THE INSURANCE AND REINSURANCE LAW REVIEW

SEVENTH EDITION

Editor
Peter Rogan

THE LAWREVIEWS

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CONTENTS

PREFACE

It is hard to overstate the importance of insurance in personal and commercial life. It is the key means by which individuals and businesses are able to reduce the financial impact of a risk occurring. Reinsurance is equally significant; it protects insurers against very large claims and helps to obtain an international spread of risk. Insurance and reinsurance play an important role in the world economy. It is an increasingly global industry, with emerging markets in Asia and Latin America developing apace.

Given the expanding reach of the industry, there is a need for a source of reference that analyses recent developments in the key jurisdictions on a comparative basis. This volume, to which leading insurance and reinsurance practitioners around the world have made valuable contributions, seeks to fulfil that need. I would like to thank all of the contributors for their work in compiling this volume.

Insured losses in 2018 have been estimated at between US$79 billion and US$90 billion, a 40 per cent reduction from the disastrous 2017, but still above the 10-year average. While no single event stands out, the aggregation of losses from hurricanes Michael and Florence in the United States, and typhoons Jebi, Trami and Mangkhut in the Asia-Pacific region, along with earthquake losses and the California fires has been significant. Also noteworthy in 2018 were the number and scale of cyber events, including the huge data breaches of Facebook and Marriott International, which may be a portent of things to come. Events such as these test not only insurers and reinsurers but also the rigour of the law. Insurance and reinsurance disputes provide a never-ending array of complex legal issues, and new points for the courts and arbitral tribunals to consider.

Looking ahead, 2019 is likely to see new developments and new legal issues. In particular, the impact of insurtech on the way in which insurance is underwritten, serviced and distributed will present challenges around the world. To reflect this, we have added a new chapter on artificial intelligence.

I hope that you find this seventh edition of *The Insurance and Reinsurance Law Review* of use in seeking to understand today's legal challenges, and I would like once again to thank all the contributors.

Peter Rogan
Ince Gordon Dadds LLP
London
April 2019

Chapter 3

FRAUD INSURANCE CLAIMS: WHERE ARE WE NOW?

Simon Cooper[1]

I INTRODUCTION

Dishonesty in general, and fraudulent claims in particular, cost the insurance market considerable amounts each year. The legal consequences of dishonesty are not always the same, however, and will depend on a number of factors, including how it manifests itself and the point in the process at which it occurs.

Since 2016, the definitions of dishonesty, a fraudulent claim and the remedies available to insurers battling against such claims have been radically reformed through a combination of legislation and guidance from the highest court in the United Kingdom.

II DISHONESTY DURING THE CLAIMS PROCESS

Historically, the courts have recognised three types of fraudulent insurance claim:

a wholly invented claims;
b fraudulently exaggerated claims; and
c genuine claims advanced by 'fraudulent devices'.

Until 2016, the insurer's remedy in respect of each of the above-mentioned categories was forfeiture of the entire claim – the fraudulent claims rule. The essence of the rule is that, if an insured presents a claim that is in whole, or in part, fraudulent, the insured will forfeit the entirety of the claim. Since the Supreme Court's decision in *Versloot Dredging v. HDI-Gerling* (*The DC Merwestone*),[2] however, genuine claims that are advanced by fraudulent devices or collateral lies are no longer classified as fraudulent claims and so do not attract this remedy.

Under the Insurance Act 2015 (which came into effect on 12 August 2016), in the event of a fraudulent claim, the insurer is also entitled to cancel the insurance from the date of the fraud and to retain the premium in its entirety.

If a claim has come before the courts, acts of fraud or dishonesty by the insured during the litigation will give rise to a different set of remedies that are governed by the rules of the court. Similarly, the fraudulent claims rule and the Insurance Act 2015 remedies do not apply to a fraudulent claim by a dishonest third party against an innocent insured who is entitled to an indemnity from insurers, but the sanctions available under the court rules may be applied against the third party in those circumstances.

The different types of fraud and the remedies available are discussed further below.

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1 Simon Cooper is a partner at Ince Gordon Dadds LLP.

2 *Versloot Dredging v. HDI-Gerling* (*The DC Merwestone*) [2016] Lloyd's Rep IR 468.

i Wholly invented claims

These are claims in respect of which the loss has either been deliberately brought about by the insured's own actions (e.g., scuttling a ship) or where the loss has been completely fabricated (e.g., arising from a staged motor accident). The forfeiture rule applies to wholly invented claims.

ii Exaggerated claims

Claims may arise where the loss itself is genuine but the value of the claim has been deliberately exaggerated. The fact that a claim has been exaggerated does not of itself mean that it is fraudulent. Judges are prepared to accept that a certain amount of 'horse trading' goes on between an insured and its insurer. The difficulty is in deciding where the line is to be drawn between 'acceptable' exaggeration and fraud. Generally, the courts look at the degree to which the claim has been inflated; the greater the exaggeration the easier it is to impute a fraudulent intent.

In *Orakpo v. Barclays Insurance Services*,[3] Lord Justice Hoffman stated that: '. . . one should naturally not readily infer fraud from the fact that the Assured has made a doubtful or even exaggerated claim.'

If, however, there is fraudulent exaggeration, Sir Roger Parker said: 'If he is fraudulent, at least to a substantial extent, he will recover nothing, even if his claim is in part good.'

In *Danepoint Ltd v. Underwriting Insurance Ltd*,[4] an insured claimed for loss of rent in relation to a property divided up into 13 flats, each of which had been sublet. The insured claimed that all flats had been vacated following a fire at the property and his loss of rent claim was based on all of the flats being unoccupied. This was untrue; a lot of the flats remained occupied. In deciding whether the claim should be forfeit for fraud, the court found that an exaggerated claim would be categorised as fraudulent where:

a the exaggeration was more than trivial;

b the insured was dishonest – exaggeration of itself did not establish dishonesty; there had to be an intention to deceive the insurer, or recklessness; and

c the fraud must have been material, in that it would have had a decisive effect on the readiness of the insurers to make payment.

On the facts of this case, it was not difficult for the court to conclude that all of these criteria had been satisfied and that the evidence in favour of a finding of fraud was overwhelming.

If a claim for, say, loss of items by theft is partly genuine and partly fraudulent, the law says the claim is not severable. Thus, if the degree of fraud in relation to one part of the claim is material, the entire claim will be forfeited. For example, in *Galloway v. Guardian Royal Exchange (UK) Ltd*,[5] Mr Galloway suffered a burglary and submitted a claim not just for the probable true value of the loss (£16,133) but an additional £2,000 claim being the supposed value of a computer. In fact there had been no theft of a computer as there had been no computer at all. The Court of Appeal held that the degree of fraud was sufficient to render the entire claim fraudulent.

3 *Orakpo v. Barclays Insurance Services* [1995] LRLR 443.

4 *Danepoint Ltd v. Underwriting Insurance Ltd* [2006] Lloyd's Rep IR 429.

5 *Galloway v. Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209.

The position in relation to personal injury claims is governed by Section 57 of the Criminal Justice and Courts Act 2015. This provides that if a claimant is fundamentally dishonest in relation to a claim, the claim must be dismissed in its entirety (including any valid element), unless doing so would cause the claimant to suffer a substantial injustice. The definitions of fundamental dishonesty and substantial injustice have been examined recently in *London Organising Committee of the Olympic and Paralympic Games v. Sinfield*[6] and *Razamus v. Ministry of Justice*.[7] In judging dishonesty in this context, the courts applied the test set out by the Supreme Court in *Ivey v. Genting Casinos (UK) Ltd*.[8] This requires the Court to ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts and then determine whether his or her conduct was honest or dishonest by the (objective) standards of ordinary decent people. There is no requirement that the individual concerned must appreciate that what he or she has done is, by those standards, dishonest. Fundamental dishonesty is dishonesty of the type described above, which goes to the 'root' of the claim. That means that the dishonesty substantially affects the presentation of the claimant's case in respect of either liability or quantum in a way that potentially adversely affected the defendant in a significant way.

The legislation is intended to have a punitive or deterrent element and so the mere fact that the claimant will lose the valid element of his or her claim is not enough to establish that he or she will suffer substantial injustice – something more is required.

iii Fraudulent devices

In *Agapitos v. Agnew* (*The Aegeon*),[9] the Court of Appeal held that if an insured used a fraudulent device to support his or her claim or to better his or her chances of a favourable settlement before litigation, then the insurer could rely on the common law defence of forfeiture. A fraudulent device in this context meant a lie or other false evidence that was deployed in support of a genuine claim.

This principle was approved and applied in subsequent cases by courts up to and including the Privy Council.[10]

As previously mentioned, in its landmark 2016 decision in *The DC Merwestone*, however, the Supreme Court (by a majority of 4–1, Lords Sumption, Toulson, Clarke and Hughes, with Lord Mance dissenting) abolished the insurer's remedy of forfeiture for the insured's use of a fraudulent device.

In doing so, it overturned the Court of Appeal's judgment in the same case and decided that the Court of Appeal had been wrong in *The Aegeon* in expressing the opinion that the public policy objective of deterring fraud in the insurance claims context warranted the forfeiture of a claim that had been promoted by fraudulent means, even though the claim was in all other respects valid.

6 *London Organising Committee of the Olympic and Paralympic Games v. Sinfield* [2018] EWHC 51 (QB).

7 *Razumas v. Ministry of Justice* [2018] EWHC 215 (QB).

8 *Ivey v. Genting Casinos (UK) Ltd* [2017] UKSC 67.

9 *Agapitos v. Agnew* (*The Aegeon*) [2003] 3 WLR 616.

10 Equivalent to the Supreme Court, the Judicial Committee of the Privy Council is the court of final appeal for the UK overseas territories and Crown dependencies, and for those Commonwealth countries that have retained the appeal to Her Majesty in Council or, in the case of Republics, to the Judicial Council.

While upholding the fraudulent claim rule in respect of fraudulently exaggerated claims, the majority considered it to be 'a step too far' and 'disproportionately harsh' to deprive a claimant of his or her claim by reason of his or her fraudulent conduct if it turns out that the fraud had been unnecessary because the claim was in fact always recoverable.

In reaching that decision, the majority considered there to be an important difference between a fraudulently exaggerated claim and a legitimate claim supported by a fraudulent statement or evidence. It was held that forfeiture is appropriate in the former case because the insured will have been seeking to obtain something to which it was not entitled, but not in the latter case because the fraud deployed would not have involved an attempt to obtain anything more than the insured's actual legal entitlement.

In a strong dissenting judgment, Lord Mance expressed the opinion that there was no distinction to be drawn between the deployment of a fraudulent device and the pursuit of a fraudulently exaggerated claim. In his view, forfeiture was proportionate in both cases, and justified by the public policy objective of deterring fraud in the insurance claims context. Lord Mance stated that the proposition that a lie told to promote a claim 'is immaterial to the parties' rights and obligations' [per Lord Toulson] simply because, perhaps years later, it can be seen that the lie was unnecessary and the claim good without it, appears to be a 'charter for untruth'. He stated that this proposition overlooked both the 'obvious imperative of integrity on both sides in the claims process' and 'the obvious reality that lies are told for a purpose, almost invariably as here to obtain an uncovenanted advantage of having the claim considered and hopefully met on a false premise'.

The implications of this judgment are significant for insurers. Lord Mance put it thus: 'Abolishing the fraudulent devices rule means that claimants pursuing a bad, exaggerated or questionable claim can tell lies with virtual impunity.'

III DISHONESTY DURING THE LITIGATION PROCESS

Different rules governing the consequences of fraudulent claims come into effect once legal proceedings are commenced in respect of that claim.[11] That does not mean that the insured will receive no sanction for dishonesty during the legal process; simply that the court rules of procedure apply instead.

There is a very old rule that witnesses, even if malicious or dishonest, have absolute immunity from civil suit for what they say in proceedings. However, immunity from civil suit is not a complete answer to dishonesty in civil litigation. There has been a lot of attention in recent years on the ways in which dishonesty in proceedings can be controlled.

i Contempt of court

Since the introduction of the Civil Procedure Rules (CPR) in 1999, statements of case, witness statements and disclosure lists must be verified by a statement of truth, putting them almost on a par with sworn evidence. CPR 32.14 provides that '[P]roceedings for contempt of court may be brought against a person if he makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief in its truth.'

11 *Manifest Shipping Co Ltd v. Uni-Polaris Shipping Co Ltd* (*The Star Sea*) [2001] 2 WLR 170.

In the 2004 case of *Sony Computer Entertainment v. Ball*,[12] the judge suggested that the court's discretion to permit such proceedings should be exercised with caution: 'the claimant must satisfy the court that there is a strong case – and preferably an admitted case – that a particular misrepresentation is untrue.'

Since then, however, the courts have become increasingly willing to penalise parties who knowingly give false evidence. In the 2016 case of *Aviva Insurance Ltd v. Randive*,[13] for example, following the trial of a road traffic accident claim that was held to be fundamentally dishonest, the court granted the defendant insurer permission to bring contempt proceedings against the claimant for making false statements verified by a statement of truth. The court noted that bringing a false claim in the courts was extremely serious, leading to a waste of court time and resources. Although the claim in this case was small in financial terms and contempt proceedings would be costly, in the interests of justice and the overriding objective of the CPR (namely, to deal with cases justly and at proportionate cost), the court found that it was appropriate to pursue them. Similarly, in the 2017 case of *Liverpool Victoria Insurance Company v. Yavuz*,[14] nine individuals were given prison sentences after being found guilty of contempt of court for making false and dishonest statements in support of their motor insurance claims.

ii Striking out

The question for the Supreme Court in *Fairclough Homes Ltd v. Summers*[15] was whether the defendants were entitled to have an entire claim struck out in circumstances where the claimant had put forward a grossly exaggerated and fraudulently maintained claim for personal injuries. It held that while the court had jurisdiction to strike out such a claim, it should only do so in very exceptional circumstances. The test in each case, it held, must be what was 'just and proportionate'.

iii Adverse costs consequences

The default position under English law is that a losing party pays the winning party's legal costs – the 'costs follow the event' rule. However, in deciding whether to make a different order the court is entitled to take into account the conduct of the parties. The courts have shown that they will express their disapproval of dishonest claims in adverse costs orders. For example, in *Sulaman v. Axa Insurance Plc*,[16] insurers sought to recover sums paid before discovery of a fraud. After a three-month trial they succeeded against most of the defendants but failed against Sulaman. Following her 'victory', Sulaman applied for her costs but was awarded only one-third of them because the trial judge was satisfied she had lied in two respects in her evidence. This decision was upheld on appeal.

12 *Sony Computer Entertainment v. Ball* [2005] FSR 9.

13 *Aviva Insurance Ltd v. Randive* [2016] EWHC 3152 (QB).

14 *Liverpool Victoria Insurance Company Ltd v. Yavuz & Ors* [2017] EWHC 3088 (QB).

15 *Fairclough Homes Ltd v. Summers* [2013] Lloyd's Rep IR 159.

16 *Sulaman v. Axa Insurance Plc* [2009] All ER (D) 116.

iv Reopening a fraudulent settlement

In 2016, the Supreme Court gave a landmark judgment in *Hayward v. Zurich Insurance Company plc*,[17] holding that where an insurer suspected fraud but nonetheless chose to settle a claim, it was entitled to set aside the settlement when new evidence of the fraud came to light.

Mr Hayward injured his back in an accident at work and sued his employer, which was insured by Zurich. In the litigation, Zurich contended that Mr Hayward had exaggerated the consequences of his injury, relying on video surveillance evidence. Shortly before trial the parties settled, Zurich agreeing to pay approximately £135,000. Two years later, Mr Hayward's neighbours gave evidence to Zurich that Mr Hayward had entirely recovered from his injuries at least a year before the settlement and that his claim to have suffered a severe back injury was dishonest. Zurich commenced proceedings asking for the settlement agreement to be set aside. The judge at first instance found in favour of Zurich, set aside the settlement agreement and awarded Mr Hayward the much reduced sum of £14,720. Mr Hayward appealed and the Court of Appeal unanimously allowed the appeal. The Supreme Court, however, unanimously allowed Zurich's appeal. It found that Zurich did as much as it reasonably could do to investigate the position before entering into the settlement but it did not know the extent of Mr Hayward's misrepresentations until the neighbours came forward. Qualified belief in a misrepresentation did not rule out the conclusion that the insurer was induced by it.

In *UK Insurance v. Gentry*,[18] an insurer who had paid out sums in relation to a road traffic accident successfully claimed repayment after suing the claimant for fraudulent misrepresentation after evidence subsequently came to light that the accident giving rise to the claim had been staged.

III CONCLUSION

The common law remedy of forfeiture is available to insurers where the insured has: deliberately or recklessly caused a loss; fabricated a loss; or suffered a genuine loss but fraudulently exaggerated the value of the claim.

Following the decision in *The DC Merwestone*, however, forfeiture no longer applies to cases where the insured has presented a genuine claim but used a fraudulent device – what was described in the judgment as a collateral lie – in support of it; such claims are no longer considered fraudulent claims. This represents a seismic shift, upsetting settled expectations and assumptions as to the state of the law.

In a move that may provide some comfort to insurers, however, Section 12 of the Insurance Act 2015 gives them the right to cancel an insurance from the date of a fraudulent claim on the policy and to retain the entire premium.

Once legal proceedings are brought in respect of a claim, the sanctions for fraud are governed by the courts' procedural rules. These rules apply not only to fraudulent insureds but also to dishonest third parties bringing claims against innocent insureds. A range of penalties is available and the courts are increasingly willing to use them. Finally, the Supreme Court's decision in *Hayward v. Zurich* provides authority at the highest level that it is now open to an insurer who suspects fraud, but has insufficient evidence to prove it, to reopen the settlement should further evidence subsequently come to light.

17 *Hayward v. Zurich Insurance Company plc* [2016] UKSC 48.

18 *UK Insurance Ltd v. Gentry* [2018] EWHC 37 (QB).

Appendix 1

ABOUT THE AUTHORS

SIMON COOPER

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Simon Cooper has over 33 years' experience of advising clients in the London and international insurance and reinsurance markets. He has extensive experience of acting in large-scale disputes in the English Commercial Court and appellate courts, in *ad hoc* arbitrations and in overseas jurisdictions. Many of these disputes have involved multiple parties and complex issues of fact and law. He also has comprehensive experience of mediation and other forms of alternative dispute resolution.

Mr Cooper's practice has included most areas of non-marine insurance and reinsurance, including PI and cyber, property, and space risks. He is recommended in various guides including *Chambers Guide* (in which he is recognised as a Notable Practitioner) and *The Legal 500*. He is a member of the IUA clauses subcommittee and edited the second edition of *Reinsurance Practice and the Law*. He writes and lectures frequently on insurance and reinsurance law.

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