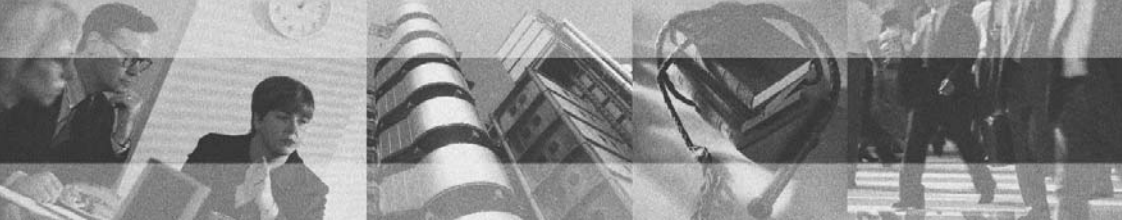


THE PRICE OF UNFAIR TREATMENT

by
Jonathan Goodliffe, Solicitor

Introduction

In this article I consider the level of damages commonly awarded for inconvenience, upset or personal distress arising in retail claims against insurers and insurance intermediaries. Where such awards ("damages for distress" for short) are made, the damage suffered by the claimant will not usually include psychiatric injury or illness as such. Where it does, distinct issues arise which are not addressed in this article. I will suggest that there is a case for raising the financial levels at which distress awards are commonly made.

Distress awards may be made in the courts or by statutory bodies established to award compensation, such as the Financial Ombudsman Service (FOS) or the Pensions Ombudsman. In determining the level of awards, these bodies usually follow, more or less, what they consider to be the practice of the courts in contract and tort cases.

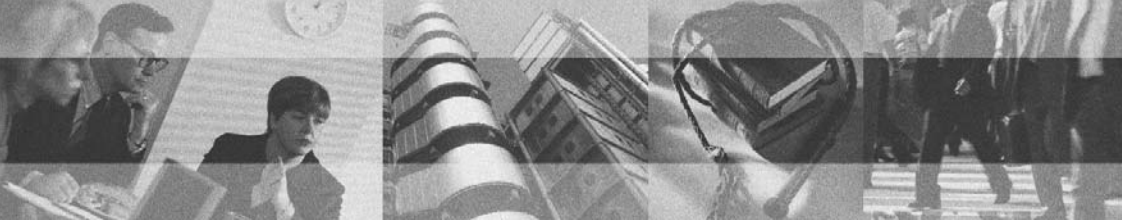
The question whether such awards are currently made at an appropriate level was raised recently by the Law Commission and the Scottish Law Commission in an issues paper,[1] the primary focus of which was whether damages should be recoverable for non-payment of insurance claims in the wholesale market. The Law Commissions' paper is discussed in more detail in another article in this issue of the BILA Journal by Michael Mendelowitz and Jonathan Goodliffe, entitled "Damages for late payment and the insurer's duty of good faith: BILA views". The Law Commissions point out:[2]

> *"Under normal contract law principles, where a consumer enters into a contract to provide "pleasure, relaxation and peace of mind", then damages would be available where a breach of contract causes the consumer distress or discomfort. In cases where the consumer's home has been left in serious disrepair for a prolonged period, it has been suggested that it might be appropriate to award up to £2,000 per person per year. The Financial Ombudsman Service follows this approach."*

Examples of likely claims for distress in the insurance sector

At common law damages are not currently awarded for non-payment of an insurance claim. The Law Commissions recommend that this rule should be changed. The British Insurance Law Association (BILA) supports this recommendation. However, apart from the common law rule, the handling of claims in respect of non-investment insurance otherwise than fairly and promptly is a regulatory breach under Chapter 8 of the Financial Services Authority's Insurance Conduct of Business Rules (ICOBS). This is the case regardless of whether the policyholder is a business, a consumer, a human person or a legal person.

A cause of action for damages, however, in respect of a breach of these rules under section 150 of the Financial Services and Markets Act 2000 (FSMA), only currently arises for the benefit of a "private person". This expression is defined in the FSA's rule Glossary. In the case



of human persons the loss may, *inter alia*, be suffered in the course of a business (other than a FSMA regulated activity). In the case of legal persons (including partnerships) the loss must have been suffered otherwise than in the course of carrying on a business of any kind. So damages for late payment of an insurance claim may be included in a claim under section 150 for breach of ICOBS 8 by a retail customer or a person carrying on a business in his or her own name only. The question whether such damages should include damages for distress, and at what level, is discussed below.

A similar right to damages for delayed payment may arise where a regulated firm is in breach of its duty to handle complaints fairly under rule 1.4.1R of the FSA's Dispute Resolution Complaints Sourcebook (DISP). Typically such complaints might arise from, for instance, mis-selling of insurance products such as mortgage endowments, pension policies or payment protection insurance. Again, where the firm has not properly dealt with the complaint the customer may wish to claim damages for distress, in addition to any other heads of damage.

Claims where damages for distress are not recoverable

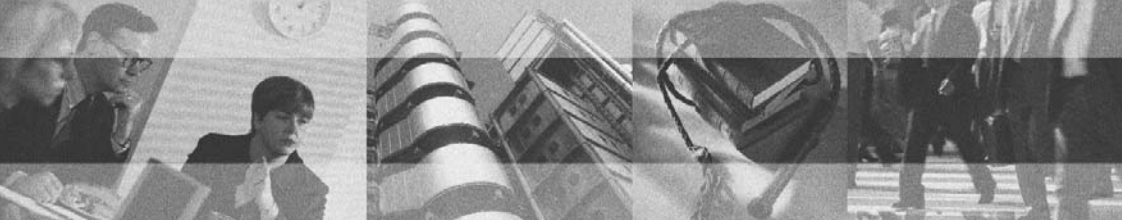
By contrast, under section 13 of the Data Protection Act 1998, compensation recoverable by a data subject from a data controller for a breach of the requirements of the Act can only include compensation for distress where the data subject also "suffers damage by reason of the contravention", meaning pecuniary or special damage. Insurers and insurance intermediaries usually process data relating to policyholders and customers. So there is scope for claims against them under the 1998 Act to arise. A number of recent FSA enforcement cases[3] demonstrate that firms do not always have appropriate governance arrangements for ensuring that they comply with their responsibilities under the 1998 Act.

Where a data subject's personal data is not processed in accordance with the requirements of the Data Protection Act 1998 it will in most cases be rare for the subject to be able to prove loss other than distress. Only in rare cases will he be able to prove that the breach has led directly to, for instance, an identity theft or his own wasted time. Damages for wasted time are usually only recoverable in the courts where the time lost would otherwise have been productively used.[4] So claims under section 13 of the Act will in most cases not be worth pursuing.

It has been pointed out accordingly[5] that the UK exclusion of distress as a head of damage under section 13 may be incompatible with the Data Protection Directive 95/46/EC, which the Act purports to transpose. Article 23 of the EU directive provides: *"member States shall provide that any person who has suffered damage as a result of an unlawful processing operation or of any act incompatible with the national provisions adopted pursuant to this Directive is entitled to receive compensation from the controller for the damage suffered."* It could be argued that a right to compensation is imperfectly recognised and transposed where only nominal damages are likely to be recoverable.

Claims where damages for distress are likely to be the only amount recoverable

There are other examples of claims which may arise against insurers where the only damages



recoverable, if any, are likely to be damages for distress. An example is a claim for unlawful discrimination in the underwriting or mediation of insurance products by reference to what are described in the Equality Act 2010 as "protected characteristics". These include, for instance, sex and disability. Mental health Charities such as Rethink and Mind are concerned that unlawful discrimination by reference to disability does take place.[6] Such discrimination claims against regulated firms are within the jurisdiction of the FOS (even when the victim of discrimination is only a "potential customer" because he does not end up with any insurance).[7]The FOS has yet, however, to receive a single claim.[8] This might mean that the charities' concerns are misplaced, because such discrimination does not in fact take place. Or it might be that such claims are not pursued because of factors such as the difficulty of proof, the low level of compensation recoverable and the stigma attaching to mental health problems.

A person applying for, say, travel insurance, who is quoted and accepts an unlawfully loaded premium might in theory sue under the Equality Act 2010 for recovery of the loading. Such a claim would be difficult to prove. He would be better advised to go on trying other insurers until he finds one willing to quote a reasonable premium or gives up trying to get insurance. In either event he may have a claim for distress and inconvenience against the insurer who provided the unlawful quote, and probably nothing more.[9] Section 119(4) of the Equality Act 2010 expressly provides that damages for compensation for injured feelings may be recovered under that Act.

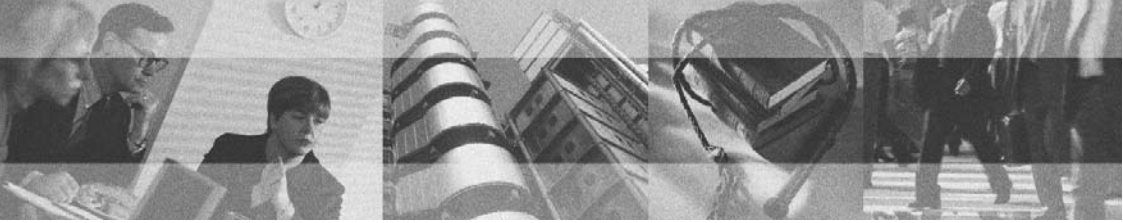
Before the event legal expenses insurance (LEI) is also in a sense in this category. Disputes in relation to this product typically arise before court proceedings are issued when the insured wants to choose his own lawyer and the insurer insists on a lawyer on its panel being used. If the insured pursues such a claim with the FOS or the courts, the best he can do is to get a declaratory ruling in his favour with possibly a small award for distress and inconvenience. Many litigants who are entitled to choose their own lawyer despite the insurers' objections do not bother to pursue the issue with the courts or the FOS. The main outcome of such "satellite proceedings" would be to delay the main case. Instead such litigants typically enter into a conditional fee arrangement with their chosen lawyer and take out after the event LEI to cover themselves for party and party costs.[10] In effect, therefore, they give up on the before the event LEI.

The FOS's views on what damages for distress should be awarded

The FOS has published a technical note on compensation for distress, inconvenience or other non-financial loss[11] in claims within its jurisdiction. The note explains when such compensation is likely to be awarded and at what levels. It suggests that in some cases the FOS is willing to make such awards where the courts do not on the basis that, by statute, its awards are required to be "fair and reasonable in all the circumstances".[12] Its awards may, among other things, take into account time wasted by the complainant and how the firm reacts to the complaint and runs its defence.

The FOS classifies cases where such awards are made into three categories, namely

- cases where modest awards may be made (£300 or less)
- cases where significant awards may be made (£300 to £1,000) and



- cases where exceptional awards may be made (more than £1,000)

The first category includes: *"Two-month delay by the financial business in providing the surrender proceeds of a policy."*

The second category includes: *"Excessive intransigence by the financial business right from the start – i.e. failure to accept responsibility for its mistakes, frustrating the complaint process, and fighting the case through every stage in the ombudsman service, despite the ombudsman service pointing out at an early stage that the business was failing to follow a settled and published FSA or ombudsman service approach."*

The third category includes: *"Significant error by the financial business in connection with a pension policy, meaning that the consumer had to consider working again after initial retirement."*

Other organisations in the public sector performing an informal dispute resolution function follow a similar approach to the FOS in making awards for distress and inconvenience. These include the Pensions Ombudsman. By way of example that ombudsman made an award in August 2010 of £450 compensation for distress and inconvenience arising from maladministration of a pension scheme by its trustees.[13]

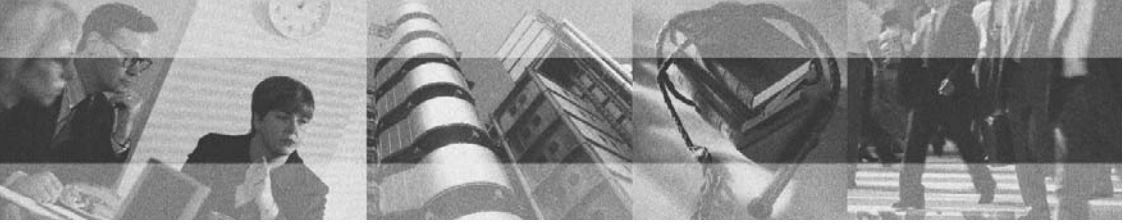
The FSA Complaints Commissioner is another such body. Sir Anthony Holland, who currently discharges this function, advises the FSA on compensation which might be paid *ex gratia*[14] where complaints against the FSA itself are upheld. In a recent case[15] the Commissioner was minded to award £300 where the FSA had acted unlawfully in searching the complainant's premises. The complainant rejected the award on the grounds that the sum was derisory. This award seems very low even by the standards of the FOS tariff.

The Law Commissions, in their issues paper on "damages for late payment and the insurer's duty of good faith", expressed approval of the FOS practice in awarding damages for distress and inconvenience[16] although they provide no further analysis in support of this view. They sought comment before making more specific recommendations which will follow on from its issues paper. A majority of BILA agree with the Law Commission on this issue as outlined in the article by Michael Mendelowitz and Jonathan Goodliffe, cited above. I do not.

Current levels of awards for distress in the courts

The actual monetary levels applied by the FOS in its technical note seem low. In some recent judgments significantly higher awards have been made for distress. In *Douglas v Hello* [2003] EWHC 2629 (Ch) a married couple were awarded damages for distress of £3,750 each arising from the unlawful publication of photographs of their wedding. In *Milner v Carnival plc* [2010] EWCA Civ 389 a married couple were awarded £4,500 and £4,000 for inconvenience and distress arising from a ruined holiday. The claimants in *Douglas* were two international film stars and the holiday in *Milner* was supposed to have been particularly luxurious. These factors should surely not, however, make a difference to the amount awarded for distress.

There is no predictable pattern in the level of distress awards. So an award of only £500 damages for inconvenience arising from several months' delay in completing building works was upheld by the Court of Appeal in *Boynton v Willers* [2003] EWCA Civ 904. Giving the



leading judgment, Lord Justice Potter distinguished *Ezekiel v McDade* (CA) [1995] 47 EG 150, in which the Court of Appeal reduced an award of £6,000 to £4,000 for general damages. The award was for physical inconvenience and discomfort caused by the defendants' negligence and for mental suffering directly related to it. In that case the plaintiffs were rendered homeless persons living in single room council accommodation for a long period.

Awards in building cases are influenced by the dictum of Lord Justice Bingham (as he then was) in *Watts v Morrow* [1991] 1 WLR 1421 that in cases not falling within the category of contracts whose object is to provide relaxation, peace of mind or freedom from molestation:

> *"… damages are in my view recoverable for physical inconvenience and discomfort caused by the breach and mental suffering directly related to that inconvenience and discomfort. If those effects are foreseeably suffered during a period when defects are repaired I am prepared to accept that they sound in damages even though the cost of the repairs is not recoverable as such. But I also agree that awards should be restrained."*

Arguably one of the main purposes of insurance is to provide peace of mind.[17] So the same level of "restraint" is not required as in building cases.

Awards in overseas jurisdictions

Large awards may sometimes be made in North American jurisdictions against insurers whose delay in settling claims is established as amounting to "bad faith".[18]

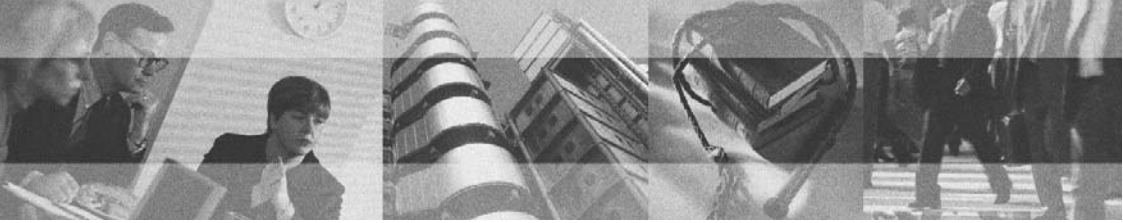
In *Whiten v Pilot Insurance Co* [2002] 1 SCR 595 the claimants discovered a fire at their home at night in the Canadian winter when the temperature was minus 18º Celsius. The fire totally destroyed the home and contents, including three cats. One of the claimants suffered serious frostbite.

Initially the claimants' household insurer made a payment to allow them to move into temporary accommodation. It changed its mind shortly thereafter and hotly defended the claim through to trial, claiming that the claimants had torched their home. The defence was not, however, supported by the local fire chief or the expert initially instructed by the insurer. It was discredited at trial. The insurer's own counsel conceded that there was an air of unreality to the allegation of arson.

The jury awarded compensatory damages of Can$318,000 and $1 million in punitive damages for the insurer's bad faith. This was aggravated by misconduct, which the jury appears to have considered to be "high-handed, malicious, arbitrary or highly reprehensible".

The punitive damages were reduced to $100,000 by the Court of Appeal of Ontario, but a majority of the Canadian Supreme Court restored the jury's award. It considered that although $1m was more than it would have awarded it was "still within the high end of the range where juries are free to make their assessment".

Not all US and Canadian jurisdictions would make such large awards. They may have significant negative consequences. These could include an increased reluctance to investigate



suspected insurance fraud on the part of insurers and a rise in premiums. Large damages awards can, however, sometimes serve a useful purpose in discouraging anti-social behaviour or enforcing public policy.

So for instance, some bars and pubs may serve alcohol to customers who are obviously already drunk. The customers then get into their cars and may be involved in an accident. In the USA and Canada heavy damages awards may then be made against the bars in question. Scientific research has shown that these awards encourage the bars in question (encouraged no doubt by their liability insurers) to train their staff to act more responsibly.[19]

A distress award in the *Whiten* case, calculated according to the FOS's tariff, would probably have produced a sum of about 1% of what was actually awarded. This might not have had much impact on an insurer or intermediary with poor claims handling systems. Equally the Canadian Supreme Court surely did not need to go as high as a million in punitive damages to influence the behaviour of the insurance industry.

Policy considerations

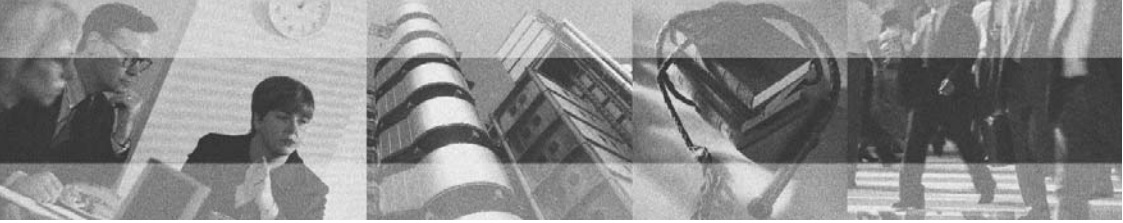
Where a statutory or regulatory provision (such as ICOBS 8, DISP 1.4.1R and Schedule 1 of the Data Protection Act 1998) requires the application of a fairness standard and the defendant is shown to be in breach, the consequence is that the claimant has been treated unfairly, a fact which arguably should amount to a head of damage in its own right.

This may, indeed, be a possible argument circumventing section 13 of the Data Protection 1998 Act. A cause of action to which that section relates could give rise to an award of damages for unfairness. It seems right in principle that compensation for injury to feelings, distress and inconvenience should be recovered (except under the 1998 Act) whether such a "fairness" claim is made to the FOS or in the courts. Distress etc. is a natural and foreseeable consequence of such unfairness. Unfair treatment should, however, qualify for compensation quite apart from any distress.

The "fairness" rules and the rule on discrimination in the Equality Act 2010 are, in any event, quite new. They are part of public law as well as having consequences in private law. There is no necessary reason why the tariff for such awards should follow the practice in the law of contract and negligence.

A further relevant factor is that the FSA's regulatory objectives include the protection of consumers. A major objective of its regime is the fair treatment of customers (TCF) in accordance with Principles 6, 7 and 8 of the FSA's Principles for Businesses. Awards of damages and compensation may, if they are set at an appropriate level, support TCF, particularly in relation to products such as household and motor insurance which are not currently the subject of any other regulatory initiatives. A similar argument may apply in relation to discrimination covered by the Equality Act 2010. It is not within the FSA's mainstream regulatory agenda, so the underlying policy needs people to assert their rights to make that policy effective.

In determining, as a matter of policy, what compensation should be awarded for distress it is also relevant to consider the time and effort that must be invested by the complainant in



formulating the claim and either issuing proceedings in the courts or making a complaint to the FOS. Apart from this there will invariably be stress and sometimes distress[20] associated with taking on very powerful organisations such as insurance companies. The procedures applied by the FOS may reduce these factors but will not eliminate them.

Most sensible litigants, before they embark on presenting a court or the FOS with a claim, will carry out at least a mental process of cost benefit analysis, assisted by their advisers. Often compensation for distress may be well worth pursuing when it is part of a larger claim, say, under a household policy or for mis-selling, but rarely, under the FOS's tariff, when it is the only amount recoverable and there are no exceptional factors. Indeed the cases reported by the FOS in *"Ombudsman News"* where distress awards are made invariably relate to cases where some other award is also made.

Rarely, if ever, will it be worth pursuing a claim for distress where, for instance, an insurance claim is paid, say, a year late but where it has actually been paid before court proceedings are issued or a claim is made to the FOS.

When a claim against an insurer is novel, controversial or complex that will also affect the equation. In some cases the process of making a claim and resolving it through the FOS or the courts may be rendered more difficult because of the very facts and matters which give rise to the claim. A typical example might be a medical condition in respect of which a claim is being made on a critical illness or private health insurance policy and which seriously affects the claimant's ability to communicate.

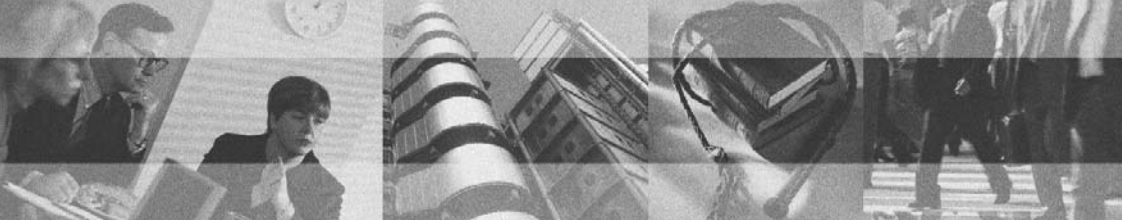
The FOS has carried out satisfaction surveys in relation to its dispute resolution procedures. The most recent available on its website[21] was generally favourable and showed an improved performance over previous years. It might, however, be a useful exercise to generate some more detailed evidence as to what influences the decision not to bring what might be a valid claim and what complainants and their advisers think of the FOS "distress" tariff.

Particular thought should perhaps be given to cases, for instance under the Equality Act 2010, where the only compensation recoverable is likely to be compensation for distress.

There may also be cases where the compensation, apart from distress, is likely to be very modest. An example is home contents insurance. The Association of British Insurers is currently promoting this product,[22] not just with a view to enhancing the profits of its members, but within its own corporate social responsibility programme. This is because poorer people living in rented accommodation often do not have this species of cover and may suffer hardship when they are affected by fire, theft or flood. The success of this ABI initiative might be affected if, when disputes arise on such policies, claimants are not adequately compensated.

A scientific approach might be applied to the question of determining what compensation should be payable for distress. An actuary with appropriate experience should be able to put financial figures on:

- typical levels of distress and inconvenience arising from unfair treatment;
- the experience of going through the court or FOS dispute resolution process;



- what level of award might encourage firms to improve their claims management systems; and
- what levels of award might have the negative consequences of significantly raising premiums or discouraging firms from disputing fraudulent claims.

Endnotes

1 Law Commission issues paper 6

2 *Ibidem*, paragraph S.41

3 See, for instance, the recent enforcement proceedings against Zurich Insurance http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/134.shtml

4 *Salvage Association v. CAP Financial Services Ltd* [1995] FSR 654

5 See "Data Protection Act is out of kilter with EU law", Warwick Ashford, Computer Weekly, 9 June 2010.

6 "Insurance issues for people with mental health problems", Jonathan Goodliffe, Complinet Insurance, April 2008

7 DISP 2.4.8R.

8 Information supplied by FOS itself to the author.

9 Unless, perhaps, he decides to travel outside Europe without insurance, gets sick and has to pay for his own treatment.

10 See "The right to choose your own lawyer", Jonathan Goodliffe, BILA Journal, issue 119, June 2010 page 40.

11 http://www.financial-ombudsman.org.uk/publications/technical_notes/distress-and-inconvenience.htm

12 Section 228(2) Financial Services and Markets Act 2000.

13 *Westernprint Limited Pension Scheme*, ref: 27876/2.

14 *Ex gratia* because at law the FSA enjoys statutory immunity (subject to some exceptions) from suit under Schedule 18 paragraph 19 to the Financial Services and Markets Act 2000.

15 http://www.fscc.gov.uk/documents/final/GE-L0905.pdf

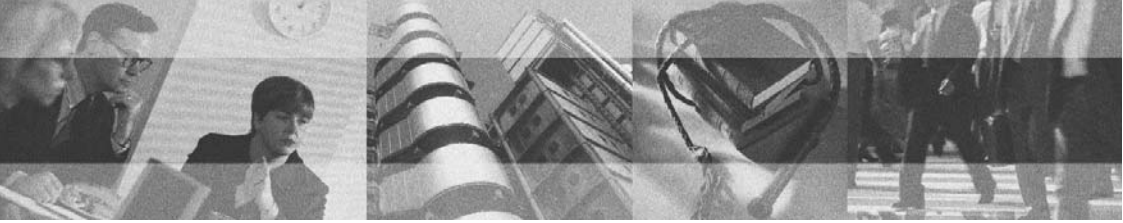
16 Law Commission issues paper 6, paragraph 9.60-61.

17 As in, for instance, Banco Santander's "Peace of mind home insurance" http://www.santander.co.uk

18 See "Fair play in claims handling: the US and UK experience", Jonathan Goodliffe and Richard Longaker, BILA Journal, November 2004.

19 "Can the Civil Law enforce Alcohol Policy?" Jonathan Goodliffe, "Alcohol Alert", issue No 3 2003 http://www.ias.org.uk/resources/publications/alcoholalert/alert200303/al200303_p20.html

20 See, for instance, "Litigation Stress" Paul Elson, Ron Bracey and Hugh Koch, Solicitor's Journal, September 2006.



[21] In its 2009/2010 annual report http://www.financial-ombudsman.org.uk/publications/ar10/ar10.pdf . See also the Kempson Report "Fair and reasonable: An assessment of the Financial Ombudsman Service" http://www.financial-ombudsman.org.uk/publications/pdf/kempson-report-04.pdf

[22] "Promoting contents insurance: what is in it for you?" http://www.abi.org.uk/Access_to_Insurance/Landlords/Whats_in_it_for_you.aspx