

BRITISH INSURANCE LAW ASSOCIATION

Lunchtime Lecture
Tuesday June, 8, 2010
David Hertzell
Law Commissioner





**Law
Commission**

Reforming the law



Scottish Law Commission

promoting law reform

INSURANCE CONTRACT LAW REFORM

**Post contractual duties and
damages for late payment**

Damages for Late Payment (Issue Paper 6)

- If an insurer delays payment causing the policyholder loss what compensation can the policyholder claim?
- Can the policyholder claim for all foreseeable losses caused by delay? If so on what basis?
Or.....
- Is the policyholder confined to interest on the original loss?
- English law follows the second option – sometimes!

Damages for delay – liability

- What is an insurer's obligation when loss occurs?
 - Life Insurance - To pay money due = debt
 - General Insurance - To prevent the loss occurring
 - Policyholder's remedy is therefore damages for breach of contract.

The legal principles

- General insurer is in breach of contract and liable for damages when loss occurs.
- Ss 67 & 68 MIA cap insurer's liability for loss under policy
- No liability for damages on damages
- No implied obligation to pay within reasonable time
- Insurer's "bad faith" – S17 MIA – avoidance only

- Is this what general insurers/insureds think?

(The Lips, Banque Keyser Ullman SA v Skandia, The Fanti and the Padre Island, The Italia Express(No.2) Sprung v Royal Insurance, Insurance Corporation of the Channel Islands v McHugh)



Limited remedy – English Law unique

- Insured's only effective remedy for loss caused by any delay is interest
- Position different in Scotland (and all other Common Law countries)
- Only general insurance – not life or brokers' PI
- Only money not reinstatement
- FOS - the “service element” – therefore not consumers
- Is the English position correct?
- Just theoretical? AIRMIC concern – restricted access to other finance = requirement for prompt payment.

The problem

- Law took strange route but.....
- Insurers have obligations to specific insured and.....
- Insurers have obligations to other insureds in risk pool
- Should insurers be liable for the consequences of all delay in all circumstances? Who pays?
- Delay might be reasonable and justifiable
- Insurers should investigate carefully
- Insured could purchase other cover eg BI
- Proportionality?
- What is breach of contract?

Solutions?

- Reform of remedies in S17 MIA to allow policyholder to recover damages if insurer acts without “good faith”? or
- Reform of general law to introduce standard contractual liability (by legislation or court decision?)
- ..or both?

Contract - Judicial reform/Legislation?

- Insurer's obligation to hold insured harmless is legal oddity
- Supreme Court can reverse *Sprung* and decide insurer obliged to pay valid claim after reasonable investigation but will that occur or is legislation required?
- Exclusion clauses? – Consumers UTCCR. Business insurance – freedom of contract
- Will exclusion clauses become standard?

Amend S17 MIA?

- Insurance contracts are not “buyer beware”
- Insurance contracts are contracts of mutual good faith – consequence of breach?
- Insurer could be liable for breach of good faith obligations to insured (dishonest, malicious, maladministration) but
- only for loss which was foreseeable when the contract was made (ie no separate bad faith tort).
- Statutory duty = damages not avoidance
- Cannot exclude duty of good faith.

Nature of duty?

- To investigate a claim fairly and promptly
- To decide a claim fairly and promptly
- To pay an agreed claim within a reasonable time
- Delay not of itself = breach
- FSA - ICOB rule 8.1.1 very similar.

Embryonic developments

- *Gan Insurance v Tai Ping Insurance (no 2)* – re-insurer obliged to exercise rights under claims co-operation clause “in good faith”.
- *Eagle Star Insurance Co Ltd v Cresswell* – reinsurers must operate claims control clause in good faith.
- *Drake Insurance Co v Provident Insurance plc* – “ a failure to make any enquiry of the insured before...avoiding the policy was...a breach of the duty of good faith.”

Insured's Post Contract Duty of Good Faith - Background

- Historically insurance contracts subject to good faith – not buyer beware
- Inherent moral hazard
- UK preference for annual contracts – limited obligations on policyholder once contract agreed
- Main focus of post contract disputes is therefore claims.

Claims fraud

- Major cost to insurance industry – and customers
- ABI estimate £1.9bn of undetected fraud
- Detected fraud increasing – better methods but more fraud too?
- Social attitudes to dishonesty are complex
- Fraud in practice is hard to define.

Fraud and dishonesty

- £1m industrial fire loss:-
 - What normally happens
 - What happens in Uberrimae fidei land
- Negotiation – Exaggeration/Exaggeration – invention
- Substance – not de minimis
- Mental element
- Fraudulent devices?
- Fraud is a fluid concept – fact specific. Best left to courts not legislation.

Current law

- Marine Insurance Act S17 quite clear:
A contract of marine insurance is a contract based upon utmost good faith, and, if good faith be not observed by either party the contract may be avoided by the other party
- Is S17 in this context a codification of the common law? – probably not.
- Does this apply post contract? – courts say yes
- Do the courts apply S17? – no, not recently
- Law incoherent.

The Problem

- Relationship between the common law rules and the duty under S17 ...will remain opaque and logically irreconcilable (Lord Justice Aikens)
- Complexity may have generated more disputes
- Difficult to explain UK Law to an international audience or to resist calls to harmonise law
- If the law on fraud is to act as a deterrent, more certainty is needed on the penalty.

Options

- 1 Avoidance from the start
- 2 Forfeit whole claim
- 3 Lose only dishonest part
- Courts prefer forfeiture for first party claims
- We agree – correct balance of justice, penalty and practicality
- Will therefore need to clarify application of S17.

Insurers' contractual remedies

- Insurance policy may provide for remedy if fraud – many do
- Consumer contracts – subject to UTCCR's
- Should party be able to exclude or limit liability for own fraud? Public policy issues.
- Should party be able to exclude or limit liability for fraud by agent?

Joint policies

- What is effect of fraud by joint policyholder?
- Relationship breakdown – jointly insured spouse attacks person/property of the other
- Joint insurance (not composite) general rule is fraud by one taints the whole
- Define as rebuttable presumption?
- Group insurance – fraud by beneficiary affects only that beneficiary?

Third party fraud

- Significant issue (“cash for crash” etc)
- Duty of good faith does not apply to third party claimants
- No contractual obligations – no policy
- Law is fraudulent claimant risks losing only dishonest part of claim [Shah v Ul Haq]
- Beyond scope.

Some residual questions

- Fraud gives insurer right to terminate contract – how?
- Claims between fraud and termination?
- Can insurer claim damages for investigation costs?
- Does policyholder's duty of good faith go beyond claims and if so to what?

ANY QUESTIONS

NEXT EVENT
MOCK MEDIATION FOLLOWED BY GARDEN
PARTY AND BBQ
22 JUNE, 2010 – MAIN HALL, INNER TEMPLE

REGISTER AT BILA@INSURANCEEVENTS.COM

