INSURANCE LAW CONTRACTS | POSITION OF FRAUDULENT DEVICES & FORFEITURE

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Introduction

Insurance Law Contracts unlike other contracts are one of Utmost Good Faith as the Insurer undertakes to indemnify all the risk and prospective losses of the Insured. The only method of ascertainment of Risk, which he so promises to make good, is the account of facts and circumstance as presented and deposed, by the Insured and Insurer stands alien as well ignorant to the situation and resultant risk in the present state of things. So, the duty cast upon Insured to observe good faith in Insurance contracts supersedes the general duty to observe good faith in all other types of Contracts in practice. We refer this as 'Utmost good faith'. Therefore, not just the present state of things but all the events and occurrences that can increase the Risk in future are to be mentioned at the time of execution of the policy.

Additionally as the law stands today this duty of disclosure and observing good faith is one of continuing nature and doesn't cease to be in force post formation of policy.

This comment will argue that the position of law with respect to 'utmost good-faith' in context of **Fraudulent Claims by way of Exaggerated Claims** and **Fraudulent Claims through Fraudulent Devices** to promote insured's interest is an area of ambiguity and merits its own special treatment vis-à-vis blatant breaches of 'uberrimæ fidei'. Three situations may arise when we talk of 'Utmost Good-faith' breaches-

Utmost Good Faith

1- Utmost Good Faith breach **at the time of 'Effecting' the Policy** covered under S.17[1]

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[1] The Marine Insurance Act, 8 Edw. 7 c.41 § 17 (1906); Indian Marine Insurance Act, §19 (1963).

[Duty of Disclosure]

Non Observance Effect- Insurance policy can be **avoided ab-initio**

2- Post Contractual Breach of Utmost Good Faith **covered under S.17**

[Disclosing any material Alteration of Risk]

Non Observance Effect- Insurance policy can be **avoided ab-initio**

3- **Post Contractual Breach** of Utmost Good Faith **not covered under S.17** and governed by Common Law Principle- '**Fraud defeats the claim in entirety'.**

3.1- **Fraudulent Claims:** Dishonest Intention to defraud the Insurer

3.1.1**- Exaggerated Claims**

Claims made by way of deliberate overvaluation

3.1.2- **Fraudulent Devices**

Claims made by employing fraudulent devices that must have tended to yield a not insignificant improvement in the insured's prospects of success prior to any final determination of the parties' rights.

3.2- **Reckless Statements**: Not caring for the falsity or trueness of a Statement

Non Observance Effect- **Forfeiture of Present and Future Claims**

The following two propositions have always presented a challenge before the courts dealing with Insurance Law Contract Disputes-

a- How to distinguish b/w reckless statements and fraudulent devices, which attempt to achieve similar objectives of not insignificant improvement in insured's prospects of success?

b- How does the gravity of fraudulent devices employed be mapped to decide upon penalty or complete forfeiture of claim?

'Insurance is '*uberrimæ fidei*'. A contract of marine insurance is a contract based upon the utmost good faith, and, if either party not observes the utmost good faith, the other party may avoid the contract.'

This comment shall also delve into whether the objective test of The Aegeon[2] to include 'fraudulent devices' into 'fraudulent claims' and to provide similar treatment is good or bad in law. Further an analysis shall be made on aspects of Materiality and Proportionality.

How to maintain a balance that –

Neither a defrauder goes without sanction nor it encourages insurers[3], whose obligation is to indemnify upon the occurrence of the loss, to keep asking questions in the hope that the assured will slip up and make what can then be characterized as a recklessly false statement.

Analysis

This case comment argues that the whole area of law concerning the Fraudulent Devices and thereby resultant breach of Utmost Good Faith is a total mess and full of ambiguity.

Such cases presently observe similar treatment as in case of Fraudulent Claims made by way of Exaggerated Claims and will lead to Forfeiture of Present and Future claims.

iv. Pre *Aegeon*[4] Position of Law

a) ARCHAIC LAW/CLASSICAL ARRANGEMENT FOR TREATMENT OF FRAUDULENT DEVICES-

'The test was whether the matter misrepresented or concealed justified a defense to the claim.'[5] This means that if not for the concealment or misrepresentation done by the insured the courts wouldn't have favored to allow benefits under the insurance policy. In other words the insurer

[2] *See Agapitos v Agnew*, [2003] QB 556.
[3] *See* Galloway v. Guardian Royal Exchange (UK) Ltd, [1999] 1 Lloyd's Rep 209. [**Hereinafter 'Galloway'**]
[4] *See* Agapitos v Agnew, [2003] QB 556.
[5] *See* Royal Boskalis, [1997] LRLR 523.

has to prove that the fact concealed/misrepresented is so material to the case at hand that the decision of the court stands reversed if the fact stands as it is. Thus hiding or deceiving a fact so vital led to complete forfeiture of the claim (present and future) on ground of fraudulent devices employed to get a favorable outcome of the Case.

This test justified three things objectively-

a) The matter concealed/misrepresented stands **closely connected** to the main claim under the policy and is not one, which could be incidental to it.

b) The fraudulent device must have been **intended by the insured** to **promote** his **prospect of success**, and

c) The fraudulent device must have tended to yield a **not insignificant improvement** in the insured's **prospects of success** prior to any **final determination of the parties' rights**.

(1) Critique-

The above test was later overruled by a subsequent authority in the famous Aegeon[6] Case, which laid down a test that is discussed in the upcoming section. This Archaic arrangement is criticized for being one that can aid the fraudsters to leave without sanction for the fraudulent device so employed, as they can always take the plea that the decision of the Court is not primarily based upon the misrepresentation/fraud so done and it was just to aid their own chances of winning the litigation and speedy claim settlement.

v. Post Aegeon[7] Position of Law

Lord Justice Mance expounded the following test to include fraudulent devices as sub-specie of the Fraudulent Claim itself in ***Agapitos v Agnew*****, [2003] QB 556-**

[6]GALLOWAY, s*upra* note *3*.
[7]*Ibid.*

There are many grounds on which an insurer can avoid having to meet a claim under a policy: nondisclosure; misrepresentation; breach of warranty or condition precedent; or fraud by the insured. What constitutes a fraudulent claim is well understood: a claim for a loss that did not occur, or which was caused or procured by the insured, or alternatively, a genuine claim that has been exaggerated.

There are ways in which an insurer can avoid a genuine-looking claim where it has considerable concerns about the insured's story, even though it is unable to prove the kinds of wrongdoing outlined above. An insured's lies to an investigator – told, perhaps, to conceal wrongdoing or a defence that might be available to an insurer, or to embellish an account about which the insured has anxieties – may, in themselves, defeat the insurance claim. This issue was explored by the Court of Appeal in Agapitos v Agnew [2003] QB 556. In giving the leading judgment (with which Lord Justice Brooke and Mr Justice Park agreed), Lord Justice Mance noted that 'such devices' are a not unfamiliar response to insurers' probing of the merits of a claim.

(1) Fraudulent devices

Strictly speaking, Lord Justice Mance's observations in Agapitos on "fraudulent means and devices" (meaning a fraud where an insured gives a false statement to embellish or improve the surrounding facts of a genuine claim) were expressed to be a tentative view and that they have been followed and approved by both the judiciary and commentators.

If a claim is found to be fraudulent, the insurer can avoid liability for that claim and any subsequent claim made under the same policy, even if the subsequent claim is genuine. Should the same remedy be available when it comes to otherwise genuine claims where the policyholder tells lies to the insurer?

It is not any lie, though, that will give an insurer a remedy. Lord Justice Mance contemplated "the possibility of an obviously irrelevant lie". The fraud, he said, must be "directly related to and intended to promote the claim". In such a case, the usual reason for the use of a fraudulent device "will have been concern by the

insured about [the] prospects of success and desire to improve them by presenting the claim on a false factual basis".

Lord Justice Mance then turned to the question of the appropriate legal response to a fraudulent device used to promote a claim "which may… prove at trial to be otherwise good, but in relation to which the insured feels it expedient to tell lies to improve his prospects of settlement or at trial".

Giving a tentative answer to the question, Lord Justice Mance said that the law should treat the use of a fraudulent device "as a subspecies of making a fraudulent claim – at least as regards forfeiture of the claim itself in relation to which the fraudulent device or means is used". For this purpose, the law should treat as relevant any lie:

a) Directly related to the claim to which the fraudulent device relates; and
b) Which is intended to improve the insured's prospects of obtaining a settlement or winning the case; and
c) Which would, if believed, tend "to yield a not insignificant improvement in the insured's prospects… for obtaining a settlement, or a better settlement, or of winning at trial".

In ***Wisenthal v World Auxiliary Insurance Corporation (1930) 38 Ll L Rep 54,*** Mr Justice Roche told the jury: "Fraud… was not merely lying. It was seeking to obtain an advantage, generally monetary, or to put someone else at a disadvantage by lies and deceit. It would be sufficient, within the definition of fraud, if the jury thought that, in the investigation, deceit had been used to secure payment or quicker payment of the money that would have been obtained if the truth had been told".

So a lie to an investigator that is intended to improve the likelihood of the claim being paid, the amount of the payment or the speed of the payment is likely to constitute a "fraudulent device". Any such false statement will give the insurer a strong weapon to defeat the claim.

An insurer does not have to show that:

a) It was persuaded by the lie into taking action; or
b) That the lie was an attempt by the insured to conceal grounds on which the insurer could decline or limit the claim (although that would still be one reason to categorize a lie as a fraudulent device).

The insurer can rely on lies told by the insured's agents or representatives. However, it cannot rely on lies told after the start of legal proceedings, as the rules relating to contempt of court take over at that point.

The following section shall discuss how this test was applied to Versloot Dredging BV & Another v. HDI Gerling Industrie Versicherung AG and others[8].

vi. Versloot Dredging BV & Another v. HDI Gerling Industrie Versicherung AG and others

The Court of Appeal judgment in Versloot Dredging v HDI Gerling [2014] EWCA Civ 1349 -the court has dismissed the appeal of an insured whose claim was held forfeit after it was proved he made a fraudulent statement to bring what otherwise would have been a legitimate claim.

Although set in a marine context it has a wider application to property claims and also raises an interesting contrast to the casualty market.

a) THE CAUSE

The judge at first instance concluded that the cause of the casualty was unseaworthiness as a result of crew negligence, along with a lack of watertight integrity of the bulkheads and the defective state of the vessel's engine room pumping system, which was unable to cope with the rate of

[8]Versloot Dredging BV & Another v. HDI Gerling Industrie Versicherung AG and others, [2014] EWCA Civ 1349.

ingress of water.

All of the above causes were insured perils meaning, but for any misstatement, the claim would have succeeded.

b) THE FRAUDULENT DEVICE

The general manager of the vessel was alleged to have falsely claimed (1) that the bilge alarm had gone off at about noon on 28 January 2010 (2) that it had been ignored because it was commonly understood to have been caused by the rolling of the vessel in rough weather and (3) that he had been told both of these things by the Master of the vessel and its crew.

The general manager's statement, whilst not directly related to the amount of the loss, was false. He had in fact not spoken to the Master of the vessel at the time of giving the statement and his account of why the alarm was not investigated was, he later admitted, speculation. The courts held that as a result, the whole claim was forfeit.

c) THE APPEAL

The Claimants appealed the decision on the basis that the fraud was unconnected to the level of losses, which were legitimately claimed. The statement by the crewmember, whilst false, had no impact of the validity of the claim or the value.

The Court of Appeal applied the test in Agapitos v Agnew [2003] QB 556 . That test says that in order for the claim to be forfeit, the fraudulent device must be directly related to the claim and must have been intended to enhance the prospects of the claim's success.

The Claimants argued that forfeiture of the entire claim was disproportionate to the gravity of the fraud, however the Court of Appeal was reluctant to deviate from a common law doctrine, which has been in application, particularly in the insurance field, for over 150 years.

The Court of Appeal held that if a case by case basis for determining what portion of a claim were to be forfeit due to fraud were introduced, it would cause confusion

and lead to inconsistency in application. Also, the Law Commission had looked at the issue as part of their insurance law reform proposals and it appeared they had no appetite to bring about any change. It was considered that a change in approach "might be seen to encourage policyholders to commit minor frauds in the expectation that such conduct would not affect the legitimate element of the claim".

The Court of Appeal held that deterrence of fraud is a legitimate aim and whilst forfeiture appears to be disproportionate in some circumstances, it is not disproportionate to the aim of discouraging and reducing insurance fraud. This doctrine arises as Lord Mance put it, "from a perception of appropriate policy and jurisprudence on the part of our 19th century predecessors, which time has done nothing to alter".

The Court of Appeal considered that the test under Agapitos v Agnew had been met and dismissed the appeal.

vii. Critique of the Present position of Law post *The Aegeon- 'A draconian law'*

a) DISPROPORTIONATE-

The fraudulent claims doctrine involves a **disproportionately harsh sanction** and is an anomaly. In seeking to penalise and deter it usurps the function of the criminal law but with a lesser burden of proof and lesser safeguards. The forfeiture of the whole claim, without even the return of the premium, provides insurers with a windfall and a powerful weapon. (The Bar Council in its response to the Law Commission said that The Aegeon had led to a sudden surge in insurers' lawyers pleading "fraudulent means and devices").

It does not apply to other civil claims for damages where there may well be asymmetry of information between claimant and defendant and where a claimant may have both motive and opportunity to put forward false evidence before litigation starts. The court should not, as a matter of policy, extend the doctrine of fraudulent claims so as to apply it to fraudulent devices. This would be so even if there were no logical divide between cases to which the fraudulent claims doctrine

applies and those to which the fraudulent devices doctrine would apply.

b) GRAVITY AND CULPABILITY-

It ignores the gravity or culpability of the device and, as the judge said, makes no distinction between "a reckless untruth ... told on one occasion" and "a carefully planned deceit or conspiracy". The same consequence to the man who claims a large sum for a totally fictitious loss as it does to someone who has a house and contents claim worth £ 500,000 including the real loss of a computer, who provides an invoice for a similar one which he has not lost because he cannot be bothered to find the right one.

Nor is account taken of the consequences of the lie for the insurer, whether and for how long the insurer was deceived by it, or the size of the penalty or its impact on the assured. A doctrine which has the potential to inflict disproportionately harsh sanctions on an individual, when a downright lie in a non insurance civil claim would not have that consequence, cannot have struck a fair balance. Nor is there any statistical evidence, which justifies so disproportionate a rule in relation to fraudulent device, whatever may be the position in relation fraudulent claims.

c) FRAUDULENT CLAIM V. FRAUDULENT DEVICE-

But there is, in any event, a critical distinction between a fraudulent claim and a fraudulent device. In the former case the insured is seeking to obtain a benefit to which he is not entitled; in the latter he is not. In short, the claim in a case such as this was payable when it was made, before any fraud had even been considered. That is the central difference between a fraudulent claim, which is never properly payable either at all or, at any rate, in relation to the part fraudulently exaggerated, and a fraudulent device (where the claim may have been properly due and payable before the fraud occurred).

d) ENCOURAGING INSURANCE COMPANIES TO AVOID PERFORMANCE AND TO QUESTION ON TOTALLY TECHNICAL ASPECTS-

It would encourage premature resort to litigation to avoid the effect of the doctrine. It would also encourage insurers, whose obligation is to indemnify upon

the occurrence of the loss, to keep asking questions in the hope that the assured will slip up and make what can then be characterized as a recklessly false statement.

Professor Clarke's ***The Law of Insurance Contracts 4th Ed at 27.2 B***[9], expresses the view that **the settlement of a claim is or is closely akin to a legal agreement and that it would be an unusual departure from principle to vitiate it on account of a lie which was not causative unless designed to uphold a clear overriding principle of public policy**. He also expressed the view that to do so would overlook the concerns expressed by ***Lord Mustill in Pan Atlantic [1995] 1 AC 501, 549D.*** Lord Mustill's concern was against allowing avoidance for non-disclosure without any reference to causation since "**to enable an underwriter to escape liability when he has suffered no harm would be positively unjust".**

Professor Clarke also expresses the view that the recognition of a fraudulent devices rule gives rise to concerns for the interests of consumers and small businesses and would potentially encourage insurers continually to attempt to question the insured after the loss in the hope of obtaining misstatements.

(1) What's happened since Agapitos?

How have the courts dealt with lies to insurers since the Agapitos case? The short answer is that there have been very few reported cases on this point. This is surprising, given Lord Justice Mance's observation that deceitful statements to insurers' investigators "are a not unfamiliar response" to investigations.

In Eagle Star Insurance v The Games Video Company (GVC) SA [2004] EWHC 15, which concerned the destruction of a ship, the insurer avoided having to indemnify the owner of the vessel. During the course of the insurer's investigation into the cause of the loss, the vessel owners presented fabricated documents about the supposed nature and value of the ship. The court concluded that these documents had been created and presented to try and bolster what the vessel owners had said about the ship's value: "They were asked for documents",

[9] CLARKE, THE LAW OF INSURANCE CONTRACT'S 27.2 B (4TH ED, 2002).

said Mr Justice Simon, "and they handed over the documents whose contents were deceitful. They used fraudulent devices in order to advance the claim, with the intention and expectation that the insurer would accept the documents at face value, be reassured and promptly pay the assureds".

The Commercial Court in ***Marc Rich Agriculture Trading SA v Fortes Corporate Insurance NV [2004] EWHC 2632 (QB)*** responded favourably to the insured's argument: an alleged failure by the insured to disclose information to an insurer did not constitute a fraudulent device. In recognising that Lord Justice Mance's comments in Agapitos were incidental rather than central to the decision – and given the developing nature of the relevant law – Mr Justice Cooke in Marc Rich dismissed the insured's application for summary judgment on certain aspects of the insurer's defence. However, the judge went on to say that "were the matter to come before me at trial, my inclination would be to say that Lord Justice Mance is right in the approach that he has adopted". Mr Justice Cooke would prefer the insured's arguments on non-disclosure during the insurer's investigations.

In ***Stemson v AMP General Insurance (NZ) Ltd [2006] UKPC 30***, the Privy Council allowed the insurer to rely on a fraudulent device defense. Following a fire at the insured property, the insured lied to the investigator about his intention to sell the property. That was a fraudulent device and remained so even though the insured admitted his true intention before the insurer's rejection of the claims.

Conclusion – Is it a Good Law?

The **public policy justification** for the rule as applied to both claims and devices. In either case its draconian consequence only applies to those who are dishonest. The importance of honesty in the claiming process is manifest. Most insurance claims get nowhere near litigation because insurers rely on their insured. It is true that, if the rule applies to claims and devices, insurers' scope for asserting an entitlement to avoid will be greater than if it only applies to claims. But insurers are entitled to protection from either type of fraud and the scope of the rule should not be determined by the fact that unscrupulous insurers might assert a fraudulent device without good reason to do so.

So the accepted position on fraudulent devices in property claims has been upheld. Insurance contracts, of course, carry the duty of utmost good faith. If an insured breaches their duty of utmost good faith to the insurer and inflates their claim, knowing that is not worth the stated value, the insurer can avoid liability for the whole claim.

This is in contrast to how fraudulent claims are dealt with in personal injury claims where the injured party owes no duty of utmost good faith to the insurer because its relationship is with the defendant. In all but the rarest of cases, a claimant in a personal injury claim does not lose the right to the 'good' part of the claim as a result of any dishonesty. This has arguably led to a win-win scenario for the dishonest claimant and an industry wide problem with exaggerated claims.

Fraud defeats the claim in entirety'- A Good Law

It should be seen that a law is Good only if it seeks to establish a proper balance between two conflicting set of interests and without providing an opportunity to abuse it by either party. Neither a defrauder goes without sanction nor it encourages insurers[10], whose obligation is to indemnify upon the occurrence of the loss, to keep asking questions in the hope that the assured will slip up and make what can then be characterized as a recklessly false statement. While adjudging on the proposition of public policy against Fraud the judges must take Materiality and Proportionality of the Device used into account for proper administration of Justice.

FUTURE-

Section 49 of the Criminal Justice and Courts Bill seeks to address this by introducing the concept of 'fundamental dishonesty' in personal injury claims so that where dishonesty is discovered the whole of the claim will be forfeit rather than just the fraudulent part.

[10] *See* Galloway v Guardian Royal Exchange (UK) Ltd [1999] 1 Lloyd's Rep 209.