AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Level 30
20 Bond Street
Sydney NSW 2000
www.companydirectors.com.au
ABN 11 008 484 197

T: +61 2 8248 6600
F: +61 2 8248 6633
E: ceo@aicd.com.au

1 June 2016

Policy Manager, Strategy and Policy
New South Wales Law Reform Commission
GPO Box 31
SYDNEY NSW 2001

via email: nsw_lrc@agd.nsw.gov.au

Dear Sir / Madam

Review of section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) – Third party claims on insurance money

The Australian Institute of Company Directors (AICD) welcomes the opportunity to comment on the issues raised in Consultation Paper 17 *Third party claims on insurance money: Review of s 6 of the Law Reform (Miscellaneous Provisions) Act 1946* (NSW) (Consultation Paper).

The AICD is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 38,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

Good governance requires good law, specifically, law that is necessary, clear and effective. Legislation that lacks these characteristics can create burdens for individuals, businesses and communities. It can give rise to unintended consequences, undermine the rule of law and hinder economic activity.

For the reasons set out below, the AICD considers that section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946* (NSW) (Section 6) is not good law. Accordingly, we strongly supports its repeal (ie Option 4 in the Consultation Paper).

1. Summary

In summary, the AICD believes that Section 6 should be repealed because:

- the drafting of Section 6 is unclear and ambiguous. This has made Section 6 notoriously difficult to interpret, resulting in inconsistent application, unnecessary complexity and an unacceptable degree of uncertainty for insurers, insureds, third party plaintiffs and their advisers. Of the numerous difficulties with this provision, a key problem is the uncertainty of whether a Section 6 charge affects the ability of directors and officers to access insurance money to meet defence costs; and

- the continued need for a provision like Section 6 in New South Wales (NSW) is highly doubtful. Section 6 was introduced to remedy an issue 70 years ago

that is today sufficiently addressed by Commonwealth legislation, the common law, the NSW workers' compensation and motor accidents regimes, and modern insurance practices. Further, the fact that no other State Government, nor the Federal Government, has enacted a similar provision supports the conclusion that Section 6 is unnecessary.

To the extent that any material public policy need persists (which we question), it should be addressed under Commonwealth law, not State legislation.

A more detailed explanation of our views follows.

2. Section 6 is unclear and ambiguous

Section 6 provides a mechanism by which a third party plaintiff can assert and enforce a statutory charge over the proceeds of an insurance policy held by the insured. Importantly, the provision's drafting has been condemned for its lack of clarity by industry, practitioners, academics and, most notably, the courts. For example, members of the NSW judiciary have stated that the section's "ambiguity may be its only clear feature",[1] it is "undoubtedly opaque and ambiguous",[2] and it "should be repealed altogether or completely redrafted in an intelligible form, so as to achieve the objects for which it was enacted".[3]

Unsurprisingly, the poor construction of Section 6 has led to many difficulties with both its interpretation and application. These problems have been well documented over a long period.[4] The provision is also considered problematic at a conceptual level, particularly its reliance on a charge mechanism.[5]

While the AICD agrees that all of these difficulties (as summarised in paragraphs 1.20 to 1.22 of the Consultation Paper) undermine the efficacy of Section 6, this submission focuses solely on the defence costs issue relating to directors' and officers' (D&O) liability insurance policies because it is of particular concern to our members.

Uncertainty regarding whether a Section 6 charge affects the ability of company officers to access money under a D&O policy to meet investigation and defence costs has arisen due to conflicting court decisions in New Zealand (NZ) and in NSW. The NZ decisions are relevant to interpreting Section 6 because that provision was modelled on the equivalent NZ section[6].

A summary of the conflicting judicial findings follow:

- ***Bridgecorp 2011***[7] – In 2011, the NZ High Court held that the NZ section prevented directors from accessing defence costs under a D&O policy in circumstances where a charge had been asserted over money payable under the policy. The charge was found to exist even though claims had not actually been filed against the directors at the time and liability was contested. In reaching this conclusion, Lang J acknowledged that "although this result may

[1] *McMillan v Mannix* (1993) 31 NSWLR 538 at [542].
[2] *NSW Medical Defence Union v Crawford* 1993) 31 NSWLR 469 at 479.
[3] *Chubb Insurance Company of Australia Limited v Moore* [2013] NSWCA 212 at [55].
[4] See, for example: Justice RD Giles, "Reflections on Section 6" (1996) 7 *Insurance Law Journal* 152; SW Drummond and P Mann, "Abolish Section 6" (1997) 8 *Insurance Law Journal* 1; and D Willmott, "Third party claims against insurers: the case for uniform national reform" (2003) 15 *Insurance Law Journal* 24.
[5] Giles, above n 4.

be harsh for the directors, it is clearly in accordance with the object and purpose of [the NZ section]".[8]

- ***Bridgecorp 2012***[9] – The *Bridgecorp 2011* decision was subsequently reversed in 2012 by the NZ Court of Appeal on the basis that the statutory charge had "not crystallised" and would not do so until the director's liability to the third party claimants was established.[10] This decision was also appealed (see *Bridgecorp 2013* below).

- ***Chubb***[11] – In July 2013, the NSW Court of Appeal held that Section 6 creates a charge in relation to insurance moneys that are, or may become, payable in respect of a liability to pay damages or compensation; not insurance moneys payable in respect of defence costs or expenses paid before judgment is entered or settlement is agreed in respect of the claim for damages or compensation.[12] In reaching this conclusion, the court had regard to the *Bridgecorp 2011* and *2012* cases. However, contrary to the finding in *Bridgecorp 2011*, the NSW Court of Appeal stated:

  "*There is nothing on the face of s 6 to suggest that it was intended to alter the contractual rights of the parties in such a radical fashion. If the New South Wales Parliament intended s 6 to have such a drastic effect on the contractual rights of an insured, it could be expected to have provided so in express terms*."[13]

  Additionally, the court recognised that defence costs provisions in D&O policies "ensure that the insureds are not placed in the invidious position of having insufficient resources to defend major claims while the Insurers consider the question of indemnity."[14]

- ***Bridgecorp 2013***[15] – Just over five months after the *Chubb* decision was handed down in NSW, the NZ Supreme Court confirmed the decision in *Bridgecorp 2011*. In doing so, the court considered the decision in *Chubb* and concluded that it was "inherently unlikely that the purpose of [the NZ section] was as narrow" as had been construed by the NSW Court of Appeal in relation to Section 6.[16]

  While the NZ Supreme Court did not need to decide whether the insurer could refuse to pay defence costs, it held that the effect of the charge is that payments on the contractual obligation to meet directors' defence costs can be met only at the "peril" of the insurer when there is insufficient insurance cover under the limit of the policy to meet both third party liability claims and directors' defence costs".[17]

---

[6] Section 9 of the *Law Reform Act 1936* (NZ).
[7] *Steigrad & Ors v BFSL 2007 Limited & Ors* [2011] NZHC 1037.
[8] *Bridgecorp 2011* at [58].
[9] *Steigrad v BFSL 2007 Limited* [2013] NZCA 253.
[10] *Bridgecorp 2012* at [45].
[11] *Chubb Insurance Co of Australia Ltd v Moore* [2013] NSWCA 212.
[12] *Chubb* at [117], [135] and [207].
[13] *Chubb* at [124].
[14] *Chubb* at [123].
[15] *BFSL 2007 Limited & Ors (In liquidation) v Steigrad* [2013] NZSC 156.
[16] *Bridgecorp 2013* at [48].
[17] *Bridgecorp 2013* at [9].

Together, these four cases illustrate that Section 6 is unclear and ambiguous. Importantly, they have created an unsatisfactory level of uncertainty and apprehension regarding the implications of Section 6 on contractual rights under D&O policies to be advanced moneys on account of defence costs and expenses. While the decision in *Chubb* provides a measure of comfort that a Section 6 charge asserted over D&O policy moneys would not prevent advances of defence costs to company officers, unfortunately it is far from decisive on the issue. Significantly, the NSW Court of Appeal's finding in this regard is not binding as the decision in that case turned on the territorial operation of Section 6.[18]

Although the *Chubb* case would carry greater persuasive weight in NSW courtrooms than the NZ *Bridgecorp* cases, in the absence of a decision by the High Court of Australia, this issue is not settled. Furthermore, as Section 6 is derived from the NZ section, it may be that our High Court (or a differently constituted NSW court) would reject the reasoning in *Chubb* in favour of the broader construction given to the statutory charge by the NZ courts in *Bridgecorp 2011* and *2013*. If this were the case, directors and other officers could be placed in the "invidious" position of having to defend claims without the benefit of advances on account of their defence costs. They may even be unable to defend claims. It is these very outcomes that D&O insurance is intended to avoid.

The lack of certainty regarding the effect of Section 6 is of real concern to directors, other insureds and insurers[19] as it casts doubt on the operation of D&O policies and poses substantive personal, procedural and timing risks for affected parties. Some insurers and insureds have sought to address this problem through D&O policies that offer a separate limit of liability in the policy for defence costs, however as noted in the Consultation Paper, this practice is not without its own potential drawbacks.[20]

This issue, together with all of the other very significant problems outlined in the Consultation Paper, is a compelling case for repeal of Section 6.

3. Section 6 is unnecessary

Section 6 was enacted in 1946 to address a perceived unfairness that could arise where an insured obtains a sum from its insurer and then either disappears or fritters away the sum or enters into a collusive arrangement with the insurer, such that a claimant may not recover any payment from the insured.[21] In the AICD's view, this concern is no longer material.

In the 70 years since Section 6 was introduced, regulatory developments and changes in insurance practices have obviated the need for a provision of this nature. Notable among these has been the creation of additional statutory rights of third party access to insurance moneys under s48 and s51 of the *Insurance Contracts Act 1984* (Cth), s117 of the *Bankruptcy Act 1966* (Cth), s601AG *Corporations Act 2001* (Cth), s159 and s162 of the *Workers Compensation Act 1987* (NSW), s23 and s113 of the *Motor Accidents Compensation Act 1999* (NSW) and s54 of the *Motor Accidents Act 1988* (NSW). Importantly, regulatory oversight and powers have also been significantly enhanced. And it is now the usual practice of liability insurers to pay money to claimants, or on the direction of claimants, rather than to insureds.[22]

---

[18] *Chubb* at [206].
[19] Submission of the Insurance Council of Australia on the Consultation Paper dated 20 May 2016.
[20] Paragraph 1.22.
[21] *Chubb* at [8].
[22] Drummond and Mann, above n 4, 19.

It is also notable that when the Australian Law Reform Commission recommended changes to the regulatory regime governing insurance contracts, it did not propose that a provision based on Section 6 be included in what was to become the *Insurance Contracts Act 1984* (Cth). This was despite the fact that the Commission was aware of that section.[23]

4. Any perceived need for Section 6 should be addressed by Commonwealth law

For the reasons set out above, we contend no material public policy rationale for Section 6 persists. However, if a contrary view is formed, then we submit that any perceived deficiency should be addressed at the Commonwealth level. Our reasons are twofold. First, any gap in third party protections would have to exist in the other States as they do not have an equivalent to Section 6. Secondly, Commonwealth legislation would prevent forum shopping by third party claimants seeking to assert a charge unavailable in other Australian jurisdictions.

In any event, irrespective of whether a policy need exists, the AICD strongly contends that Section 6 is bad law and should be repealed without delay.

We hope this submission will be of assistance. If you would like to discuss our views, please do not hesitate to contact Lysarne Pelling, Senior Policy Adviser, on (02) 8248 2708 or at lpelling@aicd.com.au.

Yours sincerely

JOHN BROGDEN
Managing Director & Chief Executive Officer

[23] Drummond and Mann, above n 4, 19.