

Compound interest for late payment of the indemnity insurance claim

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Abstract: Interest is awarded to compensate the claimant for the loss of use of money and available under Section 35A of the Senior Court Act 1981. Nevertheless, only simple interest can be given under this statute, leading to inadequate compensation for the claimant. The assured also suffers from the loss of use of money when the insurer delays paying the insurance proceeds. Since Section 13A(1) of the Insurance Act 2015 took effect, things may have become more favourable for the assured in that context. This article proposes two alternative solutions at common law by which the assured can be fully compensated for the loss of use of money: awarding compound interest as compensatory damages or negotiated damages.

Keywords: Compound Interest; Compensatory Damages; Negotiated Damages; Indemnity Insurance; Late Payment

1. Introduction

In respect of indemnity insurance, it has been accepted for a long time that an insurer's obligation is to hold the assured harmless and prevent risk insured against from occurring instead of paying claims sufficiently and duly.¹ Once the assured sustains a loss arising from the peril insured against, the insurer breaches the obligation and must indemnify the assured. The claims on insurance money under indemnity policy naturally sound in unliquidated damages rather than debts.² Since section 13A(1)³ of the Insurance Act 2015 took effect, every insurance contract contains an implied term, pursuant to which the insurer must pay any sums due (the "insurance money") in respect of any claims made by the assured

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¹ *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti)* [1990] 2 Lloyd's Rep 191.

² *Apostolos Konstantine Ventouris v Trevor Rex Mountain (The Italia Express (No.2))* [1992] 2 Lloyd's Rep 281; *Sprung v Royal Insurance (UK) Ltd* [1996] 6 WLUK 173, [1999] Lloyd's Rep 111; *Normhurst Ltd v Dornoch Ltd* [2004] EWHC 567 (Comm) [2004] EWHC 567 (Comm), [2005] Lloyd's Rep IR 27.

³ Section 13A(1): It is an implied term of every contract of insurance that if the insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time.

within a reasonable time. If the insurer is in breach of that implied term, under section 13A(5), the assured can seek remedies for the insurer's breach which are in addition to, and distinct from (a) any right to enforce payment of the sums due, and (b) any right to interest on those sums (whether under the contract, under another enactment, at the court's discretion or otherwise). Where interest has not been contractually agreed in the policy, the assured can make a claim for statutory interest. In light of section 35A⁴ of the Senior Court Act 1981, simple interest can be awarded on the sum at the court's discretion in proceedings for the recovery of a debt or damages. Thus, in this situation, the assured is likely to recover an award of simple interest on the insurance money under section 35A. The purpose of interest on damages is to compensate for the loss of use of money.⁵ The best measure of such compensation, which Professor Andrew Burrows summed up in light of a number of leading cases, is the cost of borrowing replacement money⁶ incurred by the claimant during the relevant period, namely, as to the assured's claim on the insurer's late payment, between the date following the expiration of a reasonable time and the date of the judgment given for the sum of money. However, financial institutions would not lend money to the borrower, such as the assured, based on simple interest only. Thus, it is suggested that such an award under section 35A would not provide a sufficient level of protection as desired for the assured.⁷ This article proposes two alternative solutions to overcome this difficulty for the assured. The answer mainly lies on the two alternatives available at common law as follows.

⁴ Section 35A(1): (1) Subject to rules of court, in proceedings (whenever instituted) before the High Court for the recovery of a debt or damages there may be included in any sum for which judgment is given simple interest, at such rate as the court thinks fit or as rules of court may provide, on all or any part of the debt or damages in respect of which judgment is given, or payment is made before judgment, for all or any part of the period between the date when the cause of action arose and—
(a) in the case of any sum paid before judgment, the date of the payment; and
(b) in the case of the sum for which judgment is given, the date of the judgment.

⁵ *BP Exploration Co (Libya) Ltd v Hunt (No.2)* [1981] 1 WLR 232; *Kuwait Airways Corporation v Kuwait Insurance Company SAK* (No.3) [2000] 1 All ER (Comm) 972, [2001] CP Rep 60.

⁶ Andrew Burrows, "Interest" in Graham Virgo & Sarah Worthington (edn), *Commercial Remedies: Resolving Controversies* (CUP, Cambridge, 2018), p.255.

⁷ Chris Nicoll, "Compound Interest?" (2008) *Insurance Law Monthly* Vol. 20(2); Chris Nicoll, "Compound interest for late payment of an insurance claim" (2008) 124 *LQR* 199; Malcolm Clarke, "Compensation for failure to pay money due: a 'blot on English common law jurisprudence' partly removed" (2008) *JBL* 291, 292; Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, (Sweet & Maxwell, London), [C-0118].

First, the assured may be able to obtain “compound interest” as compensatory damages. In *Sempre Metals Ltd v Commissioners of Inland Revenue*,⁸ their Lordships allowed a claim for compound interest in restitution to recover the use-value of money mistakenly paid. At the same time, they awarded interest, simple or compound, as damages on claims for non-payment of debts or on claims for breach of contract and tort for the loss of interest. The aspect of the decision holding that a claim on unjust enrichment could be brought to recover the use-value of money has now been overruled by *Prudential Assurance Co Ltd v Revenue and Customs Commissioners*.⁹ However, the rule established in *Sempre* that simple or compound interest could be recovered as damages for the loss of interest was not in issue in *Prudential* and remains effective. The interest award as damages here, as their Lordships observed, also represents the compensation for the claimant’s loss of use of money.¹⁰ Thus, it is arguable that the purposes of an interest-as-damages award in *Sempre* and the statutory interest award under section 35A are both to compensate for the loss of use of money. A simple interest award under section 35A would not provide sufficient reparation to the assured for that loss. Can the assured recover compound interest as damages based on *Sempre* at common law?

Secondly, the assured may be able to claim compound interest as “negotiated damages”. Usually, in light of the traditional compensation principle, a claimant will only be awarded nominal damages if no financial loss caused by the defendant’s breach of contract can be proven. However, the courts have recognised that nominal damages are not an adequate and just remedy for the claimant in some cases. Thus, the courts have awarded negotiated damages assessed as a quid pro quo for a lesser or inadequate performance of the contract by the other party¹¹ or measured by reference to a hypothetical release fee that the claimant would have charged for accepting the change to the other party’s performance of the contract.¹² These cases are similar to the situation where the assured, encountering the insurer’s late payment, seeks a simple interest award under section 35A that provides inadequate protection for the

⁸ [2007] UKHL 34, [2008] 1 AC 561.

⁹ [2018] UKSC 39, [2018] 3 WLR 652.

¹⁰ [2007] UKHL 34, [2008] 1 AC 561, [59], [66], [135], [143], [190], [225].

¹¹ *Wrotham Park Estate Co. Ltd v Parkside Homes Ltd. and Others* [1974] 1 WLR 798, [815]; *Experience Hendrix LLC v PPX Enterprises Inc* [2003] EWCA Civ 323, [2003] 1 All ER (Comm) 830, [45].

¹² *WWWF-World Wide Fund for Nature and another v World Wrestling Federation Entertainment Inc* [2007] EWCA Civ 286, [2008] 1 WLR 445, [53]; *Lane v O’Brien Homes* [2004] EWHC 303, [2004] 2 WLUK 105, [24].

assured. This gives rise to the question of whether an assured could argue that they are entitled to compound interest by way of negotiated damages at common law.

2. Compound Interest as Compensatory Damages for Late Payment

It is a fundamental principle that interest is awarded to compensate the claimant for the loss of being kept out of money¹³ or the loss of use of the money during the corresponding period when the claimant was without that money.¹⁴ Where the insurer unreasonably withholds the payments due under the policy, the assured may suffer from the loss of use of money that usually takes the form of the cost of borrowing replacement money.¹⁵ Thus, the assured may have the right to recover interest as compensation for that loss. As mentioned above, section 13A(5) of the Insurance Act 2015 stipulates that the assured can recover interest upon the insurance payouts in accordance with the contractual terms, statute, or others. Unless interest is contractually agreed, the assured is presumably to seek interest by virtue of statutes. However, section 13A(5) does not provide any method to calculate interest. It is necessary to seek interest by other statutes.

First, section 35A of the Senior Court Act 1981 gives the court the power to award simple interest in proceedings for the recovery of a debt or damages. Considering that the claims on insurance money under indemnity policy naturally sound in unliquidated damages rather than debts,¹⁶ simple interest would be awarded to the assured under section 35A. Nevertheless, simple interest is not an appropriate reflection of the assured's loss of use of money in that any assured is unlikely to be able to borrow money merely on simple interest terms. Thus, if the costs of borrowing an equivalent sum of money for the period the insurance money remains due and unpaid represents the assured's loss for not being paid the insurance money within a reasonable time, the assured cannot be said to be fully compensated by a simple interest payment. Moreover, section 35A only gives the court the power to award interest when giving the

¹³ *BP Exploration Co (Libya) Ltd v Hunt (No.2)* [1981] 1 WLR 232; *Kuwait Airways Corporation v Kuwait Insurance Company SAK* (No.3) [2000] 1 All ER (Comm) 972, [2001] CP Rep 60.

¹⁴ Adam Kramer, *The Law of Contract Damages*, 2nd edn (Hart, Oxford, 2018), [7-46].

¹⁵ Andrew Burrows, "Interest" in Graham Virgo & Sarah Worthington (edn), *Commercial Remedies: Resolving Controversies* (CUP, Cambridge, 2018), p.255.

¹⁶ *Apostolos Konstantine Ventouris v Trevor Rex Mountain (The Italia Express (No.2))* [1992] 2 Lloyd's Rep 281; *Sprung v Royal Insurance (UK) Ltd* [1996] 6 WLUK 173, [1999] Lloyd's Rep 111; *Normhurst Ltd v Dornoch Ltd* [2004] EWHC 567 (Comm), [2005] Lloyd's Rep IR 27.

judgment for a debt or damages or where the defendant pays in proceedings brought for the recovery of the debt or damages. In other words, where the insurer delays paying the insurance money but pays it before proceedings are brought by the assured, the assured cannot seek any interest under section 35A.

Secondly, section 49(3)¹⁷ of the Arbitration Act 1996 gives the arbitrators power to award interest upon any award, whether simple or compound. If the parties of the insurance contract choose arbitration procedure to resolve their disputes, the assured would seek to recover compound interest under section 49(3). However, this section also stipulates that the arbitrators can only award interest when giving the award claimed or where the amount claimed is paid in arbitral proceedings. It means that if the insurer does not indemnify the assured timeously but pays the insurance money before the commencement of arbitration, the assured is not entitled to interest under section 49(3).

Based upon these analyses, a claim for interest under statutes seems not to be a satisfactory course to compensate for the assured's loss of use of money. In contrast, in *Sempra*, their Lordships held that the claimant was entitled to simple or compound interest as damages to compensate the loss of interest. Their Lordships also regarded the interest award as damages as the reparation to the claimant's loss of use of money.¹⁸ So, can the assured recover compound interest at common law by *Sempra* for full compensation?

2.1 Interest as compensatory damages in *Sempra*

Prior to the decision in *Sempra*, there had been a long-established rule at common law that interest should not be available by way of damages for failure to pay a sum of money (whether a debt or damages) when it is due, unless there is an express or implied promise to pay any interest.¹⁹ Then, the rule was relaxed so that it would only apply to general damages, and interest was available for special damages in the

¹⁷ Section 49(3): the tribunal may award simple or compound interest from such dates, at such rates and with such rests as it considers meets the justice of the case—

(a) on the whole or part of any amount awarded by the tribunal, in respect of any period up to the date of the award;

(b) on the whole or part of any amount claimed in the arbitration and outstanding at the commencement of the arbitral proceedings but paid before the award was made, in respect of any period up to the date of payment.

¹⁸ [2007] UKHL 34, [2008] 1 AC 561, [59], [66], [135], [143], [190], [225].

¹⁹ *Higgins v Sargent, Esq. and Others* [1823] 107 ER 414; *The London, Chatham and Dover Railway Company v The South Eastern Railway Company* [1893] AC 429.

second limb of *Hadley v Baxendale*.²⁰ In *Sempre*, an award of interest as compensatory damages developed further.

In *Sempre*, the claimant, *Sempre*, a subsidiary resident in the U.K. owned by a German parent company, prematurely paid advance corporation tax to the defendant, HMRC (“the Revenue”). The Revenue agreed to pay simple interest in respect of the amount of prematurely paid tax but refused the claimant’s request for compound interest. By way of background, under the Income and Corporation Taxes Act 1988, dividends paid by companies resident in the U.K. were subject to advance corporation tax (ACT) which could later be set off against mainstream corporation tax (MCT). The statute also provided that two companies resident in the U.K., the parent company owning over 51% of the subsidiary one, could make a group income election so that the subsidiary company was not on duty to pay ACT on dividends paid to the parent company. In March 2001, the Court of Justice of the European Communities (“CJEC”) held that the relevant provisions of the Income and Corporation Taxes Act 1988 were contrary to Article 52 of the E.C. Treaty (free establishment) since they applied the ACT tax benefit to resident parent companies, but not non-resident ones. However, the CJEC also said that companies who had already made ACT payments on a group basis should be entitled to reimbursement or reparation of the financial losses they sustained or to a refund deriving from the enrichment of the member state.

Consequently, the claimant made a claim against the Revenue for compound interest as restitution based upon the sum of tax paid prematurely between the date when ACT was paid and the date on which MCT was payable. The first instance tribunal held that the claimant had an entitlement to a remedy by which the claimant could recover damages to be put in the same position as if had it not prematurely paid ACT, and thus, that the award should be calculated based upon the compound interest instead of simple interest. The Court of Appeal followed it and dismissed an appeal. The Revenue then appealed to the House of Lords. The House of Lords, in relation to the claimant’s restitutionary cause of action, allowed compound interest award to reverse the defendant’s unjust enrichment. Incidentally, their Lordships took the opportunity to further restrict that long-established rule, and allowed a remedy of interest as damages when the loss of interest can be proven.

²⁰ *Trans Trust SPRL v Danubian Trading Co. Ltd* [1952] 1 Lloyd's Rep 348; *Wadsworth v Lydall* [1981] 1 WLR 598; *President of India v La Pintada Compania Navigacion SA* [1984] 2 Lloyd's Rep 9.

As regards a claim for unjust enrichment where payments had been made prematurely, compound interest as restitution was awarded on a restitutionary basis, representing the use-value of money unjustly deprived of by the defendant. However, this aspect of *Sempre* has since been overruled by *Prudential Assurance*.²¹ In *Prudential Assurance*, the claimants paid corporation tax in a mistake of law and brought proceedings against the Revenue for compound interest on the tax levied unlawfully. They claimed that the Revenue was unjustly enriched by the opportunity to use the sum of money, namely, the use-value of money. Their Lordships held that the claimant was not entitled to the transfer of value representing the opportunity to use that money. The primary reason for such a ruling is that there was no direct transfer of value from the claimant to the Revenue.²² Although the use-value of money may have been enriching the Revenue, such enrichment cannot be treated as being “at the expense of the claimant”.

The Supreme Court in *Prudential* did not consider the aspect of *Sempre* that a remedy of interest as damages was available for the loss of use of money.²³ Thus, despite that the aspect of *Sempre* upon the restitutionary award had been overruled, the decision that the claimant could recover compound interest as damages on claims for non-payment of debts, breach of contract or tort remains effective up until now. Their Lordships in *Sempre* unanimously asserted that the unprincipled and anomalous rule at common law that no damages should be awarded for interest losses caused by a failure to pay a sum of money should be changed. Although their Lordships refused to award interest by way of general damages, they admitted that as long as the claimant can plead and prove actual interest losses, the claimant can recover the simple or compound interest as damages for compensation.²⁴ The award of interest as damages was allowed in this case on claims for non-payment of debts as well as claims for breach of contract and tort.²⁵ Their Lordships in *Sempre* further stated that an award of interest as damages is also subject to principles employed in all claims for damages, such as remoteness and mitigation.²⁶ Therefore, either simple or compound interest can be accounted for sufficient compensation depending on actual losses incurred by the claimant.²⁷

²¹ [2018] UKSC 39, [2018] 3 WLR 652.

²² *Ibid*, [47].

²³ *Ibid*, [44], [79].

²⁴ [2007] UKHL 34, [2008] 1 AC 561.

²⁵ *Ibid*, [94],[100],[132],[151],[216].

²⁶ *Ibid*, [94].

²⁷ *Ibid*, [90].

In respect of the explanation for “interest losses”, Lord Nicholls in *Sempra* stated:²⁸

“The loss may be the cost of borrowing money. That cost may include an element of compound interest. Or the loss may be loss of an opportunity to invest the promised money. Here again, where the circumstances require, the investment loss may need to include a compound element if it is to be a fair measure of what the plaintiff lost by the late payment. Or the loss flowing from the late payment may take some other form.”

Again, Lord Scott said in that decision:²⁹

“The claim to recover interest based upon the interest that would have been earned if the money used to pay the ACT had instead been placed on deposit with a bank, or upon the interest that would have been saved if the money had been used to repay borrowings, is a claim for compensatory damages.”

Based on their Lordships’ words, “interest losses” generally consist of the cost of borrowing replacement money or benefits that would have been earned by depositing the sum of money in a bank. The loss of use of money also normally takes the form of the cost of borrowing replacement money.³⁰ Therefore, the loss of interest could be considered to be a type of loss of use of money, and the interest award as damages in *Sempra* was also to compensate the claimant’s loss of use of money, which was confirmed by their Lordships.³¹

2.2 Applying Sempra to an insurance claim on the insurer’s late payment

For a long time, it has been accepted that an insurer’s obligation in indemnity insurance contracts is to hold the assured harmless from the loss caused by an insured peril.³² Once the assured sustains a loss arising from the peril insured against, the insurer has breached its primary obligation to hold the assured harmless and then is under a secondary obligation to indemnify the assured for its insured loss. The

²⁸ *Ibid*, [95].

²⁹ *Ibid*, [149].

³⁰ Andrew Burrows, “Interest” in Graham Virgo & Sarah Worthington (edn), *Commercial Remedies: Resolving Controversies* (CUP, Cambridge, 2018), p.255.

³¹ [2007] UKHL 34, [2008] 1 AC 561, [59], [66], [135], [143], [190], [225].

³² *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti)* [1990] 2 Lloyd’s Rep 191.

claims on insurance money under indemnity policy sound in unliquidated damages rather than debts.³³ As mentioned above, since section 13A(1) of the Insurance Act 2015 came into effect, a statutory implied term applies to every contract of insurance, whereby an insurer assumes a separate obligation of timely payment.³⁴ Once the insurer delays paying the insurance money, the insurer is in breach of the insurance contract.

In light of *Sempra*, the claimant can recover the award of simple or compound interest as damages on claims for non-payment of debts as well as claims for breach of contract and tort if the actual loss of interest can be pleaded and proven.³⁵ Because the nature of the insurance money of an indemnity insurance claim is unliquidated damages rather than debts, the assured who hopes to recover the interest as damages only can seek it in the cause of action for breach of contract. Specifically, in respect of contractual breach, Lord Scott in *Sempra* said:³⁶

“interest losses caused by a breach of contract... should be held to be in principle recoverable, but subject to proof of loss, remoteness of damage rules, obligations to mitigate damage and any other relevant rules relating to the recovery of alleged losses.”

Lord Mance also said that “loss of interest is recoverable as damages for breach of contract, if it was within the reasonable contemplation of the parties.”³⁷

As mentioned above, the loss of interest, in essence, is a type of loss of use of money. As a result, the assured can seek compound interest by *Sempra* as damages to compensate the loss of use of money if the loss incurred by the insurer’s late payment can be pleaded and proven. Compared with the statutory award under section 35A, this remedy at common law would provide more comprehensive compensation to the assured.

Nevertheless, it should be noted that following *Sempra*, the courts have expressed different views on what constitutes proof of loss in respect of compound interest. In *Equitas Ltd v Walsham Brothers & Co*

³³ [1992] 2 Lloyd’s Rep 281; [1996] 6 WLUK 173, [1999] Lloyd’s Rep 111; [2004] EWHC 567 (Comm), [2005] Lloyd’s Rep IR 27.

³⁴ Jonathan Gilman, *Arnould: Law of Marine Insurance and Average*, 19th edn (Sweet & Maxwell, London, 2018), [12-05].

³⁵ [2007] UKHL 34, [2008] 1 AC 561, [94],[100],[132],[151],[216].

³⁶ *Ibid*, [132].

³⁷ *Ibid*, [216].

Ltd,³⁸ the defendant, an insurance broker, breached the contractual obligation and failed to remit the funds to the claimant, a successor to Lloyd's syndicates, reasonably promptly. Even if the claimant could not provide any evidence showing the loss that the claimant sustained due to the late payment, Mr Justice Males still drew on *Sempra* to hold that the claimant suffered from the loss of being kept out of its money and that the measure of the claimant's loss was the cost of borrowing with conventional rate to replace the funds the claimant had been deprived of.³⁹ As regards the proof of loss, Mr Justice Males stated,⁴⁰

“...unless there is some positive reason to do otherwise, the law will proceed on the basis, at any rate in the commercial context, that a claimant kept out of its money has suffered loss as a result. That represents commercial reality and everyday experience. Specific evidence to that effect is not required and, even if adduced, may well be somewhat hypothetical and thus of little assistance. For example, a business man may well be unable to say precisely what he would have done differently if a particular payment had been made to him when it ought to have been, especially if (as apparently in this case) he was unaware that the money was being withheld. Extensive disclosure, which would no doubt be demanded by the defendant, is unlikely to assist. But that does not mean that no loss has been suffered. In the present case the general evidence of the importance attached in the market to prompt remittance of funds is more than sufficient to justify the conclusion that the syndicates did suffer a loss by being kept out of their money.”

Then, Mr Justice Males argued that adopting simple interest would lead to an unjust outcome because it is unlikely to borrow in a transaction on simple interest and embraced the compound interest at a conventional rate in measuring damages for the defendant's breach of an obligation to remit funds.⁴¹

In *Peacock v Imagine Property Developments Ltd*,⁴² the claimant's breach of contract led to the defendant's failure to sell a plot of land and to obtain a sum of money which undermined the defendant's further engagement in the development. Although the evidence of lost investment opportunity was not enough, Mr Justice Stuart-Smith awarded the defendant the cost of borrowings to a commercial entity as damages, by compounding interest, to compensate the defendant's loss of use of money. Mr Justice

³⁸ [2013] EWHC 3264 (Comm), [2014] Bus LR D7.

³⁹ *Ibid*, [123].

⁴⁰ *Ibid*.

⁴¹ *Ibid*.

⁴² [2018] EWHC 1113 (TCC), [2018] 5 WLUK 196.

Stuart-Smith said that in respect of a business entity like the defendant, the commercial cost of borrowing money was a loss that would naturally arise according to the *Hadley v Baxendale* rule if the defendant was kept out of its money.⁴³

In contrast, in *JSC BTA Bank v Ablyazov*,⁴⁴ Mr Justice Teare adopted a different approach to proof of loss. Prior to this case, the claimant bank claimed that it paid away sums of money due to the defendant's fraud. Then, the claimant acquired judgments against the defendant who repaid those sums of money to the claimant. In this case, the claimant sought to recover compound interest as damages upon those sums of money paid away as a result of the defendant's fraud. Mr Justice Teare stated that the claimant bank did not allege that those sums of money paid away would have been put into any use had there been no fraud, such as lending those money to bona fide borrowers or using those money as the bank's capital reserves, and thus, that the claimant could not prove actual interest losses.⁴⁵ Mr Justice Teare held that the claimant could not recover the compound interest as damages, and could only recover simple interest award under section 35A of the Senior Court Act 1981,⁴⁶ although he noted that it might be "unrealistic and unduly formalistic" for the claimant bank specifically to plead the actual loss of interest.⁴⁷ Therefore, in this case, Mr Justice Teare did not agree with Mr Justice Males and Mr Justice Stuart-Smith's view that a business man or commercial entity kept out of money will incur a loss.

Mr Justice Barling in *Sainsbury's Supermarkets Ltd v Mastercard Inc* said that the evidence the judge needs depends upon the circumstances of each case.⁴⁸ As a result, at present the case law does not provide uniform guidance on what evidence the courts expect to see in order to provide proof of losses for compound interests.

This article suggests, for the reasons stated below, that the courts should adopt different requirements for the proof of interest losses or the loss of use of money in accordance with whether the insurance contract is a business insurance contract or a consumer insurance contract.

In respect of a business insurance contract, there should be a presumption in favour of the assured that

⁴³ *Ibid*, [150].

⁴⁴ [2013] EWHC 867 (Comm), [2013] 4 WLUK 410.

⁴⁵ *Ibid*, [12].

⁴⁶ *Ibid*, [19].

⁴⁷ *Ibid*, [18].

⁴⁸ [2016] CAT 11, [2016] 7 WLUK 355, [521].

the assured suffers the interest losses. Unless the insurer proves that the assured does not suffer such a loss, the loss of interest should be awarded in favour of the assured. This is because a business entity typically needs funds to carry out daily business transactions. It is a commercial reality that if the entity is deprived of a sum of money, it will either suffer from the cost of borrowings or the lost debit interest that would have been earned with the sum of money.⁴⁹ In addition, in certain situations, it is impossible for the business to prove the loss of interest or the loss of use of the money. If the courts always require the business entity to provide evidence showing its actual interest losses before it can recover compensation for those losses, it would be inconsistent with the commercial reality and unjust for the business entity. Furthermore, this view is in line with the opinions of many judges. For example, Lord Hope in *Sempre* stated,⁵⁰

“The reality is that every creditor who is deprived of funds to which he is entitled and which he needs to run his business will have to incur an interest-bearing loan or employ other funds which could themselves have earned interest. It is a short step to say that interest losses will arise ‘in the ordinary course of things’ in such circumstances.”

Lord Hope asserted that every businessman would normally suffer interest losses in commercial transactions if the businessman’s funds are employed. Justice Males in *Equitas Ltd v. Walsham Brothers & Co Ltd* and Justice Stuart-Smith in *Peacock v. Imagine Property Developments Ltd* also held this view. Thus, the courts should generally award compound interest as damages for the assured in the business insurance at a conventional rate.

By contrast, the assured in a consumer insurance contract should prove the specific interest losses before interest as damages can be awarded to such assured. If the assured fails to prove the actual loss of interest or the loss of use of money, the assured cannot recover compound interest as damages to compensate for such loss at common law. At this time, the assured can only seek simple interest under section 35A of the Senior Court Act 1981. The strict requirement for the consumer assured to demonstrate the evidence of actual interest losses is supported by the Financial Ombudsman Service (FOS). The FOS has a jurisdiction to hear the complaints from consumers or micro-enterprises. The Ombudsman generally grants 8% simple interest to the consumers for being kept out of money unless they can provide evidence

⁴⁹ [2013] EWHC 3264 (Comm), [2014] Bus LR D7, [123].

⁵⁰ [2007] UKHL 34, [2008] 1 AC 561, [16].

of the actual losses. For example, in the first case (Ref: DRN7494970), the consumer assured, Mr B, complained that he was mis-sold a policy by Barclays Bank Plc. Barclays accepted his complaint and refunded him the sum of premiums paid with simple interest at the contractual rate. However, Mr B sought to recover compound interest upon the sum. The Ombudsman stated that Mr B's bank statements showed that Mr B paid off his credit card during the relevant period and did not incur any interest losses on the premium. Therefore, the Ombudsman refused to award compound interest to Mr B. In the second case,⁵¹ Mr and Mrs A complained that they were mis-sold a number of policies by Barclays Bank Plc. Mr and Mrs A argued that they would have invested the money spent on premiums and that they should be awarded compound interest upon the sum which ought to be repaid to them. The Ombudsman did not see any proof of the investment they would have made, and so he could not confirm what they would have done with that money. The Ombudsman finally did not uphold Mr and Mrs A's complaint. By contrast, in the third case,⁵² compound interest was awarded by the Ombudsman. In this case, after reporting his subsidence claim to the Esure Insurance Limited, Mr L, the assured, moved abroad to take up his new job, and hoped to sell his old house. However, Esure delayed handling his subsidence claim, leading to his failure to sell his old house. Mr L had to pay the extra mortgage payments, council tax, utility bills and other costs. Mr L complained that Esure unreasonably delayed handling his claims and thus, sought to recover compensation for his consequential losses. As regards reimbursing Mr L for the interest paid by Mr L upon the mortgage payments, Esure only offered 8% simple interest. The Ombudsman finally rejected the offer, and decided to reimburse Mr L for the actual interest losses with compound interest. Given these cases in the FOS, it can be concluded that the FOS requires the consumer assured to prove his actual interest losses to a high level. This article argues that the courts should also adopt such a high standard of proof to handle a consumer assured's claim.

In a nutshell, *Sempra* can apply to interest as compensatory damages for the assured's loss of interest or the loss of use of money incurred by the insurer's failure to pay the insurance money within a reasonable time. In practice, specific evidence to show the assured's loss of interest should be relaxed by the courts when facing a commercial assured seeking compound interest for the loss of use of money. Such loss is a commercial reality for a business entity if it is deprived of a sum of money. Awarding compound interest as damages would provide sufficient compensation to the commercial assured. However,

⁵¹ (Ref: DRN8867682).

⁵² (Ref: DRN4772691).

regarding the assured in the consumer insurance contract, specific proof of loss of interest should be required before the assured can recover compound interest as damages. If the consumer assured cannot show the evidence, the assured can only seek a statutory interest award under section 35A.

3. Compound Interest as Negotiated Damages for Late Payment

3.1 The background and issues

As mentioned above, where the assured cannot prove the loss of interest or the loss of use of money, an award of compound interest as damages by *Sempra* will be unavailable. Moreover, it has been explained in the foregoing paragraphs that, whereas the assured can recover an interest award pursuant to section 35A of the Senior Courts Act 1981, the court can only award simple interest at its discretion under this provision, which may not provide a sufficient level of compensation to the assured.⁵³ Therefore, neither a statutory interest award under section 35A nor a *Sempra* interest award at common law may be appropriate for the purposes of providing the assured with proper compensation for late payment. Is there a third route towards achieving this?

The situation where the assured is inadequately compensated is similar to the circumstance in *Wrotham Park Estate Co. Ltd v Parkside Homes Ltd*.⁵⁴ In *Wrotham Park*, although the claimant could not prove identifiable losses, the court proposed that nominal damages would not have adequately compensated the claimant. Brightman J gave a seemingly novel award —“negotiated damages” — distinguished from conventional compensatory damages, and allowed the claimant to recover an adequate amount. This case brings some inspiration for an insurance claim of late payment. Damages for breach of contract at common law are conventionally awarded to compensate the claimant’s economic losses. Where the assured cannot prove the actual loss of interest or the loss of use of money, such as the cost of borrowings, caused by the insurer’s delay, as mentioned above, the assured cannot recover compound interest as compensatory damages by *Sempra*. The only way for the assured to be compensated in this situation is to seek a statutory remedy by section 35A, which, as with nominal damages for *Wrotham Park*, cannot

⁵³ Chris Nicoll, “Compound Interest?” (2008) *Insurance Law Monthly* Vol. 20(2); Chris Nicoll, “Compound interest for late payment of an insurance claim” (2008) 124 *LQR* 199; Malcolm Clarke, “Compensation for failure to pay money due: a ‘blot on English common law jurisprudence’ partly removed” (2008) *JBL* 291,292; Robert Merkin, *Colinvaux & Merkin's Insurance Contract Law*, (Sweet & Maxwell, London), [C-0118].

⁵⁴ [1974] 1 *WLR* 798.

provide enough protection for the assured. Is the assured entitled to compound interest at common law by way of negotiated damages?

Negotiated damages arise from a deficiency in conventional compensatory damages for breach of contract. In addition to some non-pecuniary losses, compensatory damages can only be awarded for pecuniary losses or economic losses. As Lord Reed pointed out, the measure of economic losses in some cases is ‘inherently impossible’.⁵⁵ This deficiency of conventional compensatory damages leads to inadequate compensation for the claimant where the claimant cannot prove economic losses incurred by the other party’s breach. Whereas many statements have supported that negotiated damages should be regarded as reversing the defendant’s gains by awarding an equivalent amount to the claimant,⁵⁶ Lord Reed confirmed the compensatory nature of negotiated damages in *One Step (Support) Ltd v Morris-Garner and another*.⁵⁷

This section of the article will primarily explore the circumstances in which negotiated damages can be awarded and then discuss whether the assured can recover negotiated damages as compound interest in an insurance claim on the insurer’s late payment. Since the Supreme Court allowed the appeal in *One Step*,⁵⁸ it seems that their Lordships reversed a broader basis for negotiated damages, which previous cases had adopted,⁵⁹ restricting the scope of awarding these damages. Therefore, the following analysis will be divided into two stages, pre-*One Step* and post-*One Step*.

⁵⁵ [2018] UKSC 20, [2018] 2 WLR 1353, [37].

⁵⁶ See the citations and discussions by James Edelman in *McGregor on Damages*, 21st edn (Sweet & Maxwell, London, 2020), [14-012]. It should be noted that the subtraction from the claimant here is different from the deprivation by the defendant at the expense of the claimant in unjust enrichment. Unjust enrichment is an event and restitution is a response to the event. However, unjust enrichment is not the only event to which restitution responds, and restitution is also not the only response to unjust enrichment. Restitutionary award also results from wrongs, including breach of contract, tort and equitable wrongs. Restitution here in *Wrotham Park*, if damages on a *Wrotham Park* basis are understood as restitution, is for wrongs rather than for unjust enrichment. See Charles Mitchell, *Goff & Jones: The Law of Unjust Enrichment*, 9th edn (Sweet & Maxwell, London, 2016), [1-03-1-04].

⁵⁷ [2018] UKSC 20, [2018] 2 WLR 1353.

⁵⁸ [2018] UKSC 20, [2018] 2 WLR 1353.

⁵⁹ [1974] 1 WLR 798; [2003] EWCA Civ 323, [2003] 1 All ER (Comm) 830; [2006] EWCA Civ 430, [2006] 2 EGLR 29; [2010] EWHC 424, [2010] Bus LR D141; [2009] UKPC 45, [2011] 1 WLR 2370.

3.2 Negotiated damages pre-One Step: Wrotham Park basis and its aftermath

Wrotham Park is the starting point to discussing negotiated damages. In that case, part of an estate was sold to the first defendant subject to a covenant stating that the claimant or his surveyor must first approve any subsequent building development of the land. However, the first defendant began building work without such approval. Consequently, the claimants issued a writ seeking a mandatory injunction to demolish those buildings erected in breach of that covenant. Brightman J disallowed a mandatory injunction to demolish those buildings on the ground that it would be “an unpardonable waste”.⁶⁰ The claimants had suffered no loss in the value of the property but Brightman J went on to say that it would be unjust that the claimants should only be able to recover nominal damages, whilst the defendants would profit from “the fruits of their wrongdoing”.⁶¹ Thus, Brightman J put forward another solution: a ‘fee’ for a hypothetical consent or relaxation of the covenant equivalent to a sum of money that the claimants might have reasonably demanded had the parties negotiated a relaxation of the covenant. The judge regarded this as a just substitute for a mandatory injunction as “a quid pro quo for relaxing the covenant”.⁶² In *Wrotham Park*, these negotiated damages were set by the judge at 5% of the first defendant’s anticipated profits as a proper price for relaxation.

Since *Wrotham Park*, several cases either analysed or directly adopted the *Wrotham Park* basis for awarding damages. In *Experience Hendrix LLC v PPX Enterprises Inc*,⁶³ the first defendant breached the agreement by granting a licence regarding 39 masters to a third party without the claimant’s consent. While the claimant did not prove any economic losses, not only did the court grant an injunction to restrain future breaches but also gave the claimant an award of damages representing a sum “as might reasonably have been demanded by Jimi Hendrix’s estate as a quid pro quo for agreeing to permit the two licences into which PPX entered in breach of the settlement agreement”,⁶⁴ which is the same approach as that in *Wrotham Park*.

⁶⁰ [1974] 1 WLR 798, [811].

⁶¹ *Ibid*, [815].

⁶² *Ibid*, [815].

⁶³ [2003] EWCA Civ 323; [2003] 1 All ER (Comm) 830.

⁶⁴ *Ibid*, [45].

Additionally, in *WWF-World Wide Fund for Nature and another v World Wrestling Federation Entertainment Inc (WWF)*,⁶⁵ Chadwick LJ stated that an award of damages on the *Wrotham Park* basis is to pay the covenantee a reasonable sum for the hypothetical release of the covenant⁶⁶ and that they serve as compensation to remedy the claimant when he cannot demonstrate identifiable economic losses.⁶⁷ In *Pell Frischmann Engineering Ltd v Bow Valley Iran Ltd and others*⁶⁸ and *Vercoe and others v Rutland Fund Management Ltd and others*⁶⁹, the defendants were both in breach of the confidentiality contracts. Although the defendants never sought an injunction or a specific performance, the courts held that the claimants were entitled to an award of negotiated damages on the *Wrotham Park* basis assessed on a sum representing the commercial value of the claimant's rights infringed.

In many of the earlier cases, negotiated damages were treated as a remedy in lieu of equitable relief under Lord Cairns's Act⁷⁰ where the claimant sought, but the courts did not grant specific performance or an injunction. In practice, negotiated damages were mostly awarded in connection with infringements of proprietary rights.

Going one step further, in *Attorney General v Blake*,⁷¹ the defendant broke the confidential agreement. The House of Lords held that the defendant should account for all profits which he accrued from the breach of the agreement to the claimant. Although this decision was in relation to a remedy for an account of all profits, Lord Nicholls took the opportunity to express his opinions about the availability of negotiated damages in *Blake*. Lord Nicholls saw no reason why negotiated damages should not also be available for breach of contract. After comparing with the availability of user damages in tort where there is no financial loss, he argued that in some circumstances, the claimant's interest of performance cannot be protected with damages for breach of contract if the claimant, where his loss cannot be measured in terms of money, is merely entitled to nominal damages; although specific relief can provide enough protection towards the claimant, specific relief may be unavailable. Lord Nicholls thus endorsed the

⁶⁵ [2007] EWCA Civ 286; [2008] 1 WLR 445.

⁶⁶ *Ibid*, [53].

⁶⁷ *Ibid*, [59].

⁶⁸ [2009] UKPC 45; [2010] BLR 73; [2011] 1 WLR 2370.

⁶⁹ [2010] EWHC 424; [2010] Bus LR D141.

⁷⁰ Lord Cairns's Act had been replaced by s.50 of the Senior Courts Act 1981.

⁷¹ [2001] 1 AC 268.

decision in *Wrotham Park*, treating it as “a solitary beacon”⁷² for breach of contract, and submitted that “in a suitable case, damages for breach of contract may be measured by the benefit gained by the wrongdoer from the breach”.⁷³ Lord Reed in *One Step* stated that the substance of Lord Nicholls’ idea was to allow the broader availability of negotiated damages for breach of contract.⁷⁴

In *Experience Hendrix*, regarding the reasons why the claimant was entitled to such damages, Gibson L.J. raised three criteria,⁷⁵

“because (1) there has been a deliberate breach by PPX of its contractual obligations for its own reward, (2) the claimant would have difficulty in establishing financial loss therefrom, and (3) the claimant has a legitimate interest in preventing PPX’s profit-making activity carried out in breach of PPX’s contractual obligations, the present case is a suitable one (as envisaged by Lord Nicholls ([2001] 1 A.C. at pp.283H–284A) in which damages for breach of contract may be measured by the benefits gained by the wrongdoer from the breach.”

Where the defendant’s breach of contract is consistent with the criteria, Gibson L.J. argued in *Experience Hendrix* that the negotiated damages could be awarded as in *Wrotham Park* without limiting such damages to an infringement of a property right or a breach of a restrictive covenant.⁷⁶ Furthermore, regarding this extended availability, Chadwick LJ expressly stated in *WWF*:⁷⁷

“In my view...The power to award damages on a *Wrotham Park* basis does not depend on Lord Cairns’s Act: it exists at common law. Further, as it seems to me, the power to award damages on the basis of what it would have been reasonable for the covenantor to pay for a hypothetical release does not depend on the covenantee establishing (as a factual premise) that, absent a release, the covenant could have been enforced by injunction.”

Thus, Chadwick LJ broke the link between negotiated damages and specific performance or an injunction under Lord Cairns’s Act, and even if the claimant would not have intended to seek equitable relief in proceedings or there would have been no possibility of it being granted, it is still possible that such

⁷² *Ibid*, [283]

⁷³ *Ibid*.

⁷⁴ [2018] UKSC 20, [2018] 2 WLR 1353, [48].

⁷⁵ [2003] EWCA Civ 323; [2003] 1 All ER (Comm) 830, [58].

⁷⁶ *Ibid*, [56].

⁷⁷ [2007] EWCA Civ 286; [2008] 1 WLR 445, [54].

damages can be awarded at common law. Lord Walker in *Pell Frischmann* also concurred in the point of view that it is unnecessary to only award negotiated damages in equity.⁷⁸

In conclusion, the broader availability of negotiated damages appears to have been accepted by the courts in the pre-*One Step* stage. This remedy can be granted for the breach of the restrictive covenant related to the disturbance of proprietary rights and other non-proprietary contracts. Besides, the claimant can seek such damages in equity and at common law to protect the claimant's performance interest.

3.3 Negotiated damages post-One Step: a vague restriction to their scope

One Step was the first time that the highest court in the U.K. discussed the circumstances in which negotiated damages are available. In this case, the claimant company, One Step, provided accommodation and support services to vulnerable children and adults. Mrs Costelloe and the first defendant each held 50% of its issued share capital. The second defendant served as a manager in the company. After the cooperative relationship between Mrs Costelloe and the first defendant worsened, the first defendant sold her share to Mrs Costelloe and divested the claimant. They entered into an agreement in which the first defendant had an obligation to keep the business information of the claimant confidential and, without the claimant's consent, to avoid conducting similar business that competed with the claimant or soliciting its clients. The second defendant also agreed to comply with similar covenants against competition and solicitation. However, the defendants operated another company in competition with the claimant company. The claimant brought proceedings against the defendants, alleging that the defendants were in breach of non-compete and non-solicit covenants and used confidential information. In the first instance, because of the difficulty of identifying the pecuniary losses caused by the defendants' breaches, the judge held that the claimant had an option to claim compensatory damages or an award of damages assessed according to the notional sum on which the parties would have reasonably agreed to release the defendants from their obligations on the *Wrotham Park* basis.⁷⁹ The defendants then appealed, but the court of appeal dismissed their appeal. The court of appeal upheld the trial judge's decision and agreed to award damages on the *Wrotham Park* basis.⁸⁰ The court of appeal also asserted that the test for such damages was whether this award was the just response in that case, and the judge could decide this

⁷⁸ [2009] UKPC 45; [2010] BLR 73; [2011] 1 WLR 2370, [48].

⁷⁹ [2014] EWHC 2213, [2015] IRLR 215.

⁸⁰ [2016] EWCA Civ 180, [2017] QB 1.

matter on a broad-brush basis.⁸¹ Nevertheless, the Supreme Court allowed the defendants' appeal. They reversed the judgments made in the courts below, holding that negotiated damages were not available in this case, and the claimant was only entitled to compensatory damages assessed by the claimant's economic loss even though it was difficult to quantify the amount of losses.

Lord Reed, giving the leading opinions,⁸² distinguished two different principles for compensation: one is the principle for assessing the damages in general by reference to pecuniary loss or physical damage suffered by the claimant in the breach of contract or tort; the other is the "user damages" principle which originates from some tortious cases where the claimant's property is occupied or used by the defendant but without leading to the claimant's economic losses.⁸³ Regarding the "user damages", where the defendant makes unlawful use of the claimant's property, the defendant prevents the claimant from exercising the right to acquire the economic value of the use, which results in a different kind of loss (unconventional loss) from the conventional damage. Therefore, the defendant should compensate the claimant for the losses. Lord Reed differentiated conventional common law damages for breach of contract from damages in equity under Lord Cairns's Act in light of those two different principles. Based upon further exploration into previous authorities, he found that damages under Lord Cairns's Act, such as those awarded in *Wrotham Park*, were simply an initial form of negotiated damages, and observed that since *Blake*, negotiated damages had been applied to more cases at common law where the claimant was deprived of his right as a commercial asset.⁸⁴ However, Lord Reed disagreed with the general availability of negotiated damages for breach of contract, in that he thought that the common law damages for breach of contract should not depart from the conventional way to measure the claimant's loss, and the difficulty of establishing the financial loss cannot directly render the claimant recover negotiated damages.⁸⁵ In addition to an award of damages assessed on the *Wrotham Park* basis as a substitute for specific performance or an injunction under Lord Cairns's Act, he held that negotiated damages measured by a

⁸¹ *Ibid*, [119]-[121].

⁸² Lord Reed's decision was agreed by the majority of the Supreme Court, while Lord Sumption held a different opinion of the availability of negotiated damages. Lord Sumption asserted a broader availability of negotiated damages, but his view was criticised by Lord Carnwath as leading to too much uncertainty.

⁸³ [2018] UKSC 20, [2018] 2 WLR 1353, [27].

⁸⁴ *Ibid*, [84].

⁸⁵ *Ibid*, [73], [95], [97].

hypothetical release fee can be awarded at common law for the unconventional loss simply “in cases concerned with the breach of a restrictive covenant over land, an intellectual property agreement or a confidentiality agreement,”⁸⁶ or be awarded only as an evidential tool to quantify the conventional loss.⁸⁷

In respect of awarding negotiated damages to compensate the unconventional loss, Lord Reed further explained that negotiated damages are only available in circumstances in which the claimant’s loss is “the economic value of the right which has been breached, considered as an asset”.⁸⁸ Negotiated damages are a tool for arriving at that value.⁸⁹ As regards which kind of contractual right can be described as an asset, Lord Reed continued to state that “its breach can result in an identifiable loss equivalent to the economic value of the right, considered as an asset, even in the absence of any pecuniary losses which are measurable in the ordinary way.”⁹⁰ Although Lord Reed's explanations have been criticised for putting forward a circular test,⁹¹ it is clear that Lord Reed distinguished the cases in which the claimant suffered from pecuniary losses due to the defendant’s non-performance of contractual obligation from the cases in which the claimant only sustained the unconventional loss thanks to the infringement of his rights with economic value.⁹² Lord Reed took *One Step* as an example to illustrate his division, saying,⁹³

“...the breach of a non-compete obligation may cause the claimant to suffer pecuniary loss resulting from the wrongful competition, such as a loss of profits and goodwill, which is measurable by conventional means, but in the absence of such loss, it is difficult to see how there could be any other loss.”

In other words, if in a case there is no loss to the claimant other than the loss measured by conventional means, this contractual right infringed cannot be regarded as having economic value or an asset.

⁸⁶ *Ibid*, [92].

⁸⁷ *Ibid*, [94], [100].

⁸⁸ *Ibid*, [93].

⁸⁹ *Ibid*.

⁹⁰ *Ibid*.

⁹¹ Paul Davies, “One Step Backwards: Restricting Negotiating Damages for Breach of Contract” (2018) 4 LMCLQ 433, 439.

⁹² Caspar Bartscherer, “Two Steps Forward, One Step Back: *One Step (Support) Ltd v Morris-Garner and Another*” (2019) 82(2) MLR 367, 370.

⁹³ [2018] UKSC 20, [2018] 2 WLR 1353, [93].

Interestingly, in addition to those contractual rights in the three types of cases mentioned above, it seems that this judgment did not entirely reject the possibility of awarding negotiated damages in other types of cases because Lord Reed said that negotiated damages would not simply apply to those circumstances that he mentioned.⁹⁴ He asserted that the award of negotiated damages in equity or at common law was affected by the award of user damages for invasion of tangible property rights or infringement of intangible property rights.⁹⁵ Thus, for other circumstances where negotiated damages can be supported, Lord Carnwath in *One Step* reasonably submitted that the rights in the contract treated by Lord Reed as having economic value or an asset are the contractual rights, the breach of which will involve the infringement of proprietary or analogous rights.⁹⁶ In other words, if the breach of contractual rights involves disturbing proprietary or analogous rights under some circumstances other than the three types of cases above, an award of negotiated damages may be granted. Regrettably, Lord Reed did not clarify which rights can be seen as analogous rights, and this uncertainty has attracted much criticism and discussion.⁹⁷

To sum up, this judgment identifies that negotiated damages consist of three different categories of contractual breach: an award of damages on the *Wrotham Park* basis as a substitute for specific performance or an injunction under Lord Cairns's Act; an award of damages as an evidential tool to quantify conventional loss; an award of damages at common law for an unconventional loss. In respect of the last one, their Lordships restricted the availability of negotiated damages. They did not look favourably on a broader application of negotiated damages as had emerged from the preceding case law. Although Lord Reed also agreed to extend this award to other contractual rights with economic value, it is still unclear what contractual rights satisfy the above requirement.

⁹⁴ *Ibid*, [94].

⁹⁵ *Ibid*, [24].

⁹⁶ *Ibid*, [128].

⁹⁷ Daryl Xu, "Negotiated Damages: Rationalising the Compensatory View" (2020) 7 JBL 561, 571; Andrew Burrows, "One Step Forward?" (2018) 134 LQR 515, 520; Yevhenii Shevchuk, "Negotiating Damages for Breach of Contract after *Morris-Garner v One Step*" (2019) 19(2) OUCIJ 284, 297.

3.4 Applicability of negotiated damages to an insurance claim

Since section 13A(1) of the Insurance Act 2015 took effect, every contract of insurance contains an implied term that the insurer assumes a separate obligation to pay any sums due within a reasonable time. The assured's right to be paid promptly is not a right equivalent to the rights to control the use of land, intellectual property or confidential information that were considered in the negotiated damages cases referred to above. Thus, it could be argued that negotiated damages are not available when the insurer is in breach of that implied term under section 13A(1) in an insurance contract. However, it seems that the nature of the assured's right is consistent with that contractual right described by Lord Reed in *One Step* as having economic value or an asset.

By reference to section 2.1 in this article, the loss of interest or the loss of use of money in the context of late payment generally takes the form of the cost of borrowing replacement money or benefits that would have been earned by depositing the sum of money in a bank. It is possible that the assured does not incur the cost of borrowing replacement money or could not have earned any benefit. However, even if the assured cannot prove any loss of interest or loss of use of money, the assured's losses can be regarded as existing in an unconventional way, because the assured should have obtained the insurance money earlier but for the insurer's late payment. The insurer's breach of the implied term by late payment prevents the assured from exercising the right to use the insurance proceeds and gain the economic value of the right. Hence, the assured's losses are not conventional financial losses but can be seen as the unconventional losses owing to the breach of the assured's right itself or the deprived economic value of the assured's right infringed. The assured's right to be paid within a reasonable time can be regarded as "of such a kind that its breach can result in an identifiable loss equivalent to the economic value of the right, considered as an asset, even in the absence of any pecuniary losses which are measurable in the ordinary way".⁹⁸

In addition, if the insurer pays the insurance money within a reasonable time, the assured will own the sum of insurance money from the date when the insurer pays it. That is to say that because of the late payment, the insurer still holds the insurance money since the date following the expiration of a reasonable time, which should have been held by the assured. To some extent, the situation is similar to those situations where Lord Reed applied the "second principle" or the "user principle".⁹⁹ Can this

⁹⁸ [2018] UKSC 20, [2018] 2 WLR 1353, [93].

⁹⁹ *Ibid*, [92].

situation be regarded as a case where the insurer's breach of the assured's right leads to the disturbance of the assured's abovementioned "analogous rights"? It depends on a more explicit explanation in a judgment in future.

The court from now on may refuse to award negotiated damages, because of *One Step*, in cases different from those cases involving the breach of a restrictive covenant over land, an intellectual property agreement or a confidentiality agreement.¹⁰⁰ However, where the insurer delays paying the insurance money but without resulting in the identifiable losses to the assured, according to the aforesaid analyses of the nature of the assured's right, there is some scope for the assured to be awarded negotiated damages. The negotiated damages would present the release fee for permitting the insurer to pay outside the timeframe set by the implied term (i.e. later than within a 'reasonable time'). Moreover, an award of such damages here is a just response to the assured: otherwise, the assured will not recover any reparation except an inadequate remedy under the statute where the assured cannot prove the loss of interest or the loss of use of money and so cannot recover compound interest by *Sempre*. While the insurer is in breach of that implied term, what the insurer should do is merely to pay the insurance money back to the assured after the judgment. This is in line with Lord Reed's view that "the defendant has taken something for nothing, for which the claimant was entitled to require payment."¹⁰¹ The court should avoid this unjust result, and an award of negotiated damages is an ideal tool to reverse the unfair effect. An entitlement to seek compensation by way of negotiated damages would make good the defects in a claim of interest as damages at the common law and benefit the assured where that remedy is not perfect.

Furthermore, how should the court assess the amount of negotiated damages in an insurance claim of late payment? Lord Reed measured the claimant's losses by reference to the economic value of the right¹⁰² or a hypothetical release fee.¹⁰³ In respect of all previous cases in which negotiated damages were awarded, the damages were assessed as a sum of money which might reasonably have been demanded by the claimant (1) as a quid pro quo for relaxation of the contract,¹⁰⁴ or (2) to accept the

¹⁰⁰ In *Team Tours Direct Ltd v Aspire Sports Tours Ltd and another* [2018] EWHC 1541, a case decided after *One Step*, Keyser QC awarded negotiated damages for the defendant's breach of a restrictive covenant regarding illicit use and retention of confidential information.

¹⁰¹ [2018] UKSC 20, [2018] 2 WLR 1353, [92], [95].

¹⁰² *Ibid.*

¹⁰³ *Ibid.*

¹⁰⁴ [1974] 1 WLR 798, [815]; [2003] EWCA Civ 323, [2003] 1 All ER (Comm) 830, [45].

hypothetical release of the contract,¹⁰⁵ or (3) as a compulsory purchase of the claimant's right of refusal.¹⁰⁶ Where the insurer does not pay the insurance money within a reasonable time, the assured sustains the unconventional loss. To compensate the assured adequately, the amount of compound interest upon the insurance money seem to comply with the measure of negotiated damages described as above because, according to Lord Reed's statement, the quantum of negotiated damages can be assessed by a hypothetical release fee¹⁰⁷ which in turn can be regarded as the cost that the insurer normally should pay for borrowing a sum of insurance money. Typically, banks or other financial institutions will lend money by imposing compound interest on the sum. As a result, an award of compound interest upon the insurance money can reasonably be regarded as the cost that the insurer should pay when the insurer delays paying the insurance money and retains them. The starting date for compound interest is generally the date following the expiration of a reasonable time. The interest rate generally should be 1 per cent above the base rate or an appropriate index.¹⁰⁸ Without a doubt, the assured can only select one remedy between an award of negotiated damages and an award of interest as damages at common law to avoid a double recovery where both of them are recoverable.

In summary, although the scope for negotiated damages has been curtailed by the Supreme Court's decision in *One Step*, there are good arguments for extending the *One Step* categories to negotiated damages for late payment of insurance claims. If the courts were to do so, it would be fair and reasonable to assess the negotiated damages by reference to the compound interest upon the sum of insurance money. In addition, a remedy by way of interest as negotiated damages, compared with a remedy of interest as compensatory damages, would be beneficial to the assured who probably cannot seek interest as damages at common law due to a lack of evidence of losses.

¹⁰⁵ [2007] EWCA Civ 286, [2008] 1 WLR 445, [53]; *Lane v O'Brien Homes* [2004] EWHC 303, [2004] 2 WLUK 105, [24].

¹⁰⁶ [2001] 1 AC 268, [298].

¹⁰⁷ [2018] UKSC 20, [2018] 2 WLR 1353, [94].

¹⁰⁸ James Edelman, *McGregor on Damages* 21st edn (Sweet & Maxwell, London, 2020), [19-108].

4. Conclusion

In light of section 13A(5) of the Insurance Act 2015, the assured can seek interest on a claim for the insurer's late payment. Interest is to compensate the claimant's loss of use of money during the relevant period. However, section 35A of the Senior Court Act 1981 only grants the court the power to award simple interest. It is submitted that the statutory award cannot provide a sufficient level of compensation to the assured for the loss of use of money incurred by the insurer's late payment. This article proposes two alternative solutions to overcome this difficulty for the assured. The answer mainly lies in the two alternatives available at common law as follows.

Firstly, in *Sempre*, the court held that if the claimant can prove the actual loss of interest or the loss of use of money, interest as compensatory damages can be awarded to the claimant on the claim for breach of contract. If the business entity is deprived of a sum of money, it will either suffer from the cost of borrowings or the lost debit interest that would have been earned with the sum of money. Considering relevant judgments after *Sempre*, this article suggests that the assured in a business insurance contract should not be required to provide specific evidence concerning the loss of use of money. The business assured can seek compound interest on an insurance claim by *Sempre* to compensate for such loss. Regarding the assured in the consumer insurance contract, specific proof of loss should be required before the assured can recover compound interest as damages. If the consumer assured cannot show the evidence, the assured can only seek a statutory interest award under section 35A. In such a situation, the remedy by *Sempre* at common law will be unavailable.

Secondly, whereas since *One Step*, the court may reject negotiated damages for an insurance claim, it is fair and reasonable for the assured to seek negotiated damages assessed by the objective value of the assured's right to be indemnified timeously, namely, the compound interest upon the insurance money. The remedy is of great avail to the assured, especially where the assured cannot prove the loss of use of money and so, interest as damages by *Sempre* is not available. The assured can only select one remedy between an award of negotiated damages and an award of interest as damages at common law to avoid a double recovery where both of them are recoverable.