

# Do insurers have to pay for bad behaviour in settling claims?

## *Legal aspects of insurers' wrongful claims handling*

by

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*Abstract: This article presents a comparative legal analysis of wrongful claims handling by insurance companies in indemnity and liability insurance. From the outset, it is clear that it may be difficult to draw the line between legitimate claims denial and refusal to pay, on the one hand, and malicious protraction, procrastination and rejection of valid claims, on the other hand. Therefore, it is interesting to find that European legal systems diverge considerably in their stance against wrongful claims handling. In some legal systems, the issue of wrongfulness does not seem to play a significant role. There, the focus is on less value-laden concepts such as delay, default and the imputability of the delay. The result is that, at some point in time, statutory interest may become due. Sometimes, additional damages may be claimed as well. In other legal systems, 'bad faith' is considered a special category for all insurance contracts, allowing an escape from the limited amounts paid by way of interest. Again other legal systems seem to regard the obligation to pay interest as the only consequence of wrongful claims handling. The analysis of the different approaches towards wrongful claims handling shows that there are different solutions not only across legal systems but also within jurisdictions. Tort law and insurance law may have to compete with alternative sources of law such as insurance business regulation. Given the wide variety of positions, the Principles of European Insurance Contract Law (PEICL) seem to go beyond merely restating the current common core.*

### *I. Introduction*

[77] Insurers' behaviour is under increasing societal scrutiny.<sup>1</sup> In particular, there are popular stories of insurers deliberately engaging in unfair practices by delaying payment, denying liability and defending valid claims. For example, the 2009 Annual Report of the French *Médiateur de la Fédération Française des Sociétés d'Assurances* (French Insurance Ombudsman) states:<sup>2</sup> [78]

As far as insurance companies are concerned, it has been noted that certain of them more or less wilfully delay making payments, and sometimes issue an automatic refusal at the outset of the processing of each claim and then only make payment if the insured is particularly insistent, or after the intervention of the mediator.

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<sup>1</sup> *L van der Berghe/C Louche*, The Link Between Corporate Governance and Corporate Social Responsibility in Insurance (2005) Geneva Papers on Risk and Insurance 425 ff.

<sup>2</sup> *Médiateur de la Fédération Française des Sociétés d'Assurances*, Annual Report 2009, accessible at <[www.ffsa.fr](http://www.ffsa.fr)>. For examples of unfair (precontractual) marketing practices in England, see *Financial Services Authority*, General Insurance Telephone Sales: Results of Thematic Work (Examples of Good and Poor Practice) (2007). American literature on this topic abounds. I merely refer to *J M Feinman*, *Delay Deny Defend* (2010).

There are more examples of such criticism and undoubtedly there is truth in some of the horror stories that circulate. Indeed, the relatively weak bargaining powers of both the individual insured in indemnity insurance and the individual claimant in liability insurance as well as the ramifications of this weakness for the insurance settlement process have already been analysed in academic writing.<sup>3</sup> Accordingly, efforts by the media, consumer associations, political bodies and the insurance industry itself to improve the overall quality of claims handling and customer treatment seem to be both necessary and timely. Unfortunately, an objective indication of the extent of the problem of wrongful claims handling in practice is not available. This is not surprising because evidence of the element of wrongfulness is hardly ever unambiguous. Indeed, more often than not, the line between legitimate claims denial and refusal to pay, on the one hand, and malicious *protraction, procrastination and rejection of valid claims*, on the other hand, is difficult to draw. Moreover, there is a considerable lack of clarity regarding the legal rights of insurers' clients – both businesses and consumers – in cases of wrongful claims denial and delay. Under which conditions do these clients acquire a cause of action against the insurer? And what is the object of their claim? This article focuses precisely on these two questions by presenting a comparative legal analysis of how wrongful claims handling behaviour is dealt with in the English, German and French legal systems.

The format of this article is as follows. First, I briefly examine the regulation of claims handling at the European Union (EU) level (Section II). EU law, which does not as yet constitute a full-grown body of law in this area, is briefly presented because it nevertheless highlights two interesting and underexposed dimensions of the issue under consideration. There is a specific rule on the claims handling process in international motor vehicle accidents that can serve as 'best practice' for purely national processes. Furthermore, EU law offers a more general framework under the Unfair Commercial Practices Directive<sup>4</sup> [79] which may be relevant to insurance claims handling. Secondly, I turn to the laws of England and Wales<sup>5</sup> (Section III), Germany (Section IV) and France (Section V). I then (Section VI) add a further piece to the puzzle, namely the Principles of European Insurance Contract Law (PEICL).<sup>6</sup> As I will show, the differences between the various regimes are vast (Section VII). In the final part of this article (Section VIII), I therefore consider some core issues concerning the relationship between civil law and (self-)regulation of the insurance industry and how the concept of 'wrongfulness' in wrongful claims handling may be considered in a wider context.

When discussing insurance claims handling behaviour it is always useful to keep in mind the difference between first-party insurance (indemnity insurance and fixed-sums insurance) and third-party insurance (liability insurance). In the latter case, the injured is not party to the insurance contract. Indeed, his right to compensation does not derive from the insurance contract itself but from liability

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<sup>3</sup> Eg *P Cane*, *Atiyah's Accidents, Compensation and the Law* (7th edn 2006), chs 8 and 9. This strand of literature can also be connected with the broader debate on compensation culture and shifts from the liability system to no-fault compensation. See, eg, *Lord Young of Graffham*, *Common Sense Common Safety* (2010); *JT Schmit*, *Factors Likely to Influence Tort Litigation in the European Union* (2006) *Geneva Papers on Risk and Insurance* 304; and generally the references in *WH van Boom/MG Faure* (eds), *Shifts in Compensation between Private and Public Systems* (2007) and *M Lunney/K Oliphant*, *Tort Law: Text & Materials* (4th edn 2010) ch 18.

<sup>4</sup> Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market (Unfair Commercial Practices Directive).

<sup>5</sup> Hereafter England, English, etc.

<sup>6</sup> US law is not included in the analysis. Though the American 'bad faith' doctrine may be an interesting point of comparison, I decided against including American insurance law for reasons of space constraints. Moreover, there is already some literature in which English law is compared with the insurance law doctrine of 'good faith' in other English-speaking nations. See, eg, *J Lowry/P Rawlings*, *Insurers, Claims and the Boundaries of Good Faith* (2005) 68 *Modern Law Review* (MLR) 82, 90 ff; *Law Commission/Scottish Law Commission*, *Insurance Contract Law. Issues Paper 6: Damages for Late Payment and the Insurer's Duty of Good Faith* (2010) 103 ff.

law. As a result of this difference other rules may also apply concerning damages for non-payment by the insurer.

Before commencing, some remarks on terminology may be helpful. The ‘claims handling process’ commences with the claim’s submission, after which the insurer may start an investigation of the insured event (studying causes and effects, collecting and assessing documentary and other evidence, and inspection on site) and, finally, will take a position on the claim, that is, decide whether and to what extent it is covered.<sup>7</sup> The concept of ‘wrongful claims handling’ is used in a broad sense, that is, not in the strict sense of tortious liability for wrongful behaviour but as a more general notion of behaviour contrary to the applicable legal standard of conduct befitting a reasonable insurance company.

## *II. Substantive rules at EU level*

### *A. The Unfair Commercial Practices Directive*

[80] The main European framework for judging wrongful claims denial and delay is the 2005 Unfair Commercial Practices (UCP) Directive. The Directive is applicable to unfair commercial practices in business-to-consumer commerce, that is, those practices contrary to the requirements of professional diligence which materially distort or are likely to materially distort the economic behaviour of the average (targeted) consumer with regard to a product (art 5). The concept of ‘unfair’ is further subcategorized into misleading and aggressive practices.

Misleading practices are those which either contain false or deceptive information or omit material information, thus impairing the average consumer’s ability to make an informed transactional decision (arts 6 and 7).

A commercial practice is considered aggressive if, ‘in its factual context, taking account of all its features and circumstances, by harassment, coercion, including the use of physical force, or undue influence, it significantly impairs or is likely to significantly impair the average consumer’s freedom of choice or conduct with regard to the product and thereby causes him or is likely to cause him to take a transactional decision that he would not have taken otherwise’ (art 8). In determining whether a commercial practice uses harassment, coercion or undue influence, account has to be taken of several aspects, including ‘the exploitation by the trader of any specific misfortune or circumstance of such gravity as to impair the consumer’s judgement, of which the trader is aware, to influence the consumer’s decision with regard to the product’ and ‘any threat to take any action that cannot legally be taken’ (art 9).

Though one would perhaps be inclined to think that unfair commercial practices relate to the marketing and selling of products and services – that is, the phase that precedes the conclusion of a contract – the Directive also applies to post-conclusion behaviour. In fact, it applies even when no contract is concluded as it relates to any ‘decision taken by a consumer concerning whether, how and on what terms to purchase, make payment in whole or in part for, retain or dispose of a product or to exercise a contractual right in relation to the product, whether the consumer decides to act or to refrain from acting’ (‘products’ is defined as including services: art 2).

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<sup>7</sup> Sometimes this process is referred to as the settlement process (not to be confused with settlement of a dispute, eg through party compromise). Cf *J Basedow et al*, *Principles of European Insurance Contract Law (PEICL)*. Prepared by the Project Group ‘Restatement of European Insurance Law’ (2009) 215.

Since the implementation of the Unfair Commercial Practices Directive, one particular insurance practice has already been banned as ‘aggressive’. Furthermore, Annex I to the Directive consists of a ‘black list’ of certain practices deemed unfair under any circumstances (art 5 (5)). This Annex includes a practice allegedly committed in the insurance industry, namely ‘[r]equiring a consumer who wishes to claim on an insurance policy to produce documents [81] which could not reasonably be considered relevant as to whether the claim was valid, or failing systematically to respond to pertinent correspondence, in order to dissuade a consumer from exercising his contractual rights.’<sup>8</sup> Though at first sight a seemingly relevant prohibition, in practice cases are seldom as clear-cut as this, as we will see further on.

The UCP Directive does not prescribe the enforcement instrument to be used at Member State level. Evidently Member States are bound to ensure that ‘adequate and effective means exist to combat unfair commercial practices in order to enforce compliance with the provisions of this Directive in the interest of consumers’ (art 11) and to introduce effective, proportionate and dissuasive penalties (art 13) but the implications for private law regulation are left to the Member States. Thus, some may have implemented the Directive by directly linking unfair practices with traditional contractual and delictual remedies. Others may not have done so and may have kept the Directive isolated from civil law. In those jurisdictions, unfair commercial practices may be primarily remedied by public law ‘command and control’ orders issued by consumer authorities. Individual consumers accordingly need to make creative use of unrelated civil law remedies which, as we will shortly see, may be of little avail.

### *B. Motor Insurance Directive*

In addition to the general unfair commercial practices framework, one further particular rule is worth closer attention, namely the rule comprised in the European Motor Insurance Directive (art 22 Directive 2009/103/EC). This article contains a specific rule on the claims handling process in international motor vehicle accidents which can serve as a ‘best practice’ for purely national claims handling processes. Art 22 provides:<sup>9</sup>

*The Member States shall create a duty, backed by appropriate, effective and systematic financial or equivalent administrative penalties, to the effect that, within three months of the date when the injured party presented his claim for compensation either directly to the insurance undertaking of the person who caused the accident or to its claims representative,*

*(a) the insurance undertaking of the person who caused the accident or its claims representative is required to make a reasoned offer of compensation in cases where liability is not contested and the damages have been quantified, or*

*(b) the insurance undertaking to whom the claim for compensation has been addressed or its claims representative is required to provide a reasoned reply to the points made in the claim in cases where liability is denied or has not been clearly determined or the damages have not been fully quantified.*

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<sup>8</sup> Annex I no 27, Unfair Commercial Practices Directive.

<sup>9</sup> Directive 2009/103/EC of the European Parliament and of the Council of 16 September 2009 relating to insurance against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against such liability (codified version), Official Journal (OJ) L 263, 7.10.2009, 11–31.

*Member States shall adopt provisions to ensure that where the offer is not made within the three-month time-limit, interest shall be payable on the amount of compensation offered by the insurance undertaking or awarded by the court to the injured party.*

## [82]

As can be gleaned from art 22 Member States are free to choose the appropriate sanction in cases where the prescribed time-limit is not complied with. The Directive's Preamble gives an overview of possible sanctions. In recital 40-41 it is said:

(40)... [I]t is appropriate to guarantee the specific right of the injured party to have the claim settled promptly; it is therefore necessary to include in national law appropriate effective and systematic financial or equivalent administrative penalties – such as injunctions combined with administrative fines, reporting to supervisory authorities on a regular basis, on-the-spot checks, publications in the national official journal and in the press, suspension of the activities of the company (prohibition on the conclusion of new contracts for a certain period), designation of a special representative of the supervisory authorities responsible for monitoring that the business is run in line with insurance laws, withdrawal of the authorisation for this business line, sanctions to be imposed on directors and management staff – in the event that the insurance undertaking or its representative fails to fulfil its obligation to make an offer of compensation within a reasonable time-limit; this should not prejudice the application of any other measure – especially under supervisory law – which may be considered appropriate; however, it is a condition that liability and the damage and injury sustained should not be in dispute, so that the insurance undertaking is able to make a reasoned offer within the prescribed time-limit; the reasoned offer of compensation should be in writing and contain the grounds on the basis of which liability and damages have been assessed.

(41) In addition to those sanctions, it is appropriate to provide that interest should be payable on the amount of compensation offered by the insurance undertaking or awarded by the court to the injured party when the offer has not been made within the said prescribed time-limit; if Member States have existing national rules which cover the requirement for late-payment interest this provision could be implemented by a reference to those rules.

Art 22 is a relevant point of reference for the setting of time-limits on claims handling and the accrual of statutory interest. Indeed, as far as implementation of the latter aspect is concerned, some Member States have merely referred to their existing rules on statutory interest.<sup>10</sup> One can debate whether that type of sanction amounts to 'appropriate, effective and systematic financial or equivalent administrative penalties' as required by art 22.

### *III. United Kingdom*

#### *A. English law in general*

English law is of particular interest not in the least because recently a 'joint issues paper' entitled 'Damages for Late Payment and the Insurer's Duty of Good Faith' [83] was published for consultation by the Law Commission and the Scottish Law Commission. The paper is critical of the current state of English law. However, before turning to this recent development, I will first discuss the state of English law as it stands. Generally, according to English law, if one party breaks the contract, the other party may claim compensation for the loss suffered. The victim must prove actual financial loss and must take reasonable steps to mitigate the loss. Provisions in the contract may limit or expand the

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<sup>10</sup> See eg the Netherlands: *Kamerstukken II* 2002/03, 28 636, no 3, p 6 f (Parliamentary Proceedings of the Dutch Parliament, Second Chamber, Session 2002/2003, Bill 28 636, no 3, p 6 f).

level of compensation.<sup>11</sup> Traditionally, indemnity insurance contracts fall outside the scope of these general rules.<sup>12</sup> Instead, the insurance contract is considered to be a contract aimed at ‘holding the insured harmless’.<sup>13</sup> Therefore, the insurer is generally deemed to be in breach of the contract from the moment the insured loss occurs. The essence of the contract reflects this starting point, namely the obligation to pay damages rather than to perform a primary obligation of paying an amount. The insurer thus incurs the obligation to pay damages and, since English law states that there will be no damages for failing to pay damages, the insurer is only held liable to pay statutory interest ancillary to the damages award rather than ancillary damages themselves.<sup>14</sup> The court has a wide margin of discretion concerning the award of interest itself, the running period and the rate.<sup>15</sup> In principle, interest is simple, not compound.<sup>16</sup>

**[84]** Courts usually take the date on which the assured’s cause of action arises and in property insurance the date of the casualty as the point at which interest starts to run. Courts are sometimes prepared to postpone the running of interest to the notification date or the date at which a reasonable investigation of the claim ought to have been completed. The latter position bears resemblance to the German approach, as we will see shortly.

In any event, the English rules on interest are ambiguous and fall short of providing for compensation in cases of wrongful behaviour by the insured. One obvious reason for this is that pre-judgment interest is not due if proceedings have not yet commenced:<sup>17</sup> postponing payment until just before proceedings are initiated by the insured may thus be more lucrative than in a legal system where interest is due as of right.

As far as interest on unpaid debts is concerned, the 2000 Late Payments Directive<sup>18</sup> is worth mentioning. In some countries, the Directive has been implemented with the effect that the raised interest rate fully applies to commercial first-party insurance contracts.<sup>19</sup> The English remain, however, unconvinced that the Directive applies to indemnity insurance. This is understandable

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<sup>11</sup> *Law Commission/Scottish Law Commission* (fn 6) vi.

<sup>12</sup> Fixed-sums insurance contracts (eg, life insurance) are governed by the normal contract law rules on damages. See *Law Commission/Scottish Law Commission* (fn 6) 10.

<sup>13</sup> *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti)* [1991] 2 Law Reports, Appeal Cases (AC) 1, 35 (Lord Goff).

<sup>14</sup> *MA Clarke et al*, *The Law of Insurance Contracts* (6th edn 2009) paras 26-5B, 30-2, 30-7; *Lowry/Rawlings* (2005) 68 MLR 82, 85 ff. Note that under Scottish law the fiction of the insurance contract being a contract to ‘hold harmless’ is rejected and therefore the more generous common contractual remedies apply. See *Scott Lithgow Ltd v Secretary of State for Defence* 1989 Session Cases, House of Lords (SC (HL)) 9, 20 (Lord Keith): ‘It is to be observed in passing that Scots law has not adopted the English view that the right of action in the event of non-payment under a policy of insurance is one for unliquidated damages.’ Cf *Strachan v Scottish Boatowners’ Mutual Insurance Association* 2010 Session Cases (SC) 367 (Outer House, Court of Session); *Hawkins v Scottish Mutual Assurance plc* [2005] CSOH 10 (Outer House, Court of Session). Cf *Law Commission/Scottish Law Commission* (fn 6) 22 ff.

<sup>15</sup> See *Law Commission, Pre-Judgment Interest on Debts and Damages* (Law Com No 287, 2004), 13 ff. Note, however, that § 8.2.9 (3) ICOBS (*Financial Services Authority, Insurance Conduct of Business Sourcebook* (ICOBS) (rev edn 2008), accessible at <<http://www.fsahandbook.info/FSA/html/handbook/ICOBS>>) provides that non-compliance with the rules on settlement offers stemming from the Motor Insurance Directive is sanctioned with the running of interest at the Bank of England’s base rate plus 4%.

<sup>16</sup> Sec 35A Senior Courts Act 1981; sec 69 County Courts Act 1984. Cf *AS Burrows*, *Remedies for Torts and Breach of Contract* (3rd edn 2004) 348; *H McGregor*, *McGregor on Damages* (18th edn 2009) 617 f.

<sup>17</sup> *MA Clarke et al* (fn 14) para 30-8; *M Clarke*, *Policies and Perceptions of Insurance Law in the Twenty-First Century* (2007) 245; *H McGregor* (fn 16) 619 f.

<sup>18</sup> Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions (Late Payments Directive).

<sup>19</sup> See eg the Dutch position in arts 6:81–83 and 6:119a Burgerlijk Wetboek (Dutch Civil Code).

because, though the Directive seemingly applies to late payment in all commercial transactions, recital 13 of the Directive seems to exclude money claims under indemnity insurance contracts:

This Directive should be limited to payments made as remuneration for commercial transactions and does not regulate transactions with consumers, interest in connection with other payments, eg payments under the laws on cheques and bills of exchange, payments made as compensation for damages including payments from insurance companies.

The joint issues paper by the Law Commission and the Scottish Law Commission therefore concludes:

It is not clear how far the Act [sc Late Payments of Commercial Debts (Interest) Act 1998] applies to the late payment of insurance claims. While insurance contracts are not one of the types of contracts specifically excluded from the 1998 Act, it is doubtful that it would apply where an insured is seeking a remedy for late payment of a claim. The Directive underlying the 1998 Act appears to exclude insurance claims in Recital 13 of the Preamble. Furthermore, the characterisation of an indemnity insurance claim as one for damages, rather than a debt, would seem to exclude such a claim from being one which might be subject to an award of interest under the 1998 Act.<sup>20</sup>

As mentioned above, English law does not recognize the obligation to pay [85] damages for failure to pay damages.<sup>21</sup> Accordingly, the insurer who is in default of payment under the policy will only be held liable to pay interest on the amount due under the policy. This ancillary obligation to pay interest may not always fully compensate for the losses incurred. In *Sprung v Royal Insurance (UK) Ltd*,<sup>22</sup> the insured business eventually went bankrupt as a consequence of the insurer's failure to timeously pay out on an indemnity insurance for damage to the insured's property. The Court of Appeal held (per Beldam LJ):

The insurers did not make a payment under the policy in respect of the plant and equipment the subject of the claim until some three and a half years later. The plaintiff pursued his claim for the loss caused by the insurers' refusal to indemnify him and to pay him his loss or damage, which the judge was later to assess at the sum of £75,000.

The insurers argued that they were not liable to their assured for damages for failure to meet their obligations under the policy. By long-standing decisions it is settled that the liability of insurers under a policy arises when the loss occurs and the liability is to pay money for that loss. That the insurers have the option themselves to reinstate or to pay for the reinstatement of the property damaged under the terms of the policy does not alter the essential nature of their liability, which is to pay the sum of money as damages. Thus the failure to pay is a failure to pay damages and, by decisions binding on this court, an assured has no cause of action for damages for non-payment of damages. To compensate a plaintiff in such circumstances Parliament has provided that the court should be able to award interest on the damages which the court eventually assesses.<sup>23</sup>

This is rather unhelpful for the insured. Other remedies at law do not offer significantly more assistance. In theory, to the extent that an insurance contract is considered to be a contract of utmost good faith, wrongful delay and denial may constitute a breach of the duty of good faith. In practice, however, this is not a very helpful conclusion. According to English law, breach of the duty of good

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<sup>20</sup> *Law Commission/Scottish Law Commission* (fn 6) 52.

<sup>21</sup> *Banque Financière v Westgate Insurance Co* [1990] 1 Queen's Bench (QB) 665 (Court of Appeal, CA); *Sprung v Royal Insurance (UK) Ltd* [1997] Commercial Law Cases (CLC) 70 (CA). See *Law Commission/Scottish Law Commission* (fn 6) 2 ff.

<sup>22</sup> [1997] CLC 70.

<sup>23</sup> [1997] CLC 70.

faith by the insurer could give rise to the remedy of avoidance.<sup>24</sup> This would not really remedy the situation since avoidance results in nullification of the insurance contract leaving the insured without any cover whereas what he in fact needs is compensation for the financial detriment incurred as a consequence of the breach. Hence, the insurance contract law remedies available do little to provide insurers with an incentive to abstain from wrongful delay and denial. English courts are reluctant to read an implied term into insurance contracts entailing a duty not to delay and deny.<sup>25</sup> In addition, they [86] are *reticent* to construe explicit words in the contract as giving rise to an obligation to this effect. In *Tonkin v UK Insurance Ltd*, a consumer took out property insurance, the terms of which explicitly stated: ‘Caring for you – We will always try to be fair and reasonable whenever you have need of the protection of this Policy. We will also act quickly to provide that protection.’ In interpreting these solemn words the High Court essentially denied that they had any legal ramifications.<sup>26</sup>

Similar reluctance on the part of the courts is noticeable when it comes to the scope of so-called ‘contracts to provide peace of mind or freedom from distress’. In principle, English law allows awards for financial loss and for pain, suffering and loss of amenity. English courts are sometimes also willing to award monetary compensation for loss of pleasure, relaxation or peace of mind if the contract is interpreted as having the purpose of preventing such loss.<sup>27</sup> To date, however, English civil courts have refused to categorize insurance contracts as contracts aimed at securing peace of mind, thereby effectively withholding financial compensation for consumer distress.<sup>28</sup> Contrastingly, in cases brought before the English Financial Ombudsman Service (FOS) by consumers and small businesses,<sup>29</sup> both simple interest and (modest) damages for distress and inconvenience may be awarded in the event of unreasonable claims handling behaviour by the insurance company involved.<sup>30</sup> Moreover, the FOS also takes into account the special regulatory regime of the Financial Services Authority (FSA) which has promulgated a comprehensive ‘handbook’, the ICOBS (Insurance: Conduct of Business Sourcebook).<sup>31</sup> Breach of FSA rules may result in fines imposed on the insurer, a civil claim before the High Court for breach of statutory duty and a complaint (by consumers) before the FOS.<sup>32</sup> There are a number of duties imposed on the insurer by the ICOBS that are relevant to the matter under discussion: [87]

#### § 8.1.1 ICOBS

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.

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<sup>24</sup> Sec 17 Marine Insurance Contract Act 1906. Cf *A Naidoo/D Oughton*, The Confused Post-Formation Duty of Good Faith in Insurance Law: From Refinement to Fragmentation to Elimination? (2005) *Journal of Business Law* (JBL) 346; *Law Commission/Scottish Law Commission* (fn 6) 29 ff.

<sup>25</sup> *Naidoo/Oughton* (2005) JBL 346, 364 ff.

<sup>26</sup> *Tonkin v UK Insurance Ltd* [2006] England & Wales High Court (EWHC) 1120 (Technology and Construction Court (TCC)).

<sup>27</sup> *Farley v Skinner* [2001] United Kingdom House of Lords (UKHL) 49; *Haysman v Mrs Rogers Films Ltd* [2008] England and Wales Court of Appeal (EWCA) 2492. Cf *Clarke et al* (fn 14) para 30-9C.

<sup>28</sup> See *Law Commission/Scottish Law Commission* (fn 6) 60 f.

<sup>29</sup> The FOS can be addressed by micro-enterprises with an annual turnover below GBP 2 million and fewer than ten employees. See <[www.financial-ombudsman.org.uk](http://www.financial-ombudsman.org.uk)>.

<sup>30</sup> *Law Commission/Scottish Law Commission* (fn 6) 62; *Clarke* (fn 17) 247.

<sup>31</sup> See *A Padfield*, *Insurance Claims* (2007) 97 ff.

<sup>32</sup> *Law Commission/Scottish Law Commission* (fn 6) 53 f.

### § 8.1.2 ICOBS

A rejection of a consumer policyholder's claim is unreasonable, except where there is evidence of fraud, if it is for:

- (1) non-disclosure of a fact material to the risk which the policyholder could not reasonably be expected to have disclosed; or
- (2) non-negligent misrepresentation of a fact material to the risk; or
- (3) breach of warranty or condition unless the circumstances of the claim are connected to the breach and unless (for a pure protection contract):
  - (a) under a 'life of another' contract, the warranty relates to a statement of fact concerning the life to be assured and, if the statement had been made by the life to be assured under an 'own life' contract, the insurer could have rejected the claim under this rule; or
  - (b) the warranty is material to the risk and was drawn to the customer's attention before the conclusion of the contract.

§ 8.1.1 sets general standards of conduct and § 8.1.2 provides a 'black list' of defences that an insurer may not raise against a claim.

### *B. Recent developments in the United Kingdom*

The restrained approach taken by English civil courts concerning wrongful claims handling is not shared by Scottish law. There, late payment of insurance claims is governed by the ordinary principles of damages under contract law. Unjustifiable delays and wrongful refusal are considered to be an actionable breach of contract. As already mentioned, the Scottish and English Law Commissions jointly issued a consultation paper entitled 'Damages for Late Payment and the Insurer's Duty of Good Faith'. Their findings are highly critical of English insurance law on this topic. They argue that a complete overhaul of the law here is required as it is currently unprincipled, unfair, inefficient, rewards dishonesty and leads to unjustified differences:

We tentatively conclude that the insurer's primary obligation should be to pay valid claims. If the insurer fails in this obligation, then normal contract principles should apply.<sup>33</sup>

In their joint paper, the Commissions discuss two ways of looking at the exact nature of an indemnity insurer's obligation. First, there is the straightforward approach of an insurance contract in terms of which there is a primary [88] obligation under the contract to make a payment within a reasonable time. Under this approach, non-performance of the duty gives rise to a claim for damages as under any other contract. The alternative approach is the 'good faith' approach in terms of which an insurer is under the duty to adequately and fairly investigate and assess the claim. Here, if a court ultimately finds in favour of the insured this does not automatically render the insurer liable for damages: only if the claims handling was contrary to the good faith standard will he incur liability.

The Commissions (tentatively) conclude that statutory reform is needed. However, they oppose the development of a specific tort or delict of 'wrongful claims handling' as well as the use of the remedy of avoidance for breach of the good faith requirement. Instead, they propose that a 'stand-alone duty' giving rise to specific remedies defined by statute should be developed. The duty would entail three

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<sup>33</sup> Ibid vii.

main requirements: to investigate a claim fairly, to decide a claim fairly and to pay a claim within a reasonable time.<sup>34</sup>

#### IV. Germany

The general rules on claims handling under German law are laid down in § 14 Versicherungsvertragsgesetz (VVG):

##### § 14 VVG Fälligkeit der Geldleistung

(1) Geldleistungen des Versicherers sind fällig mit der Beendigung der zur Feststellung des Versicherungsfalles und des Umfangs der Leistung des Versicherers notwendigen Erhebungen.

(2) Sind diese Erhebungen nicht bis zum Ablauf eines Monats seit der Anzeige des Versicherungsfalles beendet, kann der Versicherungsnehmer Abschlagszahlungen in Höhe des Betrags verlangen, den der Versicherer voraussichtlich mindestens zu zahlen hat. Der Lauf der Frist ist gehemmt, solange die Erhebungen infolge eines Verschuldens des Versicherungsnehmers nicht beendet werden können.

(3) Eine Vereinbarung, durch die der Versicherer von der Verpflichtung zur Zahlung von Verzugszinsen befreit wird, ist unwirksam.

##### Section 14 Due date of money debts

(1) Money debts owed by the insurer shall be due from the moment of the conclusion of the enquiries necessary to establish the occurrence of the insured event and the extent of the insurer's liability.

(2) If these enquiries have not been concluded within one month after notification of the occurrence of the insured event, the policyholder may demand part payment of the minimum amount which the insurer will be expected to pay. The time limit shall be suspended for as long as the enquiries cannot be concluded due to the fault of the policyholder.

(3) An agreement freeing the insurer from the obligation to pay interest on arrears is void.

#### [89]

§ 14 VVG applies to insurance contracts with money payment coverage and it roughly operates as follows.<sup>35</sup> In the insurance context, the payment of the claim is due (*fällig*) after an initial 'enquiry period' during which the insurer has the right to investigate and assess and then to conclude whether and to what extent the claim is covered. The period is not fixed but the insurer is held to pay the uncontested part of the claim one month after claim submission at the latest. To ascertain when the period effectively ends and the insurer is in default of payment, an objective standard is applied: how long would it take a normally circumspect insurer in the specific insurance branch involved to handle the claim? In any event, as soon as the insurer acknowledges the claim, the period ends and the claim should be paid forthwith. Likewise, if the insurer denies coverage and it is later established that the

<sup>34</sup> *Law Commission/Scottish Law Commission* (fn 6) 83.

<sup>35</sup> See *RM Beckmann/A Matusche-Beckmann* (eds), *Versicherungsrechts-Handbuch* (2009) § 21. Fälligkeit und Verjährung, no 5 ff; *L Xie*, *Versicherungsrecht der VR China. Eine deutsch-chinesische Rechtsvergleichung mit besonderem Schwerpunkt auf Versicherungsvertragsrecht* (2010) 339 f.

refusal was unjustified, the period is deemed to have ended as well at the moment of refusal.<sup>36</sup> In cases of delayed and protracted claims handling, the objective standard applies.<sup>37</sup>

All of this is relevant to ascertaining the moment of default of the debtor (*Verzug*) and therefore for the running period of damages for delay (*Verzugsschaden*). Note that the insured's right to damages as such cannot be excluded by contract. However, the moment from which payment is due in accordance with § 14 (1) VVG can be varied by contract.<sup>38</sup> Furthermore, specific statutory rules may apply to certain types of insurance.<sup>39</sup>

As mentioned, the refusal to pay an insurance claim due after expiration of the enquiry period leads to default and hence to liability for damages. In exceptional circumstances, where the insurer refuses payment on account of some unsettled legal issue but later the court finds in favour of the insured, the court may find the refusal excusable. In that case, no claim for damages would ensue.<sup>40</sup>

According to § 288-289 BGB, the right to damages for delay consists of simple interest for delayed payment and additional damages for any loss not covered by the interest: [90]

#### § 288 Verzugszinsen

(1) Eine Geldschuld ist während des Verzugs zu verzinsen. Der Verzugszinssatz beträgt für das Jahr fünf Prozentpunkte über dem Basiszinssatz.

(2) Bei Rechtsgeschäften, an denen ein Verbraucher nicht beteiligt ist, beträgt der Zinssatz für Entgeltforderungen acht Prozentpunkte über dem Basiszinssatz.

(3) Der Gläubiger kann aus einem anderen Rechtsgrund höhere Zinsen verlangen.

(4) Die Geltendmachung eines weiteren Schadens ist nicht ausgeschlossen.

#### § 289 Zinseszinsverbot

Von Zinsen sind Verzugszinsen nicht zu entrichten. Das Recht des Gläubigers auf Ersatz des durch den Verzug entstehenden Schadens bleibt unberührt.

#### Section 288 Default interest

(1) Any money debt shall bear interest during the time of default. The default rate of interest per year is five percentage points above the basic rate of interest.

(2) In the case of transactions not involving a consumer, the rate of interest for the payment of money claims is eight percentage points above the basic rate of interest.

(3) The creditor may demand a higher interest rate on a different legal basis.

(4) The claiming of compensation for further damage is not excluded.

#### Section 289 Prohibition of compound interest

Default interest is not to be paid on interest. The right of the creditor to compensation for damage caused by the default remains unaffected.

The interest accrues irrespective of the actual loss suffered by the insured. If the insured claims damages beyond the fixed interest, the amount in interest accrued will be taken into account and if necessary deducted from the actual loss.<sup>41</sup> If the insured claims full compensation beyond the amount

<sup>36</sup> BGH 12 March 1966, *Versicherungsrecht* (VersR) 1966, 627; *E Deutsch*, *Das neue Versicherungsvertragsrecht. Ein Grundriss* (2008) 124.

<sup>37</sup> In principle, in the case of refusal to pay the insured should send the insurer a formal letter of notification of default (*Mahnung*) and thus put the insurer in default. See *C Armbrüster et al*, *Prölss/Martin Versicherungsvertragsgesetz* (2010) § 14, no 22.

<sup>38</sup> *Beckmann/Matusche-Beckmann* (fn 35) § 21 nos 29 ff. Some property damage policies state a two-week period for claims handling.

<sup>39</sup> See fn 43.

<sup>40</sup> *Prölss/Martin VVG* (fn 37) § 14 no 18; *Deutsch* (fn 36) 124.

<sup>41</sup> BGH 19 September 1984, *VersR* 1984, 1137.

in interest, he is required to prove the loss and that it was suffered during and as a consequence of the default.<sup>42</sup>

§ 14 VVG essentially applies to first-party insurance contracts with monetary coverage. For specific insurance contracts, more detailed rules on claims handling – in particular the time period in which the insurer must handle the submitted claim – may apply.<sup>43</sup> § 14 VVG itself is restricted to monetary claims under the policy and does not apply to other obligations of insurers such as the obligation of liability insurers to investigate the factual and legal position of the liable insured, to pay valid claims and to defend against invalid claims. For liability insurance, some of those aspects are dealt with in § 106 VVG: [91]

§ 106 Fälligkeit der Versicherungsleistung

Der Versicherer hat den Versicherungsnehmer innerhalb von zwei Wochen von dem Zeitpunkt an, zu dem der Anspruch des Dritten mit bindender Wirkung für den Versicherer durch rechtskräftiges Urteil, Anerkenntnis oder Vergleich festgestellt worden ist, vom Anspruch des Dritten freizustellen. Ist der Dritte von dem Versicherungsnehmer mit bindender Wirkung für den Versicherer befriedigt worden, hat der Versicherer die Entschädigung innerhalb von zwei Wochen nach der Befriedigung des Dritten an den Versicherungsnehmer zu zahlen. Kosten, die nach § 101 zu ersetzen sind, hat der Versicherer innerhalb von zwei Wochen nach der Mitteilung der Berechnung zu zahlen.

Section 106 Due date for performance by the insurer

The insurer shall indemnify the policyholder against the third party's claim within two weeks, beginning from the moment when the third party's claim is established with binding effect for the insurer by final judgment, acknowledgement or settlement. If the third party has been compensated by the policyholder with binding effect for the insurer, the insurer shall indemnify the policyholder within two weeks following compensation of the third party. The insurer shall reimburse any costs in accordance with section 101 [ie legal protection costs] within two weeks following communication of the calculation.

Note that § 106 VVG works with time intervals and thus tries to ensure that the claims handling process maintains momentum. It only applies where the claim is either acknowledged or the case has been settled amicably by party compromise or court decision. Hence, § 106 VVG does not regulate the prior claims handling process.

A different point of entry for a remedy against wrongful claims handling can be seen in third-party insurance conflicts. There, the point of entry is the tortious liability of the insured. In most cases of tortious liability for personal injury, the claimant has a right to damages for non-pecuniary loss. The exact quantum of such damages depends on a number of factors concerning the accident such as the degree of blameworthiness and the gravity of the injuries,<sup>44</sup> but the amount can also increase if the handling process by the liability insurer ('master and manager of the claim')<sup>45</sup> after the injury is found lacking. The liability insurer can be held liable to pay a 'topped-up' amount as compensation for non-material suffering.

<sup>42</sup> *Beckmann/Matusche-Beckmann* (fn 35) § 21 no 69.

<sup>43</sup> See *Deutsch* (fn 36) 123. Two paragraphs are worth mentioning: § 91 (property insurance) and § 187 (accident insurance). § 91 VVG provides that interest on property insurance claims is to be paid anyway after one month, on penalty of the application of a minimum interest rate of four percent. § 187 (2) VVG (acknowledgment) provides a time limit of two weeks for payment in the event that the insurer acknowledges the claim or if the policyholder and insurer have settled on the basis for and the amount of the claim.

<sup>44</sup> See generally *WVH Rogers* (ed), *Damages for Non-Pecuniary Loss in a Comparative Perspective* (2001).

<sup>45</sup> *G Wagner* (ed), *Tort Law and Liability Insurance* (2005) 333 ff.

In German court practice, this instrument is predominantly used in personal injury litigation. Take for instance a 2009 Landesgericht (Civil Court of First Instance) decision involving brain injury in a neonate following medical complications during birth in 1993. The obstetrician was found to be negligent. Originally, the injured child claimed € 500,000 in compensation for non-pecuniary loss. However, the Court held that, at some point in the process of amicable settlement, there was overwhelming evidence in favour of liability [92] in the form of a number of expert reports. At that point, the defendants no longer contested liability but nevertheless refused to voluntarily proceed with advance payments. The Court therefore awarded € 600,000 noting that:<sup>46</sup>

Das Gericht konnte sich dabei nicht des Eindrucks erwehren, dass diese Verweigerungs- und Verzögerungshaltung einzig und allein dem Zweck dient, einen Zeitgewinn zu erreichen und den Kl und seine Familienangehörigen zu einem sachlich nicht gerechtfertigten Nachgeben zu bewegen.

The Court cannot escape the impression that this attitude of refusal and procrastination had the exclusive purpose of gaining time and persuading the claimant and his family to give in, for which there was no objective justification.

This is not an isolated decision.<sup>47</sup> In Germany there is an accepted approach in case law that augmenting the award in respect of non-pecuniary loss for reasons of wrongful claims handling by defendants can be an appropriate remedy against such behaviour.<sup>48</sup>

#### V. France

According to the general rule laid down in art L113-5 Code des Assurances (Insurance Code), the insurer can be held liable to perform according to the period stipulated by the contract: [93]

Article L113-5 Code des Assurances

Lors de la réalisation du risque ou à l'échéance du contrat, l'assureur doit exécuter dans le délai convenu la prestation déterminée par le contrat et ne peut être

Article L113-5 Insurance Code

Upon occurrence of the risk or the contract becoming due, the insurer shall perform within the agreed period

<sup>46</sup> Landesgericht (LG) Gera 6 May 2009, VersR 2009, 1232 (Spastische Tetraplegie). Cf BGH 18 November 1969, VersR 1970, p 134.

<sup>47</sup> To mention one other example: a case in which the liability insurer admitted full liability but nevertheless took one year to transfer a first advance on the compensation for non-pecuniary loss; the court held that there was wrongful delay: Oberlandesgericht (OLG) Hamm 11 September 2002, VersR 2003, 780, 781.

<sup>48</sup> BGH 23 June 1963, VersR 1964, 1103; BGH 18 November 1969, VersR 1970, 134. Topping-up, however, seems less likely if the claim for non-pecuniary loss accrues to the victim who subsequently dies and the dubious claims handling stance was taken vis-à-vis the victim's legal successors. See OLG Koblenz 10 January 2008, VersR 2008, 923 at 924. On the inflationary effect of wrongful claims handling on compensation for non-pecuniary losses, see *F Schellenberg*, Regulierungsverhalten als Schmerzensgeldfaktor [2006] VersR 878; *H-P Schwintowski*, Der Anspruch auf angemessene Schadensregulierung [2005] Verbraucher und Recht 204 ff. Seminal was the typology by *H Honsell*, Die Funktion des Schmerzensgeldes [1974] VersR 205 ff, of factors to be taken into account when assessing quantum in compensation for non-pecuniary loss. Cf for the Netherlands: *AJ Verheij*, Vergoeding van immateriële schade wegens aantasting in de persoon (dissertation: VU [Vrije Universiteit] Amsterdam, 2002) 505; *SD Lindenbergh*, Smartengeld, 10 jaar later (2008) 74; *JL Smeehuijzen*, Schadevergoeding wegens onzorgvuldige afwikkeling van letselschadevorderingen [2009] Nederlands Tijdschrift voor Burgerlijk Recht (NTBR) 328 ff; *N van Tiggele-van der Velde*, Onverkwikkelijke afwikkeling van schade: Een (zelfstandige) grond voor schadeplichtigheid? (inaugural lecture Nijmegen) (2009) 46 ff.

tenu au-delà.

and he shall not do so beyond this period.

If he does not perform on the due date, the insurer may incur *intérêts moratoires* (interest for delayed payment) in accordance with art 1153 of the Code Civil:

#### Article 1153 Code Civil

Dans les obligations qui se bornent au paiement d'une certaine somme, les dommages-intérêts résultant du retard dans l'exécution ne consistent jamais que dans la condamnation aux intérêts au taux légal, sauf les règles particulières au commerce et au cautionnement.

Ces dommages et intérêts sont dus sans que le créancier soit tenu de justifier d'aucune perte.

Ils ne sont dus que du jour de la sommation de payer, ou d'un autre acte équivalent telle une lettre missive s'il en ressort une interpellation suffisante, excepté dans le cas où la loi les fait courir de plein droit.

Le créancier auquel son débiteur en retard a causé, par sa mauvaise foi, un préjudice indépendant de ce retard, peut obtenir des dommages et intérêts distincts des intérêts moratoires de la créance.

#### Article 1153 Civil Code

In obligations concerning the payment of a certain sum, the damages resulting from delay in performance shall only consist in the award of interest at the statutory rate, except under the special rules for commerce and suretyship.

These damages are due without the creditor having to prove any loss.

They are due only from the day of a demand for payment or of another equivalent act such as a letter, provided it contains a clear demand, except in the case where the law makes them due as a matter of right.

A creditor of whom his debtor in delay has caused, by his bad faith, a loss independent of that delay may obtain damages distinct from the interest on arrears of the debt.

In principle, the interest for delayed payment runs from the moment that the debtor is *en demeure* (in default) by the *mise en demeure* (demand for payment, effected by a *sommation de payer* or *lettre missive*). Moreover, art 1153-1 adds that statutory interest is due from the moment of the claim adjudication by the civil court.<sup>49</sup> In liability insurance, however, the interest starts to run from the day of the court decision which constitutes the realisation of the insured risk.<sup>50</sup> The statutory interest rate is set by *décret* in accordance with art L313-2 Code *monétaire et financier* (Monetary and Financial Code) and a 5% increase is added in case of a court ordered payment.<sup>51</sup> Compensation for [94] damage surpassing the fixed *intérêts moratoires* can only be awarded if *mauvaise foi* (bad faith) of the insurer is proved.<sup>52</sup>

For specific insurance contracts, the French legislature has introduced specific rules on statutory interest.<sup>53</sup> The general idea behind these variations is that with an increase of the interest percentage after some time has passed the insurer may have an incentive to speed up the claims handling

<sup>49</sup> Y Lambert-Faivre/L Leveneur, *Droit des assurances* (2005) 382.

<sup>50</sup> Cass 1st Civ 25 May 1992, *Bulletin des Arrêts de la Chambre Civile de la Cour de Cassation* (Bull Civ) I, no 151; cf Dalloz *Code Civil* (110th edn 2011) art 1153, nos 12, 27.

<sup>51</sup> Cf Décret no 2010-127, 9 February 2010 (JO 11 févr 2010). See Y Lambert-Faivre/L Leveneur (fn 49) 382.

<sup>52</sup> Cass Civ 2 June 1947, *Gazette du Palais* (Gaz Pal) 1947.2.107; Cass 1st Civ 18 October 1988, *Responsabilité civile et assurances* (RCA) 1989, Comm 7; Cass 1st Civ 20 December 1988, RCA 1989, Comm 119. Dalloz *Code des Assurances* (16th edn 2010) art L113-5 no 3. Cf P Malinvaud/D Fenouillet, *Droit des obligations* (2010) 578 f; S Völker, *Frankreich*, in: J Basedow/T Fock (ed), *Europäisches Versicherungsvertragsrecht*, vol 1 (2002) 529.

<sup>53</sup> See eg art L242-1 *Code des Assurances*.

process.<sup>54</sup> In motor vehicle liability insurance, the following rules (based on the 1985 *Loi Badinter* and the 2003 amendments<sup>55</sup>) apply:

Article L211-9 Code des Assurances

Quelle que soit la nature du dommage, dans le cas où la responsabilité n'est pas contestée et où le dommage a été entièrement quantifié, l'assureur qui garantit la responsabilité civile du fait d'un véhicule terrestre à moteur est tenu de présenter à la victime une offre d'indemnité motivée dans le délai de trois mois à compter de la demande d'indemnisation qui lui est présentée. Lorsque la responsabilité est rejetée ou n'est pas clairement établie, ou lorsque le dommage n'a pas été entièrement quantifié, l'assureur doit, dans le même délai, donner une réponse motivée aux éléments invoqués dans la demande.

Une offre d'indemnité doit être faite à la victime qui a subi une atteinte à sa personne dans le délai maximum de huit mois à compter de l'accident. En cas de décès de la victime, l'offre est faite à ses héritiers et, s'il y a lieu, à son conjoint. [...]

Cette offre peut avoir un caractère provisionnel lorsque l'assureur n'a pas, dans les trois mois de l'accident, été informé de la consolidation de l'état de la victime. L'offre définitive d'indemnisation doit alors être faite dans un délai de cinq mois suivant la date à laquelle l'assureur a été informé de cette consolidation.

[...]

Article L211-9 Insurance Code

Irrespective of the nature of the damage, if liability is not disputed and the damage has been fully quantified, an insurer covering liability resulting from a motor vehicle accident shall make a reasoned compensation offer to the victim within three months after submission of the claim notice. If liability is disputed or is not clearly established, or if the damage is not fully assessed, the insurer shall give a reasoned response within the same period on the issues raised in the claim notice.

A compensation offer shall be made to the victim of personal injury within eight months after the accident. If the victim dies, the offer shall be made to his heirs and, where applicable, to his spouse. [...]

The offer may be provisional if the insurer has not been informed within three months after the accident of the stabilised condition of the victim. The final offer of compensation must then be made within five months after the moment he is notified of the stabilisation.

[...]

Article L211-13

Lorsque l'offre n'a pas été faite dans les délais impartis à l'article L. 211-9, le montant de l'indemnité offerte par l'assureur ou allouée par le juge à la victime produit intérêt de plein droit au double du taux de l'intérêt légal à compter de l'expiration du délai et jusqu'au jour de l'offre ou du jugement devenu définitif. Cette pénalité peut être réduite par le juge en

Article L211-13

When the offer has not been made within the period prescribed by Article L211-9, the amount of the compensation offered by the insurer or awarded by the court to the victim shall automatically bear interest at double the statutory interest rate running from the end of said period until the date of the offer or the final judgment. This penalty can be reduced by the court in case of circumstances not imputable to the

<sup>54</sup> *Lambert-Faivre/Leveneur* (fn 49) 384, 685 f.

<sup>55</sup> Loi no 85-677 du 5 juillet 1985 tendant à l'amélioration de la situation des victimes d'accidents de la circulation et à l'accélération des procédures d'indemnisation (loi Badinter), as amended by art 83 of the 2003 Financial Security Act (Loi n° 2003-706 du 1er août 2003 de sécurité financière) which implemented the Fourth Motor Insurance Directive (Directive 2000/26/EC of the European Parliament and of the Council of 16 May 2000 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles and amending Council Directives 73/239/EEC and 88/357/EEC, OJ L 181, 20.7.2000, 65–74). See further *Y Lambert-Faivre/S Porchy-Simon*, *Droit du dommage corporel: Systèmes d'indemnisation* (2009) 689 f.

raison de circonstances non imputables à l'assureur. | insurer.

[95] Note that the court can also apply a monetary sanction in accordance with art L211-15 Code des Assurances if it finds that the amount offered by the insurance company in the settlement negotiations was derisory and ‘manifestly inadequate’. In that case, the court shall order the payment by the insurer of an additional 15% on top of the damages award to the French *fonds de garantie* (motor vehicle guarantee fund).<sup>56</sup> Here, the obligation to pay ‘interest’ clearly assumes the role of a monetary incentive to act in good faith.

## VI. Adding the PEICL piece to the puzzle

### A. Principles of European Insurance Contract Law (PEICL)

[96] Concerning the claims handling process, the Principles of European Insurance Contract Law (PEICL) provide a number of rules that warrant attention here. In Chapter 6 ‘Insured Event’, art 6:102 PEICL sets out a duty for the policyholder and the insured to cooperate with the insurer in the claims handling process. Thus, it provides the basis of deduction or lapse of cover in cases of after-the-event fraud and gross negligence committed by the insured. Art 6:103 PEICL imposes a duty on the insurer to handle claims promptly, art 6:104 clarifies when performance is due and art 6:105 provides for the accrual of interest and further damages in cases of default and late payment:

#### *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.*

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<sup>56</sup> See *Lambert-Faivre/Porchy-Simon* (fn 55) 692. The same applies in medical liability claims. See art 1142-14 (9) Code de la santé publique (Public Health Code). If an insurance company covering medical liability is found to have made a ‘manifestly inadequate’ settlement offer to the injured patient, it shall be ordered to pay an additional 15% on top of the damages award to the French Office for Medical Injury Claims (*Office National d’Indemnisation des Accidents Médicaux, des Affections Iatrogènes et des Infections Nosocomiales*, ONIAM). Cf *V Dang-Yu*, *L’Indemnisation du préjudice corporel: Les assurances de personnes, l’indemnisation des victimes d’accidents médicaux, l’indemnisation des victimes d’infractions* (2010) 31.

*Article 6:105 – Late Performance*<sup>57</sup>

(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 seven percentage points.

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

In essence, art 6:103 PEICL aims to keep the claims handling process moving forwards by setting time limits and introducing a general duty to settle a claim promptly<sup>58</sup> (though this does not necessarily mean payment of the claim<sup>59</sup>). [97] Art 6:103 gives the insurer one month after receipt of the relevant documents and other information ‘to make up his mind’. Moreover, if he does not respond he is considered to have accepted the claim. Under art 6:104 PEICL, the insurer is essentially obliged to make part payment to the extent that the claim is uncontested. Finally, art 6:105 PEICL gives the claimant<sup>60</sup> the right to claim interest from the moment that payment was due. Moreover, additional damages exceeding the interest can also be claimed (art 6:105 (2) PEICL). While it is not entirely clear from the text and comments whether art 6:105 PEICL also applies to those cases where the insurer contests coverage but the case is ultimately decided against him, such cases appear to be included.

Art 6:105 is roughly based on the Late Payments Directive (2000/35/EC) in the sense that the calculation mode (ECB MRO-rate<sup>61</sup> + 7 percentage points) is identical.<sup>62</sup> The Late Payments Directive does not explicitly deal with the question of whether claims for damages beyond interest are to be allowed. The PEICL however answers this question in the affirmative.

*B. Resulting differences*

Having discussed the various legal systems above, we can now draw a comparative picture. Let us take a simple case from the wide variety of examples of ‘remedies’ for wrongful claims handling by insurers and see how the various legal systems respond to it. Consider a case in which the insured, a consumer, has property insurance covering damage caused by fire. A fire breaks out and the insured suffers damage to his property. The insurer refuses coverage for spurious reasons. In the matrix below, the previous analysis is summarized and applied to this basic case: [97-98]

	England and Wales	Germany	France	PEICL
Moment at which payment is due	Depends on policy wording but generally speaking from the moment of the incident	Depends on the policy wording; absent a specific clause payment is due after the period mentioned in § 16 VVG	Depends on the policy wording; absent a specific clause payment is said to be due from the moment of the incident	Tacit acceptance one month after receipt of relevant documents unless contested. Payment due one week (art 6:104 (3) after acceptance (art 6:103)

<sup>57</sup> This article is modelled on art 3, para 1 (d) Directive 2000/35/EC [comment in original].

<sup>58</sup> In the comments to art 6:103 PEICL (*Basedow et al* (fn 7) 216 n 1) it is said that ‘the duty of the insurer to settle a claim promptly is, in effect, inherent to most European insurance laws’. Further references on p 218 f (n 2 with art 6:104 (2)).

<sup>59</sup> *Basedow et al* (fn 7) 215.

<sup>60</sup> Though not defined in the PEICL it seems that the word covers both the insured and the injured in the case of third-party insurance.

<sup>61</sup> European Central Bank’s Main Refinancing Operations rate.

<sup>62</sup> Cf *Basedow/Fock* (fn 52) 99.

Running period of interest	Discretionary power of the court; usually between the date of the casualty and the date of payment or judgment. (However, if the case does not reach court, interest cannot be awarded either.)  [For motor vehicle liability claims handling, specific rules (ICOBS) apply]	During the period the insurer is in default of payment (usually after giving notice of default), then § 16 VVG and § 288-289 BGB apply  Note: a special rule in § 91 VVG	During the period the insurer is in default of payment (usually after giving notice of default (art 1353 CC, but in any event from the date of the court decision; art 1153-1 CC)	Payment due one week (art 6:104 (3)) upon acceptance (art 6:103); if payment does not follow, interest starts running until payment
Percentage of interest	Discretion of the court <sup>63</sup>  [For motor vehicle liability claims handling, specific rules (ICOBS) apply]	At least 4 % but in case of default five percentage points above the basic statutory rate of interest; no compound interest though	At least the statutory interest rate plus 5 percentage points. However, for some insurance contracts the percentage increases with the duration of the delay	ECB MRO-rate + 7 percentage points
Can insured claim additional damages exceeding the interest?	No, damages for not paying damages are not admissible, though this is increasingly criticized in academic writing. Possibly, the ADR Board (FOS) may be more generous	Yes	No, unless the insurer acted with <i>mauvaise foi</i> (bad faith).	Yes

[99] The matrix shows that the differences between the legal systems are formidable. In fact, the PEICL appears to be a ‘statement’ rather than a ‘restatement’ of European insurance law.

### VII. Issues to consider

It is not uncommon for both the English and continental legal systems that there are no specific rules in private law (ie laid down in either case law, or codes and statutes) on the exercise of diligence in the claims handling process.<sup>64</sup> In that case, the general framework of private law applies. In theory, it could offer several remedies for wrongful claims handling. In some legal systems, these remedies would be considered primarily part of the realm of (semi-)contractual remedies whereas others would consider the insurer’s wrongful behaviour to be a concern of tort law. A failure to pay an amount due may result in an ancillary obligation to pay statutory or contractual interest. Moreover, sometimes wrongful claims handling may be categorized as a breach of a statutory duty or tortious deceit or fraud. However, some of these remedies are more theoretical than truly viable options: it may not always be possible to collect all the necessary evidence to show what the true motives of the insurer were for delaying and denying. In short, the burden of proof may be too burdensome.<sup>65</sup>

In addition, such general principles may not always address the specific problems that insureds encounter when dealing with a reluctant insurer. Sometimes, this gap is filled by self-regulatory codes in the insurance industry which provide more specific rules and terms for claims handling.<sup>66</sup> Yet, the intensity of compliance with and enforcement of such codes is by no means uncontested. Indeed, in

<sup>63</sup> For an overview of the methods of calculation used in practice, see *Law Commission* (fn 15) 18 ff.

<sup>64</sup> *K Bernauw*, Buitengerechtelijke schaderegeling met aansprakelijkheidsverzekeraars, in: G Jocqué et al (ed), *Aansprakelijkheid, aansprakelijkheidsverzekering en andere schadevergoedingssystemen* (2007) 469.

<sup>65</sup> *Law Commission/Scottish Law Commission* (fn 6) 55.

<sup>66</sup> See eg for Belgium the ‘Gedrageregels van de Verzekeringsonderneming’ (1999) issued by the Belgian *Beroepsvereniging van de Verzekeringsondernemingen* (Association of Insurance Companies), accessible at <[www.assuralia.be](http://www.assuralia.be)>.

practice there may be few private law remedies available to individual claimants to ensure compliance.<sup>67</sup> In some instances, public regulators such as financial services authorities have stepped in and promulgated such rules.

Before discussing the remedies for wrongful claims handling, it should be emphasized that, in some legal systems, the divide between private law remedies and regulatory law is upheld relatively strictly. For example, in some legal systems private law does not provide specific redress for wrongful delay [100] and denial and therefore the ordinary standards of contract and tort law apply. These ordinary standards may offer some remedy in clear-cut cases of abuse but seem to offer neither a more general structure for the claims handling process nor a solution to more subtle yet still wrongful handling practices.<sup>68</sup> In such jurisdictions the behaviour of insurance claims handlers may be effectively steered by regulatory rules obliging insurance companies to take due care. Sometimes, this body of specific regulation deals with both the content and the speed of the handling process and individual enforcement is procured through financial services complaints boards, panels and ombudsmen via compensatory awards to the benefit of (mainly) consumers. A form of collective enforcement may be found in the power of authorities to order insurance companies to implement and comply with specific regulatory standards on penalty of a fine and/or some form of ‘naming and shaming’.

Thus, the regulation of insurance services may open new routes for seeking redress alongside the traditional route via the civil courts and the application of traditional contract and tort law remedies.<sup>69</sup> Moreover, these alternative routes may offer remedies that are unknown in ‘ordinary’ civil law.<sup>70</sup> For instance, the concept of ‘damages’ for breach of contract in a civil court may not always include non-pecuniary loss for mere inconvenience or time spent on submitting the initial complaints. Yet Alternative Dispute Resolution (ADR) bodies such as Financial Ombudsmen may be governed by less strict rules on ‘damages’ and may indeed have the power to award small amounts in damages as a ‘token’ of acknowledgement.<sup>71</sup>

Such alternative routes may not offer solutions for all kinds of problems of all insureds but they may offer more effective redress than civil courts for certain issues. [101] For instance, the remedy of damages for wrongful claims handling – if granted by a civil court – may be a case of too little too late. Inherently problematic is the requirement that the claimant proves damage and causation. If a business is interrupted by the wrongful refusal to pay a claim and then becomes insolvent, it is not easy to prove unequivocally that the business in fact went into receivership as the ultimate result of this refusal. Would the business not have gone bankrupt anyway?<sup>72</sup> And in cases of consumers who are faced with years of uphill struggle with their insurers, will the concept of ‘damage’ as adhered to in civil courts also cover compensation for anguish and distress?

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<sup>67</sup> *Bernaauw* (fn 64) 467 ff.

<sup>68</sup> On the overriding influence of the insurance industry on the overall quality of the claims handling process and the relative absence of external standards influencing this bureaucracy, cf *R Lewis*, How Important are Insurers in Compensating Claims for Personal Injury in the UK? (2006) Geneva Papers on Risk and Insurance 323 and the contributions by *R Lewis* and *T Baker* to *Wagner* (fn 45).

<sup>69</sup> In fact, in England, redress offered by the Financial Ombudsman Service is not necessarily in conformity with private law as applied by civil courts. See *Law Commission/Scottish Law Commission* (fn 6) 62.

<sup>70</sup> Cf *Clarke* (fn 17) 243 f; *I MacNeil*, Consumer dispute resolution in the UK financial sector: the experience of the Financial Ombudsman Service (2007) *Law and Financial Markets Review* 515.

<sup>71</sup> See eg Technical Note: Compensation for distress, inconvenience or other non-financial loss (FOS July 2008), accessible at <[www.financialombudsman.org.uk](http://www.financialombudsman.org.uk)>. Sometimes, a nominal amount for time spent on consideration of the complaint by the insurer is deemed compensable as well. See the Dutch case before the *Geschillencommissie Financiële Dienstverlening* KIFiD (Disputes Commission Financial Services of the *Klachteninstituut Financiële Dienstverlening*, Complaints Institute Financial Services) no 44 of 10 June 2009.

<sup>72</sup> Cf *Bernaauw* (fn 64) 468.

It is possible that regulatory law and self-regulation may deal with some of these aspects of wrongful claims handling more effectively, swiftly and informally than the courts. From this perspective, it seems that it could be beneficial to stimulate ‘competition’ between the ordinary redress offered by civil courts and that offered by other, more flexible instruments such as branch Codes and ADR. The apparent disadvantages of having several more or less autonomous ‘routes to redress’ are disparity and the potential for confusion and arbitrariness, though it is by no means certain that these outweigh the benefits of increased pressure on the insurance industry to behave according to transparent rules (eg time periods) and to be held accountable for their claims handling policies.

### VIII. Final considerations

This article set out to survey the territory of wrongful claims handling by insurance companies. When we look at some of the legal systems, the issue of wrongfulness does not seem to play a significant role. The German concept hinges on rather less value-laden concepts such as delay, default and the imputability of the delay. The result is that, at some point in time, statutory interest may become due and additional damages may be claimed as well. The extent and impact of wrongfulness seems to play a bigger role in the assessment of non-pecuniary loss against liability insurers. Other legal systems do consider ‘bad faith’ (eg the French position on *mauvaise foi*) a special category for all insurance contracts, but merely a way to escape the limited damages payable as interest and to open up the possibility of claiming additional damages. Arguably, the least principled set of rules is to be found in England: here, there are no general rules other than that, in the case of non-performance by the insurer, no damages other than interest are owed. Whether interest accrues and, if so, from which date, is left to the court’s discretion.

An interesting effort at setting the right level of financial incentives for speeding [102] up the handling process is to be found in the French stepped-interest increase for motor vehicle liability. Without explicitly linking this stepped approach to the wrongfulness of the insurer’s behaviour, the implicit message is clear: no slacking is allowed. The French example shows that legislative intervention in this area should try to set sanctions for wrongful delay and denial at an efficient level so as to steer insurers in the right direction. In their joint paper, the English and Scottish Law Commissions rightly warn against ‘overdeterrence’ of insurers:

Insurance contracts are for specific risks. An insurer should not be exposed to uncertain and additional risks (which it may not be able to reinsure) simply because it disputes liability... Remedies should be proportionate. It would be unfair if an insurer as a result of delay on a relatively small policy faced a very large claim for consequential loss... An overly generous right to compensation for late or non-payment of valid claims may result in higher premiums for all.

Hence, a genuine but mistaken view on the part of the insurer should not be considered as a breach of ‘good faith’ or the duty of fair claims adjustment whilst knowingly delaying and denying should.<sup>73</sup> However, since it is extremely difficult for the insured to collect evidence of wilful and deliberate stalling and unscrupulous antagonism, perhaps a mixture of solutions could be helpful: the French solution of stepped interest and the German solution of leaving open the possibility of claiming further damages seem interesting instruments to consider, as is the concept of multiple ‘routes to redress’.

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<sup>73</sup> *Law Commission/Scottish Law Commission* (fn 6) 43.