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# The eternal triangle: liability insurers, insureds and third parties

**For every policy of liability insurance, there are at least three parties with an interest in the cover: the insurer, the insured and the actual or potential third party claimant. This article considers the awkward procedural triangle formed by the involvement of these parties where the insured is, or may become, insolvent.**

The first consideration is the unhappy events that have occurred since the publication of a joint report by the Law Commission of England and Wales and the Scottish Law Commission in July 2001 entitled "Third Parties – Rights Against Insurers" (Law Com No.272/Scot Law Com No.184, Cm 5217). The report recommended the repeal and replacement of the much-criticised Third Parties (Rights against Insurers) Act 1930, and appeared to herald a new dawn in this area of the law. Several years on, the 1930 Act is still in force and the first part of this article examines the reasons why.

The second part of the article considers the procedural triangle formed by an insured, its insurer and a third party where there is a policy of liability insurance which the insurer contends does not respond to the insured's potential liability to the third party, and the third party remains solvent – at least for the time being – so that the 1930 Act has no immediate application. Two recent decisions involving joinder applications under CPR 19.2 in this situation are considered: *Humber Work Boats Ltd v Owners of the Selby Paradigm* [2004] 2 Lloyd's Rep. 714 and *Chubb Insurance Co of Europe SA v Davies* [2004] EWHC 2138.

## Part I: the slow road to reform of the Third Party (Rights against Insurers) Act 1930

The Law Commissions' July 2001 report included a draft Third Parties (Rights against Insurers) Bill. The key elements of the draft Bill were as follows.

- The third party would be entitled to issue proceedings against the insurer without first establishing the liability of the insured, and to establish and quantify that liability in those proceedings, avoiding the need to bring consecutive actions against the insured and then the insurer. As the insured would no longer be a necessary party to the proceedings, there would be the added advantage where it was a company which had been dissolved that there would be no need for the third party to restore it to the register of companies in order to proceed. In the proceedings brought by the third party, the insurer would be entitled to rely on any defence on which the insured would have been able to rely if those proceedings were proceedings taken against the insured by the third party.
- The third party would be entitled to information about the insurance policy from various sources, including the insurer and former officers of the insured, before establishing the insured's liability, to enable it to decide at an early stage whether to devote time and expense to legal proceedings.
- The insurer's right to rely on any defences that would have been available to it, as against it the insured would be preserved, subject to the following exceptions:
  - where the insured's rights under the policy were subject to a condition that the insured had to fulfil, anything done by the third party which, if done by the insured, would have amounted to or contributed to fulfilment of the condition would be treated as having been done by the insured;



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  - where the insured was a corporate body which had been dissolved, and the rights under the contract of insurance which had been transferred to the third party were subject to a condition requiring the insured to provide information or assistance to the insurer and the condition was not fulfilled, but only because of the insured's inability to act after being dissolved, the transferred rights would not be subject to the condition; and
  - where the rights of an insured under the contract of insurance were subject to a condition requiring the prior discharge by the insured of his liability to the third party, the transferred rights would not be subject to the condition, except in marine insurance (and then only where the liability of the insured was not in respect of death or personal injury).
- The new provisions would apply to all forms of bankruptcy and insolvency.
- Obligations incurred voluntarily by the insured, such as legal expenses incurred pursuant to a policy of legal expenses insurance, or medical expenses incurred under a policy of health insurance, would be covered (although, following the decision of the Court of Appeal in *First National Tricity Finance Ltd v OT Computers Ltd (In Administration)* [2004] EWCA Civ 653, which held that *Tarbuck v Avon Insurance Plc* [2002] Q.B. 571 was wrongly decided, this appears to be the position under the 1930 Act in any event).
- The law would be clarified to make it clear that the provisions would apply to cases with a foreign element.

In July 2002, when the Government indicated that it accepted the Law Commissions' recommendations, the future of this long-criticised area of the law looked rosy. Shortly afterwards, the Lord Chancellor's Department published a consultation paper on the implementation of the report. Surprisingly, the Lord Chancellor's Department proposed that the Law Commissions' recommendations be implemented by means of a regulatory reform order under the Regulatory Reform Act 2001, rather than by means of primary legislation (which was clearly what the Law Commissions had envisaged, hence the draft Bill). The purpose of the Regulatory Reform Act 2001 was to reduce regulatory burdens on businesses. Although many of those who responded to the consultation paper were in favour of implementation by means of a regulatory reform order, the Department for Constitutional Affairs (the renamed Lord Chancellor's Department) stated in February 2004, when its analysis of the responses to the September 2002 consultation paper was published, that the Law Officers had advised that only certain aspects of the Law Commissions' recommendations could be carried out by way of a regulatory reform order, and that the others fell outside the scope of the Regulatory Reform Act 2001 and would require primary legislation.

It appears that the Law Officers advised that of the Law Commissions' recommendations, the following could be implemented by a regulatory reform order:

- the remedy in a single set of proceedings;
- the third party's improved rights to information about the insurance position; and
- clarification that the law applied to proceedings with a foreign element.

The Department for Constitutional Affairs said in its analysis of the responses to the September 2002 consultation paper that it considered that these were the Law Commissions' core recommendations and that, rather than waiting until sufficient parliamentary time became available for primary legislation on all of the proposals, the Government intended to press on with the implementation of these elements of the Law Commissions' recommendations by way of a regulatory reform order. This was in February 2004. Even at that stage, the disadvantages of this approach were obvious, as the remainder of the Law Commissions' proposals were unlikely ever to see the light of day. In the event, the advantage of proceeding swiftly with at least some of the recommendations has been lost, as it is now over a year since the Department for Constitutional Affairs published its analysis of the responses to the consultation paper, and there is still no sign of the promised regulatory reform order.

It seems that, for the time being, insurers, insureds and third parties (and their advisers) must continue to grapple with the inadequacies of the 1930 Act.

## Part II: the solvent insured

Even where the insured is solvent, insurers are sometimes involved directly in proceedings with the insured and a third party claimant. This arises, typically, in two situations. First, where insurers have avoided the policy or rejected the insured's claim to an indemnity and apply to be joined as defendants so that they can nonetheless defend an action brought by a third party against the insured without running the risk that they will be held to have affirmed the policy. Secondly, where insurers claim a declaration that they have avoided the policy validly or that the insured is otherwise not entitled to an indemnity, and the third party applies to be joined as a defendant so that it can resist the insurer's claim.

In the first situation, the insurer's desire to be joined in the proceedings is motivated by a concern that the insured will not defend the proceedings on the merits, invariably because, while not yet formally subject to bankruptcy or an insolvency regime, it is on the brink of insolvency. In the latter situation, which is perhaps less common, the insured is not concerned to preserve its rights against the insurer because it knows that it will become insolvent if it is found liable to the third party, whether or not its insurance policy is effective, because at least a significant part of its potential liability to the third party is uninsured.

Two recent decisions under CPR 19.2 illustrate these respective situations. These are *The Selby Paradigm* and *Chubb Insurance Co v Davies*.

Both decisions concerned CPR 19.2. This provision falls within Part I of CPR 19, which deals with the addition and substitution of new parties. CPR 19.2 provides:

"The court may order a person to be added as a new party if

(a) it is desirable to add the new party so the court can resolve all the matters in dispute in the proceedings; or

(b) there is an issue involving the new party and an existing party which is connected to the matters in dispute in the proceedings, and it is desirable to add the new party so the court can resolve that issue."

*The Selby Paradigm* concerned *in rem* proceedings claiming salvage remuneration for refloating a barge. The defendant shipowners filed an acknowledgment of service indicating an intention to defend the proceedings. The barge was insured under a policy of insurance for Hull Port Risks, and the underwriters had avoided the policy for nondisclosure. The underwriters were aware of the proceedings, and had indicated to the shipowners that, without prejudice to their contention that they had validly avoided the policy, they expected the shipowners to defend the claim. The claimants then obtained judgment in default and the underwriters applied to be joined as a party to the proceedings in order to defend the claim against the insured on its merits, in case, notwithstanding their purported avoidance, the policy of insurance was held to be effective.

David Steel J. allowed the underwriters' application that they be joined as a party to the proceedings and set aside the judgment in default. The judge indicated that the position under CPR 19.2 was no different from that under the former RSC Ord 15, r.6 (2)(b)(ii), and referred to *Wood v Perfection Travel Ltd* [1996] L.R.L.R. 233. *Wood*, it will be remembered, was a case in which insurers successfully applied to be joined to proceedings as a defendant rather than exercising their right to conduct the defence on the part of the insured, as they did not wish to run the risk of later being held to have waived their right to deny liability under the policy. In reaching their decision in *Wood*, the Court of Appeal indicated that they doubted whether the exercise of the right to take over the conduct of the action would constitute an election, or affirmation of cover, but if it would they saw no reason why the insurers should be put on the horns of that dilemma and that justice required that the insurers be permitted to join the action as a second defendant.

Returning to *The Selby Paradigm*, David Steel J. also confirmed, applying *Rees v Mabco* (1999), *Times*, December 16, 1998, that the discretion to permit joinder was available despite the fact that a default judgment had been obtained. In *Rees v Mabco*, the discretion was exercised against the insurer, which considered that the third party's claim was outside the scope of the policy wording, and on that basis had taken a commercial decision at an early stage not to take any part in the proceedings. An application by the insurer to be joined as a defendant and to set aside a default judgment for damages to be assessed, which had been obtained against the insured, was rejected by the judge at first instance, and the insurer's appeal was dismissed by the Court of Appeal. In *The Selby Paradigm*, the discretion was exercised in favour of the insurer, which was held to have acted reasonably promptly after it became aware that the insured was not, after all, defending the proceedings on the merits. The essential difference between the two cases appears to be that the underwriters in the later case had not indicated that they were not prepared to participate in the proceedings, and had therefore not "nailed their colours" (the phrase used by Wall J. in the Court of Appeal in *Rees v Mabco*, and adopted by David Steel J. in *The Selby Paradigm*) to the mast of the argument that they were not liable under the policy.

The situation in *Chubb Insurance Co v Davies* was the converse of that in *The Selby Paradigm*. In *Chubb*, the insurer took proceedings against their insured for a declaration that they were not liable to indemnify him under a policy of directors' and officers' insurance in respect of his liability to three third parties who had obtained a judgment against him in the High Court. The High Court judgment was subject to appeal in the Court of Appeal, and the insurer had agreed to fund the insured's appeal. As execution of the High Court judgment had been stayed pending the appeal, the third parties could not seek a bankruptcy order against the insured and proceed to claim directly against the insurer under the Third Party (Rights against Insurers) Act 1930.

The insured served a defence to the claim by the insurers which simply stated that the insured did not admit that the insurer was entitled to the relief which it sought, and the insurer applied for summary judgment under CPR, Pt 24. The third parties applied under CPR 19.2 to be joined to the proceedings, on the grounds that they, rather than the insured, were the real target of the insurer's claim. Langley J. noted that CPR 19.2 was in very general terms, and did not require the "new party" to have a cause of action. In his view, the wording of CPR 19.2 was, "if anything, more general" than the wording of RSC Ord 15, r.6, and should be interpreted more generously if the overriding objective required it. Langley J. therefore took a slightly different approach to the interpretation of CPR 19.2 from that of David Steel J. in *The Selby Paradigm*, although whether there is any real difference in approach between the two may be perhaps doubted. The insurer's objection to the third parties' application to be joined in the proceedings was that they had only a prospective cause of action, but, as Langley J. observed, the insurer was itself seeking prospective relief in the form of a declaration. This being so, the judge held that justice required that the third parties should be permitted to advance such a case so that the insurance should respond to their claim against the insured.

In each of these cases, the court was able to ensure that the "real" party to the litigation was able to participate in it by being joined as a defendant. Although, depending on one's position in the triangle, it may sometimes appear that the insurer is having its cake and eating it, the court is likely to want to allow all three parties to participate in the proceedings if they wish to do so. But this will not be the case if, on the facts, this would be unfair to one of the parties, as in *Rees v Mabco*. It is perhaps worth noting here that a comparison of *Rees v Mabco* and *The Selby Paradigm* suggests that a relatively small difference in the facts – or perhaps in how the facts are presented to the court – may determine the outcome of the application.

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