

INSURANCE UPDATE

Consequential Damages In Excess Of Policy Limits

The Commercial Court in the case of *Normhurst Ltd & ors v Dornoch Ltd & ors* [2004] EWHC 567 (Comm) ("Normhurst") has confirmed that an insured is not entitled to recover as damages for breach of contract, consequential losses flowing from an insurer's failure or refusal to pay a valid claim under an indemnity policy.

Background

Normhurst involved the trial of a preliminary issue: whether an insured is entitled to recover as damages for breach of contract, consequential losses flowing from an insurer's failure or refusal to pay a valid claim under an indemnity policy.

The case concerned the consequences of a fire, which caused considerable damage to the Insured's property. The cover in question included property cover in respect of fire and cover for business interruption caused by fire. The Insured sought to recover not only the amount of the policy limit in question but also losses incurred as a result of the Insurers' refusal to pay. These 'consequential losses' were not covered by the terms of the policy and the question before the Court was whether the Insured could claim damages in excess of the policy limits for such uninsured 'consequential losses, which had been incurred as a result of the Insurers' failure to pay.

The legal basis for rejecting the claim for consequential damages

The position under English law in respect of recovery of damages for failure to pay a valid claim under an indemnity policy, is governed by three main decisions: *The President of India v Lips Maritime Corporation* [1987] 2 Lloyd's Rep. 311 ("*The Lips*"); *Apostolos Konstantine Ventouris v Trevor Rex Mountain (The Italia Express (No. 2))* [1992] 2 Lloyd's Rep. 281 ("*The Italia Express*") and *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep. 111 ("*Sprung*").

The House of Lords in *The Lips* held that there can be no such thing as a cause of action in damages for the late payment of damages. In *The Italia Express* the Court, following the decision in *The Lips*, held that the insurers'

obligation to indemnify the insured under a policy of insurance gives rise to a liability in damages on the part of the insurer with the consequence that there can be no recovery of damages in respect of a failure to pay the original indemnity. The Court of Appeal in *Sprung* approved and applied *The Italia Express*.

The obligation to pay under an insurance policy is an obligation in damages because it provides the insured with an indemnity by the insurer. The policy is equally one of indemnity whether the insurance is property or liability insurance. The obligation to pay damages is a secondary obligation, which arises upon a breach of the primary obligation to hold the insured harmless against the occurrence of an insured event, and it is to such secondary obligations that the principle in *The Lips* applies.

The Insured attempted to demonstrate that the claims in question related to breaches of primary, as opposed to secondary, obligations, and that the policy in question was not therefore one to which the decisions in the above cases would apply.

The Insured argued that the Insurers' obligation to pay under the policy in question was not an obligation to pay damages but rather an obligation to make a contractual payment upon the occurrence of certain events specified in the policy. In this sense, liability (a primary obligation) only arose in certain circumstances, which were distinct from the peril insured against. The Insured argued that a failure to meet that obligation constituted a breach for which damages, including damages for losses flowing from the Insurers' failure to honour that primary obligation, would be recoverable.

The Court rejected this argument. It was held that whilst a cause of action may sometimes arise only after the occurrence of the event insured against, this did not prevent a policy being one of indemnity. The Court highlighted the difficulty facing the Insured in identifying the nature of the policy if it was not one of indemnity. The Court concluded that it was unable to see how the policy in question could be anything other than an indemnity policy. As such, the obligation to pay damages was a secondary obligation and the policy fell within the ambit of application of the decisions in the cases referred to above.

If the Insured were to succeed, they would have had to secure the reversal of previous authorities. This was not something that was open to the Court to do and therefore the preliminary issue had to be answered in the negative. Accordingly, an insured is not entitled to recover as damages for breach of contract, consequential losses flowing from an insurer's failure or refusal to pay a valid claim under an indemnity policy.

An Appeal was originally lodged against the Commercial Court's decision but the case settled before the Appeal was heard.

Commentary

An insured might assert that certain losses incurred as a result of an insurer's failure to pay a claim are more damaging for the insured than the occurrence of the insured event itself. However, the decision in *Normhurst* has confirmed that the insurer's obligation under a policy of indemnity is restricted to paying claims that arise directly from the insured event and that fall within the limits of the policy.

Furthermore, if insureds were permitted to recover losses incurred as a result of insurers' failure to respond immediately to a demand under a policy, it would mean (as pointed out by Mr Justice Hirst in *The Italia Express*) that generations of Counsel in innumerable marine insurance cases must have overlooked a very valuable head of damages available to insureds.

Consequently, as matters stand no cause of action exists under English law for late or non-payment of damages. The only remedy that English law affords to an insured for delay in payment under an insurance policy is the discretionary award of interest.

The contents of this Bulletin are not intended to be a substitute for specific legal advice on individual matters. If you wish to discuss any issues raised in this bulletin, or for further information please contact:

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