

Remedies for the Late- and Non- Payment of Insurance Claims: A View from the Boundary

James Davey*

I. Remedies for Breach of Underwriter’s Duty to Pay Claims in a Reasonable Time: Framing a Plausible Hypothetical

One of the most obvious differences between the UK and US systems of liability insurance is found in the remedies enforceable against an insurer that fails to indemnify its insured as required by the insurance policy. Whilst there have been recent steps to narrow the gap, the UK insured is in a notably weaker position and this is by design. The spectre of ‘bad faith’ litigation has been used to scare policymakers and politicians away from substantial intervention in these markets.¹ The limited change that has been introduced may be both costly and ineffective, which is regulatory failure squared. This paper reviews the recent changes in the UK regulatory, statutory and common law realms and provides a brief comparison with the US model. This is a sketch of a more focused piece to follow, which will provide a consideration of the underlying policy objectives visible in each jurisdiction.

Take the following hypothetical case as the basis of our comparison:

Apex Decorating Services Ltd (ADSL) was a small family business operating at a regional level in an English town. Incorporated in 1966, it renovated private homes and small-scale commercial and government buildings. This work included the use (and removal) of asbestos for much of the first fifteen years of the company’s existence. In 2016, it became insolvent in the face of several claims brought against it by former workers who are suffering from mesothelioma, presumably related to the inhalation of asbestos particles. For the sake of simplicity, we will operate on the basis of a single claim from Edward, who worked for Apex from 1966 – 1980, and who was exposed to asbestos particles throughout this period.

For most of the 50 years of its existence, ADSL was insured under an employer’s liability policy, as required under English law. Prior to the adoption of the Employer’s Liability Compulsory Insurance Act 1969, it was uninsured. Between 1971-74, there is evidence that it was insured with three different UK insurers (*Alpha, Bravo & Charlie Ins Co Ltd*), but there is no detailed record which records the terms or the precise policy dates of cover. In 1975, it started a long-term relationship with Sun Alliance (later Royal & Sun Alliance), with the policy renewed annually during that period. That policy excluded asbestosis risks as standard during

* Professor of Insurance & Commercial Law, University of Southampton. This is work in progress and I am happy to receive comments.

¹ See the evidence of insurers, representative lawyers and the judiciary to the Special Public Bill Committee considering the Insurance Act Bill (<https://services.parliament.uk/Bills/2014-15/insurance/stages.html>).

this period. In 1980, six months before Edward left the company (to work in an alternative industry with no asbestos exposure) ADSL moved insurers to *Delta*.

Assuming Edward (and his representatives) seeks to recover in full damages in tort for mesothelioma from Delta, on the basis of its rights following the insolvency of ADSL:

(a) How is the loss distributed between the insurers (and/or the uninsured ADSL during 1966-1980)?

(b) What further potential liability would arise from *Delta* taking a considerable amount of time to investigate its liability to ADSL, in light of questions regarding the potential liability of other insurers to ADSL; and the possibility for contribution from other insurers?

Take the following alternative circumstances in which Delta delayed payment:

(i) One of four of *Delta*'s claims handling teams had taken the strategic decision to 'slow ball' all 'direct action' mesothelioma employer liability claims in the hope that some claims fall away after the employee is deceased.

(ii) Delta seeks to delay payment to Edward, aware that its limitation period for recovery from other underwriters is capped at two years. It hopes that a short delay (an extra 3 months) will enable it to establish the position of Alpha, Bravo and Charlie and commence proceedings against them.

(iii) *Delta* resist claims to pay the entirety of a tortious claim, on the basis that its legacy employers' liability policy contained a 'rateable contribution' clause where double insurance exists. Case law exists that this clause is inoperative in these circumstances.

(iv) *Delta* has recently moved offices and subjected its legacy data systems to a GDPR compliance review and update. A number of the legacy systems are now suffering from substantial IT issues. Furthermore, a serious illness to the manager of the claims handling team responsible for Edward's claim, and the failure to swiftly appoint a replacement, means that paperwork is not acted upon swiftly. Following this delay, the claimant's representative (his wife) asks for a pause in the process as Edward is in a hospice. There is a further delay of 3 months.

II. Liability, Liability Insurance, Contribution between Insurers and the Peculiar World of 'Hold Harmless' Indemnification in English Law

As in much of English commercial law, the mechanism for determining the remedies which can be used against a party in breach stem from a classification of the duty breached. The juridical basis on which an insurer is liable to pay a claim under English law is ancient and extraordinary. Under English law, an insurer's promise of indemnification is normally found to have (implicitly) promised to 'hold harmless' the insured. This is viewed as a promise to avoid a loss from occurring, so that recovery from the underwriter is on the basis that it failed to prevent the loss, and so is liable in damages for breach of contract.

As I have written before, this was not a positive choice in favour of this classification but the result of the undeveloped nature of contract law, theory and practice at the time when the rule first emerged.² This rule can have perverse consequences, not least on the remedies for breach.

To exemplify the difficulties that arise from this archaic model, we work towards a review of the recent decision in *RSA Insurance PLC v Assicurazioni Generali SpA*.³ To do so, we need to unpack the liability and liability insurance rules which the UK courts (and to a lesser extent, Parliament) have developed in the Twenty-First Century as a response to malignant mesothelioma. This section broadly establishes part (a) of the hypothetical question set: the scheme for indemnification. The second element, part (b), on remedies for late payment in English law and beyond are discussed in more detail in parts III-IV. This latter part is the real focus of this paper, but it can only be appreciated in the context which part (a) provides.

We proceed in the short term by identifying some key principles of English law in respect of liability and liability insurance:

[A]. Direct Right of Action Where the Insured Tortfeasor is Insolvent

Under English law, where the insured becomes insolvent, the injured third-party is entitled to bring an action directly against the underwriter once it has ‘established liability’ against the insured tortfeasor.⁴ This is a form of statutory assignment, and the injured third-party is subject to contractual defences which the underwriter would have had against the insured (including coverage questions and other contractual defences). Much more could be said on the detail of these rules (which have been recently amended by statute) but this paper rests only on the general principle: that the monies due under the liability insurance policy are not simply distributed to the other creditors of the insolvent company, but may be hypothecated to the tortious liability at hand.

[B]. Liability & Quantum Assessment for Mesothelioma

In the breakthrough case of *Fairchild*,⁵ the Supreme Court held that practical justice required that the courts adapt the normal requirements of proof of harm. Faced with workers who had

² This paper is an update on work published as J Davey, ‘Once More Unto the Breach: Remedies for the Non-Payment of Insurance Claims after *Blake*’, in P Giliker (ed), *Re-examining Contract and Unjust Enrichment*, (Brill NV, 2007). I am happy to supply copies of that work, although the law has moved on considerably since 2007. Correspondence to J.A.Davey@soton.ac.uk.

³ [2018] EWHC 1237 (QB).

⁴ Third Party (Rights Against Insurers) Act 1930, replaced by the Third Party (Rights Against Insurers) Act 2010 with effect from 01/08/16.

⁵ *Fairchild v Glenhaven Funeral Services Ltd* [2003] 1 AC 32.

been exposed to asbestos dust and contracted mesothelioma during a career working among hazardous substances, the court was prepared to impose liability even where it could not be proven during which during period of employment the fatal particle had been inhaled. However, the effect of this was substantially limited in *Barker v Corus*⁶ in which the Supreme Court restricted the extent of the individual tortfeasor's liability to their contribution to the risk run. The *Corus* rule does not alter the 'breach of duty' question in *Fairchild*, but establishes the measure of quantum in such cases. This would mean that successive employers (and normally, their respective liability insurers) would each bear a portion of the loss, normally corresponding to the number of years covered. This was reversed for mesothelioma caused by the inhalation of asbestos by statutory intervention under s. 3, Compensation Act 2006. The basis for the statutory intervention was that the *Corus* rule placed the risk of insolvency, under-insurance or lack of available information on the fatally ill claimant, each defendant only paying their contribution. Under the Compensation Act, asbestos / mesothelioma cases attracted joint and several liability between defendants. On this basis, the final employer in the chain, who might only have employed the worker for a few months at the end of its corporate life, might be liable for the entire claim. It would be able to seek contribution from other employers, but the risk of recovery of these sums would fall on that company. The limited nature of the Compensation Act rule should not be overlooked, and the *Corus* common law rule remains for other forms of illness or causal pathway.

[C]. Liability Underwriter Exposure for Mesothelioma Cases

As is to be expected, litigation at the highest level has subsequently tested the effect of these rules on liability insurer's exposure. We can identify here a core principle on the distribution of liability between insurers, and a series of related propositions, related to the interpretation of contractual provisions, including trigger and 'double insurance' clauses.

C.1 Liability Allocation between Insurers

The Supreme Court in *Zurich v IEG*,⁷ sat as an extraordinary panel of seven justices, rather than the standard five. The significance of the issue is such that even though the case could be resolved on an unrelated point of law (as the issue arose in a jurisdiction in which the Compensation Act 2006 was not in force), the court nonetheless gave fully reasoned opinion on this *obiter* point. For simplicity's sake, I will refer to these as the majority and minority

⁶ [2006] 2 AC 572.

⁷ [2016] AC 509.

positions. This resulted in a 4:3 division, with the majority position captured by Lord Mance and the minority by Lord Sumption. Under the majority position, just as any one employer who has exposed the worked to asbestos during the relevant period is liable for the entirety of the loss, so any one insurer would be liable for the entirety of the loss, irrespective of the period of coverage. This decision was, in the eyes of Lord Mance, a necessary consequence of the changes to the principles of causation and harm adopted in the *Fairchild* exception, associated case law. The justification for this extension in principle is lengthy and complex, but should be quoted in full:

[51]... An insurer, whether for the whole or part of the period for which the insured employer has negligently exposed the victim to asbestos, is on the face of it liable for the victim's full loss. However, I agree that the analysis cannot stop here. The court is faced with an unprecedented situation, arising from its own decisions affecting both tort and insurance law. A principled solution must be found, even if it involves striking new ground. The courts cannot simply step back from an issue which is of their own making, by which I do not mean to suggest that it was in any way wrong for the courts, from *Fairchild* onwards, to have been solicitous of the needs of both victims and insureds. But by introducing into tort and liability insurance law an entirely novel form of causation in "Trigger",⁸ the courts have made it incumbent on themselves to reach a solution representing a fair balance of the interests of victims, insureds and insurers.

[52] In my view, the law has existing tools which can be adapted to meet this unique situation. The concepts of co-insurance and self-insurance are both at hand. Co-insurance is relevant in so far as the insured has other insurance to which it could also have resorted on the basis that it had also exposed the victim during the period of that insurance. Self-insurance is relevant, because an insured who has not (i) taken out or (ii) kept records of or (iii) been able to recover under such other insurance must be regarded as being its own insurer in respect of the period in question for which it has no cover. A sensible overall result is only achieved if an insurer held liable under a policy like the Midland policy is able to have recourse for an appropriate proportion of its liability to any co-insurers and to the insured as a self-insurer in respect of periods

⁸ The litigation which resulted in the Supreme Court decision in *Durham v BAI (Run off) Ltd* [2012] 1 WLR 867. has become generally known as the 'Trigger' case.

of exposure of the victim by the insured for which the insurer has not covered the insured...’

The imposition of liability on any one insurer which was on risk for a relevant period of employment is then assumed to be counterbalanced by its ability to recover from the other insurers (and the insured, where treated as ‘self-insured’) for a contribution. The operation of this contribution principle is what was at stake in the *RSA* case.

C.2 Allocation between Reinsurers

The immediate academic response to *Zurich v IEG* queried whether the logic behind making any one liability insurer responsible for the entirety of the loss (subject to later contributions), also extended to subsequent layers of reinsurance and retrocession cover. This issue is not directly before the courts, but has been discussed in an action seeking leave to appeal from an arbitral decision given by an eminent Court of Appeal judge (Julian Flaux LJ) sitting as judge-arbitrator. In *Equitas Ins Ltd v Municipal Mutual Ins Ltd*,⁹ the Court of Appeal held that the findings of Flaux LJ as arbitrator were ‘open to serious doubt’, the relevant test under the Arbitration Act 1996 to allow the issue to be tested before the courts. On this basis, Flaux LJ’s determination that there was **no** ‘principled basis for concluding that [the apportionment principle, not applied to primary insurers] should nonetheless dictate the issue of the liability of the reinsurers and indeed, every principled basis for concluding that it should not’ must be considered unproven at best.¹⁰ The practical effect of this is that the reinsured could allocate any and all incoming losses to any reinsurance period which overlapped with the primary indivisible tort liability. This would be of great significance where to do so would bring the reinsured’s liability above Treaty limits, and trigger extended cover. Gloster LJ also doubted his decision that any continuing duty of utmost good faith at claims was limited to a duty to act honestly, and that the reinsured was entitled to allocate losses in its commercial interest. Given the lack of consensus among senior judiciary, and the likely sums involved, these issues may well return to the courts as substantive arguments in due course.

⁹ [2018] Lloyd’s Rep IR 377.

¹⁰ At [7].

C.2 Liability ‘Trigger’ Provisions

In the leading authority of *Durham v BAI (Run off) Ltd*,¹¹ underwriters tested the ‘triggers’ for coverage across a wide variety of employer’s liability insurance wordings, variously described as the illness being ‘contracted’ or ‘sustained’ during the period of cover.

It was reported by the court that the historic market position on these clauses was to assume that the date of exposure operated to trigger potential liability for insurers.¹² The court was particularly troubled by standard form insurance policies that attached coverage to an illness or disease being ‘sustained’ during a period of cover. Insurers argued that such policies only required indemnification for diseases that were physically manifested during cover:

‘These alternative bases of response (or “triggers” of liability) have been loosely described as an occurrence (or manifestation) basis and an exposure (or causation) basis’.¹³

On the construction point, on the meaning of ‘sustained’, Lord Mance was prepared to find that this still referenced exposure and not manifestation. His reasoning was based on a wide variety of factors,¹⁴ but was strongly influenced by the compulsory nature of employer’s liability insurance, and the Parliamentary and actuarial assumptions that the scheme for compensated injured workers was based on the risk at the moment of exposure and not the circumstances at the moment that the harm became apparent. The further issue, on the nature of causation in such cases, is of considerable interest for a wider study of the area, but detailed discussion is omitted at this point for reasons of space. The majority were prepared to find that exposure to asbestos in these circumstances could be viewed as infliction of the disease which later occurred, and that it was not the ‘increase in risk’ that represented the basis for a claim against the employer. This brought those claims within the liability insurance policies, but required a degree of legal fiction to achieve.

¹¹ Above, n 8.

¹² At [10], ‘As a matter of insurance practice, however, until the decision in *Bolton Metropolitan Borough Council v Municipal Mutual Insurance Ltd* [2006] 1 WLR 1492, all these wordings, whether tariff or non-tariff and whether using the language “caused”, “sustain” or “sustained or contracted”, paid out on long-tail claims (including the mesothelioma claims which became increasingly frequent in the 1980s) by reference to the date(s) of exposure’. The *Bolton* case concerned public liability policies (as opposed to employers’ liability policies), and the policy concerns are not identical in each.

¹³ At [3].

¹⁴ (a) Linguistic ambiguity: Sustained & disease is always a strained connector; (b) Actuarial calculation of risk as guide to interpretation; (c) Workplace mobility would render occurrence highly ineffective at matching compulsory insurance cover with those affected; (d) Real risk of non-renewal of cover where dangerous activities were observed but long term effects not yet felt; (e) Statutory & policy territorial limits (UK) and ‘sustain’ where employer develops disease whilst abroad; and (f) Consistent with proper interpretation of EL(CI)A 1969.

C.4 ‘Double Insurance’ Clauses

In *Phillips v Syndicate 992 Gunner*,¹⁵ we see the next step in this line of case law. We now take as read that any one liability underwriter may be liable for the entirety of the loss as a matter of principle if it insured a period in which exposure occurred which would be taken as having caused the mesothelioma. But what if the policy contains a ‘double insurance’ clause, such as cl 6 below:

‘If at the time any claim arises under this policy there be any other insurance covering the same liability the Underwriters shall not be liable to pay or contribute more than their due proportion of any such claims and costs and expenses in connection therewith’

There is a substantial body of case law derived from marine insurance dealing with situations where insurers seek to move themselves back in the queue, where multiple insurers have covered the same risk. There are immediately obvious issues where such clauses create mutually incompatible claims (eg that every insurer would only indemnify if no insurance was in place), but this clause cannot be objected to on that basis. It merely states that the underwriter will only pay a proportionate share, and this would not conflict with other underwriters using the same clause. The court noted that it was the first time that insurers had relied on such a clause in mesothelioma practice, and articulated a wide variety of reasons why such a clause was ineffective at altering liability. The clause was said to be limited to double insurance and not successive policies. There are undoubtedly conceptual difficulties with this issue, as the appellate court decisions discussed above treat indivisible illness such as mesothelioma as operating on the basis of payment by one insurer followed by contribution from other issues covering the period of exposure of the injured third party. The alternative measure- which applies for other types of industrial disease- which is proportional payment is the default position under English law, other than where the ‘*Fairchild*’ exception and *Corus* applies. Eady J’s analysis depended on viewing each material contribution to the risk as representing discrete liabilities (‘different slices of a continuing breach of duty’¹⁶) rather than an indivisible infliction of a disease at some indeterminate point of exposure.

C5. Contribution between Underwriters for Mesothelioma Exposure

The *RSA* case arose in the context of a Compensation Act 2006 claim. Three insurers were ultimately found to have provided liability insurance to the insured tortfeasor during the period

¹⁵ [2004] Lloyd’s Rep IR 426.

¹⁶ At [31].

of employment of the worker in question. However, on the basis of *Zurich v IEG* and the principle established in s. 3, RSA was liable.¹⁷ The material contribution to the risk faced was assessed (by RSA) accordingly:

Period of Cover	Start	End	Insurer	% Contribution claimed
1	1 October 1975	15 June 1979	Aviva	59.74%
2	16 June 1979	31 March 1981	-	
3	1 April 1981	31 March 1983	Generali	32.24%
4	1 April 1983	31 March 1985	-	
5	1 April 1985	30 September 1985	RSA	8.02%

RSA therefore sought substantial contributions from the other insurers discovered to have insured the tortfeasor during the relevant periods of employment. The juridical basis of the insurers' duty to pay liability claims was crucial to the application of the law on contribution. HHJ Rawlings QC distinguished between two types of indemnity: 'Damages Indemnity Liability' and a 'Debt Indemnity Liability'. This analysis, as we will see, is vital for the determination of rights under English law for the late payment of claims. It is yet another notable 'legal fiction' in the field, with unintended consequences.

The key issue in *RSA* was whether the sole basis for claims for contribution between insurers on risk for mesothelioma exposure was the general statutory provision that applies between parties which each have liability in damages (for the same damage), or whether the court could allocate by some other means, such as a rule in Equity. It was agreed between the parties that s. 1 applied if the liability of an insurer under a mesothelioma case was a claim in damages and not in debt. Moreover, if s. 1 applied, any claim for contribution was time barred, as s. 10(1) Limitation Act 1980 imposed a two-year limit on such calls. The provisions are as below:

Civil Liability (Contribution) Act 1978
--

¹⁷ S. 3(2) 'The responsible person shall be liable—

- (a) in respect of the whole of the damage caused to the victim by the disease (irrespective of whether the victim was also exposed to asbestos—
 - (i) other than by the responsible person, whether or not in circumstances in which another person has liability in tort, or
 - (ii) by the responsible person in circumstances in which he has no liability in tort), and
- (b) jointly and severally with any other responsible person'.

1.— Entitlement to contribution.

(1) Subject to the following provisions of this section, any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage (whether jointly with him or otherwise).

Limitation Act 1978

10 Special time limit for claiming contribution.

(1) Where under section 1 of the Civil Liability (Contribution) Act 1978 any person becomes entitled to a right to recover contribution in respect of any damage from any other person, no action to recover contribution by virtue of that right shall be brought after the expiration of two years from the date on which that right accrued.

In determining the debt / damages basis for an underwriter's liability to its insured (and by logical extension, when paying an injured third party directly), the High Court took a somewhat circuitous route to the generally agreed position, that insurance claims are normally classified as claims for unliquidated damages. The legal basis for this is the somewhat perverse legal fiction that the underwriter has promised that the insured event (here, the liability of the employer) will not arise. This 'hold harmless' version of indemnification is well established, and while judges have raised a critical eye at the rule on first discovery, it has never been seriously challenged.¹⁸ Rather than repeat my review of the origins of the rule, which can be found elsewhere,¹⁹ note that one of the core reasons that I was given for NOT reforming it in the recent remaking of English insurance contract law was that it usefully answered the questions on limitation in insurance law. The *RSA* case is the biter bit.

At this stage we can usefully summarise the rules of liability distribution through the liability insurance chain as below, but with the caveat that the reinsurance position (not shown) is unsettled.

¹⁸ A classic example of judicial disquiet but eventual submission to the rule is *Transthene v Royal Insurance* [1996] 1 LRLR 32, 40:

'Insurers could be forgiven for thinking that they commit a wrong when, but only when, they wrongly refuse to meet a claim made against them. [Counsel's] argument is one of pure law, based on authority; its strength is not reduced by the surprise which property insurers may experience if [his] argument is correct, with the consequence that they are, collectively, in breach of contract hundreds or thousands of times every day, whenever a fire, a flood, a road accident or other such event occurs'.

I will not rise to the bait of discussing his account of a breach of contract as a 'wrong'.

¹⁹ See above, n 2.

Summary of the Liability chain

Asbestos
Risk
(Employer)

Other disease

Liability for material
contribution to risk, but
quantum limited to
representative share.

Mesothelioma

Joint and Several Liability
for Employers
[Compensation Act
2006]

Joint & Several Liability
for Insurers of any one
Employer (if multiple
years of exposure)

Contribution
between insurers
of that employer

III. The Remedial Regime Proposed in the Restatement

For reasons of space, I will limit my discussion of the US position as found in the Restatement to the remedies available for a breach. I will not discuss the duties, other than in passing. In order to explain the position adopted elsewhere, I have explained the substantive duties at claims in greater detail by way of framing the remedies in other jurisdictions, as I assume the audience will be less familiar with UK or New Zealand law and the outcome of the Principles of European Insurance Contract Law working group.

§ 48. Damages for Breach of a Liability Insurance Policy

The damages that an insured may recover for breach of a liability insurance policy include:

- (1) In the case of a policy that provides defense coverage, all reasonable costs of the defense of a potentially covered legal action that have not already been paid by the insurer, subject to any applicable limit, deductible, or self-insured retention of the policy;
- (2) All amounts required to indemnify the insured for a covered legal action that have not already been paid by the insurer, subject to any applicable limit, deductible, or self-insured retention of the policy;
- (3) In the case of a breach of the duty to make reasonable settlement decisions, the damages stated in § 27; and
- (4) Any other loss, including incidental or consequential loss, caused by the breach, provided that the loss was foreseeable by the insurer at the time of contracting as a probable result of a breach, which sums are not subject to any limit of the policy.**

§ 49. *Liability for Insurance Bad Faith*

An insurer is subject to liability to the insured for insurance bad faith when it fails to perform under a liability insurance policy:

- (a) Without a reasonable basis for its conduct; and
- (b) With knowledge of its obligation to perform or in reckless disregard of whether it had an obligation to perform.

§ 50. *Remedies for Liability Insurance Bad Faith*

The remedies for liability insurance bad faith include:

- (1) Compensatory damages, including the reasonable attorneys' fees and other costs incurred by the insured in the legal action establishing the insurer's breach of the liability insurance policy and any other loss to the insured proximately caused by the insurer's bad-faith conduct;
- (2) **Other remedies as justice requires;** and
- (3) **Punitive damages when the insurer's conduct meets the applicable state law standard.**

IV. 'Common Law' Variations on a Theme: Insurer Duties at the Claims Stage

[A]. *Sprung* and the Mischief of Late and Non- Payment of Insurance Claims

We begin with the mischief that existed in UK when I last reviewed this area in print, with the 'hold harmless' vision of indemnity denying insureds any remedy against underwriters for late or non-payment of insurance claims.

The case which best demonstrates this principle is *Sprung*,²⁰ which involved a 'litigant in person' seeking to recover for consequential losses (in essence the loss of his business as a going concern) as a result of his insurer refusing to cover damage. The insurer's representatives visited the premises twice in a five week period, made almost no inspection of the damage before declaring that the insured was not covered for wilful damage, such as vandalism. There was no such limit on the insurance. The subsequent process was described by the Court of Appeal as:

'[the] not altogether unfamiliar... history of correspondence and discussions when an insurance claim is made and the insurance company, for whatever reason, is clearly

²⁰ *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep IR 111.

most reluctant to pay... it has never once been suggested that the claim by the plaintiff is otherwise than honest and was made in good faith throughout'

Unable to repair the damaged machinery without the claim being accepted, and at the end of his credit, the business collapsed.

The legal position, as became apparent, was not helpful to the claimant. It should be said that both the court and counsel for the insurer sought to identify the relevant authorities in such a way to not disadvantage Mr Sprung who was representing himself, but to no avail. Once the court had determined that an insurance claim was an action for unliquidated damages (and not an action for debt), it foundered on the well-established principle that 'there is no such thing as a cause in action in damages for the late payment of damages'.²¹ Interest might be recovered, and sometimes at above market rates, but not consequential losses, such as the loss of the business in this case.

Having determined the position for the late payment of the claim, the court sought to investigate the possible breach of some other duty- for example an implied duty to consider and resolve the case in a timely fashion (as distinct from a duty to pay a sum owed). It was acknowledged that this had not been formally pleaded before the first instance court or appellate court. Nonetheless, the Court found that sufficient reference to this issue had been raised. It began by noting that the insured had a contractual duty not to repair any damaged property without the consent of the underwriter. This was part of the standard clauses protecting the underwriter's position to investigate the claim and/or preserve its rights in subrogation. Evans LJ therefore found a matching duty 'to respond promptly to a request from [the insured] that the damage should be inspected and the question of repairs considered forthwith'.²² However, the effect of the apparent breach of this duty (by summarily denying liability) was, in the eyes of the Court, merely to discharge Sprung from his duty to obtain consent. He could act 'as if uninsured'. Having established that in those circumstances he would be unable to obtain the funds to repair his property, and would lose his business, the court were not prepared to find that the insurers' behaviour caused the loss of the business. The court would not impose on the underwriter any duty to consider the ultimate liability at that stage of the proceedings, it was only in breach of its duty to give consent to repairs. It should be noted that the Court was distinctly unimpressed

²¹ As a general principle of English law, see *President of India v Lips Maritime Corp, The Lips* [1988] AC 395 and on its application to insurance contracts, *The Italia Express (No 3)* [1992] 2 Lloyd's Rep. 28.

²² At 117.

by the tone of the underwriter's argument (even if successful in law): 'I do not find the [insurer's] submissions at all attractive either from a commercial or from a moral point of view, and found for the, 'with undisguised reluctance'.²³

The judicial reluctance to impose substantial duties on insurers to negotiate and pay claims in a timely fashion has form, Mance J specifically refused such as duty in *McHugh*:

'If any such term existed at all, it would, presumably have to be mutual. In other words, there would be a duty on the insured to present and progress the claim with reasonable speed and efficiency. Just as insurers would be obliged not unreasonably²⁴ to refuse or delay indemnity, so, presumably, the insured would be under a duty not unreasonably to delay, misstate or overstate his case'.²⁵

The existence of express contractual terms describing the duties of the insured at claims, and the existence of an effective remedy to compel performance (making compliance with claims conditions a condition precedent to the claim) are ignored here. The mutuality issue here is a particularly ripe red herring. It is the lack of contractual controls on underwriter behaviour that makes these forms of contracts incomplete.

[B]. Filling the 'Insurer Duty at Claims' Lacuna

The divergence in approach across the common law world in controlling insurer behaviour at claims is remarkable. Recent litigation in New Zealand confirmed the existence, but negligible impact, of the implied obligation of utmost good faith on insurers in that jurisdiction.²⁶ The Restatement has its tort of bad faith, nestling among other contractually based remedies. English law provides a mixture of codes of conduct and statutorily implied terms. The English rules have been generally cleansed of any association with good or bad faith, and exist as statutory duties and/or standard contractual terms. English law has shed much of the insurance exceptionalism which characterised much of its legal history. Canadian law has used the mechanism of exemplary damages, a variation on the theme of 'standard' exceptional contractual remedies.

²³ At 118.

²⁴ In the original judgment, this is recorded as 'not reasonably...', and I assume that this is a typographic error, which I have corrected.

²⁵ *ICCI v McHugh* [1997] 1 Lloyd's Rep IR 94, 136.

²⁶ *Kilduff v Tower Ins* [2018] NZHC 704.

The first organising principle then to be used in this area is to distinguish between insurance rules and general rules. Loosely correlated to this is the nature of the breach, whether it is simple in character (payment was late) or requires proof of some additional mental element denoting particular culpability, such as bad faith, negligence or a lack of good faith. Finally, we can sort by the juridical nature of the rule (contractual, tortious, statutory). This is much more significant in some jurisdictions than in others. In the UK, for example, judicially assessed damages for a promise sounding in common law tort, contract or breach of statutory duty might only show minor technical variations, such as the limitation period.

This does not mean that the basis of the rule is unimportant in setting its limits. The imposition of tort liability will draw on different normative bases than a contractual rule for legitimacy. Contract rules often require some degree of reciprocity, unless the court can be persuaded of a market failure requiring regulatory intervention, and even then, is likely to simply flag the area as requiring Parliamentary consideration. Statutory rules (in the UK system at least) are unconstrained by normative fit and may simply reflect political choice.

There is a final element that I will utilise in this work and that is what we might call the ‘(in)determinacy’ of the rule, and its associated sanction. By this, I mean the extent to which a party, making a choice between compliance and non-compliance, could calculate the price point at which non-compliance would be less costly. At this point, I make no normative claim at which level is optimal for any given type of breach, but this is fundamental but often overlooked element in the design of legal rules.

Model 1: Implied Contractual Duty of Utmost Good Faith

The most obvious source of a bespoke insurance rule lies in the invocation of the three little words that stir the heart of any insurance lawyer: ‘utmost good faith’. Derived from what is almost certainly a misreading of the position of *Carter v Boehm*²⁷ in the development of Eighteenth-Century contract law, English law (and many successor nations) created an indelible link between information asymmetries present at contractual formation and an assumption that underwriters are routinely the weaker party in information flows. This colours English law’s approach to claims more generally, and in particular the risk of fraudulent claims. There is a kernel of ‘insurance exceptionalism’ at the heart of this model, which assumes that the insurance relationship cannot be captured by general contract rules, principles and theory.

²⁷ (1766) 3 Burr 1905.

Whatever other objections might be raised to a bespoke insurance rule, the notable lack of effectiveness of utmost good faith in constraining insurer behaviour is remarkable. For reasons of space, I will exemplify this by reference to the English and New Zealand positions, but it holds good across the majority of common law jurisdictions.

The English Court of Appeal was specifically asked to consider the remedies available for a breach of the insurer's duty of utmost good faith in the *Banque Financiere* litigation.²⁸ This was decided under the original version of s.17, Marine Insurance Act 1906 which gave the remedy of avoidance of the policy as the remedy for a failure by either party to act in the utmost good faith. The *Banque Financiere* case concerned the alleged failure of underwriters to inform insureds that the broker which was representing them had been acting dishonestly in other market activity. The kind of alleged behaviour could easily affect the enforceability of the insurance contracts on which the insured was reliant for cover.

In overturning the decision of Steyn J at first instance that the doctrine of utmost good faith gave rise to the recovery of damages, Slade LJ held: 'If the banks' right to full disclosure of material facts is founded neither on tort nor on contract nor on the existence of a fiduciary duty nor on statute, we find it difficult to see how as a matter of legal analysis it can be said to found a claim for damages'.²⁹ The remedy provided in s. 17 was avoidance *ab initio*, and this was the remedy granted to the insured, even if it was of no practical use against the underwriter.

Even where courts have found a contractual basis for duties of utmost good faith, they have failed to identify a principled basis to determine the level of damages recoverable. The courts in New Zealand are faced with a swathe of insurance claims settlement cases in light of the Christchurch earthquake. In many of these cases, there were difficult factual issues as to whether the house could be repaired or had to be rebuilt from scratch. The costs of these two options often differed significantly. The situation was undoubtedly made more complex by the existence of a statutory scheme which provided partial compensation for these losses and which had to be resolved alongside the claims against underwriters.

Whilst the issue of remedies for the continuing duty of utmost good faith has been discussed for a number of years, it was only upheld as doctrine in 2016. In *Young v Tower Insurance*,³⁰ the insurer's project managers withheld one of the reports which it had commissioned, which

²⁸ *Le Banque Financiere v Westgate* [1988] 2 Lloyd's Rep 513.

²⁹ At 547.

³⁰ [2016] NAHC 2956, [2017] Lloyd's Rep IR 605.

favoured the insured's position that the house had to be rebuilt. This was only one example of an almost total breakdown of the relationship between underwriter and insured at the claims stage, but was the lodestone of a claim for exemplary damages and/or compensation for the underwriter's failure to act with utmost good faith. I will deal with the role of exemplary damages as an aspect of general contract law remedies below, but the court's decision on utmost good faith is paradigmatic. The court recognised, but without giving it full shape, a continuing duty of utmost good faith on the underwriter. This was said to contain at least the following elements:

- '(a) disclose all material information that the insurer knows or ought to have known, including, but not limited to, the initial formation of the contract and during and after the lodgement of a claim;
- (b) act reasonably, fairly and transparently, including but not limited to the initial formation of the contract and during and after the lodgement of a claim; and
- (c) process the claim in a reasonable time'³¹

These principles have the potential to limit substantially the underwriter's commercial freedom. There are information handling duties, overarching principles when commercial decisions are being made, and obligations of timeliness. This will require considerable resource, in both the creation of systems for ensuring that processes are managed well, but also in engendering the culture of reasonableness, fairness and transparency required in (b). But judicially imposed duties without some form of sanction are likely to be underwhelming in practice. If we examine the application of these principles to real world cases, the lack of effective enforcement is remarkable. In *Young*, the deliberate withholding by a key agent of the underwriter of a document which supported the claim of the insured led to an award of NZD\$5,000 (£2,607; US\$ 3,400). Taking Gneezy's now famous empirical evidence showing that 'A Fine is a Price'³² to heart, putting a low price on this kind of behaviour might well encourage 'gaming' of the system, because those involved in the claim process can readily establish that the costs of creating a compliant system and culture are far in excess of the costs of non-performance. Whilst there might be reputational and market effects of failing to perform with the utmost good faith, the immediate private law sanctions are very limited. I have written

³¹ At [163].

³² U Gneezy & A Rustichini, 'A Fine is A Price' (2000) 29 Journal of Legal Studies 1.

in detail elsewhere on the extraordinary willingness of the courts to impose ‘Draconian’ sanctions on insureds who fail to comply with claims conditions, and in particular where the court is persuaded of dishonest intent. By comparison, this sanction is trivial.

In the second case to apply this principle, *Kilduff v Tower Insurance*,³³ the court was faced with allegations including the suggestion of a low-ball offer made by Tower Insurance before any proper assessment of the property damaged. Tower’s view was that any offer only had to be reasonable on the information then available to it, even if a proper investigation was obviously required. The *Kilduff* case has considerable value in its explanation of the decision in *Young*. Gendall J sought to further restrict the duty, and justified the ‘nominal’ level of damages awarded: ‘The standard for an award of general damages for breaching a duty of good faith in insurance contracts is a high one...’³⁴ The lack of deliberateness in the breach in *Kilduff* placed it lower in the ranking than the breach in *Young*, and the deliberate breach there was offset in part by the fact that it was the agent of the underwriter that acted in that way. The remedial regime in place therefore undercuts much of the apparently extensive duties to act with the utmost good faith.

The crucial message is it is not the lack of judicial imagination as to what duties might be imposed, but the absence of effective remedies, that prevents utmost good faith from operating to regulate insurer conduct at the claims stage.

Model 2: Insurance Specific ‘Claims Handling’ Rules & ADR

The next option is to develop rules which are insurance specific, but not reliant on utmost good faith for their force. I would argue that this is the direction that English law has adopted, through the mechanism of regulatory codes of conduct, and non-judicial enforcement mechanisms. The Financial Services & Markets Act 2000 created the Financial Services Authority (then broken into the Financial Conduct Authority and the Prudential Regulatory Authority) and the Financial Ombudsman Service. The FCA creates and enforces rules applicable across all financial services and specific codes applicable to particular markets, such as insurance. The insurance rules are known as ICOBS.³⁵ These represent regulatory standards and substantial fines (and other measures) can be taken against firms that breach these principles.

³³ [2018] NZHC 704, [2018] Lloyd’s Rep IR 621.

³⁴ At [114].

³⁵ <https://www.handbook.fca.org.uk/handbook/ICOBS/>.

ICOBS, 8.1: ‘An *insurer* must:

- (1) handle claims promptly and fairly;
- (2) provide reasonable guidance to help a *policyholder* make a claim and appropriate information on its progress;
- (3) not unreasonably reject a claim (including by terminating or avoiding a *policy*); and
- (4) settle claims promptly once settlement terms are agreed’.

These rules are not dissimilar in content to the utmost good faith rules developed in New Zealand, but are freed from the complicating factor of showing a lack of good faith. It is not whether the breach was opportunistic, these map on to failures to maintain sound business and market practice, rather than particularly egregious behaviour.

Most of these rules are enforceable by private individuals as breach of statutory duty,³⁶ and have been held to limit the ability of insurers to act contrary to these rules in actions before a court.³⁷ This provides a quasi-tortious private law remedy to support administrative action by regulators. Breach will be determined by compliance, and there is not normally any requirement that the non-compliance was deliberate, or wilful, or in bad faith.

For commercial parties, there is no formal legal mechanism for enforcing the regulatory codes, although SMEs would be able to argue them before the Financial Ombudsman Service as evidence of good practice in the insurance sector.³⁸

By locating this duty within tort, it raises the possibility of punitive damages, where the requirements of the exceptional remedy are met. A full review of the limits of this principle are beyond the scope of this paper,³⁹ but *Rookes v Barnard* treats action by the tortfeasor ‘where the defendant calculated that he would make a profit by his conduct which may exceed the compensation payable to the claimant’ as a potential application of the rule.⁴⁰ I deal with the application of these exceptional non-compensatory common law remedies under model 4, below.

The bespoke regulatory controls introduced into UK law in the Twenty-First century are not limited in their remedial outcomes. There is the possibility of simple, private law enforcement

³⁶ S. 138D, Financial Services & Markets Act 2000 (as amended). The current definition of private person is found in para 3, Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256).

³⁷ *Parker v NFU* [2013] Lloyd’s Rep IR 253.

³⁸ The jurisdiction of the FOS was extended to SMEs as from 01/04/19.

³⁹ See J Goudkamp & E Katsampouka, ‘An Empirical Study of Punitive Damages’ (2018) 38 OJLS 90.

⁴⁰ *Rookes v Barnard* [1964] AC 1129.

for compensatory damages through an action by a private person for breach of statutory duty (as quasi-tort). For commercial lines the sanctions would generally fall within the administrative law sphere, with regulators imposing fines and placing conditions on continuing market access. This will often be a last resort, and much administrative action is informal, with undertakings by financial bodies to alter their behaviour for the future. This permits an iterative, data driven model of enforcement, although that is inevitably constrained in the real world by limited resources, and political reality. This is what I would describe as a moderately indeterminate series of outcomes, with private law rules generally representing the low level, compensatory aspect of the remedial regime, and the public law operating on the less predictable and inherently deterrent based model. This is closer to the bad faith model in the US than might first appear.

Model 3: Bring Insurance Contracts into Line with other Contractual Regimes

The approaches discussed above create bespoke insurance rules, and then seek to integrate them (to a greater or lesser extent) within the private law framework. The measures adopted below do not rely on any insurance law ‘exceptionalism’ and look to ensure that insurance contract law reflects the same kinds of rights and duties that would arise in other areas of commercial law. These may be adopted alongside rules which enhance the insurance position, the models are not mutually exclusive. This variety of legal process is evident in the reformed English model. We have not merely added the regulatory ICOBS rules discussed above (which operate with greatest effect in consumer markets) but have also added terms in the contractual sphere. The statutory reform of this area- a direct reaction to the *Sprung* decision- came into force in 2017, and has yet to be tested before the courts. S. 13A, Insurance Act 2015⁴¹ now reads:

13A Implied term about payment of claims

- (1) It is 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.
- (2) A reasonable time includes a reasonable time to investigate and assess the claim.
- (3) What is reasonable will depend on all the relevant circumstances, but the following are examples of things which may need to be taken into account—
 - (a) the type of insurance,

⁴¹ This provision was added to the Insurance Act 2015 by virtue of the Enterprise Act 2016, with effect from 04 May 2017.

- (b) the size and complexity of the claim,
 - (c) compliance with any relevant statutory or regulatory rules or guidance,
 - (d) factors outside the insurer's control.
- (4) If the insurer shows that there were reasonable grounds for disputing the claim (whether as to the amount of any sum payable, or as to whether anything at all is payable)—
- (a) the insurer does not breach the term implied by subsection (1) merely by failing to pay the claim (or the affected part of it) while the dispute is continuing, but
 - (b) the conduct of the insurer in handling the claim may be a relevant factor in deciding whether that term was breached and, if so, when.

This provides both an implied contractual duty on the underwriter (reversing *Sprung* and *McHugh*) and a series of factors by which to assess performance. It does not describe the remedies that flow for breach and those will be determined by the general application of contract law rules. The primary remedy for breach of contract is a claim for compensatory damages under the expectation interest model, putting the claimant in the position as if performance had occurred. Exemplary or punitive damages are not recoverable. Even this step was considered too controversial to be introduced by way of the Law Commission, and required government backed legislation. Key voices representing the insurance industry made clear the risk that claimant representatives (described as ‘a very active entrepreneurial claims handling industry’)⁴² would add in speculative claims for unreasonable delay even after claims were paid. Despite this, the industry was in broad support of what is now s. 13A, but amended to control for these new incentives to claim. The introduction of s.13A saw the creation of a specific limitation period for such claims in the Limitation Act 1980 (as amended):⁴³

- (5) Remedies (for example, damages) available for breach of the term implied by subsection (1) are in addition to and distinct from—
- (a) any right to enforce payment of the sums due, and
 - (b) any right to interest on those sums (whether under the contract, under another enactment, at the court's discretion or otherwise).

The duties under the Insurance Act 2015 can be mapped on to those developed in the Principles or European Insurance Contract Law (PEICL). The most significant differences are the imposition of default timeframes for insurers to take action, or otherwise be taken to have either

⁴² See generally the evidence of Kees Van der Klugt (Lloyd’s Market Association) and Philippa Handyside (Association of British Insurers) to the Special Public Bill Committee (<https://services.parliament.uk/Bills/2014-15/insurance/stages.html>), and especially the answers to Qn 21 & 22.

⁴³ S. 5A limits such claims to one year from the date of the contractual indemnity being paid in full.

accepted the claim (Art 6:103(2)) or to be in breach of a duty to handle claims promptly (Art 6: 104(3)). However, the remedies provided are limited. The insurer has to pay interest (at a substantial rate) and any additional loss, but this is compensatory in nature. There is no mention of an aggravating principle, such as bad faith, to lift the award above compensatory levels.

Article 6:103 Acceptance of Claims

(1) The insurer shall take all reasonable steps to settle a claim promptly.

(2) Unless the insurer rejects a claim or defers acceptance of a claim by written notice giving reasons for its decision within one month after receipt of the relevant documents and other information, the claim shall be deemed to have been accepted.

Article 6:104 Time of Performance

(1) When a claim has been accepted the insurer shall pay or provide the services promised, as the case may be, without undue delay.

(2) Even if the total value of a claim cannot yet be quantified but the claimant is entitled to at least a part of it, this part shall be paid or provided without undue delay.

(3) Payment of insurance money, whether under para. 1 or para. 2, shall be made no later than one week after the acceptance and quantification of the claim or part of it, as the case may be.

*Article 6:105 Late Performance**

(1) If insurance money is not paid in accordance with Article 6:104, the claimant shall be entitled to interest on that sum from the time when payment was due to the time of payment and at the rate applied by the European Central Bank to its most recent main refinancing operation carried out before the first calendar day of the half-year in question, **plus eight percentage points.**

(2) The claimant shall be entitled to recover damages for any additional loss caused by late payment of the insurance money.

* This Article is modelled on art. 3 para. 1(d) of the Late Payment Directive (2000/35/EC).

As is made clear in the note to Art 6:105, this is not an insurance specific measure, but an attempt to ensure that the duties on insurers match those on commercial parties generally. It might be asked why this is needed, if the Late Payment Directive applies. And here the spectre of the ‘hold harmless’ analysis of insurance liability raises its head for the final time. The Late Payments Directive applies to the late payment of commercial debts. But insurance claims are not universally classified as debts, but as a claim in damages. There is therefore an argument that the conventional rules on the payment of commercial monies does not apply to insurance claims. The PEICL statement therefore simply states that standard contract law controls on the late payment of monies ought to be extended *mutatis mutandis* to insurance.

Model 3 is highly predictable as a system. Insurers are not being asked to undertake duties above normal commercial market actors in compensating for the immediate consequences of their breach and yet even this extension was viewed as potentially invasive. The leading insurance judge of his era, Lord Mance, in giving evidence on the Bill argued that insurers should not be liable for the consequences of late payment as they would not have accounted for this risk when setting the premium:

‘More fundamentally, this risks the introduction into insurance claims—let us say a property insurance or a liability insurance claim—of what would effectively be a business interruption element. You would have a claim that was brought for damages. The damages would say, “Because of lack of funds, we were unable to run our business properly”. That sort of claim involves quite different experts and, as is well known, quite complex considerations, where the people’s business really has been affected. There would be associated questions about foreseeability: at what stage do you measure whether the insurer had sufficient knowledge or anticipation of the suggested loss? Is it at the time of the insurance contract, which is the normal rule in contract claims where damages are later claimed, or would it exceptionally be at the date of the alleged breach?’⁴⁴

The idea that breach of a duty is not to be treated as actionable because it might alter the profitability of the breaching party is extraordinary. This is a feature and not a bug in the design of the remedies for breach of contract. This comes very close to the idea of ‘insurance

⁴⁴ In evidence to the Special Public Bill Committee considering the Insurance Act Bill (<https://services.parliament.uk/Bills/2014-15/insurance/stages.html>).

insurance’, whereby insureds have to purchase cover to protect themselves against the risk that their underwriter fails (wrongly) to cover the risk insured.

Model 4: Invoke Extraordinary Sanctions

Private law does have a mechanism for expressing its disfavour with conduct, normally found within the sphere of exemplary damages. In the UK, these are not available for breach of contract, and only available in restrictive circumstances in tort. The English courts have given some useful indication of likely scale when awarded against which keeps these awards at a relatively modest level. When considering exemplary damages against government officials (primarily police officers) for wrongful arrest and/or prosecution, the Court of Appeal in *Thompson* stated:

‘Where exemplary damages are appropriate they are unlikely to be less than £5,000. Otherwise the case is probably not one which justifies an award of exemplary damages at all. In this class of action the conduct must be particularly deserving of condemnation for an award of as much as £25,000 to be justified and the figure of £50,000 should be regarded as the absolute maximum, involving directly officers of at least the rank of superintendent’.⁴⁵

In private law cases, where exemplary damages are used to signify opportunistic conducts designed to extract a profit from wrongful conduct even after the payment of compensation, the purpose of exemplary damages is entirely different:

‘When one recalls that the rationale of the second category of exemplary damages is, precisely, the confiscation of profits which cannot be got at through the ordinary compensatory mechanisms, this is an attractive synthesis. Exemplary damages fill a moral gap, and it has always been the principal moral objection to them that by handing the penal sum to whoever happens to be the claimant the law hands them a windfall’.

On the facts of the case in *Borders*,⁴⁶ the Court of Appeal was evidently of the view that the sum awarded as exemplary damages represented the illegitimate gains obtained by the defendant, which could not be returned to those harmed by the conduct by standard compensatory means. This case concerned the wholesale theft (and resale) of books, and the

⁴⁵ *Thompson v Commissioner of Police* [1998] QB 498 (CA).

⁴⁶ *Borders (UK) Ltd v Commissioner of Police of the Metropolis* [2005] Po. L.R. 1

stock captured could only be identified as belonging to the book shops concerned once they had begun specific marking of books on display.

In these purely private law cases, there is no upper limit on the award which is used to signify disapproval of the conduct, as these are operating (in effect) as a form of restitutionary head of damage. These kinds of damages would seem most appropriate in cases where insurers can be shown to have extracted a small advantage from a wide range of customers, such that the individual harm is slight but the overall effect is great. As noted above, this is restricted in English law to cases where the claim is in tort and not in contract, and this will most readily arise for breach of ICOBS rules as enforced by private persons. There is no obvious route for this to arise in commercial markets.

Canadian law is the obvious example of a system that has dealt with by developing the common law. For insurance, *Whiten v Pilot Insurance*⁴⁷ is a key step forwards in that regards, with exemplary damages awarded against an insurer for its handling of an insurance claim. This is not an untrammelled extension of contract damages, and normally requires some aggravating factor (some ‘further independent legal wrong’) to add to a simple breach of contract. This is generally limited to deliberate actions, and so would map to a reasonable degree on much of the bad faith jurisdiction. What is key is that there is no need for the character of the complaint to vary from contract- it need not be reshaped as a tort- but that some additional element such as the mutual basis of the contract as one of the utmost good faith. This is inherently difficult to justify- why should two breaches which would each give compensatory damages become punitive on overlap? Moreover, why should a cynical breach of a simple contract promise not give punitive damages? This is likely to be the subject of further common law development in Canada, following the decision in *Bhasin*⁴⁸ that there is distinct duty of good faith in general contract law (and not only in insurance contract law).

There is clearly a substantial variation in approach here. New Zealand has contractual duties and implied duties of utmost good faith, but no exemplary damages unless recast as a duty in tort.⁴⁹ English law has moved away from duties of utmost good faith and has moved to a regulatory model of enforcement. Canada has extended exemplary damages to ‘contract+’

⁴⁷ (2002) SCC 18. An excellent introduction is found in E Andrews, ‘*Lex Punit Mendacium*: Punitive Damages and *Bhasin v Hrynew*’ 7 W. J. Legal Stud. 1 (2017)

⁴⁸ (2014) SCC 71.

⁴⁹ See *Kilduff*, above n 33.

breaches, but many examples of cynical non-performance in insurance would readily fall within that. The crucial issue is the measure of damages under this head. Recall that English law (in tort cases) has identified a restitutionary model for damages, to enable the reversal of ‘unjust enrichment’. This is different from an overtly punitive model, as might be seen in *Whiten*, where it was said the level of damages should ‘sting’.

Some Conclusions on the Models Considered

The Restatement provides for a range of remedies for the failure to indemnify as required by the policy. There are a range of compensatory models, and we might discuss the precise outer limits of these, and what form of interest should be awarded (simple or compound? Base rate or higher? How much higher?) Beyond this lies the remedies which will normally be triggered as a response to cynical breaches which are designed to generate a profit over and above the payment of compensation. Here, the approach is mixed, but most systems have some form of deterring this conduct. It may arise by private enforcement of a rule in contract, or more normally, in tort, but may be handled by regulatory sanction that is able to draw on controls outside of the private law sphere, such as removing market access. A crucial lesson I have taken away from my study of this area is the need to examine these issues holistically. The private law rules need to be situated within the public law framework. The measure of damages, and who assess them, is a key factor. Where costs lie in civil litigation is also a key restraining factor, particularly when it is claimed that insurers will be exposed to systemic unmeritorious claims for ‘bad faith’ by litigants in search of a windfall.

I turn at this point to the literature in search of a useful organising principle, and in this case to the work of Ken Abraham, whose work on insurance law first drew me to study the US system some 20 years ago.⁵⁰

[C]. Good Faith, Bad Faith and Reflections on Abraham’s ‘Principle Without a Name’

There is an immediate question as to whether the remedies available under the Restatement reflect a principled series of measures, or simply capture the *ad hoc* development of the common law. The same question can be asked of the other legal systems under review. In seeking to unpack this issue, I would broadly characterise both the UK and the US regimes in the following terms:

⁵⁰ In particular, *Distributing risk: Insurance, legal theory, and public policy*, (Yale University Press, 1986).

1. They are broadly concerned with compensation, but may in certain circumstances seek to provide a more generous approach to eg remoteness questions, so as to provide wider recoverability of consequential losses;
2. Generally, they do not seek to impose set limits, but work on basis of ‘reasonableness’, both in terms of when performance must take place and what performance requires. Whilst this does not exclude ‘wholly innocent’ breaches from the system, the majority of cases would arise where there has been some sort of process error (ie negligence of some sort)
3. Where behaviour shades beyond innocent / negligent errors, the range of remedies scales upwards sharply. In the US, this is the ‘bad faith’ rule. In the UK, the possibility of exemplary damages for breach of ICOBS (where the claimant is a private person), and the imposition of a system of regulatory sanctions. In this both the likely range of compensation, but also the predictability (the indeterminacy of the regime), varies considerably from standard contract principle;

Generally speaking, this is consistent with the treatment of private law remedies outside of insurance, although there are examples where the insurance rule scales upwards more sharply. This is a matter of degree of change, and not the nature of change. The largest differences that can be observed between the systems are the result of practices and process outside of insurance law *per se*, such as the way in which damages are assessed, and the costs mechanism in place at the end of litigation.

It is my contention that remedies should become less predictable at the point at which we wish to ensure that market actors will not engage in simple cost/benefit analysis around compliance. This is the potential deterrence function. But there is also in this a justification for predictability at the wholly innocent / mildly negligent level. Firms ought to invest sensibly in systems and cultures that deliver desired outcomes. If an insurer’s way of working creates dissatisfaction in its customer base, then the payment of low levels of compensation is a small price for understanding that the system is not meeting customer satisfaction.⁵¹ Assuming that all such claims are ‘bad faith’ claims by insureds and their claims management companies is poor business management. But the design of legal processes needs to reflect these concerns where valid, by use of complementary legal rules. So, if claims for compensation for late payment are 40% spurious, then rather than deny the right to recovery of the honest claimants, create a costs

⁵¹ This was my central point in earlier published work. See above n 2.

rule so that unmeritorious ‘late payment’ claims are uneconomic to pursue. If this is impossible, create regulatory principles (and resource them from a fixed percentage of recovered sanctions), so that the regulators are effectively controlled at an administrative level. There is no magic bullet here and all systems will be imperfect. This is no reason to permit ‘insurance exceptionalism’ to deny regulation of this process.

There is the question of why insurance attracts a potentially scaled remedy for what is essentially breach of contract when other market actors generally do not. There is no exemplary or punitive damages element in most contract law regimes. To make sense of these principles, I turn to Ken Abraham’s work and in particular his ‘Principle Without a Name (Yet)’ paper.⁵² This was an update on his earlier work mapping the bad faith doctrine in the US,⁵³ and he began by describing a central principle:

‘This is a principle that, as my title suggests, does not yet have a name, but that treats insurers as having obligations that are more demanding than those imposed on ordinary contracting parties, though not as demanding as those we impose on governments. An obligation to handle claims fairly is one of the obligations that flows from this principle, though it is not the only one’.⁵⁴

This was written in response to what he saw as a drift in the kinds of ‘bad faith’ issues to which insurance law had to respond. This was a gradual move from examples largely explained as ‘sporadic or isolated bad faith’ (equivalent to manufacturing defects) to examples of ‘institutional or systemic bad faith’ (design defects). His argument was that insurers were necessarily in a position where their duties ought to be above those of other commercial actors in markets but below those of administrative bodies undertaking government action.

The classic justification for the treatment of insurers in this way- as above market standards- can be explained by formal law (the ‘utmost good faith’ approach) but is better viewed as a result of the situational monopoly that insurers are in at claims. It is not possible to go into the market to arrange insurance cover for a loss which has already occurred, I am committed irrevocably to the insurance provider. We do not need then to find an insurance law reason, we

⁵² K Abraham, ‘Liability for Bad Faith and the Principle without a Name (Yet)’ 19 Conn Ins LJ 1 (2012-2013).

⁵³ He was revisiting his article: ‘The Natural History of the Insurer’s Liability for Bad Faith’, 72 TEX. L. REV. 1295 (1994).

⁵⁴ At 2.

can find the explanation from general principles, and it is their application which generates the result in insurance law.

There are further social reasons why this might particularly true in liability insurance. It has marked third-party effects, in addition to other social significance. Abraham identifies two key parts of insurance law as of particular social significance:

‘It seems pretty clear that we should expect the law governing the two forms of insurance that are most essential to individual well-being, health insurance and consumer auto insurance, to more systematically reflect the principle than the law governing other, less essential forms of insurance. There is also room for distinguishing generally between consumer and commercial insurance. Sizable corporate policyholders' dealings with their insurers are in many respects identical to their dealings with other private enterprises, and do not need as much legal regulation of the sort that I have been describing’⁵⁵

In the United Kingdom, employer’s liability insurance and motor insurance are compulsory and therefore have the greatest social significance. This is shown in the clearest empirical terms by the data collected by the Compensation Recovery Unit, which brings subrogation claims on behalf of the State to recover government expenditure:

Year	Clinical negligence	Employer	Motor	Other	Public	Liability not known	Total	%
2017/18	£18,466,404.68	£67,745,014.91	£29,563,561.43	£1,393,013.54	£6,352,690.96	£59,823.54	£123,580,509.06	78.74
2016/17	£18,127,873.28	£68,824,913.42	£30,063,642.68	£1,350,643.56	£7,621,284.35	£38,017.81	£126,026,375.10	78.47
2015/16	£15,628,754.03	£69,766,631.33	£31,261,593.92	£1,112,025.06	£7,921,893.96	£67,776.73	£125,758,675.03	80.33
2014/15	£14,043,706.35	£73,719,340.95	£32,280,370.93	£1,137,645.58	£8,510,389.92	£28,726.62	£129,720,180.35	81.71
2013/14	£12,959,073.92	£74,417,163.07	£36,056,513.55	£1,057,788.86	£9,828,792.82	£118,179.85	£134,437,512.07	82.17
2012/13	£14,756,267.61	£71,336,357.06	£36,165,277.90	£1,009,172.47	£9,614,093.86	£54,175.86	£132,935,344.76	80.87
2011/12	£13,851,502.19	£75,245,271.28	£38,120,831.98	£946,957.54	£10,459,138.84	£76,062.31	£138,699,764.14	81.73
2010/11	£11,355,690.97	£75,834,759.13	£41,072,611.98	£909,794.54	£10,606,832.81	£68,343.40	£139,848,032.83	83.60

The vision of insurers as normally operating in a system created by the State, and performing administrative like functions (the compensation of those injured by others), leads to Abraham’s conclusion:

‘Insurers owe, or ought to owe those with whom they deal, a higher obligation of fair dealing than ordinary private enterprises typically owe those with whom they deal. As critical legal theory taught us decades ago, the public-private distinction tends breaks down in such instances...’⁵⁶

⁵⁵ At 10.
⁵⁶ At 8-9.

Whilst the broad arrangement then of the various jurisdictions is often broadly consistent with the US, there are stark differences. In the UK, whilst it is theoretically possible for a private person as claimant to seek exemplary damages from an insurer that calculatedly underperformed its indemnity duties, such a claim is unlikely. It would be much more likely for the Financial Conduct Authority to use its range of sanctions, including extensive punitive fines and ultimately the removal of licences, to deal with such a situation. This is both a wider and less ‘gameable’ system but less dependent on any vision of compensation. We should worry less about the windfall effect of a substantial fine being taken by the State than we would an \$80million ‘bad faith’ award to a small group of private litigants.

To take a real world example, a UK investment company trading in products related to US STOLI life products collapsed after its chief executive was fined £76million and banned from the market for using ‘misleading brochures and without properly assessing whether the products could meet what was promised’.⁵⁷ This is the most realistic pressure on insurer conduct in the UK system, and not private law enforcement of standards.

V. The Hypothetical Revisited: The 2019 Position

Having set a hypothetical, I ought to prove at least a basic answer.

(i) One of four of Delta’s claims handling teams had taken the strategic decision to ‘slow ball’ all ‘direct action’ mesothelioma employer liability claims in the hope that some claims fall away after the employee is deceased.

Under English law, the third-party claimant would normally be treated as ‘private person’ for the enforcement of ICBOB rules. This would mean that what is normally a commercial line would be subject to potential enforcement action by Edward (or his representative). A claim in tort for exemplary damages for breach of ICBOB standards would be novel, but not impossible. Certainly enforcement action by the FCA would be expected, with very high levels of fine and possible withdrawal of access to the market.

(ii) Delta seeks to delay payment to Edward, aware that its limitation period for recovery from other underwriters is capped at two years. It hopes that a short delay (an extra 3 months)

⁵⁷ ‘UK court upholds FCA fines, ban on former Keydata executives’, <https://www.ft.com/content/44eda80c-e1de-11e8-8e70-5e22a430c1ad>.

will enable it to establish the position of Alpha, Bravo and Charlie and commence proceedings against them.

Compensatory damages would normally be recoverable, whether under the insurance contract or for breach of ICOBS rules. I would not expect exemplary damages or substantial market sanctions to follow.

(iii) Delta resist claims to pay the entirety of a tortious claim, on the basis that its legacy employers' liability policy contained a 'rateable contribution' clause where double insurance exists. Case law exists that this clause is inoperative in these circumstances.

This is an error of law. Compensatory damages would be available under IA 2015, but have never been sought before. The Act enables this kind of remedy, but does provide examples of what might be recovered beyond simple damages and interest.

(iv) Delta has recently moved offices and subjected its legacy data systems to a GDPR compliance review and update. A number of the legacy systems are now suffering from substantial IT issues. Furthermore, a serious illness to the manager of the claims handling team responsible for Edward's claim, and the failure to swiftly appoint a replacement, means that paperwork is not acted upon swiftly. Following this delay, the claimant's representative (his wife) asks for a pause in the process as Edward is in a hospice. There is a further delay of 3 months.

This would be compensatory damages. The likelihood is that this would be a small sum. Recall that in New Zealand, around NZ\$5,000 were awarded.