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RIGHTS OF THIRD PARTIES AGAINST INSURERS
by Peter Goldsmith, Q.C.

I was asked to deliver this lecture because it came to the attention of Alison Green, your Chairman, that I had expressed reservations about the operation of the Third Parties (Rights Against Insurers) Act. Indeed I proposed to the Law Commission that this was an area where a review of the legislation was called for. I had long felt that the Act was deficient in one particular respect. That concern was heightened by the experience of appearing in a long action against an obviously insolvent professional adviser. I thought it was high time that the Act was amended and I so proposed first to the Law Reform Committee of the Bar Council and then to the Law Commission itself.

That rash step has led me here. I am here with trepidation on two counts.

Firstly, I recognise that some of the views I shall express may be unpopular with some sections of the insurance industry and will offend against some received market wisdom. I hope you will forgive me for that and will no doubt point out my errors at the end.

Secondly, since I have agreed to speak, Sir Jonathan Mance, Mr Justice Mance, has delivered in the twelfth Donald O'May Annual Lecture a lecture on the topic of this Act which not only sets out my own concerns more learnedly and lucidly than I could do but also adds other concerns. I have had the great advantage of reading the lecture and must acknowledge my indebtedness to it for insights which I would not have had. I will endeavour all the same to set out in my own way the problems as I see them. But first let me set out shortly the basic history and framework of the Act.

The moving force behind the Act was two events. First, by 1930 the motoring revolution had wholly arrived and the implications of that in terms of litigation had been understood. Secondly, two cases had been decided in 1928 which produced an injustice which, as is well known, this Act was designed to remedy.

In the first of these cases: re *Harrington Motor Company ex p. Chaplin* [1928] 1Ch. 105 Walter Chaplin had been knocked down in the street by a motor belonging to

the Harrington Motor Company. He recovered judgment for £324. After judgment but before execution the Company went into liquidation. The Company was insured against such losses and the amount of the judgment and costs was paid by the insurance company to the liquidator. The issue was whether that money should be used by the liquidator to meet Mr Chaplin's claim or should go into the general estate of the insolvent company to meet the claims of all creditors. With considerable reluctance Eve J. and then the Court of Appeal held that the money must go into the general estate. The decision was one which Lord Hanworth M.R. described as one "which would, at first, appear to run counter to what I might call the common-sense view of the proceedings". Atkin L.J. expressed the position more strongly characterising it as one where the "very reasonable and proper precaution" of compulsory insurance was "defeated in the very case in which it is intended to be of most use".

In *Hood's Trustees v Southern Union General Insurance Company of Australasia, Limited* [1928] 1Ch 793 that decision was followed. So iniquitous was the rule that if the third party's claim was one in tort and unliquidated at the date of insolvency the Plaintiff would not even receive a dividend.

The strong sympathy expressed by both Courts with the unlucky – and the uncompensated – Plaintiff and their distaste for the resulting legal principle had forced upon them led swiftly to the 1930 Act.

In the final and enacted version the Act has three parts. The genesis of how they developed in Parliament is of interest and to that I shall return.

Let me firstly remind you of the basic structure of the Act. It is well known of course that the basic mechanism of the Act is to transfer the rights of the assured against the insurer to the third party who has been injured by the assured. The condition triggering that transfer is insolvency which can broadly be taken for present principles as bankruptcy and winding up.

The part of the Act which has given rise to the first of the problems to which I would refer today is the other condition which applies for the Act provides that if a person who is insured against third party liability "incurs" such liability his rights against the insurer in respect of that liability shall be transferred to the third party.

The difficulty which decided case law has thrown up arises by interpreting this

requirement as meaning that in an ordinary liability policy no transfer takes place until there has been established the insured's liability to the injured third party. This follows from the decision of the Court of Appeal in *Post Office v Norwich Union* [1967] 2QB 363 and of the House of Lords in *Bradley v Eagle Star* [1989] AC 957.

In *Post Office v Norwich Union* a cable was damaged by the negligence of contractors who then went into liquidation. The Post Office, relying on the Act, sued Norwich Union direct. The Court of Appeal held they could not. In short it was true that the third party stepped into the shoes of the insured and could exercise his right against the insured but, so held the Court, under an ordinary liability policy, the insured had no rights to claim an indemnity against the insurer until his liability to the Third Party had been established. The position was summarised by Lord Denning:

> "Under the section it is clear to me that the injured person cannot sue the insurance company except in such circumstances as the insured himself could have sued the insurance company. The insured could only have sued for an indemnity when his liability to the third person was established and the amount of the loss ascertained. In some circumstances the insured might sue earlier for a declaration, for example, if the insured company were repudiating the policy for some reason. But where the policy is admittedly good, the insured cannot sue for an indemnity until his own liability to the third person is ascertained."

In *Norwich Union*, the only real consequence of this ruling was delay and some extra costs whilst liability against the contractor was established.

In *Bradley* the consequence to the Plaintiff was far more serious. Mrs Doris Bradley worked for many years on the cardroom of a cotton mill owned by Dart Mill Limited. She worked there intermittently for nearly 40 years between 1933 and 1970. In 1970 she was certified as suffering from byssinosis – a respiratory disease caused by the inhalation of cotton dust. Mrs Bradley did not attempt to commence an action until 1984. By then Dart Mill had not only gone into liquidation but had been dissolved and therefore ceased to exist. It was too late (as the law then stood) to apply to restore the company to the register so she could not sue Dart Mill at all.

Her lawyers decided she should sue Eagle Star instead whom they believed to have insured Dart Mill during the relevant period. She applied for pre-trial discovery of the insurance policies.

The Court of Appeal and the House of Lords held that she should not have it.

The five steps which led inexorably to that conclusion depended on the correctness of *Norwich Union* being accepted. The steps were summarised by Lord Brandon:

> "First, under section 1(1) of the Act of 1930 the appellant only had transferred to and vested in her such rights against the respondents as Dart Mill Ltd itself would have had under the relevant contracts of insurance. Secondly, Dart Mill Ltd would only have been entitled, under such contracts of insurance, to be indemnified by the respondents in respect of any liability incurred by it to the appellant if the existence and amount of that liability had first been established either by a judgment of a court, or by an award in an arbitration, or by an agreement between Dart Mill Ltd and the appellant. Thirdly, the existence and amount of any liability incurred by Dart Mill Ltd to the appellant had never been established in any of those three ways while Dart Mill Ltd existed or was capable of being restored to existence, and there was now therefore no longer any means by which the existence and amount of any such liability could be established. Fourthly, that being so, there was not, and could not now ever be, any right of indemnity of Dart Mill Ltd against the respondents in respect of any such liability, which could be transferred to and vested in the appellant under section 1(1) of the Act of 1930. Fifthly, that being so, the appellant's proposed action against the respondents could not succeed, and it would therefore serve no useful purpose to make the order for pre-action discovery sought by her."

That was a result which in justice cannot really be tolerated, I would suggest. Why should the fortuity of Dart Mill's dissolution have deprived Mrs Bradley from all remedy which the insurance policy was there to provide?

Some limited relief was given to that problem by extending the period for restoring a company to the register. But that is only part of the solution. It seems unnecessary to restore the company which would have no interest in a quarrel over an insurance policy between the insurers and Mrs Bradley. As Lord Templeman in a characteristically trenchant dissent observed:

> "To restore the Dart Mill company in these circumstances would do no more than authorise Mrs Bradley to make use of a name carved on a tombstone. The use of the name could not restore life to the skeleton".

This case law has therefore firmly established that in the case of the ordinary liability policy it will usually be necessary to sue the assured to judgment first before being in a position to proceed against the insurers. I will return to the practical problems to which that may give rise.

In his lecture, Sir Jonathan Mance has argued that the law did not need to reach this conclusion. He accepts the proposition that a contractual right to indemnity only arises on proof of loss. He takes issue however, with the need to establish loss by obtaining judgment. Basing himself particularly on the judgment of Megaw J. in *Chandris v Argo Insurance Company Ltd* [1963] 2LLR 65, he argues that, given that the claim against insurers is one for unliquidated damages, the cause of action is complete once all events have occurred which give rise to the liability of the assured to the third party, even though the amount of the liability is not quantified.

On this view, the decision in the *Post Office v Norwich Union* case took too narrow a view and a different conclusion could have been reached. Nevertheless, that decision and the decision in *Bradley* are now, I believe, too well established for the Courts to be able to take a different line. Indeed in *Nigel Upchurch v Aldridge Estates* [1993] 1L I.L. Rep. 535 a submission similar, though less well developed and cogent, to that proposed by Mance J. was rejected by the deputy Official Referee.

This result, I suggest, is unsatisfactory for four reasons. I have already referred to the first reason: it is wasteful in time and money to have to pursue a defendant which has no interest in the proceedings, deferring the real argument between third party and insurer until later. In some cases it may even lead to the great injustice that a claim may not be pursuable at all, as Mrs Bradley found although a remedy for that particular case has been found in the amendment to the Companies Act.

Secondly, the effect of the rule may be that the injured Plaintiff encounters limitation problems to which I shall revert.

Thirdly, the effect of the rule may be to cause great practical problems in the ascertainment of the underlying claim to no advantage to Plaintiff or insurer.

I have in mind particularly cases where there is a question whether the policy will respond and insurers are unwilling or not in a position to ensure that the insurer's defence is properly considered and advanced.

The insolvent assured will have little motivation and perhaps no resources to act as a responsible or effective defendant. That may be to the detriment of the Plaintiff because issues are not defined or limited. Or it may be to the ultimate detriment of the insurer because a significant liability may not be adequately defended.

In a long case to which I will revert the primary layer insurer of the defendant professional adviser repudiated liability at a late stage. The defendant was plainly without means to satisfy a judgment but not yet in liquidation. By an even later stage, as the trial was actually underway, the next lawyer saw the liability looming and paid for a substantial defence. Now the Plaintiff was faced with the worst of both worlds. It had an expensive fight against the defendant but with no more than the prospect of obtaining a judgment which it would not know if it could enforce. Proceedings to test the repudiation of the primary layer could not be commenced using the Act (and the defendant had no incentive itself to commence them) until liability had been established.

Fourthly, the effect of the *Norwich Union* and *Bradley* decisions is to lead to a problem in the provision of information. That topic requires some collaboration and to that I now turn.

Information

The second part of the Act contains an important provision enabling the third party to obtain

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

The duty is extended to insurers by Section 2(2).

This is plainly a provision of great importance to the third party to enable him to assess what rights are transferred to him and whether they are worth pursuing.

Perhaps the most important area where such a right will be of use when a third party wants to assess whether to pursue his claim at all. He may recognise that the claim against the assured is one which will be expensive to establish, or expensive relative to the value of the claim. He knows or suspects the assured cannot meet a judgment

without insurance. He needs to know if there is insurance, if it is likely to cover the claim and to what extent.

This is just the situation where information may be most needed. Yet the effect of the decisions in *Post Office v Norwich Union* and *Bradley* is to deny the information in that very case. This was the conclusion reached first in October 1992 by Miss Barbara Dohmann QC sitting as Official Referee in *Nigel Upchurch v The Aldridge Estates Investment Co Ltd* [1993] 1L I.L.Rep 535.

The same result was reached by Mr Justice Lindsay in *Woolwich Building Society v Taylor and Another* [Times Law Report 17 May 1994].

The problem is that the words of Section 2 of the Act require that the purpose of the information should be to ascertain "whether any rights *have been* transferred to and vested in him by this Act" (emphasis added).

Once it is established that no rights can have been transferred until liability against the insured has been established (*Norwich Union* and *Bradley*) it follows, so the Court held, that information cannot reasonably be required to ascertain if there has been a transfer before the moment that transfer can have taken place.

In the words of Lindsay J.:

> "Section 2(1) was not concerned with rights that would or might be transferred but ones which already had been."

As Mance J. has pointed out, however, an examination of the legislative history of the Act shows a very different parliamentary intention.

The information provision was a late entrant to the Bill.

In the Third Reading (10 April 1930) Mr R. A. Taylor moved an amendment expressing his concern that the insurance companies should be obliged to provide information. His concern was "with the poor person, the ordinary pedestrian who is knocked down by a motor car and injured." Such a person, he went on, would not have the assistance of expert legal advice. He particularly wanted to ensure that such persons could obtain the policy and the proposal form and was worried that they should not be forced to embark on expensive litigation. Reading the debate one

has a strong sense that neither Mr Taylor nor the Solicitor General who accepted the spirit of the amendment, although putting forward a different form of words, intended the right to be available only after an expensive action to establish liability.

Against that background one confronts the case which arose in *BBL v Eagle Star* where plaintiffs wanted to know the level of cover held by the insolvent defendant they were suing. That will be a heretical proposition to many of those here who hold the generally accepted market view that level of cover is something not to be disclosed; it will encourage claims and act in settlement to the detriment of insurers.

Philips J. in an interlocutory decision rejected that view. He believed that in the context of expensive litigation it was "a perfectly reasonable desire" for parties to know the level and terms of any insurance covered. Assuming, however, that *Bradley* precluded information being ordered at that stage, he made no order under the 1930 Act. He did, however, order discovery of the policy on the grounds it was relevant to a pleaded issue, namely whether BBL had been contributorily negligent in advancing monies on the faith of a surveyor's report without checking the level of cover the surveyors carried. That allegation of contributory negligence, never strong, was quickly abandoned by the defendant in the light of that decision!

It may be that *Nigel Upchurch* and *Woolwich* will come up for reconsideration at a higher level. If they do, then both Sir Jonathan Mance and Mr Jonathan Goodcliffe of Simmons and Simmons (whose article in 1993 British Business Law deserves tribute also) argue that these debates satisfy the *Pepper v Hart* test and should be taken into account in reassessing Section 2.

It is plain that I would welcome such a result but if this result cannot be achieved by judicial interpretation – and given the wording of the Section there may well be doubts whether it can – I believe the result should be achieved by legislation.

The tendency over the past ten years has been to move to a more and more open approach to litigation. We had witness statements, skeleton arguments and pre-trial hearings all designed to give both sides a better understanding in advance of the trial of the other side's case so realistic assessments can be made of the merits of settlement. In the modern age of "cards on the table" litigation, is it really wrong to suggest that the one factor which may be most key to a plaintiff's view, what is the limit of cover and will the costs eat it up anyway, should be known?

I restrict that question to the case of the insolvent defendant for I recognise different considerations may apply to solvent defendants even though the level of insurance cover is a significant factor. Observations on that case may be for another day.

Limitation

A further consequence of the *Bradley* decision may be to cause unexpected limitation problems. If the third party has no right transferred to him until insolvency what happens if that event occurs *after* the expiry of an applicable limitation period against the insurer? It must follow that the claim is statute barred at least if the insured had not previously commenced an action, but what if he had?

In *Lefevre v White* [1990] 1LI.L.Rep. 569, Popplewell J. held that in such a case the third party's claim was statute barred. A passenger in the assured's car, he had brought his action against the insurers more than six years after he had obtained judgment by consent for £275,000 against the driver. On *Bradley* he could not have commenced proceedings before because the driver was not bankrupted until more than six years after the judgment. The driver had brought his own proceedings, however, against the insurers in time – just.

Popplewell J. held the claims of the third party statute barred.

Firstly, he rejected the submission that the third party had six years to sue from the moment of transfer. Given that all that is transferred are the rights of the assured that conclusion must be right.

Secondly, he held that the third party's action was not saved by the earlier writ of the driver. It was the third party's cause of action and he had to bring proceedings.

What was not explored, however, was whether the third party could not simply have sought to take over the existing action of the driver, relying on RSC 015 R 7.

This might not always be an attractive solution to the third party who may not wish to take over an existing action with the costs and other consequences that may bring.

A different conclusion was reached by Philips J. in the *Felice (London Steamship Owners Manual)* [1990] 2LI.L.Rep. 21. The judgment was in fact given in 1989

preceding *Lefevre v White* but not referred to in it. He declined to hold that a third party was entitled to continue an arbitration commenced by an insured against its Club. He said there would be considerable practical difficulties and the reference was personal to the parties.

The judge was invited not to decide whether a new arbitration against the Club by the third party after the six-year period was out of time. Philips J. nonetheless said he was unable to close his eyes to this point and would have reconsidered his decision had he thought the third party would be faced with a time bar which would not have applied to the insured. Regrettably, however, he did not explain why he thought – as he plainly did – the third party's claim would not be statute barred.

Even this decision does not stand unchallenged for in the *Jordan Nicolov (Montedipe v Jugotanker* [1990] 2 LL.C.R. 11, Hobhouse J. distinguished it saying that it only applied to 1930 Act cases and that a third party assignee had the right to intervene in a pending arbitration.

Examination of those cases will show how difficult and unsatisfactory an area this is. For example, what is the liability for pre-existing costs of a party intervening in an arbitration in this way? Philips J. assumed the incoming third party would have to bear them. Hobhouse J. took a different view: the assignment could not relieve the assignor on familiar principles of law from a pre-existing contractual liability.

One further problem is worth mentioning in this context. Thus far, I have been assuming that the limitation period for both assured and third party are co-extensive i.e. both commencing when liability to the third party is established by judgment, award or compromise. What, however, if the assured has an earlier cause of action e.g. because there has been accepted repudiation of the policy? This point was argued in *Lefevre v White* although on the facts Popplewell J. held that there had been no acceptance of the repudiation.

There is an even greater danger in such a case that the third party will lose the right intended by the Act to be his before he ever had the right to sue. This is an unacceptable result for which a legislative situation is likely to be better than one fashioned by the Courts.

I have left till last the topic of the third section of the Act which deals with dealings between assured and insurer after insolvency.

There are two points to be made. First, nothing in the 1930 Act affects a settlement made before insolvency. That is understandable in the interests of certainty of transactions. But it may mean, save where insolvency law can help, that a third party may be prejudiced by an unfavourable agreement made on the eve of bankruptcy.

The second is that the section only deals with settlements and does not, for example, allow the third party even to satisfy a precondition to the policy which as *Farrell v Federated Employers Mutual* [1985] 1LL.R 274 shows may otherwise operate to defeat the claim.

Conclusion

I conclude in the same vein in which I started. The 1930 Act provides a valuable protection for third parties but it has given rise to some serious problems of application, quite possibly not intended when first enacted.

The time to review has come. When it arrives, there will be opportunity to consider not only those I have highlighted but no doubt many others. Perhaps the whole policy of the Act should be re-examined. Should the same principles apply to personal injury and motor cases as to commercial claims? Should the third party's rights be identical to the assured or should there be differences? These and many other cases should be considered.

The purpose of the Act was to ensure that the insolvency of a wrong-doer did not deprive the injured claimant of the benefits of the insurance policy taken out to protect him against that very event. The application of the Act must be made to reflect that purpose.

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