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Damages for Late Payment of Insurance Claims: A Satisfactory Solution?

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I. INTRODUCTION

Insurance underpins a prosperous economy by enabling businesses to protect themselves against risk.¹ The City of London is one of the world's leading insurance capitals, and insurance products and services are a crucial UK export.² Despite this, the law governing insurance contracts in England and Wales is not always favourable to the policyholders that make the insurance industry so successful.³ Guided by the need for a modern insurance law that more effectively balances the rights of insurers and the rights of the insured, English insurance law has been the subject of recent review and gradual transformation.⁴ One area of reform has been in relation to the late payment of claims by insurers. This paper begins by outlining the position at common law, which provided no additional remedy in damages where an insurer unreasonably refused to pay a claim or paid it only after unreasonable delay. A comparative assessment with the position in other common law jurisdictions is presented. The paper then sets out the arguments

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¹ Law Commission and Scottish Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, Scot Law Com No 238, 2014).

² Association of British Insurers, *UK Insurance & Long-Term Savings Key Facts* (2019).

³ Peter MacDonald Eggers, 'Late payment of insurance claims' (2013) 3 LMCLQ 341.

⁴ Law Commission and Scottish Law Commission, *Insurance Contract Law: A Joint Scoping Paper* (2006); Law Commission and Scottish Law Commission, *Insurance Contract Law: Analysis of Responses and Decisions on Scope* (2006); Robert Merkin and Ozlem Gurses, 'The Insurance Act 2015: rebalancing the interests of insurer and assured' (2015) 78 MLR 1004.

that led to reform, before outlining the new statutory provisions enacted under the Enterprise Act 2016. The paper concludes by assessing whether the current law is satisfactory, measured both in terms of its ability to protect policyholders and its coherence within a wider insurance law framework. A number of issues are identified that may limit the practical utility of the reforms in protecting policyholders or promoting change in insurance practices.

II. THE POSITION AT COMMON LAW

To understand the position at common law, the nature of an insurer's liability must first be examined. Most insurance contracts, other than life and personal accident insurance, are contracts of indemnity.⁵ The insured pays a premium to the insurer in return for the insurer's contractual promise to indemnify the insured should an insured event occur. Modern case law has characterised the insurer's promise to pay as a primary obligation to prevent the insured from suffering loss,⁶ with Lord Goff stating obiter in *The Fanti and The Padre Island* that the promise of indemnity in insurance contracts is "simply a promise to hold the indemnified person harmless against a specified loss or expense".⁷ It follows that an action for unliquidated damages for breach of contract arises upon occurrence of the loss. As such, a claim under an insurance contract is considered a claim for damages, and not a claim in debt.⁸

In many circumstances, the manner in which a claim is handled may be as important as the adequacy of the final settlement.⁹ An important consequence of categorising an insurance claim as a claim in damages for breach of contract, however, is that the insured has no additional cause of action where an insurer unreasonably refuses to pay a claim or pays it only after unreasonable delay, even where this has resulted in financial detriment to the insured. This stems from the well-established principle that damages are not awarded for late payment of damages.¹⁰ The insured's entitlement was thereby limited to the value under the claim plus a discretionary award of interest under section 35A of the Senior Courts Act 1981.

⁵ Franziska Arnold-Dwyer, 'Insurance law reform by degree: late payment and insurable interest' (2017) 80 MLR 489.

⁶ Neil Campbell, 'The nature of an insurer's obligation' (2000) 1 LMCLQ 42.

⁷ *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti)*; *Socony Mobil Oil Co Inc v West of England Shipowners Mutual Insurance Association (London) Ltd (The Padre Island) (No 2)* [1991] 2 AC 1, 35.

⁸ *F&K Jabbour v Custodian of Israeli Absentee Property* [1954] 1 WLR 139; *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep 281.

⁹ Marion Egan, 'Insurer's duty to pay' (1998) 6 Int ILR 166.

¹⁰ *President of India v Lips Maritime Corp (The Lips)* [1988] AC 395.

The practical problems with this legal position and the harshness of the rule, as admitted by the Court of Appeal who reached their decision “with undisguised reluctance”,¹¹ were illustrated by the leading case, *Sprung v Royal Insurance (UK) Ltd*.¹² The facts of the case were uncomplicated, and concerned damage to insured business premises and machinery.¹³ Sprung, the insured, brought a claim for damages for late payment after his insurers initially denied liability on what proved to be spurious grounds and payment of the indemnity was withheld for three-and-a-half years. Sprung lacked the necessary financial resources and had been unable to raise a loan to fund essential repairs in the intervening period. His claim was for consequential loss and was intended to provide compensation for the fact he was out of pocket for so long that his business collapsed, quantified at £75,000 by reference to the value of the lost opportunity for sale. The Court of Appeal however, as a matter of law, had little difficulty dismissing the claim. Sprung was compensated by a payment of interest only. The same authorities had previously led Hirst J in *The Italia Express* to dismiss a claim for damages resulting from late payment under a marine insurance policy.¹⁴

In *Sprung*, the Court of Appeal suggested that breach of a separate contractual obligation may render the insurer liable in damages.¹⁵ This left open the possibility that, where an insurance policy contained a term requiring the insurer to pay within a reasonable time, damages may be available for breach of that specific term. The courts, however, subsequently rejected the argument that insurance policies contain an implied term requiring insurers to assess and pay claims with reasonable diligence and due expedition. As expounded by Mance J, as he then was, in *Insurance Corporation of the Channel Islands Ltd v McHugh*, a term will not be implied “unless it is necessary to give the contract business efficacy or represents the obvious, although unexpressed, intention of the parties. Mere reasonableness or convenience is not sufficient”.¹⁶ In *Tonkin v UK Insurance Ltd*, the courts went further still; no contractual obligation was imposed on insurers to act quickly despite the policy appearing to include an express term to that effect.¹⁷

III. ARGUMENTS FOR REFORM

Although the ruling in *Sprung* was based on sound legal reasoning, that

¹¹ *Sprung v Royal Insurance (UK) Ltd* [1997] CLC 70, 79.

¹² *Sprung v Royal Insurance (UK) Ltd* [1997] CLC 70.

¹³ John Birds, ‘No damages remedy when insurers unjustifiably repudiate liability’ (1997) JBL 368.

¹⁴ *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd’s Rep 281.

¹⁵ *Sprung v Royal Insurance (UK) Ltd* [1997] CLC 70.

¹⁶ *Insurance Corporation of the Channel Islands Ltd v McHugh* [1997] LRLR 94, 136.

¹⁷ *Tonkin v UK Insurance Ltd* [2006] EWHC 1120 (TCC).

damages were not recoverable from an insurer who unjustifiably delayed payment was a result that attracted widespread criticism.¹⁸ As a compensatory remedy, an award of simple interest alone is clearly inadequate in serious cases. As Egan notes, it is unlikely to compensate for lost profits and business opportunities or even the compound interest paid on borrowed funds.¹⁹ The law governing insurance contracts must balance fairly the rights of insurers and the rights of the insured. While the law should seek to protect insurers in light of their contribution to the UK economy,²⁰ Al-Asady argues that it is especially important to protect the rights of the insured who, as a result of the insured event, are already placed in a vulnerable position.²¹ In such circumstances the effect of the insured event on the business impacts credit and makes it difficult or expensive to borrow money pending payment by the insurer.²²

The decision in *Sprung* tipped the balance of protection in favour of the insurer at the expense of the insured. It prejudiced the impecunious insured who had suffered hardship as a result of their inability to afford necessary remedial work, inability to obtain funding, or unwillingness to incur such liability where there was no certainty of the insurance claim being met. This was particularly problematic for small businesses where the insured had neither the bargaining strength nor the resources to compete with an insurer.²³ As noted by Hirst J, it would be commercially inconceivable to require insurers to pay large, complex claims immediately and without investigation as to validity or value.²⁴ There was, however, a perception among policyholders that there was often unreasonable delay, and moreover that insurers benefitted from its use as a bargaining tactic to negotiate lower settlements and to encourage business interruption insurance.²⁵ The failure of the law to require prompt payment or to provide a remedy in its absence arguably frustrated the purpose of insurance. Judicial criticism surfaced in the judgment in *Sprung* itself, where Beldam LJ argued that the inadequacy of the

¹⁸ Janan Al-Asady, 'Damages, late payment and indemnity insurance' (2006) JBL 396; Colin Ying, 'Damages for late payment of insurance claims' (2006) 122 LQR 205; Malcolm Clarke, 'Late payment of insurance money' (2012) 5 ELR.

¹⁹ Marion Egan, 'Insurer's duty to pay' (1998) 6 Int ILR 166.

²⁰ Association of British Insurers, *UK Insurance & Long-Term Savings Key Facts* (2019).

²¹ Janan Al-Asady, 'Damages, late payment and indemnity insurance' (2006) JBL 396.

²² Malcolm Clarke, 'Late payment of insurance money' (2012) 5 ELR.

²³ John Birds, 'No damages remedy when insurers unjustifiably repudiate liability' (1997) JBL 368.

²⁴ *Ventouris v Mountain (The Italia Express) (No 3)* [1992] 2 Lloyd's Rep 281.

²⁵ Marion Egan, 'Insurer's duty to pay' (1998) 6 Int ILR 166.

compensation highlighted the need for insurance law reform.²⁶

The position under English common law strikes a discord with the approach of other common law jurisdictions. Under Scots law, an insurance claim is not considered to be damages for breach of an obligation to hold the insured harmless. Instead, the insurer has an implied contractual obligation to pay a sum of money equivalent to the insured's loss after a reasonable period for investigation.²⁷ If the insurer breaches this obligation through unjustifiable delay in payment or wrongful repudiation of the claim, it may be held liable for damages subject to ordinary contract law principles; where one party breaches a contractual term, the innocent party may claim damages for actual loss suffered as a result, provided it was reasonably foreseeable at the time the contract was made.²⁸ This is subject to three main limitations: the claimant must prove actual financial loss; the claimant should take reasonable steps to mitigate;²⁹ and damages may be limited by express provisions of the contract. A similar position has been adopted in Australia, Canada and the United States, where the law recognises a right to recover damages for late payment. Damages have been awarded for consequential losses that include money paid out servicing interim loans,³⁰ loss of profit,³¹ loss of opportunity,³² and distress and inconvenience.³³ All jurisdictions offered greater protection for policyholders.

Insurance under English law is governed by private law whereas other jurisdictions consider it a matter of public law with decisions made in the public interest.³⁴ In such jurisdictions damages for late payment may also be available under the insurer's duty of good faith.³⁵ In Australia, good faith is considered an implied term in insurance contracts;³⁶ where breached, it gives rise to an action for contractual damages. In some states of the United States a lack of good faith

²⁶ *Sprung v Royal Insurance (UK) Ltd* [1997] CLC 70, 80.

²⁷ *Scott Lithgow Ltd v Secretary of State for Defence* 1989 SC (HL) 9; *Strachan v Scottish Boatowners' Mutual Insurance Association* 2010 SC 367.

²⁸ *Hadley v Baxendale* (1854) 9 Ex 341; *Margrie Holdings Ltd v City of Edinburgh District Council* 1994 SC 1.

²⁹ *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd (No 2)* [1912] AC 673.

³⁰ *Moss v Sun Alliance Australia Ltd* (1990) 55 SASR 145; *Tropicus Orchids Flowers and Foliage Pty Ltd v Territory Insurance Office* (1998) 148 FLR 441.

³¹ *Reichert v General Insurance Co* (1967) 428 P 2d 860 (Cal); *Brescia Furniture Pty Ltd v QBE Insurance (Australia) Ltd* [2007] NSWSC 598.

³² *Highway Hauliers Pty Ltd v Maxwell* [2012] WASC 53.

³³ *Warrington v Great-West Life Assurance Co* (1996) 24 BCLR (3d) 1.

³⁴ Janan Al-Asady, 'Damages, late payment and indemnity insurance' (2006) JBL 396.

³⁵ *Moss v Sun Alliance Australia Ltd* (1990) 55 SASR 145; *Ontario Inc v Non-Marine Underwriters, Lloyd's of London* [2000] OJ No 866; *Beck v Farmers Insurance Exchange* (1985) 701 P 2d 795 (Utah).

³⁶ Insurance Contracts Act 1984, s 13.

may also be considered a tort, giving rise to damages on a more generous scale,³⁷ while the Canadian courts have recognised that punitive damages may be awarded exceptionally to act as a deterrent and as retribution for insurers who have acted maliciously or oppressively.³⁸ The limited availability of a tortious remedy for pure economic loss³⁹ and the rejection by the House of Lords in *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* of the availability of damages where an insurer breaches its duty of good faith⁴⁰ precluded the possibility of similar developments in the English courts.

Despite the strength of the arguments advanced that English insurance law should do more to protect the insured by recognising a claim for consequential losses arising from late payment, reform at common law was hindered by the well-established doctrine of precedent. There is a long line of authority in favour of the traditional stance.⁴¹ As Birds notes, as a matter of strict law, unless and until the Supreme Court re-examines the view of insurance indemnities as damages for breach of contract, an act of significant judicial activism, the decision in *Sprung* seems unimpeachable.⁴²

In the face of the common law's inflexibility and slowness in adapting to the challenges of modern commercial practice, the issue of damages for late payment was identified by the English and Scottish Law Commissions as an area ripe for legislative intervention. In a 2010 Issues Paper and subsequent 2011 Consultation Paper, the Law Commissions reviewed in detail the question of whether a policyholder should be entitled to claim damages from their insurer for the late or non-payment of a valid insurance claim.⁴³ The Law Commissions, having analysed the existing law and recapitulated the judicial and academic criticism, identified four key reasons for reform.

First, the law lacked principle. When compared with the general principles and contemporary developments of English contract law,⁴⁴ the rule preventing

³⁷ John Lowry and Philip Rawlings, 'Insurers, claims and the boundaries of good faith' (2005) 68 MLR 82.

³⁸ *Whiten v Pilot Insurance Co* [2002] 1 SCR 595.

³⁹ *Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd* [1973] QB 27.

⁴⁰ *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1991] 2 AC 249.

⁴¹ Marion Egan, 'Insurer's duty to pay' (1998) 6 Int ILR 166.

⁴² John Birds, 'No damages remedy when insurers unjustifiably repudiate liability' (1997) JBL 368.

⁴³ Law Commission and Scottish Law Commission, *Insurance Contract Law Issues Paper 6: Damages for Late Payment and the Insurer's Duty of Good Faith* (2010); Law Commission and Scottish Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Law Com CP No 201, Scot Law Com DP No 152, 2011).

⁴⁴ *Lagden v O'Connor* [2003] UKHL 64; *Sempre Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners* [2007] UKHL 34.

recovery of damages for late payment of an insurance claim appeared increasingly anomalous. The Law Commissions, in line with arguments established by Campbell,⁴⁵ expressed the view that the “hold harmless” doctrine and conception of the insurer’s primary obligation as a duty to prevent loss occurring was a complex, misconceived and counter-intuitive fiction that ignored the commercial reality of the insurance bargain.⁴⁶ The traditional view of indemnity is highly questionable as an insurer is in no position to actually prevent a specified peril from materialising,⁴⁷ and it is at odds with other authoritative pronouncements on the nature of contracts of property insurance.⁴⁸ Furthermore, it is unlikely to reflect the intentions or expectations of the parties.⁴⁹ One party pays another in return for a promise to indemnify by way of compensation should an insured loss occur, and insurance contracts are often worded as such.⁵⁰ Second, the law appeared unfair, being biased against the interests of policyholders and undermining trust and confidence in the insurance industry. Third, the law appeared to reward inefficiency and dishonesty by insurers, failing to incentivise good faith practice or efficient claims-handling. Fourth, the law may lead to injustice. Although the Financial Ombudsman Service can provide redress for some micro-businesses, it cannot assist businesses with more than ten employees or annual turnover over 2 million euros, provide damages of over £100,000, or deal with disputed oral evidence. The Law Commissions concluded that the case for reform was overwhelming.⁵¹

The Law Commissions identified two potential solutions in the 2010 Issues Paper.⁵² The first was to amend section 17 of the Marine Insurance Act 1906 so as to provide policyholders with damages where an insurer breached their post-contract duty of good faith by refusing to investigate, advancing spurious defences or delaying payment on a claim it knows to be valid. The second was a reversal of *Sprung*, in line with the strict liability approach adopted in other major common law jurisdictions, by recharacterising the insurer’s primary obligation as a duty to pay

⁴⁵ Neil Campbell, ‘The nature of an insurer’s obligation’ (2000) 1 LMCLQ 42.

⁴⁶ Law Commission and Scottish Law Commission, *Insurance Contract Law Issues Paper 6: Damages for Late Payment and the Insurer’s Duty of Good Faith* (2010).

⁴⁷ Lord Mance, ‘The 1906 Act, common law and contract clauses – all in harmony?’ (2011) 3 LMCLQ 346.

⁴⁸ Neil Campbell, ‘The nature of an insurer’s obligation’ (2000) 1 LMCLQ 42.

⁴⁹ *Transhene Packaging Co Ltd v Royal Insurance (UK) Ltd* [1996] LRLR 32.

⁵⁰ *Normhurst Ltd v Dornoch Ltd* [2004] EWHC 567 (Comm).

⁵¹ Law Commission and Scottish Law Commission, *Insurance Contract Law Issues Paper 6: Damages for Late Payment and the Insurer’s Duty of Good Faith* (2010).

⁵² *ibid.*

valid claims within a reasonable time. Following consultation with stakeholders, final recommendations in line with the second approach were formalised in a 2014 Report.⁵³ The incorporated late payment provisions were omitted from the Insurance Bill, having been regarded by the Government as insufficiently uncontroversial.⁵⁴ They were, however, included in the Enterprise Bill.

IV. A NEW STATUTORILY-IMPLIED RIGHT TO DAMAGES

There is now a statutorily-implied right to damages for late payment. The Enterprise Act 2016 inserted section 13A into the Insurance Act 2015;⁵⁵ it is now an implied term of every contract of insurance that if the insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time.⁵⁶ The concept of reasonable time includes a reasonable time to investigate and assess the claim, thus protecting the insurer's right to properly consider claims.⁵⁷ What is reasonable will depend on the relevant circumstances, but the statute provides a non-exhaustive list of factors that may be taken into account: the type of insurance; the size and complexity of the claim; compliance with any relevant statutory or regulatory rules or guidance; and factors outside the insurer's control.⁵⁸ The insurer has a defence for non-payment where it can show there were reasonable grounds for disputing the quantum or validity of a claim, although its conduct in handling the claim may nevertheless constitute a breach.⁵⁹ Thus, although recognising the need for robust decision-making where fraud or non-compliance with policy terms is suspected, insurers are not given carte blanche to prolong even genuine disputes unnecessarily.⁶⁰ Remedies, including damages, available for breach are in addition to and distinct from any right to enforce payment and any right to interest.⁶¹ As a result of legislative reform, therefore, an independent contractual obligation on the insurer has been introduced, breach of which would, in appropriate cases, allow the award of contractual damages in addition to the basic measure of an insured's loss.

⁵³ Law Commission and Scottish Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, Scot Law Com No 238, 2014).

⁵⁴ John Birds, *Birds' Modern Insurance Law* (11th edn, Sweet & Maxwell 2019).

⁵⁵ Enterprise Act 2016, s 28(1).

⁵⁶ Insurance Act 2015, s 13A(1).

⁵⁷ *ibid* s 13A(2).

⁵⁸ *ibid* s 13A(3).

⁵⁹ *ibid* s 13A(4).

⁶⁰ Andrew McGee, *The Modern Law of Insurance* (4th edn, LexisNexis 2018).

⁶¹ Insurance Act 2015, s 13A(5).

V. IS THE CURRENT LAW SATISFACTORY?

The late payment provisions offer a practical remedy to the insured who suffers loss as a result of late payment. At an academic level, such reform ultimately fails to strike at the heart of the debate by ignoring the deficiencies of the judicial analysis. The flawed premise that the insurer promises to hold the insured harmless is reinforced. Ying has argued that precedent should not be a tool for perpetuating error,⁶² while both Clarke and Al-Asady have argued that resolving the distinction between damages and debt for insurance payments is required to make the English jurisdiction more insured-friendly and better reflect commercial reality.⁶³ Characterisation as an action in debt would allow recovery of damages for non-payment or late payment under the court's common law jurisdiction. Legislative reform in this instance is fundamentally a workaround bound by the court's traditional view of insurance.

While it is important to ensure that insurers do not abuse their position of power, an effective law of insurance must strike a fair balance between the rights of insurers and the rights of the insured. In determining the efficacy of the statutory reform, the position of both parties to the insurance contract must be considered. Ostensibly, the availability of damages for late payment of claims is a welcome development. In practical terms, it alters the dynamic in negotiations for settlement of claims and alleviates the previous asymmetry generated by the insurer's ability to simply refuse to pay.⁶⁴ By incentivising prompt payment, it should also encourage insurers to review and, if necessary, adjust their claims-handling procedures to make the industry more efficient.⁶⁵ Despite this, many of the questions regarding the adequacy of the new legislation have been left unanswered as no proceedings have been brought since its introduction. A pragmatic concern was that speculative claims for damages are relatively easy to advance, but time-consuming and expensive to investigate.⁶⁶ Fears that reform would lead to the emergence of

⁶² Colin Ying, 'Damages for late payment of insurance claims' (2006) 122 LQR 205.

⁶³ Janan Al-Asady, 'Damages, late payment and indemnity insurance' (2006) JBL 396; Malcolm Clarke, 'Compensation for failure to pay money due: a "blot on English common law jurisprudence" partly removed' (2008) 4 JBL 291; Malcolm Clarke, 'Late payment of insurance money' (2012) 5 ELR.

⁶⁴ Robert Merkin, *Colinvaux's Law of Insurance* (12th edn, Sweet & Maxwell, 2019).

⁶⁵ Franziska Arnold-Dwyer, 'Insurance law reform by degree: late payment and insurable interest' (2017) 80 MLR 489.

⁶⁶ Lord Mance, 'The 1906 Act, common law and contract clauses – all in harmony?' (2011) 3 LM-CLQ 346.

increasing satellite litigation, however, have not materialised.⁶⁷

There are a number of issues that may ultimately reduce the practical impact of the new statutorily-implied right to damages for late payment of insurance claims. The first issue concerns the need for judicial interpretation and discretion in objectively determining what constitutes “reasonable time” for payment, which will differ considerably depending on the facts. There are no prescribed time-limits within which insurers are obliged to investigate, assess and pay claims in order to satisfy their duty. As such, unless and until seminal decisions of judicial determination are handed down, it will be difficult for insurers to redesign their standard internal business processes to ensure compliance. Jing points to developments in Chinese law, where the insurer’s primary obligation is to pay valid claims in a timely manner, as an example highlighting both the difficulties in practice caused by a flexible approach and the need to set clearly defined time-limits.⁶⁸ Given the judiciary’s historic unwillingness to side with the insured, in the face of such ambiguity the practical utility of the legislative reform as a remedy must be doubted.

Additionally, in court proceedings the burden of proof is placed on the insured. As a result of the implied duty’s contractual nature, following normal contractual principles the policyholder must prove to the satisfaction of the court that: their underlying claim was valid; the insurer was responsible for unreasonable delay; they suffered loss; the loss was foreseeable; the delay caused the loss; and they took reasonable steps to mitigate. The test of remoteness may preclude a number of claims for consequential loss, which must fall within one of two branches to be recoverable: losses arising naturally from the breach; or losses arising from special circumstances communicated when the contract was made.⁶⁹ Authorities from other common law jurisdictions provide some guidance on how the late payment provisions might operate. The Scottish experience has seen the test for foreseeable loss applied restrictively and suggests that the English courts will be restrained in awarding and measuring damages.⁷⁰ The Law Commissions, when promoting

⁶⁷ Law Commission and Scottish Law Commission, *Summary of Responses to Issues Paper 6: Damages for Late Payment and the Insurer’s Duty of Good Faith* (2010); Law Commission and Scottish Law Commission, *Summary of Responses to Second Consultation Paper: Post Contract Duties and Other Issues* (2012).

⁶⁸ Zhen Jing, ‘The insurer’s primary obligation to pay valid claims in a timely manner’ (2015) 1 JBL 37.

⁶⁹ *Hadley v Baxendale* (1854) 9 Ex 341.

⁷⁰ *Plews v Plaisted (No 1)* 1997 SLT 804.

reform, stated that they anticipated few successful cases.⁷¹ Furthermore, as asserted by the Lloyd's Market Association, *Sprung* itself would have been decided in the same way because the collapse of the business was not something that could reasonably have been contemplated by the insurer when the policy was taken out; the loss was not reasonably foreseeable at the time the contract was made.⁷² As such, it must be seriously questioned whether the new legislation even solves the problem as manifested in the paradigm case.

The third issue is the creation of uncertainty for insurers. Damages for late payment are not fixed in amount. The open-ended nature of the insurer's liability means that the quantum of damages may, alone or in conjunction with the sum owing under the policy, significantly exceed policy limits. The stability of the insurance market is dependent on insurers being incentivised to investigate claims and root out fraudulent or invalid claims.⁷³ This reform, however, may make it difficult for insurers to challenge claims or repudiate liability for fear of disproportionate economic consequences should their decision later be found to be incorrect and unreasonable. Additionally, while it may be argued that exposing insurers to uncertain additional risk and unrestricted liability is unfair, the impact on insurers' risk management and reserving policies may ultimately be detrimental for the insured too. Long-term, insurers may simply increase premiums to reflect their increased exposure and to compensate for difficulty in accurately calculating their contingent liabilities.⁷⁴

The final issue, and the most damaging to the reform's practical impact, is the ability in non-consumer insurance contracts under section 16A of the Insurance Act 2015 to contract out of the new regime.⁷⁵ A term excluding liability for late payment is only valid where the transparency requirements set out in section 17 of the Insurance Act 2015 have been satisfied,⁷⁶ and will have no effect where failure to pay within a reasonable time is deliberate or reckless.⁷⁷ While preserving freedom of contract between commercial parties, it is hard to envisage any situation

⁷¹ Law Commission and Scottish Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, Scot Law Com No 238, 2014) 266.

⁷² Special Public Bill Committee, *Insurance Bill* (HL 2014-15, 81) 41.

⁷³ Law Commission and Scottish Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, Scot Law Com No 238, 2014).

⁷⁴ Peter MacDonald Eggers, 'Late payment of insurance claims' (2013) 3 LMCLQ 341.

⁷⁵ Inserted by Enterprise Act 2016, s 29(1).

⁷⁶ Insurance Act 2015, s 16A(4).

⁷⁷ *ibid* s 16A(2).

in which an insurer would not automatically exclude or limit their liability to pay damages for late payment in all standard commercial insurance contracts. In insurance negotiations, freedom of contract is more apparent than real.⁷⁸ Given the noted inequality in bargaining power between insurers and the insured, there are likely to be very few companies in a position to resist such an exclusion when negotiating policy terms. Further, as argued by Arnold-Dwyer, insurers could make payment of a claim conditional upon the insured agreeing that such payment is in full and final settlement and that the insurer is discharged from any further liability, including in relation to late payment.⁷⁹ Claims settlement agreements, the terms of which are freely negotiable,⁸⁰ thereby provide an additional indirect escape route from the implied term. This effectively renders the reform nugatory and, as such, whether the protection benefitting the insured has been improved in any significant or meaningful way must be doubted.

VI. CONCLUSION

Reform in this area was intended to make English insurance law fairer, more effective and, as a result, more likely to be selected as the governing law for insurance contracts in a competitive international marketplace. The position at common law was clearly inadequate. Predicated on the “hold harmless” doctrine and the characterisation of insurance payments as damages for breach of contract, the insured was provided no additional cause of action where an insurer unreasonably refused to pay a claim or paid it only after unreasonable delay. This not only failed to reflect contemporary developments of English contract law but, as revealed by a comparative law approach, was unique amongst common law jurisdictions, all of which offered greater protection for policyholders. The practical problems with such a position are illustrated by the case of *Sprung v Royal Insurance (UK) Ltd*.⁸¹ Presented with strong arguments for reform, the Law Commissions identified the issue of damages for late payment as an area ripe for legislative intervention.

The provisions introduced by the Enterprise Act 2016 offer a potential remedy to the insured who suffers loss as a result of late payment. It is now an implied term of insurance contracts that insurers must pay valid claims within a reasonable

⁷⁸ Law Commission and Scottish Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, Scot Law Com No 238, 2014).

⁷⁹ Franziska Arnold-Dwyer, ‘Insurance law reform by degree: late payment and insurable interest’ (2017) 80 MLR 489.

⁸⁰ Insurance Act 2015, s 16A(6).

⁸¹ *Sprung v Royal Insurance (UK) Ltd* [1997] CLC 70.

time; where breached, policyholders may claim damages for consequential loss subject to normal contractual principles. Such reform was intended to alleviate injustice for policyholders, incentivise prompt payment and encourage efficient claims-handling. Yet the overall objective of the law in this area is to effectively balance the rights of both insurer and insured. This paper has identified four major concerns with the current law: the need for judicial determination of a “reasonable time” for payment; a restrictive application of the test for remoteness that may preclude a majority of claims; the creation of uncertainty and exposure to increased liability for insurers; and the ability in non-consumer insurance contracts and in claims settlement agreements to simply contract out of the new regime. Any fundamental reform of a relatively settled area of law will engender issues and uncertainties to be addressed by the courts, legal practitioners and the market. Given the concerns identified, however, the practical utility of the new legislation in providing a remedy to the insured who suffers loss as a result of late payment must be doubted. Furthermore, when considered against subsisting commercial and regulatory pressures to handle claims fairly, act with transparency and make payments promptly, it is unclear that the new late payment provisions will render any significant impact on insurers or their practices.