17. Insurance procedures in corporate insolvency: a comparison of the arrangements in the United Kingdom, Australia, and New Zealand

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1. INTRODUCTION

Through a comparison of the applicable legislation and relevant caselaw in the United Kingdom (UK), Australia and New Zealand, this chapter examines insurance procedures during corporate insolvency. The chapter is structured into two parts.

First, after noting the relevant international standards for managing the insolvency of insurers, section 2 examines the applicable legislation and regulatory arrangements for managing the insolvency of insurers in the UK, Australia and New Zealand. Through the use of case studies from each jurisdiction, it explains how the winding up of insurers can frequently be a complex process, frequently involving transfers of an insurer's business, negotiated compromises by way of schemes of arrangement and in some cases direct government intervention. In light of the 'long tail' nature of the liabilities of many insurers,[2] the winding up of an insurer may take many years, with many insolvent insurers being placed into 'run-off'[3] for many years before their eventual winding up. Section 2 also examines the Australian legislation which imposes obligations on liquidators that receive proceeds from contracts of insurance from the companies they are administering.

Second, section 3 compares and contrasts the applicable legislation and case law dealing with the rights of aggrieved third parties to claim on an insured's policy in the event of their insolvency. Common examples of third-party claimants in such situations include aggrieved clients of professionals that become insolvent; shareholders of failed companies and persons that suffer injuries due to the fault of insured individuals and companies that subsequently become insolvent.

[1] The author would like to note the assistance of the editors with feedback and comments on this chapter.

[2] A 'long-tail' liability is a liability with a long time period between the initial event causing loss, damage or injury, and the manifestation of harm giving rise to a claim. A common example is exposure to asbestos and similar substances, which may take many years to manifest in physical harm.

[3] When an insurer is closing down its business, it is ordinarily placed into 'run-off', whereby it ceases writing new business and instead only settles its existing liabilities. Through this process, the insurer's existing liabilities are 'run-off' over time.

2. MANAGING THE INSOLVENCY OF INSURERS

A helpful starting point when examining the legislative and regulatory arrangements for managing the insolvency of insurers are the principles developed by the International Association of Insurance Supervisors (IAIS). Since its establishment in 1994 as a voluntary international association of insurance regulators, the IAIS has progressively developed a range of principles and guidelines for the supervision of the insurance sector. These include the Insurance Core Principles (ICPs), which provide a benchmark on the essential elements that should be addressed in the national supervisory regimes in order to promote a financially sound insurance sector and provide an adequate level of policyholder protection. The 26 ICPs are referred to by international organisations such as the International Monetary Fund (IMF) when undertaking its periodic Financial System Stability Assessments of selected countries.[4] Relevantly to this chapter's discussion, ICP 12 'Winding-up and Exit from the Market' envisages that:

> The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimizing disruption to provision of benefits to policyholders.

The IAIS includes further commentary to guide national supervisory authorities in implementing legislative and regulatory arrangement that adhere to the ICPs. In relation to ICP 12, the IAIS emphasises the importance of effective oversight and early intervention by the national supervisory authority; clear rules for the payment to policyholders in priority to other stakeholders of the insurer; and in the case of cross-border insolvencies, cooperation with the supervisory authorities in other jurisdictions. As discussed below, in its recent Financial System Stability Assessments of the United Kingdom, Australia and New Zealand the IMF has reached a range of conclusions on each jurisdiction's adherence to the standards envisaged by ICP 12,[5] as well as recommendations to improve the effectiveness of the applicable domestic regulatory arrangements.

2.1 United Kingdom

In the UK the Financial Services and Markets Act 2000 (UK) (FSMA 2000) sets out the requirements for the authorisation and conduct of financial services, which includes the

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4 'Insurance Core Principles and ComFrame' (International Association of Insurance Supervisors) https://www.iaisweb.org/page/supervisory-material/insurance-core-principles accessed 17 January 2020. For an overview of the evolution and function of the IAIS generally, see John Lowry, Philip Rawlings, and Robert Merkin, *Insurance Law: Doctrines and Principles* (3rd edn, Hart Publishing 2011) 18–19; and Louise Steinberg 'International Organisations: Their Role and Interconnectivity in Insurance Regulation' in Julian Burling and Kevin Lazarus (eds), *Research Handbook on International Insurance Law and Regulation* (Edward Elgar Publishing 2011) 302–4.

5 In its assessments of the regulatory arrangements in each jurisdiction, the IMF assesses the observance of the ICPs according to the ratings of 'Observed'; 'Largely observed'; 'Partly Observed' and 'Not observed'.

conduct of insurance businesses.[6] Between 2001 and April 2013 the FSMA 2000 was administered by the Financial Services Authority (FSA). In response to concerns about the overly wide ambit of the FSA's regulatory responsibilities, from April 2013 the FSA's functions (including the administration of the FSMA 2000) were divided between two new regulators. The Prudential Regulation Authority (PRA), which is a subsidiary of the Bank of England, became responsible for the prudential regulation of the UK's financial institutions, and the Financial Conduct Authority (FCA) became responsible for regulating the business conduct of financial services firms.[7]

Under the FSMA 2000 the PRA has extensive powers to make rules for the authorisation and prudential management of insurers, which are set out in the PRA Rulebook.[8] In setting out the prudential requirements for insurers, the PRA Rulebook distinguishes between Solvency II firms and non-Solvency II firms (which are generally smaller-scale insurers).[9] The Solvency II standards were set down in a 2009 European Union (EU) Directive[10] with the objective of providing a harmonised prudential framework for insurance and reinsurance firms in the EU, and have applied within the UK since 1 January 2016.[11]

Since January 2016, the PRA and FCA have jointly administered a New Insurer Start-up Unit, which sets out the requirements for the authorisation of insurers in the UK.[12] Once authorised, UK insurers are subject to ongoing supervision by the PRA. In determining the appropriate level of supervisory oversight, the PRA adopts five descending 'categories' of potential impact of the insurer's failure on policyholders, based on the size and scale of the insurer's business.[13] In cases where it develops concerns about the insurer's ability to satisfy its obligations to policyholders, the PRA describes five stages of possible supervisory action in its Proactive Intervention Framework. These range from Stage 1 ('Low risk to viability of insurer') down to Stage 5 ('Insurer in resolution or being actively wound up'). For each of

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6 For an overview of the regulation of insurance in the UK, see George Walker and Robert Purves (eds), *Financial Services Law* (3rd edn, Oxford University Press 2014) 657–736.

7 Walker and Purves, ibid., 3–6.

8 'PRA Rulebook Online' (Bank of England – Prudential Regulation Authority) http://www.prarulebook.co.uk/ accessed 17 January 2020.

9 Non-Solvency II firms are generally those with gross premium income below €5 million and gross technical provisions of less than €25 million – see 'Non-Directive Firms' (Bank of England) https://www.bankofengland.co.uk/prudential-regulation/supervision/non-directive-firms accessed 17 January 2020.

10 Directive 2009/138/EC of the European Parliament. The Solvency II standards were developed by the European Insurance and Occupational Pensions Authority (EIOPA), which has the role of overseeing and providing guidance to national supervisory authorities within the EU. For an overview of the Solvency II regime, see 'Solvency II – Going Live!' (EIOPA 2016) https://eiopa.europa.eu/Pages/Supervision/Insurance/Solvency-II-Going-Live.aspx accessed 17 January 2020. For an overview of the EU's system of insurance regulation, see Robert Purves 'Europe: The Architecture and Content of EU Insurance Regulation' in Julian Burling and Kevin Lazarus (eds), *Research Handbook on International Insurance Law and Regulation* (Edward Elgar Publishing 2011) 621–55.

11 Solvency II was implemented into UK law by the Solvency 2 Regulations 2015 (UK). For an overview of the key features of Solvency II, see The Prudential Regulation Authority's Approach to Insurance Supervision (Bank of England – Prudential Regulation Authority, October 2018) 13 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/insurance-approach-2018.pdf accessed 17 January 2020.

12 See 'New Insurer Start-Up Unit' (Bank of England) https://www.bankofengland.co.uk/prudential-regulation/new-insurer-start-up-unit accessed 17 January 2020.

13 Bank of England (n 11) 14–15.

these five stages, the PRA notes possible supervisory actions which may include additional reporting requirements, removal of authorisation and/or the initiation of appropriate insolvency processes.[14] Under the Financial Services Act 2012 (UK) the PRA has extensive powers to investigate potential contraventions of the FSMA 2000.[15]

In cases where insurers fail, there are two main ways by which they may exit the market.[16] The first of these is to cease writing new business and to have their liabilities run-off over time. A common procedure for facilitating such an exit is through a scheme of arrangement under Part 26 of the Companies Act 2006 (UK) (previously Part XIII of the Companies Act 1985 (UK),) which may involve the transfer of the failed insurer's liabilities to another authorised insurer in accordance with s 105 of the FSMA 2000.[17]

The second process for facilitating an exit from the market is by entering a formal insolvency process under Part XXIV of the FSMA 2000. Under section 360 of the FSMA 2000 an insurer may be placed into administration by an order of the court, with administrators being required to carry on the insurer's business and assist in ensuring the compensation of policyholders.[18] In order to protect the interests of policyholders, section 366 of the FSMA 2000 prevents insurers that carry out contracts of long-term insurance from voluntarily winding up without the consent of the PRA.[19] The PRA may apply to the court for the winding up of an insurer under section 367 of the FSMA 2000. In cases where an insurer has been proved to be unable to pay its debts, section 377 of the FSMA 2000 allows the court to reduce the value of one or more of the insurer's contracts as an alternative to making a winding up order. Section 378 of the FSMA 2000 enables HM Treasury to make regulations for the treatment of an insurer's assets on its winding up, which are set out in the Insurers (Winding Up) Rules 2001.

In cases where an insurer is being wound up, the Insurers (Reorganisation and Winding Up) Regulations 2004 (UK) (which modify the application of the UK's general law of insolvency in the winding up of authorised insurers) sets out the priority rules for the payment of the insurer's debts.[20] Under Regulation 21, in the winding up of an authorised insurer the first priority is the payment of 'preferential debts' (which include contributions to occupational pension schemes and remuneration of employees);[21] followed by insurance debts; and lastly by all of the insurer's other debts. Regulation 21 also provides for the equal ranking of preferential

[14] Ibid., 27–33.

[15] Policy Statement – Conducting Statutory Investigations (Bank of England – Prudential Regulation Authority April 2013) https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2013/conducting-statutory-investigations accessed 17 January 2020.

[16] See 'The PRA's Approach to Supervision of Insurers' (Bank of England – Prudential Regulation Authority, October 2018) 26 https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-approach-documents-2018 accessed 17 January 2020.

[17] See also The Prudential Regulation Authority's Approach to Insurance Business Transfers (Bank of England – Prudential Regulation Authority, April 2015) https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-to-insurance-business-transfers accessed 17 January 2020.

[18] The procedures for insurers to be placed into administration are set out in the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 (UK).

[19] Financial Services and Markets Act 2000 (UK) s 366.

[20] Insurers (Reorganisation and Winding Up) Regulations 2004 (UK) reg 8.

[21] Ibid., reg 17.

debts[22] and insurance debts,[23] and if the insurer's assets are insufficient to meet them, they are to abate in equal proportions. The 2004 Regulations also set out priority rules for cases where the insurer's assets are insufficient to fully meet its debts,[24] and for cases where the insurer's assets exceed its debts.[25]

As at 1 July 2020, the small handful of cases that have applied the 2004 Regulations have involved applications to convene meetings of creditors to consider proposed schemes of arrangement for insurers in run-off,[26] as well as the approval of schemes.[27] Other cases have involved the applications for directions on the application of the 2004 Regulations by administrators[28] and by liquidators.[29]

Under Part XV of the FSMA 2000[30] the Financial Services Compensation Scheme (FSCS) provides protection for policyholders of authorised financial services firms (including insurers) in the event of the firm's failure. For policyholders with compulsory insurance (including third party motor and employer's liability insurance), long-term life and income protection insurance, professional indemnity insurance and claims arising from the death or incapacity of the policyholder due to injury, sickness or infirmity, the FSCS provides 100 per cent of the compensation available to the policyholder. For all other forms of insurance including travel,

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[22] Ibid., reg 21(3).
[23] Ibid., reg 21(4).
[24] Ibid., reg 25.
[25] Ibid., reg 26.
[26] See e.g., *Re Sovereign Marine & General Insurance Company Ltd* [2006] EWHC 1335 (Ch), where Warren J ordered that there should be two separate classes of creditors to consider the proposed scheme – firstly those creditors with unpaid agreed claims, outstanding claims and other claims not requiring estimation; and secondly those creditors Incurred but Not Reported (IBNR) claims – with the key differentiating factor being the degree of uncertainty in the status of each class of claims. For commentary on this decision and more generally on the use of schemes of arrangement for insurers in the UK and in Australia, see Dean Carrigan and Christopher Prestwich, *Solvent Schemes of Arrangement: Bringing an End to Early Run-Off in the Insurance Industry* (Allens Arthur Robinson 2006) https://data.allens.com.au/pubs/pdf/insur/pap7dec06.pdf accessed 17 January 2020.
[27] See e.g., *Re Stronghold Insurance Company Ltd* [2018] EWHC 2909 (Ch), where the Hildyard J approved a scheme of arrangement under Part 26 of the *Companies Act* 2006 (UK) for an insurer that had ceased underwriting in 1985 and which had been in run-off since that time. Most of the insurer's creditors were based in USA and EU. In noting that the PRA and FCA had no objections to the scheme, and that the shareholders were unwilling to provide the substantial additional capital to enable the insurer to achieve Solvency II compliance, the scheme was approved. In the earlier decision of *Re DAP Holding NV* [2005] EWHC 2092 (Ch) Lewinson J approved a scheme of arrangement under s 425 of the Companies Act 1985 (UK).
[28] See e.g., *Re Kaplan & Ors* [2015] EWHC 1493 (Ch) where Warren J provided a direction to an administrator under schedule B1 of the Insolvency Act 1986 (UK) that the Insurers (Reorganisation and Winding Up) Regulations 2004 (UK) had no application to a company that was licensed to carry on an insurance business, but which in fact had been in run-off for many years and only carried on a reinsurance business.
[29] See e.g., *Re Whitely Insurance Consultants (a/k as Kingfisher Travel Insurance Services)* [2008] EWHC 1782 (Ch), where Richards J directed the insurer's liquidators under s 168(3) of the Insolvency Act 1986 that the Insurers (Reorganisation and Winding Up) Regulations 2004 (UK) had no application to claims by policyholders who had been provided insurance by a partnership that was not authorised to carry on an insurance business.
[30] Financial Services and Markets Act 2000 (UK) ss 212–224.

property and public liability cover the FSCS provides 90 per cent of the available cover.[31] As at 1 January 2020, the FSCS was involved with a total of 38 general insurers and two life insurers, with a considerable number of these insurers having been in run-off for many years.[32] As at 1 January 2020, two recent insolvencies that the FSCS has been involved with include the Danish taxi insurer Alpha Insurance A/S (Alpha), which before its collapse in early 2018 had been authorised to write business in all EU states;[33] and the Gibraltar-based Elite Insurance Company Ltd (Elite), which before its collapse in December 2019 had provided a range of consumer and motor vehicle insurance products within the UK.[34] Highlighting the inter-connectedness of the insurance industry, as explained below, the failure of Alpha and Elite was also a contributing factor in the collapse of CBL Insurance Ltd in New Zealand in 2018.

In its 2011 assessment of the UK's observance of the ICPs, the IMF concluded that the UK's arrangements for regulating the insurance sector were thorough and effective. The IMF noted that the UK had clear provisions for the exit and winding up of insurers, which gave priority to policyholders. The IMF was also satisfied that the FSCS afforded appropriate protections to policyholders.[35]

2.2 Australia

In Australia there are separate legislative provisions governing the insolvency and winding up of insurers (which are examined in 2.2.1), and the distribution of proceeds from contracts of insurance and reinsurance received by liquidators (which are discussed in 2.2.2).

2.2.1 Australian legislation governing the insolvency of insurers

The statutory framework for the prudential regulation of Australian insurers is set out in the Insurance Act 1973 (Cth) for general insurers and the largely parallel Life Insurance Act 1995 (Cth) for life insurers. As insurers must also be registered Australian corporations in order to carry on an insurance business, the Corporations Act 2001 (Cth) is also applicable to the insolvency and winding up of Australian insurers. As the small handful of insurer insolvencies in Australia over the last two decades have involved the collapses of general insurers, the

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31 For an overview of the FSCS generally see www.fscs.org.uk; and 'Financial Services Compensation Scheme' (Bank of England – Prudential Regulation Authority) https://www.bankofengland.co.uk/prudential-regulation/authorisations/financial-services-compensation-scheme accessed 20 January 2020.

32 For a listing of the insurers with which the FSCS was involved as at 1 January 2020, see 'Insurance Insolvencies' (Financial Services Compensation Scheme) https://www.fscs.org.uk/what-we-cover/insurance/insurance-insolvencies/ accessed 20 January 2020.

33 For a timeline of the involvement of the FSCS in the insolvency of Alpha, see 'Alpha Insurance A/S' (Financial Services Compensation Scheme 2018) https://www.fscs.org.uk/failed-firms/alpha/ accessed 20 January 2020.

34 For a timeline of the involvement of the FSCS in the insolvency of Alpha, see 'Elite Insurance Company Ltd' (Financial Services Compensation Scheme 2019) https://www.fscs.org.uk/failed-firms/elite/ accessed 20 January 2020. See also 'Elite Insurance Company Ltd has entered into administration (Financial Conduct Authority 2019) https://www.fca.org.uk/news/news-stories/elite-insurance-company-ltd-elite-has-entered-administration accessed 20 January 2020.

35 *Financial Sector Assessment Program Update – United Kingdom – Detailed Assessment of Observance of Insurance Core Principles* (International Monetary Fund 2011) 67–8.

discussion below focuses on the Insurance Act 1973, with the key differences under the Life Insurance Act 1995 being noted where relevant.

The Insurance Act 1973 (Cth) sets out a framework for the authorisation and prudential regulation of general insurers operating throughout Australia. Since 1 July 1998, the Insurance Act 1973 has been administered by the Australian Prudential Regulation Authority (APRA), in addition to a range of other statutes that provide for the regulation of financial institutions.[36] APRA was formed in response to the conclusions of the 1997 Wallis Financial System Inquiry, which recommended a 'twin peaks' model of financial sector regulation for Australia. From 1 July 1998, the newly formed APRA assumed responsibility for the prudential supervision of Australian financial institutions (including Authorised Deposit-Taking Institutions, general and life insurers and superannuation funds) which were previously regulated by the Reserve Bank of Australia and the former Insurance and Superannuation Commission.

The other key agency under the 'twin peaks' model of Australian financial sector regulation is the Australian Securities and Investments Commission (ASIC). Under the ASIC Act 2001, ASIC is charged with monitoring and enforcing compliance with the Corporations Act 2001[37] which sets out the legal framework for the administration of Australian companies, financial markets, financial services, consumer credit and business names. Under Chapter 7 of the Corporations Act 2001,[38] most forms of insurance in Australia are classified as 'financial services'. In contrast to the prudential regulatory role of APRA, the focus of ASIC is on licensing, disclosure and consumer protection. As discussed below, the Corporations Act 2001 governs the insolvency and deregistration of Australian companies.

APRA's role in regulating general insurers under the Insurance Act 1973

In order to carry on a business as a general insurer in Australia, a corporation must be authorised by APRA.[39] Once authorised, general insurers must comply with the prudential standards made by APRA.[40] The Insurance Act 1973 requires general insurers to have an auditor and an actuary,[41] and also enables APRA to appoint an independent actuary to investigate the liabilities of a general insurer[42] and to direct the removal of a general insurer's auditor or actuary.[43] Part V of the Insurance Act 1973[44] provides APRA with wide powers to investigate a general insurer when it has concerns about the insurer's ability to meet its liabilities or its statutory

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[36] The other legislation that APRA administers includes the Banking Act 1959 (Cth), the Superannuation Industry (Supervision) Act 1993 (Cth), the Financial Sector (Shareholdings) Act 1998 (Cth), the Financial Sector (Transfer and Restructure) Act 1999 (Cth) and the Financial Sector (Collection of Data) Act 2001 (Cth).

[37] The other legislation that ASIC administers includes the Insurance Contracts Act 1984 (Cth), the Superannuation Industry (Supervision) Act 1993 (Cth), the National Consumer Credit Protection Act 2009 (Cth), and the Business Names Registration Act 2011 (Cth).

[38] 'Financial Services and Markets'.

[39] Insurance Act 1973 Part III sets out the requirements for the authorisation to carry on an insurance business.

[40] Insurance Act 1973 Part IIIA sets out the framework for the prudential supervision and monitoring of general insurers, authorised non-operating holding companies and their subsidiaries'. Section 32 authorises APRA to issue prudential standards, with which general insurers must comply: s 38.

[41] Insurance Act 1973 s 39.

[42] Ibid., s 49E(1).

[43] Ibid., s 49R.

[44] Ibid., Part V: Investigations of General Insurers etc.

obligations.[45] These include the powers to appoint an inspector to investigate the affairs of an insurer;[46] to enter onto premises;[47] to require the production of books and records;[48] and to conduct examinations of persons involved with the management of the general insurer.[49]

In cases where APRA has grounds to believe a general insurer may be unable to meet its liabilities, or that the insurer has failed to comply with its regulatory obligations, Part VB of the Insurance Act 1973[50] provides for the external administration and winding up of general insurers. The most commonly used form of external administration under Part VB is judicial management,[51] which was introduced into the Insurance Act 1973 in 2008.[52] The judicial management regime under Part VB was modelled on the very similar provisions in the Life Insurance Act 1995, which enables APRA to regulate Australian life insurers. Whilst as at 1 January 2020 the judicial management provisions of the Life Insurance Act 1995 have not yet been utilised, the equivalent provisions of the former Life Insurance Act 1945 (which were modelled on the South African Insurance Act 1943 (SA) have been utilised on three occasions, firstly in the early 1950s and subsequently in the early 1990s.

Under Part VB, judicial managers are subject to the control of the Federal Court[53] and have wide powers to manage the relevant general insurer and undertake various actions including selling assets and bringing or defending legal proceedings.[54] Judicial management also imposes a moratorium on court and tribunal proceedings against the general insurer.[55] Section 62ZI requires a judicial manager to file a report with the Federal Court as soon as possible after starting to manage a general insurer recommending a course of action for the future of the general insurer that is most advantageous to the interests of policyholders. This may include transferring the general insurer's business to another general insurer; allowing the general insurer to carry on its business after a period of judicial management; or winding up the general insurer.[56] The judicial management process concludes either when ordered by the Federal Court, or where the Federal Court orders that the general insurer be wound up.[57] Alternatively, APRA may also apply to the Federal Court for an order that a general insurer be wound up following an investigation under Part V of the Insurance Act 1973.[58] Whilst the winding up process of general insurers is largely governed by the corporate insolvency provi-

45 Ibid., s 52(1).
46 Ibid., s 52.
47 Ibid., s 54.
48 Ibid., s 55(1)(a).
49 Ibid., s 55(1)(c).
50 Ibid., Part VB 'Judicial Management, External Administration and Winding Up'.
51 Whilst the *Life Insurance Act* 1995 (Cth) Division 1A provides a parallel regime of 'statutory management', to date this regime has not been utilised.
52 Part VB was inserted into the Act by cl 11 of Sch 3 to the Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008 (Cth) which commenced on 18 October 2008. For a comprehensive summary of the background to the judicial management regime under Part VB of the Insurance Act 1973, see APRA v A.C.N 000 007 492 (Under Jud Mgt) (Subject to DOCA) (2010) 79 ACSR 492 [2010] FCA 912 [5]–[25].
53 Insurance Act 1973 s 62X.
54 Ibid., s 62Y.
55 Ibid., s 62P.
56 Ibid., ss 62ZI(2); 131A.
57 Ibid., s 62ZE.
58 Ibid., s 62ZU.

sions of Chapter 5 of the Corporations Act 2001, s 116A of the Insurance Act 1973 requires that in the winding up an insurer, the insurer's assets in Australia must be applied first to discharge the insurer's liabilities in Australia.

Whilst the provisions of the Life Insurance Act 1995 largely parallel those of the Insurance Act 1973, one difference for Australian life insurers is the requirement to maintain at least one or more statutory funds for managing their life insurance business.[59] In the winding up of an Australian life insurer, the assets of a statutory fund must firstly be applied to discharge the debts and claims referred to in section 556 of the Corporations Act 2001, which sets out the general rules for determining the priority according to which liquidators must pay the debts and claims of companies they are administering. If any assets remain after this process, the assets must then be applied firstly to discharge the life insurer's policy liabilities; then to discharge other liabilities referable to the business of the statutory fund; and thereafter are to be applied in the manner directed by the Court.[60] However as the insolvency provisions of the Life Insurance Act 1995 have yet to be utilised, the next section discusses case studies of Australian general insurer insolvencies over the last two decades.

Case study 1 – collapse of HIH Insurance in 2001

Several of the provisions of the Insurance Act 1973 noted above that now enable APRA to set and monitor prudential standards to lessen the risk of general insurers becoming insolvent, and also to respond to suspected instances of insurer insolvency, were introduced as responses to the collapse of HIH Insurance Ltd in 2001 – which was one of Australia's most significant corporate failures.

Established in 1968, the business that eventually became known as HIH Insurance Ltd grew rapidly in the late 1990s through a series of joint ventures and acquisitions to become Australia's second largest general insurer. However (as detailed below) due to a combination of its overly aggressive business expansion and the failure to adequately provision for its liabilities, HIH was placed into provisional liquidation in March 2001. With debts over $5 billion, the collapse of HIH has to date been the largest corporate insolvency in Australia's history, with far-reaching implications both for the Australian insurance market and for corporate governance practices more broadly.

Due to the scale and complexity of HIH's collapse, the federal government announced several measures to manage the fall-out from the collapse. These included the formation of the HIH Claims Support Scheme to manage the consumer and small businesses claims by HIH policyholders, which operated from July 2001 until April 2013.[61] Secondly, with federal government assistance HIH's liquidator negotiated transfers of HIH's businesses to other licensed general insurers.[62] Thirdly, in May 2001, the federal government announced a Royal Commission into the Collapse of HIH Insurance to be chaired by Justice Neville Owen. In his final report in April 2003, Commissioner Owen noted that several factors had contributed to HIH's failure. These included the under-pricing of risks insured and under-reserving for potential liabilities (especially from long-tail liabilities); inadequate corporate governance practices,

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59 Life Insurance Act 1995 Part 4 'Statutory funds of life companies'.

60 Life Insurance Act 1995 (Cth) s 187.

61 Claudio Damiani, Naomi Bourne and Martin Foo HIH Claims Support Scheme (Commonwealth Treasury 2015) 27.

62 Ibid., 7–8.

particularly the board's failure to exercise adequate oversight of management; financial mismanagement; a series of ill-conceived business acquisitions; and poor risk management frameworks. Whilst Commissioner Owen was critical of APRA's slowness to identify and respond to the warning signs of HIH's precarious financial position,[63] he conceded there was little that APRA could have done to prevent HIH's collapse, commenting that the judicial management regime (which as noted above existed under the Life Insurance Act 1995, and before that under the Life Insurance Act 1945) would have done little to salvage HIH's precarious financial position.[64] Commissioner Owen also acknowledged that APRA was still in the process of being established as a new regulator (with the merging of systems and staff from the former Insurance & Superannuation Commission) between July 1998 and March 2001.

Commissioner Owen made a total of 61 wide-ranging recommendations to minimise the scope for future failures of Australian financial institutions and listed entities more broadly. In welcoming the reforms to the Insurance Act 1973 which from 1 July 2002 enabled APRA to make prudential standards,[65] amongst several recommendations to improve the functioning of APRA, he recommended that it adopt 'a more sceptical, questioning and, where necessary, aggressive approach to its prudential supervision of general insurers'.[66]

It is worth noting that since these recommendations, in addition to promulgating a range of prudential standards (with more detailed guidance being provided to regulated financial institutions through prudential practice guides), APRA has published guidelines which set out its policy on the licensing of general insurers.[67] Once licensed to operate, APRA continually monitors the financial status, capital adequacy and risk management arrangements of regulated financial institutions through its Probability and Impact Rating System (PAIRS), which considers the probability and impact of a financial institution. Based on the financial institution's PAIRS score, APRA then determines the appropriate level of regulatory oversight for the financial institution according to its Supervisory Oversight and Response System (SOARS), with the possible ratings being 'Normal', 'Oversight', 'Mandated Improvement' and 'Restructure').[68] It has been widely noted that APRA's 'close-touch' supervisory approach (including regular monitoring and onsite visits to its regulated financial institutions) contributed to the resilience of Australia's financial institutions – which in comparison to those in the US and the UK – survived the 2008 Global Financial Crisis without major failures.[69]

Noting the contributions of the HIH claims support scheme in settling claims by former HIH policyholders, Commissioner Owen recommended the introduction of a generally-applicable policyholder protection scheme to support policyholders in the event of future insolvencies

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[63] Hon Justice Neville Owen, 'The Failure of HIH Insurance' (Report of the Royal Commission, Australian Government Publishing Service 2003) Vol I, 40–42.

[64] Ibid., 121; 246.

[65] Ibid., Vol I, 44.

[66] Ibid., Vol I, 54.

[67] 'Licensing Guidelines for General Insurers' (Australian Prudential Regulation Authority 2007) https://www.apra.gov.au/licensing-guidelines-for-general-insurers accessed 20 January 2020.

[68] Risk Assessment and Supervisory Response Tools (Australian Prudential Regulation Authority 2018) https://www.apra.gov.au/risk-assessment-and-supervisory-response-tools accessed 20 January 2020.

[69] Claudio Damiani, Naomi Bourne and Martin Foo, *HIH Claims Support Scheme* (Commonwealth Treasury 2015) 10.

by Australian insurers.[70] In response, the federal government introduced the Financial Claims Scheme (FCS),[71] which since its inception in 2008 has provided protection for policyholders of Australian general insurers.[72] The federal government decided not to extend the FCS to include policies of life insurance, as it was considered that in comparison to the short-term nature of general insurance policies, the long-term nature of life insurance policies could require the FCS to remain in activation for many years, even decades. Instead, the federal government considered the preferable option in the event of a life insurer's insolvency would be for APRA to utilise its existing powers under Part 9 of the Life Insurance Act 1995 to facilitate the transfer of an insolvent life insurer's business to another licensed life insurer.[73]

More broadly, in response to Commissioner Owen's recommendations for a review of Australia's corporate governance guidelines,[74] in 2004 the Australian Securities Exchange (ASX) promulgated its Corporate Governance Principles and Recommendations – a set of best practice corporate governance guidelines, which ASX-listed entities must either adopt, or explain why they do not adopt. These corporate governance guidelines (which have been updated in four subsequent versions)[75] are now a key aspect of Australia's corporate governance landscape. Additionally, in response to Commissioner Owen's recommendations to more effectively ensure the independence of company auditors,[76] enhanced requirements for auditor independence and rotation were enacted in 2004.[77]

Another major Australian legal reform that was significantly influenced by the collapse of HIH and its significant under-pricing of both public and professional liability risks, as well as increasingly litigious community attitudes and the tendency of courts to award significant damages, was seen in the area of tort law reform. Following a major review of the law of negligence,[78] in late 2002 the Australian states and territories enacted uniform civil liability legislation to reform the law governing compensation for personal injuries.[79]

Case study 2 – collapse of United Medical Protection Group

Shortly after the collapse of HIH, another general insurance insolvency (which ultimately had a successful outcome) was seen in the case of the United Medical Protection Group (UMP

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70 Owen (n 63) Vol I, 290.

71 Insurance Act 1973 Part VC 'Financial Claims Scheme for Policyholders with Insolvent General Insurers'.

72 Financial Claims Scheme (Australian Prudential Regulation Authority) https://www.apra.gov.au/financial-claims-scheme-0 accessed 20 January 2020.

73 International Monetary Fund, Financial Sector Assessment Program Update – Australia – Detailed Assessment of Observance of Insurance Core Principles (November 2012) 83.

74 Owen (n 63) 50.

75 Corporate Governance Council (ASX) https://www.asx.com.au/regulation/corporate-governance-council.htm accessed 20 January 2020.

76 Owen (n 63) 51–3.

77 These auditor rotation requirements introduced into Pt 2M.4 of the Corporations Act 2001 by the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004. For further details on these requirements, see ASIC Regulatory Guide 187 'Auditor independence' (February 2007).

78 Hon David Ipp *Final Report of the Review of the Law of Negligence* (Australian Government Publishing Service 2002).

79 Claudio Damiani, Naomi Bourne and Martin Foo *HIH Claims Support Scheme* (Commonwealth Treasury 2015) 11–12.

Group). The parent company of the UMP Group was United Medical Protection Ltd (UMP), which since 1997 had been a not-for-profit medical defence organisation. UMP's membership of doctors and other health professionals were entitled to receive professional indemnity insurance from UMP's controlled entities including the licensed general insurer Australasian Medical Insurance Ltd (AMIL). UMP's directors resolved to wind up the companies in the group on 3 May 2002 after APRA had appointed an inspector to investigate AMIL's affairs.[80] On that date in the Supreme Court of NSW Austin J appointed a provisional liquidator to the companies of the UMP Group.[81] Shortly afterwards on 26 June 2002 APRA authorised the provisional liquidator to carry on the general insurance business of AMIL, subject to its close oversight.[82] On 10 November 2003, Austin J terminated the appointment of the provisional liquidator and granted leave to discontinue the winding up proceedings, after which the UMP Group returned to normal operations. His Honour accepted the provisional liquidator's findings that the difficulties experienced by the UMP Group had resulted from factors outside of the control of its directors, including a withdrawal of commercial insurers from the medical malpractice market in 2001; a significant increase in claims notified to AMIL just prior to the commencement of legislative changes governing the liability of health care professionals in 2001; as well as a reduction of capacity in the relevant reinsurance markets following the collapse of HIH in May 2001 and later the terrorist attacks in the United States on 11 September 2001.[83] Austin J also noted that APRA was supportive of the transition plan arranged by the provisional liquidator involving changes to the corporate governance, strategic and business planning, operational risk and management, and capital management arrangements for the UMP Group.[84]

Case study 3 – Australian Family Assurance Ltd[85]

On 30 October 2009 orders were made in the Federal Court for the winding up of Australian Family Assurance Ltd (AFAL) under section 62ZJ of the Insurance Act 1973. AFAL had commenced as a licensed general insurer in April 1986, initially focusing on providing insurance products relating to the diagnosis of cancer. AFAL's business subsequently expanded into other lines of consumer insurance, with the company progressively assuming a greater proportion of risk through its entry into various underwriting agreements with other insurers. However, as a result of transfers of parts of its portfolio, AFAL's financial position deteriorated and in July 2002 APRA varied AFAL's insurance licence by placing it into run-off. In July 2009, an order was made by the Federal Court to place AFAL under judicial management. In noting the judicial manager's assessment that AFAL's adjusted financial position involved a deficiency of $1,023,900,[86] Lindgren J accepted the judicial manager's recommendation for the winding up of AFAL.

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80 *Re United Medical Protection Ltd* (2003) 47 ACSR 705; (2004) 22 ACLC 56; [2003] NSWSC 1031 [8].

81 *Re United Medical Protection Ltd* (2002) 41 ACSR 623; [2002] NSWSC 413.

82 *Re United Medical Protection Ltd* (2003) 47 ACSR 705; (2004) 22 ACLC 56; [2003] NSWSC 1031 [10].

83 Ibid., [44]–[47].

84 Ibid., [116]–[156].

85 *Smith as Judicial Manager of Australian Family Assurance Ltd* [2009] FCA 1449.

86 Ibid., [22].

Case study 4 – Rural & General Insurance Ltd
Shortly after the AFAL affair, the Federal Court made orders for the appointment of a judicial manager to Rural & General Insurance Ltd (Rural) in August 2010.[87] Perram J noted with concern that Rural had previously failed to respond to APRA's notice to show cause why an investigation into its affairs should not be held. Following this failure, the APRA-appointed inspector had determined that Rural was only marginally solvent on an optimistic scenario and that as a result of its dysfunctional management arrangements it failed to comply with most of APRA's prudential standards.[88] In a subsequent decision Perram J ordered the winding up of Rural, accepting the judicial manager's assessment that Rural's balance sheet deficit on a pessimistic scenario amounted to $2,264,693, and on the most optimistic scenario amounted to $379,732.[89] Accordingly His Honour appointed the judicial manager as the liquidator to wind up Rural in insolvency.

In its 2012 assessment of Australia's observance of the ICPs, whilst the IMF was satisfied overall with Australia's arrangements for supervising its insurance sector, it rated ICP 12 as 'largely observed'. After noting the availability of the FCS as a means of protecting the interests of general insurance policyholders, and the requirements for Australian life insurers to maintain statutory funds in relation to their insurance businesses, the IMF identified the scope for more clearly prioritising the legal priority of claims by policyholders ahead of unsecured creditors in both the Insurance Act 1973 and the Life Insurance Act 1995.[90] Its remains to be seen if this suggestion will be acted upon over the coming years.

2.2.2 Australian legislation regulating the application of proceeds from contracts of insurance and reinsurance received by liquidators

The Corporations Act 2001 imposes detailed requirements for liquidators that receive proceeds from contracts of insurance and reinsurance from the companies they are administering.

Corporations Act 2001 s 562 'Application of proceeds of contracts of insurance'
As noted above in 2.2.1, section 556 of the Corporations Act 2001 sets out the general rules for determining the priority according to which liquidators must pay the debts and claims of companies they are administering.[91] However, the general priority rules in section 556 are subject to a number of exceptions. In cases where an Australian company was insured under a contract of insurance in respect of liabilities to third parties before going into liquidation, and the liquidator receives moneys pursuant to that contract of insurance, section 562(1) requires the liquidator to pay such insurance moneys directly to a third-party claimant, in priority to the general priority regime under section 556, after deducting any expenses of or incidental to getting in that amount. Section 562(2) further provides that if the liability of the insurer to the

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87 *APRA v A.C.N 000 007 492 (Under Jud Mgt) (Subject to DOCA)* (2010) 79 ACSR 492; [2010] FCA 912.

88 Ibid., [36]–[38].

89 Ibid., [2].

90 *Financial Sector Assessment Program Update – Australia – Detailed Assessment of Observance of Insurance Core Principles* (IMF November 2012) 80–84.

91 Under the Bankruptcy Act 1966 (Cth), which governs personal insolvency, s 117 'Policies of insurance against liabilities to third parties' is the analogous provision to s 562 in relation to the administration of personal bankruptcies.

company is less than the liability of the company to the third-party claimant, section 562(1) does not limit the rights of the third-party claimant in respect of the balance.

The High Court of Australia broadened the scope of section 562 in *CGU Insurance Ltd v Blakeley*.[92] In that matter, the liquidators had commenced proceedings against former directors of a company. Whilst the liquidators sought to recover over $14 million, the former directors had insufficient assets to satisfy this claim. The former directors had been indemnified under a directors' and officers' insurance policy with CGU Insurance Ltd (CGU). However, CGU refused a claim by the former directors, relying on an exclusion clause in the policy for insolvent trading and breach of duty. The Supreme Court of Victoria granted the liquidators application for CGU to be joined to the liquidators' recovery action against the former directors, which was also upheld on appeal by the Victorian Court of Appeal. In dismissing CGU's appeal against being joined to the liquidators' proceedings against the former directors, the High Court reasoned that:

> […] although s 562 of the Corporations Act does not confer a legal right on a plaintiff liquidator as against a defendant's insurer, it confers a right of priority in respect of the proceeds of any successful claim by the defendant against the insurer. That gives the plaintiff liquidator a 'very real interest' in having the insurer's obligations to the defendant determined by way of declaration in the course of the proceeding in which the defendant's liability to the liquidator is determined.[93]

Corporations Act 2001 s 562A 'Application of proceeds of contracts of reinsurance'

In cases where a liquidator receives proceeds from contracts of reinsurance during the winding up of an Australian insurer, since 1992[94] section 562A has detailed the procedure for the liquidator to distribute such proceeds. Where a liquidator receives proceeds from contracts of reinsurance that exceed or equal the insurer's liabilities, section 562A(2) requires the liquidator to pay such proceeds in accordance with the general priority regime under section 556. In cases where the reinsurance proceeds received by the liquidator are insufficient to pay the insurer's liabilities, section 562A (3) sets out a formula for the distribution of the proceeds. However section 562A(4) enables the court to direct the liquidator to apply the reinsurance proceeds in a different manner if the court considers it just and equitable to do so, with section 562A(5) noting a non-exhaustive list of factors that the court may take into account in exercising this discretion.[95] The court's discretion under section 562A(4) only relates to amounts already received under a contract of reinsurance, and does not apply to future proceeds that the liquidator has not yet received.[96] The High Court of Australia has found that section 562A also applies to contracts of retrocession (reinsurance arranged by reinsurers).[97]

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92 *CGU Insurance Ltd v Blakeley* (2016) 327 ALR 564; (2016) 111 ACSR 247; [2016] HCA 2.

93 *CGU Insurance Ltd v Blakeley* [2016] HCA 2 [98].

94 For an overview of the legislative predecessors of s 562 of the Corporations Act 2001, see Robert Austin and Ashley Black Austin & Black's Annotations to the Corporations Act [5.562] – [5.562A], Annotations to sections 562 and 562A (LexisNexis Online 2019).

95 For an example where the court refused to exercise the discretion under s 562A(4), see *Sydney Water Corporation v McGrath* [2014] NSWCA 197.

96 *Amaca Pty Ltd & Ors v McGrath& Anor as liquidators of HIH Underwriting and Insurance (Australia) Pty Ltd* (2011) 82 ACSR 281; [2011] NSWSC 90 [91].

97 *Assetinsure Pty Ltd v New Cap Reinsurance Corporation Ltd (in liq) and Others* (2006) 225 CLR 331; (2006) 226 ALR 1; (2006) 80 ALJR 733; (2006) 57 ACSR 409; (2006) 24 ACLC 491; (2006) 14 ANZ Ins Cas 61-683; [2006] HCA 13.

Section 562A was also considered by the courts in the UK in relation to the assets of HIH in England. In *McGrath v Riddell* [2008] UKHL 21, the House of Lords allowed an appeal by the Australian liquidator of HIH for HIH's assets in England (consisting mostly of reinsurance claims on policies issued in the London market) to be remitted back to Australia for distribution to HIH's creditors. At first instance, the David Richards J had refused to accede to a request from the NSWSC to direct the provisional liquidators of HIH's assets in England to remit HIH's assets back to the Australian liquidator.[98] A key reason for this refusal was that under section 562A in Australia, the proceeds from HIH's reinsurance policies would be distributed in a different manner to the *pari passu* basis under section 107 of the Insolvency Act 1986 (UK). This reasoning was upheld on appeal to the England and Wales Court of Appeal.[99] On final appeal after considering the interaction between section 426(4) of the Insolvency Act 1986 (which enables UK courts with jurisdiction in relation to insolvency law to assist courts of other countries) and section 425(5) of the Insolvency Act 1986 (UK) (which requires courts to have regard to the rules of private international law) the House of Lords held that whilst section 562A would result in a different treatment of HIH's assets,[100] this difference would not ultimately be unreasonable or unfairly discriminatory to the creditors of HIH.

2.3 New Zealand

In New Zealand, life and general insurers are subject to prudential regulation by the Reserve Bank of New Zealand (RBNZ). Since September 2010, the RBNZ has administered the Insurance (Prudential Supervision) Act 2010 (NZ) (IPSA 2010), which sets out the prudential licensing system for general and life insurers to operate in New Zealand.

Part 2 of the IPSA 2010 sets out the RBNZ's licensing and prudential requirements for insurers, which include the requirements for life insurers to maintain statutory funds for their insurance businesses.[101] Once licensed, insurers must comply with the conditions of their licenses and with the standards issued by the RBNZ.[102] The two key standards under the IPSA 2010 are the Fit and Proper Standards[103] and the Solvency Standards.[104] Part 3 of the IPSA 2010 sets out the RBNZ's prudential supervision and investigative powers, which include the powers to undertake investigations;[105] to obtain information and documents;[106] and to enter and search places of business.[107]

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98 *Re HIH Casualty and General Insurance Ltd* [2005] EWHC 2125 (Ch).

99 *Re HIH Casualty and General Insurance Ltd* [2006] EWCA Civ 732.

100 *McGrath v Riddell* [2008] UKHL 21. At [40]–[41] Lord Phillips noted that whilst the *Insurers (Reorganisation and Winding Up) Regulations* 2004 (UK) made special provision for the distribution to creditors of insolvent insurers, these Regulations had no application to the appeal because they were not in force when the provisional liquidators were appointed to HIH's assets in England in 2001.

101 *Insurance (Prudential Supervision) Act* 2010 (NZ) Part 2, Subpart 3.

102 See 'Guidelines for Insurers' (Reserve Bank of New Zealand) https://www.rbnz.govt.nz/regulation-and-supervision/insurers/supervision/guidelines-for-insurers accessed 20 January 2020.

103 *Insurance (Prudential Supervision) Act* 2010 (NZ) ss 34 and 36 enable the RBNZ to issue fit and proper standards.

104 Ibid., ss 55 and 56 enable the RBNZ to issue solvency standards. For an overview of the Solvency Standards, see *Reserve Bank of New Zealand v CBL Insurance Ltd (No 3)* [2018] NZHC 2969 [14]–[17].

105 Insurance (Prudential Supervision) Act 2010 (NZ) s 130.

106 Ibid., s 131.

107 Ibid., s 132.

Part 4 of the IPSA 2010 entitled 'distress management' provides the RBNZ with extensive powers to take action in relation to insurers experiencing financial distress. These include the powers to require the insurer to prepare a recovery plan; to give directions to the insurer; and to appoint and/or remove directors, auditors and actuaries.[108] In cases where it has serious concerns about an insurer's solvency the RBNZ may apply to the High Court for orders that the insurer be placed into liquidation[109] or to reduce the value of contracts of insurance.[110] The RBNZ may also apply for the appointment of an administrator to the insurer under section 239L of the Companies Act 1993 (NZ).[111]

Another option available to the RBNZ in cases where it has concerns in relation to an insurer's solvency and/or compliance with the requirements of the IPSA 2010[112] is to recommend to the relevant Minister that the insurer be subject to statutory management.[113] In New Zealand, statutory management is a regime designed to deal with instances of fraudulent and/or reckless management of companies.[114] Once appointed, statutory managers must consult with, and report to, the RBNZ in relation to their management of the insurer.[115] Statutory managers must also comply with any directions given by the RBNZ,[116] subject to the application of specified provisions of the Corporations (Investigations and Management) Act 1989 (NZ).[117]

The collapse of AMI Insurance Ltd in 2012 following significant losses from the 2011 Canterbury earthquakes resulted in a direct government intervention through the formation of Southern Response Earthquake Services Ltd – a government-owned company responsible for settling claims by AMI's policyholders before AMI was sold to IAG.[118] More recently the RBNZ utilised a range of its powers in response to the failure of CBL Insurance Ltd (CBL) in 2018. On 16 November 2018 the NZHC ordered that CBL be placed into liquidation on the application of the RBNZ.[119] As at 1 January 2020, the liquidation of CBL is still on-going.[120] Whilst CBL had been a licensed insurer in New Zealand for several years, nearly all of its business had been written overseas. CBL had been heavily exposed as a reinsurer of builders' warranty insurance in France, with its premiums from these insurance products from $1 million in 2006 to $38 million in 2011 to $130 million in 2016. CBL had an extensive network of deal-

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[108] Ibid., s 149.
[109] Ibid., s 151.
[110] Ibid., s 154.
[111] Ibid., s 153.
[112] *Insurance (Prudential Supervision) Act* 2010 (NZ) s 174 sets out the range of grounds upon which the RBNZ may recommend that an insurer be subject to statutory management.
[113] *Insurance (Prudential Supervision) Act* 2010 (NZ) s 170.
[114] For an overview of the regime of statutory management in New Zealand (which is set out in the *Corporations (Investigations and Management) Act* 1989 (NZ)), see Lynne Taylor 'Formal Insolvency Proceedings' in John Farrar and Susan Watson (eds), *Company and Securities Law in New Zealand* (Thomson Reuters 2013) 675 – 676.
[115] *Insurance (Prudential Supervision) Act* 2010 (NZ) s 178(2).
[116] Ibid., s 179.
[117] Ibid., s 180.
[118] 'About Us' (Southern Response) http://www.southernresponse.co.nz/more-information/about accessed 20 January 2020.
[119] *Reserve Bank of New Zealand v CBL Insurance Ltd (No 3*) [2018] NZHC 2969.
[120] For an overview of the RBNZ's actions against CBL Insurance, see *Reserve Bank of New Zealand, CBL Insurance Limited – (in liquidation)* 'Lessons to be Learned: CBL Failure puts Heat on NZ Regulator' (Insurance News.co.au 2019) https://insurancenews.com.au/analysis/lessons-to-be-learned-cbl-failure-puts-heat-on-nz-regulator accessed 20 January 2020.

ings with various insurers around Europe. These included the Gibraltar-based Elite Insurance Company Ltd (Elite) which had ceded[121] some 80 per cent of the French construction policies it wrote to CBL, and the Denmark-based Alpha Insurance A/S (Alpha) that also underwrote these French construction risks and ceded approximately 90 per cent of them to CBL. By early 2018 Elite and Alpha represented around 80 per cent of CBL's outstanding claims liabilities.[122] Alpha and Elite subsequently became insolvent in 2018 and 2019, respectively.

During 2016, the RBNZ became concerned about CBL's solvency given its rapid expansion and lack of prudent reserving to meet its potential liabilities. These concerns intensified in light of developments affecting Elite and Alpha, which were CBL's two key counterparties. By early 2017 the Financial Services Commission of Gibraltar had been sufficiently concerned about Elite's adequacy of reserving for the French insurance business that it required it to cease issuing and renewing policies. In July 2017, the Danish Financial Supervisory Authority had required Alpha to substantially increase its claims provision as a result of concerns about the company's exposure to the French construction business reinsured by CBL. Furthermore, the Central Bank of Ireland had required CBL's sister company CBL Europe Ltd to strengthen its balance sheet. This in turn led to CBL Europe Ltd withholding reinsurance premia from CBL.[123] By July 2017, the RBNZ had become increasingly concerned about CBL's financial viability and directed CBL to maintain a solvency ratio of at least 170 per cent and to avoid entering into further transactions that would increase its exposure to Elite.[124] However, by November 2017, CBL's financial situation deteriorated to the point where its solvency ratio had fallen to 25 per cent, prompting the RBNZ to apply for the appointment of provisional liquidators in February 2018.[125] During February 2018, the RBNZ also became aware of CBL's intention to make a payment of €25 million to Alpha in relation to reinsurance claims. Whilst the RBNZ instructed CBL not to make the payment, CBL proceeded with payments totalling $55 million during February 2018, which included the €25 million payment to Alpha.[126] In agreeing with the RBNZ's submission that with its liabilities exceeded its assets by between $122,813,064 and $274,815,430, CBL was insolvent, and also with the RBNZ's submission that CBL's failure to comply with its directions to avoid further transfers to Alpha, Courtney J concluded it was just and equitable for CBL to be wound up.[127]

In May 2017, the IMF issued its assessment of New Zealand's observance of the ICPs. In relation to ICP 12, the IMF noted that the range of options available to the RBNZ under the IPSA 2010 for managing financially distressed insurers were a significant improvement since its previous assessment in 2003–2004. However, in issuing its 'Largely Observed' rating for ICP 12, the IMF made several recommendations for enhancing the policyholder protection objectives of the IPSA 2010. The measures suggested included the introduction of a policyholder protection scheme; the extension of the statutory fund requirements under the IPSA 2010 to non-life insurers; and through providing a general priority of claims for policyholders

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121 Under reinsurance arrangement, an insurer will cede a portion of a risk exposure to a reinsurer as a means of managing its risk exposure.

122 *Reserve Bank of New Zealand v CBL Insurance Ltd (No 3)* [2018] NZHC 2969 [9]–[10].

123 Ibid., [11].

124 Ibid., [12].

125 Ibid., [16].

126 Ibid., [20]–[22].

127 Ibid., [24]–[41].

in the absence of a statutory fund.[128] It will be interesting to see if these recommendations are acted upon over the coming years.

3. THE RIGHTS OF THIRD PARTIES TO CLAIM ON LIABILITY INSURANCE POLICIES IN THE EVENT OF A POLICY HOLDER'S INSOLVENCY

As explained below, there are a range of legislative approaches used in the UK, Australia and New Zealand that enable aggrieved third parties to claim on an insured's policy in the event of the insured's insolvency. Whilst over the years a range of reforms have been enacted to improve the fairness of these legislative provisions in the UK and in Australia, as at 1 January 2020, the scope for further reform still remains in New Zealand.

3.1 UK Legislation Enabling Claims by Third Parties Against the Insurers of Insolvent Policyholders

Before 1930, persons in the UK who suffered injury, loss or damage as a result of the negligence of others faced significant challenges in claiming against the insurance policies held by defendants that subsequently became insolvent – with the courts steadfastly adhering to the doctrine of privity of contract.[129]

The Third Parties (Rights Against Insurers) Act 1930 (UK) (TPRAIA 1930) represented a significant advancement on this strict application of the common law by providing aggrieved third parties with a right to claim on insurance policies held by an insured defendant prior to the insured defendant's insolvency. In such cases, section 1(1) of the TPRAIA 1930 provided for the rights of the insured under the policy would 'be transferred to and vest in the third party to whom the liability was so incurred'.[130]

However, a significant limitation of the TPRAIA 1930 was that the liability of the insured to the third party needed to have already been conclusively established in order for the third party to be able claim on the insolvent insured's policy. The leading decision of *Post Office v Norwich Union Fire Insurance Society Ltd*[131] illustrated these limitations. The Post Office had alleged that a firm of construction contractors had damaged one of its telegraph cables when undertaking excavation works in 1963. However, the construction contractors disputed

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[128] *Financial Sector Assessment Program Update – New Zealand – Detailed Assessment of Observance of Insurance Core Principles* (IMF 2017) 90–93.

[129] For example, in *Re Harrington Motor Co Ltd; Ex parte Chaplin* [1928] Ch. 105, Mr Chaplin had been injured by a motor vehicle being driven by an employee of Harrington Motor Co Ltd in 1927. Shortly after he obtained judgement against Harrington (which was insured against such liabilities), the company went into liquidation. The insurer paid the sums due to the liquidator, which were then combined into the amounts to be distributed to Harrington's creditors. The Court of Appeal dismissed Mr Chaplin's appeal against the liquidator's actions, holding that he had no claim on the insurance monies.

[130] Third Parties (Rights Against Insurers) Act 1930 (UK) s 1(1). This provision became enlivened in the event of a personal bankruptcy or in the case of companies, a winding up order or a voluntary arrangement with creditors under Part 1 of the Insolvency Act 1986 (UK). See Lowry, Rawlings, and Merkin (n 4) 440–41.

[131] *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363; [1967] 1 All ER 577; [1967] 2 WLR 709 (Court of Appeal).

this, claiming instead that the damage to the cable had resulted from the fault of a Post Office engineer who had incorrectly advised the location of the cable. After the firm of contractors had gone into liquidation, the Post Office claimed on the construction contractors' insurance policy under the TPRAIA 1930. However, the Post Office's appeal against the insurer's refusal of its claim was unsuccessful both at trial and on appeal. Lord Denning MR (with whom Harman and Salmon LJJ agreed) held that until the contractors' liability had been established and quantified, either by judgement of the court, by an arbitral award or by agreement, then the Post Office as the aggrieved third party would be not be able to maintain its action against the insurer under section 1(1) of the TPRAIA 1930. As Lord Denning MR reasoned:

> Under [s 1(1)] the injured person steps into the shoes of the wrongdoer. There are transferred to him the wrongdoer's 'rights against the insurers under the contract.' What are those rights? When do they arise? So far as the 'liability' of the insured is concerned, there is no doubt that his liability to the injured person arises at the time of the accident, when negligence and damage coincide. But the 'rights' of the insured person against the insurers do not arise at that time.[132]

The Court of Appeal's reasoning in *Post Office* (1967) was approved by the UK House of Lords in *Bradley v Eagle Star Insurance Co Ltd.*[133] For 24 years, Ms Bradley had worked for an insured company that had operated a cotton mill, which was wound up in 1975 and was dissolved in 1976. In 1984, Ms Bradley instituted proceedings under the TPRAIA 1930 against the dissolved company's insurer. However, applying reasoning from *Post Office*, the House of Lords held that as the dissolved company's liability could no longer be established, the rights of the company that could be transferred to and vest in Ms Bradley.[134]

A range of limitations of the TPRAIA 1930 were highlighted in a 2001 Report by the UK's Law Commission, which made a number of recommendations for a fairer legislative regime to enable aggrieved third parties to claim against the insurers of insolvent policyholders.[135] After several delays, the Law Commission's recommendations were finally enacted by the Third Parties (Rights Against Insurers) Act 2010 (UK) (TPRAIA 2010). The TPRAIA 2010 repealed and replaced the TPRAIA 1930 and entered into effect on 1 August 2016.[136]

As Lowry, Rawlings and Merkin explain,[137] the TPRAIA 2010 made several significant improvements to more fairly enable aggrieved third-party claimants to proceed against the insurers of insolvent policyholders. First, the TPRAIA 2010 removed the often complex two-stage requirement under the TPRAIA 1930 whereby the aggrieved third-party claimant had to firstly obtain judgement against the insured before being able to claim on the insurance policy. Instead, the TPRAIA 2010 has enabled the third-party claimant to issue proceedings directly against the insurer.[138] Secondly, the TPRAIA 2010 has enabled third-party claimants to request information about a defendant's liability insurance arrangements, thereby enabling third-party claimants to make informed decisions about the potential rights that might be

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132 *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 QB 363, [374].
133 *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957; [1989] 1 All ER 961; [1989] 2 WLR 568.
134 Noted Lowry, Rawlings, and Merkin (n 4) 442–3.
135 'Third Parties – Rights Against Insurers' (Report 272, Law Commission 2001).
136 *Redman v Zurich PLC* [2017] EWHC 1919 (QB) [16].
137 Lowry, Rawlings, and Merkin (n 4) 449–50.
138 *Third Parties (Rights Against Insurers) Act* 2010 (UK) s 1(3).

available to them at an early stage.[139] Finally, the TPRAIA 2010 has more accurately reflected recent changes in UK insolvency law through allowing for an insured's rights to be transferred to third-party claimants in situations where the insured has entered into alternative procedures to formal insolvency such as voluntary arrangements with creditors.[140]

As at 1 January 2020, a small handful of decisions on applications by aggrieved third parties under the TPRAIA 2010 have been handed down by the UK's courts. In *Peel Port Shareholder Finance Co Ltd v Dornoch Ltd*[141] the court considered an application by the owners of a warehouse that was damaged by a fire caused by the actions of an electrical contracting company. Jefford J refused the owner's application to claim against the electrical contactor's insurer under the TPRAIA 2010 on the grounds that electrical contracting company might become insolvent as a result of a judgement debt, emphasising that the TPRAIA 2010 Act became enlivened upon the actual insolvency of the insured; rather than the possibility of the insured becoming insolvent in the future.[142]

In *BAE System Pension Funds Trustees Ltd v Royal & Sun Alliance Insurance Plc*[143] it was held that a dispute about an insurer's liability under a policy (in that case the availability of an exclusion clause relating to defective construction works) did not prevent the insurer of an insolvent construction firm from being joined to the proceedings under section 2(1) of the TPRAIA 2010. In *Redman v Zurich Insurance Plc and another*,[144] it was held that the TPRAIA 2010 (which came into effect on 1 August 2016) did not apply to a claim by the widow of a worker who died from lung cancer in 2013, allegedly from exposure to asbestos during the course of his employment with a company that had been voluntarily wound up on 30 January 2014 and which was later dissolved on 30 June 2016. In dismissing Ms Redman's claim Turner J held that the transitional provisions of the TPRAIA 2010 precluded the TPRAIA 2010 from operating retrospectively and in parallel with the TPRAIA 1930. As the TPRAIA 1930 applied, the court was bound to apply *Bradley v Eagle Star Insurance Co Ltd*,[145] in which the House of Lords had ruled that 'liability is incurred when the cause of action is complete and not when the claimant's rights against the wrongdoer are thereafter crystallised whether by judgment or otherwise'.[146]

In summary, the TPRAIA 2010 has improved the standing for aggrieved third parties to claim against the insurers of insolvent policyholders, and with time further cases will progressively help to clarify its operation. It is also worth noting that under section 1030 of the Companies Act 2006 (UK), an application can be brought to restore a company to the register at any time for the purposes of bringing an action in respect of personal injury or death at any time, and within six years in any other case.

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139 Ibid., s 11 and sch 1. See Lowry, Rawlings, and Merkin (n 4) 449.

140 Ibid., s 4(1). See Lowry, Rawlings, and Merkin (n 4) 450.

141 *Peel Port Shareholder Finance Co Ltd v Dornoch Ltd [*2017] EWHC 876 (TCC).

142 Ibid., [15]–[17].

143 *BAE System Pension Funds Trustees Ltd v Royal & Sun Alliance Insurance PLC* [2017] EWHC 2012 (TCC).

144 *Redman v Zurich Insurance Plc and another* [2017] EWHC 1919 (QB).

145 *Bradley v Eagle Star Insurance Co Ltd* [1989] AC 957; [1989] 1 All ER 961; [1989] 2 WLR 568.

146 *Redman v Zurich Insurance Plc and another* [2017] EWHC 1919 (QB) [23].

3.2 Beneficial Direct Access Legislation in New Zealand and NSW

Section 9 of the Law Reform Act 1936 (NZ) (LRA 1936 (NZ) has provided a means for aggrieved third parties to assert a statutory charge over an insured's insurance policy in the event that the insured policyholder becomes unable to meet its liability to the third party due to insolvency. Section 9(1) provides as follows:

> (1) If any person (hereinafter in this Part of this Act referred to as the insured) has, whether before or after the passing of this Act, entered into a contract of insurance by which he is indemnified against liability to pay any damages or compensation, the amount of his liability shall, on the happening of the event giving rise to the claim for damages or compensation, and notwithstanding that the amount of such liability may not then have been determined, be a charge on all insurance money that is or may become payable in respect of that liability.

Whilst an almost identical equivalent to s 9 of the LRA 1936 was later enacted by the Law Reform (Miscellaneous Provisions) Act 1946 (NSW), (LRMPA 1946 (NSW)),[147] as explained below the latter statute was repealed and replaced by more contemporary legislation in 2017.[148]

Both section 9 of the LRA 1936 (NZ) and section 6 of the LRMPA (NSW) were enacted for the remedial purpose of ensuring that injured third-party claimants were not deprived of the proceeds of insurance moneys through the actions of insured persons disappearing with insurance monies and/or forming collusive bargains with their insurers.[149] However in more recent years the application of these near-identical provisions to claims-made liability policies[150] has proven to be problematic. In contrast to occurrence-based policies, where the event giving rise to a claim for damages or compensation is in most cases readily apparent,[151] contemporary claims-made liability policies frequently involve significant time lags between the happening of the event giving rise to the claim for damages or compensation, the making of a claim on the policy, and the final determination of an insured's liability to pay damages or compensation. For example, an architect might negligently design a building in a certain year, but it might be many years later that defects become apparent in that building, prompting owners of such buildings to take legal action against the architect. In such cases, as aggrieved third-party claimants, the owners might also experience challenges in articulating when the 'event' giving rise to the architect's liability occurred. Claims-made liability policies also usually contain

[147] For an overview of the background to both provisions, see Robin Bowley and Catherine Moore 'The Application of s 6 of the Law Reform (Miscellaneous Provisions) Act 1946 (NSW) to Claims-Made Insurance Policies: An Analysis of Recent Developments' (2014) 25 Insurance Law Journal 151.

[148] Whilst New South Wales has to date been the only Australian state to have enacted this type of direct access legislation, similar legislation exists in the Northern Territory in ss 26 – 29 of the Law Reform (Miscellaneous Provisions) Act (NT), and in the Australian Capital Territory in ss 206 – 209 of the Civil Law (Wrongs) Act 2002 (ACT). However, given the smaller populations and economies of those jurisdictions, there have been significantly less cases decided by the courts under those statutes. See Bowley & Moore (n 147) 170.

[149] Bowley & Moore (n 147).

[150] A 'claims-made' policy provides coverage for claims made and notified to the insurer during the period of the policy, regardless of when an event giving rise to a potential liability for loss or damage occurred.

[151] An occurrence-based policy provides coverage for events that occur during a policy period – for example, the loss or destruction of a property.

a range of unique policy characteristics – including retroactive cover,[152] and provisions for the advancement and/or reimbursement of legal costs in defending legal proceedings (commonly referred to as defence costs).

As claims-made liability policies with such characteristics were almost non-existent in the 1930s and 1940s when section 9 of the LRA 1936 (NZ) and section 6 of the former LRMPA 1946 (NSW) were enacted, in a number of cases over recent decades the courts in NZ and in NSW were faced with the challenging task of applying outmoded legislation to determine claims by aggrieved third parties seeking to assert statutory charges over liability policies held by policyholders before their insolvency.

One question that caused a divergence of judicial opinion in Australia was the question of whether the section 6 charge could apply to insurance moneys payable under a policy entered into by the policyholder after the happening of the 'event' giving rise to a third party's claim against the policyholder for damages or compensation. Whilst the NSWSC had answered this question in the negative[153] and the FCA answered it in the affirmative,[154] this uncertainty was later resolved by the NSWCA in *Owners - Strata Plan No 50530 v Walter Construction Group Ltd (in liq)*,[155] which held that a section 6 charge could not apply to a policy entered into after the event giving rise to a claim against an insured.[156]

Another legal uncertainty in the application of these direct access provisions has concerned the breadth of the statutory charge. This uncertainty was highlighted by the litigation in the courts of New Zealand between 2011 and 2013 against former directors of the Bridgecorp property finance group of companies, which caused significant consternation for the insurance industries of New Zealand and Australia.[157]

After Bridgecorp had collapsed in 2007 owing investors nearly $500 million, several of the company's former directors were charged with offences under the former Securities Act 1978 (NZ), for which they were convicted in late 2011. The former directors also faced civil claims by the Bridgecorp companies for alleged breaches of their common law and statutory duties totalling $450 million.

Since 1996, the Bridgecorp companies had held a directors and officers (D&O) insurance policy with QBE Insurance (International) Ltd (QBE), which indemnified the Bridgecorp directors in respect of any civil or criminal liability they might incur through their acts or omissions as directors. The D&O policy also provided coverage for any costs the directors might incur in defending civil and criminal proceedings seeking to establish such liability (defence costs), with this policy having a limit of indemnity of $20 million. Additionally, in 2000 the Bridgecorp directors took out a separate statutory liability policy with QBE providing them with cover for defence costs incurred in respect of claims based on breach of their statutory obligations (the statutory liability policy), which upon the collapse of the Bridgecorp group provided cover for $2 million.

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[152] Retroactive insurance provides cover for losses resulting from events before the inception of a contract of insurance.

[153] *Manettas v Underwriters at Lloyds* (1993) 7 ANZ Ins Cases 61–180.

[154] *FAI General Insurance Co Ltd v McSweeney* 1997) 73 FCR 379; (1997) 154 ALR 229; (1997) 10 ANZ Ins Cas 61-400.

[155] *Owners - Strata Plan No 50530 v Walter Construction Group Ltd (in liq)* (2007) 14 ANZ Ins Cas 61-734; [2007] NSWCA 124.

[156] Bowley and Moore (n 147) 150–58.

[157] For an overview of the Bridgecorp litigation between 2011 and 2013, see ibid., 165–81.

At the commencement of the criminal proceedings, QBE and the directors agreed they would resort first to the statutory liability policy to pay their defence costs, with the $2 million indemnity limit to be divided between the directors. By August 2011 the directors had exhausted their entitlements under the statutory liability policy, and as their defence costs through to the end of the trial were estimated to amount to around $3 million, they sought to resort to the D&O policy to meet their ongoing defence costs. In June 2009, the Bridgecorp companies had asserted a charge under section 9 over moneys payable under the D&O policy for amounts they intended to claim from the directors in civil proceedings. Following unsuccessful attempts by the directors to negotiate with the Bridgecorp companies to have the charge removed, the directors sought a declaration from the NZHC that section 9 did not prevent QBE from meeting its contractual obligation under the D&O policy to reimburse the directors for defence costs.

At first instance in the NZHC, Lang J took a broad interpretation of the phrase 'all insurance money that is or may become payable in respect of that liability' in section 9 of the LRA 1936 (NZ) by placing emphasis on the remedial character of section 9. In noting that section 9 did not include mechanisms to enable the release of insurance monies subject to a statutory charge, this decision meant the former Bridgecorp directors were unable to access their entitlement to defence costs.

The former Bridgecorp directors successfully appealed to the Court of Appeal of New Zealand (NZCA), which favoured a narrow interpretation of 'all insurance money that is or may become payable in respect of that liability'. The NZCA took account of the former directors' contractual entitlement to be advanced defence costs (which the NZCA characterised as an existing liability) in comparison to the former Bridgecorp directors' yet-to-be-determined liability to the company (which the NZCA characterised as a contingent liability). The NZCA also reasoned that section 9 was neither intended to rewrite the contractual bargain struck between insurer and policyholders by diminishing the policyholder's rights under the contract; but rather took the view that section 9 was simply a procedural mechanism for third party claimants to directly access funds from which the insurer was liable to meet the policyholder's liability to the third party.

However, the Bridgecorp companies were finally successful in their appeal to the Supreme Court of New Zealand (NZSC), which by a 3:2 majority favoured a broad interpretation of 'all insurance money that is or may become payable in respect of that liability'. Elias CJ and Glazebrook J (with Anderson J substantially agreeing) placed emphasis on the words 'may become liable' and 'notwithstanding that the amount of [the insured's] liability may not then have been determined'. They also reasoned that section 9 displaced any contractual provisions regarding the priority of claims on monies under the policy; and that section 9 provided a mechanism for enabling third-party claimants to have the same claim over insurance monies as the insured to the extent of the charge (rather than to the extent of available insurance monies). This ultimately meant that the former Bridgecorp directors were unable to access their contractual entitlement to defence costs

The Bridgecorp litigation led to considerable consternation within the Australian and New Zealand insurance industries, with concerns about the potentially lengthy freezing of policies until the policyholder's liability was determined; the scope for uncertainty in terms of the ranking of competing statutory charges; and disputes about the quantum of the amounts that aggrieved third parties might initially claim, and the policyholder's final liability.

In response to these uncertainties, the NSW Law Reform Commission (NSWLRC) conducted a review of section 6 of the LRMPA 1946 (NSW). Whilst noting that in a decision around the same time of the Bridgecorp litigation, the NSWCA had adopted a similar narrow interpretation of section 6 (along similar lines to the NZCA),[158] the NSWLRC concluded the scope for significant uncertainty still remained with the possibility of further appeals. The NSWLRC therefore recommended the repeal and replacement of section 6 of the LRMPA with legislation that better reflected the realities of the contemporary liability insurance market.[159]

The NSWLRC's recommendations were adopted with the passage of the Civil Liability (Third Party Claims Against Insurers) Act 2017 (NSW) (CLTPCAIA 2017), which repealed and replaced section 6 of the LRMPA (NSW) 1946. The CLTPCAIA 2017 now enables third-party claimants to apply to the court[160] to make direct claims against a policyholder's insurer in the event of the policyholder's insolvency, replacing the concept in the former LRMPA 1946 of a charge over all insurance monies might become payable.[161] The CLTPCAIA 2017 addresses the uncertainty highlighted through the Bridgecorp litigation in relation to policy cover for defence costs by making it clear that the insurer's liability is the amount of indemnity (if any) payable pursuant to the terms of the contract of insurance in respect of the insured person's liability to the third-party claimant.[162] The CLTPCAIA 2017 also removed the ambiguous language of 'on the happening of the event giving rise to the claim for damages or compensation' used in the former LRMPA 1946, which was replaced with the more direct terms of 'liability'[163] and 'insured liability'.[164] The CLTPCAIA 2017 also makes it clear that the insurer is able to rely on the same defences that the insured policyholder could have relied on in an action brought by the third-party claimant.[165]

The decisions to date on applications under the CLTPCAIA 2017 by third parties to claim on insurance policies of insolvent policyholders (and also to join the insurers to proceedings) have proceeded relatively smoothly. For example, in *Zaki v Better Buildings Constructions Pty Limited*,[166] Campbell J granted leave under section 5 for an injured worker to join the insurer of an insolvent construction company to a personal injury action. His Honour dismissed the insurer's submission that the injured worker's claim was commenced outside the three-year limitation period for personal injury proceedings,[167] commenting that section 6 of

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158 *Chubb Insurance v Moore* (2013) 302 ALR 101; [2013] NSWCA 212.

159 'Third Party Claims on Insurance Money: A Review of s 6 of the Law Reform (Miscellaneous Provisions) Act 1946' (Report No 143, New South Wales Law Reform Commission 2016).

160 Under s 5 of the Civil Liability (Third Party Claims Against Insurers) Act 2017 (NSW), third-party claimants must seek leave of the court to commence proceedings against the insurer. Such proceedings may be refused in the court's discretion; and must be refused if insurer can establish it is entitled to disclaim liability under the contract of insurance or under any Act or law; and under s 6 claims against insurers must be commenced within applicable limitation periods.

161 *Civil Liability (Third Party Claims Against Insurers) Act* 2017 (NSW) s 4(1).

162 Ibid., s 4(2).

163 Ibid., s 3(1) defines 'liability' to mean a liability to pay damages, compensation or costs.

164 Ibid., s 3(1) defines 'insured liability' to mean a liability in respect of which an insured person is entitled to be indemnified by the insurer.

165 Ibid., s 7.

166 *Zaki v Better Buildings Constructions Pty Ltd* [2017] NSWSC 1522.

167 The applicable legislation in this case was s 50C(1) of the Limitation Act 1969 (NSW).

the CLTPCAIA 2017 referred to the time within which the proceedings must be brought, not the time within which the leave application to bring the proceedings must be brought.[168]

Secondly, in *Rushleigh Services Pty Ltd v Forge Group Ltd (in liq) (receivers and managers appointed)*,[169] the court granted leave under section 5 to join the insurers of an insolvent mining services company to a shareholder representative action against the company and its former directors. Markovic J dismissed the insurers' argument that it would be prejudiced (in terms of costs and forensic disadvantage) as a stranger to the proceedings in defending the proceedings against the company, citing a clause in the policy requiring the company (and by that stage its liquidators) to fully cooperate with the insurer.

Thirdly, in *Ritchie v Advanced Plumbing and Drains Pty Ltd*,[170] leave was granted to a property owner whose property had been extensively damaged by fire through the alleged negligence of a plumbing contractor, which subsequently went into liquidation. Campbell J concluded that the insurer had not discharged its onus under section 5(4) of the CLTPCAIA 2017 through proving that it would be able to avoid liability to indemnify the plumbing contractor by relying on exclusion clauses in the relevant liability policy.

However, in other cases applications to join the insurers of insolvent policyholders were dismissed. In *Re Reed Constructions Australia Pty Ltd (in liq) Walley v Chubb Insurance Australia Ltd*,[171] Leeming JA refused to grant leave to the liquidators of a construction company to join the D&O insurers of the construction company to recovery proceedings against the former directors. His Honour concluded there was no utility in joining the insurer to the liquidators' recovery proceedings, given that the insurer had already indicated its willingness to indemnify the former directors of the company. Secondly, in *Sergienko v AXL Financial Pty Ltd*,[172] the court dismissed an application to join the insurer of a deregistered legal practice to negligence proceedings against the legal practice by an equitable mortgagor of a property. Ward CJ in Eq[173] ruled that as the equitable mortgagor's pleading had not properly articulated the claim against the insured, a reasonably arguable cause of action against the insurer had not been established.

In April 2019, as part of a consultation process to review New Zealand's system of insurance contract law (which is still largely common law based), the Ministry of Business, Innovation and Employment released a consultation paper exploring potential options for insurance contract legislation, including reform of section 9 of the LRA 1936.[174] However, as at 1 July 2020 this law reform process is still ongoing.[175]

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168 *Zaki v Better Buildings Constructions Pty Ltd* [2017] NSWSC 1522 [23].

169 *Rushleigh Services Pty Ltd v Forge Group Ltd (in liq) (receivers and managers appointed)* [2018] FCA 26.

170 *Ritchie v Advanced Plumbing and Drains Pty Ltd* [2019] NSWSC 1028.

171 *Re Reed Constructions Australia Pty Ltd (in liq) Walley v Chubb Insurance Australia Ltd* (2019) 372 ALR 684; [2019] NSWSC 1007.

172 *Sergienko v AXL Financial Pty Ltd* [2019] NSWSC 1610.

173 The Supreme Court of New South Wales has two trial divisions – the Common Law Division (CL) and the Equity Division (Eq). See http://www.supremecourt.justice.nsw.gov.au/Pages/sco2_aboutus/sco2_aboutus.aspx.

174 'Insurance Contract Law Review' (Options Paper, Ministry of Business, Innovation and Employment 2019) 42–4, which is accessible at https://www.mbie.govt.nz/dmsdocument/5157-insurance-contract-law-review-options-paper accessed 16 July 2020.

175 See 'Insurance Contract Law Review' (Ministry of Business, Innovation and Employment) https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/insurance-contract-law-review/ accessed 1 July 2020.

3.3 Australian Commonwealth Legislation Enabling Direct Claims on Insurance Policies of Deregistered Companies

Since its introduction through the Corporate Law Reform Act 1998 (Cth), section 601AG of the Corporations Act 2001 has provided a means for aggrieved third parties to seek compensation for their losses through directly claiming on insurance policies held by companies immediately before their deregistration. The section provides that:

> A person may recover from the insurer of a company that is deregistered an amount that was payable to the company under the insurance contract if:
> (a) the company had a liability to the person; and
> (b) the insurance contract covered that liability immediately before deregistration.

The purpose behind the introduction of section 601AG was to enable aggrieved third parties to 'short-cut' the complex alternative of applying to the court to seek the reinstatement of the deregistered company under section 601AH. The case law on section 601AG since its introduction has shown that the provision provides a fair and workable mechanism for enabling aggrieved third parties to claim on insurance policies held by companies immediately before their deregistration. Section 601AG represented a significant improvement to the ability of aggrieved third parties to pursue compensation, given that section 51 of the Insurance Contracts Act 1984 (Cth)[176] (which since 1986 has provided a basis for claims against insurance policies of natural persons by aggrieved third parties in cases where an individual insured has died or cannot after reasonable inquiry be found) has been held not to apply to deregistered companies.[177]

In *Hutchinson v ASIC*,[178] the claimant had been injured when he tripped on a footpath outside a property where a construction company was undertaking building works. By the time he commenced proceedings against the construction company it had gone into liquidation. In the Supreme Court of Victoria, whilst Mahoney M ordered the reinstatement of the company under section 601AH for the claim to be determined, his Honour also considered that an alternative remedy under section 601AG was available. In rejecting the insurer's submission that the term 'had a liability' within section 601AG was restricted to actual liabilities determined by a court judgement, Mahoney M reasoned that the term meant:

> […] a cause of action which would have supported a proceeding against the company which, absent its being defended, would have succeeded; or, in other words, a claim which could be made by pleading on which a judgment in default of defence could be obtained. Whether such claim would have succeeded against the company strictly cannot be determined because of its deregistration.[179]

In the later decision of *Langridge v Insurance Commission of Western Australia & Ors*,[180] Barker J held a section 601AG cause of action could continue even if the deregistered

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[176] For most forms of insurance in Australia (with the exceptions of marine, workers compensation and compulsory third-party motor vehicle insurance), the Insurance Contracts Act 1984 (Cth) governs the relationship between insurers and insureds throughout the life cycle of the insurance contract.
[177] *Norsworthy v Encel & State Government Insurance Commission* [1999] SASC 496.
[178] *Hutchinson v ASIC* [2001] VSC 465.
[179] Ibid., [25].
[180] *Langridge v Insurance Commission of Western Australia & Ors* [2003] WASC 24.

company was subsequently reinstated under section 601AH.[181] Along similar lines in *Tzaidas v Child*[182] it was held that the phrase 'the insurer was obliged to pay that liability immediately before deregistration' within section 601AG(b) did not require the liability of the deregistered company to have already been conclusively determined by judgment, award or settlement. Rather, the court held that the phrase was directed at the question of whether the alleged liability fell within the scope of the contract of insurance held by the company immediately before its deregistration.[183]

However, it has also been held that the phrase 'had a liability' in section 601AG(a) enables insurers to raise defences, such as exclusion clauses with policies to resist claims by aggrieved third parties. For example, in *Smart v AAI Ltd*[184] the insurer's refusal of a claim by investors in a finance company (which subsequently became insolvent and which was later deregistered) was upheld on account of an exclusion in the finance company's professional indemnity policy for dishonest and fraudulent acts by the company's former director.[185]

The Australian courts have arrived at differing conclusions on the interaction between section 601AG and state and territory legislation governing actions for negligence in personal injury cases.

In *Almario v Allianz Australia Workers Compensation (NSW) Insurance Ltd*,[186] the NSWCA allowed an appeal by an injured worker who had commenced damages proceedings against his former employer (a construction company) after the expiry of the three-year limitation period under the applicable workers compensation legislation (which could be extended by leave of the court).[187] The construction company had been wound up in December 1992, and deregistered in April 1999. In June 2001, the worker commenced proceedings under section 601AG against the insurer of the construction company. In allowing the worker's appeal, Ipp JA (with whom Hodgson JA and Hunt AJA agreed) adopted a purposive construction of section 601AG by construing the section to read, '[a] person may recover from the insurer of a company that is de-registered (<u>as if the insurer was the deregistered company</u>) an amount that was payable to the company under the insurance contract […]'. With this purposive construction of section 601AG, the court was able to grant leave to the injured worker to recover against the insurer of the deregistered construction company.

However, in the factually similar case of *Allianz Australia Insurance Ltd v Mercer*,[188] the Full Court of the Supreme Court of Tasmania reached the opposite conclusion. In noting that unlike the NSW workers compensation legislation considered in *Almario*, the applicable Tasmanian legislation on limitation periods[189] did not allow the court to grant leave for proceedings to be commenced after the expiry of the three-year limitation period. Proceeding

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181 Ibid., [36]–[39]; [53]–[55].

182 *Tzaidas v Child* [2009] NSWSC 465.

183 Ibid., [43]–[46].

184 *Smart v AAI Ltd* [2015] NSWSC 392.

185 Ibid., [150]–[152]; [187]–[195].

186 *Almario v Allianz Australia Workers Compensation (NSW) Insurance Ltd* [2005] NSWCA 19.

187 Section 151D of the Workers Compensation Act 1987 (NSW) requires claims by injured workers for personal injury damages to be commenced within three years of the date of the injury, unless the court grants leave.

188 *Allianz Australia Insurance Ltd v Mercer* [2014] TASFC 3.

189 In this case s 5A(3)(a) of the Limitation Act 1974 (Tas) precluded claims for personal injury damages being brought after three years from the date of discoverability of the injury.

from this basis, the Full Court reasoned that as the action was governed by the limitation period of the underlying cause of action, the injured worker's claim under section 601AG was subject to the unexpired duration of the applicable limitation period. As this limitation period had expired, the injured worker's claim was dismissed.

Whilst New Zealand does not currently have a direct equivalent provision to section 601AG, section 329 of the Companies Act 1993 (NZ) enables the court to restore a dissolved company to the New Zealand Register of Companies.

4. CONCLUSION

This chapter has shown how managing the insolvency of insurers can be a lengthy and complex process, with significant disruptive effects on both insurance markets and national economies more broadly. It has shown how a variety of approaches have been adopted in the UK, Australia and New Zealand to manage this process, and also issues that warrant further law and policy reform.

It has also compared and contrasted the legislation in these three jurisdictions that enables aggrieved third parties to pursue claims in the event of an insured policyholder's insolvency. It is suggested that the legislative reforms in the UK and Australia could provide a useful model for the current insurance contract law reform process that is currently underway in New Zealand; as well as for other reviews of the insurance law arrangements in other jurisdictions in the future.