# THIRD PARTIES (RIGHTS AGAINST INSURERS) ACT 2010: BACKGROUND TO THE PROVISIONS IN THE INSURANCE BILL

1.1 The Third Parties (Rights against Insurers) Act 2010 implements the recommendations of the Law Commission and the Scottish Law Commission, as set out in our 2001 joint report *Third Parties – Rights Against Insurers.* The Bill passed through the pilot House of Lords procedure for uncontroversial Law Commission Bills and received Royal Assent in March 2010.

1.2 Unfortunately, the 2010 Act is not yet in force. This is because it does not cover all relevant insolvent and defunct organisations and requires amendment. The necessary amendments are now before Parliament in the Insurance Bill 2014.

1.3 This note is in three parts.

(1) Part 1 sets out the background to the 2010 Act.

(2) Part 2 explains the amendments in the Insurance Bill 2014.

(3) The Bill adds a regulation making power to the 2010 Act. In Part 3 we set out how we would like to see that power used.

## BACKGROUND

### The purpose of the third parties regime

1.4 Third parties legislation dates back to the 1930s. The underlying policy behind the legislation is to assist a third party who has a claim against an insolvent or defunct person, where that claim is insured. The legislation allows the third party to sue the insurer directly.

1.5 This avoids the scenario where insurance money is paid out to the insolvent insured and divided amongst general creditors in insolvency proceedings. In essence, the legislation allows the intended beneficiaries of an insurance policy to benefit from the insurance.

1.6 For example, all employers are required to take out liability insurance to protect employees who are injured at work, even if the employer becomes insolvent. Without third parties legislation this protection would not be possible. An insurer would pay out money to the insolvent insured which would be divided amongst all creditors rather than be given directly to the injured employee. It would undermine the government policy for compulsory insurance if employees were not able to benefit from it in the event of their employer's insolvency.

1.7 Importantly, the third parties legislation does not simply apply to employee liability claims but any third party claims which are insured.

### The 1930 legislation

1.8 The legislation currently in force is the Third Parties (Rights against Insurers) Act 1930 and the Third Parties (Rights against Insurers) Act (Northern Ireland) 1930. Unfortunately, these Acts are procedurally complex. For example, where the defendant company has been dissolved, the claimant must first restore that company to the register to bring a claim against it, which adds at least two months and several thousand pounds to the process.[1] This can be a particular burden in mesothelioma cases where claimants typically have less than a year to live after diagnosis.

### The 2010 Act

1.9 The 2010 Act simplifies the process: for example, by allowing a third party to bring a claim directly against the insurer, without restoring the original defendant to the registry. This saves money for both parties. The Act also gives claimants greater rights to find out about whether a company has insurance before issuing a claim, thus saving unnecessary costs.

1.10 The 2010 Act received Royal Assent just before the last election. The incoming Government asked that all legislation listed in the previous Government's Forward Regulatory Programme should be scrutinised by the Regulatory Policy Committee (RPC). The RPC approved the amendment and implementation of the 2010 Act in summer 2012. By then circumstances had been identified in which the 2010 Act would not achieve the desired result. Furthermore, new forms of insolvency had been introduced, and the wording of the 2010 Act had not kept pace with those developments.

### How does the 2010 Act work?

1.11 To trigger the application of the 2010 Act an insured must:

(1) incur a liability to a third party for which they have insurance; and

(2) be or become a relevant person within the definition of the 2010 Act.

1.12 In order to become a relevant person the insured must undergo one or more of the specified insolvency events listed in sections 4 to 7 of the Act.

1.13 The 2010 Act does not describe insolvency procedures generally. Rather, it describes them by referring to specific legislative enactments. This approach has the benefit of certainty as it clearly delineates which insolvency events are within the scope of the 2010 Act. Unfortunately, several insolvency procedures have not been included.

[1] See Third Parties (Rights against Insurers) Act 2010, Impact Assessment, 17.07.2012 under "The requirement to restore companies to the Register".

1.14 The underlying policy of the 1930 Acts is that an insured should fall within the scope of the legislation whenever they have lost the effective power and control over their assets, due to insolvency, dissolution or an analogous event.[2] The Law Commissions intended that the 2010 Act would continue this policy, but the 2010 Act as currently drafted does not fully achieve this objective. The amendments proposed to the 2010 Act in the Insurance Bill are intended to correct this defect.

## AMENDMENTS IN THE INSURANCE BILL 2014-11-28

### A regulation making power (Clause 17)

1.15 Clause 17 introduces a new section 19 into the 2010 Act. It permits the Secretary of State to introduce regulations to add or remove circumstances in which a person is a "relevant person". Regulations under the new section 19 will have to be approved by both Houses of Parliament before they can be made.

1.16 The Law Commissions discussed the need for a regulation making power in their 2001 Report. It states:

> In order to prevent a new Act from failing to keep pace with the law in this way, the draft Bill contains a power of amendment, exercisable by the Secretary of State, so that new developments can easily be accommodated.[3]

1.17 The 2010 Act did not implement this provision. Instead, it was hoped that any legislative enactment that created a new insolvency procedure would update the 2010 Act. Unfortunately insolvency is a fast paced area of the law which is consistently developing, both generally and in relation to specific sectors. In practice new procedures have been introduced since 2010 which are not reflected in the 2010 Act.

1.18 The regulation making power provides a mechanism through which this problem can be addressed at the point a problem arises, minimising harm to third parties.

### Substantive amendments: clause 18 and schedule 2

1.19 Clause 18 of the Insurance Bill applies schedule 2 to the 2010 Act. Schedule 2 paras (2)-(3) add two new insolvency procedures through which an insured may qualify as a "relevant person" to the 2010 Act.

#### *Debt relief orders in Northern Ireland*

1.20 First, schedule 2 para (2) adds debt relief orders in Northern Ireland to the list of circumstances in which an individual becomes a relevant person. These only came into force after 2010. Debt relief orders have the effect of prejudicing third parties as there is a moratorium on claims for 12 months.

[2] See Law Com No 272 and Scot Law Com No 184, paras1.3 and 2.36.

[3] See Law Com No 272 and Scot Law Com No 184, para 2.37.

***Administration***

1.21 Second, schedule 2 para (3) of the Bill inserts new drafting to capture all forms of administration under the Insolvency Act 1986. At present, section 6(2)(b) and section 6(4)(b) of the 2010 Act state that where an insured is subject to an administration order it will become a relevant person. However, very few administrations of corporate bodies are done through a court order.

1.22 There are three ways a body corporate can be put into administration: by a court order, by the holder of a floating charge and by the directors of a company. The current drafting has the effect of excluding administrations initiated by directors or holders of a floating charge. Under the amended section, an insured will be a relevant person if it is "in administration under Part 2 of the Insolvency Act 1986", which includes all forms of administration.

**Transitional cases**

1.23 Paragraph 4 of schedule 2 to the Insurance Bill inserts a new paragraph in schedule 3 of the 2010 Act. This deals with cases where an insured became a relevant person before commencement but incurs a liability to a third party after commencement.

1.24 The amendment is designed to deal with long-tailed liabilities, such as mesothelioma which may have a latency period of between 20 and 50 years. The problem is that the 2010 Act refers only to current insolvency events: for example, section 6(2)(d) refers to voluntary winding up in accordance with Chapter 2 of Part 4 of the Insolvency Act 1986. It does not necessarily capture a company which was would up *before* 1986 under other legislation. The new addition to schedule 3 means that any insureds who underwent one of the listed types of insolvency event in the past under previous legislation are included within the scope of the 2010 Act.

1.25 Note that this paragraph only operates where the insured incurs a liability after commencement. The 1930 Acts will continue to apply where an insured has both undergone a qualifying event and incurred a liability to a third party before commencement.

**Interpretation provision**

1.26 Paragraph 6 of schedule 2 to the Insurance Bill adds an interpretation provision to the 2010 Act. This provision has a limited purpose. It is to ensure that references to certain legislative enactments in the 2010 Act continue to apply, even if that particular legislation is subsequently amended.

1.27 Take the example given above: namely the reference in section 6(2)(d) to voluntary winding up in accordance with Chapter 2 of Part 4 of the Insolvency Act 1986. The interpretation provision means that unless another outcome is intended the reference will continue to apply even if Chapter 2 of Part 4 of the Insolvency Act 1986 is subsequently amended or extended. It would also cover the scenario where regulations extend the application of Chapter 2 of Part 4 of the Insolvency Act 1986 to new forms of organisation.

1.28 However, this provision is limited. It would not apply if a new statute were to replace the Insolvency Act 1986. In that case, the new legislation would need to amend the 2010 Act. Alternatively, the Secretary of State would need to exercise the regulation making power set out in clause 17.

## USING THE REGULATION MAKING POWER

1.29 The Law Commission hopes that regulations can be made soon within the life of the new Parliament, allowing the 2010 Act to be brought into force in October 2015.

1.30 We would envisage that the regulations would add the following insolvency events:

(1) The dissolution under UK law of a body corporate;

(2) The dissolution under UK law of an unincorporated association; and

(3) Sector specific administration procedures.

1.31 They would also need to make consequential amendments to the definition of dissolved bodies in section 9 and schedule 1 paragraph 3 (the "assistance provisions").

### The dissolution under UK law of a body corporate

1.32 At present, if an insured is a body corporate which is dissolved under section 1001, 1002 or 1003 of the Companies Act 2006 it becomes a relevant person (see section 6(1)(b) of the 2010 Act). However, there are several legislative mechanisms which can be used to dissolve a corporate body (see Para 86 of schedule B1 of the Insolvency Act 1986).

1.33 We consider that the dissolution of a body corporate is a situation in which a transfer of rights should occur. For this reason, we would suggest that the power is used to draft a regulation which refers to the dissolution of a body corporate in general terms. This would include the full range of corporate bodies, including not only companies but also, for example, Limited Liability Partnerships and Charitable Incorporated Organisations.[4]

### The dissolution under UK law of an unincorporated association

1.34 It would not be right to include all dissolved partnerships within the 2010 Act as technically a partnership dissolves each time a new partner leaves or is added. This would extend the scope of the legislation too widely as many such partnerships would be going concerns. In the case of a partnership which is no longer trading, the insured would need to proceed against the individual partners.

[4] See Limited Liability Partnership Act 2000, section 1(2) and Charities Act 2011, section 205.

1.35 However, any dissolved unincorporated association will have lost effective power and control over their assets, and will therefore fall within the scope of the policy.

1.36 Clearly an unincorporated association would only fall within the 2010 Act if it incurs a liability. This is rare, but not unknown. In particular statute provides that trade unions and friendly societies may incur liabilities even though they are unincorporated associations.[5] As the law develops, other forms of unincorporated association may also be able to incur liabilities.[6]

**Consequential amendments to assistance provisions**

1.37 The 2010 Act also helps third party claimants where the insured cannot provide information to a claimant or assist the insurer with the claim because it is dissolved. The list of circumstances in which this provision applies is too restrictive, as it relies on a narrow definition of dissolved.

1.38 We would suggest that the regulations should extend these provisions so that they apply whenever a corporate body or unincorporated association has been dissolved. Otherwise, a third party prejudiced by the dissolution of a corporate body or unincorporated association may not be able to obtain the necessary information to substantiate their claim. Nor would they gain the assistance of the 2010 Act should the insurer argue that it is not liable under the policy because the defunct insured has failed to co-operate with it.

**Sectoral administration procedures**

1.39 Sectoral administrations are special insolvency procedures tailored for particular sectors. For instance, they provide additional protections in sectors where company failure has the potential to damage public interest or cause market contagion (for example, financial services, postal or energy companies). The legislative enactments that create sectoral administrations are distinct from the Insolvency Act 1986, though they largely mirror its provisions. There is no policy justification for why they should be left out the scope of the 2010 Act. We suggest that the regulation should add the 19 sectoral administration provisions listed in Appendix A as qualifying events.

[5] See the Trade Union and Labour Relations (Consolidation) Act 1992 and Friendly Societies Act 1974.

[6] See N Stewart, N Campbell, S Baughen, *The Law of Unincorporated Associations* (1st ed, 2011, para 4.30) for a discussion of how creditors can proceed directly against the association's assets through subrogation.

# APPENDIX A: LIST OF SECTORAL ADMINISTRATIONS TO BE ADDED TO THE 2010 ACT

| ***Sectoral administration*** | ***Jurisdiction*** |
|---|---|
| A bank insolvency under Part 2 of the Banking Act 2009 | England and Wales, Scotland or Northern Ireland |
| A bank administration under Part 3 of the Banking Act 2009 | England and Wales, Scotland or Northern Ireland |
| An investment bank special administration under regulation 1-27 of the Investment Bank Special Administration Regulations 2011/245 | England and Wales, Scotland or Northern Ireland |
| A special administration (bank insolvency) under schedule 1 of the Investment Bank Special Administration Regulations 2011/245 | England and Wales, Scotland or Northern Ireland |
| A special administration (bank administration) under schedule 2 of the Investment Bank Special Administration Regulations 2011/245 | England and Wales, Scotland or Northern Ireland |
| A financial market infrastructure administration under Part 6 of the Financial Services (Banking Reform) Act 2013 | England and Wales, Scotland or Northern Ireland |
| A building society administration under the Building Society Special Administration (England and Wales) Rules 2010/2580 | England and Wales |

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|---|---|
| An administration made in relation to a building society under Part 2 of the Insolvency Act 1986 (as it has effect by virtue of section 249 of the Enterprise Act 2002) | England and Wales or Scotland |
| A postal administration made under Part 4 of the Postal Services Act 2011 | England and Wales, Scotland or Northern Ireland |
| An energy administration made under Chapter 3 of Part 3 of the Energy Act 2004 | England and Wales or Scotland |
| An energy supply company administration made under Chapter 5 of Part 2 of the Energy Act 2011 | England and Wales or Scotland |
| A special administration made under Chapter 2 of Part 3 of the Water and Sewerage Services (Northern Ireland) Order 2006 (S.I. 2006/3336 (N.I. 21)) | Northern Ireland |
| An energy administration made under Part 2 of the Energy Act (Northern Ireland) 2011 (c. 6 (N.I.)) | Northern Ireland |
| An administration made in relation to a building society under Part 3 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19)) (as it has effect by virtue of article 4 of the Insolvency (Northern Ireland) Order 2005 (S.I. 2005/1455) (N.I. 10)) | Northern Ireland |
| A railway administration made under Part 1 of the Railways Act 1993 | England and Wales or Scotland |
| An air traffic administration order made under Chapter 1 of Part 1 of the Transport Act 2000 | England and Wales, Scotland or Northern Ireland |
| A health special administration made under Chapter 5 of Part 3 of the Health and Social Care Act 2012 | England and Wales or Scotland. |
| A special administration order made under Chapter 2 of Part 2 of the Water Industry Act 1991 | England and Wales |
| A PPP administration made under Chapter 7 of Part 4 of the Greater London Authority Act 1999 | England and Wales or Scotland |