

## ***Section 9 of the Law Reform Act 1936 - the legislative background***

Louise Affleck\*

---

*It is commonly accepted that section 9 of the Law Reform Act 1936 is designed to secure the insurance money for the third party, as against other creditors, in situations where the insured is insolvent. Why should the third party obtain priority over the general body of creditors? In determining whether the third party should obtain the insurance money in priority to other creditors, it is useful to consider the legislative background to section 9. This analysis is intended to achieve three purposes: first, to identify the social purpose that section 9 was intended to achieve; second, to demonstrate that it is no longer equitable for the third party to obtain priority over other unsecured creditors; third, that reform is necessary as the courts are now unable to reconsider the issue from first principles.*

---

### **I THE EFFECT OF INSOLVENCY ON CLAIMS AGAINST THE INSURED PRIOR TO THE INTRODUCTION OF THE LAW REFORM ACT 1936**

Where the insured is indemnified under a contract of insurance, section 9 of the Law Reform Act 1936 creates a charge over the insurance money "on the happening of an event giving rise to a claim for damages, or compensation". The creation of a charge effectively takes the insurance money out of the assets of the insolvent estate, in the same way that assets subject to a security in favour of a third party do not form part of the assets for distribution to the general body of creditors.

In this article the term "insolvency" will be used to refer to the bankruptcy of an individual or the liquidation of a company. Unless otherwise noted, the rules applicable to bankruptcy and liquidation in this area of the law are identical.

Upon the commencement of bankruptcy, the assets of the bankrupt pass to the Official Assignee.<sup>1</sup> In the case of a company, the assets do not automatically vest in the liquidator, but like a bankrupt, the company no longer has any power to deal with its assets.<sup>2</sup> The rights of an unsecured creditor to file a proof of debt in a liquidation of an insolvent company are the same as for a bankruptcy of an individual.<sup>3</sup> A proof of

---

\* Barrister and Solicitor of the High Court of New Zealand. This article is an extract from a paper submitted in partial fulfilment of the LLM degree at Victoria University of Wellington.

1 Bankruptcy Act 1908, s 98; Insolvency Act 1967, s 42.

2 Companies Act 1993, s 248(1).

3 Companies Act 1933, s 257; Companies Act 1955, s 307; Companies Act 1993, s 276.

debt can be filed only in respect of debts in existence at the commencement of insolvency.<sup>4</sup>

Although these rules have remained unchanged since before the introduction of the Law Reform Act 1936, the treatment of certain creditors in an insolvency has changed. The relevant legislative changes are summarised in the Table at the end of this article; the effect of those changes are examined here.

#### A *Claims by Third Parties against an Insolvent Estate*

The Bankruptcy Act 1908 provided that "demands in the nature of unliquidated damages arising otherwise than by reason of a contract, promise, or breach of trust shall not be provable in bankruptcy."<sup>5</sup> A claim for unliquidated damages arising out of a breach of contract was subject to an assessment of damages. If the Official Assignee and claimant could not agree on the assessment, the court had the power to quantify the damages to enable the creditor to share in a distribution of the insolvent estate.<sup>6</sup>

Victims of insolvent tortfeasors who had unliquidated claims were, by virtue of section 98(1), unable to lodge a proof of debt. Under the Bankruptcy Act 1908 the following rules applied:

- (a) If the third party obtained judgment prior to the commencement of insolvency the claim, having become liquidated, was capable of proof in the insolvent estate;<sup>7</sup>
- (b) If the insolvency commenced before the third party obtained judgment, and the claim was for unliquidated damages, the third party was unable to file a proof of debt;<sup>8</sup>
- (c) If the claim was not provable in the bankruptcy of an individual, any proceedings brought by the third party could continue. However, the third party was unable to execute judgment until after the discharge from bankruptcy.<sup>9</sup>
- (d) In the case of an insolvent company, assets were distributed to creditors able to file proofs of debt and the company was dissolved,<sup>10</sup> so the continuation of proceedings against an insolvent company was pointless.

So, for example, if a tortfeasor became insolvent before the third party obtained judgment, the third party could not share in a distribution of the insolvent estate. Where

---

4 Bankruptcy Act 1908, s 98(3); Insolvency Act 1967, s 87(1).

5 Section 98(1).

6 Bankruptcy Act 1908, s 110.

7 Bankruptcy Act 1908, s 98(1).

8 Bankruptcy Act 1908, s 98(1).

9 See Spratt & McKenzie *The Law of Insolvency* (Butterworths, Wellington, 1972, 2 ed) para. 32/3.

10 Companies Act 1933, s 220.

the insolvent was an individual, the third party was entitled to continue an action against the bankrupt. Although the third party's cause of action survived the bankruptcy, such a right was of limited worth, as the bankrupt's assets had already passed to the Official Assignee. Further, prior to 1936, claims for unliquidated damages could not be pursued if the tortfeasor died.<sup>11</sup> This scenario was not uncommon as the increasing use of motor vehicles in this period led to more fatal accidents.

The insolvency legislation seriously prejudiced third parties who had personal injury claims which, by their nature, were unliquidated. Unless the third party had judgment at the time of insolvency, there was no recourse against the insolvent estate and even if there was a right of action against the bankrupt, it was an empty remedy.

Parliament intervened in respect of claims by employees for compensation under the Workers Compensation Act 1922. Claims for compensation arising from accidents in the workplace were provable in the bankruptcy of the employer even if the claim was unliquidated at the time of the commencement of bankruptcy.<sup>12</sup>

#### *B The Status of Proceeds from Insurance Policies*

Prior to the Law Reform Act 1936, the right of the insured to make a claim under a contract of insurance was a chose in action which passed to the Official Assignee.<sup>13</sup> The position is summarised in an early edition of Spratt:<sup>14</sup>

Moneys payable by an insurance company as an indemnity to the assured in respect of third party risks pass on his bankruptcy to the assignee in bankruptcy and the third party, on recovering judgment for damages in an action against the assured in respect of personal injuries caused to him covered by the policy, has no right at law or in equity as against the liquidator to require that the moneys so paid should be handed over to him. Such moneys form part of the assets of the bankrupt available for distribution amongst the general creditors, including the third party so injured.

The cases cited in support of this proposition concern situations where the third party claimed damages for personal injuries suffered as a result of a motor vehicle accident. In *Harrington Motor Company Ltd, ex parte Chaplin*,<sup>15</sup> the third party obtained judgment prior to the insolvency of the tortfeasor, and was able to share in a distribution of the insolvent's assets including the insurance money. However, in *Hood's Trustees v Southern Union General Insurance Co of Australasia Ltd*,<sup>16</sup> the tortfeasor became insolvent prior to the third party obtaining judgment; although the

---

11 Section 3(6) of the Law Reform Act 1936 provided that if the tortfeasor died insolvent, the third party could file a proof of debt in the bankruptcy, even if the claim was unliquidated.

12 Workers Compensation Act 1922, s 53.

13 Bankruptcy Act 1908, s 61.

14 FC Spratt *The Law and Practice of Bankruptcy in New Zealand* (Butterworths, Wellington 1930, 1st ed) p 165.

15 [1928] 1 Ch 105 (CA).

16 [1928] 1 Ch 793 (CA).

insurance money passed to the Official Assignee, the third party could not file a proof of debt and share in a distribution of the estate.

In a New Zealand case, *Smith v Horlor*,<sup>17</sup> the insured assigned his assets to a trustee for benefit of his creditors. The assignment occurred after the date of the event giving rise to a claim by the third party, but before the third party obtained judgment. The court, applying the English authorities, held that the right to make a claim under the insurance policy was a chose in action capable of being assigned prior to the insured's liability being determined by judgment.

### C *Legislative Forerunners to Section 9*

Prior to the Law Reform Act 1936, two statutes gave the third party direct access to the funds held by an insurer. The Motor-vehicles Insurance (Third Party) Risks Act 1928 imposed a compulsory scheme of insurance on the owners of motor vehicles requiring them to insure against any liability to pay damages for accidental death or personal injury caused by the use of the motor vehicle.<sup>18</sup> Although insurance against an employer's liability under the Workers Compensation Act 1922 was not compulsory, the Act gave injured employees certain rights over any insurance held by the employer.

McElroy and Gresson<sup>19</sup> summarise the effect of section 10 of the Motor-vehicles Insurance (Third Party) Risks Act 1928 and section 48 of the Workers Compensation Act 1922 in their text:<sup>20</sup>

... the amount of the insured's liability - ... in respect of a particular accident to which these statutes applied - was a first charge on all insurance-moneys payable in respect of the accident, whether this amount had been determined or not, in the event of -

- (i) The employer or motor vehicle owner dying insolvent or making a composition or arrangement with his creditors.
- (ii) Proceedings being commenced for winding-up, if the employer or motor-vehicle owner was a body corporate.
- (iii) An employer becoming bankrupt, or a motor vehicle owner being bankrupt at the time of the accident or thereafter becoming bankrupt.

These provisions endeavoured to ensure that the insolvency of the insured did not prevent the insurance money from reaching the third party whom the legislation intended to benefit. Thus in the *Smith v Horlor* situation,<sup>21</sup> where the insured attempted to assign the benefit of the insurance policy to creditors, the charge would attach to the insurance money to prevent it passing to a trustee for the benefit of other creditors.

---

17 [1930] GLR 211 (SCt); [1930] NZLR 537.

18 See L Affleck *Third parties and the Insolvent Insured - Section 9 of the Law Reform Act 1936* (LLM Research Paper 1994, Victoria University of Wellington, unpublished).

19 *The Law Reform Act 1936* (Butterworths, Wellington, 1937).

20 Above n 19, p 30.

21 Above n 17.

There was an element of social insurance in this legislation. Parliament encouraged insurance as a means of providing protection to third parties. Third party motor vehicle insurance for personal injury claims was compulsory and insurers offering workers compensation insurance were required to have the terms of such policies approved by the Governor-General.<sup>22</sup> This element of social insurance is further illustrated in the insolvency context; where the third party became insolvent, payments due the third party under the workers' compensation legislation did not form part of the estate for distribution to the third party's creditors.<sup>23</sup>

The policy behind this legislation was to ensure that the third party received the insurance moneys even if the insured subsequently became insolvent. However the legislation was not totally effective in achieving this purpose. The charge arose not upon the happening of the event giving rise to a claim by the third party, but upon the insured becoming insolvent. Provided the insured was not insolvent, he or she could receive the insurance money due under the policy and use it for other purposes.

Nor could the legislation deal with the situation where the wrongdoer died as, prior to the introduction of the Law Reform Act 1936, claims against a wrongdoer were extinguished upon the death of a wrongdoer. If the insured was killed in a collision due to his or her own negligence, the rights of the third party were extinguished by the insured's death; the liability of the insurance company under the Motor-vehicle (Third Party Risks) Act 1928 was also extinguished.<sup>24</sup>

The next section of this paper examines the social policy behind section 9 of the Law Reform Act 1936 and considers whether it is still valid in light of the legislative, social and economic changes which have subsequently occurred.

#### *D Policy behind Section 9 of the Law Reform Act 1936*

Section 10 of the Law Reform Act 1936 repealed section 10 of the Motor Vehicles Insurance (Third Party Risks) Act 1928 and section 48 of the Workers Compensation Act 1922, replacing those provisions with the more general provision in section 9 of the Act. Like the legislation which preceded it, section 9 was designed to ensure that the third party received the insurance money in priority to other creditors. However under section 9 the charge attached upon the happening of the event giving rise to the claim, regardless of whether the event occurred before or after the insolvency of the insured. In line with other reforms enacted by the Law Reform Act 1936, it was also intended that the charge over the insurance money survive the death of the insured.

---

22 Workers Compensation Act 1900, s 21.

23 *In re George McMahon (a bankrupt)* [1932] NZLR 1196.

24 *Findlater v Public Trustee and Queensland Insurance Co Ltd* [1931] GLR 403, 407. Section 3 of the Law Reform Act 1936 prevented the third party's cause of action against the insured from being extinguished, and s 9 prevented the insurer's liability from being extinguished.

The policy basis behind the legislation is readily understandable in the context of the society that existed at the time. In the absence of a social welfare system and a state controlled accident compensation scheme, death or injury seriously affected the economic well-being of the injured third party and his or her dependents.

The insolvency legislation often prevented the third party sharing in a distribution of the insolvent estate, yet it was considered that the injured third party was more deserving of compensation than the general body of creditors. The insolvency legislation recognised that employees should receive limited priority over the general body of creditors for the same reason:<sup>25</sup>

salaries and wages are generally needed for, and generally expended in, the support and maintenance of the persons earning them, their wives and families and others dependent on them, and so may well be given priority, for a short period, over debts due to other creditors in the ordinary course of business.

By analogy, the injured parties' need for compensation was seen as more deserving than that of a general creditor whose debt was generally "more related to the profit and loss account of the creditor than his sustenance or that of those dependent upon him."<sup>26</sup> In other words, an individual whose personal welfare was affected by the insolvency of another was more deserving of priority than creditors who merely suffered a reduced profit as a result of their dealings with an insolvent.

The third party with a claim for unliquidated damages, being unable to share in the assets of the insolvent estate, was instead given a charge over any insurance fund available to meet the insolvent's liability to third parties. Where the insolvent had no insurance, the insolvency legislation gave priority to third parties with claims under the workers compensation legislation the same priority shared by employees over the general body of creditors; employees with claims under the workers' compensation legislation were, within certain monetary limits, paid their claims before the remainder of the assets were distributed on a *pari passu* basis to other unsecured creditors.<sup>27</sup>

In the author's view, the social purpose that the Act was designed to achieve has disappeared with the social and legislative developments which have occurred since the introduction of the Act. The next Part of this paper reviews those developments and considers whether there is any justification for retaining section 9 on the statute books.

---

25 *Re Parkin Elevator Co* (1916) 41 DLR 123, 125 per Meredith CJ.

26 Above n 25, p 125.

27 Companies Act 1933, s 258; Companies Act 1955, s 308; Companies Act 1993, Seventh Schedule.

## II RE-EXAMINATION OF THE POLICY BEHIND SECTION 9

### A *Legislative and Social Developments since 1936*

The rules preventing claims for unliquidated damages arising from a tort were amended when the Insolvency Act 1967 was introduced. The amended rules continue to apply to companies in liquidation.<sup>28</sup> The current insolvency legislation provides that if the event giving rise to a claim for damages occurs prior to the insured's insolvency, then the third party may file a proof of debt and share in the assets of the insolvent estate on a *pari passu* basis, even if the claim is for unliquidated damages.<sup>29</sup> Where the event occurs after the commencement of insolvency, the third party still cannot file a proof of debt.<sup>30</sup> The amendment of the Insolvency Act 1967 to allow claims for unliquidated damages puts the third party in the same position as unsecured creditors in that a proof of debt may now be filed.

The social purpose which the Law Reform Act 1936 was designed to achieve has also disappeared with the introduction of a no-fault accident compensation scheme and the prohibition of personal injuries claims against wrongdoers.

Although the accident compensation scheme has removed the need for individuals to insure against the risk of causing personal injuries to third parties, private insurance against the risk of causing property damage is common. Today, liability insurance is not limited to business operations; most individuals obtain third party insurance as part of their motor vehicle insurance cover and most policies of household insurance provide some third party cover.

Unlike other countries, New Zealand has not moved to require compulsory insurance for certain occupations. There is no duty to insure against the risk of causing property damage or economic loss to third parties, yet section 9 remains on the statute books. Although there is some support for an argument that section 9 is limited to claims for personal injuries,<sup>31</sup> the language of section 9(1) makes it clear that the change applies to liability insurance in respect of any claim for damages or compensation. The next section examines whether there is any rationale for continuing to give the third party a charge over the insurance money in priority to other creditors.

### B *Rationale for according Priority to Third Parties*

A fundamental principle of insolvency law is that unsecured creditors should have their claims met out of the assets available for distribution in proportion to their claims. This principle of rateable or *pari passu* distribution is subject to a number of statutory

---

28 Companies Act 1955, s 307; Companies Act 1993, s 302.

29 Insolvency Act 1967, s 87(1).

30 Insolvency Act 1967, s 87(1).

31 Above n 18, Appendix 3.

exceptions. Advocates of insolvency law reform in New Zealand,<sup>32</sup> Australia<sup>33</sup> and the United Kingdom<sup>34</sup> have consistently recognised that unsecured creditors should receive preferential treatment only if it can be justified by reference to principles of fairness and equity.

As far as the author is aware, the treatment of insurance money due under third party liability policies has never been considered in the context of insolvency law reform. Despite having legislation comparable to section 9, this issue was not considered when insolvency law reform was considered and then implemented in Australia and the United Kingdom. Nor was the issue considered in New Zealand when the Insolvency Act 1967 was introduced, or in the Justice Department's Discussion Paper<sup>35</sup> released in 1988.

In the Australian states which have no equivalent to section 9, the federal companies legislation accords third parties preferential status in an insolvency. Although the insurance money goes to the liquidator, the liquidator must pass those funds on to the third party. Curiously, the Harmer Report did not discuss the justification for according third parties this priority.<sup>36</sup>

It is possible that the justification for giving third parties priority over insurance money was not considered by the Harmer and Cork Reports because Australia and the United Kingdom continue to have personal injuries claims and associated regimes for compulsory insurance. The justification for retaining third party priority in those jurisdictions is the same as that which existed in New Zealand when the Law Reform Act 1936 was introduced.<sup>37</sup>

Now that claims for damages for personal injuries have been abolished in favour of an universal accident compensation scheme, actions today are limited to claims for property damage or economic loss. There is no difference in principle between these claims and those of other creditors of an insolvent estate.

It could be argued that a third party with a claim in tort against the insured is an involuntary creditor and therefore should be treated differently from those creditors who choose to deal with the insured. But there are often many involuntary creditors in an insolvency; that, in itself, is not a reason for the third party to receive priority. Further, why should one involuntary creditor receive priority if the insured happens to carry insurance, when another involuntary creditor has no priority simply because the insolvent has neglected to insure against that particular risk?

---

32 Law Reform Division *Insolvency Law Reform - A Discussion Paper* (Department of Justice, Wellington, 1988).

33 Australian Law Reform Commission *General Insolvency Enquiry* (ALRC Report no.45, Canberra, 1988) (The Harmer Report).

34 Insolvency Law Review Committee *Insolvency Law and Practice* (1982 Cmnd 8558), Ch 32-33 (The Cork Report).

35 Above n 32.

36 Above n 33, p 309.

37 See Part I of this paper.



The Cork Report<sup>38</sup> concluded that involuntary creditors should not receive preferential status over other unsecured creditors in an insolvency. In the context of considering the Crown's preferential claim for unpaid revenue, the Cork Report stated:<sup>39</sup>

In any event, the Crown is not alone in being an involuntary creditor. Many suppliers of goods and services are constrained and extend credit facilities in accordance with custom and trade. In a practical sense they have no real choice in the matter, and are sometimes unable to exercise credit control. Many other categories of involuntary creditor may readily be called to mind. Litigants who obtain judgment for costs, for example, and the victims of breach of contract and tort do not normally extend credit voluntarily to their debtors. It is no fault of theirs that they find themselves owed money by an insolvent. In many cases, such creditors are deserving of much sympathy, yet their debts are subordinated to the Crown's preferential claim to tax. In our view, sympathy for the misfortune of an involuntary creditor is not a sufficient ground for setting aside the cardinal principle of rateable distribution of an insolvent's estate.

The charge which the third party enjoys over insurance money due under a liability policy can be likened to the statutory charge over land which local authorities have for unpaid rates. The Cork Report questioned the basis for a statutory charge, considering that arrears of rates should be treated as just another unsecured liability of the insolvent.<sup>40</sup>

It could be argued that the insolvent's estate is unjustly enriched by insurance money it would not have otherwise received but for the third party's claim, and for that reason the other creditors should not share in the insurance money. However, the insurance premiums were paid from the insolvent's assets so if there is any realisation under the policy it should be for the benefit of all creditors. The insolvent estate is often unjustly enriched at the expense of claimants; for example, an unpaid supplier of goods is not entitled to priority (in the absence of a retention of title agreement) even though the goods supplied to the insolvent may be sold by the Official Assignee or liquidator.

Also, it should be recognised that the insured obtains insurance to cover his or her own financial risk; it is unrealistic to think the insured obtains insurance to protect third parties in the event of the insured's insolvency. Unlike other jurisdictions, there is no duty to insure against third party risks in New Zealand; therefore there should be no duty owed to third parties to pay the claim out of the insurance proceeds, as opposed to other assets. There is no reason why this position should change when the insured is insolvent. There is no social justification for allowing a third party to be treated differently from other creditors simply because the insolvent has insured against one risk and not another.

---

38 Above n 34.

39 Above n 34, p 321.

40 Above n 34, p 333.

A distinction could possibly be made where a third party has expressly contracted with the insolvent on the basis that the latter would carry insurance. For example, many carriers will only sub-contract with parties who carry liability insurance. However, if the third party was concerned about the insured's insolvency, first party insurance is available to protect the third party. Alternatively, it may be possible for the third party to contract that any proceeds arising from insurance claims are held on trust for the benefit of the third party.

In the author's view, there is no theoretical basis for according the third party priority over the insurance funds. However, there may be some practical justification, and that is the risk that the insurer will avoid liability upon the insured's insolvency if the charge in favour of the third party did not arise. This consideration was a decisive factor in the Court of Appeal's decision in *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd*;<sup>41</sup> a decision which will be considered in some detail because of its binding authority on New Zealand courts.

### *C Prevention of a Windfall to the Insurer*

In *FAI*<sup>42</sup> the event giving rise to a claim by the third party occurred in April 1985, but the insured's bankruptcy did not commence until June 1992. Counsel for FAI argued that section 9(1) did not apply if the insured became bankrupt subsequent to the event giving rise to a claim for damages. Richardson J rejected that argument.<sup>43</sup>

The charge against the insurance moneys arises immediately on the happening of the event giving rise to the claim. The solvency status of the insured is not a complicating factor at that time so as to call for special consideration. The provisions apply in the ordinary way whether or not the insured subsequently becomes bankrupt. There is no justification for reading into subs (1) and (4) any qualifications of the kind suggested by [FAI]. On the contrary to do so would run counter to the policy of the legislation by arbitrarily curtailing its broad scope. It would put the insurer in the extraordinary position of being able to argue that the claimant should have recourse against the insured not the insurer - then when bankruptcy supervenes it could contend that s 9 could not be invoked against it.

In other words, the section should not be interpreted in a manner that would enable the insurer to avoid liability if the insured subsequently becomes bankrupt. That view was shared by the other members of the Court of Appeal:

The scheme is to give the plaintiff direct access to the moneys payable to the insured under the policy of insurance indemnifying the latter against liability for the plaintiff's claim: subs 1. The purpose is to protect the plaintiff, and to prevent the insurer obtaining a windfall at the plaintiff's expense, should there be a failure by the insured to make or pursue a claim under the policy or should it be impractical for the

---

41 [1994] 1 NZLR 11 (CA).

42 Above n 41.

43 Above n 41, p 15.

plaintiff to sue the insured personally .... In a word, the object of the section is to preserve the plaintiff's position by avoiding unjust profit to the insurer;<sup>44</sup>

and<sup>45</sup>

I am satisfied that the subsequent bankruptcy of [the insured] demonstrates the purpose for which the provision was enacted. To interpret the section so as to limit its application to situations where the bankruptcy existed prior to the claim arising would rob it of its effect and create a legislative absurdity.

As a matter of principle the insured's insolvency should not create a windfall for the insurer. It was not argued, and the Court of Appeal did not consider, whether the insurance money should fall into the general pool of assets available for distribution to all creditors. In that event, there would be no windfall for the insurer.

In terms of insolvency policy, the purpose of section 9 is best effected by having the charge arise at the time of the event. If the insured subsequently became insolvent, then the insurance money would pass to the Official Assignee or liquidator for the benefit of all creditors. If the insured was insolvent at the time of the event, then the charge would arise in favour of the third party who was unable to claim in the insolvent estate. If the section were to operate in this way, there should, in theory, be no windfall to the insurer.

A windfall to the insurer could arise in two ways: first, a failure by the Official Assignee or liquidator to pursue a claim against the insurer; second, a clause in the contract of insurance purporting to avoid the insurer's liability in the event of the insolvency of the insured.

The Official Assignee or liquidator may not be prepared to pursue a claim against the insurer because of either a lack of funds or the uncertainty of a successful outcome. In that event, the party with a real impetus in pursuing the claim, the third party, should be given the option of standing outside the insolvency and pursuing the charge against the insurer. This could be achieved by the Official Assignee or liquidator disclaiming the insured's rights to indemnity under the policy.<sup>46</sup>

A more difficult issue is the situation where the contract of insurance seeks to avoid the insurer's liability upon the insolvency of the insured. Section 77 of the Insolvency Act 1967 provides:<sup>47</sup>

Where a bankrupt is a party to a contract and the contract is on the adjudication terminated by the other party to the contract under the provisions of the contract, then, notwithstanding anything to the contrary in the contract, the Assignee shall be

---

44 Above n 41, p 18 per Hardie Boys J.

45 Above n 41, p 26 per Robertson J.

46 Insolvency Act 1967, s 75; Companies Act 1955, s 312; Companies Act 1993, s 270.

47 There is no equivalent provision in the companies legislation. See BH McPherson *The Law of Company Liquidation* (Sweet & Maxwell, Sydney, 1987, 3ed) 172-173.

entitled to recover from the other party such sum as the Court thinks just and equitable in all the circumstances ....

Section 77 operates where the contract contains a term which allows one party to terminate the contract upon the bankruptcy of the other. If, for example, the insurer purported to terminate the contract of insurance following the bankruptcy of the insured, then the Official Assignee could rely on section 77 to enforce the contract. As the author of Spratt and McKenzie notes,<sup>48</sup> it is arguable that this section will not apply where the contract provides for automatic termination upon the insolvency of the insured. There are no reported cases on section 77 and it is beyond the scope of this paper to consider potential amendments to this section. However, in respect of section 9, insurers could be prevented from avoiding insurance contracts by a specific statutory provision preventing the contract of insurance purporting to avoid the insurer's liability upon the insured's insolvency.<sup>49</sup>

#### *D Reconsideration of the application of section 9*

Section 9 is now inconsistent with the policy behind the existing insolvency legislation. Because reform is likely to be some years away, is it possible for the courts to reconsider the policy behind the legislation to achieve a purpose congruent with the equal sharing principle of insolvency law?

In the author's view, the rights of the third party under section 9 should be limited to situations where the event occurs *after* the commencement of insolvency. If the event occurs prior to the commencement of insolvency, then the charge should arise for the benefit of all creditors of the insolvent estate.

This interpretation is possible if the assumption that the charge arises in favour of the third party is re-examined. Recognising that insolvency should not be grounds to enable the insurer to avoid liability to the insured, the argument runs as follows:

Section 9(1) is intended to prevent the situation of the insured receiving the proceeds of a claim under the policy and dissipating the funds before the third party is able to obtain judgment. The basis for imposing the charge in the first instance is to prevent the insured being enriched at the expense of the insurance company if the insured does not use the funds for the purpose intended by the contract of insurance. It also prevents other unsecured creditors gaining access to funds, for example, by way of assignment, in a pre-insolvency situation.

Section 9(2) is intended to prevent the insurance company avoiding its obligations in the event of the insured's death or insolvency. It also ensures that the charge arises in favour of the third party if the event occurs after the commencement of insolvency to protect third parties who are unable to claim against the insolvent estate. Subsections (3) to (7) are both procedural and substantive; they facilitate enforcement

---

48 *The Law of Insolvency* (2ed, Butterworths, Wellington, 1972).

49 See Third Parties (Rights Against Insurers) Act 1930, s 3 (UK).

of the charge against the insurer, and at the same time preserve the insurer's rights under the contract of insurance.

The difficulty with this argument is that the courts have assumed that the charge does in fact arise in favour of the third party and, although that intention is not explicit in section 9, it is certainly implied in section 9 that the right to enforce the charge lies with the third party. The courts are, of course, bound by the Court of Appeal decision in *FAI*. If the matter fell for reconsideration, it is therefore unlikely that a court could adopt a construction of section 9 which accords with insolvency policy.

### **III CONCLUSION**

In the author's view, section 9 should be repealed and replaced with legislation protecting the third party only where the event giving rise to a claim against the insured occurs after the commencement of insolvency. Where the third party can share in a distribution of the assets of the insolvent, there is no rational basis for according the third party priority. The only justification for allowing the third party to pursue a claim directly against the insurer is where the Official Assignee or liquidator has decided not to pursue such a claim.

---

**TABLE**  
(Referred to in Part I)

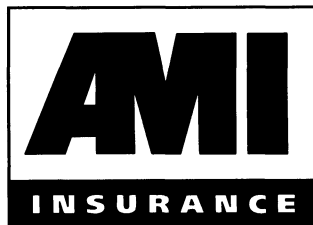
EFFECT OF LEGISLATION ON	CLAIM ON INSOLVENT ESTATE	CHARGE ON INSURANCE MONEY	APPLICABLE LAW
<b>CLAIMS BEFORE 1936</b>			
1. Third party has judgment or liquidated claim at commencement of insolvency			
(a) damages claim (other than personal injury)	—	x	Insolvency Act 1908
(b) motor vehicle accident (personal injury)	—	—	
(c) workers' compensation claim	—	—	
(d) other personal injury claim	—	x	
2. Third party has unliquidated claim at commencement of insolvency			Motor Vehicles (Third Party Risks) 1928
(a) damages claim (other than personal injury)	x	x	Workers' Compensation Act 1922
(b) motor vehicle accident (personal injury)	x	—	
(c) workers' compensation claim*	x	—	
(d) other personal injury claim	x	x	
3. Event giving rise to claim by third party occurs after commencement of insolvency			* If the employer was uninsured, the employee became a preferential creditor in the insolvent estate
(a) damages claim (other than personal injury)	x	x	
(b) motor vehicle accident (personal injury)	x	—	
(c) workers' compensation claim*	x	—	
(d) other personal injury claim	x	x	
<b>CLAIMS AFTER 1936</b>			
1. Third party has judgment or liquidated claim at commencement of insolvency			
(a) damages claim (other than personal injury)	—	—	Insolvency Act 1908
(b) motor vehicle accident (personal injury)	—	—	
(c) workers' compensation claim*	—	—	
(d) other personal injury claim	—	—	
2. Third party has unliquidated claim at commencement of insolvency			Law Reform Act 1936
(a) damages claim (other than personal injury)	x	—	
(b) motor vehicle accident (personal injury)	x	—	
(c) workers' compensation claim*	x	—	
(d) other personal injury claim	x	—	
3. Event giving rise to claim by third party occurs after commencement of insolvency			
(a) damages claim (other than personal injury)	x	—	
(b) motor vehicle accident (personal injury)	x	—	
(c) workers' compensation claim*	x	—	
(d) other personal injury claim	x	—	

<b>CLAIMS AFTER 1972</b>			
1. Third party has judgment or liquidated claim at commencement of insolvency			
(a) damages claim (other than personal injury)	-	-	Insolvency Act 1967
(b) motor vehicle accident (personal injury)	x	x	
(c) workers' compensation claim*	x	x	
(d) other personal injury claim	x	x	
2. Third party has unliquidated claim at commencement of insolvency			
(a) damages claim (other than personal injury)	-	-	Accident Compensation Act 1972 (and subsequent ACC legislation)
(b) motor vehicle accident (personal injury)	x	x	
(c) workers' compensation claim*	x	x	
(d) other personal injury claim	x	x	
3. Event giving rise to claim by third party occurs after commencement of insolvency			
(a) damages claim (other than personal injury)	x	-	Law Reform Act 1936
(b) motor vehicle accident (personal injury)	x	x	
(c) workers' compensation claim*	x	x	
(d) other personal injury claim	x	x	

# Your home is where our heart is

For flexible policies and competitive payment options on Dwelling and Household Contents Insurance, AMI has everything covered. With a speedy and efficient claims settlement plus the security of our 24 hour AMI ASSIST Emergency Helpline, you're home and dry.

For more information or an obligation-free quote, call in to your nearest branch or phone free on 0800-100-200, 24 hours, 7 days a week.



**0800 100 200**

*"not a problem"*