

THE INSURERS' DUTY OF GOOD FAITH

Bob Moxon Browne QC looks at remedies against insurers who fail to pay promptly



As every schoolboy knows, failure to pay damages does not itself sound in damages at English law. And as every other schoolboy knows, the money due under a contract of indemnity insurance is in the nature of unliquidated damages; from which it follows that the only remedy for late payment of insurance money is interest.

This is sometimes called the rule in *Sprung*. See *Sprung v. Royal Insurance Co. (UK) Ltd.* [1977] CLC 70, following *President of India v. La Pintade Cia Nav SA* [1985] AC 104 and *The Italia Express* [1992] 2 LL Rep 281.

Despite widespread acceptance, it seems an odd proposition. Failure to provide a prompt indemnity following a fire at commercial premises can and not infrequently does lead to disastrous consequences, which can include a total loss of the business. For this there is no recompense. Insurers' motives for delaying settlement may vary, but sometimes they are not wholly creditable. Yet despite the characterisation of the contract as "uberrimae fidei", the law provides no remedy, even for deliberate stone walling which is actuated by bad faith.

The justification for this anomaly is found in the law and, perhaps also, in considerations of public policy.

The relevant law purports to be well-established and of high authority (The decision of the House of Lords in *President of India* followed *London Chatham and Dover Railway Co. v. SE Railway Co.* [1893] AC 429). The root of the matter is that in the case of indemnity insurance, the action sounds in damages rather than debt. This is because the insurers' primary contractual promise is to provide the insured with an indemnity by a payment of money, non payment giving a right of action in damages. This will be so, even if the claim has been adjusted and agreed, the adjustment being said to be no more than evidence of the amount to be paid.

This analysis leads to the somewhat artificial conclusion that as soon as the loss occurs, the primary obligation is broken, giving rise to a secondary obligation to pay damages. The insured's right of action thus accrues as soon as the loss occurs, no prior demand being necessary, and no separate breach being established by the insurers' failure to pay immediately.

Despite the impressive authority with which pronouncements to this effect have been made, some contrary arguments come to mind fairly readily.

Perhaps most obviously, it would seem possible to imply a term into a contract of insurance that the insurers should pay up within a reasonable time, and/or should act reasonably in settling a claim in good faith.

IN THIS ISSUE

1. *The Insurers' duty of good faith*

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4. Case notes

8. 2tg Insurance and Reinsurance Group

“As matters stand, the continuing duty of good faith is probably confined to a duty not to act fraudulently.”

The standard answer to this suggestion is that Courts should be very slow to import any terms into commercial contracts where the parties have chosen precise written terms to govern their transactions.¹ Put another way, if there was any real need to imply such a term, pressure from the market place would long ago have obliged insurers to offer wording of this sort, which, conspicuously, has not been the case.

Thus expressed, this argument sounds a little pious and unrealistic. It may be that in cases of marine insurance, and the insurance of very large commercial enterprises, something like equality of bargaining power is found, as between underwriters and the major brokers. But in the vast majority of ordinary cases, the insured has little or no opportunity to negotiate policy wordings. Nor I think would it occur to most insureds to do so. Most would naturally assume that the insurers were in any event bound to settle claims reasonably promptly, whatever the policy said; and would be very surprised to learn that this might not be so. It should, however, be noted that FSA regulations now require insurers to settle claims by retail customers promptly (see ICOB Rules, Chapter 7).

It is also sometimes argued that the real nature of the insurance contract is that it is an agreement to give the insured peace of mind. Viewed in this light, the insurers' primary obligation is to “be there” for the insured in the event of a loss, and that any unreasonable delay in payment will on that account alone be a breach of contract. This may be no more than a variant on the theory that there is an implied term in the policy that insurers will pay promptly, and if so, the same contrary arguments apply. The characteristic of the insurance policy as a contract giving peace of mind has gained some ground in certain states in America² but has never received any encouragement from the Courts in this country.

¹ See *Baker v. Black Sea & Baltic General Ins Co Ltd* [1998] 1 W.L.R. 974, *Gan Insurance Insurance Company Ltd v. Tai Ping Insurance Ltd* [2001] Lloyd's Rep.I.R. 667 and *Dornoch Ltd v. Royal & Sun Alliance Insurance PLC* [2005] Lloyd's Rep.I.R. 544.

² There are decisions reflecting this in the Courts of Utah, West Virginia and Hawaii.

What then of good faith? It is of course the case that the contract is one of utmost good faith, and that the duty of good faith is placed on insurers as it is on the insured.³

However there are problems about using this concept as the source of an obligation to ensure prompt settlement of claims. The duty of good faith is familiar in its application to the stage at which the contract is formed (e.g. typically in the context of disclosure). The law has recently developed, so as to clarify that the duty extends beyond the conclusion of the contract, to at least the claims stage, and of course it remains reciprocal.⁴ However as matters stand, the continuing duty of good faith is probably confined to a duty not to act fraudulently. This makes sense, when it is remembered that the remedy for a breach of good faith is avoidance. None of this fits very well with a duty (necessarily reciprocal) to deal with contractual matters promptly. Certainly an insured might be startled to learn that delay in submitting claims details might lead to a forfeiture of the insurance; and of course the insured's right to avoid the policy would not be of much use in the case of the insurer who is dilatory in settling claims. This may be what Lord Hobhouse had in mind when he said, in his speech in *The Star Sea*:

“the Courts should be on their guard against the use of the principle of good faith to achieve results which are only questionably capable of being reconciled with the mutual character of good faith”.

In American jurisdictions the position is very different. There is now an established body of jurisprudence in most American states which permits and encourages Claimants to seek damages for late or non payment of insurance money. However it is interesting that the law has developed very largely in the context of a presumed duty of care in tort, ie. independently

³ See *Carter v. Boehm* (1766) 3 Burr 1905 and Marine Insurance Act 1906, s.17.

⁴ See *The Star Sea, The Manifest Shipping Co Ltd v. Uni-Polaris Insurance Co Ltd* [2001] 2 W.L.R. 170 and *Drake Insurance PLC v. Provident Insurance PLC* [2004] Lloyd's Rep. I.R.277.

of the terms of the contract, express or implied, and therefore effectively independently of the characterisation of the contract as *uberrimae fidei*. Substantial awards of damages are regularly made, especially in cases where special damage has flowed from non-payment of insurance (e.g. leading to business failure); and also in cases where juries wish to mark their disapproval of deliberate and/or bad faith delay on insurers' part.⁵ In some States, notably California, punitive or exemplary damages may be imposed.

It does not appear likely that English law will head in the same direction. In *Banque Finance de le Cilé v. Westgate Ins. Co.* (1990) QB 665 (CA) it was held that the insurer does not owe the insured a duty of care actionable in tort. While affirming the decision on other grounds (1991 2 AC 249) the House of Lords agreed with the Court of Appeal that no such duty of care existed.

Nevertheless, there is a perception that English law is due for a change. Recently, the merits of English and American law were debated at a seminar organised by the British Insurance Law Association, in the format of a mock trial based on Sprung-like facts, before three distinguished insurance lawyers headed by the recently retired Lord Justice Staughton, and in the presence of many English and a few American insurance law specialists. There was much argument about the perils of following American developments, leading to disproportionate awards of damages and higher premiums all round.⁶ Nevertheless, after the judges had delivered their verdicts, the matter was put to a popular vote with the audience. The result was a clear majority in favour of the abolition of the rule in Sprung, and the adoption in this jurisdiction of damages against insurers for late payment of claims.⁷

Whether any such change will arrive soon and what form it will take is not clear. The rule in Sprung has recently attracted rather equivocal comments from the Courts.

Countrywide Assured Group PLC [2005] EWCA Civ 840, concerned a deed of indemnity, rather than a policy of insurance. The claimants applied to amend their pleadings to include a claim for damages for late payment under the deed. The application was refused on the basis of the rule in Sprung.

The Court of Appeal gave permission to appeal but dismissed the appeal. Permission was not granted to appeal to the House of Lords. However, giving the leading judgment with which the rest of the Court agreed, Rix LJ said:

"it seems to me that the controversial issues raised by the new claim may well interest their Lordships' House, and, if [they do], may well lead to some clarification and amendment of the law"

The House of Lords refused permission to appeal on 10th November 2005.

More recently, in *Tonkin v UK Insurance Ltd*, 107 Con LR 107, when applying Sprung, HHJ Coulson QC accepted that some aspects of that case were unsatisfactory, in particular, the fact that the claimant had argued his own case.

This issue will be considered by the Law Commission in their forthcoming review of insurance law. While preliminary reports suggest that loud voices may be raised in favour of abolishing the rule in Sprung, the jurisprudential basis for any dispensation is a matter for conjecture.

Bob Moxon Browne QC⁸

⁵ See e.g. *Silberg v. California Life Ins. Co.* 511P 2d 1103

⁶ For an exposition of these perceived dangers, see *Hanser* 27 Tort and Insurance Law Journal 665 and *Emerson* 46 Univ. Miami Law Review 907.

⁷ See British Insurance Law Association "The Case For Bad Faith Damages" www.bila.org.uk

Mandrake Holdings Limited and another v

⁸ Bob Moxon Browne QC and Alison Green argued the case for bad faith damages at the BILA mock trial in the Lord Chief Justice's Court.

"There is a perception that English law is due for a change."

CASE NOTES

Apparent authority **ING RE (UK) LTD v R & V VERSICHERUNG AG**
[2006] EWHC 1544 (COMM)

The Claimant entered into a quota share treaty with Risk Insurance and Reinsurance Solutions ('Risk') in March 2003 in the belief that Risk was authorised to act as the Defendant's agent. In April 2003, the Defendant announced publicly that it had withdrawn any underwriting authority from Risk. The Claimant wrote to the Defendant asking whether Risk still had authority to accept payment under the treaty. The Defendant replied that it was reserving its position while it investigated. In June 2003 the Defendant notified the Claimant that it did not regard the treaty as binding. In November 2004, in an action between the Defendant and Risk ([2004] EWHC 2682 (Comm)), Moore-Bick J held that Risk had had no actual authority to enter into the contract on behalf of the Defendant. The Claimant was not a party to that action but accepted in the present case that that was the case. However, it argued (1) that Risk had ostensible authority and (2) that the Defendant had ratified the contract in any event.

The Claimant based its arguments on 3 documents: a letter, a "Memorandum of Authority", and a fax. Toulson J rejected the Defendant's allegation of a conspiracy and accepted that the Claimant had seen and been influenced by the three documents. However, he held that the letter was evidence of no more than a relationship between the Defendant and Risk and that it would have been apparent to a reasonable underwriter that the memorandum was a summary of a more detailed document, namely a binder, and that the Claimant should have been on notice that the treaty went outside the terms of the binder.

The Claimant argued that appointing the sender of the fax to a senior position would reasonably lead anyone who had dealings with the Defendant to believe that he had the Defendant's authority. However, Toulson J held that if the Claimant had enquired of the Defendant before relying on the fax it would have learnt that the sender was no longer employed by the Defendant and never had authority to issue the fax. He accepted that there may be cases where a principal would be bound by ostensible

authority in circumstances where the third party did not know the precise position of the agent, but where the principal had organised its affairs in such a way as to make it appear to any reasonable person in the third party's position that the agent had the necessary authority. However, in this case the Claimant did not know the identity or status of the issuer of the fax and no representation by the Defendant as to who the author was or his authority could be inferred. Toulson J also held that a representation that an agent has authority need not be intended by the principal to be acted upon because intention in the formation of contracts must be approached objectively. However, the Claimant did not believe the fax was intended to be sent to it or for its benefit, so there was no good reason in principle why it should be entitled to rely on it to create a contract.

In relation to ratification, Toulson J held that the Defendant's knowledge of the essentials of what happened, namely that Risk entered into the treaty with the Claimant on its behalf, was sufficient for ratification because in most cases a principal would know or be in a position to find out very quickly whether the agent had authority. If a principal knows what the agent has done but does not know that the agent lacked authority because of a lack of adequate records or internal organisation that should not operate to the detriment of a third party.

However, he found that the Defendant's conduct was not ratificatory conduct because the Claimant had failed to show that the only reasonable inference from the Defendant's silence was an intention to adopt the contract as binding. The Defendant's silence could sensibly be attributed to uncertainty as to its position.

Charles Dougherty appeared on behalf of the Defendant (with Colin Edelman QC).

Stewart Chirnside

**SHINEDEAN LTD v (1) ALLDOWN
DEMOLITION (LONDON) LTD (IN
LIQUIDATION) (2) AXA INSURANCE UK PLC**

20th June 2006

This claim concerned a public liability and contractor's all risk insurance policy held by All-down with AXA.

Shinedean employed Alldown to carry out various demolition and excavation works. All-down carried out the works negligently and the walls of the neighbouring property began to collapse on 24th April 2002. The owners of the property sued Shinedean for withdrawal of support and Shinedean settled the action for £110,000.00. Shinedean sought to recover this sum from Alldown, together with other damages arising out of Alldown's negligence. Alldown subsequently went into voluntary liquidation.

Shinedean obtained judgment in default against Alldown for damages to be assessed. AXA was joined for the purposes of a claim under the Third Parties (Rights Against Insurers) Act 1930.

General condition 3 of Alldown's policy contained a requirement that, in the event of any loss, destruction or damage or event likely to give rise to a claim, Alldown should notify AXA immediately and should deliver to AXA at its own expense all such proofs and information relating to the claim as might reasonably be required. This requirement was a condition precedent to AXA's liability under the policy. Two further conditions precedent required Alldown to provide AXA with all necessary information and assistance to enable AXA to settle or resist any claim.

Alldown notified AXA of the collapse of the neighbours' wall on 25th April 2002. However, AXA declined indemnity on the basis that All-down had failed to provide information and assistance as required under the policy. At first instance, HHJ Richard Havery QC found that there was significant information which had not been provided to AXA until two and a half years after the incident. However, the Judge found that, in order to establish breach of the conditions precedent under the policy, AXA had

to show that it had been prejudiced by the delay. The Judge found that the only prejudice which AXA could show was in its inability to close its books and that this was "miniscule". Accordingly, there had been no breach of the terms of the policy.

The Court of Appeal reversed this decision. Giving the leading judgment with which the rest of the Court agreed, May LJ found that it was not necessary for AXA to show that it had suffered prejudice as a result of the delay in order to establish breach of the condition precedent in this case. The question of whether an insurer has been prejudiced by delay in providing information may be, but is not necessarily, of relevance to the question of whether that delay is unreasonable. In this case, the delay of more than two years had been unreasonable, whether or not AXA had suffered prejudice as a result. AXA was therefore entitled to refuse to indemnify.

Tom Montagu-Smith

**WILLIAM FRANCIS RENDALL v COMBINED
INSURANCE COMPANY OF AMERICA [2005]
EWHC 678 (Comm)**

This dispute arose from the terrorist attacks on the World Trade Centre in September 2001.

Some 176 employees of the AON Group were killed as they attempted to evacuate the second tower. AON's insurers, Combined Insurance Company, paid out to the victims' families under a business travel accident policy which expressly covered acts of terrorism. The premium had been priced by reference to AON's estimate that its employees would complete 160,000 annual travel days. Combined, meanwhile, had reinsured this risk with Rendall but the reinsurance did not extend to acts of terrorism. Combined, inventively, sought an indemnity from Rendall, arguing that the evacuation constituted a "business trip". Rendall resisted this interpretation. Rendall further submitted that Combined's failure to reveal the basis on which the annual travel days had been estimated entitled them to avoid the policy. Rendall sought declarations:

Claims cooperation

**Non-disclosure and
waiver**

1) That the failure by Combined to disclose to Rendall the means by which the annual travel days were calculated represented a material non-disclosure (or misrepresentation) permitting Rendall to avoid the reinsurance contract;

2) That the evacuation was not a “business trip” and so the loss was not reinsured.

Avoidance

1 - Non-disclosure

Rendall’s case was as follows: its underwriter was entitled to assume that the figure presented as the “estimated number of business travel days” had been produced following analysis of AON’s historical travel data; in fact, the estimate relied on a hypothesis that the larger a given employee’s salary, the more days he or she would spend on business trips; Combined’s failure to explain to Rendall the methodology behind the estimate constituted material non-disclosure.

The parties agreed that the nature of the approach taken to the task of estimating the travel days was a material fact. Further, it was common ground that Combined had not disclosed to Rendall that fact. The live issue was whether Rendall had waived Combined’s duty to disclose the approach taken to the estimate.

Waiver

The learned judge identified three preconditions to waiver:

- a) The presentation of the risk to the insurer is fair;
- b) The presentation contains information which would lead a prudent insurer to make a further inquiry which would elicit the material fact;
- c) The further inquiry is not made.

Rendall’s position was that as the estimate had been based on a forward-looking hypothesis rather than, as Rendall had assumed, expected historical data, the presentation had not been fair. As the first precondition was not met there could be no waiver.

Combined argued that the underwriter should have appreciated that the estimate could have been generated by various possible approaches; following *WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial* [2004] Lloyd’s Rep IR 764 CA, the Court was entitled, in assessing whether the presentation was fair, to consider whether the presentation contained facts which put the insurer on notice to make further inquiries. Cresswell J agreed. In failing to inquire as to which approach was taken, the underwriter had waived any obligation Combined might have been under to disclose the nature of that approach.

2 - Misrepresentation

Reinsurers argued that the estimate of travel days carried with it an implied representation that the estimate was calculated by reference to historical data, and that such a representation was falsely made. Cresswell J considered the provisions of ss. 17 – 20 of the Marine Insurance Act 1905. Of crucial importance was Section 20 (5) which states:

“A representation as to a matter of expectation or belief is true if it be made in good faith”.

Cresswell J found that the estimate of travel days was a representation of expectation or belief. Following the Court of Appeal’s decision in *Economides v Commercial Union* [1998] QB 587 there was no room within a representation of belief or expectation for any further, implied representation that there were reasonable grounds for that belief. The Claimant’s case on misrepresentation was accordingly rejected and the judge refused to make the first of the declarations sought.

Was the evacuation a “Business Trip”?

This discrete issue is unlikely to be of any great significance for readers and it is not analysed in detail. Suffice to say that the learned judge found it impossible to shoe-horn the evacuation of the WTC into the ambit of the phrase “business trip”. Accordingly, he declared that the loss sustained by Combined in paying the families’ claims fell outside of the reinsurance cover.

Simon Goldstone

ENTERPRISE OIL LTD. v STRAND INSURANCE CO. LTD. [2006] 1 LLOYD'S REP 500

26th January 2006

This was a claim by Enterprise against Strand for an indemnity pursuant to the terms of a liability policy.

The facts of the case were complex. They arose in the context of an agreement between Enterprise, Amoco UK Exploration Company and Amara Hess Ltd. to explore and develop certain oil fields including Arbroath. Amoco was to operate the Arbroath field and hired a drilling unit from British American Offshore Ltd ("BAO"). Amoco (supported by Enterprise) rejected the drilling unit when it was delivered and terminated the hire contract on the grounds that it was unsafe and not fit for its purpose. The subsequent dispute led to litigation in the Commercial Court and in Texas.

In the Texan proceedings, Enterprise and various other Defendants were sued by Rowan Companies Inc, the owner of the drill unit, together with various other associated companies. Rowan had a service agreement with BAO under which Rowan agreed to perform the obligations of BAO under drilling contracts concluded by BAO. Five causes of action were alleged, the most important being that Enterprise had tortiously interfered with the service agreement.

In a mock trial on 3rd December 2001, a mock jury found in favour of Rowan and awarded US\$85 million in damages. Following the mock trial, Enterprise and its co-defendants settled the Texan proceedings for US\$175 million. Enterprise contributed approximately US\$20.5 million to this sum. The settlement agreement made no apportionment between the various heads of claim.

Enterprise sought to recover its part of the settlement sum from Strand, which denied liability.

Aikens J. dismissed the claim on the basis that a judge and jury in Texas should have found that Enterprise was not liable to Rowan.

The case is of interest, however, because, notwithstanding his rejection of the claim, Aikens J. addressed the Defendant's argument that, as the settlement agreement made no apportionment between the tortious interference claim and the other heads of claim in respect of which Enterprise was not insured, Enterprise should not be entitled to recover at all.

This argument was based on the controversial decision of Colman J. in the case of *Lumberman's Mutual Casualty Co. v Bovis Lend Lease* [2005] 1 Lloyd's Rep 494. There, Colman J. found as a general rule that, where global settlements encompass both insured and uninsured liabilities, but do not attribute specific amounts to each head of claim, the insured liabilities cannot be "ascertained" and therefore no recovery can be made.

Aikens J. rejected this approach and found that it was not a precondition for recovery under a liability policy that the insured has "ascertained" by the wording of a judgment, award or settlement the "specific cost to the insured of discharging its insured liability". It is open to the insured and the insurer to go behind the settlement agreement and present extrinsic evidence to show that a particular sum or part thereof does (or does not) represent a loss covered by a liability policy. Aikens J. noted that the Lumberman's approach was uncommercial and would tend to discourage settlement.

Although obiter, this dicta is likely to provide a powerful response to *Lumberman's*.

Tom Montagu-Smith

**Liability insurance.
Ascertainment of loss.**

2tg Insurance and Reinsurance Group

We have great pleasure in sending out this edition of On Risk for the winter of 2006. In this issue, Bob Moxon Browne QC provides his views on the rule in Sprung, following his appearance with Alison Green at the BILA run mock trial in the Lord Chief Justice's Court. Some of the more interesting recent judgments touching on issues of insurance law are also discussed inside.

This Autumn's seminar programme has included talks on the interface between Employers' Liability, Public Liability and Motor Policy insurance cover (by Martin Porter QC and Sonia Nolten) on construction and the recovery of settlements against insurers and reinsurers (by Krista Lee and Peter de Verneuil Smith) and on fraudulent claims (by Andrew Miller and Rehana Azib).

We expect to have another busy programme of seminars in the new year and we hope to see you there.

Howard Palmer QC
Alison Green

Bob Moxon Browne QC

Bob has acted for most of the leading insurers over the last 30 years, frequently appearing in high-profile cases both at first instance and on appeal. He acted for the successful appellant in *Gacca v. Pirelli* [2004] 3 All ER 348, for the respondent motor insurers in *Drake v. Provident* [2004] 2 WLR 530 and for product liability insurers in *Budgett Sugars v. Norwich Union* [2002] LI Rep IR 48.



Tom Montagu-Smith

Tom is the editor of On Risk. His practice includes insurance and reinsurance and commercial fraud. He has extensive experience of applications for emergency interim relief. Recent instructions include (with Paul Downes) *In Re P&O* [2006] EWHC 389 (Ch). He has recently completed drafting (with Michael Black QC) the Rules of Court of the Dubai International Financial Centre.

