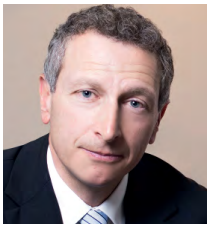
INSURERS' LIABILITY TO THIRD PARTIES: *CGU INSURANCE LIMITED v BLAKELEY & ORS*



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By Anthony Lo Surdo SC

At issue in *CGU Insurance Limited v Blakeley & Ors* [2016] HCA 2 (11 February 2016) was whether the liquidator of a company was entitled to join an insurer to proceedings for the purpose of seeking a declaration that a professional indemnity policy responded to an insolvent trading claim against a former director and a former shadow director. The resolution of this issue, in turn, depended upon whether there was a 'justiciable controversy' as between the liquidator and the insurer.

Background facts

The second respondent, Akron Roads Pty Ltd ('**the company**') was placed into voluntary administration in February 2010, with the first respondents being appointed as liquidators in March 2010.

The liquidators commenced proceedings in the Supreme Court of Victoria against a former director, Mr Crewe and a former shadow director Crewe Sharpe Pty Ltd ('**Crewe Sharp**', which was Mr Crewe's consultancy company), alleging insolvent trading in breach of s 588G of the *Corporations Act 2001* (Cth) ('**the Act**'), and an order under s 588M(2) of that Act that the directors pay as a debt due to the company, an amount equal to any resultant loss or damage suffered by the creditors of the company.

The directors lodged a claim with the appellant, CGU Insurance Ltd ('**CGU**'), under their professional indemnity policy. The indemnity claim was denied on the basis that the liability asserted by the directors was not covered by the policy. The directors did not challenge CGU's denial. Crewe Sharp went into liquidation and whilst not bankrupt, Mr Crewe did not have the means to meet any potential judgment awarded against him.

During the interlocutory stages of the proceedings, the liquidators applied to the Court to join CGU as a defendant and to amend the statement of claim to include a declaration that CGU was liable to indemnify the directors under the policy, in respect of the claims made in the proceedings. In support of their claim for a joinder and declaration, the liquidators argued that they had sufficient interest in the determination of CGU's liability, relying on s 562 of the Act, which provides:

Snapshot

- The judgment broadens the circumstances in which a liquidator may seek to challenge determinations made by insurers to deny liability under policies of insurance to which the company in liquidation is not a party and where the policy may inure for the benefit or potential benefit of creditors.
- The bringing of such proceedings does not offend the doctrine of privity of contract.
- The decision has obvious important ramifications for the Australian insurance industry.

'Application of proceeds of contracts of insurance

1. Where a company is, under a contract of insurance (not being a contract of reinsurance) entered into before the relevant date, insured against liability to third parties, then, if such a liability is incurred by the company (whether before or after the relevant date) and an amount in respect of that liability has been or is received by the company or the liquidator from the insurer, the amount must, after deducting any expenses of or incidental to getting in that amount, be paid by the liquidator to the third party in respect of whom the liability was incurred to the extent necessary to discharge that liability, or any part of that liability remaining undischarged, in priority to all payments in respect of the debts mentioned in section 556.
2. If the liability of the insurer to the company is less than the liability of the company to the third party, subsection (1) does not limit the rights of the third party in respect of the balance.
3. This section has effect notwithstanding any agreement to the contrary.'

At first instance, the primary judge made the orders sought. CGU's appeal to the Court of Appeal was dismissed. CGU then sought special leave to appeal to the High Court. Leave was granted for the determination of the following questions:

1. The Supreme Court did not have jurisdiction to effect the joinder and to grant declaratory relief, where the directors were not in a position to pursue any claim against CGU arising from the insurance contract between them; and
2. There was no justiciable controversy between CGU and the liquidators, there thus being no 'matter' on which to found federal jurisdiction.

The decision of the HCA

In dismissing the appeal, the High Court held that there was a justiciable controversy between CGU and the liquidators, and the latter's claim for relief fell within federal jurisdiction exercisable by the Supreme Court of Victoria.

Did the federal jurisdiction vested in the Supreme Court of Victoria authorise it to determine a claim for a declaration, by a plaintiff against a defendant's insurer, that the insurer is liable to indemnify the defendant?

CGU submitted that the primary judge had erred in law in joining it as a defendant to the proceedings 'because courts have no jurisdiction at the suit of a stranger to grant declaratory

relief as to the meaning and effect of a private contract between parties who will not pursue any claim relating to rights or duties under that contact.' In effect, CGU's primary contention was that s 562 of the Act did not create any substantive third-party rights in a contract of insurance and that therefore the Court lacked jurisdiction to make the award the relief sought.

The High Court accepted that the validity of the declaration was contingent upon establishing that the Supreme Court had jurisdiction with respect to the matter. The plurality (French CJ, Kiefel, Bell and Keane JJ) noted that the Supreme Court of Victoria, like all superior courts, possesses 'inherent power to grant declaratory relief' (at [13]), citing s 50 of the *Chancery Procedure Act 1852*:

'A proceeding is not open to objection on the ground that a merely declaratory judgment is sought, and the Court may make binding declarations of right without granting consequential relief.'

It found that the exercise of power conferred on a superior court to grant a joinder is based on the premise that that court has jurisdiction with respect to the proceedings 'so far as they relate to the party to be joined'. In the event that the court is exercising federal jurisdiction, that jurisdiction is derived from s 79 of the *Judiciary Act 1903* (Cth), which provides:

'(1) The laws of each State or Territory, including the laws relating to procedure, evidence, and the competency of witnesses, shall, except as otherwise provided by the Constitution or the laws of the Commonwealth, be binding on all Courts exercising federal jurisdiction in that State or Territory in all cases to which they are applicable ...'.

The Court accordingly concluded that the question raised by the liquidator is one within the subject matter of federal jurisdiction.

Was there a justiciable controversy between the liquidators and CGU?

Having established that the claims against CGU brought by the liquidators involved a question arising under a law of the Commonwealth, the question upon which the appeal would turn was whether there was a justiciable controversy between the parties. As a corollary, the question of justiciability also gave rise to the question of whether the court could make a declaration in favour of the liquidators, in respect of an insurance policy to which Akron (the company in liquidation) was not a contractual party.

The Court noted that s 562 of the Act does not confer upon a claimant, any right of action against a defendant's insurer (with any right under s 117 of the *Bankruptcy Act* arising in a claim against Mr Crewe also being 'hypothetical and contingent' (at [51]).

However, the Court held that in the event that Crewe Sharp had made a claim against CGU, the denial of which was accepted by neither Mr Crewe nor Crewe Sharp, it was enough to constitute a 'sufficient' interest that created a justiciable controversy between the liquidators and CGU. The liquidators' claim was not dependent upon an incursion upon the principles of either contract law or privity of contract, but rather the legal consequence created by:

1. Section 562 of the Act, in the event that CGU is liable to indemnify Crewe Sharp; and
2. Section 117 of the *Bankruptcy Act*, in the event that CGU is liable to indemnify Mr Crewe and he becomes bankrupt.

That legal consequence was characterised by the plurality of the Court as follows (at [67]):

'... That legal consequence would be the bringing into existence, in favour of the Akron liquidators, of a right to the proceeds of the insurance policy payable to Crewe Sharp in respect of its liability to Akron. The interest upon which the claim for declaratory relief is based and CGU's denial of liability under the policy are sufficient to constitute a justiciable controversy between the Akron liquidators and CGU involving a question arising under a law of the Commonwealth. Because of these statutory provisions, it is the Akron liquidators who stand to benefit (to the exclusion of Crewe Sharp and Mr Crewe) from the making of the declaration sought. It would be distinctly to ignore this reality if the liquidators' interest in this regard could be defeated by reason of inaction on the part of Crewe Sharp and Mr Crewe against CGU given that the statutory provisions themselves deprive Crewe Sharp and Mr Crewe of all incentive to pursue a claim under the policy.'

Conclusion

This judgment has, at least in the limited area of claims available to liquidators, broadened the circumstances in which a liquidator may seek to challenge determinations made by insurers to deny liability under policies of insurance to which the company in liquidation is not a party and where the policy may inure for the benefit or potential benefit of creditors.

It provides yet a further circumstance in which an insurer may have direct accountability in respect of insolvent insureds to third parties. (See also the direct right of action conferred on third party claimants by section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946* (Cth) and its analogues in New South Wales (*Law Reform (Miscellaneous Provisions) Act 1946* (NSW), Northern Territory (*Law Reform (Miscellaneous Provisions) Act 1956* (NT) and Australian Capital Territory (*Civil Law (Wrongs) Act 2002* (ACT); and *Selig v Wealthsure Pty Ltd* [2015] HCA 18 where an insurer of an unsuccessful, impecunious defendant was ordered to pay the third party claimant's legal costs).

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