INSURERS BOUND UNDER 2010 ACT BY DEFAULT JUDGMENTS AGAINST POLICYHOLDERS

SCOTLAND GAS NETWORK PLC v QBE UK Ltd and others [2024] CSIH 36

Summary:

Third parties' rights against insurers have become more straightforward to enforce where the third party has default judgment against the policyholder. This decision of the Inner House, on reclaiming (appeal proceeding from) a decision of the commercial judge, confirms that if a third party obtains a default judgment against a policyholder the Third Parties (Rights against Insurers) Act 2010 does not permit insurers to dispute the policyholder's liability under that judgment to the third party. Comity requires that this decision should be accepted in England and Wales up to and including the level of the Court of Appeal.

BACKGROUND

The case revolves around a gas pipeline owned by Scotland Gas Networks Plc ("Scotland Gas") the integrity of which was alleged to have been harmed by quarrying operations by Skene, a company.

Key Events

1. **Damage Discovery**: In 2011, an aerial inspection revealed a landslip at Cowdenhill Quarry, which was leased and operated by Skene. Skene's blasting work had fractured the rock around Scotland Gas's pipeline. The quarry face was close to collapse, which would have caused the pipeline to buckle and rupture. Scotland Gas carried out expensive remedial works.

2. **Action against Skene**: In 2015, Scotland Gas initially sued Skene for £3,000,000 in damages. Skene went into liquidation in 2017. A decree (final judgment) by default

was granted against Skene for the full amount and there was no attempt to reclaim (appeal) or reduce (set aside) the decree.

3. **Declinature and Insurers' conduct**

Skene's public liability insurers, QBE and others ("QBE"), were notified of the claim but chose to decline cover to Skene. QBE initially assumed conduct of Skene's defence but opted not to maintain it. There was also a lack of clarity regarding which insurer was on risk at the relevant time.

4. **Current Action**: Scotland Gas now seeks to recover the damages from Skene's insurers under the 2010 Act**.** Among the issues raised by insurers was the question whether, in such proceedings, insurers could dispute the liability of Skene, the policyholder, to Scotland Gas. That question was whether the liability of Skene was "established" within the meaning of section 1(4) of the Act. It was held in the Outer House that it was, and that decision was upheld in the Inner House.

The 2010 Act: The 2010 Act was enacted following a joint report from the Law Comissions (Law Com no, 272; Scots Law Com no. 184), and its main purpose was to enable a third party to issue proceedings against an insurer without having first established the liability in proceedings against an insolvent policyholder. It remains the case, however, that the third party can establish liability in a claim against the policyholder first.

Section 1 reads [emphasis ours]

1 Rights against insurer of insolvent person etc

(1) This section applies if—

(a) a relevant person incurs a liability against which that person is insured under a contract of insurance, or

(b) a person who is subject to such a liability becomes a relevant person.

(2) The rights of the relevant person under the contract against the insurer in respect of the liability are transferred to and vest in the person to whom the liability is or was incurred (the "third party").

(3) The third party may bring proceedings to enforce the rights against the insurer without having **established** the relevant person's liability; but the third party may not enforce those rights without having **established** that liability.

(4) For the purposes of this Act, a liability is **established** only if its existence and amount are **established**; and, for that purpose, **"establish"** means **establish**—

(a) by virtue of a declaration under section 2 or a declarator under section 3,

(b) by a judgment or **decree**,

(c) by an award in arbitral proceedings or by an arbitration, or

(d) by an enforceable agreement.

(5) In this Act—

(a) references to an "insured" are to a person who incurs or who is subject to a liability to a third party against which that person is insured under a contract of insurance;

(b) references to a "relevant person" are to a person within sections 4 to 7 (and see also paragraph 1A of Schedule 3);

(c) references to a "third party" are to be construed in accordance with subsection (2);

(d) references to "transferred rights" are to rights under a contract of insurance which are transferred under this section.

Issues before the Court

1. **Establishment of Liability**: The court had to determine whether the decree by default against Skene established liability for the purposes of the 2010 Act.

2. **Insurance Coverage**: The insurers argued that the liability established by the decree did not fall within the scope of their policies, which excluded pure financial loss.

The Inner House Decision

1. **Decree by Default**: The court held that the decree by default did establish Skene's liability to Scotland Gas under the 2010 Act. A judgment or decree by default established both the existence and amount of liability.

2. It is submitted that the essential point is the rejection of the insurers' arguments that, firstly, section 1(4) of the Act was not necessarily determinative of whether a liability existed for the purposes of section 1(1) and, secondly, the word "established" involved consideration by the authority publishing the decree (or equivalent) of the merits of the dispute between the third party and the policyholder. Although this submission was based on decisions made before the Act came into force, and was argued to be supported by language of the Law Commissions (in section 3 of their report, we suppose), the Inner House noted that the wording of the Act provided no support for such a restriction, and that such a restriction might give rise to uncertainty (see, principally, paragraph 38). The conclusion was that a default decree (judgment) did establish a liability for the purposes of section 1(1).

3. **Remaining Issues**: the case will proceed to trial to determine the distinct issue whether the losses claimed are a risk covered by the insurance policies such that Scotland Gas acquired rights of Skene as against one or more of the insurers which it can enforce. The test is whether there is a "liability against which that person is insured": s1(1)(a) of the 2010 Act. Insurers argue that the risk was in fact pure economic loss and was therefore excluded under Skene's public liability policies: thus it will be argued that although Skene is liable to Scotland Gas the particular liability is not insured.

Effect of decision for English claims

The decision of the Court of Session should be followed in English courts applying the 2010 Act. Although decisions from Scotland are not regarded as technically binding in England and Wales, this decision on interpretation of a statute should be treated as authoritative at Court of Appeal level. Given that the statute is derived from the work of the two Law Commissions it should be inconceivable that the Courts of the two jurisdictions – or, indeed the Courts of Northern Ireland, to which that Act also applies – should interpret it differently. Texts note that Lord Reid said in *Abbott v Philbin* [1961] A.C. 352 (at p.373) that:

> "In the present case the Court of Appeal, though not bound to do so, very properly followed the decision of the Court of Session in *Forbes's Trustees v. Inland Revenue Commissioners*. … I say very properly, because it is undesirable that there should be conflicting decisions on revenue matters in Scotland and England."

The same principle applies to this statute, which is generally (and in all respects material to this decision) applicable throughout the United Kingdom, and very carefully identifies the few instances in which the law of Scotland is to differ from that elsewhere: see section 21(3) and (4).

How will this decision impact insurers?

On the court's interpretation, when a default judgment, including one for a quantified sum, is given against a policyholder the insurer will not be able to contest the policyholder's liability under the judgment without (as noted by the Court of Session) taking steps to have the judgment set aside. The insurer may, of course, have other rights which enable it to defeat the third party's claim against the insurer, but if it wants to contest the policyholder's liability (and quantum) as against the third party it needs to step in to the proceedings between those parties at an appropriate stage and see that that contest takes place. This may be a difficult commercial decision.

How will this decision impact third party claimants?

Third party claimants may breathe a sigh of relief in this case. Despite the chosen course involving two proceedings, there was value in obtaining default judgment against the policyholder because it reduced the issues before the court in the QBE dispute. While the 2010 Act is designed to short-circuit this process, the decision provides certainty that default judgment is sufficient to establish a policyholder's liability to the third party.

What could happen next?

The Court of Session noted that in the Second Supplement to the 15th edition of MacGillivray on Insurance Law (March 2024), a new paragraph to paragraph 28-026 of the principal work referred to the decision of the commercial judge in this case and submitted that the commercial judge's conclusion must be open to doubt on the basis of the pre-2010 case law. It may therefore be that the Inner House decision is controversial, but it is authoritative. At the time of writing we do not know whether the insurers will seek to appeal to the Supreme Court.

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