

Policyholders Gain Right to Damages for Late Payment

May 9, 2016

Insurance

On May 4, 2016 the Enterprise Act received the Royal Assent and became law in the UK. Once its relevant provisions come into force on May 4, 2017, it will introduce for the first time into English law a right for policyholders to recover damages for late payment of insurance claims from insurers (Scottish law already recognizes an implied obligation for an insurer to assess a claim reasonably quickly and with diligence).

The new right had been scheduled by the Law Commission for inclusion in the draft legislation that became the Insurance Act 2015. The provisions originally drafted by the Law Commission were amended as a result of pro-insurer pressure during the passage of the Enterprise Bill to add a one-year time limit for policyholders to bring claims.

Background to the Legislation

Prior to the passing of the Act, English law did not recognize a right of the policyholder to recover damages for late payment by the insurer of its claim. This omission was illustrated by the oft-cited 1999 case of *Sprung v Royal Insurance*, in which a policyholder, forced out of business while his insurer delayed payment of his claim for four years, was unable to recover damages from the insurer to compensate him for his losses because English law did not permit an award of damages for late payment of a valid insurance claim.

Because of the widespread criticism of the existing law, the Law Commission included in its drafts for an Insurance Bill provisions introducing a right to recover damages for late payment of an insurance claim. The Law Commission noted and quoted submissions made to it by Covington that the current position of English insurance law was out of step with general contractual law, and acted as a disincentive to international policyholders from seeking cover under English-law-governed contracts.

However, the damages for late payment provisions were omitted from the Insurance Bill introduced in the House of Lords in July 2014 because they were judged to be too contentious to ensure the desired unopposed passage of the Bill under the special procedure for uncontroversial Law Commission Bills before the May 2015 UK General Election.

UK Government representatives stated nevertheless that the Government supported the principle that insurers should make payment of valid claims within a reasonable time and that they should be liable for compensation where appropriate if they did not do so. The Government also stated that it hoped legislative opportunities would arise to include that measure: the Enterprise Bill was that opportunity and the provisions originally drafted by the Law Commission were included in that Bill when it was introduced in the House of Lords in September 2015.

In the course of the Bill's passage through the House of Lords, certain amendments were put forward to weaken its effect in the interests of insurers. Eventually only a one-year time limit on the policyholder bringing claims was introduced.

The Policyholder's Right to Damages for Late Payment

The Act introduces into every contract of insurance governed by English Law an implied term that the insurer must pay any sums due in respect of a policyholder's claim within a "reasonable time", which includes a reasonable time to investigate and assess the claim.

- The Act gives some examples of factors that a court will take into account in assessing whether the claim was paid within a reasonable time. These factors are the type of insurance, the size and complexity of the claim, compliance with statutory or regulatory rules or guidance and factors outside the insurer's control.
- The burden is on the insurer to prove that there were reasonable grounds for disputing the claim. Even if it does have such grounds, the court will look at the insurer's conduct to determine whether it acted in breach of the implied term.
- The Act also makes clear that the policyholder's remedies (including damages) are in addition to its right to enforce payment of the claim and interest.

The parties to a business insurance contract can agree to contract out of the insurer's liability to pay damages for late payment resulting from a breach of the implied term which is neither deliberate nor reckless, but an insurer seeking to exclude this policyholder right must take steps to draw the exclusion provision to the policyholder's attention before the contract is entered into, failing which the exclusion has no effect. Parties to a consumer insurance contract cannot contract out of this liability.

The policyholder must bring a claim for damages for late payment within one year of the date on which the insurer has paid all the sums that were due in respect of the insurance claim, otherwise the claim for damages is time-barred.

Comment

English legislators stopped short of introducing a U.S.-style bad faith regime, and it remains to be seen how effective the new right will be and in what circumstances policyholders will use claims for damages for late payment of claims. In the meantime:

- Policyholders must in the first instance be vigilant for attempts by insurers to exclude the damages for late payment implied term in all new or renewal policy wordings.
- Where an insurer delays payment of claims, policyholders should be aware of the existence of the new right to help compel prompt payment of the claim.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Insurance team:

Richard Mattick	+44 20 7067 2023	rmattick@cov.com
Alexander Leitch	+44 20 7067 2354	aleitch@cov.com
John Buchanan	+1 202 662 5366	jbuchanan@cov.com
Benedict Lenhart	+1 202 662 5114	blenhart@cov.com
David Goodwin	+1 415 591 7074	dgoodwin@cov.com

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.