

IN THE HIGH COURT OF JUSTICE

Claim No.

QUEEN'S BENCH DIVISION

B E T W E E N:

GOODHEART LIMITED

Claimant

-and-

HONOUR BRIGHT INSURANCE PLC

Defendant

SKELETON ARGUMENT ON BEHALF OF INSURERS

Breach of Indemnity Policy – Debt or Damages?

1. Insurers' position is that English law does not allow recovery of damages in respect of insurers' failure to pay claims promptly. The rule against recovery of such damages confirms with basic and well settled principles of law, which should not be disturbed. See President of India v. Lips Maritime Corp [1988] AC 395.
2. An action against insurers in respect of breach of an indemnity policy sounds in unliquidated damages and not debt. See Forney v. Dominion Insurance Co [1969] 1 Lloyd's Rep. 502, 509 and The Fanti [1991] 2 AC1, 35 per Lord Goff. The argument¹ that breach of insurers' obligation to provide an indemnity should sound in debt rather than damages is founded on the proposition that the insurers' basic obligation is to pay a sum of money in a defined eventuality. This misstates the true nature of indemnity insurance, which involves an on-going obligation to allocate funds and organise resources so as to save the insured harmless in relation to insured perils. This primary obligation subsists whether or not a claim is made, but gives way to a secondary obligation to pay damages in the event of a claim. The insured has a right of action as soon as a loss occurs, and there is no separate subsequent breach if

¹ Favoured by some academic writers see e.g. *The Law of Insurance Contracts* by Malcolm Clarke, 4th Edition, para 30-7A

the insurers fail to respond to a demand for payment. The remedy for such failure is for the Court to award interest on the delayed payment. The Fanti (1991) AC 1 per Lord Goff at 35-36.

3. The law as to payment of statutory interest has evolved against the background that damages cannot be awarded for late payment of damages, however catastrophic the consequences for a Claimant kept out of his money (see Sprung v. Royal Insurance (UK) Ltd [1999] Lloyd's Rep.I.R.111 and Normhurst Ltd v. Dornoch Ltd [2005] Lloyd's Rep.I.R.27). An insurer who wrongfully withholds payment will be condemned in costs.² It should be noted that costs are rarely awarded to the successful party in North American jurisdictions.

An Implied Term?

4. It is not appropriate for the Court to rewrite the parties' contract by implying a term into the policy imposing an obligation to resolve coverage issues promptly; and/or to pay claims promptly. Commercial insurance contracts are negotiated in a competitive market between insurers and usually brokers with financial muscle acting on behalf of insureds. The form of the resultant written contracts should be respected. See Gan Insurance Co Ltd v. Tai Ping Insurance Co Ltd (No.s 2&3) [2001] Lloyd's Rep.I.R. 667, per Sir Christopher Staughton at p.702³.
5. The need for implied terms such as those suggested is not so plain as to obviate the need to state them. On the contrary, most insurers would probably regard them as pernicious. There are at least three difficulties, which might be perceived as affecting insureds, as well as insurers:
 - (a) Insurers should not be inhibited from thorough investigation of doubtful claims. The public interest and the interests of honest policyholders are served by such investigations. Changing the law would increase the cost of insurance to the detriment of insureds.
 - (b) Implying such terms would only benefit the limited class of insureds whose financial position and vulnerability were known to and/or were in the immediate contemplation of the insurers. Thus bringing their special damage claim within the second limb of Hadley v. Baxendale

² English Courts can exercise a variety of powers where insurers have behaved badly in delaying payment of claims or by denying coverage on unmeritorious grounds, including awarding indemnity costs against insurers, awarding a higher rate of interest on sums due and awarding interest on costs.

³ see also Mance J in ICCI v. McHugh [1997] LRLR94 at p.136

(1854) 9 Ex 341. This would give rise to a risk that this class of insureds might find it difficult to obtain insurance on level terms. There are strong policy reasons for spreading premiums on a reasonably level basis between as many insureds as possible.

(c) The duty of good faith is reciprocal. Insureds might bridle at the suggestion that dilatory presentation of their claims might be characterised as a breach of good faith with penal consequences.⁴

6. These arguments apply equally to both of the suggested implied terms. Thus, the existence of a contractual duty to resolve coverage issues promptly (as opposed to paying claims) would inhibit investigation of coverage issues, and would only assist a small number of insureds who could assert that their special financial vulnerability was a matter within their insurers' contemplation. In practice, protracted investigation of claims and delayed payment tend to go hand-in-hand, the explanation for both being the same.

Foreseeability of Receivership.

7. On the facts before the Court, the insured's receivership was caused by its financial vulnerability, rather than any breach of insured's duty. Following the decision of the House of Lords in Lagden v. O'Connor [2003] UKHL 64, the test is simply whether having regard to the circumstances of the case, the receivership was foreseeable. Absent very clear evidence of what insurers knew of the insured's financial position, it could hardly be said that a loss of £30m as a result of delay in paying insurance could be regarded as foreseeable. If sums of this order were at stake, the insured should have taken steps to mitigate the worst financial consequences of the loss.

Duty of Good Faith and Avoidance.

8. The nature of any duty of good faith reposing on insurers at the claims stage is open to question. The duty of good faith is mutual and reciprocal (see s.17 Marine Insurance Act 1906 and Carter v. Boehm) and any attempt to analyse the duty of the two parties at a single point in time in different ways would lead to hitherto uncharted complications. In The Star Sea [2001] 2 WLR170 the duty of the insured

⁴ see ICCI v. McHugh *op cit.* where Mance J. expressed the view that this was an argument against implying a

at the claims stage was found to be limited to a duty to be honest. See per Lord Scott at para 111.⁵ It is submitted that the insurers' reciprocal duty can be no higher or different.

9. It was conceded by both Counsel in The Star Sea that the sole remedy for breach of good faith is avoidance. See per Lord Hobhouse at para 49, who went on to voice concerns about the draconian nature of this unilateral remedy. A suggested alternative that the remedy should be proportionate to the breach has been mooted in the context of avoidance for material nondisclosure and misrepresentation at the pre-contractual stage.⁶ It is difficult to see how such a principle could be extended to the duty to be honest at the claims stage. Avoidance is a proportionate remedy for dishonesty.

Evidence before the Court of Appeal.

10. The evidence shows the following:
- (i) Insurance in the UK is regulated by the F.S.A.⁷ and by the market place. There is no evidence that bad faith on the part of insurers is a widespread problem. See Earp passim.
 - (ii) Bad faith remedies are variously available in different states in the U.S., where bad faith on the part of insurers may be more widespread than in the UK. However the existence of the remedy appears to have very little measurable effect on the conduct of insurers. See McVisk 7(e), Leahy passim.
 - (iii) Empirical evidence from the U.S. suggests that bad faith claims lead to higher insurance costs, via higher settlements generally, the payment of bad faith damages and the failure to pursue investigations of doubtful claims. See Leahy passim, especially citation of studies by Rand Corp Institute of Civil Justice.

duty that insurers should meet meet claims promptly

⁵ see also The Mercandian Continent [2001] 2 Lloyd's Rep 563 and Agapitos v. Agnew [2002] 2 Lloyd's Rep 42

⁶ see Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd [1993] 1 Lloyd's Rep.496,CA, Sir Donald Nicholls V.C. at p.508.

⁷ The FSA Handbook lays down Principles for Business which include Principle 1: a firm must conduct its business with integrity, Principle 2: a firm must conduct its business with due skill, care and attention and Principle 6: a firm must pay due regard to the interests of its customers and treat them fairly. Enforcement action may be taken for breach of such a principle, as well as for breach of a specific rule, which can result in substantial fines. The FSA Handbook sets out specific rules for claims handling: ICOB 7.3.1. provides that an insurer must carry out claims handling promptly and fairly. When handling a claim of a commercial customer ICOB 7.3.2. provides that an insurer should ensure that the commercial customer is kept reasonably informed of how his claim is progressing; and payment is made promptly once settlement terms have been agreed.

- (iv) Leahy's conclusion is that bad faith claims benefit a small number of individual claimants, and a large number of lawyers; but not the general public. In particular there is no empirical evidence that the existence of a bad faith remedy does anything to improve insurers' conduct.

Policy.

11. At the heart of the problem is the paradox that while a general duty of good faith between the parties to an insurance contract is nothing if not reciprocal, the accepted remedy for a breach of the duty (avoidance) can provide a windfall for the insurer, while being of no use to the insured.
12. Recent developments in the law have made a denial that the duty of good faith extends to the claims phase "past praying for".⁸ At the same time the proposition that avoidance is the exclusive remedy for a breach has been tempered (and thereby strengthened) by the gloss that the post-contractual duty is limited to the general duty of honesty. And indeed insureds might be surprised by a contention that in making claims their duty was other or higher than to act honestly towards insurers. The law relating to a continuing duty of good faith at the claims stage, as explained in The Star Sea, is a finely wrought "work in progress", which will not be improved by "cut and paste" additions from other jurisdictions.
13. The alternative – recommended by the BILA's subcommittee, which reported to the Law Commission⁹, is either to treat claims under insurance policies as debts (a proposition which the subcommittee recognised would require a change in the law); or to imply a contractual good faith term into insurance policies.
14. Both these routes forward would only help impecunious Claimants driven to business failure by malevolent insurers if the Claimants could bring their bad faith damage claim within the second limb of Hadley v. Baxendale (in other words – broadly – if their special financial circumstances were known to the insurer). This in turn would create a sub-class of insured business perceived by insurers to be at special risk of business failure (as opposed to at risk of conventional perils) which might make those businesses difficult to insure on level terms. Insurers submit that before contemplating changes in the law of questionable benefit to the consumers most concerned, the Court of Appeal would need to be

⁸ Per Lord Clyde in The Star Sea para 6

⁹ Under the Chairmanship of Mr. Adrian Hamilton QC

satisfied that there is presently a serious and widespread problem in the UK which needs to be addressed. The evidence for that is lacking.

ROBERT MOXON BROWNE QC

ALISON GREEN

**2 Temple Gardens
Temple EC4Y 9AY**

29th June 2005

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