the insurance policy specified that a particular thing should be done by the insured, and if, after a transfer of rights under the draft Bill, the third party did that thing, the insurer would not be able to rely on the non-performance of the policy condition.[34]

[28] See Part 6 below.

[29] *Re Greenfield* [1998] BPIR 699 and *Sea Voyager v Bielecki* [1999] 1 All ER 628.

[30] That is to say, Individual Voluntary Arrangements (governed by IA 1986, Part VIII) and Company Voluntary Arrangements (governed by Part I).

[31] See Part 2 below.

[32] [2001] 2 All ER 503.

[33] See Part 5 below.

[34] In practice, the third party is only likely to be in a position to comply with terms which require the insured to take procedural steps.

Third party generally protected from pay-first clauses[35]

1.24 The House of Lords has decided[36] that rights transferred to a third party by the 1930 Act are useless if the insurance contract contains a clause requiring the insured to pay the claim before the right to an indemnity arises (a "pay-first" clause).

1.25 By contrast, in most cases under the draft Bill,[37] the third party's claim would not be adversely affected by such a clause.

Operation in cases with a foreign element clarified[38]

1.26 In cases with a foreign element (where, for example, the incident giving rise to the alleged liability of the insured happened abroad, or where the law governing the insurance contract is not English or Scots law), it can be unclear whether the 1930 Act applies. It may also not be certain whether a court in Great Britain has jurisdiction to hear the third party's claim. This is likely to be an increasingly serious problem as cross-border insurance activity grows.

1.27 The draft Bill sets out clearly the occasions on which it would apply. In many cases jurisdictional questions will be settled by the Brussels Convention.[39] However, in a case in which a third party domiciled in one part of Great Britain faces an insurer based in another part of Great Britain, or in Northern Ireland,[40] we recommend that third parties should be given the choice of suing in their own domicile, or in that of the insurer. In cases in which the insurer is based outside Great Britain, and in which the Brussels Convention does not allocate jurisdiction, we are recommending a minor amendment to the rules of court in England and Wales to enable the courts to exercise jurisdiction over claims against insurers based abroad.

THE STRUCTURE OF THIS REPORT

1.28 The arrangement of the main text of this report is as follows. In Part 2 we consider the scope of the draft Bill, including the range of insurance policies to which it applies, and the occasions on which it will confer rights on third parties. In Part 3 we explain the nature of the rights under the insurance contract which are conferred on the third party by the draft Bill, and how the procedural

[35] See Part 5 below.

[36] *The Fanti and The Padre Island* [1991] 2 AC 1.

[37] We do not recommend, as part of this project, any change in the treatment of pay-first clauses in the context of marine insurance, unless the claim is for personal injuries or death. See para 5.37 below.

[38] See Part 8 below.

[39] The Brussels Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters 1968, applied by Civil Jurisdiction and Judgments Act 1982. With effect from 1st March 2002 revised rules will come into effect in the form of an EC Regulation. See Part 8 below.

[40] See para 2.52 below for the position in Northern Ireland.

problems which beset the parties under the 1930 Act would be avoided. In Part 4 we discuss the rights to disclosure which we recommend the third party should receive. In Part 5 we set out our recommendations for limited restrictions on the ability of insurers to rely on defences against third party claimants.

1.29 We have allocated an entire part, Part 6, to the important issue of the operation of the draft Bill in the context of voluntary procedures. In Part 7 we review the effect of the draft Bill on various rights of the insurer, the third party and the insured. In Part 8 we illustrate the way in which the draft Bill would work in cases with a foreign element. We conclude, in Part 9, with a summary of our reasons for declining to make special provision in the draft Bill to cater for multiple claimants against a limited fund.

DRAFT BILL

1.30 Appendix A contains a draft Bill to give effect to our recommendations. For ease of reference we set out the 1930 Act in Appendix B. As the draft Bill is appended to a joint report, we wish to record that it is the opinion of the Scottish Law Commission that the subject matter of the draft Bill is not within the legislative competence of the Scottish Parliament, as it relates to the reserved matter of insurance.[41]

AMENDMENTS TO RULES OF COURT

1.31 We recommend below three amendments to the rules of court in England and Wales, and one in Scotland, to improve the operation of the draft Bill once it is enacted.[42]

ACKNOWLEDGEMENTS

1.32 We thank the many individuals and organisations, listed in Appendices C and D, who commented on our consultation paper or who helped us with specific advice. We are grateful, in particular, for the assistance of the Law Reform Advisory Committee for Northern Ireland whom we consulted on the application of these reforms in Northern Ireland.[43]

[41] Scotland Act 1998, Sched 5.

[42] See paras 3.52-3.56, para 4.47 and paras 8.32-8.35 below.

[43] See para 2.52 below.

PART 2
THE SCOPE OF THE DRAFT BILL

INTRODUCTION

2.1 The 1930 Act confers rights on the third party if the insured has become insolvent and in certain other specified circumstances. In this Part we explain why we have retained this general approach in the draft Bill. At the same time, we identify a number of respects in which the 1930 Act has failed to keep pace with developments in company and insolvency law, and set out and explain the way in which the draft Bill remedies these deficiencies.

2.2 We go on to discuss two restrictions on the scope of the 1930 Act. First, the 1930 Act does not specifically cover a case in which the insured is anything other than an individual or a company, omitting, for example, partnerships. Second, the 1930 Act does not apply in the case of legal expenses insurance, or other insurance covering voluntarily incurred liabilities. We explain our view that these restrictions are major failings. The omission of legal expenses insurance, in particular, represents a serious obstacle to the government's stated aim that such insurance should play a wider role in the funding of litigation.[1] Both restrictions are removed by the draft Bill.

2.3 We then set out our recommendations on issues relating to the scope of the draft Bill which are unique to Scotland. We conclude this Part with a brief explanation of the way in which, if the draft Bill is enacted, equivalent reform is likely to take place in Northern Ireland.

2.4 The degree to which the 1930 Act fails to reflect modern developments in company and insolvency law only became clear during the preparation of the draft Bill. In addition, the operation of the 1930 Act in the context of legal expenses insurance has only recently been clarified by the High Court.[2] For these reasons, a number of the issues in this Part were not covered in the consultation paper. We have, however, consulted informally before arriving at out recommendations.

CIRCUMSTANCES IN WHICH RIGHTS ARE CONFERRED ON THIRD PARTY

Definition of insured's insolvency etc

2.5 The 1930 Act specifies what must befall the insured before rights are conferred on the third party.[3] In the consultation paper we asked whether it would be desirable to describe these circumstances in general terms. Consultees strongly

[1] See for example *Hansard* (HC) 21 November 1997, vol 301, col 536 where the government expressed the hope that legal action brought by "ordinary working people" will, in the future, be funded by conditional fees or legal expenses insurance.

[2] *Tarbuck v Avon Insurance plc* [2001] 2 All ER 503.

[3] Section 1(1)(a) and (b) and s 1(2).

opposed any such change. In particular, they objected to the suggestion that the third party should receive rights if the insured encountered "financial difficulties"[4] or "disappeared".[5] Consultees felt that these events would be difficult to define and might occur in the case of insureds who were able and willing to pay their own debts and manage their own affairs. We agree. Accordingly, the draft Bill identifies precisely what must happen to the insured before rights are conferred on the third party.

2.6 The list of circumstances in which the 1930 Act confers rights on the third party was altered by the Insolvency Act 1985,[6] the Insolvency Act 1986,[7] the Bankruptcy (Scotland) Act 1985[8] and recently by the Limited Liability Partnerships Regulations 2001.[9] Some consultees pointed out, however, that the 1930 Act has not kept pace with other developments in company and insolvency law. We have adopted a number of improvements suggested by consultees; others we have identified ourselves. We set these out below.

Rights conferred in the circumstances set out in the 1930 Act

2.7 The draft Bill effects a statutory transfer in all the circumstances in which the 1930 Act currently does so. These include the commencement of formal insolvency procedures (bankruptcy in the case of an individual and insolvent winding-up in the case of a company) and the death of the insured whilst insolvent. In the case of corporate insureds, they also include the commencement of a number of other procedures not involving, or not always involving, insolvency. These are: the making of an administration order, a solvent winding-up[10] and the appointment of a receiver.

2.8 The 1930 Act also effects a transfer in the case of the insured "making a composition or arrangement with his creditors" or on the approval of a voluntary arrangement under Part I of IA 1986.[11] In view of the serious problems with the operation of the 1930 Act in the context of such voluntary procedures, we examine these issues separately in Part 6 below.

4 Consultation paper, para 12.9.

5 Consultation paper, para 12.49.

6 Section 235(1), Sched 8, para 7.

7 Section 439(2), Sched 14.

8 Section 75(1), Sched 7, Pt I, para 6(1).

9 Schedule 5, para 2, inserting s 3A into the 1930 Act.

10 A voluntary winding-up under Chapter II of Part IV of IA 1986 is available to a solvent company. In addition, six of the seven grounds on which a company may be compulsorily wound up in s 122(1) of IA 1986 may be used against a solvent company. It is worth noting that even a company wound up under s 122(1)(f) as a "company ... unable to pay its debts" though insolvent in one sense, might still have an excess of assets over liabilities (for example if it is experiencing cash flow problems) so that the creditors will, in the end, recover what they are owed in full.

11 Section 1(1).

Striking off under section 652 or section 652A of CA 1985

2.9 Companies may be struck off the register of companies under CA 1985 without being formally wound up under the procedures laid down by IA 1986. In particular, sections 652 and 652A of CA 1985 empower the Registrar of Companies, in certain circumstances, to strike a company off the register when it is not carrying on business. A substantial majority of companies which cease to exist do so in this way.[12]

2.10 Under the 1930 Act, third parties must apply to restore such companies to the register under section 653 or section 651 of CA 1985; in order to receive a transfer of rights, they must then institute a formal insolvency (or bring about one of the other events specified in the 1930 Act).[13]

2.11 One consultee suggested that a third party faced with an insured which had been struck off the register of companies without having gone through a formal winding-up under IA 1986 should also receive a statutory transfer of rights. We agree. The requirement that a third party apply to court in order to restore such a company only to institute formal insolvency proceedings against it serves no purpose.[14] Accordingly, the draft Bill confers on the third party direct rights against the insurer if the insured is struck off the register of companies,[15] relieving third parties of the delay and expense currently caused.[16]

Voluntary winding-up as part of a reconstruction or amalgamation

2.12 The 1930 Act confers rights on the third party if the insured enters a voluntary winding-up.[17] This is subject to a proviso which prevents a statutory transfer if

[12] Of 116,600 companies removed from the register of companies in 1998-99, only 17,400 (15%) had been through a formal winding-up (Companies in 1998-99: report by the Department of Trade and Industry (1999) DTI pp 33-34).

[13] Third parties using the 1930 Act have an additional reason to revive such companies. In order to convert the rights against the insurer transferred to them by the 1930 Act into actionable rights they must establish liability against the insured (see *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363). The insured must be revived for the third party to do this. As we explain in Part 3 below, under the draft Bill, third parties would be entitled to proceed against the insurer without first establishing liability against the insured.

[14] This is illustrated by the fact that applications to restore are almost never refused. All of the 1,299 applications to restore surveyed by us when preparing Appendix C of the consultation paper were granted.

[15] Clause 1(3)(h).

[16] That this difficulty is encountered in practice by substantial numbers of third parties is illustrated by the fact that 85% of the applications to restore analysed in Appendix C of the consultation paper were made under s 653 of IA 1986 (which may only be used in the case of companies struck off under s 652 or s 652A). In addition, some applications brought under s 651 (which may be used in the case of any defunct company) will have involved such companies.

[17] Section 1(1).

the voluntary winding-up is entered into "merely for the purposes of reconstruction or of amalgamation with another company".[18]

2.13 This proviso is designed to limit the occasions on which a transfer occurs in cases which do not involve insolvency. However, one consultee pointed out that if an insured ceased to exist as a result of a voluntary winding-up of this kind, perhaps on the advice of the insured's tax advisers, the third party might be put in a difficult position. The consultee suggested that this proviso should not be reproduced in the draft Bill.

2.14 We agree. Like the 1930 Act, the draft Bill assists the third party by conferring on him direct rights against the insurer in a number of situations in which there may be no insolvency.[19] The suggestion that a winding-up for the purposes of reconstruction or amalgamation should be in the same category seemed to us to be sensible. The draft Bill therefore does not reproduce the proviso in section 1(6)(a) of the 1930 Act.

Appointment of a provisional liquidator

2.15 The draft Bill, like the 1930 Act, effects a statutory transfer on the making of an administration order.[20] The 1930 Act does not do so on the appointment of a provisional liquidator.[21] We have considered whether the draft Bill should do so.

2.16 The two regimes can be similar and may have a similar practical effect on the third party. Companies may appoint a provisional liquidator as a prelude to the implementation of a compromise or arrangement under section 425 of CA 1985 or a voluntary arrangement.[22] An administration order may be granted for the same purpose.[23] Whichever option the insured chooses, the third party will face a moratorium which will prevent him from starting, or continuing, proceedings against the insured to recover his debt without the leave of the court.[24]

2.17 In view of the similarity of the two regimes, the appointment of a provisional liquidator is treated in the same way as the appointment of an administrator in the draft Bill.[25]

[18] Section 1(6)(a).

[19] For example a corporate insured may be wound up, subject to a receivership or struck off the register of companies without being insolvent at any stage.

[20] Clause 1(3)(b) and s 1(1)(b) of the 1930 Act. See para 2.7 above.

[21] Under IA 1986, s 135.

[22] On which see Part 6 below. Such schemes were described and approved by Harman J in *Re English & American Insurance* [1994] 1 BCLC 649. Although it seems that the scheme in that case was being used by an insurance company because it was not entitled to an administration order (s 8(4)(a) of IA 1986), there seems to be no reason in principle why companies other than insurance companies should not use a similar procedure.

[23] IA 1986, s 8(3)(c).

[24] IA 1986, s 11(3) (administration order); IA 1986, s 130(2) (provisional liquidator).

[25] Clause 1(3)(e).

Crystallisation of a floating charge

2.18 The 1930 Act confers rights on a third party in the vast majority of cases in which a floating charge crystallises.[26] However, exceptionally, crystallisation may (in England and Wales only) occur before any of the events set out in section 1(b) of the 1930 Act. For example, a floating charge over all the insured's assets may crystallise on notice to the insured by the charge holder.[27] In such a case, when the insurance fund becomes payable, it would benefit the charge holder.[28]

2.19 On one view, sums payable under an insurance policy, which would not be payable at all were it not for the insured having incurred liability to the third party, should always benefit the third party rather than other creditors. On these grounds, we considered recommending that the new Act should effect a statutory transfer on the crystallisation of a floating charge over the insurance proceeds, however that crystallisation came about. Nevertheless, we have concluded that this is not appropriate. Neither the insurer nor the third party would be likely to know about the crystallisation of a floating charge which occurred before one of the other circumstances effecting a statutory transfer.[29] It would have unfortunate effects if the draft Bill effected a statutory transfer in such a case. For example, the insurer might, after such a transfer, purport to enter into a settlement with the insured which, as a result of the transfer, but unknown to the insurer, did not discharge the insurer's obligations to the third party. The insurer might thereby find itself obliged to pay out again to the third party.[30]

2.20 Accordingly, whilst the draft Bill, like the 1930 Act, effects a statutory transfer in most of the circumstances in which a floating charge crystallises, it does not specify that a crystallisation *per se* will effect a transfer.[31] An insured who allows a charge over insurance proceeds to crystallise has effectively divested himself of

[26] For example, the making of a winding-up order.

[27] *Re Brightlife Ltd* [1987] Ch 200. Hoffmann J in that case also recognised, *obiter*, another situation in which crystallisation might occur before one of the events specified in the 1930 Act, namely when an appropriately worded clause caused automatic crystallisation without any intervention at all by the chargee.

[28] In *Banner Lane Realisations Ltd (in liquidation) v Berisford plc and Another* [1997] 1 BCLC 380, the Court of Appeal held that, in the case of a debenture securing "present and future indebtedness", "future indebtedness" included not only a present obligation to pay a sum certain in the future but also a present obligation to pay an unquantified sum in the future or on a contingency. The charge holder's claim may be subordinated to the claims of preferential creditors by s 175(2) IA 1986.

[29] Suppose for example, that the insured entered into an agreement with a bank which provided that a floating charge would crystallise should the insured attempt to create a further charge over its assets. The third party and insurer would be unlikely to know of this term, or of any crystallisation under it.

[30] See Paras 7.40-7.44 below for an analysis of settlements in the context of the draft Bill.

[31] In Scotland, a floating charge attaches on the class of assets comprised in it when a company goes into liquidation (see CA 1985, s 463(1)) or on the appointment of a receiver (see IA 1986, s 53(7) and s 54(6)). In both of these situations a transfer of rights would occur under the draft Bill.

the benefit of the insurance policy and, unless the event which causes the crystallisation coincidentally brings about a statutory transfer, the third party will not benefit from it.[32]

Recovery of insured: effect on statutory transfer of rights

2.21 If an insured incurs a liability to a third party before becoming subject to, or during the currency of, an administration order, the 1930 Act confers rights on the third party against the insurer. The third party retains these transferred rights even if the administration order is subsequently discharged. The position is the same should the insured recover from one of the other conditions which trigger a statutory transfer under the 1930 Act.[33]

2.22 One consultee objected to this feature of the legislation. He suggested that, if the insured recovers in this way and the third party has not taken any steps against the insurer to enforce his rights, the new Act should reverse the transfer so that the third party's remedy is again against the insured.

2.23 We have not adopted this suggestion for two reasons. First, it is not obvious how such a retransfer should work.[34] Secondly, the case in favour of such a reform is not clear-cut. Even if he has not begun proceedings against the insurer, the third party may have been disadvantaged by the insured's original failure.[35] Therefore, under the draft Bill, a third party retains rights transferred to him regardless of what subsequently happens to the insured.

Liability to third party incurred after discharge from bankruptcy

2.24 The position is different should the insured incur a liability to a third party after it has recovered. In such a case the third party is unaffected by the insured's former problems and it would be anomalous to transfer rights to him. It appears to be the case that, under the 1930 Act, a third party might receive a transfer of rights in these circumstances.[36] We have clarified this in the draft Bill.[37]

[32] This is consistent with the way the draft Bill operates in a case in which the insurance proceeds are subject to a fixed charge (otherwise than as a result of the crystallisation of a floating charge). See paras 7.13-7.14 below.

[33] For example, the third party retains rights transferred to him by the 1930 Act if the insured's winding-up proceedings are stayed, or a receivership or voluntary arrangement comes to an end.

[34] After a statutory transfer the third party and insurer are free to litigate; they are also free to compromise their rights and might do so in a number of ways. It would be difficult to identify the occasions on which it would be appropriate to reverse the transfer, or to specify the effect of doing so in every circumstance.

[35] For example, in the case of an administration order, the third party may have been prevented from enforcing a judgment against the insured (IA 1986, s 11(3)(d)).

[36] It seems that the effect of s 1 of the 1930 Act is that this would be the case if the insured retained the same insurance contract after its revival as it possessed when it first became insolvent, entered into a voluntary arrangement etc.

Partnerships in English law

2.25 In the course of preparing the draft Bill we considered when the statutory transfer should occur if the insured is a partnership.[38] This was not an issue we discussed in the consultation paper.

The Insolvent Partnerships Order 1994

2.26 A range of orders (referred to in this Part as "IPO orders") analogous to those available against companies under IA 1986 is available in English law against partnerships. A partnership may, *inter alia*, be wound up, subjected to an administration or enter into a voluntary arrangement, as if it were a company.[39]

2.27 No amendment has been made to the 1930 Act to take account of these developments. We considered whether an IPO order would nevertheless trigger a transfer of rights under section 1 of the 1930 Act. In our view it would not.[40] Section 1(1)(a) of the 1930 Act appears to deal with orders against individuals only[41] and section 1(1)(b) is restricted to cases in which the insured is a company.

2.28 That appears to be anomalous. A third party faced by an insured which is, for example, being wound up under IPO 1994, will encounter many of the same practical disadvantages as a third party faced by a company in the course of a winding-up.[42] Most importantly, the insurance proceeds may go into a central fund and be distributed pro-rata to general creditors.

[37] Clause 1(3) is directed generally to *states of affairs*, which may come to an end. Cf s 1(1) of the 1930 Act which is in terms of *events*.

[38] A partnership in English law does not have a legal personality separate and distinct from the partners who at any time may comprise it (cf the position in Scots law on which see para 2.32 below). For a full description of the current law, and an exploration of how it might be improved, see Partnership Law (2000) Law Com No 159; Scot Law Com No 111. At para 4.32 of that consultation paper we propose the introduction of separate legal personality for partnerships in England and Wales.

[39] See IPO 1994, made under IA 1986, s 420. See also the provisions referred to in IPO 1994, s 19(4). Insurance taken out by a partnership is "in theory a bundle of contracts between the insurer and the individual partners" (*Scher v Policyholders' Protection Board* [1994] 2 AC 57 at p 115 *per* Lord Mustill). Nevertheless, IPO 1994 treats a partnership as though it were a separate entity.

[40] We have found no authority on this point.

[41] See para 6.14, n 17 below.

[42] The presentation of a winding-up petition prohibits any form of execution against partnership assets (IA 1986, s 128) and the partnership or any partner or creditor may apply to stay any proceedings against the partnership or any partner (IA 1986, s 126 and s 127).

2.29 Accordingly, the draft Bill confers rights on the third party in all cases in which an event occurs to the insured[43] which would have conferred rights on the third party had the insured been a company.[44]

Orders against individual partners

2.30 It appears that the bankruptcy[45] of an individual partner triggers a statutory transfer under the 1930 Act, even if the other partners and the partnership as a whole remain solvent.[46] Although we have not found any direct authority on the point, this is consistent with the treatment of partnerships in the case law.[47]

2.31 We considered whether this feature of the 1930 Act should be reproduced in the draft Bill. It could be argued that, so long as one or more partners remain solvent, the third party should sue them rather than receive a transfer of rights giving direct rights against the insurer. However, we have concluded that the scheme in the 1930 Act is correct. Suppose a third party, confronted by a partnership in which all the partners are solvent, sues just one partner and obtains judgment. If that partner were then declared bankrupt, the 1930 Act would operate to prevent the insurance proceeds being claimed by the Trustee in Bankruptcy and to ensure that the third party received the full benefit of the insurance. The draft Bill does the same, effecting a statutory transfer irrespective of whether any other possible defendants are solvent and covered by the insurance policy.[48]

Partnerships in Scots law

2.32 Unlike those in England and Wales, Scottish partnerships (both under the Partnership Act 1890 and the Limited Partnerships Act 1907) have separate legal

[43] Under IPO 1994 or under one of the provisions set out in IPO 1994, s 19(4).

[44] Clause 1(3) applies to an "unincorporated body", which includes a partnership. References in that subsection to statutory provisions will be interpreted as references to those statutory provisions as applied by (for example) IPO 1994. See Interpretation Act 1978, s 20(2).

[45] Or other event listed in s 1 of the 1930 Act. For simplicity, we only analyse bankruptcy in the text.

[46] By virtue of s 1 of the 1930 Act and the nature of joint and several liability. A third party owed money by a partnership may sue one partner (call him X) for the whole of the debt, leaving to X the option of claiming contributions from other partners. If the third party does so, and if the debt for which he sues X is covered by an insurance policy taken out by the partnership, X would be able to claim on it. So if X became bankrupt, he would both owe money to the third party and have rights under an insurance contract in respect of the liability. This would generate a transfer of rights under s 1 of the 1930 Act.

[47] In *Jackson v Greenfield* [1998] BPIR 699 the insured was a three person partnership. Two of the partners entered into voluntary arrangements; the other remained solvent. It was held that there had not been a transfer of rights under the 1930 Act because the liability of the partnership had not been established. It seems to have been assumed, however, that had liability been established, a transfer of the rights of the two partners could have taken place when they entered into voluntary arrangements (by virtue of s 1(1)(a)) and that this would have given the third party direct rights against the insurer under the insurance policy.

[48] Clause 1.

personality.[49] However, whereas the 1930 Act included a limited partnership within the expression "company" in the application of the Act to Scotland, an ordinary Scottish partnership was not included.[50] We can only speculate about the reason for this. The answer may lie in the fact that, initially, the Limited Partnerships Act 1907 required that a limited partnership be wound up under the Companies Acts.[51] That requirement was repealed by the Companies (Consolidation) Act 1908[52] which gave the court a discretion to wind up a limited partnership under the Companies Acts.[53] That arrangement continued in Scotland until the Bankruptcy (Scotland) Act 1985 brought limited partnerships under the bankruptcy regime.[54] Ordinary partnerships, too, are subject to the regime of the 1985 Act. All Scottish partnerships are included in the draft Bill.

Limited Liability Partnerships

2.33 A new legal entity, the "limited liability partnership" ("LLP") is created in Great Britain by the Limited Liability Partnerships Act 2000 ("LLPA 2000"). Provisions regulating the insolvency and winding-up of LLPs are contained in the Limited Liability Partnerships Regulations 2000 ("LLPR 2000").[55] Schedule 5 of the LLPR 2000 amends the 1930 Act so as to bring LLPs within its scope.

2.34 The draft Bill reproduces the effect of this recent amendment to the 1930 Act. A third party will receive a transfer of rights if he is owed money by an insured LLP which becomes subject to a winding-up or other procedure under the LLPR 2000.[56]

Other corporate and unincorporated bodies

2.35 The nature of the insured's legal personality does not seem to us to be relevant to the rationale for effecting a statutory transfer. In other words, if the insured is (for example) wound up under the IA 1986, it seems to us that this should bring

[49] One of the consequences of separate legal personality is that somebody owed money by a partnership in Scotland must sue the partnership as principal in the first place. He may proceed against the partners (who have subsidiary liability), either at the same time as he sues the partnership, or after constituting the claim against the partnership (see *Mair v Wood* 1948 SC 83).

[50] Section 4(a).

[51] Limited Liability Partnerships Act 1907, s 6(4).

[52] Section 286 and Sched 6.

[53] *Muirhead v Boreland* 1925 SC 474.

[54] Schedule 8.

[55] Made under LLPA 2000, ss 14-17.

[56] Clause 1(3) applies to a "body corporate". This includes an LLP (which is defined as such in LLPA 2000, s 1(2)). References in clause 1(3) will be construed as references as applied by LLPR 2000 (see para 2.29, n 44 above).

about a statutory transfer, whether the insured is a limited company, a partnership, an LLP or some other entity.[57] This is the effect of the draft Bill.[58]

POWER TO AMEND NEW ACT BY SECONDARY LEGISLATION

2.36 It may be that in the future it will be thought desirable to effect a statutory transfer in additional circumstances which meet Bingham LJ's test.[59] The chance of this is increased by the rapid development of insolvency law which produces a large amount of case law, is often amended by statute,[60] and is the subject of continuing review by the Government.[61]

2.37 It might be hoped that relevant primary legislation would, in the future, update a new Act where appropriate. Past experience, however, does not make us confident that this would always occur. It is also possible that future developments might come about by way of secondary legislation (for example by amendments to the Insolvency Rules). In order to prevent a new Act from failing to keep pace with the law in this way, the draft Bill contains a power of amendment, exercisable by the Secretary of State, so that new developments can easily be accommodated.[62]

INSURANCE POLICIES COVERED

Application to full range of insurance policies

2.38 We asked consultees whether a new Act should, unlike the 1930 Act, apply only to a restricted range of liability insurance.[63] We canvassed various ways such restrictions might be defined and justified.[64] Consultees were broadly opposed to

[57] Although we are not aware of any other entities to which this could happen at the time of writing, more may emerge in the future. For example, we have proposed in our consultation paper on partnership law ((2000) Law Com No 159; Scot Law Com No 111) that partnerships be given separate legal personality in England and Wales. In addition, there is a proposal to create a new form of legal personality for charities. See: Completing the Structure (2000) Company Law Review Steering Group of the DTI.

[58] Clause 1(3).

[59] See para 1.3 above.

[60] For example, the Insolvency Act 2000.

[61] See in particular: A Review of Company Rescue and Business Reconstruction Mechanisms (2000) Insolvency Service, which contains a number of recommendations for change and describes itself as "a starting point in what should be a continuing process of change and improvement in our insolvency law" (Executive Summary, para 16).

[62] Clause 18. An exercise of the power in this clause would be subject to the affirmative resolution procedure, the highest level of Parliamentary scrutiny available over a statutory instrument. We understand that this has been the preference of the Delegated Powers Scrutiny Committee when considering "Henry VIII clauses" such as this.

[63] We use "liability insurance" to refer to insurance policies which indemnify the insured against liabilities which he may incur. A vast range of types of liability insurance exists. See the discussion in *MacGillivray on Insurance Law* (9th ed 1997) para 28-52.

[64] Consultation paper, Part 11. In particular, we raised the possibility that the new Act might be restricted to cases in which the insurance policy was compulsory, in which the claim

all of the suggested limitations. The idea that a new Act be limited to cases of compulsory insurance received some support, but other consultees objected that the regime of compulsory insurance in the United Kingdom is haphazard. It was suggested that the rationale of the 1930 Act applied equally to all types of liability insurance and that any restrictions would be arbitrary and unnecessarily complicated. We agree. The draft Bill applies in cases of liability insurance generally.

Application to policies insuring voluntarily incurred liabilities

2.39 Although we referred briefly in the consultation paper to the view that the 1930 Act does not cover legal expenses insurance,[65] we did not consult specifically on this; nor did consultees raise the subject themselves.

2.40 Since the consultation paper, this issue has been brought into focus by *Tarbuck v Avon Insurance plc*,[66] in which Toulson J held that insurance covering liabilities voluntarily assumed by the insured, such as legal expenses insurance, or health insurance, is not covered by the phrase "liabilities to third parties" in section 1 of the 1930 Act.[67] The judge regretted the result and called on the Law Commissions to re-examine this aspect of the 1930 Act as part of the present project. We have done so.

2.41 Insurance proceeds only arise in the context of this kind of insurance as a result of a creditor's claim. If the draft Bill did not confer rights on such a creditor, part of these proceeds would swell the dividend payable to all those with claims in the insolvency. We see no reason why the insured's general creditors should receive such a windfall.

2.42 The creditor may only have dealt with the insured because he had such insurance. For example, a private hospital might only agree to treat a patient on evidence of health insurance; or a solicitor might only be prepared to act for a litigant on the basis of his legal expenses insurance. *Tarbuck* shows that even if such insurance is in place, and even if the insurer pays out under the policy, the creditor will not necessarily receive those funds. We find this objectionable.[68]

was for death or personal injury, in which the claim was brought by a consumer, or in which the claim was in tort (in Scotland, delict) rather than in contract.

[65] See consultation paper, para 11.19, n 41.

[66] [2001] 2 All ER 503. We understand that, at the time of writing, Tarbuck (the claimant firm of solicitors) are considering an appeal.

[67] The judge based his judgment on the probable intention of Parliament when passing the 1930 Act. See p 508 g-h and p 509 b-c.

[68] We recognise that, in theory, the insured might be able to protect his position by demanding an assignment of the third party's rights under the insurance contract. However, that course of action might not occur to him, or the insured might refuse to co-operate. Even if these difficulties were overcome, such a course would involve expense; our proposed reform would render such steps unnecessary.

2.43 This is an important issue as legal expenses insurance is likely to play an increasing role in funding litigation in the future.[69] Although we did not consult specifically on this matter, we took account of the general opposition to restrictions on the type of insurance which should be covered when deciding how to treat this kind of insurance in the draft Bill. We have also consulted informally. The Law Society has suggested to us that:

> ...the judgment [in *Tarbuck*] is likely to have a negative effect on the [legal] professions' confidence in the developing legal expense insurance market both on the pre event insurance side and the after the event legal expense insurance side.

2.44 We agree with that view. Accordingly, the draft Bill reverses the effect of *Tarbuck* by extending the operation of the legislation to insurance covering voluntarily incurred liabilities.[70]

No application to reinsurance policies

2.45 We asked consultees whether a statute replacing the 1930 Act should be extended so as to cover reinsurance policies. We set out a number of difficulties with such a proposal.[71] The vast majority of consultees agreed with our provisional view that a new Act should not be extended in this way. In addition to the objections set out in the consultation paper, consultees emphasised the complexity of reinsurance arrangements and the problems of correlating particular claims to the correct reinsurance policies. Like the 1930 Act, the draft Bill excepts reinsurance from its scope.[72]

RIGHTS AGAINST THE INSURER IN SCOTS LAW

2.46 In the consultation paper we proposed that the phrase "becoming bankrupt" in the case of Scottish bankruptcies be replaced with the phrase, "person's estate being sequestrated".[73] This was supported by Scottish consultees and the draft Bill incorporates this reform.[74]

2.47 In addition to sequestration under the Bankruptcy (Scotland) Act 1985 and in line with the policy that the insolvency processes which bring about a transfer

[69] See for example, Access to Justice with Conditional Fees (1998) LCD consultation paper and para 2.2, n 1 above.

[70] Clause 16 provides that voluntarily incurred liabilities are within the scope of the draft Bill**.** Note also that clause 1(1) does not restrict the statutory transfer to cases in which the debt is owed to a "third party". Cf s 1(1) of the 1930 Act which is in terms of "liabilities to third parties".

[71] Consultation paper, paras 11.3-11.8.

[72] Clause 15, reproducing the effect of s 1(5) of the 1930 Act. Other exceptions arise where the 1930 Act is specifically excluded by legislation giving third parties specific rights as in s 165(5) Merchant Shipping Act 1995. The other exceptions are preserved by the draft Bill (clause 19).

[73] Paragraph 12.10.

[74] Clause 1(4)(a). Clauses 1(3)(i), 7(a), 8(c) and 2(2)(b) also refer to sequestration.

under the draft Bill should be British insolvency processes, the draft Bill includes judicial compositions and protected trust deeds as found in the Bankruptcy (Scotland) Act 1985, Schedules 4 and 5 respectively.[75]

2.48 We did not think it appropriate to include either other trust deeds or extra-judicial composition contracts, which are private as opposed to public events and which may not be peculiar to Great Britain. Moreover, a third party may have difficulty in determining the existence of these voluntary arrangements which do not involve the courts. Whilst it could be argued that these arrangements have a Scottish connection where their proper or applicable law is Scots law, it would be a matter of considerable difficulty for a third party to determine that they were governed by Scots law.

2.49 While judicial composition will arise only after sequestration, the effect of the composition is that the individual is discharged and the sequestration ceases. In our view, a third party faced with an insured who incurs a relevant liability while a judicial composition is in force in respect of him should receive a transfer of rights: accordingly, the draft Bill so provides.[76]

2.50 Separate provision has been necessary to bring a Scottish trust within the ambit of the draft Bill.[77] This is due to the fact that, in Scotland, the trust estate itself can be subject to sequestration, a protected trust deed or a judicial composition.

2.51 Where the individual has died insolvent, in addition to sequestration, the draft Bill provides that the appointment of a judicial factor under the Judicial Factors (Scotland) Act 1889, section 11A, will effect a statutory transfer. As the section 11A procedure covers cases where it is not known whether a deceased individual's estate will be able to meet his debts, it was necessary to restrict the reference to this procedure so that it applies only where the estate does transpire to be insolvent. Accordingly, the draft Bill provides for the judicial factor to certify that the estate is absolutely insolvent within the meaning of the Bankruptcy (Scotland) Act 1985.[78]

NORTHERN IRELAND

2.52 The draft Bill, like the 1930 Act, applies in Great Britain only.[79] An Act in similar terms to the 1930 Act is in force in Northern Ireland[80] and we anticipate that, if the draft Bill is enacted, corresponding legislation would be introduced for Northern Ireland.

[75] Clause 1(2)(e) and (f) and clause 1(4)(k) and (i).

[76] Clause 1(3)(l).

[77] Clause 1(4).

[78] Clause 2(2)(c).

[79] Clause 21(5). That subsection does extend clause 13(1)-(3) to Northern Ireland. This is necessary in order to ensure that jurisdictional rules (on which see Part 8 below), both before and after the implementation of parallel legislation in Northern Ireland, are consistent within the UK.

[80] Third Parties (Rights against Insurers) Act (Northern Ireland) 1930.

PART 3
A THIRD PARTY'S RIGHT OF ACTION UNDER THE DRAFT BILL

INTRODUCTION

3.1 In Part 2 we set out the circumstances in which the draft Bill would confer rights on the third party. We now explain the nature of those rights and how the third party would be entitled to use them.

3.2 We examine first the nature of the rights to be conferred on the third party. After summarising the problems which have arisen under the 1930 Act, we review the responses to consultation and explain our recommendations. The most important of these are: that the transfer mechanism in the 1930 Act should be retained; that third parties should be entitled to enforce transferred rights against the insurer in a single set of proceedings; that they should be entitled to issue proceedings as soon as the transfer occurs; and that they should be entitled, but not required, to proceed against the insured in addition to the insurer.

3.3 We conclude this Part with a brief review of the procedural issues raised by the draft Bill and recommend the addition of a rule of court, in both England and Wales, and in Scotland, to oblige third parties to notify the insured if they issue proceedings in which the insured's liability to them is in issue without joining the insured.

THE NATURE OF THE THIRD PARTY'S RIGHTS

The need for reform

3.4 A third party faced with a financially sound insured is not able to recover any money from the insured until he has established the insured's liability to him, either by agreeing it with the insured or by obtaining a judgment or arbitration award. The third party only "establishes liability" for these purposes once the amount (as well as the existence) of the liability has been ascertained. Only then is the third party entitled to enforce his rights, and only then is the insured entitled to make a claim on the insurance policy.[1]

[1] *West Wake Price & Co. v Ching* [1957] 1 WLR 45 in which Devlin J held at p 49: "The essence of the main indemnity clause is that the assured must prove a loss. The assured cannot recover anything under the main indemnity clause or make any claim against the underwriters until they have been found liable and so sustained a loss." In *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363 at p 374, Denning MR approved this dictum, and made clear that "The insured could only have sued for an indemnity when his liability to the third party was established and *the amount of the loss ascertained*." (emphasis added). For a recent application and confirmation of this principle, see *Thornton Springer v NEM Insurance Co. Ltd and others* [2000] 2 All ER 489.

3.5 Under the 1930 Act the courts have held that the third party is in the same position as the insured. The third party is only entitled to issue proceedings against the insurer once the insured's liability has been established:

> His [the insured's] liability to the injured person [the third party] must be ascertained and determined to exist, either by judgment of the court or by an award in arbitration or by agreement. Until that is done the right to an indemnity does not arise.[2]

3.6 The requirement that the third party establish the insured's liability before issuing proceedings against the insurer can involve the third party in a number of otherwise unnecessary applications. For example, before he can proceed against the insured, he may have to apply for an order restoring the insured to the register of companies[3] or for an order allowing proceedings to begin or continue,[4] or for both of these. The third party may have to commit substantial funds and may fail to recover his costs, even if successful.[5] The requirement may cause the third party to lose his claim against the insurer altogether[6] or force him to discontinue.[7]

3.7 In the consultation paper, we suggested that this requirement is unnecessary. The insured is unlikely to have any interest in the proceedings brought by the

[2] *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363 at p 374 *per* Denning MR. The House of Lords confirmed this in *Bradley v Eagle Star Insurance Co. Ltd* [1989] 1 AC 957. These cases have been approved in Scots law. See *McDyer v Celtic Football and Athletic Co Ltd* 1999 SLT 2 and *Cheltenham and Gloucester plc v Royal and Sun Alliance Insurance Co.* (OH), 2001 SLT 347. For a full discussion see the consultation paper, Part 4.

[3] Under s 651 or s 653 of CA 1985.

[4] For example under s 130 (company winding-up) or s 285 (bankruptcy) or s 11(3)(d) (administration) of IA 1986.

[5] The insured is likely to be unable to pay the costs of a successful action by the third party. A costs order will only be made against an insurer conducting the defence of the insured in exceptional circumstances (*Symphony Group plc v Hodgsons* [1994] QB 179). This may not matter to the third party who may be able to claim his costs from the insurer under the insurance contract. However, this will depend on the wording of the insurance contract (and on the insurer finally proving to be liable under it). See paras 7.29-7.33 below.

[6] Illustrated by *Bradley v Eagle Star Insurance Co. Ltd* [1989] 1 AC 957 in which Mrs Bradley was out of time on her application to restore her defunct employer to the register of companies. This case led to an amendment to the law (CA 1985, s 651 was amended by Companies Act 1989, s 141), though only in the context of personal injuries and Fatal Accident Act 1976 claims.

[7] The third party's predicament is made worse by the fact that, during this preliminary litigation, the courts have refused to grant the third party access to insurance information, either under the specific rules contained in the 1930 Act (*Nigel Upchurch Associates v Aldridge Estates Investments Co Ltd* [1993] 1 Lloyd's Rep 535) or under procedural rules (*Burns v Shuttlehurst Ltd* [1999] 1 WLR 1449). We recommend in Part 4 below that third parties have an earlier and wider right to such information.

third party.[8] Nor does a third party have a direct interest in establishing the insured's liability in this way. Doing so does not confer on him a right to recover any of the insured debt, either from the insured[9] or the insurer.[10] Indeed, recent Scottish authority suggests that such a third party may be obliged to prove the insured's liability for a second time in the subsequent action against the insurer.[11] The third party's proceedings against the insured in such a case serve no purpose at all.

3.8 For a time it was thought that a third party who has yet to establish the insured's liability might be able to obtain a declaration (or, in Scotland, a declarator) of the insurer's obligations under the insurance contract.[12] This has now been shown to be possible in Scotland[13] but not possible in England and Wales.[14]

[8] In practice the insurer will usually conduct the defence of the insured without being a party (cf the insurer's approach in *Wood v Perfection Travel* [1996] LRLR 233, in which the insurer succeeded on an application to be joined as a party in his own right.)

[9] Although this is not spelled out in the Act, the better view is that a third party is not entitled to enforce against the insured to the extent of the insurer's duty to indemnify under the insurance contract. See paras 7.5-7.8 below. Even a third party who felt able to argue that this was not the case would not be likely to attempt to enforce as, in most cases, the insured's resources are too meagre.

[10] The third party must also establish, in subsequent proceedings or by agreement, the insurer's obligations under the insurance contract.

[11] *Cheltenham and Gloucester plc v Royal and Sun Alliance Insurance Co*, IH, 30 May 2001. The court held that an insurer may be entitled to dispute the insured's liability to the third party as part of a defence to a claim under the insurance policy brought by the insured, even if that liability had already been established by a court judgment. It held that a statutory transfer under the 1930 Act did not alter the insurer's right to do this. In *Cheltenham and Gloucester* the insurer had investigated the third party's claim against the insured and had, for a time, conducted the insured's defence, before withdrawing in the belief that it could avoid liability under the insurance policy. The court held that, in those circumstances, the insurer was entitled to dispute the insured's liability to the third party in the action brought by the third party under rights transferred by the 1930 Act.

[12] On the basis that the insured would have been entitled to such a declaration. See the comments of Lord Denning in *Brice v Wackerbarth (Australia) Pty Ltd* [1974] 2 Lloyd's Rep 274 at p 276.

[13] *Bell v Lothiansure Ltd* 19 January 1990 (OH); reclaiming motion refused 1993 SLT 421. See also *Landcatch Ltd v Gilkes* 1990 SLT 688; *McDyer v Celtic Football and Athletic Co Ltd* 1999 SLT 2; *Cheltenham and Gloucester plc v Royal and Sun Alliance Insurance Co* (OH), 2001 SLT 347. The point, however, was not explored by the Inner House in the *McDyer* case: 2000 SC 379.

[14] In *Burns v Shuttlehurst* [1999] 1 WLR 1449 Stuart-Smith LJ held at p 1459C: "...the plaintiff could not sue for a declaration, quite apart from the fact that he has not done so. Although there is as a rule a contractual right for the insured to sue for a declaration, not all rights under the contract are assigned to the third party, but only those in respect of the liability to him." . This view is in line with the earlier decision of Dohmann QC in *Nigel Upchurch Associates v Aldridge Estates Investment Co Ltd* [1993] 1 Lloyd's Rep 535 who held at p 538 col 1: "...what the Act transfers to the third party is the insured's right "in respect of the liability", that is the right to be indemnified for his monetary loss in having to meet his liability to the third party. I do not find that s1 transfers to the third party some contractual right to seek declaratory relief before a specific liability has been established."

3.9 Judicial opinion has varied on the nature of the insured's rights before liability has been established. As we pointed out in the consultation paper,[15] some judges have suggested that the insured may at that stage have a contingent right to an indemnity;[16] others have rejected this.[17] So far as the position of the third party is concerned, the courts have denied that the third party has any rights of any description at this stage. Indeed, the latest authorities suggest that the 1930 Act does not effect a transfer until liability is established.[18]

3.10 The requirement that the third party establish liability before becoming entitled to sue the insurer under the 1930 Act does not appear to have been the intention of Parliament.[19] On consultation there was very great support for removing it. We have done so in the draft Bill.[20]

Consultation

Mechanism of transfer

3.11 One consultee suggested that the mechanism of transfer in the 1930 Act be abandoned and that a new Act create a fresh right for the third party which would arise on the satisfaction of a number of conditions. We have rejected this approach. The aim of the draft Bill is to assist the third party to recover from the insurer only to the extent that (1) the third party has a valid claim against the insured and (2) the insurer has already bound itself contractually to indemnify the insured for that loss. The mechanism of transfer formulated by the 1930 Act is the natural way to achieve this.

3.12 In Appendix F of the consultation paper we set out some schemes of third party rights which have been introduced in other jurisdictions. In Australia, third parties are not given direct rights against insurers but are given secured rights against the insured to any money recovered by the insured from the insurer. Some critics of the 1930 Act have advocated that a similar approach be adopted

[15] Consultation paper, Part 4.

[16] Lord Goff in *The Fanti and The Padre Island* [1991] 2 AC 1 described the right transferred to the third party as "at best, a contingent right to indemnity".

[17] In *Nigel Upchurch Associates v Aldridge Estates Investment Co Ltd* [1993] 1 Lloyd's Rep 535, it was held that, until the liability of the insured had been established, the insured had no contractual right to be indemnified contingent upon liability being established.

[18] "In my judgment the effect of [the *Post Office* and *Eagle Star* cases] is that ...no ...rights ...will be transferred to or vest in IAF [the third party] until such time as the liability of the firm is ascertained and determined", *Jackson v Greenfield* [1998] BPIR 699 at p 709E *per* Lawrence Collins QC. Similar views were expressed in S*ea Voyager v Bielecki* [1999] 1 All ER 628 at p 645.

[19] Three factors suggest this: (1) the absence of any reference to the moment when liability is established in the 1930 Act itself; (2) the absence of any reference to the requirement in the history of the Bill's reading in *Hansard*; (3) the fact that the 1930 Act was modelled on the Workmen's Compensation Act 1906 which expressly provides for the insured's liability to the third party to be litigated between the insurer and third party. That the 1930 Act was modelled on this earlier legislation is clear from the wording of the two Acts. It was also stated in Parliament (*Parliamentary Debates* (HC) 29 April 1929, vol 231, col 130).

[20] See paras 3.25-3.29 below.

here.[21] We do not support such a radical departure from the existing law. The basic approach of the 1930 Act seems to us to be preferable. It is unsatisfactory to require the office-holder[22] to become involved in a claim in which he has no direct interest. In particular:

(1) The third party, as the only person who stands to gain from a successful insurance claim, should, in our view, be the person who decides whether, and how vigorously, to pursue the insurer. The office-holder has other considerations and might decide to drop, or settle, a claim that could be won.

(2) On the Australian model, if the insurance claim is unsuccessful, the costs would be borne by the office-holder and consequently by all the insured's creditors. We think that it is preferable that the third party, who alone will gain if the claim is successful, should bear the risk of failure.

(3) The 1930 Act approach simplifies the role of the office-holder. The Australian model fails to do this.

Single set of proceedings

3.13 A large majority of consultees agreed that a new Act should remove the requirement that a third party establish the insured's liability before bringing an action against the insurer. Most consultees agreed that this would simplify and speed up litigation and reduce costs. It would also remove the possibility that third parties would lose their remedy against the insurer by failing to comply with procedural requirements.[23]

3.14 One consultee suggested that resolving all issues in one set of proceedings might occasionally increase costs incurred by litigants. An example is a case in which complex issues relating to the effect of the insurance policy ("coverage issues") are raised at the pleading stage, but the case is in fact resolved by the third party's failure to establish the insured's liability. We acknowledge that in such cases there may be some increased costs. But most cases do not involve complex coverage issues; most indeed are never litigated. We are satisfied that the overall effect of our recommendation will be to reduce costs. In cases in which complex coverage issues are raised, court procedure is flexible enough to ensure that time and money are used efficiently.

[21] See, for example, Digby Jess, "Reform of direct rights of action by third parties against non-motor liability insurers" [2000] LMCLM 192.

[22] We use this general term in the text to refer to the person in charge of the insolvency procedure which has caused a statutory transfer (for example a liquidator, an administrator, an administrative receiver, a receiver, or a supervisor of a voluntary arrangement).

[23] As occurred in *Bradley v Eagle Star Insurance Co. Ltd* [1989] 1 AC 957. See para 3.6, n 6 above.

3.15 A small dissenting group of consultees thought that it would be inappropriate in some cases to allow the third party to establish the insured's liability in an action against the insurer. It was pointed out that such a reform might occasionally require the insurer to disclose more documentation earlier.[24] In our view it is not objectionable to require the insurer to reveal information relevant to the third party's claim, however that information came into being. Whilst this may occasionally improve the third party's state of knowledge, we do not see that as an objection to our recommendations.

3.16 Concerns were also raised over conflicts of interest. For example, in a case where only negligence is alleged by the third party, the insured might wish to defend on liability by denying that the relevant conduct was negligent. The insurer, on the other hand, might wish to deny cover by alleging that the insured's conduct amounted to fraud. It was pointed out that in the United States such conflicts have led the courts to hold that, where the insurer has reserved its position on coverage, an insured has an absolute entitlement to control his own defence.[25] Such an entitlement appears to be fundamentally inconsistent with the insurer's subrogated right to conduct the defence of the insured. In addition, some courts in the United States have held that an insurer is not bound by findings of fact in litigation against the insured. This raises serious difficulties when enforcing judgments in favour of third parties against insurers.

3.17 We agree that these are serious issues. However, they exist as a result of the nature of the insurance contract and of the insurer's right to conduct the defence of the insured. They do not arise as a result of our proposal to deal with liability and coverage in a single set of proceedings. Indeed, in a case in which a third party proceeded under the draft Bill against the insurer alone, such problems would be avoided, as the insured would not be involved in the litigation and no conflict could arise. The insurer, faced with a "conflict" between denying the insured's liability by denying negligence, and denying cover by alleging fraud, would simply plead alternative defences.

3.18 In a case in which the insured is a party to the action, the position of the third party may be improved in the exceptional cases in which such conflicts arise. For example, the third party may, as a result of the single set of proceedings, discover before trial the terms of the insurance policy[26] and consequently whether the

[24] As a result of disclosure ordered in the proceedings. It was suggested, for example, that the insurer might have defences to an insurance claim, based on investigations carried out by the insurer with the insured's assistance under the terms of the policy, which involved matters that were also the subject of the third party's claim against the insured. In such circumstances it was suggested that it might be unfair to force the insurer "to make available to the third party all such material on which the insurer's defences were based, when such material had only come into existence because of the existence of the policy, and because of the insured's duty of assistance and/or good faith under the policy."

[25] *Spears v State Farm Fire and Casualty Insurance* (1987) 725 SW 2d 835, 291 Ark 465.

[26] By the usual process of disclosure. In practice they may know independently as a result of exercising their right to obtain information provided by Sched 1 of the draft Bill. See Part 4 below.

categorisation of the insured's liability under different heads of loss will affect insurance recoveries.[27] Under the 1930 Act, generally only the insurer and insured are privy to this information until judgment on liability has been obtained. Whilst one consultee objected that this would lead to "artificiality" in the presentation of the third party's case, in our view it simply puts the parties on a more equal and fairer footing. This reform will enable third parties to avoid wasting time and money alleging and proving losses which are uninsured.[28]

3.19 We acknowledge that the proposal that all issues be resolved in a single set of proceedings may make it necessary for the insurer's advisors occasionally to recommend that the insured be separately represented. In very unusual cases, the court may feel that it is necessary to order a split trial. We do not see these possibilities as substantial drawbacks to our proposals.

Joinder of insured

3.20 It was our provisional view in the consultation paper that a third party should usually proceed against both the insured and the insurer, unless the insured was a company which no longer existed, in which case he might proceed against the insurer alone.[29]

3.21 A number of consultees suggested that the third party should be given the right to proceed against the insurer alone in all cases. It was argued that in the vast majority of cases the insurer conducts the defence of the insured in any event, and the presence of the insured as a nominal defendant is simply an additional cost. It was pointed out that in many cases the insured, even if joined, would take no active part in the proceedings as he would not be able to afford to do so. In those circumstances, it was suggested, it would be better if he were not a party as he would then not be bound by the judgment. We agree. A third party will not be required to join the insured as a defendant to an action under the proposed new Act.[30]

Reform recommendations

Mechanism of transfer

3.22 Like the 1930 Act, the draft Bill confers rights on the third party by effecting a transfer to the third party of the insured's rights under the insurance contract in

[27] Issues of allocation - as between insured events and causes and as between insured and uninsured events or causes - may be crucial to the amount of cover available.

[28] We doubt whether this reform will lead third parties to present their claims in an artificial way as third parties will be aware that doing so would make their claims more difficult to prove.

[29] Consultation paper, para 12.23.

[30] However, an insured who is not joined as a defendant will not be bound by the terms of any eventual judgment. See paras 3.33-3.34 below. As an additional protection, we recommend below that a third party who chooses not to join the insured must nevertheless inform him of the proceedings. See paras 3.52-3.56 below.

respect of the insured's liability to him.[31] The draft Bill does not create new substantive rights; instead, it transfers pre-existing contractual rights agreed between the insured and insurer.[32] It does, however, give the third party a new procedural right to declarations as set out below.[33]

Timing of transfer

3.23 In Part 2 we explained that the draft Bill, like the 1930 Act, confers rights on the third party, not only if the insured becomes insolvent, but also in a number of other specified circumstances. As we noted above, the courts have held that the statutory transfer does not take place until such time as the liability of the insured to the third party is established.[34]

3.24 By contrast, under the draft Bill, the moment at which the insured's liability to the third party is established is irrelevant to the timing of the statutory transfer. In cases in which the third party is already owed money by the insured, the moment of transfer will be the onset of the insured's insolvency etc. So, for example, a transfer will occur, in the case of a compulsory winding-up, on the making of the winding-up order.[35] In terms of the draft Bill a statutory transfer will occur when the insured becomes a "person to whom this section [section 1] applies".[36] In cases in which the insured is already such a person, the statutory transfer will occur at the moment that the insured incurs liability to the third party.[37]

Third party's rights before liability is established[38]

3.25 The draft Bill differs from the 1930 Act by providing that a third party may issue proceedings against the insurer without first having established the liability of the

[31] Clause 1(1). We shall refer to the transfer effected by the draft Bill, as we do that effected by the 1930 Act, as a "statutory transfer".

[32] And modifies them in limited respects as explained in Part 5 below.

[33] Paragraphs 3.25-3.29.

[34] See para 3.9 above.

[35] Clause 1(3)(f). It is worth noting that in the case of a voluntary winding-up the transfer will occur on the passing by the members of the resolution in favour of the winding-up (clause 1(3)(d)). The difference, which we have retained from the 1930 Act, is explained by the fact that a petition for a compulsory winding-up may be opposed by the company, and indeed may turn out to be wholly unjustified. The position is not known until the court adjudicates. In the case of a voluntary winding-up, on the other hand, there is typically no-one to contest the making of the order.

[36] Clause 1(1)(b).

[37] Clause 1(1)(a). If the insured is no longer a person to whom s 1 applies then the draft Bill does not effect a transfer. So, for example, if a winding-up order has been "stayed or sisted" under IA 1986, s 147, and the insured then incurs a liability to a third party, no transfer will take place.

[38] Liability is "established" only once both the existence and the amount of the liability are ascertained (clause 10(2)). See para 3.4 above.

insured.[39] The draft Bill does this by giving the third party a procedural right, which arises at the same time as the transfer of rights, to ask the court (or tribunal) for declarations as to the insured's liability to him and as to the insurer's potential liability to him under the insurance contract.[40]

3.26 If the third party proves his case under each head then the court (or tribunal) will be obliged to grant the declarations requested.[41] A declaration, in England and Wales, is usually a discretionary remedy. However, we decided that in this context it should be a matter of entitlement. The declarations are simply steps in the process of enforcing a legal right, and we can think of no good reason why the court should be given a discretion to refuse to make the declarations if the third party makes out his case.[42]

3.27 If it makes the declarations, or declarators, the court will then be entitled to give an "appropriate judgment".[43] If it has already dealt with quantum, this is likely to be a money judgment. It may be, however, that the court leaves quantum to be determined on a later occasion, or in arbitration proceedings. In such a case the "appropriate judgment" is likely to be an award of damages to be assessed.

3.28 This mechanism in the draft Bill is optional. A third party who receives a transfer of rights before the insured's liability is established is not obliged to use it.[44] It remains open to such a third party to sue the insured and, once liability is established, sue the insurer on the insurance contract. A third party may elect to do this if he is already involved in proceedings against the insured when he receives a transfer of rights. Rather than begin again, the third party may wish to continue his existing action against the insured[45] with the aim of bringing proceedings against the insurer afterwards.[46]

3.29 A third party using the mechanism in the draft Bill is not obliged to ask the court for both declarations or declarators. He may ask for only one. However, unless the third party asks for and obtains both declarations, the court will only be

[39] The mechanism for England and Wales is contained in clause 8; that for Scotland is in clause 9.

[40] Clause 8(1). Or "declarators" in Scotland. See clause 9(1).

[41] Clause 8(2). No equivalent provision is necessary in Scotland where a declarator is a matter of right.

[42] Non-discretionary declarations are used elsewhere in legislation. See, for example: Trade Marks Act 1994, s 21; Leasehold Reform, Housing and Development Act 1993 s 61(1); and Family Law Act 1986, s 58(1).

[43] Clause 8(5) (in Scotland, clause 9(4)).

[44] Clause 8 (in Scotland, clause 9) is permissive, not obligatory.

[45] He may have to apply for permission to continue proceedings. See para 3.6, n 4 above.

[46] Alternatively, the third party may wish to join the insurer to his existing proceedings. See paras 3.40-3.42 below.

entitled to grant a money judgment after the third party has established liability in the traditional way. [47]

Third party's rights after liability is established

3.30 The third party may receive a transfer of rights after the insured's liability has been established.[48] In such a case, the new machinery described above will not be relevant.[49] Such a third party will simply exercise the contractual insurance rights against the insurer which the draft Bill has transferred to him.

Third party's rights in arbitration proceedings

3.31 The insurance contract may require, or allow, disputes to be resolved in arbitration proceedings. We explain, in Part 5 below, our decision not to alter the effect of such clauses after a statutory transfer.[50] If such a clause exists, then a third party who has already established liability may bring arbitration proceedings.[51] A third party who has yet to establish the insured's liability will be able to take advantage of the new mechanism described above in an arbitration.[52]

3.32 The third party may be contractually entitled, or obliged, to resolve his dispute with the insured in arbitration proceedings. We did not think it appropriate to prevent such a third party from benefiting from the new mechanism in the draft Bill; such a third party will be entitled to use it. As we explain in Part 5 below,[53] the arbitration clause in the contract between the third party and the insured will not affect the appropriate forum for such proceedings.

Joinder of the insured as defendant

3.33 We agree with the consultees who suggested that in most cases the joinder of the insured is simply a wasted cost. Accordingly, the third party is not obliged to join the insured to proceedings against the insurer.[54] It would, however, be

[47] The draft Bill entitles the third party to apply for one declaration only in order to allow the new mechanism to operate flexibly. A third party may decide, for example, not to ask for a declaration as to the insured's liability to him if, when he receives a statutory transfer, he is engaged in proceedings against the insured which are nearing completion. The third party may nevertheless wish to clarify the insurance position by asking for a declaration as to the insurer's duty to indemnify, pending the outcome of the action against the insured.

[48] It may be that the third party's attempt to enforce judgment precipitates the insured's insolvency.

[49] Clause 8 (in Scotland, clause 9) only applies to proceedings brought by the third party before the insured's liability has been established.

[50] See paras 5.39-5.44 below.

[51] As he may under the 1930 Act. This is a consequence of the mechanism of statutory transfer. See para 5.39 below.

[52] Clause 8(6) (in Scotland 9(5)) A third party in this situation will also be entitled to information on the insured's insurance - see Part 4 below.

[53] See para 5.44 below.

[54] Clause 8(8) (in Scotland, clause 9(7)).

inappropriate for a court to make declarations or declarators as to the insured's rights which are binding on the insured in the insured's absence. Accordingly, if the third party fails to join the insured, the insured will not be bound by any declarations made.[55]

3.34 A third party who brings an action against the insurer under the draft Bill before establishing the liability of the insured will be entitled to join the insured as a co-defendant. If he does so, the insured will be bound by the court's findings.[56] The third party may wish to do this if, for example, the insured has only partially insured his debt, or the insurer has a plausible defence to a claim under the insurance contract. If the third party follows this course then, to the extent that he is unable to recover from the insurer, he will be able to enforce the judgment against the insured without the need to take further proceedings.[57]

Terminology of "incurring liability" retained

3.35 Recent decisions have thrown doubt on when liability is treated as "incurred" for the purposes of the 1930 Act.[58] In the consultation paper we used the concept of "the event giving rise to the liability of the insured" instead.

3.36 We have concluded that any uncertainty in the context of the 1930 Act stems from the failure of that Act to spell out the consequences of a statutory transfer.[59] By contrast, under the draft Bill, the third party's rights on receipt of a statutory transfer are clear. In addition, a number of objections to the alternative phrase used in the consultation paper were raised on consultation or have since occurred to us.[60] Accordingly, the draft Bill retains the term "incurs" when referring to the creation of a liability.[61]

TRANSITIONAL PROVISIONS

3.37 We were concerned to ensure that as many third parties benefit from a new Act as possible. The transitional provisions have been drafted accordingly.[62] Their

[55] *Ibid*. In addition, in cases in which the insured's liability to the third party, or its amount, is in issue, we recommend that the rules of court be altered to require the third party to inform the insured of his allegations. See paras 3.52-3.56 below.

[56] *Ibid*.

[57] Clause 14. For a full analysis of this aspect of this clause see paras 7.4-7.8 below.

[58] In *Jackson v Greenfield* [1998] BPIR 699 at p 708E, the judge expressed the view that "incurred liability" may, on the existing authorities, have a different meaning in s 1 from that in s 3 of the 1930 Act.

[59] See paras 3.4-3.10 above.

[60] The insured's breach of duty may predate the third party's resulting loss. It would not be appropriate to effect a statutory transfer of rights before a loss is suffered. The wording of the 1930 Act clearly does not do so. Further, there may not always be an "event" giving rise to liability: it may arise from an omission rather than an act, or from a series of occurrences.

[61] See, for example, clause 1(1)(a).

[62] Clause 20.

effect is that, if the insured has both incurred liability to the third party and has been wound up[63] at the moment the draft Bill comes into force, then the 1930 Act will continue to apply. Similarly, if the insured has already died whilst insolvent, the 1930 Act will continue to apply. In all other cases, the new Act will effect the statutory transfer and will govern the third party's claim.

PROCEDURAL CONSIDERATIONS

3.38 In the consultation paper we identified a number of issues relating to joinder and substitution which would be likely to arise in claims under a new Act, and asked consultees whether we should recommend amendments to rules of court to cater for them.[64] As we explain below, we have concluded that the current rules of court in both jurisdictions already provide sufficient procedural flexibility.[65]

3.39 However, we do recommend below[66] an additional rule in both jurisdictions to require the third party to notify the insured of any action he brings under the draft Bill against the insurer in which he intends to prove the insured's liability to him.

Third party may join insurer to proceedings against insured

3.40 It may be that a third party who receives a transfer of rights has already issued proceedings against the insured in an attempt to establish the insured's liability. Such a third party may wish to join the insurer to the existing proceedings.

3.41 In England and Wales, provided the limitation period governing those proceedings has not expired, this will be possible.[67] If, on the other hand, that limitation period has expired,[68] it appears that the third party could not obtain an addition order from the court. The court would have no discretion to grant such

[63] Or one of the other events in s 1(1) of the 1930 Act has occurred.

[64] Consultation paper, para 12.23. Since the publication of the consultation paper, the Civil Procedure Rules ("CPR") have come into force in England and Wales (on 26 April 1999). They replace the old Rules of the Supreme Court and County Court Rules.

[65] In Scotland, third party procedure allows a defender to sist a third party where he claims that he has a right of indemnity against that party and in other circumstances. The insured could use this procedure to make the insurer a party to an action brought against him by the third party. Rule 20, Ordinary Cause Rules; Rule 26, Rules of the Court of Session.

[66] See paras 3.52-3.56 below.

[67] Under CPR 19.2(2)(b) which gives the court the power to order addition if (1) there is an issue involving the new party and an existing party which is connected to the matters in dispute in the proceedings, and (2) it is desirable to add the new party so that the court can resolve that issue. The court would be able to order addition of the insurer in order to resolve the issue of the insurer's duty to indemnify under the insurance contract.

[68] This may occur quite often. For example, the following sequence of events can be anticipated: (1) Third party issues liability proceedings against solvent insured; (2) limitation period applicable to that action expires; (3) before the third party receives a quantified judgment in the proceedings against the insured, the insured becomes insolvent and is wound up, triggering a transfer of rights under the draft Bill.

an application.[69] Under current Scottish procedural rules, the court has a wide discretion in all situations to permit the addition of the insurer as a defender in existing proceedings against the insured.[70]

3.42 As we explain below,[71] the inability of a third party to join the insurer to ongoing proceedings against the insured after the limitation or prescription period relating to that action has expired will not present the third party with difficulties. The draft Bill specifically provides that, in such a case, the third party will be entitled to issue fresh proceedings against the insurer.[72]

Third party may take over insured's proceedings against insurer

3.43 The third party may receive a transfer of rights after he has established the insured's liability. He may not have been paid due to a dispute between the insured and insurer about the insurance contract. Such a dispute may be the subject of litigation. If it is, the third party might wish to apply to be added or substituted as claimant into the proceedings. Under the CPR, the court would have the power to grant such an application, whether or not it was made before the end of the limitation period governing the cover proceedings.[73]

3.44 In Scotland, a pursuer can be added or substituted to an action by amendment.[74] In particular, when the rights of the pursuer have been assigned to another person, the assignee is entitled to take the pursuer's place in the action.[75]

Insurer may apply to add insured as defendant

3.45 The insurer may wish the insured to be a defendant to the third party's action. For example, the insurer may wish to ensure that the insured is bound by the court's ruling on the validity of the insurance contract. Under the CPR, the

[69] Under CPR 19.5. The addition of the insurer as defendant would not be "necessary" in the sense required by CPR 19.5(3).

[70] Rule 18.2(2)(d), Ordinary Cause Rules; Rule 24.1(2)(d), Rules of the Court of Session.

[71] See paras 5.57-5.58 below.

[72] Clause 11(1) and (2).

[73] If made before the expiry of the limitation period, the court would have discretion under both heads of CPR 19.2(2) to make an addition order, and under CPR 19.2(4) to make a substitution order. If made after the end of the limitation period the court will have a discretion under CPR 19.5. The requirement in CPR 19.5 that the order be "necessary" will be satisfied by virtue of CPR 19.5(3)(b): the insured's claim against the insurer can no longer "properly be carried on" by the insured as required by that sub-rule as the third party now possesses the insured's rights under the insurance contract. We discuss limitation and prescription issues in relation to claims under the draft Bill in Part 5 below.

[74] Rule 18.2(2)(b)(iv)-(v), Ordinary Cause Rules; Rule 24.1(2)(b)(iv)-(v), Rules of the Court of Session.

[75] *Fearn v Cowper* (1899) 7 SLT 68. The same rule seems to apply in arbitration, although the insured would remain bound by the submission to arbitration. See F Davidson, *Arbitration* (1st ed 2000) p 331; *Henry v Hepburn* (1835) 13 S 361.

insurer will be able to apply to add the insured provided that the application is made within the limitation period governing the liability proceedings.[76]

3.46 As stated above[77] it is also possible under Scottish procedural rules to add defenders to an action where parties with an interest have not been called or the action has been directed against the wrong person.[78]

Insured may apply to be made defendant

3.47 In the consultation paper we suggested that in some circumstances the insured might wish to be added as a defendant to the third party's action.[79] In our view such cases will be very rare. The insurer is likely to defend a claim as vigorously as the insured and will have greater resources.

3.48 It is important to note that the insurer defending the third party's claim may do so without regard to the insured's interests and may have different priorities.[80] There may therefore be occasions on which the insured will wish to join the proceedings as defendant. For example, if the third party's allegation is that the insured failed to provide a safe working environment, it may be that the insured will be concerned about its reputation or about possible criminal proceedings under health and safety legislation. It may be the case that the insured has an economic interest in a successful defence by the insurer (for example, a successful claim by the third party might cause future premium rises under the policy).

3.49 Under the CPR, if an insured did wish to apply to be added as defendant the court would be able to grant an addition order on the application of the insured provided it is made within the limitation period.[81] In Scotland, a person with sufficient title and interest is entitled to apply to be sisted as a party to an action.[82]

Insured may apply to be made claimant

3.50 In exceptional cases the insured may wish to intervene as claimant in the third party's action. This may be the case if the insured is concerned to protect his position under the equivalent of section 1(4)(a) of the 1930 Act, which preserves the insured's right to claim from the insurer any sums in excess of those payable

[76] Under CPR 19.2(2)(b).

[77] See para 3.41 above.

[78] Rule 18.2(2)(d), Ordinary Cause Rules; Rule 24.1(2)(d), Rules of the Court of Session.

[79] Consultation paper, para 12.23.

[80] See para 7.38-7.39 below.

[81] Under CPR 19.2(2)(b). The insured will know about the proceedings as a result of our recommendation that the third party be required by the rules of court to inform him of it. See paras 3.52-3.56 below.

[82] *Muir v Glasgow Corporation* (1917) 2 SLT 106 (OH); Rule 13.1(1), Ordinary Cause Rules.

to the third party.[83] Under the CPR, the court would be entitled to grant such an application, provided that it was made within the limitation period.[84]

Leave requirement

3.51 A large majority of respondents agreed with our provisional conclusion that a third party should not be required to obtain leave before proceeding under a new Act[85] and we recommend that no such requirement be imposed in either jurisdiction.

Notification of insured

3.52 In most cases in which the third party sues the insurer alone under rights transferred by the draft Bill, the insured will be content to do nothing.[86] As we have seen, as a non-party he will not be bound by any findings of fact or declarations made by the court.[87] It is likely to be of benefit to him to be relieved of the need to participate in proceedings where the real contest is between the third party and the insurer.

3.53 However, there are circumstances in which the insured may wish to apply to be added as a party.[88] While he will usually know about the proceedings in any event[89] this may not be the case if, exceptionally, the third party and the insurer fail to alert him.

3.54 In our view the insured should always have the opportunity to apply to be added to proceedings issued by the third party against the insurer if the insured's liability to the third party is in issue. In order to achieve this we suggest that the third party be obliged to inform the insured when he issues such proceedings. This should be done by an amendment to the rules of court.

[83] Clause 3 (on which, see para 7.37 below). For example, suppose, before any statutory transfer, that the insured incurred costs defending the third party's claim and that the insured wished to claim these costs from the insurer under the terms of the insurance policy. Suppose also that the insurer refused to meet the insured's claim, alleging a misrepresentation by the insured at the time the insurance policy was entered into which would allow it to avoid liability under the policy entirely. If, after a statutory transfer, the third party brought a claim against the insurer, and the insurer defended the claim by relying on the same misrepresentation, the insured might wish to join the action as a claimant in order to test the insurer's common defence to each claim.

[84] CPR 19.2(2)(b). For Scots law see para 3.44 above.

[85] Consultation paper, para 12.40.

[86] In most cases the insured will be represented by an office-holder.

[87] Clause 8(8) (in Scotland, clause 9(7). See para 3.33 above.

[88] See paras 3.47-3.50 above.

[89] When notified of the claim, the insurer's first step is likely be to ask the insured for the facts.

Nature of the notice requirement

3.55 We recommend that where a third party has issued proceedings against the insurer without having already established the insured's liability, a copy of the claim form (ie the originating process) should be sent to the last known address of the insured within 14 days of instituting proceedings. In addition, in Scotland, we recommend that a copy of the closed record (including any amended closed record) should be sent to the insured at the same time as it is sent to the defender.

Non-existence of the insured

3.56 Where the insured is a company which has been wound up or struck off the register of companies it will be impossible for the third party to notify the insured or for the insured to intervene in the proceedings. In Part 4 below, we explain why the draft Bill imposes on certain of the former officers (and employees) of a defunct insured, obligations to provide disclosure if it is requested by a third party.[90] There may be reasons why people notified in this way of the third party's proceedings may wish to become involved; it seems to us to be highly unlikely that other ex-officers or employees would wish to do so. We were also concerned to limit the burden of the notice requirement on the third party. We therefore recommend that the new rule of court, imposing on the third party a duty to notify the insured of his proceedings, should not apply if the insured no longer exists when proceedings are issued.

[90] Schedule 1, paras 3 and 4. See paras 4.42-4.45 below.

PART 4
DISCLOSURE OF INFORMATION TO THE THIRD PARTY

INTRODUCTION

4.1 In the consultation paper we explained the way that the disclosure provisions in section 2 of the 1930 Act have been interpreted by the courts and the difficulties to which this has given rise.[1] We provisionally proposed that substantial clarifications and extensions should be made in a new disclosure regime. This aspect of our proposals received strong support from a broad spectrum of consultees, including insurers.[2]

4.2 The draft Bill provides a new, self-contained procedure by which third parties can obtain insurance information before issuing proceedings, and without having to obtain a court order.[3] These rights to information will enable the third party, before issuing proceedings, to discover if there is insurance and, if there is, the identity of the insurer. They will therefore enable him to make an informed decision on whether or not to pursue a claim.

4.3 The draft Bill also provides, in England and Wales only, a procedure by which a third party may, in narrowly defined circumstances, obtain documentation relating to the insured's liability to him.[4] The third party will be able to use this procedure, if the insured is a company which is no longer on the register of companies, and he is proceeding against the insurer without having previously established the insured's liability. The procedure will enable the third party to obtain similar documentation to that which he would be able to obtain if he restored the insured to the register of companies and obtained orders for standard disclosure under the CPR.

4.4 In this Part we briefly review the problems with the disclosure regime in the 1930 Act. We then examine other ways in which the third party may be able to obtain information. Finally, we set out our reform proposals, referring to the views of consultees on each issue.[5]

[1] Parts 6 and 13.

[2] A small minority of consultees were strongly opposed to any form of disclosure regime in a new Act. We set out a summary of this view, and our reasons for disagreeing with it, at paras 4.21-4.24 below.

[3] Schedule 1, paras 1 and 2.

[4] Schedule 1, paras 3 and 4.

[5] We have followed the 1930 Act (s 2) by including the disclosure regime in the draft Bill itself. However, we recognise that it may be more in keeping with modern practice, and allow more flexibility, for such detailed provisions to be put in secondary legislation.

PROBLEMS WITH THE DISCLOSURE REGIME IN THE 1930 ACT

No right to disclosure until insured's liability established

4.5 The 1930 Act provides for the disclosure to the third party of such information:

> as may reasonably be required by him for the purpose of ascertaining whether any rights have been transferred to and vested in him by this Act and for the purpose of enforcing such rights, if any...[6]

The courts have held that a third party has no right to the disclosure of information under the Act until he has established the liability of the insured.[7]

4.6 Consequently, the third party who has yet to establish the insured's liability must decide whether or not to litigate without the benefit of any information other than that which has been disclosed voluntarily.[8] After incurring considerable expense, he could discover that the insurer is able to defeat his claim. This feature of the regime has attracted judicial criticism.[9] It also seems to be contrary to the intention of Parliament when it enacted the 1930 Act, which appears to have been to give the third party the right to information before issuing proceedings.[10]

[6] Section 2(1).

[7] *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957. See also *Woolwich Building Society v Taylor* [1995] 1 BCLC 132.

[8] The insurer may disclose insurance information voluntarily at an early stage in litigation under the 1930 Act. For example, if the insurer is conducting the defence of the insured and has avoided, or intends to avoid, cover, it will be in his interests to disclose this. He will hope that the third party will see the futility of proceeding against him and will desist. To a limited extent, therefore, a third party trying to establish liability in order to pursue a claim under the 1930 Act may be able to make educated guesses on the extent of cover. There are obvious problems however with relying on voluntary disclosure and inference.

[9] In an interlocutory decision in *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd*, (unreported), 26 February 1993, Phillips J considered s 2 of the 1930 Act and said "one might have expected in a situation such as this the [1930 Act] to enable a plaintiff to ascertain the extent of insurance cover before incurring costs of litigation, because the rationale of that Act is to afford to those who can establish a good claim the protection of insurance of the insolvent company against that liability." He concluded, however, that the House of Lords' decision in *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957 thwarted any such expectations. Phillips J's final judgment in that case, reported at [1994] 31 EG 68, was appealed, on issues unconnected with the 1930 Act, to the Court of Appeal ([1995] QB 375), and thereafter to the House of Lords under the name of *South Australian Asset Management Corporation v York Montague* [1997] AC 191.

[10] RA Taylor MP is reported in Hansard as saying: "I regard it as of great importance that the injured poor person should have the right to demand from the insurance company, before they resort to the expensive and uncertain processes of the law, all the relative facts disclosed to them in order to enable them to make up their minds as to whether they have a substantial claim or not" (HC) 10 April 1930, vol 237, col 2507. As Mance J has pointed out ("Insolvency at Sea" [1995] LMCLQ 34 at p 42), the record in Hansard of the Bill's third reading might properly be cited in future litigation under s 2 on the principle in *Pepper v Hart* [1993] AC 593.

Two stage disclosure

4.7 The 1930 Act only imposes a duty to disclose on insurers if the information disclosed by the insured or the office-holder "discloses reasonable ground for supposing that there have or may have been transferred to him under this Act" rights against that insurer.[11] This results in a two stage process. Not only does this lengthen the time it takes for third parties to obtain the information they need, but a third party who fails to obtain adequate information from the insured or the office-holder never acquires a right to disclosure from the insurer.

No right to require a broker to disclose information

4.8 Those with an initial duty to disclose information under the 1930 Act are:

> the bankrupt, debtor, personal representative of the deceased debtor or company, and, as the case may be, of the trustee in bankruptcy, trustee, liquidator, administrator, receiver, or manager, or person in possession of [any property comprised in or subject to a charge][12]

The Act does not impose a duty to disclose policy information on insurance brokers or others authorised to hold policy information, such as managers of pools set up by a number of insurers or travel agents arranging cover for holidaymakers. In many instances such people may be those best able to identify the insurer and the policy governing a particular claim.[13]

Unhelpful definition of the information required to be disclosed

4.9 The information and documentation which is required to be disclosed under the 1930 Act is described in general terms.[14] We referred in the consultation paper to criticisms which had been made of this vague wording.[15]

The position of office-holders

4.10 We referred in the consultation paper[16] to the difficulties which the disclosure provisions in the 1930 Act present for office-holders, both because of their imprecision and because of potential conflicts of duties.[17]

[11] Section 2(2).

[12] Section 2(1).

[13] In the case of pool managers, insurance may have been pooled to facilitate the handling of insurance cover provided by foreign insurers: there may be particular advantages to a third party having a right to disclosure against a pool manager based in this country as well as against a foreign insurer.

[14] In addition to the general formulation in s 2(1), set out at para 4.5 above, s 2(3) specifies: "...all contracts of insurance, receipts for premiums and other relevant documents in the possession or power of the person on whom the duty is so imposed...".

[15] Consultation paper, para 6.4.

[16] Consultation paper, paras 6.9-6.10.

[17] In particular, conflicts between their duty to third parties under the 1930 Act and to the insured's other creditors under IA 1986.

OTHER MEANS BY WHICH A THIRD PARTY MAY OBTAIN INFORMATION

Disclosure regime in England and Wales

Pre-action disclosure and pre-action protocols

4.11 Under the 1930 Act the third party is unable to overcome the deficiencies in the statutory disclosure regime by obtaining disclosure orders under rules of court.[18] Notwithstanding the changes we propose to the statutory transfer of rights, in our view, before he issues proceedings, the third party will still be able to obtain little (if any) information about the insured's insurance position under the CPR. We note, in particular:

(1) Orders for pre-action disclosure will only be granted against prospective litigants.[19] They would not, for example, be available against insurance brokers.

(2) Such orders will only be granted in respect of specified documents.[20] A third party who is completely ignorant of the insured's insurance position may find it difficult to specify documents.

(3) Such orders will only be granted if early disclosure is desirable in order to dispose of the future proceedings fairly, avoid future proceedings or save costs.[21]

[18] See *Burns v Shuttlehurst Ltd* [1999] 1 WLR 1449. Burns, a paraplegic, obtained judgment against his insolvent ex-employer, Shuttlehurst Ltd, in negligence for damages to be assessed. The insurer, General Accident, claimed to have repudiated cover. Burns sought discovery of insurance details. He did so, *inter alia*, in an application for pre-action discovery in his proposed action against the insurer. The Court of Appeal reversed the first instance judge and refused the plaintiff his discovery order on two grounds. First, the proposed action against General Accident was for an indemnity for damages, not for personal injuries, so the court had no jurisdiction under s 33 of the Supreme Court Act 1981 to make the order (s 33 then required the action to be for death or personal injuries. It has since been amended). Second, until the damages awarded had been quantified (which, it was recognised, would be an expensive business), no right to an indemnity crystallised. Burns had therefore no right of action against General Accident, and so it could not be said that General Accident was "likely" to be a party to the proposed action as was (and is) required by rules of court.

[19] CPR 31.16(3)(a) and (b).

[20] CPR 31.16(4)(a).

[21] CPR 31.16(3)(d). It is not yet clear how the courts will view this requirement. Commentators have suggested that the courts will view such orders as "exceptional" (*Blackstone's Guide to the Civil Procedure Rules* (2nd ed 1999) p 226). The Court of Appeal considered the application of this rule in *Bermuda International Ltd v KPMG (a Firm)* *The Times* 14 March 2001. It declined to lay down guidelines at such an early stage in the life of the new rule, and emphasised that it was a matter for the judge's discretion.

4.12 In certain circumstances it appears that a third party may be able to obtain some information without issuing proceedings, as a result of pre-action protocols.[22] In our view, however, this is by no means clear.[23]

Disclosure after proceedings have started

4.13 Once he has issued proceedings the third party will be entitled to apply[24] for a number of disclosure orders, in particular, an order for standard disclosure[25] or an order for the disclosure by a non-party of a specific document or documents.[26] In this way, the third party may be able to obtain a large amount of the information he needs.[27]

The recovery of evidence in Scotland

4.14 Section 1(1) of the Administration of Justice (Scotland) Act 1972 confers a power on the Court of Session and Sheriff Court to order the production and inspection of documents and other property which may be relevant in any existing or likely civil proceedings. This can therefore be used either during an action or before an action is raised. It can be used to obtain disclosure from sources that are not parties to the action. Alternatively, during the course of the action, the court can order a commission and diligence to recover documents

[22] To date four pre-action protocols have come into force: (1) Personal injury claims; (2) Resolution of clinical disputes; (3) Defamation; (4) Construction and engineering disputes. Each contains detailed provisions setting out the information which the prospective parties to litigation should exchange; in each case this includes documents on which they propose to rely. In the case of other types of claim, para 4 of the Practice Direction states that the prospective parties should behave as if a pre-action protocol existed.

[23] The insurer may take the view that the third party is not likely to embark on litigation. He may also consider that non-compliance with a hypothetical protocol does not amount to a breach of rules of court and he may observe that, though the court may, in its discretion, make an award of costs or interest against him, these sanctions are not punitive (see Practice Direction - Protocols, para 2.4).

[24] No automatic duty to disclose without a court order arises under the CPR. In the past, RSC O 24 r 1 automatically required mutual discovery in most cases.

[25] As defined by CPR 31.6.

[26] Under CPR 31.17.

[27] Though possibly not all that he needs. A narrower range of documents are caught by disclosure orders under the CPR than was formerly the case. Under RSC O 24 it was necessary to disclose documents "relating to any matter in question in the cause or matter" (O 24 r 3(1)). This was interpreted to include any document containing information "which may enable the party [applying for discovery] ...either to advance his own case or to damage that of his adversary, [or] if it is a document which may fairly lead him to a train of inquiry which may have either of these two consequences" *(Compagnie Financiere du Pacifique v Peruvian Guano* (1882) 11 QBD 55 at p 63). Under CPR 31.6, by contrast, it is necessary only to disclose documents which support or adversely affect the case of a party to the proceedings.

either from parties or others.[28] These rules would allow a third party to seek disclosure from sources other than the insured or the insurer.

4.15 In other words, Scots law permits broader rights to recover information than do the CPR. However, part of the recommended statutory regime is wider still. As we are in favour of permitting wide disclosure in the context of the proposed draft Bill, we recommend that this part applies to Scotland.[29]

Statutes

4.16 If the insured is a company in the course of a winding-up, the third party may apply under IA 1986, section 155 for permission to inspect the insured's books or papers. It is possible that a third party could use this provision to discover details of the insured's insurance policy, though we are not aware of any reported case under the 1930 Act in which this has been done. No equivalent provisions exist to help third parties who receive a transfer of rights from bankrupts, or companies which are not being wound up.

4.17 In Scotland, section 45(1) of the Bankruptcy (Scotland) Act 1985 provides that a permanent trustee may, not less than eight weeks before the first accounting period, apply to a sheriff for an order for the public examination before the sheriff of a debtor or of a "relevant person".[30] An examinee may be required to produce for inspection any document in his custody or control relating to the debtor's assets, his dealings with them or his conduct in relation to his business or financial affairs. The examinee may also be required to deliver the document or a copy of it to the permanent trustee for further information.[31]

Registers of insurance information

4.18 In the case of employers' liability insurance, third parties may now take advantage of a new Code of Practice, A Code of Practice for Tracing Employers' Liability Insurance Policies, (Department of Environment, Transport and the Regions ("DETR"), October 1999), which came into force on 1 November 1999. This is operated by the insurance industry and was developed in consultation with, and is supervised by, the DETR.[32] It requires insurers to record and divulge

[28] The rules for recovering evidence by commission and diligence or under the Administration of Justice (Scotland) Act 1972 during an action are found in Rule 28 of the Ordinary Cause Rules and Rule 35 of the Court of Session Rules.

[29] Draft Bill, Sched 1, paras 1 and 2. (Paragraphs 3 and 4 do not extend to Scotland as existing Scots law on this point is adequate).

[30] By virtue of s 45(1)(b), the Accountant in Bankruptcy, the commissioners or at least one quarter in value of the creditors may also request that the trustee apply to the Sheriff for a public examination. Section 45(2) provides that the Sheriff has no discretion and must grant the order. A "relevant person" is defined in the Act as the debtor's spouse or any other person the permanent trustee believes can give such information.

[31] Bankruptcy (Scotland) Act 1985, s 46(4).

[32] The DETR's involvement stems from that department's responsibility for health and safety at work.

insurance information on request. The code is potentially extremely helpful to third parties who do not know the identity of the insurer. Such third parties will be in particular difficulties as they will not be able to extract information from the unknown insurer, nor issue proceedings under transferred rights. It remains to be seen how well the scheme works in practice. The Code will not help a third party trying to trace insurers in the context of other types of insurance.

4.19 As part of the Company Law Review, the DTI is considering whether a central register of insurers of companies should be set up, possibly to be maintained by an additional question on corporate annual returns.[33] It is also considering whether to introduce a register of charges over insurance policies. It appears that the former proposal has so far received little support but that the latter has been strongly approved by consultees.[34]

CONSULTATION: THE GENERAL APPROACH

Broad support for a strengthened statutory disclosure regime

4.20 A substantial majority of consultees supported our provisional conclusion that a new Act should contain an improved disclosure regime.

Objections to a statutory disclosure regime

4.21 The specific disclosure regime we are recommending places the third party who receives a transfer of rights under the draft Bill in a better position than the third party faced with a solvent insured. In particular, it enables him to obtain information before issuing proceedings. By contrast, a third party faced with a solvent insured would in the usual case receive nothing which was not volunteered.[35]

4.22 A small minority of consultees objected strongly to this aspect of our proposals. It was suggested that it was fundamental to English law that details of insurance were a private matter between the insurer and insured and to give a third party a right to obtain such details would offend against this rule. It was also suggested that our proposals might encourage speculative "deep pocket" litigation. Moreover, it was pointed out that, in English and Scots law, those defending civil proceedings usually have no duty to disclose their financial assets, including any insurance policies which they may have.

[33] See: Modern Company Law for a Competitive Economy - Completing the Structure (2000) DTI, para 8.26.

[34] See: Modern Company Law for a Competitive Economy - Registration of Company Charges (2000) DTI, para 3.38.

[35] At no stage, even after judgment, would he be entitled to details of the insured's insurance position. Of course, if the insured failed to satisfy the judgment then the claimant might be able to petition for bankruptcy or winding-up and, if successful, would then receive a transfer of rights under the 1930 Act. He would then be entitled to information under s 2 of the 1930 Act.

4.23 In our view, information about insurance cover held by an insured who has been declared insolvent, or whose circumstances have otherwise caused a transfer of rights under the draft Bill, should be treated differently from information about insurance cover held by a solvent insured. Under the draft Bill the third party is a statutory assignee of some of the insured's rights under the insurance contract. In our view it would be inappropriate to require a third party to expend time and money discovering whether the rights conferred on him are valuable or worthless. A third party using the 1930 Act is often forced to do this; in our view a new Act should not reproduce this failing.[36]

4.24 It is worth noting that many consultees felt that our original disclosure proposals were not wide ranging enough: some advocated, for instance, that the duty to disclose should arise before insolvency. We resisted that suggestion and accepted a number of arguments limiting the disclosure requirements, including the proposal that the duty to disclose should only arise on request.

Duty to disclose will only arise on request

4.25 The disclosure regime in the draft Bill differs in one major respect from that which we provisionally proposed in the consultation paper. Our provisional view was that the obligation to disclose should arise on a transfer of rights, and that disclosure should be given within 14 days of the disclosing party becoming aware that a third party has a possible claim under the Act.[37] A number of consultees argued persuasively that this suggestion was flawed and the requirement was too onerous on insurers. It was maintained that it was wrong to require an insurer to investigate or react to possible claims of third parties who had yet to contact the insurer, let alone make a claim. It was also pointed out that it would be difficult or impossible to prove when awareness of a claim occurred. We agree, and the disclosure regime in the draft Bill only imposes a duty to disclose information on receipt of a request for information from the third party.

4.26 Notwithstanding the fact that the third party will be able to obtain much of the information to which the draft Bill entitles him under procedural rules after the issue of proceedings,[38] we decided that the statutory right to obtain disclosure should be conferred on third parties both before and after the issue of proceedings. The alternative would have been to have withdrawn the right on the issue of proceedings. In our view this would have resulted in a more complex and less transparent regime.

[36] This was the view of Mance J in "Insolvency at Sea" [1995] LMCLQ 34 at p 43: "True, a plaintiff must normally take his defendant as he finds him. But the key to the 1930 Act is to recognise the fundamental difference between an insolvent defendant and other defendants. First the insolvent defendant is and is known to be unable to pay. Secondly, despite his own insolvency, his insurers can and will often make the task of establishing liability against him extremely onerous."

[37] Consultation paper, para 13.4.

[38] See para 4.13 above.

Disclosable information under the draft Bill specified

4.27 In the consultation paper we sought consultees' views on whether the information to which the duty of disclosure extends should be clarified by a list in the proposed new Act, and whether a catch-all provision requiring disclosure of "other relevant documents and information" should be included.[39]

4.28 Consultees broadly supported our suggestion that the categories of disclosable information should be listed in the statute. There was less support for a catch-all provision: it was suggested that this might lead to 'fishing expeditions' and unnecessary litigation. It was also pointed out that, once the insurer was brought into the proceedings, relevant documentation and information could be obtained under the procedural rules governing disclosure.

DETAILS OF THE DISCLOSURE REGIME

Specified disclosable information

4.29 In the consultation paper we set out a provisional list of what should be disclosed. Consultees made many valuable suggestions on the list and this led us to make a number of changes to it. We concluded that, under the draft Bill, the following information should be disclosable:[40]

(1) the existence of any insurance contract;

(2) the identity of the insurer;

(3) policy terms;

(4) whether the insurer has purported to repudiate the policy or deny cover;

(5) details of any proceedings between the insurer and the insured concerning what is now the third party's claim under the insurance policy;

(6) how much (if any) of the fund has been paid to other claimants; and

(7) whether the insurance proceeds are subject to a fixed charge.

4.30 We comment below on the principal issues we considered while finalising the above list.

Grounds for denying liability or repudiating cover

4.31 We suggested in the consultation paper that the insurer should be required to disclose any grounds on which he had already purported to repudiate the insurance policy. We recognised that there was a danger that this might cause privileged information to be passed to the third party and argued that the insurer

[39] Consultation paper, para 13.13.

[40] Schedule 1, para 1(2).

might be given a right to apply to court for an order relieving him of this duty to disclose if the court was satisfied that the information would prejudice the insurer's case on the insured's liability to the third party.[41] A number of consultees objected to this aspect of our proposals; they thought that the insurer should only be obliged to inform the third party if he had purported to repudiate (or had successfully repudiated) cover but should not have to disclose the grounds of the repudiation. We have adopted that suggestion. We were influenced in particular by the following considerations:

(1) If the insurer does intend to deny cover or repudiate liability he is likely in any event[42] to volunteer information to the third party on how he intends to do so unless he thinks it likely that such a revelation may prejudice him later.

(2) What matters to the third party is how the insurer will defend a claim against him under the Act. What may have been said, or not said, in past correspondence with the insured could be an unreliable guide. At the time he receives a request for information under the Act, the insurer will usually not have received a claim, much less considered his response to it. Even if he has put forward grounds for repudiation, these may be altered or abandoned once the insurer comes to defend proceedings.

(3) The grounds on which the insurer actually intends to deny cover or repudiate liability will shortly be revealed to the third party in the insurer's pleaded defence.

Details of proceedings between insurer and insured

4.32 When he acquires rights under the draft Bill, the third party will be able to apply to be substituted for the insured in current cover proceedings between the insured and the insurer.[43] The third party will only be able to do so, however, if he knows that such proceedings are taking place. The draft Bill enables the third party to obtain sufficient details of any such proceedings to enable him to apply to be substituted into them.[44]

Whether insurance fund is subject to a fixed charge

4.33 It is possible that the insured may have allowed the insurance proceeds to become the subject of a fixed charge.[45] If he did so, the third party who has

[41] Consultation paper, paras 13.9-13.10.

[42] As he might thereby dissuade the third party from issuing proceedings against him.

[43] See para 3.43 above.

[44] Schedule 1, para 1(2)(iv).

[45] In *Siebe Gorman v Barclays Bank* [1979] 2 Lloyd's Rep 142, Slade J held that it was possible to create a fixed charge over prospective assets such as future book debts provided that they could be clearly ascertained. The same reasoning would apply to proceeds of an insurance policy. Although it is unlikely that such a charge would be created intentionally, it might happen accidentally. See para 7.13 below.

received a transfer of rights would find that his rights were subject to the charge. This would reduce their value, perhaps to zero. The draft Bill enables a third party to ask whether the insurance proceeds are subject to a fixed charge before deciding whether or not to issue proceedings.[46]

No disclosure of settlements between insured and insurer

4.34 Consultees supported our provisional view[47] that details of settlements reached before a transfer of rights should not be specifically disclosable. The effect of any settlement, insofar as it affects his rights, will be apparent to the third party from other details which are disclosable, in particular the terms of the insurance contract and the amount of the fund which has been paid out to other claimants.[48]

The request for information

4.35 The draft Bill imposes a duty of disclosure arising on receipt of a request for information which must be complied with within 28 days.[49] The duty will only extend to information specified in the request. The request must be in writing.[50]

The timing of the request for information

4.36 Consultees strongly supported our provisional proposal that the right to information should not be delayed until the liability of the insured was established.[51] This is the effect of the draft Bill.[52]

Persons entitled to request information

4.37 One consequence of creating a right to disclosure which arises before liability is established is that it becomes necessary to specify who is to receive that right. We have followed the approach of the test in the 1930 Act which gives rise to the insurer's duty to disclose.[53] Those entitled to issue a request for information are

[46] Schedule 1, para 1(2)(b)(vi). The third party is likely to request from the insurer most of the information to which the draft Bill entitles him. However, as we explain below (para 4.38), the draft Bill enables the third party to require information from anyone who possesses it. The insurer might well not know if the insured had subjected the insurance proceeds to a fixed charge; a third party concerned about this point would be well advised to direct a request for such information to the insured instead.

[47] Consultation paper, para 13.14.

[48] Nor does the draft Bill require disclosure of any settlements reached *after* a transfer of rights. This is because, once the transfer has occurred, the insured and insurer have no rights or obligations *inter se* under the insurance contract in respect of the insured's debt to the third party, so any arrangements they arrive at will not affect the third party's rights.

[49] Schedule 1, para 2. We agreed with consultees who argued that the 14 days suggested in the consultation paper (para 4.25) was too short a period.

[50] Schedule 1, para 1(1).

[51] Consultation paper, para 13.4.

[52] Schedule 1, para 1(1).

[53] Section 2(2).

those who believe on reasonable grounds that they have or may have received a transfer of rights under the draft Bill.[54]

Persons from whom information may be requested

4.38 We asked consultees whether anyone other than the insured, the office-holder and the insurer should be subject to a duty of disclosure.[55] Consultees generally supported the idea that third parties should be able to impose a duty of disclosure on those in control of the specified information; several emphasised that intermediaries will often have the most information. We agree. Under the draft Bill, a person entitled to request information may do so from anyone he believes on reasonable grounds has that information.[56]

Extent of duty of person from whom information requested

4.39 Consultees supported our provisional view[57] that those providing information should disclose information which was within their knowledge or reasonably ascertainable from their records. The draft Bill gives effect to this.[58] The draft Bill also provides that if the person from whom information is requested cannot provide the information, he should inform the third party why it cannot be provided and, in certain circumstances, say who might be able to do so.[59]

No "continuing duty"

4.40 Although many consultees supported our provisional conclusion[60] that the duty imposed by a new Act should be a "continuing duty", others suggested that this would be too onerous and was unnecessary. We were persuaded by the latter view. We concluded that it would be unacceptable to require insurers and others to monitor indefinitely information relevant to the third party's claim. The idea that a request for information will yield a "snapshot" of information currently held (analogous to a company search) is familiar and readily understood. Third parties will be entitled to make further requests for information to ensure that it is up to date.[61] In addition, in England, once litigation is under way, the defendants to the third party's claim are likely to be subject to continuing duties

[54] Schedule 1, para 1(1). The request for information must specify those grounds (para 1(5)).

[55] Consultation paper, para 13.20.

[56] Schedule 1, para 1(1). The request for information must specify the third party's grounds for believing that the person from whom the information is requested has that information (para 1(5)).

[57] Consultation paper, para 13.18.

[58] Schedule 1, para 2(1)(a) and para 7.

[59] Schedule 1, para 2(1)(b) and para 2(2).

[60] Consultation paper, para 13.4.

[61] See the Interpretation Act 1978, s 12(1).

of disclosure.[62] The rules on recovery of evidence in Scotland are set out in paragraph 4.14 above.

Duty to disclose information not documents

4.41 In the consultation paper we envisaged that the duty to disclose would extend to both information and documentation.[63] In the course of drafting Schedule 1 to the draft Bill, however, we came to the view that the duty should extend only to specified information. Our reason for this was as follows. The duty is imposed by the draft Bill in order to help the third party evaluate his newly acquired insurance rights. In the light of consultation we have decided what information he needs to do this, and have listed it in the draft Bill. The third party would be entitled to require the insurer to give him this information. There is, accordingly, no need to require the insurer also to provide any documents. The insurer may choose to comply with a request by providing a copy of a document; or he may prefer to set the information out separately.

Insured is company not on the register (England and Wales only[64])

4.42 Schedule 1, paragraphs 3 and 4 of the draft Bill enable a third party to obtain, by a mechanism similar to that outlined above, documentation about his claim against the insured. We did not consult on these provisions, the need for which occurred to us during the drafting process. We set out a full explanation below.

4.43 One of our aims in this project has been to remove a third party's need to restore a defunct company to the register. One reason a third party using the 1930 Act may do this is so that he can establish the insured's liability. A third party proceeding under the draft Bill will not have to resurrect a company for this purpose.[65] Another reason why a third party proceeding under the 1930 Act may do this is to bring about the insolvency of the insured (if the company has been struck off the register under section 653 or 651 of CA 1985 this may not have happened). A third party proceeding under the draft Bill will no longer have to do so.[66]

4.44 If a third party takes advantage of these reforms and brings his action against the insurer alone before the liability of the insured to him is established, he may find that he receives incomplete documentation relating to the insured's liability. He will only receive a list of the documents that the insurer controls, not those which the insured (or more precisely the insured's ex-directors) possess. Therefore, he

[62] Under CPR 31.11 duties of disclosure continue until proceedings are concluded.

[63] See, for example, para 13.13 of the consultation paper.

[64] The provisions of the draft Bill discussed here do not extend to Scotland, where the third party will be able to obtain sufficient documentation by way of court order. See para 4.14 above.

[65] See Part 3 above.

[66] See Part 3 above.

might decide to apply to restore the insured to the register in order to obtain disclosure of these extra documents.[67]

4.45 The disclosure provisions in the draft Bill at Schedule 1, paragraphs 3 and 4 are designed to remove the need for any such applications. The third party will be entitled to impose[68] the same duties of disclosure on former officers employees and office-holders of the insured as would have been imposed by the court had the insured been restored to the register and orders for standard disclosure been obtained. The third party will only be able to request such information after he has begun proceedings against the insurer.[69] The third party's rights will be the same whether he is involved in litigation or arbitration proceedings against the insurer.[70]

Privileged documents

4.46 Schedule 1 does not require the disclosure of documents subject to legal professional privilege.[71]

Sanction for non-compliance

4.47 We did not think it necessary to provide an explicit sanction for non-compliance with the disclosure provisions in the draft Bill.[72] If someone from whom information or documentation was validly requested failed to respond

[67] Alternatively, if involved in court proceedings, he might apply for non-party disclosure under CPR 31.17. This would probably not, however, solve the third party's difficulty. Not only would it require an application to court, but the order he could obtain would not be as broad as an order for standard disclosure, as all documents subject to the order would have to be specified in it (CPR 31.17(4)(a)).

[68] By issuing a request enclosing a copy of the claim form against the insurer. See Sched 1, para 3.

[69] As the rights are intended to replicate the effect of standard disclosure. For the same reason, the duty of disclosure imposed by Sched 1 paras 3 and 4 is, like that in CPR 31.6, framed in terms of documents rather than information. One difference with the CPR rule should, however, be noted: consistent with other duties of disclosure imposed by the draft Bill, the duty is not a continuing duty. See Sched 1, para 4(3).

[70] See paras 5.39-5.44 below on the circumstances in which the third party will be involved in arbitration proceedings.

[71] Schedule 1, para 2(3) makes this clear in relation to a notice requesting information under para 1. In Scotland, this covers information which is subject to confidentiality as between client and professional legal adviser. So far as a notice requesting disclosure under para 3 is concerned, the duties of disclosure and the rights of inspection under para 4(1) are the same as the corresponding rights and duties under the CPR. CPR 31.19 provides that those rights and duties are defeated by a valid claim to legal professional privilege.

[72] Where an Act creates a duty, the law will supply an appropriate remedy: see *Doe d Murray v Bridges* (1831) 1 B & Ad 847 at p 849; 109 ER 1001, *per* Lord Tenterden CJ. The closest analogy is with the *Norwich Pharmacal* jurisdiction (*Norwich Pharmacal Co v Commissioners of Customs and Excise* [1974] AC 133) under which the Court has a general jurisdiction to require the disclosure of documents or other information by a party who (albeit blamelessly) has become involved in the wrongdoing of others (see White Book 2001, Vol 1, para 31.18.3).

adequately, the third party would be able to apply for a court order to require him to do so. If there were no proceedings yet in progress this application could be by way of a fresh claim.[73] In order to clarify the position in England and Wales, however, we recommend that CPR 31 should be amended to deal specifically with the procedure under Schedule 1.[74]

Anti-avoidance

4.48 Section 2(1) of the 1930 Act makes void any provision in an insurance contract which purports to prohibit the giving of the prescribed information once rights have been transferred under the Act. The draft Bill contains a similar provision.[75]

[73] CPR 31.18, which makes clear that the specific rules do not limit any other powers to order disclosure. Note that CPR 31.16 applies to applications before commencement of proceedings, but only in relation to disclosure of documents and against a person who is likely to be a party to subsequent proceedings. By contrast, Schedule 1 para 2 of the draft Bill imposes obligations to supply *information* (not merely documents) *before* any proceedings are begun, on persons who are *not necessarily expected to be parties*. Schedule 1 para 4, under which the duty is limited to disclosure of documents, and applies only where proceedings have been begun, seems to be adequately covered by rule 31.17.

[74] This recommendation will be drawn to the attention of the Rules Councils in Scotland.

[75] Schedule 1, para 5.

PART 5
INSURERS' DEFENCES

INTRODUCTION

5.1 Rights transferred to a third party under the 1930 Act remain subject to the terms and conditions in the insurance contract. In the consultation paper we examined the difficulties this may cause the third party and, in particular, the consequence that the insurer may be entitled to rely on a default of the insured as a defence to a claim brought by the third party.[1] We asked consultees whether the third party's lot should be improved under a new Act and, if so, how this might be done.[2]

5.2 In this Part we briefly review the current law and summarise the views of consultees. We then deal separately with a number of specific defences and explain how these are treated in the draft Bill.

CURRENT LAW

Insurers' defences to an insurance claim by insured

5.3 The rights of an insurer who can identify a breach of the insurance contract will depend on the nature of the relevant clause. One possibility is that the breach enables the insurer completely to avoid liability under the policy. This will be the case first, if the clause is a warranty[3] or a condition precedent to the liability of the insurer;[4] and, second, if the breach amounts to a repudiation of the policy as a whole.[5] In *Alfred McAlpine plc v BAI (Run-Off) Ltd*,[6] the Court of Appeal identified a third way in which the insurer may be able to avoid liability. The court held that a breach of contract might be a repudiation, not of the entire insurance contract, but of the particular claim under it. Whether this is the case or not depends on the seriousness of the breach.[7]

1 Consultation paper, Part 5.

2 Consultation paper, Part 14.

3 A warranty in an insurance policy is not to be confused with a warranty in the general law of contract. For a useful discussion of the distinction see *MacGillivray on Insurance Law* (9th ed 1997) para 10-2 ff.

4 The courts require very clear wording before they find that a condition is a condition precedent allowing the insurer to escape all liability. See *Farrell v Federated Employers Insurance Association Ltd* [1970] 1 WLR 1400 and *Taylor v Builders Accident Insurance* [1997] PIQR 247. An important example of a condition precedent sometimes found in insurance policies is a "pay-first" clause which we discuss separately below (see paras 5.28-5.37).

5 A breach of contract is repudiatory if it evinces an intention no longer to be bound by the contract. The courts almost never find a breach to be repudiatory in the absence of clear wording in the contract.

6 [2000] 1 All ER (Comm) 545.

7 The Court of Appeal held that clauses subject to this analysis were "innominate terms" as defined by Diplock LJ in *Hongkong Fir Shipping Co. Ltd, v Kawasaki Kisen Kaisha Ltd*

5.4 If the insurer is not able to avoid liability altogether in one of these ways, he may still be entitled to rely on the breach to counterclaim for damages, reducing the net sum payable under the policy.

5.5 Prejudice suffered by the insurer as a result of a breach is not relevant to the question of whether the term breached is a warranty or a condition precedent[8] and is probably not relevant to the question of whether the breach amounts to a repudiation.[9] It is clearly relevant to the question whether or not the term breached is an innominate term. It may be taken into account when calculating damages.[10]

5.6 An insurer may also have defences which do not depend on a breach of the insurance contract. In particular, if the insured has made a misrepresentation, an insurer may, depending on the circumstances, be entitled to avoid the contract altogether or to counterclaim for damages. An insurer may also be able to rely on a breach of the insured's duty of utmost good faith if the insured has failed to disclose material facts to the insurer.[11]

5.7 It is important to note that, in practice, insurers often do not rely on their strict rights where there has been non-disclosure, misrepresentation or breach of warranty on the part of the insured. They may voluntarily choose not to rely on certain defences[12] or they may be bound by codes of best practice, such as the Statement of General Insurance Practice.[13]

Insurers' defences to a claim by third party under the 1930 Act

5.8 The rights of the insured against the insurer transferred to the third party by section 1 of the 1930 Act are subject to the conditions and defences in the insurance policy. As Harman LJ held in *Post Office v Norwich Union Fire Insurance Society Ltd*,[14] the third party cannot "pick out the plums and leave the duff

[1962] 2 QB 26. On the facts, the court found that the notice provision before it was such a term and held that, had the insured never provided details of the incident in relation to which he was making a claim, and had this meant that the insurer was seriously prejudiced, then the insurer would have been entitled to reject the claim altogether.

8 See *Pioneer Concrete (UK) Ltd v National Employers Mutual Insurance Association* [1985] 2 All ER 395.

9 See the review of the authorities on this point by Waller LJ in *Alfred McAlpine plc v BAI (Run-Off) Ltd* [2000] All ER (Comm) 545 at p 551.

10 See the first instance judgment of Colman J in *Alfred McAlpine plc v BAI (Run-Off) Ltd* [1998] 2 Lloyd's Rep 694 at p 702.

11 *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1990] QB 665. The law in this area was most recently surveyed by the House of Lords in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501.

12 Protection and Indemnity clubs say that they usually refrain, for example, from relying on pay-first clauses when the third party's claim relates to death or personal injury. See para 5.30 below.

13 Which was issued by the Association of British Insurers ("ABI") in 1986, last revised in 1995.

14 [1967] 2 QB 363 at p 376.

behind". As a result, the insurer may, for example, be able to rescind the insurance contract for non-disclosure of material facts or deny liability on the grounds of a breach of a condition in the policy.[15]

5.9 As we pointed out in the consultation paper,[16] a breach of the insurance contract may well occur around the time of a statutory transfer.[17] If this does occur, the third party may not be able to cure the breach, either because the term in question requires the insured to do something personally,[18] or because he is not aware of it in time,[19] or because he lacks the financial resources to do so.[20]

CONSULTATION

5.10 In the consultation paper, we suggested that the particular problems faced by third party claimants under the 1930 Act might justify restricting the ability of insurers to rely on defences against them. We consulted on a number of general bases for such restrictions.[21] We also consulted on a number of specific restrictions to policy defences.[22]

5.11 There was little support from consultees for general restrictions on the ability of insurers to rely on policy defences. While many consultees agreed that the right of insurers to rely on a breach of an insurance contract so as to avoid liability altogether was too extensive, most felt that this was not a problem which should be addressed in the narrow context of a reform of the 1930 Act. The view was that, after the statutory transfer, the third party should be subject to the same

[15] See also Lord Brandon in *The Fanti and The Padre Island* [1991] 2 AC 1 at p 29: "It is abundantly clear from the express terms of the Act of 1930 that the legislature never intended, except as provided in s 1(3) ... to put a third party in any better position as against an insurer than that of the insured himself...in a case where the insurer would have had a good defence to a claim made by the insured before the statutory transfer of his rights to the third party, the insurer will have precisely the same good defence to a claim made by the third party after such transfer." The Scottish courts have also held that all the pleas open to the insurer against the insured are also available against the third party: see *Greenlees v Port of Manchester Insurance Company* 1933 SC 383, *Cunningham v Anglian Insurance Co. Ltd* 1934 SLT 273 and *Bell v Lothiansure Ltd*, 19 January 1990, Lord Cameron of Lochbroom.

[16] Consultation paper, para 14.3.

[17] For example, an insured heading towards bankruptcy or winding-up may not pay insurance premiums.

[18] For example, a term may require the insured to provide the insurer with information and assistance.

[19] For example, a term requiring notification of a claim.

[20] For example, if the insurance contract requires the claimant to take steps for which legal assistance is not available.

[21] Specifically where the insurance was compulsory, where the third party's claim fell into a particular category, such as death or personal injury, where a policy breach occurred after a certain point or when restrictions were justified by the consequences of the breach. See consultation paper, para 14.7 ff.

[22] Specifically non-disclosure and misrepresentation; and breaches of conditions relating to the duty to co-operate and provide assistance, to preserve the assets or business insured, to hold a particular licence or qualification and to make payments to the insurer.

generally prevailing insurance law, with its imperfections, as was the insured before transfer. We agree, and have taken account of the lack of support for most of our reform options.[23]

5.12 Opinion was also largely opposed to specific restrictions, though a number of consultees supported restrictions on the use of pay-first clauses and on clauses requiring the insured to provide information and assistance. There was no consensus on whether the insurer should be prevented from relying on breaches of notice requirements in "claims made" policies where late notification provides a defence to a claim.[24] A large majority of consultees who addressed the issue agreed that a third party should be able to satisfy procedural requirements such as notice provisions imposed on the insured by the insurance contract.

REFORM RECOMMENDATIONS

Insurer's defences to a claim under the draft Bill generally

5.13 As we have seen, the case law on the 1930 Act is clear that rights under the insurance contract transferred to the third party are subject to the defences which the insurer could have used against the insured.[25] We have also seen that consultees supported this aspect of the existing regime, and urged caution in respect of our suggestions for departing from it in particular circumstances.[26]

5.14 We have adopted this approach. As a result of the retention of the concept of statutory transfer in the draft Bill,[27] the insurer defending a claim from a third party will, as under the 1930 Act, generally be entitled to rely on any defence it would have been entitled to rely on as against the insured. We recommend a limited number of enhancements to the third party's rights after the statutory transfer. These are designed to prevent particular injustices which the transfer would otherwise create. In the remainder of this Part we set out and explain the way in which specific insurer's defences would operate under the draft Bill.

Notice provisions and personal performance by insured

5.15 Most insurance policies contain notice clauses which require the insured to notify the insurer (immediately or within a specified period) of matters such as knowledge of a claim or service of proceedings.[28] Obtaining prompt notice may

[23] The difficulties faced by a third party will be substantially reduced by the greater right to disclosure under the draft Bill (see Part 4 above). As a result of his early knowledge of the details of the insurance contract, for example, the third party may be able to fulfil a condition himself; alternatively, he may become aware of weaknesses in his claim against the insurer before committing substantial funds to it.

[24] Under a "claims made" insurance policy the insured is covered for claims made against it during the period covered by the policy, whenever the event giving rise to the claim occurred. See the consultation paper, paras 2.19-2.20.

[25] See para 5.8 above.

[26] See paras 5.11-5.12 above.

[27] See para 3.22 above.

[28] See *J Rothschild Assurance plc v John Robert Collyear* [1998] CLC 1697 where the court discussed when the duty to notify circumstances "which may give rise to a claim" arose.

be vital if the insurer is to investigate the claim so as to conduct the insured's defence. Notice clauses may also require the insured to give notice in a particular form or at a particular place such as the insurer's head office. The court may hold that a notification requirement in an insurance policy must be met by the insured himself, even if rights have transferred to a third party under the 1930 Act.[29]

5.16 In the consultation paper we gave our provisional view that the draft Bill should not permit an insurer to insist on personal performance by the insured of contractual conditions, such as notice provisions, if the third party fulfilled the condition himself.[30] Consultees overwhelmingly agreed with that view. Accordingly, under the draft Bill, a third party will be able to fulfil, or contribute towards fulfilling, a contractual provision such as a notice provision.[31]

Duty to provide information and assistance

5.17 The insurance policy may require the insured to provide the insurer with information and assistance. This may be a continuing duty. There is authority that under the 1930 Act a transfer of rights does not affect such clauses, so that a failure by the insured to comply with the obligation may enable the insurer to resist the third party's claim.[32]

5.18 We were not persuaded by consultees who felt that this was a general problem which should be addressed in the draft Bill. The insured (usually in the person of an office-holder) will generally be in a position to fulfil the duty. He is also likely to attempt to do so as the interests of the other creditors would be damaged if the third party's insurance claim ran into difficulties and, as a consequence, the third party claimed in the insolvency or winding-up.

5.19 However, the position is different if the insured is a company which has been struck off the register. In such a case, the insured clearly cannot provide any information and assistance. Even if it were resurrected, it would have no interest in doing so. In these circumstances it would, in our view, be anomalous to allow insurers to rely on a clause requiring the insured to provide information and assistance. Accordingly, the draft Bill provides that such clauses are of no effect if the reason that the insured fails to comply is that it does not exist.[33]

Excesses and unpaid premiums

5.20 Conditions in insurance contracts relating to the insured's duty to pay premiums are fundamental to the insurer's agreement to provide cover. If an insured makes a claim under an insurance policy without having paid all the premiums due, the

[29] *The Vainqueur Jose* (*CVG Siderurgicia v London Steamship Owners Mutual*) [1979] 1 Lloyd's Rep 557. Cf *Barrett Bros (Taxis) Ltd v Davies* [1966] 1 WLR 1334. See consultation paper, paras 5.17-5.31.

[30] Consultation paper, paras 14.3-14.6.

[31] Clause 4(1).

[32] *Edwards v Minster Insurance Co. Ltd* (unreported) (CA) 10 March 1994 discussed in the consultation paper at paras 5.52-5.54.

[33] Clause 4(2).

insurer will often have a complete defence to the claim, though in some cases an insurer may not rely on non-payment of premiums to avoid liability altogether.[34] Conditions may also provide for an "excess" which reduces the value of the contractual indemnity.

5.21 A third party claiming under the 1930 Act will generally be bound by such terms in the same way as the insured. This is a consequence of the transfer of the rights of the insured in the 1930 Act.[35]

5.22 Consultees were strongly in favour of this feature of the 1930 Act, which we have retained in the draft Bill. Under the draft Bill, the insurer will be entitled to rely on any excess in the insurance contract, which is, in effect, an uninsured amount, and will be entitled to set off any unpaid premiums against the insurance proceeds paid to the third party.[36]

"Claw-back" clauses

5.23 The Employers' Liability (Compulsory Insurance) Regulations 1998 (the "1998 Regulations")[37] set out a number of conditions which are prohibited in employers' liability insurance policies. For example, an insurer is not allowed to frame the contract in such a way that cover lapses if the employer is negligent in providing a safe working environment for his employees.[38]

5.24 Regulation 2(2) prohibits any condition which requires an employee or an insured employer to pay the first amount of any claim. This provision is intended to ensure that excesses negotiated between the insurer and the employer do not affect the employee's right to be compensated in full by the insurer, and that payment is not jeopardised by the employer's insolvency.[39]

[34] For example if there are days of grace, or if the insurer is prevented by election or estoppel from avoiding the claim on the basis of the non-payment.

[35] Nevertheless, *Murray v Legal and General Assurance Society Ltd* [1970] 2 QB 495 is first instance authority that this is not always the case. Cumming-Bruce J held that an insurer could only rely on a policy condition as against the third party if it arose "in respect of the liability of the insured to the third party" and that a condition requiring payment of premiums did not always meet this description. The decision has been criticised by the editor of *MacGillivray on Insurance Law* (9th ed 1997) para 28-17: "The third party is [under the 1930 Act] assigned rights subject to any defences which the insurers possess against the assured and these include, it is submitted, general equitable rights of set-off". Phillips J expressly declined to follow *Murray* at first instance in *Cox v Bankside* [1995] 2 Lloyd's Rep 437 at p 451.

[36] Clause 5. The possible exception to this general rule highlighted by *Murray* (see para 5.21, n 35 above) will not apply. Cf the treatment of claw-back clauses which enable an insurer to recover some, or all, of the insurance proceeds from the insured. See paras 5.23-5.27 below.

[37] These regulations replaced the Employer's Liability (Compulsory Insurance) General Regulations 1971 and were made under the Employers' Liability (Compulsory Insurance) Act 1969 (the "1969 Act").

[38] Regulation 2(1). This applies even if the insured is thereby acting illegally (Regulation 2(1)(c)).

[39] A DETR Press Release, issued on 27 October 1998, stated that the 1998 Regulations would "extend the provisions which aim to ensure that excesses negotiated between the

5.25 Regulation 2(3) slightly relaxes this rule against excesses. It specifically allows policy conditions requiring the employer to pay or contribute any sum to the insurer in respect of the satisfaction of any claim made under the contract of insurance by a relevant employee or any costs and expenses incurred in relation to any such claim ("claw-back clauses").

5.26 As we have seen, a third party will be bound by a clause imposing an excess as a result of a transfer of rights under the 1930 Act. This will also be the case under the draft Bill.[40] It would, however, clearly be contrary to the purpose of the 1998 Regulations, were an insurer similarly entitled to rely on a claw-back clause to reduce, or reclaim, sums payable to the third party after a statutory transfer.

5.27 Recent authority has confirmed that the insurer is not able to rely on a claw-back clause in such a way under the 1930 Act.[41] The result under the draft Bill will be the same. A claw-back clause must comply with section 1 of the 1969 Act which requires an employers' liability insurance policy to oblige the insurer to meet the full amount of an employee's claim. Accordingly, the claw-back clause can only impose an obligation on the insured to reimburse the insurer after the insurer has paid out (usually directly) to the injured employee. Such an obligation is not one of the insured's "rights under the contract against the insurer in respect of the liability".[42] It will consequently remain with the insured. The insurer will be able to pursue the insured for reimbursement under the claw-back clause, but not the third party.

Pay-first clauses

5.28 Pay-first (or "pay-to-be-paid") clauses require the insured actually to have paid sums due to third parties in respect of his liability before he is entitled to an indemnity from the insurer.[43] Such clauses are usually only found in the rules of Protection and Indemnity Clubs, although concern has been voiced that they might be used more widely by other mutual insurers.[44] Historically, such clauses were included so that Club members could rely on the financial soundness of other members.[45] In practice, clubs may not require members to have paid out

insurer and the employer *do not affect the employee's right to be fully compensated by the insurer*." In its note to editors, the press release said that the purpose of the 1998 Regulations was "to ensure that funds are available to pay any compensation that might be awarded, and that *payment is not jeopardised - for instance, because the employer has gone into liquidation* or because the insurer has imposed restrictions on the cover." (emphasis added).

40 See para 5.22 above.

41 *Aitken v Independent Insurance Co Ltd* 2001 SLT 376.

42 Clause 1(1).

43 The use of such clauses was described at length in the consultation paper, para 5.58 ff.

44 Hirst J in *The Italia Express* [1992] 2 Lloyd's Rep 281 at p 298 suggested that a pay-first clause "would be entirely inappropriate in the non-club environment of a commercial insurance contract". Some consultees suggested, however, that pay-first clauses are now being used more widely by mutual insurance companies.

before indemnifying them but may seek to rely on pay-first clauses if claims are brought against them by third parties.[46]

Current law

5.29 The question of how such clauses operate in the context of a transfer of rights under the 1930 Act is not easy, and the position was unclear until *The Fanti and The Padre Island*.[47] In that case, the House of Lords held that, if the insured has not paid sums due to a third party before rights transfer to the third party, no right to be indemnified has accrued, or can be transferred. In particular:

(1) Section 1(3) of the 1930 Act does not render pay-first clauses invalid. Within the meaning of that section, such clauses do not purport either directly or indirectly to alter the rights of the parties upon a transfer of rights.[48]

(2) After the statutory transfer of rights effected by the 1930 Act, the condition precedent represented by the pay-first clause remains in place, with the effect that no right of indemnity arises until the *insured* has paid the third party. The House of Lords overruled the Court of Appeal on this point.[49] The Court of Appeal had held that, after the transfer of rights, the pay-first clause should be construed to mean that no right of indemnity arose until the *third party* had paid himself; and that, so construed, it was clear that the pay-first clause was futile and of no effect.[50]

5.30 In reaching its decision, the House of Lords stressed the commercial reasons for the use of such clauses and appeared to take comfort from the Clubs' assurance that they did not rely on them against third parties bringing claims for death or personal injury.[51]

[45] It has been queried whether this argument can be used to justify the use of such clauses, as most modern Clubs operate very similarly to insurance companies: see Sir Jonathan Mance ("Insolvency at Sea" [1995] LMCLQ 34 at p 46) who doubts whether such clauses are essential to the Clubs' security.

[46] In some cases, Club rules may allow an indemnity to be paid before actual payment by the member. For example, the committee of a Protection and Indemnity Club may exercise its discretion to make an out of court settlement possible, or rules may provide that the Club will indemnify the member for sums which the member has been legally ordered to pay, "or could be reasonably expected to pay".

[47] [1991] 2 AC 1 Lord Goff of Chievely, at p 30E, said that it had "troubled maritime lawyers, in the City of London and the Temple, ever since the enactment of the Third Parties (Rights against Insurers Act) 1930."

[48] Lord Brandon at p 29B and Lord Goff of Chievely at p 37.

[49] The Court of Appeal decision is reported at [1989] 1 Lloyd's Rep 239.

[50] See the judgments of Lord Brandon at p 29F and Lord Goff of Chievely at pp 31-32. At p 31G Lord Goff described the Court of Appeal's view as "fundamentally flawed".

[51] See the judgment of Lord Goff at p 39D.

Consultation

5.31 We asked consultees how pay-first clauses should be treated on a statutory transfer under the draft Bill.[52] Because of the particular nature of the cover provided by Clubs, we did not form a provisional conclusion on the use of such clauses in the consultation paper.

5.32 A majority of consultees who responded were in favour of reforming the law to prevent insurers from relying on pay-first clauses. Some queried whether mutual insurers are, in fact, dependent on the solvency of their members and suggested that many claims are paid without the member having to pay first. A number suggested that the practice of Protection and Indemnity Clubs not to rely on such clauses in claims for death and personal injury was inadequate protection for third parties and one stated that he had experience of an insurer attempting to rely on such a clause in a personal injury case.

5.33 Those opposing reform argued that pay-first provisions were vital to the functioning of Protection and Indemnity Clubs. They suggested that preventing clubs from relying on them might encourage them to relocate to other jurisdictions. Others warned that we should avoid reforming areas of law currently under discussion in international negotiations on marine liability insurance. The International Maritime Organisation ("IMO")[53] is considering the possibility of compulsory insurance and direct rights of action for third parties for claims other than for oil and Hazardous Noxious Substances damage.[54]

Reform recommendations

5.34 In the light of consultation we think that the result reached by the Court of Appeal accords with the policy of the 1930 Act better than that reached by the House of Lords. As Bingham LJ observed, the view that a third party is not bound by a pay-first clause does not in fact conflict with the policy of the 1930 Act:

> This is not, I think, save by denying the clubs a possible defence, to expose them to a liability to the third party greater than they would have been under to the member. The clubs' obligation to the member was to pay, but to pay only, a member who had suffered actual loss (by payment to the third party). Upon transfer, the clubs' obligation would still be to pay, and to pay only, a third party who had suffered actual loss (although not in this instance by payment out). I think this fairly reflects the intention of the 1930 Act.[55]

[52] Consultation paper, paras 14.40-14.41.

[53] The United Nations' specialised agency responsible for improving maritime safety and preventing pollution from ships.

[54] The IMO has already developed liability regimes for oil and other spills (see the 1969 Civil Liability Convention, the 1971 Fund Convention and the 1996 Hazardous Noxious Substances Convention). These are incorporated into UK law in the Merchant Shipping Act 1995 which contains its own regime for direct action by a third party against an insurer (see s 165, which excludes the operation of the 1930 Act).

[55] *The Fanti and The Padre Island* [1989] 1 Lloyd's Rep 239 at p 250.

5.35 In our view, to allow insurers to rely on pay-first clauses as a defence to a claim under the draft Bill would, as Stuart-Smith LJ observed in relation to the 1930 Act, mean that:

> any liability insurer could drive a coach and horses through the Act by the simple device of incorporating a pay to be paid clause even if, in the case of a solvent insured, he did not always insist upon its performance.[56]

5.36 The draft Bill is designed to protect a third party's claim from the consequences of the insured's insolvency or winding-up. One of these consequences is that an insured is not in a position to pay the third party before claiming on his insurance policy. Thus the general position under the draft Bill is that pay-first clauses are of no effect after a statutory transfer of rights.[57]

5.37 Similar reasoning applies to all forms of insurance. We are, however, reluctant to recommend that a new Act should intervene in the field of marine liability insurance, given current domestic and international negotiations. We wish to avoid proposing provisions which might conflict with international measures.[58] Accordingly, the draft Bill only nullifies the effect of pay-first clauses in the context of marine insurance if the claim is for death or personal injury (in which cases best practice of Protection and Indemnity Clubs is not to rely on pay-first clauses in any event).[59]

Anti-avoidance

5.38 Section 1(3) of the 1930 Act makes void any contract of insurance insofar as it "purports, whether directly or indirectly, to avoid the contract or to alter the rights of the parties thereunder" on a statutory transfer. Any term which purported, for example, to end or to restrict cover on a winding-up or bankruptcy order being made against the insured, would be of no effect. The draft Bill contains a similar provision.[60]

[56] *Ibid*, at p 259. Lord Goff of Chievely expressly disapproved this observation (*The Fanti and The Padre Island* [1991] 2 AC 1 at p 38E). He held that market forces would limit the use of pay-first clauses as an avoidance device, and that the Court of Appeal's position ignored the policy of the 1930 Act that the third party should not be placed in a better position than the insured. In the light of consultation, we are not so confident as Lord Goff of the effect of market forces. For the reasons given by Bingham LJ, extracted in para 5.34, we do not consider that our view conflicts with the original policy of the 1930 Act.

[57] Clause 4(3).

[58] We note that Viscount Goschen, on behalf of the Government, resisted proposed amendments to the Merchant Shipping and Maritime Security Act 1997 which would have allowed third parties a right of direct action against insurers, on the grounds that, in the context of marine insurance, direct action must be achieved through international agreement. (*Hansard* (HL) 26 November 1996, vol 576, cols 86-88).

[59] Clause 4(4).

[60] Clause 6.

Arbitration clauses

Current Law

5.39 An insured may be required by an arbitration clause in the insurance policy to refer disputes with the insurer to arbitration.[61] Such arbitration clauses bind third party claimants under the 1930 Act as they would have bound the insured.[62]

5.40 It is important to note that, as a general rule, this will not mean that a third party claimant under the 1930 Act is required to enter into an arbitration with the insurer if he does not wish to do so. Under the ABI / Lloyds arbitration agreement most UK insurers have now undertaken not to enforce arbitration clauses in standard-form policies if the insured prefers to have questions of coverage determined by a court. A third party under the 1930 Act will be treated in the same way as the insured.[63]

5.41 A third party may be contractually entitled, or bound, to establish part or all of his claim against the insured in arbitration proceedings. As we have seen,[64] until he establishes liability (which he may do by obtaining an arbitration award), the third party is not entitled to bring proceedings against the insurer under rights transferred by the 1930 Act. When he does so, the appropriate forum for those proceedings will be unaffected by any arbitration clause in a contract with the insured.

[61] Most arbitration clauses in insurance contracts only relate to questions of quantum which are unlikely to be relevant in the context of third party liability insurance. However, policies may contain arbitration clauses relating to questions of liability. Such clauses are enforceable as conditions precedent provided that they do not purport to oust the ultimate jurisdiction of the court: *Scott v Avery* (1856) 5 HLC 811; 10 ER 1121. In England and Wales, under s 9 of the Arbitration Act 1996, the court must grant a stay of court proceedings unless satisfied that the arbitration agreement is null and void, inoperative or incapable of being performed. In Scotland, the court must give effect to a valid agreement by the parties to refer matters to arbitration and will sist the proceedings before it: *Sanderson and Son v Armour and Co. Ltd* 1922 SC (HL) 117.

[62] *Freshwater v Western Australia Assurance Co. Ltd*. [1933] 1 KB 515; *Dennehy v Bellamy* [1938] 2 All ER 262; *Cunningham v Anglian Insurance Co. Ltd* 1934 SLT 273. One consultee suggested that this might no longer be the case following the enshrinement in statute of the doctrine of separability in s 7 of the Arbitration Act 1996. In our view the effect of s 7 (which confirms the common law position established by *Heyman and others v Darwins Ltd* [1942] AC 356 and subsequent cases), is that arbitration clauses remain binding even if the rest of the insurance contract is void or otherwise ineffective; s 7 does not imply that, on a statutory transfer of rights under the 1930 Act, rights are transferred to the third party free of the obligations imposed by an arbitration clause.

[63] The agreement (made in 1956 and confirmed in 1986) is binding on all members of the ABI and Lloyds, who write the vast majority of third party liability insurance in the UK. It applies to all insurance policies except marine and some aviation policies. The issue of whether a claim by a third party falls under the agreement was specifically considered by the ABI in 1964 in response to a request from LCD and the position of third parties was clarified in a circular to members (Circular No 64/64 of 12 June 1964).

[64] See paras 3.4-3.10 above.

Consultation

5.42 In the past, third parties bound by an arbitration clause in an insurance contract were not entitled to public funding to pursue arbitration proceedings, even if they would have been entitled to public funding for litigation. This was the subject of judicial criticism.[65] We asked on consultation whether any restrictions should be placed on the ability of insurers to rely on arbitration clauses in the insurance contract.[66] Few consultees responded to this question: the majority of those who did thought that the rights transferred to the third party should remain subject to any arbitration clause in the insurance contract.[67]

Reform recommendations

5.43 We recommend that a third party with rights transferred by the draft Bill should be bound by an arbitration clause in the insurance contract to the extent to which the insured would have been bound.[68] As explained above,[69] the new mechanism in the draft Bill allowing the third party to establish the insured's liability in proceedings against the insurer[70] will apply in an arbitration in the same way as it will in court proceedings.

5.44 The position is different if the third party is entitled or obliged by a clause in a contract with the insured to establish the insured's liability in arbitration proceedings. As explained above, the new mechanism in the draft Bill will apply.[71] In such a case, the insurer has not agreed to resolve anything by way of arbitration, and, in our view, it would be contrary to the consensual nature of arbitrations to require him to do so. Accordingly, if a third party in such a position wishes to take advantage of the new mechanism in the draft Bill to establish the insured's liability in proceedings against the insurer, he will have to do so in court proceedings (unless the insurer agrees otherwise).

Defences which would have been available to insured

5.45 A third party who receives a statutory transfer under the draft Bill is entitled to proceed, as under the 1930 Act, by attempting to establish the insured's liability

[65] *Smith v Pearl Assurance Co Ltd* [1939] 1 All ER 95 *per* Clauson LJ; *Fakes v Taylor Woodrow Construction Ltd* [1973] 1 QB 436 at p 441 *per* Denning MR. See consultation paper, paras 5.41-5.48. Under the new legal funding regime, limited funding may be available for arbitrations.

[66] Consultation paper, paras 14.32-14.35.

[67] One consultee told us that arbitration clauses are often used by insurers as a means of ensuring that disputes are resolved in a UK forum. Under the Brussels Convention a claimant may be able to insist that court proceedings are conducted abroad, regardless of what is said in the contract. The Brussels Convention does not apply to arbitration agreements. The consultee advised that we should be wary about consigning insurers to a foreign forum for a determination on UK law.

[68] This is the effect of the basic transfer mechanism in the draft Bill, Clause 1(1).

[69] See para 3.31 above.

[70] Clause 8 (clause 9 in Scotland).

[71] See para 3.32 above.

in proceedings against the insured before proceeding against the insurer.[72] Usually, a third party proceeding in this way who proves the insured's liability will obtain a judgment against the insured. Occasionally this will not be the case. For example, the insured might succeed with a limitation or prescription defence; or he might successfully rely on an estoppel.

5.46 Under the draft Bill, a third party has the alternative of bringing proceedings against the insurer without involving the insured in litigation.[73] As we have explained, this does not confer any new substantive rights on the third party.[74] Accordingly, a third party who can prove the insured's liability, but who would not have been able to obtain a judgment against the insured, will not in general succeed against the insurer in a claim under the draft Bill.[75] There are two exceptions to this which we explain below.[76]

Discharge from bankruptcy

5.47 In England and Wales, a bankrupt insured is likely, in due course, to be "discharged" from bankruptcy.[77] Discharge releases the insured, in specified circumstances, from "bankruptcy debts".[78] In many cases discharge will not affect the insured's debt to the third party, for example, if the third party's claim is for personal injuries[79] or if the events which gave rise to the liability occurred after the commencement of the bankruptcy.[80] But some claims will be affected. For example, a third party's claim in professional negligence against a sole practitioner who subsequently becomes bankrupt is likely to be lost by the insured's discharge. This will be the case even if the third party has obtained a court judgment.[81]

5.48 Similarly, in Scotland, the same mischief applies.[82] The effect of the discharge is that the debtor is discharged of all debts and obligations contracted by him for

[72] See para 3.28 above.

[73] Clause 8 (clause 9 in Scotland).

[74] See paras 3.25-3.26 above.

[75] Clause 8(3) (clause 9(2) in Scotland).

[76] See paras 5.47-5.50 (discharge from bankruptcy) and paras 5.56-5.58 (limitation).

[77] In the case of "first time bankrupts" this occurs automatically two or three years after the commencement of the bankruptcy; in other cases it occurs by order of the court (IA 1986, s 279 and s 280).

[78] *Ibid,* s 281.

[79] *Ibid,* s 281(5)(a). There are various other conditions.

[80] *Ibid,* s 382(1)(b).

[81] *Ibid,* s 382(2) and (3).

[82] Bankruptcy (Scotland) Act 1985, s 54 (automatic discharge) and s 56 (discharge on composition). In contrast to its English equivalent, s 54 does not limit the automatic discharge to "first time bankrupts".

which he was liable at the date of sequestration.[83] There are some situations in which the discharge will not affect the insured's debt to the third party; however, these are very limited[84] and do not extend to a third party's claim for personal injuries.

5.49 We considered what effect, if any, a discharge in such circumstances should have on the third party's claim against the insurer under the draft Bill. This was not an issue on which we consulted. On the one hand, it seemed to us to be important to ensure that a third party in the midst of litigation against the insurer, under rights transferred by the draft Bill, should not suddenly find his cause of action removed by the insured's discharge. That would result in wasted costs; it could also provide a reason for the insurer to protract proceedings. On the other hand, we were concerned not to confer on the third party a right to issue proceedings against the insurer at a time when the insured no longer owed any money to the third party.

5.50 Accordingly, the draft Bill provides that:[85]

(1) a discharge of the insured will be irrelevant to ongoing proceedings between the third party and the insurer; but

(2) the third party who has yet to issue proceedings against the insurer (or join him to existing proceedings against the insured) at the moment of discharge will lose his cause of action.[86]

Limitation and prescription

England and Wales

5.51 In the consultation paper we suggested that there was some uncertainty surrounding the limitation period governing claims brought under the 1930 Act.[87]

[83] *Ibid*, s 55. The insured may also have received a discharge under a protected trust deed in terms of s 59 of that Act and, although the terms of the discharge will be governed by the trust deed, the effect is likely to be similar.

[84] *Ibid*, s 55(2).

[85] Clause 12.

[86] This will only affect the third party if: (1) his claim has not already been settled with the insurer; (2) the debt is one from which discharge releases the insured (so, for example, in England and Wales, it is not a claim for personal injuries - see para para 5.47, n 79 above); and (3) the claim is not time-barred. In such a case the third party would be well advised to issue protective proceedings to preserve the rights conferred on him by the draft Bill against the insurer. If he fails to do so as a result of deficient advice, he may have a claim against his legal adviser. It is worth noting that the third party and his adviser will have at least two years in which to issue these proceedings. This is because discharge will only affect the insured's debt if the events occurred before the commencement of the bankruptcy, and the earliest time that automatic discharge occurs is two years after that - see para 5.47, n 77 above.

[87] At para 9.8 of the consultation paper we drew attention to *The Felicie* [1990] 2 Lloyd's Rep 21, in which Phillips J suggested, at p 27, that the third party could bring a fresh arbitration against the insurer, after the expiry of the limitation period governing the

5.52 In our opinion, the better view is that the limitation period governing a third party's claim under the 1930 Act is the period governing the insured's right of action under the insurance contract against the insurer. The reason for this is that the insurer may in general use defences against the third party which he could have used against the insured; these include a limitation defence to the insured's action.[88]

5.53 On consultation we asked whether this interpretation of the 1930 Act should be reproduced in a new Act.[89] The majority of consultees thought that it should. Consultees stressed the importance of the principle that, in general, the transferred rights should be subject to the same restraints in the hands of the third party as they were in the hands of the insured. We agree. Under the draft Bill, the limitation period governing proceedings brought against an insurer by a third party who has established liability without using the new mechanism in the draft Bill[90] will be that which would have applied to that action in the absence of a statutory transfer.[91]

5.54 Limitation issues also arise under the draft Bill if the third party does use the new mechanism in the draft Bill and attempts to establish the insured's liability in proceedings against the insurer. At the moment the third party issues such proceedings, the insured's right of action against the insurer will not yet have accrued. Were the limitation period governing that action to govern the third party's right of action, this would potentially subject the insurer to stale claims.

5.55 We do not think that a new Act should enable the third party to establish the insured's liability in proceedings against the insurer if he would not have been able to establish it in proceedings against the insured because that action would have been time-barred. Under the draft Bill, if a third party attempts to establish the insured's liability to him, an insurer will, in general, be able to rely on any limitation defence the insured could have relied on.[92]

5.56 However, it has been necessary to make an exception to this general rule. A third party who is already involved in litigation against the insured when he receives a transfer of rights may wish to bring an action immediately against the insurer. As we have explained,[93] if such a third party makes an application before the expiry of the limitation period governing the ongoing proceedings, it will be possible to

insured's right to start such an arbitration, if the insured had begun arbitration proceedings in time. As we said in the consultation paper the legal basis for this decision is unclear.

88 See Popplewell J in *Lefevre v White* [1990] 1 Lloyd's Rep 569 at p 578 who could find "neither logic nor sense" in the contrary argument that a transfer of rights starts a fresh limitation period running.

89 Consultation paper, Part 17. The alternative would be to regard the transfer of rights under the proposed new Act as the accrual of a fresh cause of action with a fresh limitation period.

90 In clause 8.

91 Clause 11(3).

92 Clause 8(3).

93 See para 3.41 above.

join the insurer to the existing proceedings; but if that limitation period has expired, this will not be possible.

5.57 It is one of our principal aims to ensure that a third party who receives a transfer of rights should be relieved of the requirement to obtain a judgment against the insured before obtaining the right to sue the insurer. We considered recommending that the CPR be altered in order to give the court a discretion to order addition in the above circumstances.[94] However, we concluded that it was wrong in principle to extend the circumstances in which a defendant could be joined after the end of the limitation period. In addition it seemed to us an unnecessarily complicated solution.[95]

5.58 The draft Bill takes a different approach. It prohibits the insurer from relying on a limitation defence if the third party has issued proceedings against the insured in time.[96] Thus the third party would be entitled to issue separate proceedings against the insurer. It is likely that the court would order that the two proceedings be consolidated.[97]

Scotland

5.59 As stated in the consultation paper,[98] in Scots law the Prescription and Limitation (Scotland) Act 1973 provides for a three year limitation period for claims based on death[99] or personal injury.[100] The limitation period runs from the date of injury or, if later, the date on which it was reasonably practicable for the pursuer to have become aware of the fact that the injuries were sufficiently serious to bring an action, and that the injuries were attributable to an act or omission of the defender (or his employee or agent).

5.60 As far as the law of prescription is concerned, obligations arising out of a contract generally prescribe five years after they become enforceable if no relevant claim has been made or the subsistence of the obligation has not been relevantly acknowledged within that period.[101]

5.61 Although there is no clear Scottish authority, we are of the opinion that, as in English law, the insurer's obligation to indemnify the insured only becomes

[94] Alterations to the rules must be proposed by the Rules Committee, a body of judges, lawyers and others headed by the Master of the Rolls and the Vice Chancellor. The Rules Committee was set up by s 2 of the Civil Procedure Act 1997. The Lord Chancellor has the power to accept or reject proposed alterations but may not initiate them himself.

[95] The definition of "necessary" in CPR 19.5(3) is restricted by s 35 of the Limitation Act 1980. We would accordingly have had to propose to amend this statute.

[96] Clause 11(1).

[97] Under the power in CPR 3.1(2)(g). The court will exercise this power in accordance with the overriding objective.

[98] Paragraph 9.18.

[99] Section 17.

[100] Section 18. Delictual obligations to make reparation for damage to property or pure economic loss, prescribe after five years. While subject to the three year limitation period, delictual claims in respect of death or personal injury do not prescribe.

[101] See the consultation paper, para 9.19 and s 6 and Sched 1, para 1(g) to the 1973 Act.

enforceable when his liability is established.[102] Therefore the prescriptive period in respect of the insurer's obligation to the third party will also begin to run from that date.

5.62 Hence, the provision of the draft Bill[103] which enables an insurer, in proceedings in which the insured's liability to the third party is an issue, to rely on any defence on which the insured could have relied in proceedings against him to establish that liability, includes defences relating to either the period of limitation or prescriptive period as appropriate. But it is expressly provided that an insurer cannot rely on a limitation or prescription defence if the third party had brought a claim against the insured in time.[104]

Restoration to the register

5.63 In the consultation paper, we sought consultees' views on whether the two year limitation period in CA 1985, section 651(4) for restoring dissolved companies to the register to pursue claims not involving death or personal injury should be abolished.[105] We also sought consultees' views on whether it should be possible to restore companies dissolved before November 1969.[106] We suggested that the distinction in section 651 was arbitrary and that the November 1969 cut-off could cause a problem in "long tail"[107] personal injury claims.[108] Most of those responding agreed that both section 651 and section 141 should be amended.

5.64 As third parties will have a right to proceed against the insurer alone under the draft Bill, it is not necessary to amend these sections in order to achieve the desired result. Accordingly, the draft Bill does not make these amendments.

Imminent Law Commission Report on Limitation of Actions

5.65 The Law Commission published a Consultation Paper[109] on the Limitation of Actions in 1998. The report and draft Bill are to be published shortly. By linking the limitation period governing the third party's claim under the draft Bill to the limitation period in force at the time, the draft Bill will not need amending should the draft Bill in the Limitation of Actions project be enacted before the draft Bill in this project.

[102] See *Scott Lithgow v Secretary of State for Defence* 1989 SLT 236.

[103] Clause 9(2).

[104] Clause 11. See also *Scott Lithgow v Secretary of State for Defence* 1989 SLT 236.

[105] Consultation paper, para 17.17.

[106] Prevented by Companies Act 1989, s 141. See the consultation paper, para 17.18.

[107] "Long tail" claims are those in which the symptoms and gravity of the injury on which the claim is based do not manifest themselves fully, or at all, until a long time after the cause of the injury.

[108] In their discussion paper No 2, Actions Arising out of Insidious Diseases, 1992, at para 6.8.1, the Law Reform Advisory Committee for Northern Ireland suggested that "the period of 20 years may be too short in many cases to assist the victims of insidious diseases... All lawyers engaged in litigation arising out of insidious diseases will be well aware of many cases where such diseases become manifest much later that 20 years after exposure."

[109] Limitation of Actions (1998) Law Com No 151.

PART 6
VOLUNTARY PROCEDURES

INTRODUCTION

6.1 An insolvent person (or company) may avoid or postpone a formal bankruptcy (or winding-up) by reaching an agreement with creditors. For example, a company may enter into a Company Voluntary Arrangement ("CVA") governed by Part I of IA 1986.[1] There are a number of forms which such agreements may take, and they are governed by a number of different statutory regimes. We refer collectively to all of these different regimes as "voluntary procedures".

6.2 In this Part, we explain the implications for a third party under the 1930 Act if the insured enters into a voluntary procedure and identify problems with the existing regime. We then explain the way in which these deficiencies are overcome in the draft Bill. As the voluntary procedures available to individuals in England and Wales are not the same as those available in Scotland we deal first with the law in England and Wales, and conclude with an explanation of the way in which the position differs in Scotland.

6.3 We did not consult on these issues in the consultation paper, nor were they raised independently by any of our consultees. The need for reform was highlighted by case law reported since the publication of the consultation paper[2] and we have consulted informally on our recommendations.

TYPES OF VOLUNTARY PROCEDURE IN ENGLAND AND WALES

Voluntary arrangements

6.4 Voluntary arrangements were introduced by IA 1986. They are procedures by which an insolvent person (the "debtor") can deal with his difficulties whilst avoiding a formal bankruptcy or winding-up by coming to a binding agreement with creditors. If the debtor is an individual this will be an Individual Voluntary Arrangement ("IVA") governed by Part VIII of IA 1986; if a company it will be a CVA governed by Part I.[3]

6.5 Provided he abides by the terms of the agreement, a debtor who has entered into a voluntary arrangement is not required to pay his debts in full. Instead, he is only obliged to pay a proportion of them, often in instalments. A creditor bound by a voluntary arrangement is not entitled to enforce his original debt against the debtor (this will be a term, express or implied, of the voluntary arrangement).[4]

[1] See para 6.4 below.

[2] In particular *Jackson v Greenfield* [1998] BPIR 699 and *Sea Voyager v Bielecki* [1999] 1 All ER 628.

[3] These statutory provisions have been amended by the Insolvency Act 2000.

[4] The cross-heading to IA 1986, Part VIII (on IVAs) is "moratorium for insolvent debtor". Whether the moratorium prevents a creditor from issuing or pursuing proceedings against the debtor or simply prevents him from enforcing a judgment appears to depend on the

6.6 Under IA 1986, a creditor will be bound by a voluntary arrangement as if he were a party to it, provided he was entitled to vote on it at the creditors' meeting and had actual notice of that meeting.[5] Under the Insolvency Act 2000, a creditor will be bound by a voluntary arrangement as if he were a party to it, provided he was entitled to vote at the meeting, whether or not he had notice of the meeting.[6]

Compromise or arrangement under section 425 of CA 1985

6.7 Section 425 of CA 1985 sets out a procedure whereby a company can compromise its obligations to creditors.[7] This is similar in many ways to a voluntary arrangement under IA 1986. In particular, a creditor may be prevented by such an arrangement from receiving the full amount of his debt.

6.8 There are a number of differences between arrangements under section 425 and the IA 1986 procedures: there is no moratorium during the process leading up to the scheme or arrangement under section 425; the court is more actively involved in approving such arrangements; and the procedure for voting is determined by the court rather than set out in Rules. One advantage a section 425 arrangement possesses over a voluntary arrangement from the point of view of the debtor is that, once the agreement of three quarters of the creditors of a particular class has been obtained, the arrangement binds all members of that class, even if the debt arises after the arrangement has become binding.

Deeds of Arrangement Act 1914

6.9 An individual may also compromise his debts using the procedure in the Deeds of Arrangement Act 1914. The 1914 Act does not impose a moratorium on actions by debtors, and we understand that the procedure is little used today.[8]

true construction of the IVA (*Sea Voyager v Bielecki* [1999] 1 All ER 628 at p 644). In the case of an IVA, a creditor may be prevented from enforcing his debt against the debtor even before he becomes bound by the voluntary arrangement, if the debtor obtains an "interim order" under IA 1986, s 252. In the case of a CVA, no such moratorium was included in the original scheme, so that directors of a company in difficulties who initiated the CVA procedure often found themselves facing a winding-up petition before the CVA was in place. This drawback of the CVA system is rectified by the Insolvency Act 2000 under which the directors of a company may obtain a moratorium, a reform which is likely to increase the use of CVAs.

5 IA 1986, s 5(2)(b) (CVA) and IA 1986, s 260(2)(b) (IVA). For authority that constructive notice is not sufficient see *Re A Debtor (64 of 1992)* [1994] 1 WLR 264 and *Beverley Group plc v McLue* [1995] 2 BCLC 407.

6 Insolvency Act 2000, para 6, Sched 2 and para 9, Sched 3.

7 Agreements under s 425 of CA 1985 may also be made with members. These are used to reorganise the share capital of a company. Such a reorganisation may take place in the context of a take-over, or may be undertaken within a group for financial, particularly tax, reasons. Such arrangements are not relevant to the third party and do not trigger a transfer under the draft Bill.

8 See I F Fletcher, *The Law of Insolvency* (2nd ed 1996) p 59. The *Cork Report* , which recommended the voluntary arrangement procedure, suggested that the consequential repeal of the old procedure in the 1914 Act (paras 363-399). This recommendation has not been acted upon, and the 1914 Act remains on the statute book.

TREATMENT UNDER THE 1930 ACT

Voluntary arrangements

6.10 If the third party has established the insured's liability, the 1930 Act effects a statutory transfer when the insured enters into a voluntary arrangement.[9] It seems that the transfer occurs when the voluntary arrangement is approved by a creditors' meeting.[10]

6.11 In *Sea Voyager v Bielecki*[11] the court held that, if bound by an IVA, a third party who has not established liability against the insured may succeed on an application to court to have the IVA revoked or revised.[12] The court found that the fact that the third party was prevented by the IVA from obtaining judgment against the insured for the full amount of his loss amounted to unfair prejudice, as, without such judgment, the third party was unable to proceed against the insurer under the 1930 Act for the full amount of his loss.[13]

6.12 A third party who has already established liability against the insured might find his claim against the insurer reduced by the IVA. This would depend on the wording of the IVA and the insurance contract.[14] If, on the facts of a particular case, an insurer would only be liable for the reduced amount, this might well be an additional ground on which the third party could succeed on an application to revoke the IVA / CVA.[15]

6.13 It is in the interests of both the third party and other creditors that third parties should be able to proceed against the insurer without the need to challenge voluntary arrangements. It may therefore be that under an unamended 1930

[9] Section 1(1)(a) (IVAs) and s1(1)(b) (CVAs)

[10] IA 1986, s 5(2)(a) (CVA) and IA 1986, s 260(2)(a) (IVA).

[11] [1999] 1 All ER 628.

[12] The application was under IA 1986, s 262(1)(a) (the equivalent application in the case of a CVA is under IA 1986, s 6) under which the applicant is required to show that the IVA unfairly prejudices his interests as a creditor. A similar application will be possible under the amendments proposed by the Insolvency Act 2000. It was pointed out by Lord McIntosh of Haringey at the Committee stage of the Insolvency Bill 2000 (*Hansard* (HL) 15 June 2000 CWH 43) that such an application would be available to a third party. Lord Sharman in response withdrew his proposed amendment to the Insolvency Bill 2000, which would have excluded from the proposed CVA moratorium third parties who wished to obtain judgment against the insured only in order to obtain a transfer of rights under the 1930 Act. In our view, however, for the reasons which follow in the text, legislative reform is necessary.

[13] [1999]1 All ER 628 at p 647.

[14] In *Johnson v Davies* [1999] Ch 117 the Court of Appeal confirmed that someone liable for the insolvent's debts may obtain the benefit of the IVA if, on its true construction, the IVA had that effect. The insurer's liability would also depend on the wording of the insurance contract in question and, in particular, how it defined the insured loss.

[15] The judge in *Sea Voyager* rejected (at p 645) an argument on the facts of that case that the insurer would only be liable to indemnify the third party in the IVA amount, though the reasoning, based on s 1(4) of the 1930 Act, is not entirely clear. For an example of a case in which a third party was arguably bound by a voluntary arrangement, see *Jackson v Greenfield* [1998] BPIR 699.

Act, IVAs / CVAs will come to be drafted so that the rights of a third party to proceed under the 1930 Act against the insurer for the full amount of the claim will be expressly preserved.[16]

Compromise or arrangement under section 425 of CA 1985

6.14 We have not found any reported authority under the 1930 Act in which a third party was faced with an insured which had entered into an arrangement with its creditors under section 425 of CA 1985. It is not entirely clear whether this would trigger a statutory transfer under section 1 of the 1930 Act.[17] If it does, however, the third party will face similar difficulties to those of third parties involved in a voluntary arrangement.

6.15 Although there is no express statutory basis of unfair prejudice for challenging a scheme or arrangement, as there is in the case of voluntary arrangements, the courts can reject (and have rejected) applications for the confirmation of a scheme or arrangement under section 425.[18]

Deeds of Arrangement Act 1914

6.16 We have not found any reported cases in which the 1930 Act effected a statutory transfer as a result of the insured entering into a deed of arrangement under the 1914 Act.[19] Were such a transfer to occur, however, the third party would face similar difficulties to those of third parties involved in a voluntary arrangement.

THE RATIONALE FOR REFORM

6.17 It seems to us to be anomalous that third parties may receive a statutory transfer when the insured enters into some voluntary procedures but not others. In addition, in cases in which the 1930 Act does effect a statutory transfer, the case

[16] The judge in *Sea Voyager* clearly envisaged that this should normally be the case. He observed at p 637: "The strange position, therefore, is that neither party wished to prevent SVM having whatever rights it may have under the 1930 Act, and neither side has any desire to see Mr Bielecki go into bankruptcy. One's first reaction, therefore, is that the common intention in this regard ought to be capable of resolution by suitable drafting of the arrangement, or modifications thereto to make the position entirely clear." However, the point is a marginal one which may escape the attention of the person drafting the voluntary arrangement . We understand that the Association of Business Recovery Professionals (formerly the Society of Practitioners of Insolvency) is currently working on standard terms for IVAs (though not CVAs) which preserve a third party's right to proceed against an insured, and obtain a money judgment against him, in order to use direct rights against the insurer under the 1930 Act.

[17] On the one hand it might be said that such an arrangement amounted to "the insured ... making a composition or arrangement with ... creditors" under s 1(1)(a). On the other hand, it could be argued that s 1(1)(b), which does not mention CA 1985, s 425, exhaustively sets out the circumstances in which a company will be subject to a statutory transfer. This is supported by the observation that, when voluntary arrangements were added to the circumstances in which a statutory transfer is effected (by IA 1986), Company Voluntary Arrangements were added to the list in s 1(1)(b), whereas no amendment was felt to be necessary in order to bring in Individual Voluntary Arrangements within the terms of s 1(1)(a). We prefer the latter view.

[18] For example, *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123.

[19] The transfer would be effected under s 1(1)(a).

law discussed above indicates that this may cause significant problems to the third party. Whilst it is possible that voluntary procedures may in future be drafted so as not to bind a third party (see paragraph 6.13 above), there is no guarantee that this will be the case. In our view it is likely that at least some will not do so. In such cases a third party may be bound.[20]

6.18 Were the draft Bill to remain silent on this issue then a third party would face similar difficulties to those he faces under the 1930 Act. In particular, the third party might[21] only be able to recover from the insurer the lower amount as determined by the voluntary procedure.

6.19 A third party bound by a voluntary arrangement might apply to court to have it revoked.[22] In our view it would not be satisfactory to require the third party to do so for the following reasons:-

(1) A third party may not be aware that he has a claim against the insurer under transferred rights until it is too late to challenge the arrangement.[23] This may occur, for example, in a long tail personal injury claim in which the facts giving rise to the debt occur long before the manifestation of the disease. In such a case, a third party might find that he was only able to recover from the insurer the debt as reduced by the arrangement.

(2) The procedure may involve the insured and the insured's other creditors in additional work, expense and delay as they renegotiate the reopened voluntary arrangement.[24]

(3) The requirement that the third party apply to court in order to pursue his claim against the insurer seems to us to serve no useful function.

REFORM RECOMMENDATIONS FOR ENGLAND AND WALES

Statutory transfer if the insured enters into a voluntary procedure

6.20 Under the draft Bill, a third party may receive a statutory transfer as a result of the insured's voluntary arrangement,[25] or arrangement under CA 1985, section

[20] Indeed, under the Insolvency Act 2000, third parties may become bound by voluntary arrangements more often than under the current law, as they will not need to have had notice of the creditor's meeting at which the voluntary arrangement was approved before they are bound (see para 6.6 above).

[21] This would depend on the wording of the IVA / CVA, and on the wording of the insurance policy. See para 6.12 above.

[22] As he currently must under the 1930 Act and as was done in *Sea Voyager*. See Para 6.11 above. If the court has already sanctioned an arrangement under CA 1985, s 425, the third party would appear to have no recourse.

[23] Under IA 1986, s 262 the third party must apply within 28 days of the creditors' meeting. Under the Insolvency Act 2000 the third party has 28 days from becoming aware that a meeting has taken place.

[24] The orders available to the court on a successful application in the case of an IVA are to: "(a) revoke or suspend any approval given by the meeting; (b) give a direction to any person for the summoning of a further meeting of the debtors' creditors ..." (IA 1986, s 262(4)). The equivalent section for CVAs is s 6. Paragraph 36 of Sched A1 of IA 1986, to be inserted by the Insolvency Act 2000, is in similar terms.

425,[26] or deed of arrangement under the Deeds of Arrangement Act 1914.[27] The draft Bill also provides that, if a transfer does take place for one of these reasons, the third party will not be bound by the procedure to the extent that he is able to recover from the insurer.[28] The effect is that the third party's claim against the insurer will be the same as if the procedure had not been initiated. The third party will be entitled to claim from the insurer the full amount of his insured debt.

6.21 Although the third party will not be bound by any moratorium imposed by the voluntary procedure to the extent of his (recoverable) insured debt, it is important to note that he will not, as a result, be in a position to bring down the voluntary agreement, for example, by bringing a bankruptcy / winding-up petition against the insured.[29]

6.22 It is also important to note that the draft Bill does not prevent the third party from being bound by the agreement to the extent that his debt is uninsured (for example, if there is an excess in the policy) or is not recoverable from the insurer (for example, because the insurer is insolvent).[30]

Third party's right to vote on a voluntary arrangement

6.23 One consequence of this reform will be that the third party will be entitled to vote on an IVA / CVA proposal which he knows (or strongly suspects) will not bind him to the extent of his insured debt. *Prima facie* this appears objectionable. We have, therefore, considered recommending that the third party should be prevented from voting on the proposal for a voluntary arrangement.

6.24 We concluded that this was not the correct approach. A third party is likely to be bound by the proposed arrangement to the extent of his uninsured debt, and it is right that he should retain the right to vote on it at least to this extent. Nor did it seem to us to be satisfactory to limit the weight attached to the third party's vote to the value of the uninsured portion of the debt. The chairman of the creditors' meeting,[31] at which the proposal for the voluntary arrangement is considered, is already obliged to put a value on the third party's unliquidated debt for voting

[25] Clause 1(2)(b) (IVAs); clause 1(3)(a) (CVAs).

[26] Clause 1(3)(g). If, as part of the compromise under s 425, the court orders the assets and liabilities of the insured to be transferred to another company (under CA 1985, s 427(3)(a)) then the third party's claim is against the transferee company and no statutory transfer will take place (clause 1(5)).

[27] Clause 1(2)(a).

[28] Clause 14(2).

[29] The draft Bill prohibits the third party from enforcing any part of his debt against the insured which he can recover from the insurer (clause 14(1)). See paras 7.5-7.8 below.

[30] It is probable that those who draft voluntary arrangements will wish to take advantage of this feature of the draft Bill and ensure that a third party's residual claim against the insured is subject to the voluntary arrangement. This would prevent the third party from presenting a bankruptcy petition during the currency of the voluntary arrangement.

[31] Called under IA 1986, s 257 (in the case of IVAs) or under IA 1986, s 3 (in the case of CVAs).

purposes.[32] At the time of the creditors' meeting the insurance position may also not be clear. Had we recommended that the third party be entitled to vote at the meeting only to the extent of his uninsured debt, we would also have had to impose on the chairman the additional, possibly onerous, duty of putting a value on the insurance cover (over both liquidated and unliquidated debts) for voting purposes.

Insurer with a right of recourse - effect on voluntary arrangement

6.25 An insurer may be entitled to recover from the insured some of the money it has paid out to a third party claiming under transferred rights.[33] If the statutory transfer (either under the 1930 Act or under the draft Bill) comes about as a result of a voluntary arrangement, the voluntary arrangement will not bind an insurer who has such a right of recourse.[34] As a result, the insurer would be in a position to disturb the voluntary arrangement, for example, by issuing a bankruptcy petition at a later date.

6.26 One consultee identified this as a problem and suggested that the draft Bill should provide that, in the above circumstances, the insurer is bound by the voluntary arrangement. On reflection, we did not agree. A similar issue will arise whenever the insured becomes subject to a debt after a voluntary arrangement is approved. In other words, it is an issue relating to voluntary arrangements generally and is, accordingly, not something it would be appropriate to alter in the context of this project.

VOLUNTARY PROCEDURES IN SCOTLAND

6.27 Individual Voluntary Arrangements governed by Part VIII of IA 1986 and deeds of arrangement under the Deeds of Arrangement Act 1914 do not apply to Scotland. On the other hand, CVAs governed by Part I of IA 1986 and compromises or arrangements under section 425 of CA 1985 do apply to Scotland and, under the proposed new Act, will be treated in the same way in Scotland as they are in England and Wales.

6.28 In addition, voluntary procedures in Scotland may be regulated by way of a trust deed or composition contract. In the case of a trust deed, the debtor executes a unilateral deed containing a conveyance of the whole of his property to a trustee for the benefit of his creditors in general. A major failing of the trust deed was that a non-acceding creditor could still supersede the arrangement by simply sequestrating the debtor. To avoid such a situation, the trust deed was given

[32] Insolvency Rules r 5.17 (in the case of IVAs) or Insolvency Rules r 1.17 (in the case of CVAs).

[33] For example, a "claw back" clause in the insurance contract may allow an insurer to claim back from the insured employer some (or all) of the money it has paid to a third party employee under the terms of the employers' liability insurance policy. See paras 5.23-5.27 above.

[34] The insurer's debt will not have arisen at the time of the creditors' meeting. Consequently, the insurer will not be bound, either under the rule in IA 1986 or the rule in the Insolvency Act 2000. Cf the position under an arrangement under CA 1985, s 425. See para 6.6 above.

statutory protection and the debtor now has an option to create a protected trust deed as described in Schedule 5 to the Bankruptcy (Scotland) Act 1985.

6.29 A composition contract can take the form of an extra-judicial or judicial composition contract. The terms of an extra-judicial composition contract are a matter for the debtor and creditor so that each agreement will differ. In contrast to the trust deed, under the composition contract the debtor is not divested of his entire estate. For the debtor, this is seen as the main advantage of entering into such an arrangement. The extra-judicial composition contract is to be distinguished from the judicial composition contract, or discharge on composition, which was introduced by the Bankruptcy (Scotland) Act 1985. Unlike an extra-judicial composition, the judicial composition is a means of discharge from a sequestration[35] and the procedure to be followed is set out in Schedule 4 to the 1985 Act.

6.30 Should the voluntary procedures fail or be unsuitable, the appropriate procedure would be to petition for sequestration.[36] In the case of a judicial composition contract, in certain circumstances, the order approving the composition may be recalled or the order discharging the debtor may be reduced.[37] In such instances, the sequestration will revive.

6.31 Under the proposed new Act, a transfer will take place only in the case of a protected trust deed or judicial composition contract for the reasons set out in paragraphs 2.47 to 2.49 above.

Reform recommendations in Scotland

6.32 In line with the recommendations for England and Wales,[38] in Scotland, we recommend that a third party who receives a statutory transfer of rights as a consequence of the insured's protected trust deed will not be bound by the arrangement to the extent that he is able to recover from the insurer.[39] Similarly, a third party who receives a transfer by virtue of the insured's sequestration will not be bound by any subsequent judicial composition contract to the extent that he is able to recover from the insurer.[40]

[35] The sequestration ceases once the composition is in force and the debtor has been discharged in terms of Sched 4, para 13.

[36] Bankruptcy (Scotland) Act 1985, s 12.

[37] Bankruptcy (Scotland) Act 1985, Sched 4, paras 17 and 18.

[38] See paras 6.20-6.26 above.

[39] Clause 14(2).

[40] Clause 14(3).

PART 7
THE EFFECT OF THE DRAFT BILL ON OTHER RIGHTS AND OBLIGATIONS

INTRODUCTION

7.1 The draft Bill confers rights on the third party by transferring to him certain of the insured's pre-existing contractual rights against the insurer. In general, this will mean that the insurer will be under the same liability to the third party as he would have been to the insured.[1] This general position is altered to a limited extent by the restrictions on and enhancements to the third party's transferred rights which we are recommending. To the extent that these affect the defences available to an insurer facing litigation under the insurance contract, our recommendations and the reasons for them have been set out in Part 5 above.

7.2 In the consultation paper we asked consultees whether a new Act should bestow on the third party, the insured and the insurer various other rights and obligations. In this Part we set out and explain our reform proposals. We also examine how the draft Bill would interact with other rights and obligations of the parties, in order to illustrate how a new Act would operate in practice. We look in turn at the position of the third party, the insurer and the insured.

7.3 We conclude with an analysis of the status of settlements between the insurer and the insured under the 1930 Act and under the draft Bill.

THIRD PARTY'S RIGHTS AND OBLIGATIONS

Third party's right to recover from insured

Amounts not recoverable from insurer

7.4 Section 1(4)(b) of the 1930 Act expressly preserves the right of the third party to recover from the insured any of his debt which is not covered by the insurance policy.[2] This is also the effect of the draft Bill.[3]

Amounts recoverable from insurer

7.5 Nothing in the 1930 Act expressly removes the right of the third party to recover from the insured any of his debt which he is entitled to recover from the insurer

[1] As is the case under the 1930 Act. Indeed this is expressly set out in s 1(4).

[2] Such sums will arise if some of the insured's debt is not insured under the policy, or if the loss exceeds the policy limit, or if the policy contains an excess; alternatively, the insurer may be entitled to deduct unpaid premiums from the sum payable to the third party (see para 5.20 above).

[3] As the draft Bill does not alter the pre-existing rights and obligations subsisting between the third party and the insured which do not relate to amounts due from the insurer under the insurance contract, no explicit provision to this effect is necessary.

under transferred rights. Commentators differ on whether the third party may do this.[4] In our view he cannot.

7.6 After a statutory transfer the insured no longer has any rights against the insurer under the insurance contract in respect of the third party's debt. If the third party could enforce the insured part of his debt against the insured (for instance, by proving in the insolvency) then the position would be as follows:-

(1) The insured's office-holder would not be able to make an insurance claim. He would have to fund the third party's dividend by reducing the dividend of the insured's other creditors.

(2) To the extent that the third party was compensated by such a dividend, the third party would, under general principles, be disentitled from enforcing his rights against the insurer.

7.7 In other words, the insurance policy would not operate in respect of the amount recovered from the insured; instead, funding for this amount would be obtained by reducing the dividend payable to the insured's other creditors. This is inconsistent with the entire thrust of the 1930 Act.[5]

7.8 The draft Bill eliminates the existing uncertainty under the 1930 Act by expressly prohibiting the third party from enforcing his debt against the insured to the extent that he is able to recover from the insurer.[6]

Insolvency of insurer

7.9 It is possible that a third party may find that he is unable to recover, in full or in part, what is due under the insurance contract as a result of the insurer's insolvency. Such a third party may qualify for compensation.

7.10 The current regime of compensation is governed by the Policyholders' Protection Act 1975[7] and is administered by the Policyholder's Protection Board ("PPB"). The PPB will be abolished[8] when the new Financial Services Compensation

[4] The view of the editor of *MacGillivray on Insurance Law* (9th ed 1997) is that the third party is not entitled to recover such sums from the insured. See para 28-16 n 47: "...he [the third party] can only seek to obtain [from the insured] the amount which he could not have recovered in any event from the insurer." Compare M Clarke, *The Law of Insurance Contracts* (3rd ed 1997) whose view (at p 167, para 5-8F1(c)) appears to be that the third party is only barred from recovering from the insured to the extent that he has actually obtained compensation from the insurer.

[5] The first instance decisions in *Re Pethick, Dix* [1915] 1 Ch 26 and *Re Renishaw* [1917] 1 Ch 199, on a similar point which arose in relation to the Workman's Compensation Act 1906, support the view we have taken.

[6] Clause 14(1). We explain in the following paragraphs that the third party may be able to obtain compensation if the insurer is insolvent. To the extent that this is possible, the draft Bill also expressly prohibits the third party from recovering that amount from the insured. (clause 14(4)(a) and 14(5)).

[7] As amended by the Policyholders' Protection Act 1997. Only some of the 1997 Act has come into force.

[8] By s 416(3)(b) of the Financial Services and Markets Act 2000 ("FSMA 2000").

Scheme (the "Scheme") is brought into existence by the implementation of the Financial Services and Markets Act 2000 ("FSMA 2000").[9]

7.11 In our view, a third party should possess the same right to compensation as the insured would have had in the absence of a statutory transfer. Under the current draft rules of the Scheme[10] this would be the case.[11]

Insurance proceeds subject to a charge

Floating charge crystallisation causes a transfer of rights

7.12 When a floating charge crystallises it will typically attach to all the assets of the insured. This would include an existing or future insurance claim. As we have explained, many of the circumstances in which the draft Bill comes into play will coincidentally also cause such a floating charge to crystallise.[12] In such cases, the effect is to remove the insurance claim from the ambit of the floating charge (just as, in the case of a bankruptcy order, the effect is to remove the insurance claim from the ambit of the bankruptcy) so that the third party, and not the chargeholder, receives the benefit of the insurance policy.

Fixed charge already existing at the time of transfer

7.13 It may be that at the time of the statutory transfer the benefit of all the insured's policies have been charged to a creditor other than the third party.[13] It is possible that a chargeholder might attempt to enforce such a charge over sums recovered under a third party liability policy, though we are not aware of a case in which this has happened.[14]

[9] The implementation date for FSMA 2000 is, at the time of writing, expected to be November 2001. The rules of the Scheme will be made under powers granted to the Financial Services Authority by s 213. The Financial Services Authority has appointed a company named Financial Services Compensation Scheme Ltd as Scheme Manager. The Scheme will replace the existing compensation regimes for investments business and deposits, in addition to insurance.

[10] Published by the Financial Services Authority in Financial Services Compensation Scheme Draft Rules (2000) Consultation Paper 58.

[11] By the time the draft Bill is enacted, the existing regime in the Policyholders Protection Act 1975 will no longer be in force. Accordingly, we have not analysed in this report the third party's right to compensation against the PPB either under the 1930 Act or under the draft Bill.

[12] See paras 2.18-2.20 above. As we explain there, a floating charge may occasionally crystallise without causing a transfer under the draft Bill.

[13] *Re CCG International Enterprises Ltd* [1993] 1 BCLC 1428 confirmed that insurance proceeds could be the subject of an equitable fixed charge. That it is possible to create a fixed charge over future assets was confirmed in *Siebe Gorman v Barclays Bank* [1979] 2 Lloyd's Rep 142 in which Slade J held that it was possible to create a fixed charge in equity over prospective assets such as future book debts provided that they could be clearly ascertained. A fixed charge might also arise if a floating charge crystallised over the insurance proceeds without causing a statutory transfer. See para 7.12, n 12 above.

[14] The insurance policies primarily intended to be covered by such a fixed charge will not be policies covering the insured's possible future debts, but those covering the insured's assets, for example a buildings insurance policy. We note that in *Re CCG International Enterprises Ltd* [1993] 1 BCLC 1428 at p 1430c no point was taken by the plaintiff that the insurance proceeds attributable to the third party should go to the chargeholder.

7.14 A transfer of rights effected by the draft Bill will not affect the chargeholder's fixed rights over the insurance proceeds.[15] In other words, the third party will receive a transfer under the draft Bill of the insured's rights under the insurance policy, subject to any charge which the insured has granted.

Third party's other statutory rights against insurer

7.15 The draft Bill provides a right of action for third parties against liability insurers in general. It does not interfere with legislation providing specific rights to third parties to pursue particular types of claim, for example, under the Road Traffic Act 1988.

Voluntary codes of practice

7.16 There are a number of insurers' voluntary codes of practice to which the vast majority of United Kingdom insurers subscribe.[16] It is clear in some cases that these codes will apply after a statutory transfer;[17] in others the question has yet to be addressed.

Financial Services Ombudsman

7.17 The current dispute handling scheme for insurance policies, operated by the Insurance Ombudsman Bureau, will be replaced[18] when FSMA 2000 comes into force.[19] The Insurance Ombudsman, along with seven other financial ombudsmen, will be replaced by the Financial Services Ombudsman. In our view, a third party with a claim under the draft Bill will be eligible for assistance under this new scheme.[20]

INSURER'S RIGHTS AND OBLIGATIONS

Insurer's duty to pay on a successful claim by third party

7.18 We asked consultees whether a new Act should expressly require the insurer to pay the third party directly.[21] Consultees confirmed that this was already standard practice in 1930 Act cases, but that occasionally the insurer paid out to the office-holder. A number felt that the administration, complication and delay this caused was unnecessary and should be avoided by express provision in a

[15] An equitable fixed charge over an asset will bind everyone to whom the asset is transferred save for a bona fide purchaser without notice. See *Re Charge Card Services* [1987] Ch 150 at p 176c, a decision of Millet J (affirmed by the Court of Appeal at [1989] Ch 497).

[16] For example, the Statement of General Insurance Practice issued by the Association of British Insurers and the ABI/Lloyd's arbitration agreement. Following the launch of the General Insurance Standards Council (GISC) on 3 July 2000, these codes will in due course cease to be applicable and the industry will be regulated by new GISC codes.

[17] For example, third parties will be able to use the ABI / Lloyd's arbitration agreement (see para 5.40, n 63 above).

[18] See FSMA 2000, Part XVI.

[19] See para 7.10, n 9 above.

[20] Under rules 2.4.10 and 2.4.12. The scheme's rules are published in: Complaints Handling Arrangements (2000) Financial Services Authority and Financial Ombudsman Service.

[21] Consultation paper, para 12.48.

new Act. Nevertheless, we concluded that such a provision would have been redundant. A third party who receives a right to insurance proceeds under the 1930 Act or the draft Bill, thereby receives an enforceable right to require the insurer to pay the monies directly to him.

Insurer's right to an indemnity from insured

7.19 In the consultation paper, we suggested that the insurer should have a right to recover from the insured any sums the insurer has paid to the third party which, but for the Act, he would not have been required to pay.[22] Although the insurer may have this right under the insurance contract, this will not always be the case.

7.20 Consultees pointed out that such a right would not be exercised often as in most cases the insured is insolvent. However, it was also acknowledged that the insured might be in administration and capable of paying its debts; or, even if insolvent, likely to pay a dividend. A majority of consultees who responded thought that an insurer's right to an indemnity should be included in a new Act.

7.21 In Part 5 above we explained that, in general, an insurer facing a claim from a third party will be able to rely on the same defences he would have been able to use had the claim been brought by the insured. As a result, in the usual case, the issue does not arise: the insurer will only have to pay the third party in circumstances in which, in the absence of a statutory transfer, he would have had to pay the insured. We proceeded in Part 5 to set out and justify three exceptions to the usual position.[23] In these limited cases, a statutory right to an indemnity might be valuable to the insurer. We examine each of these cases in the following paragraphs. In each case, we have concluded that a right to indemnity would be inappropriate.

7.22 First, the draft Bill enables a third party to fulfil, or contribute towards fulfilling, a contractual condition such as a provision for notice.[24] The insurer might, as a result, be obliged to pay out under the insurance policy even though he would have been able to avoid paying out altogether in the absence of a statutory transfer (because, for example, of a breach by the insured of the clause in question). In our view, it would not be right in such a case to allow the insurer to prove in the insured's insolvency, thereby reducing the dividend payable to the insured's general creditors. The draft Bill does not in this context remove substantive defences from the insurer; it merely adjusts the way in which the insured's obligations under the contract may be satisfied in the light of the statutory transfer.

7.23 Secondly, the draft Bill prevents an insurer from relying on a provision in the insurance contract requiring the insured to provide information and assistance in a case in which the insured no longer exists.[25] It is true that this provision might have the effect of requiring the insurer to pay out even though he would have been able to avoid doing so in the absence of a statutory transfer. However,

[22] Consultation paper, para 14.42.

[23] Enacted in the draft Bill in clauses 4(1), (2) and (3).

[24] Clause 4(1). See paras 5.15-5.16 above.

[25] Clause 4(2). See paras 5.17-5.19 above.

in such a case, a right to an indemnity would be unlikely to help the insurer since *ex hypothesi* the insured does not exist and so has no property.

7.24 Finally, the draft Bill prevents an insurer from relying on a pay-first clause, as against the third party, save in specified cases.[26] It is true that, in the absence of a statutory transfer, such a clause might prevent an insured from claiming on the insurance policy. However, an insured in this position is not uninsured. In other words, his failure to pay the third party does not transfer the ultimate burden of paying the insured amount from the insurer to him. In those circumstances, our view is that it is right that, after a statutory transfer, the draft Bill should not compel the insured to bear that cost.

Prejudice to insurer using subrogated rights

7.25 If an insurer uses a subrogated right under the insurance contract to conduct the defence of the insured, and if the insured loses that action, the insurer may find that he is prevented from denying his liability under the policy in a subsequent claim by the insured.[27]

7.26 One way in which this can happen is if the insurer continues to conduct the defence of the insured at a time when he is aware of a breach of condition by the insured which would allow him to repudiate the policy. Such conduct is likely to amount to a waiver of the breach so that the insurer would not be able to rely on the breach to resist a claim from the insured under the policy.[28] Another way in which this may happen is if the insurer continues to conduct the defence of the insured at a time when he believes that the insured is not in fact covered by the insurance policy. It has been suggested that this can create an estoppel preventing the insurer from arguing that the insured's claim fell outside the scope of the policy.[29]

[26] Clause 4(3) and clause 4(4). See paras 5.28-5.37 above.

[27] See *MacGillivray on Insurance Law* (9th ed 1997) para 28-24: "...care is needed in undertaking the defence of the claim on behalf of the assured, or else the insurers may become precluded from denying liability under the policy." This is perhaps unlikely to happen in Scotland where current procedure enables both the insured and insurer to be pursued in a single process. In such a situation, the insurer can conduct the insured's defence without prejudice to his own right to deny liability by presenting alternative defences: for example, the insured is not liable, but, if the insured is found liable, the insurer is not liable to indemnify him. See also *Cheltenham and Gloucester plc v Sun Alliance and London Insurance plc* IH, 30 May 2001 and para 3.7, n 11 above.

[28] See for example Diplock LJ in *Fraser v BN Furman (Productions) Ltd* [1967] 1 WLR 898 at p 909G.

[29] It seems that such an estoppel may arise in the United States and Australia (See *MacGillivray on Insurance Law* (9th ed 1997) para 28-26). In *Wood v Perfection Travel* [1996] LRLR 233 the Court of Appeal allowed an application by an insurer to be joined to an action brought by a third party against a dissolved company which had been restored to the register. The insurer was concerned that he might, if forced to use his subrogated right to conduct the defence of the insured, be estopped from later denying liability under the policy. Hirst LJ at p 235 accepted, for the purposes of the judgment, that the law was uncertain in this area, but declined to decide the point. Professor Merkin commented that "the legal basis for this risk is unclear, but after *Wood* it plainly cannot be discounted". See "When is the Reinsurer Liable?" [1996] Insurance Law Monthly, vol. 8(1) p 4. The

7.27 We asked consultees whether it was fair that a third party should be entitled to rely on this kind of estoppel in a claim against an insurer under a new Act.[30] A number of consultees felt that it was wrong that such estoppels should arise. Others pointed out, however, that insurance contracts will normally contain non-waiver agreements providing protection against this risk, if it exists.[31]

7.28 We have decided to recommend no change to the law for two reasons:-

(1) If the third party uses his right to establish the liability of the insured in his action against the insurer,[32] the insurer will never be at risk of being prejudiced. In such a case, the insurer would defend on his own behalf; he would not use subrogated rights at all. If he wished to deny the insured's liability and also to deny his own liability under the policy, he would be able to do so by running concurrent defences. No question of waiver or estoppel, or in Scotland personal bar, would arise.[33]

(2) If the third party proceeds (as he must under the 1930 Act) by proving his debt against the insured, and the insurer has conducted the insured's defence, then there is a possibility that an estoppel, a waiver or personal bar will arise. In our view, it would be inappropriate to alter such outcomes in a new Act. If, in the absence of a statutory transfer, the insured could have relied on a waiver of a breach of condition or an estoppel, then, in our view, the third party using transferred rights should also be able to do so. To provide otherwise would be to put the insurer who uses his subrogated rights in a better position when facing a claim from a third party than when facing a claim from the insured. We can see no justification for making such a distinction.

Orders for costs against insurer

7.29 Under the 1930 Act, before a third party may bring a claim against an insurer, he must establish the liability of the insured. The insurer will often conduct the defence of the insured using his subrogated right to do so. If the insured loses, then costs will usually be ordered against the insured. In exceptional cases in England and Wales, the court may make a costs order against the insurer personally.[34] Even in the absence of such an order, the insurer will in most cases

view of the editor of *MacGillivray* is that such an estoppel does not arise in English law (see para 28-29).

30 Consultation paper, para 12.13.

31 Though non-waiver agreements were not included in occurrence-based liability policies written many years ago under which insurers may still face long tail liability.

32 Conferred by clause 8(1) (in Scotland, clause 9(1)).

33 Under the 1930 Act, by contrast, an insurer will commonly conduct the defence of the insured (using his subrogated right to do so), before the third party issues proceedings against him. Although, after *Wood*, insurers alert to the problem of a possible estoppel may be able to avoid using their subrogated rights by applying to be joined as a party in their own right, this is unlikely to become standard practice, particularly as insurers may have a costs incentive not to adopt this course - see paras 7.29-7.33 below.

34 Under Supreme Court Act 1981, s 51. For recent guidance from the Court of Appeal on the very limited circumstances in which such an order will be made against a liability insurer see *Cormack and Cormack v Excess Insurance Co.* [2000] CPLR 358. But cf

end up paying these costs. This is because the insurance contract will usually cover the insured for any costs orders made against him.

7.30 On occasion, the insurer will not be obliged by the insurance contract to meet the costs incurred by the third party while pursuing his claim:

(1) If, exceptionally, the insurance contract does not cover the legal costs in question.

(2) If the legal costs, when added to the other insured liabilities, exceed the cover under the insurance policy.[35]

(3) If the insurer is able to avoid liability under the insurance contract.[36]

7.31 It was decided in *Cox v Bankside*[37] that an insurer using his subrogated right is not under a duty to indemnify the insured in respect of costs otherwise than under the insurance policy. Thus, in any of the circumstances set out in the previous paragraph, the insurer would not be obliged to pay these costs.

7.32 By contrast, under the draft Bill, if the third party succeeds in establishing the liability of the insured in proceedings against the insurer, he is likely to obtain an order that the insurer pay his costs. The exceptional circumstances in which the insurer may escape having to pay those costs under the 1930 Act will not occur under the draft Bill.

7.33 We do not think it likely that this will impose a heavy new burden on insurers. In particular, the circumstances in paragraphs 7.30 (1) and (2) will be rare in practice. The circumstances in (3) will be less rare. However, an insurer may be able to mitigate the effect of this by ensuring that any potential defence under the policy is taken as a preliminary point, thus avoiding the need to establish the liability of the insured.

Insurer's other statutory obligations

7.34 Specific schemes of third party rights against insurers are laid down in various statutes, for example the Road Traffic Act 1988, the Nuclear Installations Act 1965 and the Merchant Shipping Act 1995. The draft Bill does not derogate from the obligations or restrictions which these separate regimes impose on insurers.[38]

Monkton Court Ltd(t/a CATS) v Perry Prowse (Insurance Services) Ltd [2000] 1 All ER (Comm) 566 in which the High Court made such an order.

[35] As was the case in both *Cormack* and *Monkton Court* (see para 7.29, n 34 above). Some insurance policies provide a separate indemnity for legal costs, which may or may not be limited.

[36] In order to do so he may have to show, not just that he has a defence under the policy, but that no estoppel arises, to prevent him relying on it, from his conduct of the insured's defence. See para 7.26 above.

[37] [1995] 2 Lloyd's Rep 437 at p 463 *per* Lord Bingham MR.

[38] For example, the Road Traffic Act 1988, s 148 renders void certain policy conditions in compulsory insurance governed by that Act. An insurer defending a claim against a third party a under such a policy will be thereby prohibited from relying on certain policy conditions, notwithstanding the absence of similar prohibitions in the draft Bill.

7.35 Insurers sued by employees under the draft Bill may be restricted by employer's liability legislation in the defences which they can raise to third party claims. For example, as we have seen,[39] the Employers' Liability (Compulsory Insurance) Act 1969 and the Employers' Liability (Compulsory Insurance) Regulations 1998 prevent insurers from including certain policy conditions, or relying on them, in employer's liability policies.

Rights and obligations under rules of court

7.36 The provisions of the draft Bill are intended to supplement, rather than replace, any rights which a third party may have under general procedural rules. So, for example, a third party in England and Wales will have the option of applying for a disclosure order[40] in addition to, or instead of, using his statutory rights to disclosure in the draft Bill.[41]

INSURED'S RIGHTS AND OBLIGATIONS

Insured's right to recover from insurer

7.37 The 1930 Act preserves the rights of the insured against the insurer in respect of any amount due under the policy but not payable to the third party.[42] Such amounts might arise, for example, if the policy covered costs incurred by the insured in mounting an initial defence to the third party's claim or in seeking legal advice on whether the third party's claim was likely to be successful.[43] Such costs would be payable under the policy but not recoverable by the third party. The draft Bill contains a similar provision.[44]

Insured's right that the insurer conducts his defence properly

7.38 An insurer conducting the insured's defence must act with due regard to the insured's interests.[45] The circumstances in which the insurer will use his subrogated rights under the draft Bill are likely to be limited (see paragraph 7.28(1) above). If he does, the draft Bill does not affect any rights the insured may have against an insurer who fails to fulfil this duty.

7.39 If the third party proceeds against the insurer and uses his right to establish the liability of the insured in those proceedings, in our view the insurer will not owe

[39] See paras 5.23-5.27 above.

[40] Under CPR 31.

[41] Draft Bill, Sched 1, para 6.

[42] Section 1(4)(a).

[43] The policy might contain a "QC clause", providing that the insurer will pay a claim without requiring the insured to contest it, unless a Queen's Counsel advises that the claim could be successfully contested.

[44] Clause 3.

[45] See *MacGillivray on Insurance Law* (9th ed 1997) p 791: "Both the insurers and solicitors appointed by them owe a duty to the assured to conduct the proceedings with due regard to his interests, and an action for damages will lie for breach of that duty." See *Groom v Crocker* [1939] 1 KB 194 and *Cox v Bankside* [1995] 2 Lloyd's Rep 437.

any duty to the insured relating to the conduct of its defence.[46] As a consequence, there may be rare cases when the insured might wish to participate in the proceedings himself.[47]

SETTLEMENTS REACHED BETWEEN INSURER AND INSURED

Current law

7.40 Section 3 of the 1930 Act provides that certain agreements between the insurer and the insured are ineffective to defeat or affect the rights transferred to the third party. This section has been interpreted to apply to settlements reached at any time after (1) liability has been incurred and (2) the occurrence of one of the events specified in section 3 (for example, the bankruptcy of the insured). This is the case even if the liability of the insured has, at that time, yet to be established.[48]

7.41 The list of events in section 3 omits some events which trigger a statutory transfer under section 1.[49] Some third parties may, therefore, receive a transfer of rights under section 1 but not be protected from the settlements specified in section 3.[50]

Reform recommendations

Settlements before a statutory transfer

7.42 A number of consultees thought that a provision re-enacting section 3 in a new Act should apply also to settlements between the insurer and the insured in cases of impending insolvency. These consultees were concerned to prevent cases in which the third party was deprived of the chance to make a substantial claim on

[46] See the analysis of the Master of the Rolls in *Cox v Bankside* [1995] 2 Lloyd's Rep 437 at p 463, in which the position of an insurer under a common law duty to the insured is contrasted with that of an insurer who is "acting in its own interest only". The insurer who defends a claim from a third party under the draft Bill is also "acting in its own interest only".

[47] See para 3.48 above.

[48] See *Woolwich Building Society v Taylor* [1995] 1 BCLC 132.

[49] *Viz* (1) the approval of voluntary arrangements, (2) the appointment of a receiver, or manager; (3) possession being taken by or on behalf of the holders of any debentures secured by a floating charge or of any other property comprised in or subject to a charge. It is not clear whether these omissions were deliberate. There is no reference to this point in Hansard's coverage of the debates of IA 1986 which amended s 1 and s 3 of the 1930 Act. It appears that the distinction is between insolvency proceedings which are terminal (such as winding-up and bankruptcy) and those which may allow the insured to carry on.

[50] Such an unprotected third party appeared in *Jackson v Greenfield* [1998] BPIR 699. In that case, after incurring liability to the third party, the insured entered into an Individual Voluntary Arrangement with creditors. Before the third party had established the insured's liability, the insured attempted to settle the possible insurance claim with the insurer. The third party was concerned to block the settlement. The judge observed (at p 708H) that s 3 would have rendered such a settlement ineffective (for the purposes of the third party's claim) had the insured been declared bankrupt; but s 3 was of no avail to the third party in the current case as it did not apply in the case of an voluntary arrangements. The judge went on to hold that, as the third party had not yet established the insured's liability to him, no statutory transfer had taken place, and the insured retained the right to deal with the possible insurance claim as he saw fit.

the insurance policy under transferred rights as a result of a settlement at an undervalue reached between the insured and insurer immediately before the insured's insolvency.[51]

7.43 We are not recommending any such reform. Until a transfer of rights occurs, the insured and the insurer will be free to alter their rights *inter se* under the insurance contract, as they currently are under the 1930 Act. Reform would introduce undesirable uncertainty into dealings between the insured and insurer. In *Normid Housing Association Ltd v Ralphs (No 2)*[52] the Court of Appeal suggested that, if the third party can persuade the court that the settlement to which he objects is part of "a plan to cheat the plaintiffs", a freezing order is likely to be available to the third party to prevent it.[53] In addition, as the Court of Appeal also mentioned, without expressing a view, insolvency legislation may provide its own mechanism for challenging settlements at an undervalue.[54]

Settlements after a statutory transfer

7.44 Once rights have been transferred by the draft Bill the insured retains no rights under the insurance contract in respect of his liability to the third party. Accordingly, he will not be in a position to agree with the insurer that these rights should be changed.

[51] In *Normid Housing Association Ltd v Ralphs* [1989] 1 Lloyd's Rep 265 the third party wished to pursue the insurer for the full extent of his claim against the insured which amounted to some £5.7m. The insurance contract purported to contain a policy limit, the legal effect of which was debatable, of £250,000. The insurer and the insured wished to settle the insurance position for £250,000. The Court of Appeal held (at p 272) that the third party was not entitled to an injunction to prevent this. The third party had no rights under the 1930 Act, or otherwise, on which the injunction could be based.

[52] [1989] 1 Lloyd's Rep 274.

[53] *Ibid*, *per* Slade LJ, at p 278.

[54] Slade LJ referred to IA 1986, s 423: *ibid*, at p 277. Other sections of the IA 1986 may also be relevant, for example s 238.

PART 8
CASES WITH A FOREIGN ELEMENT

INTRODUCTION

8.1 In this Part we deal with two issues: first, the application of the draft Bill to cases with a foreign element; and, secondly, the jurisdiction of the domestic courts in such cases.

8.2 The consultation paper discussed the issue of how a new Act should apply in cases with a foreign element: for example, where one of the parties is domiciled abroad, or the insurable event occurred abroad, or the insurance policy is governed by foreign law. The 1930 Act is silent as to its applicability in such cases and there is little authority on the point.[1]

8.3 The draft Bill seeks to resolve this uncertainty. It provides that its applicability does not depend on the existence of any "connection" with England and Wales or Scotland, except as expressly provided.[2] Thus, the only necessary connection is that provided by clause 1 itself, which defines the events or situations in which a transfer takes place, all of which arise under English or Scots law.[3]

8.4 Even in a case in which the draft Bill applies, a third party will not be able to bring effective proceedings against a foreign insurer except as permitted by the rules governing the jurisdiction of the domestic courts. The draft Bill proposes a limited change to clarify the position where a third party domiciled in one part of the United Kingdom brings proceedings against an insurer domiciled in another part.

APPLICABILITY

Consultation

8.5 In the consultation paper we asked whether a new Act should clarify when it applies in cases with a foreign element.[4] A substantial majority of those who responded agreed that it should.

[1] Consultation paper, paras 8.4-8.5. The only relevant English authority on the issue, *The Irish Rowan* [1991] 2 QB 206, is inconclusive. Staughton LJ suggested a number of alternatives without deciding the matter.

[2] Clause 17. In particular, applicability does not depend on where the liability was incurred, the domicile of the parties, the law of the contract of insurance, or the place of payment under the contract: *ibid* (a)-(d).

[3] We draw attention to the likely impact of the UNCITRAL model law on cross-border insolvency, when it is brought into force in this country, and make a recommendation for a derogation to protect the position under the draft Bill: see para 8.18 below.

[4] Consultation paper, para 16.2.

8.6 We also asked what criterion should be used in the new Act to determine whether it applied. We gave the following options:[5]

(1) the insured has been declared bankrupt or wound up in this country;

(2) the insurance proceeds are payable in this country;

(3) the law governing the insurance contract is English or Scots law;

(4) the courts have jurisdiction in respect of the tort or delict or breach of contract committed by the insured;

(5) the insurer is subject to the jurisdiction of a court in the United Kingdom.

8.7 More consultees favoured (1) than any of the other criteria. It was suggested that this criterion was appropriate because of the links between the 1930 Act and insolvency law. There was some support for (2), partly again because of the link with insolvency: one consultee agreed on the basis that, if insurance proceeds are payable here, it would be possible for a winding-up order to be made. A number of consultees disagreed strongly with (4). It was pointed out that there are many 1930 Act claims involving torts or delicts committed outside the United Kingdom which would be excluded by this criterion.

8.8 We also asked whether the rule chosen for determining applicability of a new Act should always override a conflicting contractual provision in the insurance contract.[6] A majority of those who responded thought that it should.

Reform proposals

8.9 We agree with consultees that a new Act should clarify when it applies in cases with a foreign element. In our view this is particularly important in the light of the recent increase in both cross-border insurance[7] and merger activity in the insurance market.[8]

8.10 We also agree with the view of the majority of consultees who thought that a new Act should apply if the insured has been made bankrupt or wound up in

[5] Consultation paper, para 16.16.

[6] Consultation paper, para 16.16.

[7] Two recent international agreements may promote this trend: (1) In March 1999 the General Agreement on Trade in Services ("GATS"), concluded by the World Trade Organisation ("WTO") between nearly 100 countries, came into effect. Its aim is to dismantle cross-border barriers to trade in financial services, including insurance; (2) The EU Convention on Insolvency Proceedings (mentioned in the consultation paper, para 16.2, n 2) will now come into force as EC Regulation No 1346/2000 on 31 May 2002.

[8] For example, the acquisition by Denmark's Tryg-Baltica Insurance Company of Colonia Baltica Insurance Ltd, a subsidiary of AXA Colonia, an English company (Lloyd's List Insurance Day, 19.11.99). These trends have been confirmed by the ABI in their annual publication "Insurance Facts, Figures and Trends" published in November 1999.

England and Wales or Scotland.[9] This seems to us the most appropriate option since it is consistent with the principal aim of the draft Bill, namely to provide a remedy to third parties who would otherwise suffer from the domestic insolvency regime. In addition, in England and Wales, it will make the draft Bill widely applicable, given the wide discretion of the courts to grant winding-up orders against foreign insureds.[10] The Scottish courts have no power to grant winding-up orders against foreign insureds.[11]

8.11 Although we did not specifically consult on how the draft Bill should apply when a statutory transfer occurs without a bankruptcy or winding-up,[12] the same principle should in our view apply. In the draft Bill, this result is achieved by a provision making clear that the only criteria for application of the draft Bill are those contained in clause 1 itself, regardless of any other connection of the parties, or the liability, with England and Wales or Scotland.[13]

8.12 Finally, we also recommend that a provision in the insurance contract disapplying the law of England and Wales, or Scotland (either in respect of the whole contract or a part of it), should be disregarded for the purposes of determining whether the draft Bill applies (though not for any other purpose).[14] We did not think it right that an insurer and insured, who choose that their insurance contract should be governed by foreign law, should thereby disapply

[9] As we have explained, the draft Bill does not extend to Northern Ireland but, should the draft Bill be enacted, parallel legislation there is likely. See para 2.52 above. If this does occur, the two new Acts would apply in all cases in which the insured was made bankrupt or wound up anywhere in the UK.

[10] A winding-up order may be granted if the company has some assets within the jurisdiction, including a possible right of action under the Act: *Re Compania Merabello San Nicholas SA* [1973] Ch 75. The court may in some circumstances wind up a foreign company without any assets in this jurisdiction, though it will only do so if *inter alia* there is a "sufficient connection" with England and Wales (*Re Latreefers Inc, Stocznia Gdanska SA v Latreefers Inc* [1999] 1 BCLC 271, upheld on appeal in the CA, Independent 15.2.00). The court is less likely to grant a bankruptcy order: a petition may not be granted unless the debtor has or had some more permanent link with the jurisdiction. The power of the courts to make winding-up and bankruptcy orders will, however, be restricted when the European Union Insolvency Convention comes into force as a Regulation on 31 May 2002 (see para 8.9, n 7 above). The Regulation will allocate jurisdiction to a particular Member State in insolvency proceedings and will restrict the right of courts in other Member States to conduct parallel proceedings. The Regulation provides for recognition of foreign proceedings in other Member States (Article 17). Recognition reproduces the effect of the foreign judgment in the recognising State. However, recognition will not cause a transfer of rights under either the 1930 Act or the new Act. The power of the courts in this area may be further restricted when the UNCITRAL Model Law on Cross-Border Insolvency comes into force (see paras 8.13-8.18 below).

[11] The court's jurisdiction in relation to insolvency and bankruptcy is restricted to the statutory criteria *viz* IA 1986, ss 120 and 221 (insolvency); Bankruptcy (Scotland) Act 1985, s 9 (sequestration).

[12] See paras 2.7-2.8 above.

[13] Clause 17.

[14] Clause 17(c).

the new Act and nullify its important effects on the rights of the third party during a domestic insolvency.[15]

UNCITRAL model law on cross-border insolvency

8.13 For completeness, although it is not yet in force in this country, we draw attention to the Model Law on Cross-Border Insolvency (the "model law"), adopted in 1967 by the United Nations Commission on International Trade Law ("UNCITRAL"). The purpose of the model law, as described by UNCITRAL, is

> to assist states to equip their insolvency laws with a modern, harmonised and fair framework to address more effectively instances of cross-border insolvency. Those instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.[16]

8.14 Section 13 of the Insolvency Act 2000 gives the Secretary of State power to enact the model law, with or without modification, by secondary legislation.

8.15 We have considered the effect that enactment of the model law would have on third parties with claims under the draft Bill. In particular, we have looked at whether the model law would ever:

(1) prevent a statutory transfer under the draft Bill; or

(2) prevent a third party from using transferred rights.

8.16 In the vast majority of cases in which an insured is subject to a foreign winding-up the model law will have neither of these effects. Particularly important is the provision which preserves the right of a third party to commence a domestic winding-up even if one has already been started abroad.[17]

8.17 However, the model law provides for certain "mandatory effects" which come into force once foreign insolvency proceedings are recognised as "main proceedings"[18] in the enacting country. If such recognition were to occur before a transfer of rights under the draft Bill then it is possible that the third party's rights would be compromised in both of the ways listed above as follows:

[15] An insurer would typically be in a position to dictate such a term; and the insured would have no interest in opposing it. We recognise that currently, in practice, it is more common for insurers to contract into than out of English and Scots law; but they do so for reasons unconnected with the 1930 Act.

[16] Wording taken from: UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997) UNCITRAL, Part 2, I (available at http://www.uncitral.org).

[17] Article 20(4).

[18] Under Article 17(1).

(1) the suspension of the right to "transfer, encumber or otherwise dispose of any assets of the debtor"[19] might prevent a transfer of rights under the draft Bill (for example it might prevent a voluntary arrangement or the crystallisation of a floating charge);

(2) the prohibition on "commencement or continuation of individual actions ... concerning the debtor's ... liabilities"[20] might prevent a third party from proving the insured's liability in his action against the insurer.

8.18 In our view these effects of the model law should be avoided. In other words, a third party should not be deprived of the benefits which the draft Bill would otherwise give him, simply because the insured is subject to a foreign winding-up procedure. We therefore recommend that, if the model law is enacted, claims by third parties under rights transferred by the draft Bill are specifically excluded from the operation of the above provisions.[21]

JURISDICTION

8.19 In the consultation paper we discussed the relevant rules governing the jurisdiction of the domestic courts[22] and asked for views on whether the existing rules were broad enough to found jurisdiction under a revised Act.[23] As we explained, the answer to this question, in both England and Wales, and Scotland, was affected by an unresolved issue as to whether the Brussels Convention[24] applied to proceedings under the 1930 Act, or was excluded by the "bankruptcy exception".[25] The Council of the European Union has recently adopted a Regulation[26] (the "new EC Regulation") revising the Brussels Convention, with effect from 1st March 2002.[27] It is also necessary to consider the special rules for allocating jurisdiction between England and Wales on the one hand, and Scotland on the other.[28]

[19] Article 20(1)(c).

[20] Article 20(1)(a).

[21] Article 20(2) provides a "blank" clause in which States may make derogations such as that suggested in the text.

[22] Consultation paper, para 8.21 ff.

[23] *Ibid*, para 16.17 ff.

[24] The EC Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, applied by the Civil Jurisdiction and Judgments Act 1982 (the "1982 Act"). The Brussels Convention only applies when the case involves EU States. When a case involves an EFTA State the broadly parallel provisions of the Lugano Convention 1988 may apply. The latter Convention is not discussed in detail in this Part.

[25] Consultation paper, para 8.21 ff.

[26] Council Regulation (EC) No 44/2001 of 22nd December 2000.

[27] *Ibid*, Article 76.

[28] Contained in the Civil Jurisdiction and Judgments Act 1982, s 16, Sched 4. See paras 8.24-8.31 below.

8.20 To the extent that the Brussels Convention does not apply, jurisdiction of the English courts will depend on the application of the rules for service out of the jurisdiction.[29] We recommend an amendment to clarify the application of the rules to cases under the draft Bill. We make no parallel recommendation for Scotland where there is no procedure corresponding to service out of the jurisdiction.

Application of Brussels Convention

8.21 By Article 1, the Brussels Convention applies to "civil and commercial matters", but does not apply to:

> bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings (the "bankruptcy exception")[30]

8.22 As we have explained, the issue as to whether proceedings under the 1930 Act fall within the bankruptcy exception has not to our knowledge come before the courts.[31] Our considered view is that proceedings under the 1930 Act fall outside the exception. Although the events listed in section 1 which may bring about a statutory transfer are related to the statutory insolvency regime, the purpose of the 1930 Act is to take proceedings to which they apply outside the insolvency regime altogether. Thus the proceedings themselves are not bankruptcy proceedings and do not "relate" in any direct way to the insolvency regime.[32] We proceed therefore on the basis that the Brussels Convention does apply to proceedings under the 1930 Act.[33]

8.23 Under the Brussels Convention there is a special section dealing with "matters relating to insurance".[34] In respect of liability insurance, the effect appears to be

[29] See para 8.32, n 51 below.

[30] The new EC Regulation is in the same terms.

[31] Consultation paper, para 8.23.

[32] Cf *Gourdain v Nadler* [1979] ECR 733 (in which it was held that a claim against a director of an insolvent company to contribute to the assets of the company under French law fell within the bankruptcy exception); the court said (at p 744) that the action must "derive directly from the bankruptcy or winding-up and must be closely connected with the proceedings for the 'liquidation des biens' or 'reglement judicaire' [bankruptcy order]".

[33] Support for this conclusion can be found in the Jennard Report (OJ 1979 C59/1) and Schlosser Report (OJ 1979 C59/72), which suggest (at p 12 and pp 91-92 respectively), that the exception should only extend to actual bankruptcy proceedings. Under s 3(b) of the Brussels Convention, the Jennard and Schlosser Reports may be used as aids to interpretation (see also *Agnew and Others v Lansforsakringsbolagens AB* [2000] 2 WLR 497 at p 503). See also the new EC Council Regulation on Insolvency Proceedings (see para 8.9, n 7 above), which defines "insolvency proceedings" for each country, by reference to a list (in Annex A); it does not include the 1930 Act.

[34] Section 3 (Articles 7 to 12A). The justification, it appears, is that the insured's bargaining power is likely to have been weaker than that of his insurer: Briggs and Rees, *Civil Jurisdiction and Judgments* (2nd ed 1997) p 120, n 630. Articles 7- 12A do not apply to

that a third party to whom rights are transferred under the 1930 Act may sue the insurer in the courts of the domicile of the insurer or of the insured; or in the courts of the place where the harmful event occurred;[35] but not in the courts of the third party's own domicile (unless, of course, one of the other conditions is fulfilled).[36] Since these rules are not susceptible to amendment by United Kingdom legislation, the draft Bill does not alter the position.

Different parts of the United Kingdom

8.24 There are separate rules under domestic legislation for allocating jurisdiction as between different parts of the United Kingdom, where the subject-matter is within the scope of the Brussels Convention, and the defendant or defender is domiciled in the United Kingdom.[37] In such cases the Brussels Convention takes effect in the modified form set out in Schedule 4 to the 1982 Act. The special section of the Brussels Convention (section 3) relating to insurance matters does not apply. Allocation of jurisdiction therefore depends on whether the proceedings fall within any of the rules specified in the Schedule. Since this issue is governed by domestic legislation, it is open for consideration whether express provision should be made to resolve any uncertainty in the application of these rules to cases under the draft Bill.

8.25 Although we did not discuss this issue in the consultation paper, we referred to a Scottish case, *Davenport v Corinthian Motor Policies at Lloyd's*,[38] which illustrates the problem in an analogous context. That case concerned an action for damages brought by a lady injured by a car in a traffic accident. Having obtained judgment against the driver, she failed to obtain payment. She then attempted to raise an action in Glasgow Sheriff Court against the English insurer under RTA

reinsurance, but they apply to all forms of insurance, whatever the status and strength of the insured: see *Agnew v Lansforsakringsbolagens* [2000] 2 WLR 497.

[35] The general rule is that an action against the insurer may be brought in the courts of the domicile of the insurer or of the policy-holder (Article 8). In respect of "liability insurance", there are further extensions: the insurer may also be sued in the courts of the place where the harmful event occurred (Article 9); and Articles 7 to 9 are applied to actions brought by the injured party directly against the insurer, where such actions are permitted by the law of the court (Article 10).

[36] It seems clear that the third party is not to be regarded as a "policy-holder" for this purpose: see Jennard Report (OJ 1979 C59/1) p 31 ("policy-holder" means the other party to the contract of insurance); Schlosser Report (OJ 1979 C59/72) p 117 (transfer of rights to a third party will not make the third party a policy-holder). This position appears to be unaffected in substance by the new EC Regulation (see para 8.19 above). This preserves, in modified form, the special rules for "matters relating to insurance" (Articles 8-14). Although Article 9(1)(b) adds a right to sue in the domicile of "a beneficiary", this term does not seem apt to cover an injured party to whom rights are transferred by law (cf Article 11(2)).

[37] Civil Jurisdiction and Judgments Act 1982, s 16, applying Sched 4 ("Title II of 1968 Convention as Modified for Allocation of Jurisdiction within UK"). It is enough that the *subject-matter* of the proceedings is within the scope of the Convention, whether or nor the Convention actually applies to the proceedings: *ibid*, s 16(1)(a).

[38] 1991 SC 372. See consultation paper, para 8.6.

1988, section 151.[39] It was argued that Scottish courts did not have jurisdiction. This contention was upheld by the Court of Session. For the purposes of Schedule 4, the claim against the insurance company could not be characterised as delictual. It was a separate statutory right. Accordingly, the only relevant jurisdictional basis of the action in Schedule 4 was Article 2,[40] the domicile of the defender namely England. Therefore the claim had to be brought in the English and not the Scottish courts.

8.26 Before considering the position of a third party under the 1930 Act or draft Bill, it is necessary to consider how these special rules apply to the insured, whose rights are to be transferred. The two categories in Article 5 of Schedule 4, which might be considered relevant, are (1) "matters relating to a contract", and (3) "matters relating to tort, delict or quasi-delict". In the former case, the action is to be brought in "the courts for the place of performance of the obligation in question"; in the latter, "in the courts for the place where the harmful event occurred or ... is likely to occur." [41] If neither applies, allocation is governed by the default rule under Article 2.[42]

8.27 It seems clear that the insured's own right of action against the insurers, as one founded directly on the contract of insurance, falls within article 5(1).[43] As between England and Scotland, jurisdiction is therefore determined by "the place of performance...". Under English and Scots law, the normal rule, governing the "place of performance", in the case of an obligation to pay money,[44] is that the debtor must "seek the creditor in order to pay him at his place of business or residence".[45] Thus in *Davenport*, for example, the Scottish insured would have been able to sue the English insurer in Scotland.

8.28 The position in respect of rights transferred under the 1930 Act or the draft Bill is less clear. In the *Davenport* case, the Court of Session, following decisions of the European Court of Justice,[46] held that the categories in Article 5 were to be

[39] Section 151(5), in respect of a judgment to which the section applies, requires the insurer to "pay to the persons entitled to the benefit of the judgment... as regards liability in respect of death or bodily injury, any sum payable under the judgment in respect of the liability...".

[40] Art 2 provides: "Subject to the provisions of this Title, persons domiciled in a part of the United Kingdom shall be sued in the courts of that part".

[41] *Ibid*, Sched 4, Article 5(1),(3).

[42] The domicile of the defendant (or defender).

[43] See *Kleinwort Benson Ltd v Glasgow City Council* [1999] 1 AC 153 at p 163 *per* Lord Goff, for a summary of the principles established by the European Court of Justice (applied by the 1982 Act s 16(3)(a)).

[44] Subject to any express provision in the contract.

[45] *Chitty on Contracts* (28th ed Vol 1) para 22-054; see also Dicey and Morris, *Conflict of Laws* (13th ed 2000) para 11.251. For Scots law, see *Bank of Scotland v Seitz* 1990 SLT 584.

[46] In particular, *Kalfelis v Bankhaus Schroder Munchmeyer Hengst & Co* [1988] ECR 5565. See also *Kleinwort Benson Ltd v Glasgow City Council* [1999] 1 AC 153 at p 164A.

interpreted restrictively. It rejected a contention that the proceedings "related to delict", because of the link between the pursuer's original delictual claim and her cause of action against the insured; instead, the latter claim was "based upon the statutory provision and upon nothing else".[47] Article 5 did not apply and the action against the insurer had to be brought under Article 2.

8.29 Under the 1930 Act and the draft Bill, it is more readily arguable that the proceedings "relate to contract", since they operate in terms of "transferring" the rights of the insured under the insurance contract to the third party. By contrast, the statute in *Davenport* conferred on the third party a new direct right to payment of money due under a judgment. Nevertheless, a restrictive interpretation of Article 5 could lead a court to conclude that a third party's claim under the 1930 Act is also to be regarded as derived directly from the statute itself rather than from the insurance contract. On this view, Article 2 applies, with the consequence that, were the draft Bill to remain silent on this point, the third party would only be able to sue in the courts of the insurer's domicile and not in his own domicile.

8.30 The question arises whether, as part of the present project, we should recommend any change to this position. It is not part of our terms of reference to review the application of Schedule 4 to insurance contracts generally. In particular, it is not our function to examine the policy reasons for excluding the special insurance section of the Brussels Convention in relation to issues of jurisdiction as between different parts of the United Kingdom.[48]

8.31 On the other hand, there seems no reason to perpetuate any uncertainty in the application of these rules to proceedings by third parties under the draft Bill, in so far as it lies within the power of the United Kingdom legislature to remove it. Further, we see no reason why, as between different parts of the United Kingdom, there should be any restriction on the right of the third party to bring proceedings in the courts with which he has the closest connection. There seems no policy justification for reproducing the result of the *Davenport* case in the draft Bill. The simplest and clearest way to avoid uncertainty is to provide specifically that the third party (in addition to any rights under Schedule 4) may bring the action in the courts of his domicile (regardless of any specific provision in the insurance contract). The draft Bill so provides.[49]

[47] *Davenport* at p 379, *per* Lord Prosser.

[48] Any such consideration would need to take account of the changes made by the new EC Regulation: see para 8.19 above.

[49] Clause 13. Although the problem is more likely to arise in Scotland, the amendment will (in line with the other provisions of Sched 4) apply equally both sides of the border. Clause 13(4) is designed to bring Northern Ireland within a single set of rules, applying throughout the United Kingdom, if and when equivalent legislation is introduced in Northern Ireland.

Claims not governed by the Brussels Convention

England and Wales

8.32 To the extent that the Brussels Convention does not apply,[50] jurisdiction in England and Wales will depend on the common law rules, and the rules relating to service out of the jurisdiction.[51]

8.33 Consultees were asked[52] whether the rules of court then in force were already broad enough to allow service out of the jurisdiction under an amended Act, and if not, whether express provision should be made. A majority of consultees[53] favoured express provision. The consensus was that, in claims under the new Act to which the Brussels (and Lugano) Conventions do not apply, the English and Welsh courts should be able to exercise jurisdiction over insurers located abroad.

8.34 In our view, the rules relating to service should ensure that a third party with rights under the new Act is able to enforce those rights effectively in the courts of England and Wales. We agree with consultees that the procedural rules (now CPR 6.20) will not always be broad enough to allow service out of the jurisdiction.[54]

8.35 Consequently we recommend that grounds for service out of the jurisdiction with the permission of the court (under CPR 6.20), be amended by the addition of a new category expressly related to the jurisdiction of the court under the amended Act. The court will retain its discretion to refuse permission in appropriate cases.[55]

[50] The Lugano Convention 1988 may be relevant if the case involves an EFTA State. See para 8.19, n 24 above.

[51] The rules are contained in CPR 6 and the Practice Direction attached to that rule. In summary, a claim form may be served on a defendant out of the jurisdiction without the permission of the court if the claim is one which the court has been given a power to determine by statute (CPR 6.19). A claim form may be served out of the jurisdiction with the permission of the court if the claim falls within one or more of a number of categories (CPR 6.20) and the case is a proper one for service out under the common law rules. The Court will not give permission unless satisfied that England and Wales is the proper place in which to bring the claim: CPR 6.21(2A). For the principles governing the court's discretion, see *The White Book Service* (2001 Vol 1) para 6.21.16, summarising the principles derived from the cases, in particular *Seaconsar (Far East) Ltd v Bank Markazi Jomhouri Islam Iran* [1994] 1 AC 43 and *The Spiliada* [1987] AC 460.

[52] Consultation paper, para 16.18.

[53] Those who took a different view relied on RSC O 11, r 1(1)(d) (contractual claims) (now CPR 6.20); some commented that, if the insured could have served the insurer, so could the third party as his statutory assignee.

[54] For example, liability might arise under an insurance contract made abroad, and not governed by English law, in circumstances not falling within CPR 6.20(5), or any other part of the rule.

[55] See para 8.32, n 51 above.

Scotland

8.36 In Scotland, where a claim under the Act is governed by the Brussels (or Lugano) Convention(s), the situation is the same as that in England and Wales. Where the insurer against whom the claim is made has no domicile in any of the Contracting States (including the United Kingdom) those Conventions do not apply and the claim is governed by Schedule 8 to the 1982 Act. The effect of that Schedule is that where the insurer is not domiciled in any Contracting State the Scottish courts will lack jurisdiction to hear any case under the proposed Act. Unlike those in England and Wales, courts in Scotland do not possess any discretionary powers of jurisdiction. As a consequence, in Scotland there is no solution to this problem by resorting to a device such as allowing service out of the jurisdiction.

8.37 We have considered whether the new Act should confer a ground of jurisdiction whereby a third party in this situation could sue a foreign insurer in the Scottish courts. We have rejected this suggestion. Any such ground of jurisdiction would be regarded as exorbitant and could lead to problems in enforcing resulting judgments abroad (including the country of the insurer's domicile).

Jurisdiction in arbitration

8.38 The insurance contract may contain an agreement to foreign arbitration.[56] In England and Wales, one of the aims of the Arbitration Act 1996 was to limit the ability of parties to go to court when they had expressly agreed that certain matters should be resolved by arbitration, and where they had provided how and where that arbitration should proceed. Under section 9(4) of the 1996 Act,[57] the court must grant a stay to a party to an arbitration agreement against whom court proceedings are brought, unless that agreement is null and void, inoperative or incapable of being performed. Similarly, in Scotland, an arbitration clause suspends the jurisdiction of the courts and commits the parties to arbitrate the dispute.[58] The draft Bill does not alter this position.

Jurisdiction clauses

8.39 It has become common in insurance contracts for the insurer and insured to agree that the courts of a particular country should have exclusive jurisdiction to hear disputes in relation to the contract. Courts in the United Kingdom will typically uphold such clauses.[59] As a general rule, the third party, to whom the

[56] The application of the 1930 Act to contracts containing Arbitration clauses, and our proposals for reform, are discussed at paras 5.39-5.44 above.

[57] This section does not apply in Scotland.

[58] See F Davidson, *Arbitration* (2000), para 7.18; *Sanderson v Armour & Co.* 1922 SC (HL) 117 at p 126 *per* Lord Dunedin.

[59] In claims governed by the Brussels Convention, the courts are obliged to recognise exclusive jurisdiction clauses which meet certain requirements (Article 17 of the Brussels Convention and Article 23 of the new EC Regulation). Cf the position in claims within the United Kingdom governed by Sched 4 of the Civil Jurisdiction and Judgments Act 1982, Article 17 of which provides that such clauses confer, but do not exclude, jurisdiction.

rights of the insured are transferred, will be subject to the same constraint. We have recommended one exception to this principle, in relation to inter-jurisdictional issues within the United Kingdom, to allow a Scottish third party to sue an English insurer in Scotland (and vice versa).[60]

SUMMARY OF RECOMMENDATIONS

8.40 To summarise the position under the draft Bill and our proposed amendment of the rules of court:

(1) A third party will receive a statutory transfer if the insured is wound up, or becomes subject to one of the other procedures specified in clause 1.[61] All of these procedures are governed by (and are part of) the law of England and Wales or Scotland. No other connection is required. If and when the UNCITRAL model law on cross-border insolvency is brought into force, we recommend that claims by third parties under the draft Bill should be excluded from provisions which would have a contrary effect.

(2) Where the Brussels Convention (or, when it comes into force, the new EC Regulation) applies, a third party will be able to bring proceedings in a court in England and Wales, or in Scotland, if that is where the insured or insurer is domiciled, or that is where the event giving rise to the liability of the insured occurred. Our proposals will not alter this position.

(3) A third party domiciled in England and Wales, or in Scotland, faced with an insurer elsewhere in the United Kingdom, will be able to sue in the courts of his own domicile. The third party's right to do so will not be affected by an exclusive jurisdiction clause in the contract of insurance.

(4) To the extent that the Brussels Convention does not apply, or does not allocate jurisdiction, then, in England and Wales, a third party will be able to apply to the court, under an amended CPR 6.20, for permission to serve out of the jurisdiction. In Scotland, where there is no equivalent to the provisions for service out, no change is proposed.

(5) The third party's right to bring proceedings in a court in Great Britain will, as at present, be subject to any valid arbitration agreement in the insurance contract, even if that arbitration agreement provides for a foreign arbitration.

[60] See para 8.31 above and clause 13.

[61] See Part 2 above.

PART 9
DISTRIBUTION OF A LIMITED INSURANCE FUND TO MULTIPLE CLAIMANTS

THE ISSUE

9.1 The insured may incur liabilities to more than one third party. If those liabilities are insured under a single insurance policy and if their aggregate value exceeds a policy limit, the question arises as to the basis on which the insurance fund should be distributed amongst the third parties.

9.2 This issue came before the English courts in *Cox v Bankside*.[1] The Court of Appeal held that, ordinarily, the insurance fund can only be distributed on a "first come, first served" basis, under which third parties with enforceable judgments are paid in full until the insurer has paid out all of the fund.[2] After that point, third parties receive nothing from the insurer. An exception to the ordinary rule applies, in cases in which a group judgment is delivered, or in which more than one judgment is delivered at the same time. In such circumstances, and subject to any agreement to the contrary, the successful litigants will take rateably.[3]

9.3 In the consultation paper, we set out some reasons why it might be thought desirable to alter the current position in a new Act. In particular, we drew attention to the fact that a third party who received nothing from the insurance fund (because he was too far back in the queue of third parties) would be worse off than if the 1930 Act had never been passed.[4] We queried whether this was an appropriate effect of an Act designed to assist third parties. We asked consultees whether a new Act should contain a new scheme setting out how a limited fund could be distributed more fairly to multiple claimants.

9.4 We also drew attention to a number of difficulties with which any such scheme would have to deal.[5] We expressed no preliminary view on whether reform in this area was desirable.

[1] [1995] 2 Lloyd's Rep 437. We analysed this case in detail in the consultation paper, Part 7.

[2] The court held that, on the facts before it, there was no legal basis on which it could order any other method of distribution, whether in the 1930 Act, in procedural rules of court, in the maxims of equity, or elsewhere. The "first come, first served" system is sometimes called the "first past the post" system. The terms are interchangeable; we use the former in the text.

[3] "there being no sensible or fair alternative" (*Cox v Bankside* [1995] 2 Lloyd's Rep 437 at p 463 *per* Peter Gibson LJ). Peter Gibson LJ held that the exception was based on the equitable maxim "equality is equity". The exception was applied in *Cox v Deeny* [1996] LRLR 288. See p 290 and p 300.

[4] In which case he would have received a rateable share of the insolvency fund swollen by the insurance proceeds.

[5] See consultation paper, paras 15.16-15.17.

Position in Scots law

9.5 There is as yet no multi-party procedure in Scotland, although the courts can conjoin the actions of different pursuers against the same defender. The fund available to these pursuers can then be distributed rateably.[6]

CONSULTATION

9.6 Only one consultee told us that he had experienced this problem outside the Lloyd's litigation.[7] Several consultees felt that the issue would arise very rarely, but that when it did it could involve very large claims.[8]

9.7 Consultees were evenly divided on whether a new Act should contain a statutory scheme of rateable distribution. Many of those in favour said that a new Act should benefit all third parties, not just some of them. A number suggested that the first come, first served basis encouraged an unseemly and costly race to judgment.

9.8 Those who opposed reform did so for a number of reasons. Many referred to the inevitable complexity of a fair statutory scheme, the cost for third parties and others of participating in such a scheme, and the delay it would cause for third parties who had acted promptly to advance strong claims.

"FIRST COME, FIRST SERVED" RETAINED IN THE DRAFT BILL

9.9 We are not recommending reform in this area for the reasons set out below.

Power to order pro rata distribution in some group litigation

9.10 As we have seen,[9] it is already possible for the court to order rateable distribution in some cases. Moreover, the Court of Appeal has indicated that courts may be prepared to use their case management powers so as to enable them to do so if appropriate.[10] To the extent that the Court may already order rateable distribution it is clear that no reform is required.

6 See *Bell v Lothiansure Ltd* (unreported) 19 January 1990, Lord Cameron of Lochbroom.

7 The term "Lloyd's litigation" refers to the mass of actions brought by members of Lloyd's syndicates (the so-called Names) in the 1990's in an attempt to recover damages for the disastrous losses they had suffered. See the consultation paper, para 7.2 ff, for a more complete account.

8 Examples suggested by consultees included mass claims against financial advisors over mis-selling of financial products and mass product liability litigation. It may be, however, that in such cases the court would find a way to order rateable distribution in any event. See para 9.10 below.

9 See para 9.2 above.

10 In *Cox v Bankside* Peter Gibson LJ said (at p 464) "I see no reason in principle why the Court cannot in the interests of fairness in an appropriate case...engineer a situation wherein judgments are given simultaneously so as to achieve a rateable entitlement".

Statutory scheme would be complex and controversial

9.11 Nevertheless, in some group litigation, as in *Cox v Bankside* itself, the court will not have the power to order rateable distribution. The new procedural rules in England and Wales in the CPR do not alter the position. We note, in particular, that the new mechanism for group litigation does not give the court the power to order a rateable distribution of a limited fund.[11]

9.12 Any scheme which could hope to deal justly with litigation as complex and diverse as the Lloyd's litigation would have to be immensely detailed. As Sir Thomas Bingham MR pointed out in *Cox v Bankside*:[12]

> It would have to take account of a multiplicity of plaintiffs, with claims based on different grounds, relating to different periods, against different defendants; it would have to take account of a multiplicity of defendants, some fully insured, some not, some solvent, some insolvent with different E & O cover for different underwriting years; it would have to remain in force for a period of years, during which period the receivers of each policy fund would have to seek the approval of the Court to make interim distributions, and would no doubt have to be paid out of the proceeds of the cover...

9.13 One consultee pointed out that any effective scheme would require something akin to the full machinery of the insolvency legislation with the added complexity that many more claims in this context would be contentious and for unliquidated sums.

9.14 In the consultation paper, we identified a number of the central issues with which any statutory scheme would have to deal.[13] We were not persuaded by those consultees who favoured a statutory scheme that these difficulties could easily be overcome.

9.15 One difficulty is that of devising a satisfactory mechanism for identifying and co-ordinating disparate claims. A single incident might give rise to an immediate claim by one third party and to a long-tail claim from another. One third party's claim might be unarguable (and so would never ordinarily come to the attention of the court) whilst another might require a lengthy trial. At the time of the statutory transfer, one third party might be awaiting judgment against the insured, while another third party might not yet have advanced his claim.

[11] The rules on Group Litigation Orders are at CPR 19.10-19.15. We note, however, that the current situation may change. The Lord Chancellor's Department is consulting on introducing representative actions in which a representative could bring proceedings on behalf of persons with collective interests (Representative Claims: Proposed New Procedures, CP 1/01, February 2001). Were a group of third parties to take advantage of such a new procedure, the court would under the current proposals be entitled to order rateable distribution to achieve a just settlement.

[12] At p 459, col 2.

[13] Consultation paper, Part 15.

Consultees offered widely different solutions to this problem, none of which we found wholly satisfactory.

9.16 Another difficulty is the need to specify an administrator of the scheme. In the consultation paper,[14] we mooted various possibilities: the court, a court appointee, the insured's insolvency practitioner, or the insurer. We mentioned the drawbacks of each. Consultees did not persuade us that this issue could be easily resolved.

Delay caused by a statutory scheme

9.17 An inevitable effect of any system of rateable distribution would be to delay the distribution of the insurance proceeds while all the claims were processed and, if necessary, adjudicated. Third parties whose claims were straightforward or close to judgment would therefore suffer both from receiving less than the full value of their claim and from delay in receiving it. While it might be possible to provide for interim payments this would mitigate rather than remove the problem; it would also add to the complexity and cost of the scheme.

Cost of a statutory scheme

9.18 Any scheme would cost money, most obviously the fees and expenses of its administrator who might, amongst other expenses, require legal advice. The only source for these costs would be the insurance fund. The unwelcome effect would be that the aggregate sums received by third parties would be reduced further by fees paid to insolvency and legal professionals.

Not a problem central to the 1930 Act

9.19 *Cox v Bankside* is the only reported case of this problem arising in the context of the 1930 Act. Only one consultee had other experience of such a problem.[15] We accept that when the issue does arise it may do so in the context of major litigation. However, we took into account the fact that this was not a common problem for users of the 1930 Act.

Bare power to order rateable distribution unsatisfactory

9.20 We considered the possibility of giving the courts the power to order rateable distribution without devising a detailed statutory scheme. However, such a power already exists in group litigation or where the Court is able to engineer simultaneous judgments.[16] In other cases we concluded that the courts would

[14] Consultation paper, paras 15.10-15.12.

[15] One reason for this may be that many insurance policies are not limited by the total value of all claims under a particular risk (or in a particular period or arising from a particular event) but by the value of each individual claim.

[16] See para 9.10 above.

not welcome a bare power, which would require the presiding judge to resolve many of the above difficulties without statutory guidance.[17]

First come, first served is a satisfactory basis

9.21 Even if we could overcome these difficulties and construct a statutory scheme for rateable distribution, it would not always be preferable to the first come, first served basis. We accept that the first come, first served basis will not always be fair to everyone. It may penalise impoverished third parties unable to prosecute their claims, or third parties seeking to arrive at a settlement without embarking on court proceedings. There is also an element of luck involved, as the speed with which a case can be advanced, heard and judgment delivered is not entirely in a claimant's control.[18]

9.22 On the other hand, there is much to be said for the first come, first served basis. It favours those with strong claims over those with weak or speculative claims; it rewards those who take the risk of litigation rather than those who sit back and hope to benefit from the efforts of others; it avoids delay and is cheap to operate.

9.23 Moreover, in the absence of insurance, multiple claimants against a defendant with limited funds will largely be compensated on the first come, first served basis. Claimants who advance their claims early are likely to be paid in full; once funds are exhausted, the defendant is likely to be declared insolvent and third parties who advance their claims at this stage are likely to recover only a small proportion of what they are owed. In this way, those at the front of the queue will receive more than those at the back. We found it difficult to justify discriminating between the treatment of multiple claimants faced with such a defendant - ie without insurance but with limited funds - and those advancing claims under the draft Bill against a defendant with limited insurance.

[17] When considering a proposal that the court should order rateable distribution in the context of a 1930 Act claim in *Cox v Bankside,* Phillips J stated that "I consider that this would be an impossibility without statutory machinery".

[18] One consultee pointed out the possibility that the first come, first served basis might in some circumstances arbitrarily penalise those at the front, as well as those at the back, of the queue. If the insurance policy contains a policy excess the insurer would, under this system, be entitled to deduct it in full from the payout to the first third party to bring a claim (rather than deducting it pro-rata from all the claims or deducting it from the final claim). This consultee suggested that a scheme of rateable distribution could deal with this problem too. It should be noted, however, that this problem will not arise if the excess applies to the individual claim rather than to the total amount which may be claimed under the policy. In addition, an insurer aware that he would be required to pay out the full fund, might in practice deduct the excess from the last claim rather than the first.

9.24 The first come, first served basis will, in any event, work better under the draft Bill than under the 1930 Act, as the third party will have a right at any stage to require the insurer to inform him of the outstanding value of the insurance fund.[19] This will save third parties, likely to lose out because of their position in the queue, the expense of pursuing futile litigation.

(*Signed*) ROBERT CARNWATH, *Chairman, Law Commission*
HUGH BEALE
MARTIN PARTINGTON
ALAN WILKIE

MICHAEL SAYERS, *Secretary*

(*Signed*) BRIAN GILL, *Chairman, Scottish Law Commission*
PATRICK S HODGE
GERARD MAHER
KENNETH G C REID
JOSEPH M THOMSON

JANE L McLEOD, *Secretary*
14 June 2001

[19] See Part 4 above.

APPENDIX A
Draft
Third Parties (Rights against Insurers) Bill

The draft Third Parties (Rights against Insurers) Bill begins on the following page.

The Explanatory Notes begin on page 133 of this pdf file.

Appendix B begins on page 141 of this pdf file, Appendix C on page 146, Appendix D on page 147 and Appendix E on page 150.

Third Parties (Rights against Insurers) Bill

CONTENTS

DRAFT

OF A

B I L L

TO

Make provision about the rights of third parties against insurers of liabilities to third parties in the case where the insured is insolvent, and in certain other cases.

Transfer of rights to third parties

1 Rights against insurer of insolvent person etc

(1) If—

(a) a person to whom this section applies incurs a liability against which he is insured under a contract of insurance, or

(b) a person who is subject to a liability against which he is so insured becomes a person to whom this section applies,

the person's rights under the contract against the insurer in respect of the liability are transferred to and vest in the person to whom the liability is or was incurred.

(2) An individual is a person to whom this section applies if—

(a) a deed of arrangement registered in accordance with the Deeds of Arrangement Act 1914 (c. 47) is in force in respect of him;

(b) a voluntary arrangement approved in accordance with Part VIII of the Insolvency Act 1986 (c. 45) is in force in respect of him;

(c) a bankruptcy order made against him under Part IX of that Act is in force, and the individual has not been discharged under that Part;

(d) an award of sequestration has been made under section 5 of the Bankruptcy (Scotland) Act 1985 (c. 66) in respect of his estate, and the individual has not been discharged under that Act;

(e) a protected trust deed within the meaning of that Act is in force in respect of his estate; or

(f) a composition approved in accordance with Schedule 4 to that Act is in force in respect of him.

(3) A body corporate or unincorporated body is a person to whom this section applies if—

(a) a voluntary arrangement approved in accordance with Part I of the Insolvency Act 1986 is in force in respect of it;

(b) an administration order made under Part II of that Act is in force in respect of it;

(c) there is a person appointed in accordance with Part III of that Act who is acting as receiver or manager of the body's property (or there would be such a person so acting but for a temporary vacancy in the office of receiver or manager);

(d) the body is, or is being, wound up voluntarily in accordance with Chapter II of Part IV of that Act;

(e) there is a person appointed under section 135 of that Act who is acting as provisional liquidator in respect of the body (or there would be such a person so acting but for a temporary vacancy in the office of provisional liquidator);

(f) the body is, or is being, wound up by the court following the making of a winding-up order under Chapter VI of Part IV of that Act or Part V of that Act;

(g) a compromise or arrangement between the body and its creditors (or a class of them) is in force, having been sanctioned in accordance with section 425 of the Companies Act 1985 (c. 6);

(h) the body has been dissolved under section 652 or 652A of that Act, and a court has not declared the dissolution void under section 651 of that Act or ordered the body's name to be restored to the register under section 653 of that Act;

(i) an award of sequestration has been made under section 6 of the Bankruptcy (Scotland) Act 1985 (c. 66) in respect of the body's estate, and the body has not been discharged under that Act;

(j) the body has been dissolved and an award of sequestration has been made under that section in respect of its estate;

(k) a protected trust deed within the meaning of the Bankruptcy (Scotland) Act 1985 is in force in respect of the body's estate; or

(l) a composition approved in accordance with Schedule 4 to that Act is in force in respect of the body.

(4) A trustee of a Scottish trust is, in respect of a liability of his that falls to be met out of the trust estate, a person to whom this section applies if—

(a) an award of sequestration has been made under section 6 of the Bankruptcy (Scotland) Act 1985 in respect of the trust estate, and the trust has not been discharged under that Act;

(b) a protected trust deed within the meaning of that Act is in force in respect of the trust estate; or

(c) a composition approved in accordance with Schedule 4 to that Act is in force in respect of the trust.

(5) Subsection (1) does not apply by virtue of subsection (3)(g) in relation to a liability that is transferred to another body by the order sanctioning the compromise or arrangement.

(6) Where subsection (1) applies by virtue of subsection (3)(g), it has effect to transfer rights only to a person on whom the compromise or arrangement is binding.

(7) Where—

(a) an award of sequestration made under section 5 or 6 of the Bankruptcy (Scotland) Act 1985 is recalled or reduced, or

(b) an order discharging an individual, body or trust is recalled under paragraph 17 of Schedule 4 to that Act, or reduced under paragraph 18 of that Schedule,

the award or order is to be treated for the purposes of this section as never having been made.

(8) In this section—

(a) a reference to a person appointed in accordance with Part III of the Insolvency Act 1986 (c. 45) includes a reference to a person appointed under section 101 of the Law of Property Act 1925 (c. 20);

(b) a reference to a receiver or manager of a body's property includes a reference to a receiver or manager of part only of the property and to a receiver only of the income arising from the property or from part of it;

(c) for the purposes of subsection (3)(i) to (l) "body corporate or unincorporated body" includes any entity, other than a trust, the estate of which may be sequestrated under section 6 of the Bankruptcy (Scotland) Act 1985 (c. 66);

(d) "Scottish trust" means a trust the estate of which may be so sequestrated.

2 Rights against insurer of individual who dies insolvent

(1) Where an individual dies insolvent while subject to a liability against which he is insured under a contract of insurance, his rights under the contract against the insurer in respect of the liability are transferred to and vest in the person to whom the liability was incurred.

(2) For the purposes of this section an individual is to be regarded as having died insolvent if, following his death—

(a) his estate falls to be administered in accordance with an order under section 421 of the Insolvency Act 1986;

(b) an award of sequestration is made under section 5 of the Bankruptcy (Scotland) Act 1985 in respect of his estate and the award is not recalled or reduced; or

(c) a judicial factor is appointed under section 11A of the Judicial Factors (Scotland) Act 1889 (c. 39) in respect of his estate and the judicial factor certifies that the estate is absolutely insolvent within the meaning of the Bankruptcy (Scotland) Act 1985.

(3) In relation to a transfer under this section of an insured person's rights, references in this Act to an insured are, where the context so requires, to be read as references to his estate.

3 Transferred rights not to exceed insured's liability

Where the liability of an insured to a third party in respect of which there is a transfer of rights under section 1 or 2 is less than the liability (apart from that section) of the insurer to the insured, no rights are transferred under that section in respect of the difference.

4 Conditions affecting transferred rights

(1) Where—

(a) rights of an insured under a contract of insurance have been transferred to a third party under section 1 or 2, and

(b) under the contract, the rights are subject to a condition that the insured has to fulfil,

anything done by the third party which, if done by the insured, would have amounted to or contributed to fulfilment of the condition is to be treated as if done by the insured.

(2) Where—

(a) rights of an insured under a contract of insurance have been transferred to a third party under section 1,

(b) the insured is a body corporate that has been dissolved,

(c) under the contract, the rights are subject to a condition requiring the insured to provide information or assistance to the insurer, and

(d) the condition is not fulfilled, but only because of the body's inability to act after being dissolved,

the transferred rights are not subject to the condition.

(3) Where—

(a) rights of an insured under a contract of insurance have been transferred to a third party under section 1 or 2, and

(b) under the contract, the rights are subject to a condition requiring the prior discharge by the insured of his liability to the third party,

the transferred rights are not subject to the condition.

(4) In the case of a contract of marine insurance, subsection (3) applies only to the extent that the liability of the insured is a liability in respect of death or personal injury.

(5) In this section—

"contract of marine insurance" has the meaning given by section 1 of the Marine Insurance Act 1906 (c. 41);

"dissolved" means dissolved under Chapter IX of Part IV of the Insolvency Act 1986 (c. 45) or under section 652 or 652A of the Companies Act 1985 (c. 6);

"personal injury" includes any disease and any impairment of a person's physical or mental condition.

5 Insurer's right of set-off

Where—

(a) rights of an insured under a contract of insurance have been transferred to a third party under section 1 or 2,

(b) the insured is under any liability to the insurer under the contract ("the insured's liability"), and

(c) if there had been no transfer, the insurer would have been entitled to set off the amount of the insured's liability against the amount of his own liability to the insured,

the insurer is entitled to set off the amount of the insured's liability against the amount of his own liability to the third party.

6 Avoidance

(1) A provision of an insurance contract to which this section applies is of no effect in so far as it purports, whether directly or indirectly, to avoid the contract or to alter the rights of the parties under it in the event of the insured—

(a) becoming a person to whom section 1 applies; or

(b) dying insolvent (within the meaning given by section 2(2)).

(2) An insurance contract is one to which this section applies if the insured's rights under it are capable of being transferred under section 1 or 2.

Provision of information etc

7 Information and disclosure for third parties

Schedule 1 (which provides for entitlement to information and disclosure on the part of persons to whom rights have or may have been transferred under this Act) has effect.

Enforcement of transferred rights

8 Proceedings in England and Wales

(1) A person who claims that rights have vested in him under section 1 or 2, but who has not established the insured's liability, may take proceedings against the insurer for either or both of the following—

(a) a declaration as to the insured's liability to him;

(b) a declaration as to the insurer's potential liability to him.

(2) The claimant in such proceedings is entitled, subject to any defence on which the insurer may rely, to a declaration under subsection (1)(a) or (b) on proof of the insured's liability or (as the case may be) the insurer's potential liability.

(3) Where proceedings are taken under subsection (1)(a) the insurer may rely on any defence on which the insured could rely if those proceedings were proceedings taken against the insured in respect of his liability.

(4) Subsection (3) is subject to sections 11(1) and 12.

(5) Where—

(a) the court makes a declaration under each of paragraphs (a) and (b) of subsection (1), and

(b) the effect of the declarations is that the insurer is liable to the claimant,

the court may give the appropriate judgment against the insurer.

(6) Where a person applying for a declaration under subsection (1)(b) is entitled or required, by virtue of provision in the contract of insurance, to do so in arbitral proceedings, he may also apply in the same proceedings for a declaration under subsection (1)(a).

(7) In its application to arbitral proceedings, subsection (5) is to be read as if "tribunal" were substituted for "court" and "make the appropriate award" for "give the appropriate judgment".

(8) The insured may be made a defendant to an application for a declaration under subsection (1)(a); and if he is (but not otherwise), a declaration under that subsection binds him as well as the insurer.

9 Proceedings in Scotland

(1) A person who claims that rights have vested in him under section 1 or 2, but who has not established the insured's liability, may take proceedings against the insurer for either or both of the following—

(a) a declarator as to the insured's liability to him;

(b) a declarator as to the insurer's potential liability to him.

(2) Where proceedings are taken under subsection (1)(a) the insurer may rely on any defence on which the insured could rely if those proceedings were proceedings taken against the insured in respect of his liability.

(3) Subsection (2) is subject to sections 11(1) and 12.

(4) Where—

(a) the court grants a declarator under each of paragraphs (a) and (b) of subsection (1), and

(b) the effect of the declarators is that the insurer is liable to the claimant,

the court may grant the appropriate decree against the insurer.

(5) Where a person applying for a declarator under subsection (1)(b) is entitled or required, by virtue of provision in the contract of insurance, to do so in arbitral proceedings, he may also apply in the same proceedings for a declarator under subsection (1)(a).

(6) In its application to arbitral proceedings, subsection (4) is to be read as if "arbiter" were substituted for "court" and "make the appropriate award" for "grant the appropriate decree".

(7) The insured may be made a defender to an application for a declarator under subsection (1)(a); and if he is (but not otherwise) a declarator under that subsection binds him as well as the insurer.

10 Interpretation of sections 8 and 9

(1) References in sections 8 and 9 to the insurer's potential liability are references to his liability in respect of the insured's liability, if established.

(2) For the purposes of those sections and this section, a liability is established only when both the existence and the amount of it is established.

(3) In those sections and this section "establish" means establish by a judgment or decree, by an award in arbitral proceedings or by an enforceable agreement.

11 Limitation and prescription

(1) Where a person takes proceedings for a declaration under section 8(1)(a), or for a declarator under section 9(1)(a), and the proceedings are started—

(a) after the expiry of a period of limitation applicable to an action against the insured to enforce his liability, or of a period of prescription applicable to that liability, but

(b) while such an action is in progress,

the insurer may not rely as a defence on the expiry of that period unless the insured is able to rely on it in the action against him.

(2) For the purposes of subsection (1), where an action has been concluded by a judgment or decree, or by an award, it is no longer in progress even if there is an appeal or a right of appeal.

(3) In a case where a person who has already established an insured's liability to him takes proceedings under this Act against the insurer, nothing in this Act is to be read as meaning—

(a) that, for the purposes of the law of limitation (in England and Wales), his cause of action accrued otherwise than at the time when he established that liability; or

(b) that, for the purposes of the law of prescription (in Scotland), the obligation in respect of which the proceedings are taken became enforceable otherwise than at that time.

(4) Subsections (2) and (3) of section 10 apply also for the purposes of this section.

12 Discharge of insured

Where—

(a) a person takes proceedings in respect of rights that he claims have vested in him under section 1 or 2, and

(b) after the start of those proceedings, the insured is discharged—

(i) under Part IX of the Insolvency Act 1986 (c. 45), or

(ii) under the Bankruptcy (Scotland) Act 1985 (c. 66) or under a protected trust deed within the meaning of that Act,

the discharge is to be disregarded in determining the liability of the insured to the claimant for the purposes of this Act.

13 Jurisdiction within the UK

(1) Where a person domiciled in England and Wales or in Scotland is entitled to take court proceedings under this Act against an insurer domiciled in another part of the United Kingdom, he may do so in the part where he himself is domiciled or in the part where the insurer is domiciled (whatever the contract of insurance may stipulate as to where proceedings are to be taken).

(2) The following provisions of the Civil Jurisdiction and Judgments Act 1982 (c. 27) (which determine whether a person is domiciled in the United Kingdom and, if so, in which part) apply for the purposes of subsection (1)—

(a) section 41(2), (3), (5) and (6) (individuals);

(b) section 42(1), (3), (4) and (8) (corporations and associations);

(c) section 46(1), (3) and (7) (the Crown).

(3) In Schedule 5 to that Act (proceedings excluded from general provisions as to allocation of jurisdiction within the United Kingdom) insert at the end—

"Proceedings by third parties against insurers

11. Proceedings under the Third Parties (Rights against Insurers) Act 2001."

(4) If an Act of the Northern Ireland Assembly corresponding to this Act contains—

(a) provision to the effect that a person domiciled in Northern Ireland who is entitled to take court proceedings under that Act against an insurer domiciled in another part of the United Kingdom may do so either in Northern Ireland or in the part where the insurer is domiciled (whatever the contract of insurance may stipulate as to where proceedings are to be taken), or

(b) provision inserting a reference to proceedings under that Act into Schedule 5 to the Civil Jurisdiction and Judgments Act 1982 (c. 27),

the provision also has effect as part of the law of England and Wales and of Scotland.

Enforcement of insured's liability

14 Effect of transfer on insured's liability

(1) Where rights in respect of an insured's liability to a third party are transferred under section 1 or 2, the third party may enforce that liability only to the extent (if any) that it exceeds the amount recoverable from the insurer by virtue of the transfer.

(2) Where—

(a) rights in respect of an insured's liability are transferred under section 1,

(b) the transfer occurs by virtue of subsection (2)(a), (b) or (e), subsection (3)(a), (g) or (k) or subsection (4)(b) of that section, and

(c) the liability is one that is subject to the arrangement, trust deed or compromise in question,

the liability is to be treated as subject to the arrangement, trust deed or compromise only to the extent (if any) that the liability exceeds the amount recoverable from the insurer by virtue of the transfer.

(3) Where—

(a) rights in respect of an insured's liability are transferred under section 1, and

(b) the liability subsequently becomes one that is subject to a composition approved in accordance with Schedule 4 to the Bankruptcy (Scotland) Act 1985 (c. 66),

the liability is to be treated as subject to the composition only to the extent (if any) that the liability exceeds the amount recoverable from the insurer by virtue of the transfer.

(4) For the purposes of this section the amount recoverable from the insurer does not include any amount that the third party is unable to recover as a result of—

(a) a shortage of assets on the insurer's part, in a case where the insurer is himself a person to whom section 1 applies or an individual who has died insolvent (within the meaning given by section 2(2)); or

(b) a limit set by the insurance contract on the fund available to meet claims in respect of a particular description of liability of the insured.

(5) In ascertaining the amount given by subsection (4)(a), the third party is to be treated as able to recover any sum that is due to him, in respect of the insurer's liability, under or by virtue of rules made under Part XV of the Financial

Services and Markets Act 2000 (c. 8) (the Financial Services Compensation Scheme).

Application of Act

15 Reinsurance

This Act does not apply to a case where the liability referred to in section 1(1) or 2(1) is itself a liability incurred by an insurer under a contract of insurance.

16 Voluntarily-incurred liabilities

It is irrelevant for the purposes of section 1 or 2 whether or not the liability of the insured is or was incurred voluntarily.

17 Cases with a foreign element

Except as expressly provided, the application of any provision of this Act does not depend on whether there is a connection with England and Wales or Scotland; and in particular it does not depend on—

(a) whether or not the liability (or the alleged liability) of the insured to the third party was incurred in, or under the law of, England and Wales or Scotland;

(b) the place of residence or domicile of any of the parties;

(c) whether or not the contract of insurance (or a part of it) is governed by the law of England and Wales or Scotland;

(d) the place where any sum due under the contract of insurance is payable.

Supplemental

18 Power to amend Act

(1) The Secretary of State may by order made by statutory instrument amend this Act for the purposes of redefining—

(a) the circumstances in which a person is one to whom section 1 applies;

(b) the circumstances in which an individual is to be regarded for the purposes of section 2 as having died insolvent.

(2) An order under this section may—

(a) make such transitional provision as the Secretary of State thinks fit;

(b) make consequential amendments to other enactments.

(3) No order under this section shall be made unless a draft of it has been laid before, and approved by a resolution of, each House of Parliament.

19 Consequential amendments and repeals

(1) In subsections (1) and (3) of section 153 of the Road Traffic Act 1988 (c. 52) (bankruptcy etc of insured or secured persons not to affect claims by third parties), for "Third Parties (Rights against Insurers) Act 1930" substitute "Third Parties (Rights against Insurers) Act 2001".

(2) In section 165(5) of the Merchant Shipping Act 1995 (c. 21) (which excludes the application of the Third Parties (Rights against Insurers) Act 1930 (c. 25) in relation to certain contracts of compulsory insurance against liability for pollution), for "Third Parties (Rights against Insurers) Act 1930" substitute "Third Parties (Rights against Insurers) Act 2001". *5*

(3) The enactments mentioned in Schedule 2 are repealed or revoked to the extent specified.

20 Transitional provisions and savings

(1) Subsection (1)(a) of section 1 applies where the insured became a person to whom that section applies before, as well as when he becomes such a person on or after, commencement day. *10*

(2) Section 1(1)(b) and section 2 apply where the liability was incurred before, as well as where it is incurred on or after, commencement day.

(3) Despite its repeal by this Act, the Third Parties (Rights against Insurers) Act 1930 continues to apply in relation to— *15*

(a) cases where the event referred to in subsection (1) of section 1 of that Act and the incurring of the liability referred to in that subsection both happened before commencement day;

(b) cases where the death of the deceased person referred to in subsection (2) of that section happened before that day. *20*

(4) In this section "commencement day" means the day on which this Act comes into force.

21 Short title, commencement and extent

(1) This Act may be cited as the Third Parties (Rights against Insurers) Act 2001.

(2) This Act comes into force at the end of the period of three months beginning with the day on which it is passed. *25*

(3) Section 8 and paragraphs 3 and 4 of Schedule 1 do not extend to Scotland.

(4) Section 9 extends only to Scotland.

(5) Only section 13(1) to (3) extends to Northern Ireland.

SCHEDULES

SCHEDULE 1

Section 7.

INFORMATION AND DISCLOSURE FOR THIRD PARTIES

Notices requesting information

1 (1) If a person believes on reasonable grounds—

(a) that a liability has been incurred to him,

(b) that the party who incurred the liability is insured against it under a contract of insurance,

(c) that rights of that party under the contract have been transferred to him under section 1 or 2, and

(d) that there is a person who is able to provide any information falling within sub-paragraph (2),

he may by notice in writing request from that person such information falling within that sub-paragraph as the notice may specify.

(2) The following is the information that falls within this sub-paragraph—

(a) whether there is a contract of insurance that covers the supposed liability or might reasonably be regarded as covering it;

(b) if there is such a contract—

(i) who the insurer is;

(ii) what the terms of the contract are;

(iii) whether the insurer has informed the insured that he does not consider himself to be liable under the contract in respect of the supposed liability;

(iv) whether there are or have been any proceedings between the insurer and the insured in respect of the supposed liability and, if so, relevant details of those proceedings;

(v) in a case where the contract sets a limit on the fund available to meet claims in respect of the supposed liability and other liabilities, how much of it (if any) has been paid out in respect of other liabilities;

(vi) whether there is a fixed charge to which any sums paid out under the contract in respect of the supposed liability would be subject.

(3) For the purpose of sub-paragraph (2)(b)(iv), relevant details of proceedings are—

(a) in the case of court proceedings—

(i) the name of the court;

(ii) the case number;

(iii) the contents of all documents served in the proceedings in accordance with rules of court or with any orders made in the proceedings, and the contents of any such orders;

(b) in the case of arbitral proceedings—

(i) the name of the arbitrator or, in Scotland, the arbiter;

(ii) information corresponding with that mentioned in paragraph (a)(iii).

(4) In sub-paragraph (2)(b)(vi), in its application to Scotland, "fixed charge" means a fixed security within the meaning given by section 486(1) of the Companies Act 1985 (c. 6).

(5) A notice given by a person under this paragraph must include particulars of the facts on which he relies for his entitlement to give the notice.

Provision of information where notice given under paragraph 1

2 (1) A person who receives a notice under paragraph 1 shall, within the period of 28 days beginning with the day of receipt of the notice—

(a) provide to the person who gave the notice any information specified in it that he is able to provide;

(b) in relation to any such information that he is not able to provide, notify that person why he is not able to provide it.

(2) Where—

(a) a person receives a notice under paragraph 1,

(b) there is information specified in the notice that he is not able to provide because it is contained in a document that is not in his control,

(c) the document was at one time in his control, and

(d) he knows or believes that it is now in another person's control,

he shall, within the period of 28 days beginning with the day of receipt of the notice, provide the person who gave the notice with whatever particulars he can as to the nature of the information and the identity of that other person.

(3) No duty arises by virtue of this paragraph in respect of information as to which a claim to legal professional privilege or, in Scotland, to confidentiality as between client and professional legal adviser could be maintained in legal proceedings.

Notices requiring disclosure: defunct bodies

3 (1) If—

(a) a person has started proceedings under this Act against an insurer in respect of a liability that he claims has been incurred to him by a body corporate, and

(b) the body is defunct,

he may by notice in writing require a person to whom sub-paragraph (2) applies to disclose to him any documents that are relevant to that liability.

(2) This sub-paragraph applies to a person if—

(a) immediately before the time of the alleged transfer under section 1 or 2, he was an officer or employee of the body corporate; or

(b) immediately before the body became defunct, he was—

(i) acting as an insolvency practitioner in relation to the body (within the meaning given by section 388(1) of the Insolvency Act 1986 (c. 45)), or

(ii) acting as the official receiver in relation to the winding up of the body.

(3) A notice under this paragraph must be accompanied by a copy of the particulars of claim required to be served in connection with the proceedings mentioned in sub-paragraph (1) or, where those proceedings are arbitral proceedings, the particulars of claim that would be required to be so served if they were court proceedings.

(4) For the purposes of this paragraph a body corporate is defunct if it has been dissolved under Chapter IX of Part IV of the Insolvency Act 1986, or under section 652 or 652A of the Companies Act 1985 (c. 6), and a court has not—

(a) declared the dissolution void under section 651 of the Companies Act 1985; or

(b) ordered the body's name to be restored to the register under section 653 of that Act.

Disclosure and inspection where notice given under paragraph 3

4 (1) Subject to the provisions of this paragraph and to any necessary modifications—

(a) the duties of disclosure of a person who receives a notice under paragraph 3, and

(b) the rights of inspection of the person giving the notice,

are the same as the corresponding duties and rights under Civil Procedure Rules of parties to court proceedings in which an order for standard disclosure has been made.

(2) A person who by virtue of sub-paragraph (1) has to serve a list of documents shall do so within the period of 28 days beginning with the day of receipt of the notice.

(3) A person who has received a notice under paragraph 3 and has served a list of documents in response to it is not under a duty of disclosure by reason of that notice in relation to any documents that he did not have to disclose at the time when he served the list.

Avoidance

5 A provision of an insurance contract is of no effect in so far as it purports, whether directly or indirectly—

(a) to avoid the contract or to alter the rights of the parties under it in the event of a person providing any information, or giving any disclosure, that he is required to provide or give by virtue of a notice under paragraph 1 or 3; or

(b) otherwise to prohibit or prevent a person from providing such information or giving such disclosure.

Other rights to information etc

6 Rights to information, or to inspection of documents, that a person has by virtue of paragraph 1 or 3 are in addition to any such rights that he has apart from that paragraph.

Interpretation

7 For the purposes of this Schedule—

(a) a person is able to provide information only if—

(i) he can obtain it without undue difficulty from a document that is in his control, or

(ii) where the person is an individual, the information is within his knowledge;

(b) a thing is in a person's control if it is in his possession or if he has a right to possession of it or to inspect or take copies of it.

SCHEDULE 2

Section 19(3).

REPEALS AND REVOCATION

Short title or title, and chapter or number	*Extent of repeal or revocation*
Third Parties (Rights against Insurers) Act 1930 (c. 25)	The whole Act.
Insolvency Act 1985 (c. 65)	In Schedule 8, paragraph 7.
Bankruptcy (Scotland) Act 1985 (c. 66)	In Schedule 7, paragraph 6.
Insolvency Act 1986 (c. 45)	In Schedule 14, the entry relating to the Third Parties (Rights against Insurers) Act 1930.
Limited Liability Partnerships Regulations 2001 (S.I. 2001/1090)	In Schedule 5, paragraph 2.

EXPLANATORY NOTES

Summary and background

This Bill is concerned with a situation in which a person, referred to in the Bill as a "third party", is owed money by someone who is insured against that debt. In the absence of statutory intervention, the third party's rights in respect of the debt are against the insured; it is the insured who has contractual rights against the insurer. The Bill alters the structure of this three-way relationship in certain cases. If the insured is declared bankrupt, or becomes subject to one of a number of other procedures specified in the Bill, the Bill confers on the third party direct rights against the insurer. It does this by transferring to the third party the insured's rights under the insurance contract relating to the debt. The Bill also entitles a third party to obtain information concerning transferred rights from the insurer and others.

One of the aims of the Bill is to ensure that insurance proceeds, paid to cover debts to third parties, go to those third parties, even if the insured is declared insolvent. In the absence of statutory intervention this would not occur. Instead, the proceeds would be treated as an asset of the insured and be distributed pro rata under insolvency legislation to the general creditors, of whom the third party would be one. As a result, the third party might recover only a small proportion of the insurance proceeds; the balance would increase the dividends of the other creditors. The Bill also intervenes to assist third parties owed money by insureds who, whilst not involved in a formal insolvency, have otherwise to some degree lost the effective power to enforce their own rights or deal with their own assets. An example is a case in which the insured has entered into a voluntary arrangement with creditors.

The Bill, if enacted, would replace the Third Parties (Rights against Insurers) Act 1930. The 1930 Act was designed to do the same task as the Bill. However, the 1930 Act does not work as well as it should: it can be unnecessarily expensive and time-consuming to use, both for litigants and the courts; and in many cases it does not assist third parties at all. Details of the deficiencies in the operation of the 1930 Act, and reasons for replacing it with the Bill, are set out in the report.

Overview

Clauses 1 and 2 specify the circumstances in which a statutory transfer will take place, and effect the transfer. After a transfer, a third party will have the benefit of the insured's insurance cover in relation to the amount he or she is owed by the insured, subject to any alterations effected by clauses 3-6. Clause 7 confers on the third party various rights to disclosure as set out in Schedule 1. A third party will be entitled to enforce transferred rights as specified in clauses 8-13. In a major departure from the 1930 Act, clauses 8-10 provide a new mechanism allowing the third party to enforce transferred rights against the insurer without first establishing the fact and amount of the insured's liability in separate proceedings. Clause 14 sets out the consequences of the statutory transfer on the third party's rights against the insured. Clauses 15-17 set out the range of insurance policies covered by the Bill and the way in which the Bill applies to cases with a foreign element. Clauses 18-21 contain various supplemental provisions.

Clause 1

Subsection (1) effects a transfer (by virtue of subsection (1)(b)) if the insured incurs a debt to the third party and then becomes subject to one of the procedures specified in subsection (2), (3) or (4). For example, a third party will receive a statutory transfer if the insured becomes bankrupt (subsection (2)(c)) or if the insured is a company and becomes subject to a Company Voluntary Arrangement (subsection (3)(a)). Subsection (1) also effects a transfer (by virtue of subsection (1)(a)) if the insured incurs the debt whilst already subject to one of these procedures. The reasons for including each of the procedures listed in subsections (2), (3) and (4), a number of which are not included in the 1930 Act, are set out in detail in Part 2 of the report.

Subsections (5)-(7) limit the circumstances in which a transfer is effected in the case of some of the procedures listed in the previous subsections. These restrictions prevent transfers from occurring in cases in which the third party's position is unaffected by the procedure to which the insured is subject.

Clause 2

Subsection (1) effects a statutory transfer in a case in which the insured dies insolvent. Subsection (2) sets out what must occur before it can be said that someone has died insolvent for the purposes of the clause.

Clause 3

This clause ensures that a third party does not receive a right to recover from the insurer any amounts in excess of the insured debt. So, for example, if the insured incurred costs defending a claim from the third party, and the insurer was obliged by the insurance contract not only to indemnify the insured in full but also to reimburse the insured for costs, the insured would retain the right to claim the costs. See paragraph 7.37 of the report.

Clause 4

This clause prevents an insurer from defeating a third party's claim by relying on certain technical defences which might otherwise be available to it as a result of the statutory transfer. The detailed reasons for altering the transferred rights in this way are set out in Part 5 of the report. This clause has no counterpart in the 1930 Act.

Subsection (1) ensures that an insurer cannot resist a claim from a third party by arguing that the insured has not fulfilled a condition in the insurance contract if the third party has fulfilled that condition instead. So, for example, if the insurance contract required the insured to notify the insurer of a claim within a certain period, and the insured did not do this, but the third party did, the insurer would not, as a result of this subsection, be able to rely on a breach of the condition as against the third party.

Subsection (2) deals with a case in which the insurance contract contains a condition that the insured provide information or assistance to the insurer. In the usual case in which the insured still exists, the insurer will be entitled to rely on a breach by the insured of such a clause as against the third party. However, if the insured is a company that no longer exists, this subsection prevents the insurer from relying on a breach of such a clause as against the third party.

Subsections (3) and (4) deal with "pay-first" clauses. These are clauses which require the insured actually to have paid sums due to the third party before the right to an indemnity arises. Following the judgment of the House of Lords in *The Fanti and the Padre Island* [1991] 2 AC 1, it is clear that a third party's claim under rights transferred by the 1930 Act is worthless if the insurance contract contains such a clause. Subsection (3) ensures that this is not the case under the Bill, by providing that such a clause does not apply to transferred rights. Subsection (4) limits the effect of subsection (3), in cases of marine insurance, to claims in respect of personal injury or death. See paragraphs 5.34-5.37 of the report.

Clause 5

This clause ensures that, if the insured has not paid all the premiums for the insurance policy, the insurer can deduct those unpaid premiums when paying the third party's claim, to the extent to which it would have been entitled to do so had the claim been brought by the insured. See paragraphs 5.20-5.22 of the report. This clause has no counterpart in the 1930 Act.

Clause 6

This clause prevents the insured and insurer from drafting the insurance contract so as to nullify the effect of the Bill.

Clause 7

This clause introduces Schedule 1, which confers on the third party rights to obtain information about the insurance policy. See the notes on that Schedule below.

Clause 8

This clause introduces, for England and Wales, a mechanism designed to overcome a major drawback of the 1930 Act. The new mechanism will enable a third party to enforce rights transferred by clause 1 or 2 without first establishing the fact and amount of the insured's liability. Under the 1930 Act this is not possible. The serious problems to which this gives rise, and the way in which the new mechanism will operate, are explained in detail in Part 3 of the report.

Subsection (1) entitles a third party who has received a transfer of rights, but who has not yet established that the insured is liable (or who has established that the insured is liable, but has not proved the amount of that liability), to bring proceedings against the insurer. In those proceedings, the third party must ask the court for one or both of the declarations set out in the subsection. A subsection (1)(a) declaration will contain the court's decision on the third party's allegation that the insured is liable to the third party. A subsection (1)(b) declaration will contain the court's decision on the third party's allegation that the insurance policy covers that liability. It is anticipated that third parties using the new mechanism will usually apply for both declarations, as it is only if both are granted that the court is entitled, under subsection (5), to grant further remedies.

Subsection (2) provides that a third party who proves his or her case will be entitled to the relevant declaration. In the absence of such a provision, a decision on whether to grant the declarations applied for would be within the discretion of the court; such a discretion is not necessary in the context of the new mechanism.

The effect of subsection (3) is that an insurer facing a claim from a third party using the mechanism in this clause and claiming a declaration as to the insured's liability will be entitled to rely on any defence which would have been available to the insured. So, for

example, if the insured would have been able to resist a third party's action by relying on an estoppel, the insurer will be able to do the same.

Subsection (4) adjusts the way that subsection (3) operates in two specific circumstances set out in clauses 11(1) and 12.

Subsection (5) empowers a court which has made both subsection (1) declarations to give "the appropriate judgment". In many cases, this will be a judgment for a particular sum of money. However, if argument on the amount of the liability has been postponed, either to a later court hearing, or to an arbitration, the court might grant judgment for damages to be assessed. The need for this subsection arises because, under the 1930 Act, the courts have held that a third party is not entitled to judgment of any kind until the amount of the liability of the insured has been established as between the third party and the insured.

Subsections (6) and (7) extend the benefit of the new mechanism to third parties who are entitled or obliged, by a provision in the insurance contract, to resolve the issue of the insurer's liability in arbitration proceedings.

Subsection (8) provides that a third party who uses the new mechanism and applies for a subsection (1)(a) declaration has the choice of whether or not to join the insured as a defendant to the action. This will make the new mechanism flexible. A consequence of this flexibility, however, is that, if a third party chooses not to join the insured as a defendant, the court may be required to make a subsection (1)(a) declaration, concerning the insured's obligations, in the absence of the insured. It would be inappropriate if a declaration made in such circumstances bound the insured; accordingly the effect of subsection (8) is that an insured is only bound if he or she is a defendant to the third party's claim. As an additional protection, amended rules of court will require a third party to inform the insured of his or her action against the insurer, which will give the insured the option of applying to be joined as a defendant. See paragraphs 3.52-3.56 of the report.

Clause 9

This clause introduces the new mechanism in Scotland. The subsections mirror those of clause 8, except that no counterpart to clause 8(2) is necessary in Scotland, where a declarator is not a discretionary remedy.

Clause 10

This clause defines some of the terms used in the previous two clauses.

Clause 11

This clause sets out rules governing when an action under rights transferred by the Bill will be time-barred. See paragraphs 5.51-5.65 of the report. This clause has no counterpart in the 1930 Act.

Subsections (1) and (2) adjust the way that clause 8(3) (in Scotland, clause 9(2)) operates in a case in which the third party is already involved in proceedings against the insured, and the limitation (or prescriptive) period governing those proceedings has expired. In the absence of these subsections, fresh proceedings against the insurer using the new mechanism in clause 8 or 9 would, in these circumstances, be time-barred. This would not matter if the third party could join the insurer to the existing proceedings against the insured. However, it is likely that this will not be possible under procedural rules which comply with section 35 of the Limitation Act 1980. These subsections are therefore necessary to ensure that the new mechanism provided by the Bill is available to third parties in these circumstances. See paragraphs 5.56-5.58 of the report.

Subsection (3) confirms that, if the third party does not use the new mechanism in clause 8 or 9, the time limits governing the third party's claim will be those which would have governed a claim under the insurance contract by the insured.

Clause 12

This clause ensures that, once a third party has issued proceedings against the insurer under transferred rights (whether or not using the new mechanism in clause 8 or 9), the insured's subsequent discharge from bankruptcy will not affect the claim. In the absence of this clause, clause 8(3) (in Scotland, clause 9(2)) might enable an insurer to rely on such a discharge to defeat the third party's claim. See paragraphs 5.47-5.50 of the report. This clause has no counterpart in the 1930 Act.

Clause 13

This clause concerns cases in which the third party is domiciled in England and Wales or in Scotland, and the insurer is domiciled elsewhere in the United Kingdom. In the absence of this clause, the position would be governed by Schedule 4 to the Civil Jurisdiction and Judgments Act 1982 and by any relevant clause in the insurance contract. The result might be to prevent a third party from suing the insurer in the courts of his or her own place of domicile. This clause alters the position by giving the third party the choice of issuing proceedings in his or her own place of domicile, or in that of the insurer, regardless of any contrary provisions in the insurance contract. See Part 8 of the report. This clause has no counterpart in the 1930 Act.

In general, the Bill does not extend to Northern Ireland: see clause 21. However, in order to ensure that the new jurisdictional rules imposed by clause 13 in England, Wales and Scotland do not conflict with the jurisdictional rules in Northern Ireland, subsection (1) refers to the "United Kingdom" and this subsection is extended to Northern Ireland by clause 21(5). It is likely that in due course legislation in similar terms to that of the Bill will be introduced for Northern Ireland. The purpose of subsection (4) is to ensure that, after this happens, the jurisdictional rules implemented by the Northern Ireland legislation are effective throughout the United Kingdom.

Clause 14

This clause sets out the effect of a transfer of rights on the third party's rights against the insured. In addition to regulating the general position, this clause contains specific provisions necessary to ensure that the Bill operates correctly in the context of the various voluntary alternatives available to insolvent insureds that fall short of a formal bankruptcy or winding up. The general position is covered in the report at paragraphs 7.4-7.8. The issues relating to voluntary procedures are the subject of Part 6. This clause has no counterpart in the 1930 Act.

Subsection (1) provides that a third party may not seek to enforce his or her rights against the insured to the extent that there is valid insurance in place covering the debt. As the benefit of the insurance policy has been transferred by the Bill to the third party, it would not be right to require the insured to make any payments except to the extent that the insurance policy was ineffective.

Subsections (2) and (3) cater for voluntary procedures. Their purpose is to ensure that rights under the insurance contract which have been transferred by the Bill are not devalued by the voluntary procedure which caused the transfer. They do this by limiting the effect the

voluntary procedure can have on the insured's debt to the third party. If that effect, disregarding subsections (2) and (3), would have been to reduce the insured's liability to the third party, this will be effective only in relation to that part of the third party's debt, if any, which is not recoverable under transferred rights.

It is important to note that, although the effect of subsections (2) and (3) may be to remove a third party, partially or completely, from the scope of a voluntary procedure, such a third party will still be bound by subsection (1). These subsections will not, therefore, enable a third party to disturb a voluntary procedure.

Subsection (4) ensures that subsections (1), (2) and (3) do not prejudice a third party who is unable to recover from the insurer, either because the insurer is in financial difficulties itself, or because the insurer is only obliged to pay out a certain amount of its funds to claimants in the same category as the third party.

Subsection (5) clarifies that a third party who cannot recover from the insurer because of the insurer's financial difficulties must first claim statutory compensation before enforcing his or her rights against the insured.

Clause 15

The effect of this clause is that the Bill does not cover reinsurance. In other words, the Bill does not cover a case in which the third party is an insurer and is owed money by another insurer under a contract of reinsurance. This is also the case under the 1930 Act. See paragraph 2.45 of the report.

Clause 16

Tarbuck v Avon Insurance plc [2001] 2 All ER 503 has confirmed (subject to any contrary decision on appeal) that the 1930 Act does not cover insurance policies classified by insurers as "first person pecuniary loss insurance" such as legal expenses insurance and health insurance. This clause ensures that the Bill is not similarly restricted. See paragraphs 2.39-2.44 of the report.

Clause 17

This clause clarifies the application of the Bill in cases with foreign elements. Its effect is that, when deciding whether the Bill applies to such cases, the only relevant issue is whether the conditions in clause 1 or 2 (which all arise under English or Scots law) apply. If they do, then the Bill applies. Whether or not other aspects of the third party's claim are foreign is irrelevant. In particular, it does not make any difference where the liability was incurred, where the parties are domiciled, what law governs the insurance contract, or any location specified by the insurance contract for payment. See Part 8 of the report. This clause has no counterpart in the 1930 Act.

Clause 18

This clause confers on the Secretary of State a power to amend clauses 1 and 2 by secondary legislation. This will enable the Secretary of State to accommodate legal developments in insolvency law without having to introduce fresh primary legislation. The power is subject to the affirmative resolution procedure. See paragraphs 2.36-2.37 of the report. No such power is contained in the 1930 Act.

Clause 19 and Schedule 2

This clause replaces references to the 1930 Act in other legislation with references to the Bill. It also, in conjunction with Schedule 2, repeals the 1930 Act and repeals (or, in the case of secondary legislation, revokes) enactments that have amended that Act.

Clause 20

This clause sets out the provisions governing the transition from the 1930 Act to the Bill. If the insured incurs liability to the third party after commencement day, or if the insured becomes bankrupt etc after commencement day, then the Bill will apply to the claim. If both of these occur before commencement day, the 1930 Act will continue to apply. In the case of a transfer caused by the death of an insolvent insured, the 1930 Act will apply to cases in which the insured died before commencement day; the Bill will apply in all other cases. See paragraph 3.37 of the report.

Clause 21

The final clause of the Bill contains the short title, specifies when it will come into force, and sets out its extent.

Subsection (3) restricts paragraphs 3 and 4 of Schedule 1 (as well as clause 8) to England and Wales. This is because existing Scots law on this point is adequate.

Subsection (5) provides that the Bill does not extend to Northern Ireland. It is anticipated that separate legislation in similar terms to the Bill will be enacted there. Exceptionally, some of clause 13 does extend to Northern Ireland. The reasons for this are explained above in the notes relating to that clause.

Schedule 1

This Schedule confers on the third party rights to obtain information about the insurance policy. It entitles the third party to issue two kinds of notice. The first, and more important, of these is dealt with in paragraphs 1 and 2; the second, which applies in England and Wales only, is dealt with in paragraphs 3 and 4. Detailed reasons for providing the disclosure regime in this Schedule are set out in Part 4 of the report. The rights conferred by this Schedule are substantially greater than those in the 1930 Act.

Paragraph 1(1) confers on potential third parties a right to issue a notice requesting information about the insurance policy. The third party may issue a notice to anyone he or she believes on reasonable grounds has the information. The notice must specify the information requested. It must also specify the third party's reasons for thinking that he or she is entitled to make the request (paragraph 1(5)). Paragraph 1(2)-1(4) sets out the information which the third party may request.

Paragraph 2(1) provides that the recipient of a valid notice requesting information must reply within 28 days and sets out what that reply must contain. Paragraph 2(2) sets out how a recipient should reply to a valid notice if he or she once had the details requested but has passed them on. The purpose of this provision is to ensure that a third party's attempt to obtain details is not thwarted by, for example, a change of insurance broker. Paragraph 2(3) ensures that the third party is not entitled to privileged documents (such as those containing legal advice).

Once a recipient has replied to a paragraph 1 notice as required by paragraph 2, that is the end of the recipient's obligations. The recipient is not obliged to keep the third party informed of later developments. A third party who suspects that there have been such developments is, however, entitled to issue a fresh notice under paragraph 1.

Paragraphs 3 and 4 provide a separate right, applying in England and Wales only, designed to assist third parties using the new mechanism contained in clause 8 in a case in which the insured is a company which no longer exists. These paragraphs enable a third party in such circumstances to obtain documentation from the ex-officers of the defunct company without the need to restore the company to the register and obtain court orders.

Paragraph 3(1) specifies the circumstances in which a third party may issue a notice. As it is designed to assist a third party involved in litigation, such a notice may only be sent after the third party has issued proceedings against the insurer. Paragraph 3(2) sets out the people to whom a notice may be sent. Paragraph 3(3) provides that a third party who issues a notice under this paragraph must send with it a copy of the particulars of claim in the proceedings against the insurer (or, if the third party is involved in an arbitration, an equivalent document). This is necessary so that the recipient can learn what is at issue in the case, and can give the appropriate disclosure as required by paragraph 4.

Paragraph 4(1) provides that a recipient of a paragraph 3 notice must respond as if subject to an order for "standard disclosure", the usual disclosure order made by the courts. The obligations imposed by such an order of the court are set out in the Rule 31 of the Civil Procedure Rules. The only differences between the duty imposed by such an order and paragraph 4 are those in the subsequent sub-paragraphs: paragraph 4(2) requires a response within 28 days, and paragraph 4(3) provides that a recipient of such a notice is not placed under any duty to update his or her response if the situation changes. These alterations are in line with the duties imposed by a paragraph 1 notice. It would be inappropriate to impose a continuing obligation on an ex-employee of a defunct company who is playing no part in the litigation. As in the case of a paragraph 1 notice, a third party who believed that further documents might have come into the possession of the recipient of a notice would be entitled to issue a fresh notice.

Paragraph 5 prevents the insured and insurer from contracting out of the disclosure regime in Schedule 1.

Paragraph 6 clarifies that the rights to disclosure are in addition to, and do not replace, any other statutory or procedural rights which the third party may have.

APPENDIX B

Third Parties (Rights against Insurers) Act 1930

The Third Parties (Rights against Insurers) Act 1930 begins on the following page.

Third Parties (Rights against Insurers) Act 1930

1930 CHAPTER 25

An Act to confer on third parties rights against insurers of third-party risks in the event of the insured becoming insolvent, and in certain other events. [10th July 1930]

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

1 Rights of third parties against insurers on bankruptcy &c. of the insured

(1) Where under any contract of insurance a person (hereinafter referred to as the insured) is insured against liabilities to third parties which he may incur, then—

(a) in the event of the insured becoming bankrupt or making a composition or arrangement with his creditors; or

(b) in the case of the insured being a company, in the event of a winding-up order or an administration order being made, or a resolution for a voluntary winding-up being passed, with respect to the company, or of a receiver or manager of the company's business or undertaking being duly appointed, or of possession being taken, by or on behalf of the holders of any debentures secured by a floating charge, of any property comprised in or subject to the charge or of a voluntary arrangement proposed for the purposes of Part I of the Insolvency Act 1986 (c. 45) being approved under that Part;

if, either before or after that event, any such liability as aforesaid is incurred by the insured, his rights against the insurer under the contract in respect of the liability shall, notwithstanding anything in any Act or rule of law to the contrary, be transferred to and vest in the third party to whom the liability was so incurred.

(2) Where the estate of any person falls to be administered in accordance with an order under section 421 of the Insolvency Act 1986, then, if any debt provable

in bankruptcy (in Scotland, any claim accepted in the sequestration) is owing by the deceased in respect of a liability against which he was insured under a contract of insurance as being a liability to a third party, the deceased debtor's rights against the insurer under the contract in respect of that liability shall, notwithstanding anything in any such order, be transferred to and vest in the person to whom the debt is owing.

(3) In so far as any contract of insurance made after the commencement of this Act in respect of any liability of the insured to third parties purports, whether directly or indirectly, to avoid the contract or to alter the rights of the parties thereunder upon the happening to the insured of any of the events specified in paragraph (a) or paragraph (b) of subsection (1) of this section or upon the estate of any person falling to be administered in accordance with an order under section 421 of the Insolvency Act 1986 (c. 45), the contract shall be of no effect.

(4) Upon a transfer under subsection (1) or subsection (2) of this section, the insurer shall, subject to the provisions of section three of this Act, be under the same liability to the third party as he would have been under to the insured, but—

(a) if the liability of the insurer to the insured exceeds the liability of the insured to the third party, nothing in this Act shall affect the rights of the insured against the insurer in respect of the excess; and

(b) if the liability of the insurer to the insured is less than the liability of the insured to the third party, nothing in this Act shall affect the rights of the third party against the insured in respect of the balance.

(5) For the purposes of this Act, the expression "liabilities to third parties", in relation to a person insured under any contract of insurance, shall not include any liability of that person in the capacity of insurer under some other contract of insurance.

(6) This Act shall not apply—

(a) where a company is wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company; or

(b) to any case to which subsection (1) and (2) of section seven of the Workmen's Compensation Act 1925 (c. 84) applies.

2 Duty to give necessary information to third parties

(1) In the event of any person becoming bankrupt or making a composition or arrangement with his creditors, or in the event of the estate of any person falling to be administered in accordance with an order under section 421 of the Insolvency Act 1986, or in the event of a winding-up order or an administration order being made, or a resolution for a voluntary winding-up being passed, with respect to any company or of a receiver or manager of the company's business or undertaking being duly appointed or of possession being taken by or on behalf of the holders of any debentures secured by a floating charge of any property comprised in or subject to the charge it shall be the duty of the bankrupt, debtor, personal representative of the deceased debtor or company, and, as the case may be, of the trustee in bankruptcy, trustee, liquidator, administrator, receiver, or manager, or person in possession of the property to give at the request of any person claiming that the bankrupt, debtor, deceased debtor or company is under a liability to him such information as may reasonably be required by him for the purpose of ascertaining whether any rights have been transferred to and vested in him by this Act and for the

purpose of enforcing such rights, if any, and any contract of insurance, in so far as it purports, whether directly or indirectly, to avoid the contract or to alter the rights of the parties thereunder upon the giving of any such information in the events aforesaid or otherwise to prohibit or prevent the giving thereof in the said events shall be of no effect.

(1A) The reference in subsection (1) of this section to a trustee includes a reference to a supervisor of a voluntary arrangement proposed for the purposes of, and approved under Part I or Part VIII of the Insolvency Act 1986 (c. 45).

(2) If the information given to any person in pursuance of subsection (1) of this section discloses reasonable ground for supposing that there have or may have been transferred to him under this Act rights against any particular insurer, that insurer shall be subject to the same duty as is imposed by the said subsection on the persons therein mentioned.

(3) The duty to give information imposed by this section shall include a duty to allow all contracts of insurance, receipts for premiums, and other relevant documents in the possession or power of the person on whom the duty is so imposed to be inspected and copies thereof to be taken.

3 Settlement between insurers and insured persons

Where the insured has become bankrupt or where in the case of the insured being a company, a winding-up order or an administration order has been made or a resolution for a voluntary winding-up has been passed, with respect to the company, no agreement made between the insurer and the insured after liability has been incurred to a third party and after the commencement of the bankruptcy or winding-up or the day of the making of the administration order, as the case may be, nor any waiver, assignment, or other disposition made by, or payment made to the insured after the commencement or day aforesaid shall be effective to defeat or affect the rights transferred to the third party under this Act, but those rights shall be the same as if no such agreement, waiver, assignment, disposition or payment had been made.

3A Application to limited liability partnerships

(1) This Act applies to limited liability partnerships as it applies to companies.

(2) In its application to limited liability partnerships, references to a resolution for a voluntary winding-up being passed are references to a determination for a voluntary winding-up being made.

4 Application to Scotland

In the application of this Act to Scotland—

(a) the expression "company" includes a limited partnership;

(b) any reference to an estate falling to be administered in accordance with an order under section 421 of the Insolvency Act 1986 shall be deemed to include a reference to an award of sequestration of the estate of a deceased debtor, and a reference to an appointment of a judicial factor, under section 11A of the Judicial Factors (Scotland) Act 1889 (c. 39), on the insolvent estate of a deceased person.

5 Short title

This Act may be cited as the Third Parties (Rights Against Insurers) Act 1930.

APPENDIX C
USEFUL WEB ADDRESSES

Association of British Insurers	http://www.abi.org.uk
Civil Procedure Rules	http://www.lcd.gov.uk
Department of Trade and Industry	http://www.dti.gov.uk
General Insurance Standards Council	http://www.gisc.co.uk
Law Commission for England and Wales	http://www.lawcom.gov.uk
Lloyds of London	http://www.lloydsoflondon.co.uk
Scottish Law Commission	http://www.scotlawcom.gov.uk

APPENDIX D
PERSONS AND ORGANISATIONS WHO COMMENTED ON CONSULTATION PAPER NO 152

JUDICIARY AND PRACTITIONERS

(i) Judiciary

The Honourable Mr Justice Buckley

Mr Registrar Buckley, Chief Registrar in Bankruptcy

The Right Honourable Lord Justice Longmore

The Right Honourable Lord Justice Mance

The Honourable Mr Justice Thomas

The Honourable Mr Justice Toulson

The Right Honourable Lord Justice Tuckey

(ii) Barristers

Mr Adrian Briggs

Mr Graham Charkham

Mr Anthony Diamond QC

Lord Goldsmith QC

Christopher Symons QC and David Wolfson

(iii) Solicitors

Barlow Lyde and Gilbert

Mr R Craig Connal (McGrigor Donald)

Mr Richard Eveleigh (Berrymans)

Mr Peter Farthing (Clyde & Co)

D J Freeman

Mr David Hadfield (Hextall Erskine)

Mr Christopher Jackson (Burges Salmon)

Beachcroft Stanley

(iv) Legal Organisations

Association of Personal Injury Lawyers

Chancery Bar Association

City of London Law Society

General Council of the Bar

Insurance Law Sub-Committee of the Consumer and Commercial Law

Committee of the Law Society

London Solicitors Litigation Association

ACADEMIC LAWYERS

Professor John Birds (University of Sheffield)

Professor Nigel Furey (University of Bristol)

Professor Nicholas Gaskell (University of Southampton)

Mrs Margaret Hemsworth (University of Exeter)

Mr Ray Hodgin (University of Birmingham)

Insurance Law Research Group, Institute of Advanced Legal Studies

Professor Len Sealy (Gonville and Caius College, Cambridge)

INSURERS, REINSURERS AND BROKERS

Association of British Insurers

R E Brown & Others, Syndicate 702

Federation of Insurance Consultants

Griffin Insurance Association Ltd

International Group of P&I Clubs

ITT London & Edingburgh

Lloyd's

London International Insurance and Reinsurance Market Association

Mr P W Mason (Aon Group Ltd, Claims Consultancy)

Medical Protection Society

Munich Reinsurance Company

Wren Insurance Association Ltd

OTHER REPRESENTATIVE BODIES

British Insurance Law Association

Financing & Leasing Association

Institute of Legal Executives

National Consumer Council

Royal Institute of Chartered Surveyors

Society of Practitioners of Insolvency

Small Business Bureau

GOVERNMENT DEPARTMENTS AND ORGANISATIONS

Department of the Environment, Transport and the Regions

Department of Trade and Industry

Law Reform Advisory Committee for Northern Ireland

Lord Chancellor's Department

Insolvency Service

INDIVIDUALS

Mr John Richardson (P&O Nedlloyd Ltd)

Mr Donald B Williams

Mr Nick Stanbury

SCOTLAND

Bonnar & Co

Mr R Craig Connal (McGrigor Donald)

Faculty of Advocates

Mr A M Hamilton

Mr Finlay Park (Finlay Hutchison Solicitors)

APPENDIX E
OTHERS WHO HAVE ASSISTED WITH THE PROJECT

Association of Business Recovery Professionals

Elizabeth Birch

George Bompas QC

Stephen Davies

Glen Davis

Robin Dicker QC

Her Honour Judge Faber (former Company and Commercial Law Commissioner)

Chris Hanson (Lovells)

David Higgins (Herbert Smith)

David Johnston

Professor Harry Rajak (University of Sussex)