Executive Summary

On 25 March 2010, the Third Parties (Rights against Insurers) Act 2010 ("the Act") received Royal Assent¹. Although the Act was expected to come into force in April 2011, this has not happened to date. The following article briefly identifies and comments on the key differences between the Act and its predecessor, the Third Parties (Rights against Insurers) Act 1930, and considers the possible implications of the changes for insurers when the Act does come into force.

The Act continues to permit the transfer (from an insured to a potential third party creditor) of rights arising under a contract of insurance where that insured is insolvent and cannot, as a result, meet or respond to a third party’s claim for damages.

The primary function of the Act is to modernise the previous legislation, as set out in the Third Parties (Rights against Insurers) Act 1930 ("the Previous Act").

Third Parties (Rights against Insurers) Act 1930

Under the Previous Act, a potential third party creditor (i.e. persons or a body corporate who are owed money by an individual or company) could only obtain the transfer (and the benefit) of an insured’s rights (i.e. the right to an indemnity) arising under a contract of insurance if:

a) they had established the existence and amount of the insured's liability (in practice this meant that a third party creditor would have to have obtained a judgment against the insured before being able to call on their insurers to pay any sums awarded as damages;

b) they had taken steps (again involving legal proceedings) to restore a dissolved insured company to the Companies House Register; and

c) they had given notice to the insurer in accordance with the terms of the relevant insurance policy.

Third Parties (Rights against Insurers) Act 2010

The Act still concerns the transfer of an insured’s rights² arising under a contract of insurance but introduces four key changes to the Previous Act.

1. A creditor is no longer required to first establish liability against an insured before bringing proceedings against their insurers;

2. The definition of ‘insolvent’ is widened to include a) companies who are the subject of Company Voluntary Arrangements or Schemes of Arrangement (under Part 26 of the Companies Act 2006) with creditors and b) individuals, incorporated and unincorporated bodies and certain trusts;

¹ The Act extends to the United Kingdom with different Sections applicable to Scottish and Northern Irish jurisdictions. For the purposes of this note, the commentary relates to the position in England and Wales.

² The third party does not receive a right to recover from an insurer any amounts in excess of their insured’s liability. For example, if under the insured’s policy the insurer agrees to indemnify the insured in respect of legal defence costs, then these sums are not recoverable by a third party under the Act.
3. A creditor can pursue the insurer of a dissolved insured company without having to first restore that insured company to the Companies House Register; and

4. Creditors are now afforded greater access to information concerning the terms of the relevant insurance policy.

The Act now allows a creditor to litigate the substantive cause of action against the insured in conjunction with an action for a Declaration/Order that the insurer must pay any damages awarded to the creditor. Whilst the Act allows a creditor to commence proceedings against an insurer without establishing liability on the part of the insured, they still cannot enforce any Declaration/Order against an insurer until they have established liability against their insured.

The insurer’s right to set off sums owed to it by their insured from sums payable to the third party is preserved.

The insurer may rely on any defence available to their insured when facing a claim from a creditor for such a Declaration/Order save for three exceptions. These exceptions are designed to prevent an insurer from defeating a third party's claim by relying on technical defences available under the relevant policy.

1. Failure by an insured to notify their insurers of a claim is no longer an absolute defence;
2. The failure of an insured to provide continuing information and assistance to the insurer will not defeat a third party’s claim if the insured was incapable of providing such assistance; and
3. Pay-first clauses cannot be relied upon.

Conclusions and Summary

The Act is unquestionably very 'third party friendly'. Parliament’s intention has been to speed up the process of third party claims against insurers. However, by allowing third parties to commence proceedings against insurers without first establishing issues of liability and quantum against an insured may mean that insurers could be faced with having to defend such actions when it later turns out that their insured had no liability. Parliament clearly expect that the increased access to information (disclosure) will ensure that third parties do give serious thought to the issue of establishing the liability of an insured before commencing actions against their insurers. This however remains to be seen.

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3 A third party’s right to information arises before the liability of the insured has been established. Requests for information may be made to insurers and brokers regarding policy terms and conditions.

4 The benefits of the Act’s new mechanism are also extended to arbitration proceedings.

5 The guidance notes specifically refer to unpaid premiums but presumably this provision would also extend to excess payments.

6 Most insurance policies will contain a condition requiring the insured to notify a claim within a prescribed period of time. If the insured fails to notify in time but the third party has notified insurers within the prescribed period of time then the requirement to give notice is deemed fulfilled.