

BRITISH INSURANCE LAW ASSOCIATION

THE CASE FOR BAD FAITH DAMAGES IN ENGLISH INSURANCE LAW

A mock trial, with legal argument and market evidence, as to whether the English courts should have power to award damages for bad faith or for the late payment of an insurance claim.

In the Lord Chief Justice's Court, Royal Courts of Justice, 30 June 2005, before Sir Christopher Staughton, Sir Philip Otton and Adrian Hamilton Q.C.

Clerk to the Court: Lord Justice Thomas

Court Reporter: Marcus Mander, Barrister, 7 King's Bench Walk

Background

The Claimant was Goodheart Limited, a family company forced into receivership following rejection of their claim by the Defendant insurer, Honour Bright Insurance plc, for indemnity in respect of damage caused by a fire on 1 January 2000.

Goodheart went into receivership two years after the fire. Honour Bright continued to decline the claim and Goodheart's receiver subsequently settled the company's claims three and a half years after the fire, Honour Bright having offered settlement immediately proceedings were issued. The claim was settled at for the principal sum amount originally claimed less a deduction for Goodheart's irrecoverable costs of proceeding to trial. The settlement excluded Goodheart's claims for punitive and compensatory damages in respect of (i) Honour Bright's wrongful failure promptly to pay sums for which it was liable under the policy; (ii) Honour Bright's failure promptly to investigate and disclose their decision on coverage. These damages were quantified in the sum of £25 million for the reduction in the value of Goodheart's business caused by its receivership and cessation of trading.

Goodheart claimed that Honour Bright's loss adjuster had informed them that he had been told to do his utmost to find a basis on which to reject the claim, although it was prepared to make a quick payment at a serious discount. Honour Bright denied the allegation, and maintained that the period prior to payment was occupied by proper investigations.

Goodheart Limited pursued its proceedings in respect of its claim for £25 million. Honour Bright obtained summary judgment at first instance on the basis that (i) Honour Bright's only obligation had been to pay damages and in English law there could be no claim for damages flowing from a failure to pay damages; (ii) there was no room for the implication of terms that Honour Bright should either pay Goodheart's claim promptly or resolve the coverage issue promptly; (iii) even if there was, it was open to Goodheart to act independently of insurers, and if they could not do so the loss was in reality the result of their own impecuniosity and was irrecoverable; (iv) even if Honour Bright could be said to have breached its post-contractual duty of good faith, Goodheart's only remedy was avoidance of the policy.

Goodheart appealed to the Court of Appeal. The appeal was heard subject to the Supreme Court Jurisdiction (Prevention of Appeals) Act 2006, empowering the Court to review its own previous decisions and previous decisions of the House of Lords.

Counsel for the parties

Counsel for Goodheart: William Wood Q.C. and Siobán Healy.

Counsel for Honour Bright: Robert Moxon-Browne Q.C. and Alison Green.

Expert witnesses

For Goodheart:

Walter Merricks, Chief Ombudsman of the Financial Ombudsman Service.

William K. McVisk of Johnson & Bell Ltd, Chicago, Illinois.

For Honour Bright:

Michael J. Leahy of Haight, Brown & Bonesteel, Los Angeles, California.

Michael Earp, Technical & Compliance Officer for W.R. Berkley Insurance (Europe) Limited

William Rendall of Lloyd's Market Association

The evidence

MR. WOOD: May it please you Your Lordships, I appear before you with my learned friend Siobán Healy on behalf of the Claimant, Goodheart Limited. My learned friends Robert Moxon-Browne and Alison Green appear on behalf of Honour Bright. This is an appeal from a strike-out of Goodheart's claim in respect of late payment of their claim by their insurers. The judge at first instance said the claim was bad in law. We are fortunate to be able to exploit unusual legislation enabling the Court to review all the previous decisions of the Court of Appeal and the House of Lords. Ms. Healy and I will relentlessly exploit it to the full. The facts are these. Goodheart's factory burned down following a fire on 1 January 2000. Its claim was not paid for 3 years and 6 months, and even then was paid only when proceedings were issued. As a result, Goodheart was unable to rebuild its factory and resume production, and it was forced into receivership. Mr. Goodheart is now in a home for distressed manufacturers. My Lords, in an

unguarded moment, Mr. Gladhand, the Defendant's loss adjuster, informed Mr. Goodheart that he had:

“been told to take up the drains here. Non-disclosure, breach of condition, under-insurance, the lot. My claims manager says you guys were barely able to pay the premium this year. He's in no rush to pay the claim if there's a chance you will just vanish anyway. For a serious discount I might get you something as a quick payment. Then you could sell the site and retire.”

SIR CHRISTOPHER STAUGHTON: What does “take up the drains” mean Mr. Wood? Is that the same as “putting the ferrets in”?

MR. WOOD: I believe so my Lord, it is a vernacular expression.

My Lords the witnesses I will call are Mr. Walter Merricks, the Chief Ombudsman at the Financial Ombudsman Service, and Mr. William McVisk, a partner in the firm of Johnson & Bell Ltd, of Chicago, Illinois. My learned friend Mr. Moxon-Browne will then call Mr. Michael Leahy, a partner in Haight, Brown & Bonesteel of Los Angeles, California; Mr. Michael Earp, the Technical & Compliance Officer for W.R. Berkley Insurance (Europe) Limited, and Mr. Bill Rendall of Lloyd's Market Association. We shall proceed with expedition: drinks are to be served afterwards and the Act empowering us to revisit the previous decisions of this Court and the House of Lords expires at 7 p.m. My Lords, with your permission I will now call Mr. Walter Merricks.

Are you Walter Merricks?

MR. MERRICKS: I am, yes.

MR. WOOD: You are the Chief Ombudsman of the Financial Ombudsman Service, are you not?

MR. MERRICKS: Yes, I was previously the Ombudsman at the Insurance Ombudsman Bureau before it was combined with the Financial Ombudsman Service. I became Ombudsman at the IOB in 1996 and took over at FOS in 1999.

MR. WOOD: We have here a short report prepared by you, in which you talk about the ABI statement, the ABI's Statement of General Insurance Practice published in 1986.

MR. MERRICKS: Yes, when the Ombudsman was first brought into being in 1981, the Ombudsman was given the role of dealing with complaints relating to general insurance and was given the task of applying

the law and principles of good practice. The ABI produced a code setting out what was considered to be good practice for the Ombudsman to apply.

MR. WOOD: Was that in due course replaced by the Insurance Conduct of Business section of the FSA Handbook?

MR. MERRICKS: Yes, the Financial Services and Markets Act 2000 provides a particular code of conduct.

SIR CHRISTOPHER STAUGHTON: Does the FSA Handbook have the force of law?

MR. MERRICKS: Parliament gave the Financial Services Authority the power to make rules. The ICOB rules form one part of the FSA Handbook made under statutory authority.

MR. WOOD: Do the ICOB rules touch upon the prompt payment of claims?

MR. MERRICKS: Yes. The requirements reflect the ABI code, including a duty on insurers not unreasonably to reject claims.

MR. WOOD: Did this meet any resistance from the industry?

MR. MERRICKS: No, it was a voluntary initiative of the insurance industry.

MR. WOOD: Did anyone say that it might lead to an “ambush mentality”?

MR. MERRICKS: No, insurers were supportive, many of them publishing press releases at the time.

MR. WOOD: What sort of conduct do you come across in your role as Ombudsman?

MR. MERRICKS: I often come across examples of delay, incompetence, maladministration, sometime more malevolent aspects but that is rare. Usually it is no more than incompetence. When insurers at a senior level realise their staff have been incompetent they are usually prepared to provide a remedy for any loss caused.

SIR CHRISTOPHER STAUGHTON: That seems surprising. When I was an insurance practitioner, there was money to be made in the time difference between receiving the premium and paying the claim.

MR. MERRICKS: If there is serious delay which cannot be explained, the Ombudsman has always taken the view that if that has caused serious consequences, the policyholder should not be left without a remedy.

MR. WOOD: In their skeleton argument the insurers suggest that it was unforeseeable that such severe consequences as in fact were suffered by Goodheart would occur. Do you agree?

MR. MERRICKS: Insurance is taken out, on the whole, to guard against the occurrence of serious consequences, so it is wrong to suggest that it is unforeseeable that failure to pay will have serious consequences. The business of insurers is to provide cover for unforeseeable incidents that may happen.

MR. WOOD: Thank you Mr. Merricks. Could you please stay there for a moment. Mr. Moxon-Browne will have some questions for you.

MR. MOXON-BROWNE: Mr. Merricks, you said that instances of bad faith by insurers are rare.

MR. MERRICKS: I haven't encountered it often.

MR. MOXON-BROWNE: You also mentioned that the publication of the ICOB rules.

MR. MERRICKS: Yes.

MR. MOXON-BROWNE: The FSA has teeth, doesn't it?

MR. MERRICKS: Yes.

MR. MOXON-BROWNE: Stage 1 is a reprimand, stage 2 is a fine.

MR. MERRICKS: Yes, but the customer doesn't receive anything.

MR. MOXON-BROWNE: And stage 3, finally, is to withdraw the operator's authorisation to conduct business.

MR. MERRICKS: Yes.

MR. MOXON-BROWNE: Your office's remit covers the business of both insurers and consumers, but you are identified with consumers primarily.

MR. MERRICKS: The FOS is not a consumer champion. We represent both insurers and consumers.

MR. MOXON-BROWNE: And do you advocate that the duty of an insured at the claim stage should be any higher than a duty of honesty?

MR. MERRICKS: We take honesty into account in deciding whether the outcome is fair and reasonable.

MR. MOXON-BROWNE: But you would not expect the average insured to accept that in making an insurance claim he is in a different commercial

situation from any other?

MR. MERRICKS: Some contracts have time limits for claims, but these are not always upheld.

MR. MOXON-BROWNE: Would most insureds accept that they have a duty to hurry up at the claims stage or that otherwise they might find themselves in breach of their duty of good faith?

MR. MERRICKS: They wouldn't think of it in those terms.

MR. MOXON-BROWNE: But the duty of good faith is founded in reciprocity.

MR. MERRICKS: Indeed.

MR. MOXON-BROWNE: And to take the example of a company which prides itself on its good housekeeping but is of poor financial standing - is it right that such a company should have to pay higher premiums than a company of better financial standing?

MR. MERRICKS: I'm not sure that would be the case. The setting of premiums is a matter of commercial competition.

MR. MOXON-BROWNE: If your evidence was accepted, that would lead to large awards above the policy limits being made, and in due course to higher premiums being charged.

MR. MERRICKS: That is a fanciful and speculative suggestion.

MR. MOXON-BROWNE: Thank you Mr. Merricks.

MR. WOOD: Mr. Merricks, do you think a failure to make payment until three and a half years after a fire demonstrates a failure to hurry up, or something worse?

MR. MERRICKS: It looks like something worse.

MR. WOOD: And as far as compensation awardable by the Financial Ombudsman Service is concerned, is such compensation available to a small business like Goodheart?

MR. MERRICKS: If it's a small business, it's within the Ombudsman's remit, or possibly they would have a remedy under s.150 FSMA.

MR. WOOD: Do your Lordships have any questions?

SIR CHRISTOPHER STAUGHTON: Is the FSA the same body that lays down what pieces of paper you must produce in order to open a bank account?

MR. MERRICKS: Yes, it is the same.

SIR CHRISTOPHER STAUGHTON: It does seem remarkably difficult.

SIR PHILIP OTTON: You mentioned the three and a half year period which is took Honour Bright to pay Goodheart's claim. What would a reasonable period of time have been in your opinion, speaking as an expert?

MR. MERRICKS: I wouldn't offer such an opinion in my capacity as Ombudsman.

SIR PHILIP OTTON: I don't want to press you Mr. Merricks...

MR. MERRICKS: Well, on the brief facts of this case, three and a half years does seem excessive for the type of claim we see here.

SIR PHILIP OTTON: What would be a reasonable period for this insurer on this claim?

MR. MERRICKS: It would depend on how far the insurer's investigations had proceeded. There is some evidence of bad faith here, but I would need the full facts to offer an opinion.

MR. ADRIAN HAMILTON: There are quite a number of facts here. Many cases that I have been involved with have concerned period of well over three and a half years. Surely one must take into account how far the insured has pressed the claim and how far the insurer has delayed?

MR. MERRICKS: Yes, litigation can take a long time.

SIR CHRISTOPHER STAUGHTON: Why did Goodheart not start their claim earlier in this case?

MR. WOOD: My Lord, we have all the correspondence available here. Perhaps I may take you to it later?

My Lords, my next witness is Mr. William McVisk.

Mr. McVisk, you are a partner in the Chicago firm of Johnson & Bell?

MR. MCVISK: Yes, that's right. I have practised insurance law for over 28 years.

MR. WOOD: And has that been on behalf of defendant insurers or claimants?

MR. MCVISK: Both, but more usually defendant insurers.

MR. WOOD: Now, your report is entitled "Why insurers should stop hating and start loving bad faith remedies".

MR. MCVISK: Yes.

MR. WOOD: That is almost my last question! As I understand it, in America there is an available remedy for bad faith?

MR. MCVISK: Yes, it depends which State you are in, but the root of the doctrine is that an insurance contract contains an implied covenant that neither party will do anything which will injure the right of the other to receive the fruits of the agreement.

MR. WOOD: And can you brutalise the laws of all the States for me and explain in broad terms what is the test to be applied?

MR. MCVISK: The first prong of the test is objective - would a reasonable insurance company have declined the claim under similar circumstances?

MR. WOOD: Is that what is known as the “fairly debatable” test?

MR. MCVISK: Yes, there are really three parts to the analysis. The first question is whether there is a covered claim at all. If there was, the second question is whether there was any reasonable basis for denying the claim. Thirdly, did the insurer *know* there was no reasonable basis for denying it? The “fairly debatable” test is the standard by which the insurer is judged.

MR. WOOD: Are the insured’s attorney’s fees recoverable?

MR. MCVISK: Yes.

MR. WOOD: What about punitive damages?

MR. MCVISK: Yes, in egregious cases. It requires proof of “evil intent” on the part of the insurer.

MR. WOOD: And loss of earnings?

MR. MCVISK: Yes, those are recoverable.

MR. WOOD: So if a company in Goodheart’s position came to you, what damages would you advise them that they could recover?

MR. MCVISK: I would advise them that they could recover damages for slowness in payment, and value of business lost as a result.

MR. WOOD: You heard the brutal language used by the loss adjuster Mr. Gladhand in this case. Have you come across anything like that in the course of your practice?

MR. MCVISK: Yes, particularly in emails, which occasionally express unfortunate attitudes.

SIR CHRISTOPHER STAUGHTON: You mean “unfortunate” in the sense that it is found out?

MR. MCVISK: If I am representing the insurer, yes - or very fortunate if I am representing an insured.

MR. WOOD: Is it your experience that substantial but well-run insurance companies are badly hit as a result of the availability of these remedies?

MR. MCVISK: Very rarely. Usually only where there is egregious conduct.

MR. WOOD: What broad conclusions do you draw as to the effects of the remedy?

MR. MCVISK: Studies have shown that it has led to a slight increase in payments, approximately 0.3% across 38 States with tort remedies for bad faith. Significantly, bigger awards tend to be made in cases where there is no attorney representing the insured, which suggests that insurance companies try to take advantage of unrepresented clients.

MR. WOOD: Thank you Mr. McVisk. Mr. Moxon-Browne will have some questions.

MR. MOXON-BROWNE: That figure of 0.3% in States with bad faith remedies suggests insurers are paying very little attention to it doesn't it?

MR. MCVISK: No, that is across all States. Most insurers pay claims promptly.

MR. MOXON-BROWNE: That statistic doesn't take account of bad faith claims themselves either.

MR. MCVISK: No it doesn't.

MR. MOXON-BROWNE: Nor does it reflect the cost to insurers of not investigating doubtful claims fully.

MR. MCVISK: No - insurers are required to investigate claims.

MR. MOXON-BROWNE: In fact, they pay out rather than look at claims more closely.

MR. MCVISK: I don't know about that.

MR. MOXON-BROWNE: That is the single most pernicious feature of bad faith remedies is it not? It stops insurers from investigating bad claims.

The reciprocity of the duty of good faith is also recognised in the United States.

MR. MC VISK: Yes.

MR. MOXON-BROWNE: For example in the Communale decision in California. It is a point I put to Mr. Merricks: an insured would bridle at the suggestion that he would be in breach of his duty if he was too slow in putting forward his claim.

MR. MC VISK: Well their contracts require them to do that anyway - so insured's are usually charged with breach of contract, not bad faith. And delay by an insured is unlikely to cause damage to an insurer, that is the difference.

MR. MOXON-BROWNE: Is the duty of good faith higher than one of honesty?

MR. MC VISK: Not in the U.S. Once the contract has been made, there is no duty higher than would be owed generally.

MR. MOXON-BROWNE: And losses claimed must be foreseeable must they not?

MR. MC VISK: Yes.

MR. MOXON-BROWNE: So it is necessary to have some knowledge of the precarious financial position of the insured in order to found a bad faith claim?

MR. MC VISK: No, it is foreseeable that someone will suffer if their claim is not paid.

MR. MOXON-BROWNE: Either it is a remedy that favours only a few or it is a risk that every insurer takes.

MR. MC VISK: In the U.S., every insurer *does* take that risk, yes.

MR. MOXON-BROWNE: Is there any evidence that we need such a law in the United Kingdom?

MR. MC VISK: I don't know how British claims are handled.

MR. WOOD: How often are points taken in the U.S. as to whether a loss was foreseeable in circumstances such as these?

MR. MC VISK: Never.

SIR CHRISTOPHER: Mr. McVisk, are bad faith claims in the United States tried before

STAUGHTON: a jury?

MR. MCVISK: A judge decides whether the “fairly debatable” standard has been met. If he concludes it may not have been, it might go to a jury.

SIR CHRISTOPHER STAUGHTON: Are the judges elected?

MR. MCVISK: That depends on the State.

SIR CHRISTOPHER STAUGHTON: And are they able to award special damages?

MR. MCVISK: Only juries can award punitive damages.

MR. ADRIAN HAMILTON: If there is a difference in the remedies available to a poor person and a person of means, is it customary for a person insuring his house to give full disclosure of his financial means?

MR. MCVISK: That would depend on the application form.

MR. ADRIAN HAMILTON: But that could be relevant?

MR. MCVISK: In some classes of insurance, yes, for example in relation to the likelihood of arson.

MR. ADRIAN HAMILTON: That sounds somewhere near to moral hazard.

MR. MCVISK: I am not aware of United States insurance companies asking for that sort of information.

MR. WOOD: Thank you Mr. McVisk.

MR. MOXON-BROWNE: My Lords, I would like to call my first witness, Mr. Leahy.

MR. LEAHY: Are you Michael Leahy?

MR. LEAHY: Yes.

MR. MOXON-BROWNE: And you practice in California with the firm Haight, Brown & Bonesteel in Los Angeles?

MR. LEAHY: Yes.

MR. MOXON-BROWNE: You have a lifetime of experience in insurance law?

MR. LEAHY: 27 years.

MR. MOXON-BROWNE: I would like to ask you a few questions about the impact of bad faith remedies on first-party claims.

MR. LEAHY: My experience, based on the clients I have had and others, and on

studies, is that the introduction of bad faith claims causes insurers to markedly over-pay claims, which in turn leads to markedly higher premiums. A study out of the University of Wisconsin examined the impact of bad faith on automobile policies, and found that the mere *threat* of bad faith claims causes insurers to pay claims above their value. A second study, out of the Rand Corporation Institute of Civil Justice, concluded that the introduction of bad faith tort remedies nation-wide would lead to a 32 - 53% increase in premiums on auto policies, translating into a 17-29% increase on all liability policies.

MR. MOXON-BROWNE: And do these remedies make for a greater propensity to litigation?

MR. LEAHY: Another Rand Corporation study shows that if they were introduced to health insurance policies - for which there are currently no bad faith remedies - it is estimated that the mere fact of the new law would lead to a 53% increase in claims resulting in a log jam. The ability of the legal system to deter bad faith conduct is weak. Bad faith decisions will not be deterred all the time in all cases and insurers will simply act defensively by paying bad claims. The impact on honest policyholders, of course, is higher premiums. There was talk earlier on about the "fairly debatable" standard. The only people who make money out of it are the lawyers who specialise in bad faith claims and the odd claimant who hits the jackpot, not the general public.

MR. MOXON-BROWNE: In California, is an insured required to disclose their precarious financial state?

MR. LEAHY: No, it's illegal to ask that question. You may not obtain the prior claims experience.

MR. MOXON-BROWNE: Mr. Wood will now have some questions for you.

MR. WOOD: Mr. Leahy, the studies you refer to deal with the development of bad faith remedies in the context of *third* party claims don't they?

MR. LEAHY: No, the Rand study relates to first party claims.

MR. WOOD: That was the second Rand study wasn't it? The Wisconsin study related to third party claims?

MR. LEAHY: Yes.

MR. WOOD: As did the first Rand Corporation study you mentioned?

MR. LEAHY: Yes.

MR. WOOD: There is no substantive difference between you and Mr. McVisk as to the substantive law on bad faith claims?

MR. LEAHY: I don't agree with everything he said?

MR. WOOD: With what would you disagree?

MR. LEAHY: For example if a case in the U.S. gets to a jury, they will award punitive damages in every case.

MR. WOOD: That is what drives these cases into such big figures.

MR. LEAHY: Yes.

MR. WOOD: If the provable claim is for specific sums, they don't pose that kind of risk do they?

MR. LEAHY: Correct.

MR. WOOD: There is a phrase from the Filaski case. Do you know it?

MR. LEAHY: No.

MR. WOOD: It was said that to show that an "evil hand" damaged the objectives of the insurance contract it must be shown that it was "guided by an evil mind which either consciously sought to damage the insured or acted intentionally, knowing that its conduct was likely to cause unjustified, significant damage to the insured".

Do you not think that the statement of the loss adjuster in this case was shocking?

MR. LEAHY: I've seen worse.

MR. WOOD: Worse?

MR. LEAHY: The profit-earning business in this case was shut down by a fire, not by any bad faith.

MR. WOOD: Well if Goodheart had come to your office with these facts, would you have taken the case?

MR. LEAHY: Yes, and I would have retired a millionaire.

MR. WOOD: And would you have taken this case on behalf of the insurer?

MR. LEAHY: Yes, I would have tried to settle it.

MR. WOOD: In doing so, would you have told the insurer you thought the law was wrong?

MR. LEAHY: It's not my job to offer that sort of opinion to a client.

MR. WOOD: Thank you Mr. Leahy, I have no further questions.

MR. MOXON-BROWNE: My Lords, I now call my next witness, Mr. Rendall.
Are you Mr. Bill Rendall?

MR. RENDALL: I am.

MR. MOXON-BROWNE: And are you the head of underwriting and claims at Lloyd's Market Association?

MR. RENDALL: Yes.

MR. MOXON-BROWNE: The LMA is the trade association of the underwriting businesses of the Lloyd's market. It represents them in their dealings with the corporation of Lloyd's?

MR. RENDALL: Yes.

MR. MOXON-BROWNE: You have spent your career as a distinguished underwriter?

MR. RENDALL: I'm not sure about "distinguished", but I spent 30 years as active underwriter for the Kiln syndicate.

MR. MOXON-BROWNE: For syndicate 557?

MR. RENDALL: 510 and 557.

MR. MOXON-BROWNE: Are you able to comment on the insurance industry in America as well?

MR. RENDALL: Well, I have considerable experience of U.S. business. About 50% of Kiln's business was in the U.S.

MR. MOXON-BROWNE: What would you say the effects of bad faith jurisprudence in the United States are on the insurance business?

MR. RENDALL: It creates a climate of fear among insurers, causing them to settle claims that may be fraudulent and exaggerated, leading to a greater level of claims experience which is inevitably reflected in premiums.

SIR CHRISTOPHER STAUGHTON: Is it possible for a doctor to obtain coverage in the United States?

MR. RENDALL: Yes.

MR. MOXON- BROWNE: What about eminent surgeon malpractice insurance?

MR. RENDALL: It depends on the state of the market. At times it is unobtainable.

MR. MOXON- BROWNE: Looking at the U.K. situation, do you think the insurance industry is well regulated?

MR. RENDALL: Very, by world standards.

MR. MOXON- BROWNE: Does the FSA have teeth?

MR. RENDALL: Yes indeed.

MR. MOXON- BROWNE: In your opinion, do we need bad faith remedies here in the U.K.?

MR. RENDALL: It could only cause harm and encourage exaggerated claims. The FSA provides sufficient remedies for failures by insurers.

MR. MOXON- BROWNE: You have mentioned certainty of contract. What do you mean by that?

MR. RENDALL: I do not believe there is any such thing, if there was there would be no need for lawyers. But the concept as applied in the London subscription market means an attempt to obtain agreement on all the essential terms of the contract prior to inception.

MR. MOXON- BROWNE: And what is the relevance of that?

MR. RENDALL: It is intended to help to lead to clarity of contract terms and reduce the opportunity for insurers to have reason to prevaricate. Part of the motivation is to eliminate disputes to the greatest extent possible. The initiative is influenced partly by 9/11, where the lack of the existence of a policy led to increased litigation.

MR. MOXON- BROWNE: Is the FSA behind these proposed reforms?

MR. RENDALL: Yes, they have said they expect the market to put it in place by the end of next year, or be well on the way to it. The plan is to have it in place by the end of this year.

MR. MOXON- BROWNE: Mr. Wood will have some questions.

MR. WOOD: This news from the U.S. that is sending a chill through the boardrooms of Lime Street - are you thinking of punitive damages?

MR. RENDALL: That is one of the concerns, yes.

MR. WOOD: Because the problem with such damages is that they allow the jury to punish insurers regardless of the loss suffered.

MR. RENDALL: Yes.

MR. WOOD: I have not seen a statement prepared by you Mr. Rendall, but I was handed a Blackberry containing some remarks made by you. The essence seems to be that we should leave it all to the regulator.

MR. RENDALL: They have the power and the necessary ability.

MR. WOOD: Are the ICOB rules tough enough and specific enough for that purpose?

MR. RENDALL: Yes.

MR. WOOD: Did your organisation object to the introduction of the ICOB rules?

MR. RENDALL: I can't comment on that.

MR. WOOD: The insurance industry promulgated the ABI Code though.

MR. RENDALL: Yes, Lloyd's is a party to that.

MR. WOOD: Are claims managers threatened or encouraged by the guidelines?

MR. RENDALL: Claims managers do feel threatened but they desire to be compliant, so anything likely to make them non-compliant is a concern to them.

MR. WOOD: Do the guidelines cause them to rush coverage decisions?

MR. RENDALL: Yes, particularly in the U.S.

MR. WOOD: Does it cause them to take counsel's opinion less often?

MR. RENDALL: I can't answer that.

MR. WOOD: FOS has the power to award compensation, the FSA has the power to award damages to private individuals.

MR. RENDALL: Yes.

MR. WOOD: But there is no civil remedy for corporate entities - is that acceptable?

MR. RENDALL: They enter into contracts of indemnity on the terms that are

available.

MR. WOOD: Is it not odd that a wealthy underwriter whose house burns down can make a claim, but not the small window cleaner who has incorporated?

MR. RENDALL: There's a difference, undoubtedly, but it has not resulted in undue unfairness.

MR. ADRIAN HAMILTON: How is it possible to get certainty in contracts (apart from the fact that it would put the Bar out of business)?

SIR CHRISTOPHER STAUGHTON: How about abolishing implied terms?

MR. RENDALL: Undoubtedly, advocates of certainty would be in favour of that.

MR. ADRIAN HAMILTON: There is greater certainty in contracts of marine insurance, but they still throw up nice problems, and that sort of drafting ability is not available to small insured's.

MR. RENDALL: I don't like the concept of contract certainty myself, it's very difficult to achieve. Insurance is about the unforeseeable, and because you cannot foresee what might happen it is impossible to construct a contract dealing with every situation that might arise - for example the use of planes as weapons in the events of 9/11. The intention of the initiative is to try to achieve *clarity* of contract.

MR. ADRIAN HAMILTON: So I was right to spend my time challenging the drafting of others rather than indulging in it myself.

MR. MOXON-BROWNE: My Lords, I should like to call my last witness, Mr. Michael Earp.

You are Mr. Michael Earp?

MR. EARP: Yes.

MR. MOXON-BROWNE: You are the Technical and Compliance Officer at Berkley Insurance?

MR. EARP: Yes. My current job involves putting the FSA's principles into process.

MR. MOXON-BROWNE: I am going to treat your report as your evidence if I may, and tender you for cross-examination by my learned friend. Thank you.

MR. WOOD: Your report says that the FSA often finds in favour of insurers,

and therefore there is no proliferation of bad faith situations in the U.K.

MR. EARP: That is my understanding. The majority of incidents are resolved in favour of insurers.

MR. WOOD: What about the minority which does get it wrong?

MR. EARP: I concur with the FOS as the route for solving problems. The issue is whether the scope of damages should be extended.

MR. WOOD: You heard my comments to Mr. Merricks. Is there anything you disagree with?

MR. EARP: My concern is more with larger companies involved in more complex claims, probably advised by insurance brokers. The role of the broker is very important. Small companies may also be able to rely on brokers to negotiate for them. The U.K. market is parochial and things get discussed in an open manner. Bad faith remedies would be counter-productive.

MR. WOOD: Mr. Merricks's report says that the courts would be out of step with the regulators if they do not allow claims in cases of bad faith.

MR. EARP: I wouldn't want to disagree with that, but the nature of the cases he sees is very different. The sort of quantum is far less worrying than in the case of complex commercial claims, where claims can range from £100,000 to over £10 million.

MR. WOOD: £100,000 being the limit on the Ombudsman's ability to award compensation.

MR. EARP: Yes.

MR. WOOD: You are against a liability to pay where the losses flow from mal-administration.

MR. EARP: Yes, it is important to consider the size of the claims. Commercial cases can be very difficult. One problem with the American model is that it involves bad faith claims being brought *after* the insurance claim. It is better to deal with it at the same time as the claim.

MR. WOOD: There is a problem with saying there is a regulatory solution isn't there. Look at the BILA Report on Insurance Contract Law Reform, for example, where it is concluded that the "appropriate course is to remove unfairness, not alleviate it". That is right isn't it? What is needed is cure not alleviation.

MR. EARP: But there is no endemic problem to cure. The U.S. model is very revealing. You only have to look at a film like *The Incredibles* where the issue of insurer bad faith is raised right at the beginning of the film. The problem is obviously endemic in the U.S., but not here.

Legal submissions

Mr. Moxon-Browne Q.C. for Honour Bright Insurance plc

My Lords, I shall address you very briefly. We start from the position that English law does not permit recovery for the non-payment of damages. This rule has resulted in a number of hard cases - for example Sprung v Royal Insurance [1999] Lloyd's Rep. I.R. 111. The case before the Court today is another. But that does not mean this court cannot change the law if it is appropriate to do so. In our submission, however, the Court would not want to do so unless it could see that there was a widespread problem as in the United States, and there is not a shred of evidence that there any such problem in this country. The evidence shows that the insurance industry is a well regulated profession, and that the FSA has teeth and is able to deal with the few bad faith cases that arise.

If this court *were* minded to change the law, however, then there are two directions in which it might go. First, that of the stand-alone duty of good faith. Second, that of the implied term.

The problem with good faith as a stand-alone remedy is that the jurisprudence as carefully developed has decided that the duty at the claims stage should be no more than one of honesty. That at that stage, the relationship between the parties has a simple commercial character. That to ask for any more than that would be to ask too much of insured's. Insured's would find it hard to accept that there should be any special duty, and if there is to be a new principle, in our submission under our law it would have to be reciprocal. It is said that the traditional remedy for the breach of the stand-alone duty of good faith is avoidance is no good to an insured. But the law is evolving, a work-in-progress, and it is not going to be improved by bolting on solutions from other jurisdictions. Good faith is not the way to go in our submission.

This leaves the second route, that of the implied term. The BILA Report on Insurance Contract Law Reform contained two proposals. First, that claims should sound in debt, not damages. Second, that a term should be implied obliging insurers to pay claims promptly. In our submission, the court should be slow to imply terms into insurance contracts. These contracts are made in a competitive market, often between sophisticated parties, where there is equality of arms. The real vice of this route, though, is that it would only assist those insured's that can bring their claims for special damages with the second limb of Hadley v Baxendale (1854) 9 Ex 341. The law has been liberalised since The Liesboch [1933] AC 449, but one still one must assume some knowledge by the insurer of the financial position of the insured. There is thus a danger of creating a sub-class of insured's who find it difficult to obtain

insurance, at least on good terms. That, in our submission, is against the public interest.

The court should hesitate to do anything that would not serve the type of consumer that it is concerned to help. And as the witness evidence warns us, the only people who will benefit from these proposals are the lawyers.

Mr. William Wood Q.C. for Goodheart Limited

My Lords, we now experience a change of gear. Having discussed what the law ought to be, it is time for a technical discussion on issues such as the proper characterisation of a liability to indemnify. Luckily, your Lordships may tonight lay waste to the common law. There are two core propositions I wish to make. The first is that decision in The Italia Express [1992] 2 Lloyd's Rep. 281, while applying an elegant and useful construct, has serious and wrong consequences. In property insurance the insurer's primary obligation is to compensate the insured or reinstate the property, not to prevent loss from occurring. The decision places the law at odds with the ordinary expectations of insured's.

[*Sir Christopher Staughton*: that was taken into account was it not in Suisse Atlantique v. N.V. Rotterdamsche [1967] 1 AC 361, which decides that the deliberate breaking of an insurance contract is no different from the breaking of any other contract. Would you agree?]

We do not see the deliberate nature of the conduct as the touchstone. Lack of good faith is only one of the three causes of action we assert. There are two others. First, that even if The Italia Express is correct, we say there can be implied terms requiring prompt payment and investigation. In Sprung, Lord Justice Evans was willing to find such a term in the policy before him.

If Lord Justice Evans was correct to do so, as we submit he was, then my learned friend's only refuge is the second limb of Hadley v Baxendale. But the idea that damage caused by allowing the factory to burn down and then failing to pay for 3 to 5 years requires knowledge of special circumstances must surely be wrong - it is so obvious that that will have adverse consequences that no special knowledge is needed. Insolvency is an obvious result.

Our third argument is that avoidance is an inappropriate remedy for a breach of the duty of good faith by an insurer. We invite the court to review the decision in The Star Sea [2001] 2 WLR 170. Counsel's concession in that case that avoidance was the only remedy available was accepted without argument. We invite the court to find that damages are available for breach of the duty of good faith. In so doing, we make no claim for punitive damages. We will prove a specific claim.

Finally, it is in our submission no answer to the criticism that avoidance is an inappropriate remedy that the problem of insurer bad faith is not endemic. The court still has a duty to provide a remedy. The suggestion that a regulatory solution is sufficient is wrong. As Lord Justice Longmore argued in the Pat Saxon memorial

lecture he gave in March 2001, the very acceptance by the insurance industry of codes of practice shows that the law ought to be different from what it is. If even insurers accept that surely it is time that the rights of not merely consumers but of all insured persons should be enforceable as a matter of right not as a matter of discretion: “surely”, he said, “we should be able to look forward to a better day”.

The judgments

Sir Christopher Staughton

Those of you who come from the USA may be surprised to hear that it is the habit of English judges to give judgments straight away. It is not as common now as it was, but this case is perfectly clear, and I can give judgment straight away. My colleagues will have to listen to see if they agree.

Goodheart Limited had their property damaged on the 1st January 2000. It took three and a half years for the claim to be settled. Well, that is far too long. Why did they allow it? It is quite unnecessary. In the old days there used to be legal aid.

Be that as it may, we are told the loss adjuster made some unfortunate remark to the insured. But what difference does it make? How does that make it improper for the insurer to investigate the claim? As I see it, insurance is not a special case. It is no different from any other type of contract. There should be no special rule making it the law more favourable to the insured. As I have said before, English law does not recognise a concept of bad faith. In Suisse Atlantique Lord Reid said no allegation of bad faith had been made. It is obvious that he accepted that bad faith is not part of English custom law. I also have here two elderly books on insurance law. One of them was published in 1932. It says on page 215, “*interest is not payable as a matter of course on the amount due under a policy. It is only awarded if the jury thinks it fit as damages for the late payment of money.*” There it is.

We have been fortunate to have had witnesses of a very high standard. Some were more convincing than others. Mr. McVisk said that there were very rarely any outrageous judgments awarded in the United States. Mr. Leahy said that if there were bad faith damages premiums would go up. Of course they would. We cannot allow that. If that happened, how can poor householders afford insurance at all? Mr. Rendall said what he wanted was certainty. That would be hard on counsel if not a bad thing for judges, but I fear that will never be achieved. Mr. Merricks had the unfortunate task of trying to defend the enthusiasm for regulation in this country. In my judgment, commerce can manage its own affairs without too much help. At all events, I would uphold the decision of the court below.

Sir Philip Otton

It is with some hesitation that I find myself unable to agree with my brother Lord Justice Staughton. I found the evidence totally convincing. As a result, I find myself in a state of doubt. In days of yore, judges would find a Latin tag, but it is well known that Lord Justice Staughton has forbidden the use of Latin in his court. [*In*

fact, it was Lord Woolf]. I merely say that I am dubitante (which the cognoscenti will note I pronounced with an Italian accent).

The question posed is whether we need a new cause of action. In my view, assuredly yes. There is a lacuna in English law exposed by the facts of this case. Where there is an injustice there should be a remedy. A remedy in costs is not enough. In the past insurers could be trusted to deal with claims fairly, but no longer. And I share the scepticism of my brother Staughton concerning regulation. Those concerned with the oppressed could not and should not be given the same task in respect of commercial enterprises.

The question to my mind is therefore which of the four doors suggested we should open. Mr. Moxon-Browne persuades me that the door marked bad faith is a road to terror. Mr. Wood suggests three other possibilities: an implied term to pay claims promptly; an implied term to deal with a claim promptly; or damages for breach of the duty of good faith. I consider the appropriate door is that of the implied term. I consider that an implied term of a modest nature would not be repugnant to the common law and I abide with Mr. Wood's proposal that an insurer should be obliged to deal a claim in a reasonable period. Whether he has done so should be a matter for the judge alone. The rule in Hadley v Baxendale ought then to provide adequate compensation, but I am conscious that there may be grave difficulties in this case with causation. I sympathise with Mr. Goodheart. But that does not deter me from advancing an implied term. I was finally attracted to it by Mr. Earp. I would add, however, that one should not reach for the writ too early, but should explore ADR as well. That could be easily done through the insurance industry or via the City Disputes Panel. A dispute such as this might be resolved through arbitration or mediation.

I would imply a term and allow this appeal.

Mr. Adrian Hamilton Q.C.

I think there are limits to what the law can do. One has to bear those in mind as much as one also has to bear in mind what the law currently is. The law as it stands is that there is no claim for damages for the failure to pay damages. That is a point of principle. I see no reason why different principles should apply to insurance policies. But an insured is entitled to a payment to make good his loss. The effect of an insurer's obligation being to pay damages rather than to pay a sum of money is inconsistent with the proper development of the law. I would say that it is not a claim sounding in damages.

Second, I believe there is room for the implication of a term. Very few policies oblige an insurer to pay within a certain time so insurers can simply get away with it. There must be some basis for preventing this. I would be happy to go along with my brother Otton and imply a term that an insurer must pay a claim reasonably promptly. Experience shows that loss adjusters can be quite difficult, so I would say that there has to be a term, or they may never come to the moment when they have to pay.

As to the third finding of the judge below, I would be reluctant to say that it was relevant for an insurer to know the financial standing of the insured. But the point must be determined in accordance with ordinary principles.

As far as concerns the extension of the law of the post-contractual duty of good faith, as has been remarked, the law needs to develop appropriately. The right way to do that is not suddenly to put in a new term of the sort carefully debated. If such a term were to require a claim to be dealt with promptly, that would seem to me to be reasonable. I hope Parliament and the Law Commission will look at all the implications. But it is a complicated matter and it needs careful consideration and certainty.

I would reverse the judgment for reconsideration on the principles adumbrated.

Sir Christopher Staughton

Well, as Lord Denning once said, you two will have to dissent.

[Following the conclusion of the case, a vote was taken and a majority of those attending the event as spectators voted in favour of a remedy]