Damages for late payment of claims – the Enterprise Act 2016

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On 4 May 2016 the Enterprise Bill received Royal Assent and became the Enterprise Act 2016. Part 5 of the Enterprise Act contains provisions which will amend the Insurance Act 2015 to provide that (re)insurers must pay sums due within a reasonable time. Policyholders will have the opportunity to claim damages if a (re)insurer's unreasonable delay causes additional loss.

The provisions will come into force on 4 May 2017 and will apply to all insurance and reinsurance contracts entered into on or after that date.

The changes to be introduced will raise new and challenging issues for (re)insurers and particularly for claims handlers. We discuss the implications below.

The key points

- It will be an implied term in all "insurance contracts" that claims must be paid "within a reasonable time". "Insurance contracts" in this context will include reinsurance contracts.
- The remedies for breach of this implied term will be the usual remedies for breach of contract, including damages. That means, of course, that the usual tests of causation will have to be satisfied and the insured will have to prove on the balance of probabilities that any loss for which it claims damages was caused by the insurer's breach of the implied term.
- The right to claim interest for late payment will remain and any damages will be in addition to that interest and in addition to the amount payable under the insurance in respect of the original claim.
- These terms will take effect through the inclusion of a new s.13A in the Insurance Act 2015.
- The limitation period in which an insured can bring a claim for damages for late payment will be one year from the date of the last payment by the insurer in respect of the relevant loss. This will be reflected in an amendment to the Limitation Act 1980.

Contracting out

In certain circumstances the parties to a non-consumer contract will be able to contract out of this implied term, subject to the transparency provisions in the Insurance Act 2015.

Implications of the new provisions for claims handling

A 'reasonable time'

One of the key issues will be what constitutes a "reasonable time" in which to pay a claim. This will be an objective judgement and the Act makes clear that it includes time to investigate and assess the claim. What else is included will depend on all the circumstances but relevant issues are likely to include:

- The type of insurance (one can imagine, for example, that some third party claims or business interruption losses may well take longer to investigate than first party property losses);
- The size and complexity of the claim. That seems clear, although readers will know that there may be large straightforward losses which can be resolved more quickly than smaller but more complex claims;
- Compliance with regulatory rules and guidelines. These might include, for example, compliance with sanctions regimes; and
- Factors outside the insurer's control. This is largely self-explanatory and might include, for example, the failure of the insured or a third party to provide information or difficulties in gaining access to loss sites, for example for reasons of safety. It is unlikely to include things like the loss adjuster's workload, however, because one would expect the insurer to be responsible for that in any event.

Reasonable grounds for disputing the original claim
At a minimum, it seems likely that reasonable grounds for disputing the claim may well equate to "…real prospects of successfully defending the claim…", namely the same test as would be required to defend a claim for summary judgment. That is not a high standard, however, and it is certainly possible that more will be required.

Failure to pay while a dispute is continuing will not be unreasonable but the conduct of the insurer in handling a claim may be a relevant factor in deciding whether there has been 'unreasonable delay'. For example, an insurer may still be in breach of the implied term if it fails to respond promptly to developments in the case or if it moves forward only slowly in the conduct of its investigations. Other issues that may be relevant are how the insurer treats the insured in pre-action correspondence, refusal of offers of ADR (or failure to propose same), failure to make or accept reasonable offers of settlement, failure to make interim payments, unsuccessfully contesting interlocutory and summary judgment applications, appealing unfavourable judgments unsuccessfully and breaches of the Civil Procedure Rules which cause delays.

At least in the short term, the consequence of the introduction of these new rules is likely to be that pressure to settle difficult claims or to make interim payments is increased and that may well lead to higher reserves and more capital commitment.

Issues for the London Market

The nature of the London market also gives rise to some particular uncertainties about the operation of this proposed implied term. For example:

- What will be the position where a reinsurer exercises its right under a claims control clause to take control of the claim but unreasonably delays settlement? Would there be a claim by the insured against the reinsurer if the contracts were back to back? If the insured claimed against the insurer would the insurer have a right of recovery against the reinsurer?

- Subscription markets may raise a similar issue: if the following market has agreed to be bound by the settlements negotiated by the leaders, they will presumably still be liable to the insured for their share of any damages for the late payment of claims. Whether they can then make a recovery from the leaders in respect of those damages will depend on the terms of any agreement amongst the market participants.
- In layered programmes, high level insurers may not be liable to pay until the primary layer has been exhausted. If the primary layer insurer is delaying payment unreasonably, will the excess insurers be exposed to damages? Do they have an obligation to act if the primary is unreasonable? If not, could the quantum of the damage to which the primary insurer is exposed be increased as a result of any damage caused by the failure of the excess layers to pay?
- Finally, what about the position in relation to reinsurance recoveries? Will a reinsured be able to recover any damages which it has to pay to the insured for breach of this implied term from the reinsurer? There is no reason in principle or in statute why such a loss would not be recoverable in the sense that there is no public policy objection to its recovery – it is not a fine or a criminal penalty for example. In those circumstances, the issue of recovery is going to come down to the extent of the coverage under the reinsurance and how it is expressed.

Conclusion

When the requirement to settle claims within a "reasonable time" becomes implied into insurance contracts, it will be incumbent on insurers to manage claims proactively and to ensure that outsourced claims teams are properly trained and aware of the potential exposure. It is important to note, however, that nothing in the proposed changes should prevent insurers from disputing claims in good faith and it should be remembered that if the insured wishes to claim damages for late payment it will have to be able to prove, on the balance of probabilities, that it has been caused to suffer a loss as a result of the delay as well as the quantum of that loss.

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