REFORM OF ENGLISH LAW – DAMAGES FOR LATE PAYMENT OF INSURANCE CLAIMS

A case decided in the late 1990's, Sprung v Royal Insurance [1999] 1 Lloyd's Rep IR 111, drew out for many the unfairness of a longstanding rule of English insurance law. Mr Sprung's business premises were wrecked by vandals. He had cover for this type of loss and claimed under his insurance. The insurers delayed their decision and finally denied coverage. Mr Sprung sued for an indemnity. Meanwhile, in the absence of the insurance proceeds, he was unable to raise sufficient funds to effect the repairs. At the time of taking out the insurance, he would have been able to sell the business for a substantial sum. However, in the absence of the insurance proceeds, the business failed.

After Mr Sprung had won his case against the insurers, he claimed damages for the financial loss he had suffered consequent upon their non-payment of the insurance claim. He failed, because such a claim is unavailable under English law.

What is the position under English law?

The analysis under English law is that, in the case of indemnity insurance, actions against insurers sound in unliquidated damages rather than in debt. In this context the word "damages" is used in an unusual sense: the insurer is regarded as promising, as a primary contractual promise, to hold the indemnified person harmless against the specific type of loss. Such a contract of indemnity gives rise to an action for unliquidated damages, arising from the failure of the indemnifier to prevent the indemnified person from suffering damage.

Thus, as soon as the loss has occurred, the primary obligation is broken, giving rise to a secondary obligation to pay damages. The insured has an immediate right to receive the indemnity, no prior demand being necessary, and no separate subsequent breach being constituted by the insurer's failure to respond immediately to the demand for payment. This reasoning leads to the conclusion that the insured cannot claim damages for late payment by the insurer, as that would be damages on damages.

Mr Sprung argued that, over and above the failure to indemnify, the insurers had breached the contract of insurance. This he characterised as the failure to respond promptly to his request that they inspect the premises and consider carrying out repairs forthwith. The court accepted that insurers had been under obligations of this nature. However, the court rejected Mr Sprung's claim for damages. This was because, in terms of causation, the financial loss occurred as the consequence of Mr Sprung's not proceeding with the

repairs, rather than from the insurers' breach of these obligations. It was irrelevant for these purposes whether Mr Sprung's non-repair of the property was voluntary or due to his financial circumstances.

Reform

Some years later, the Law Commission proposed to introduce damages for late payment of claims, along with a number of other reforms, in a Bill that was to become the Insurance Act 2015. However, this particular reform was considered too controversial to pass through parliament under the special procedure reserved for non-contentious Law Commission Bills. The clauses on late payment were therefore removed from the draft before the Bill was enacted, on the basis that they would be reintroduced at a suitable moment.

The Enterprise Bill, introduced by the government in September 2015, includes the late payment clauses omitted from the Insurance Act. If passed, and subject to any amendments, these clauses will insert two new sections into the Insurance Act 2015.

The clauses provide that it is to be an implied term of every insurance contract that claims are paid within a reasonable time of being submitted. A failure to meet this obligation can result in liability to pay damages. This is over and above the obligation to indemnify the policyholder under the insurance, and to pay interest where this is ordered.

The Bill provides guidance on what is a reasonable time. This may vary depending on the type of insurance, the size and complexity of the claim, compliance with relevant statutory or regulatory rules and factors outside the insurers' control. Insurers are expressly allowed a reasonable time "to investigate and assess the claim". Insurers will also have a defence if there are "reasonable grounds" for disputing the claim. Insurers will not be liable "while the dispute is continuing".

An insured's claim against an insurer for failure to pay a claim will be a separate cause of action from the policy claim itself, and will have its own separate limitation period.

Insurers can contract out of these provisions in non-consumer insurance contracts, provided certain requirements are satisfied.

The controversy

The Bill is backed by the UK Department for Business Innovation & Skills and the proposals may be underpinned by the perceived need to enhance confidence in the UK insurance industry by bringing it into line with other jurisdictions. The changes would bring English insurance law more into line with general

contract principles, Scottish law, the law as it applies to life insurance, Financial Ombudsman Service practice and various other civil and common law jurisdictions.

However, in its impact assessment, the government acknowledged that late payment by insurers of valid claims is relatively rare, meaning, for the most part, that insurers are already compliant with the proposed measure.

Meanwhile, insurers have expressed concern that the amendments will place them at an unfair disadvantage. Policyholders may be able to use the new rights to threaten to sue for damages if their claims are not paid immediately on demand. Conflicts could arise with duties owed to reinsurers. There is also a fear that complex satellite litigation could develop over an insurer's conduct in handling a claim. Insurers could be forced into paying unmeritorious claims and have to increase premiums as a result.

The changes may also give rise to exposure for professional advisers, for example in cases where the professionals advise that insurers have a good defence, but the defence is then rejected by the court.

Is it possible to predict how the reforms will work in practice? They will certainly support the insured's already-existing ability to claim interest. Whether the changes will make much difference beyond that may depend on the approach taken by the courts towards the issue of causation. The insured will still have to prove that he or she suffered actual financial loss and damage caused by the insurer's breach of the duty to pay within a reasonable time, as well as that the loss was foreseeable at the time the contract was entered into and that reasonable steps were taken to mitigate the loss. Insurers will still be able to defend themselves, as in Sprung, by saying that the insured's own non-repair of the damage breaks the chain of causation between the insurer's breach and any financial loss sustained by the insured.

Therefore, unless the courts proceed on the basis that the new provisions express a legislative intention to ease the burden of causation on the insured, the reforms seem likely to make a difference to the amount the policyholder can recover only on rare occasions.

The provisions are likely to come into force in 2017 and to apply to insurance contracts entered into after that date.