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Better late than never: Late payment of damages

Roger Franklin discusses the introduction of the Enterprise Bill 2015, which will place an insurer under a duty to pay policyholders with valid claims within a reasonable time



Under the current law of England and Wales, a policyholder who has not been paid a valid claim by their insurer is entitled to sue for damages and interest, but is not entitled to damages for any further loss caused by the late payment of that insurance claim. This anomalous (and often unjust) aspect of insurance law is about to be changed by the introduction of the Enterprise Bill 2015.

Under general contractual principles, if a party breaks a contract, then, subject to certain limitations, the other party may claim damages for the actual loss suffered, provided it was foreseeable at the time the contract was made. What is foreseeable is defined as losses which (a) may reasonably be considered as arising 'according to the normal course of things; and (b) arise from any special circumstances that were

communicated at the time the contract was made (see *Hadley v Baxendale* (1954) 9 Exch 341).

Payment of damages

Insurance law is an exception to this principle. This is because of a long-established fiction relating to contracts of indemnity whereby an insurer's primary obligation is to hold the insured harmless, so that the insurer is said to promise the loss will not occur. When the loss does occur, the insurer is liable to pay the amount of the claim as damages. A breach of a contract of insurance therefore does not give rise to a primary obligation to pay money, but to a secondary obligation to pay damages.



What is a 'reasonable time' will depend on the circumstances of each claim

Since English law does not recognise an obligation to pay damages for a failure to pay damages, all an insured can recover for a delayed payment of damages is interest. The definitive case on this is *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep IR 111, which, although followed in several subsequent decisions, has been

considered by many practitioners to be ripe for challenge, not least because it was argued by a litigant in person.

However, help is at hand. The Enterprise Bill 2015 will amend the Insurance Act 2015 by adding two further sections providing for damages against an insurer for late payment of the claim. It will introduce an implied term that will place an insurer under a duty to pay policyholders with valid claims within a reasonable time.

Reasonable time

What is a 'reasonable time' will depend on the circumstances of each claim, and will be determined by:

- 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.

The insurer's conduct will also be relevant. A defence will be available if reasonable grounds exist for disputing a claim. What is reasonable in this context has been left open, but insurers will be permitted adequate time to investigate legitimate areas of concern.

If there has been a breach of the implied term to pay within a reasonable time, the usual remedies for breach of contract, including damages, will apply. Consequently, the usual causation tests will apply. Policyholders will have to prove

their additional losses on the balance of probabilities.

The new provisions are aimed at small and medium-sized enterprises with limited access to substantial financial resources or to the Financial Ombudsman Service. The government also recently introduced an amendment (to be reflected in the Limitation Act 1980) to the effect that the limitation period in which an insured can bring a claim for damages for late payment will be one year from the date of the last payment by the insurer in respect of the relevant loss. This is to provide greater certainty for insurers. As matters stand, the Bill is likely to become an Act of Parliament in mid-2016.

It will not be possible to contract out of the implied term in consumer insurance contracts, but it will be possible in contracts for business insurance, subject to the transparency provisions in the Insurance Act 2015. Whether contracting out will be popular remains to be seen. An insurance policy which expressly states the insurer will not pay valid claims within a reasonable timeframe is hardly a compelling marketing tool.

Practitioners need to be aware of this development, particularly when assessing claims for loss of rent or business interruption, where delay in the payment of a valid claim for material damage can substantially increase the losses arising from the insured peril, notwithstanding the contractual indemnity period. **SJ**