

International Corporate Rescue



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Third Parties (Rights against Insurers) Act 2010

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The Third Parties (Rights against Insurers) Act 2010 (2010 Act), which received Royal Assent on 25 March 2010, is intended to address a number of problems which have arisen in relation to the operation of the existing Third Parties (Rights against Insurers) Act 1930 (1930 Act),² which, over the years, has proven to be both expensive and time-consuming for those seeking to rely upon it.

As at the time of writing, the date upon which the 2010 Act will come into force is not known.³

The 1930 Act

In general terms, under the existing 1930 Act, if a party with a liability insurance policy becomes the subject of certain formal insolvency proceedings, its rights against its insurer are transferred to the third party to which the insured has incurred liability. This statutory transfer mechanism is designed to ensure that the third party receives the proceeds of the policy which otherwise would form part of the insolvent insured's estate and be distributed to the general body of its creditors (leaving the third party to claim as an unsecured creditor). The insured's rights are transferred to the third party subject to any policy defences which the insurer would have had against the insured. The 1930 Act does not extend to contracts of reinsurance.

The operation of the 1930 Act has given rise to a number of issues, key among these are:

- (a) That a third party cannot issue proceedings against an insurer without first establishing the existence and amount of the insured's liability, which is likely to involve an additional set of proceedings. If the insured is the subject of a bankruptcy order, administration or compulsory winding-up a separate application to the court for an order allowing such proceedings to be commenced or to continue may also be required. Substantial funds may be required in order to pursue these proceedings and ultimately the costs incurred will have been wasted – both for the third party if it does not succeed against the insurer and for the insurer if it is ordered by the court to meet the costs of multiple proceedings.
- (b) If the insured has been struck off the register of companies, it has to be restored to the register before the third party can bring proceedings against it.
- (c) The 1930 Act does not provide for a statutory transfer in the event that an insured is struck off the register of companies (where this is not accompanied by the insolvency proceedings which are caught by the 1930 Act). Nor does it provide for a statutory transfer in the event that a provisional liquidator is appointed, causing difficulties in the event that the appointment is used in conjunction with a scheme of arrangement under the Companies Acts.
- (d) The rights transferred to a third party may not respond if the policy contains a clause requiring the insured to pay the claim before the right to an indemnity arises (a 'pay-first' clause).
- (e) Although the 1930 Act affords a third party the right to obtain information about the policy, this right is problematic. For instance, it has been held that it does not arise until the insured's liability has been established (see (a) above), by which time the third party is likely to have incurred the costs associated with those proceedings (and possibly with an application for permission to commence or continue such proceedings or the restoration of the insured to the register). Further, the right is only exercisable against certain entities (which may not include the entity which has the information)

Notes

- 1 Ian McDonald heads Commercial Dispute Resolution and Restructuring, Bankruptcy and Insolvency at Mayer Brown International LLP's London office.
- 2 Which were set out in the Law Commission and the Scottish Law Commission's report – third parties rights against insurers – July 2001 (Law Com No 272 and Scot Law Com No 184).
- 3 This article focuses on the application of the 2010 Act in England and Wales.

and it is unclear what information the third party is entitled to receive (thus causing uncertainty for both third parties and insurers).

- (f) The 1930 Act does not apply to legal expenses insurance and, therefore, by analogy to other voluntarily-incurred liabilities such as health insurance.

The 2010 Act

The statutory transfer mechanism

The 2010 Act adopts the transfer mechanism used in the 1930 Act, that is, it transfers the pre-existing contractual rights as between the insured and the insurer and does not create new substantive rights. As such, the rights which are transferred to the third party are still subject to the defences which the insurer could have used against the insured. However, the 2010 Act does introduce a limited number of enhancements to the third party's rights, designed to prevent an insurer from defeating a third party's claim by relying on certain technical defences based upon the conditions in the policy. These include:

- Where a policy includes a requirement that the insured do something, such requirement will be treated as satisfied if that act is done by the third party.
- The transferred rights are not subject to any requirement that the insured provide information/assistance to the insurer if that provision cannot be fulfilled because the insured has been dissolved (or, if an individual, has died).
- If a condition requiring information and assistance includes a requirement that the insured give notice of the claim, that requirement will be satisfied if complied with by the third party.

'Pay-first' clauses

Under the 2010 Act, any 'pay-first' clause contained in the policy will not apply to the rights transferred to the third party (subject to certain exceptions in relation to maritime insurance).

'Insolvency proceedings' to which the 2010 Act applies

The 2010 Act applies in the event that an insured which is either a corporate or an unincorporated body enters into a compromise or arrangement under the Companies Act 2006, is dissolved (and has not been restored to the register), is the subject of a voluntary arrangement or an administration order, has been wound up or has a receiver or manager appointed over its property

or has a provisional liquidator appointed with respect to it. The 2010 Act applies if an individual insured is the subject of a bankruptcy order, a debt relief order, a voluntary arrangement, an administration order or enforcement restriction under the County Courts Act 1984 or a deed of arrangement registered under the Deeds of Arrangement Act 1914 or dies insolvent.

Not all of the above procedures necessarily involve an insolvent insured. Further, it should be noted that the out-of-court administration procedure has been overlooked by those drafting the 2010 Act, a point which will need to be rectified.

It remains the case that the financial difficulties or insolvency of the insured, of themselves, do not trigger the statutory transfer mechanism. Nor does the crystallisation of a floating charge over the insured's assets.

Establishing the insured's liability

The third party may initiate proceedings against the insurer without first having to establish the liability of the insured. However, it cannot enforce its rights against the insurer until the liability of the insured is established. Hence the liability of both the insurer and the insured may be established in one set of proceedings. There is no requirement that the insured be a party to these proceedings and thus no requirement that an insured which has been dissolved be restored to the register.

However, there may be circumstances in which the third party does wish to join the insured to the proceedings, for instance if there is a shortfall in the policy which the third party wishes to recover from the insured as an unsecured creditor. Presumably leave to join the insured will be required if it is the subject of bankruptcy, administration or compulsory liquidation.

Right to obtain information

The 2010 Act affords the third party the right to request information regarding the policy both from the insured and from other parties, such as insurers and brokers. The information which can be sought includes the identity of the insurer, the terms of the policy, whether the insurer has denied liability, whether there are or have been any proceedings between the insurer and the insured, how much of any fund available to meet claims has already been paid out and whether there is a fixed charge to which any sums paid out under the policy would be subject.

Where the insured has been dissolved and subsequently has not been restored to the register, the third party may request information from officers and employees of the insured and, where it had been the subject of insolvency proceedings, from insolvency

practitioners (and the Official Receiver) who were appointed in respect of the insured. This mechanism is included in the 2010 Act in order to avoid the need for the third party to restore the insured to the register in order to obtain the policy information sought.

Costs of complying with such requests are likely to be an issue, particularly if the recipients of the requests have no financial interest in the outcome of the third party's claim under the 2010 Act.

Voluntarily incurred liabilities

The 2010 Act extends to voluntarily-incurred liabilities, closing the loophole in relation to legal expenses and health insurance.

Reinsurance policies

It remains the case that the statutory transfer mechanism does not apply to reinsurance policies.

Conclusion

The 2010 Act is not yet in force, so it is difficult to say with certainty whether it will achieve the aim of addressing satisfactorily all of the perceived problems of the 1930 Act. Assuming that it does, we foresee advantages for both insurers and third parties. For instance, for both sides the 2010 Act should provide more certainty and limit the time spent debating how the regime should be applied. Insolvency Practitioners should also benefit from the fact that there is no requirement that the insured be a party to the proceedings, thus reducing the administrative burden upon them. Ultimately the speedier resolution of claims should be of benefit to all concerned.

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International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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