

Insurance Fraud: the “Convoluted and Confused” State of the Law

Philip Rawlings and John Lowry*

THE GIST OF THE PROBLEM

Insurance fraud involves deception either during the application for insurance or when a claim is made under a policy. At the application stage the party seeking insurance may falsify, or fail to disclose, information in order to obtain cover, reduce the premium, or alter the terms on which cover is offered. This paper is primarily concerned with fraudulent claims. A fraudulent claim on an insurance policy encompasses (a) a claim for a loss that was never incurred (either the entire claim is false or there are invented losses alongside genuine losses)¹ and (b) a claim that exaggerates the amount lost. A fraudulent device is where a genuine claim is supported by fraudulent evidence which conceals the fact that the insurer has a defence to the claim or otherwise improves the insured’s prospects of obtaining recovery. The law is, however, far from straightforward. What state of knowledge renders a claim fraudulent? Should fraudulent claims and the use of fraudulent devices be treated in the same way? What is the consequence of the fraud for genuine aspects of the claim, for the future of the policy and, indeed, for previous, legitimate claims? What if a third party, who is exercising a statutory right to sue a liability insurer, perpetrates the fraud? And, is fraud by policyholders the whole story or does it distort proper discussion of claims?

Insurers have long complained, in the strongest of terms, about the problem of fraud,² reporting that the cost to the industry and, therefore, to policyholders is enormous.³ The Association of British Insurers stated that fraud adds an average of £50 to every policyholder’s premium and that in 2013 insurers uncovered more than

*Respectively: The Sir Roy Goode Professor of Commercial Law/Director of the Insurance Law Institute, C.C.L.S., Queen Mary University of London; and Emeritus Professor of Commercial Law, U.C.L., Faculty of Laws/Associate of the Insurance Law Institute, C.C.L.S. The authors thank the anonymous reviewers and the editor for comments on an earlier draft. The usual caveat applies.

¹ Including situations where the insured deliberately damages property to create loss or to increase a genuine loss; *Savash v C.I.S. General Insurance Ltd* [2014] EWHC 375 (TCC); [2014] Lloyd's Rep. I.R. 471.

² Report; with minutes of evidence, and accounts, from the Select Committee on Marine Insurance, 1810 (226) at 88-9.

³ According to the Insurance Fraud Bureau, undetected general insurance claims total £2.1 billion a year: see <http://www.insurancefraudbureau.org/> (last accessed 20 Jan. 2015).

118,500 fraudulent claims totalling £1.3 billion.⁴ This has brought various responses, including the Insurance Fraud Enforcement Department in 2012, a unit within the City of London Police funded by the industry, the Insurance Fraud Bureau and the Insurance Fraud Register, which were set up by the industry, and the Insurance Fraud Taskforce, established in 2014 by Chris Grayling, the Justice Secretary.⁵ In the civil courts, the judges have expressed disapproval of insurance fraud in strong terms: “The making of dishonest insurance claims has become all too common. There seems to be a widespread belief that insurance companies are fair game, and that defrauding them is not morally reprehensible.”⁶ As well as encouraging prosecutions,⁷ the judges have taken the view that the civil courts can play a role in deterring fraud. Arden L.J. remarked that, “A civil law sanction, particularly a financial one, made in an appropriate case may be more effective than a criminal sanction or other sanction.”⁸ The civil courts have, therefore, developed the fraudulent claims rule under which the insured loses the entire claim, including any genuine part, largely irrespective of the materiality of the fraud or whether the insurer was deceived.⁹

The fraudulent claim rule is confined to insurance law because the duty of utmost good faith arises only between parties to the insurance contract. That means a claimant, including someone who brings an action against the tortfeasor’s liability insurer under a statutory right, does not lose the right to damages for genuine injuries

⁴ <https://www.abi.org.uk/Insurance-and-savings/Topics-and-issues/Fraud> (last accessed 5 Feb..2015).

⁵ See the Law Commissions of England and Wales and Scotland, *Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment*, Law Com. No. 353/Scot. Law Com. No. 238 (2014) at 207, available at http://lawcommission.justice.gov.uk/docs/lc353_insurance-contract-law.pdf (last accessed 20 Jan. 2015); Insurance Fraud Bureau website, <http://www.insurancefraudbureau.org/> (last accessed 20 Jan. 2015); Insurance Fraud Taskforce, *Interim Report* (Mar. 2015) available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413146/PU1789_Insurance_Fraud_Taskforce_interim_report_-_final.pdf (last accessed 19 Mar. 2015). See further, N.

Broomfield, “B.I.L.A. Colloquium: Insurance Fraud” (2014) 127 Journal of the British Insurance Law Association; D. Barrett, “Crackdown on Insurance Fraud Will Bring Down Premiums” *Daily Telegraph*, 2 Dec. 2014.

⁶ *Galloway v Guardian Royal Exchange (UK) Ltd.* [1999] Lloyd’s Rep. I.R. 209 at 214, Mustill L.J.

⁷ *Churchill Car Insurance v Kelly* [2006] EWHC 18 (QB); [2007] R.T.R. 26; *Shah v Ul-Haq* [2009] EWCA Civ 542; [2010] 1 W.L.R. 616; *Summers v Fairclough Homes Ltd* [2012] UKSC 26; [2012] W.L.R. 2004 at [24], [59] and [60].

⁸ *Direct Line Insurance Plc v Khan* [2001] EWCA Civ 1794 at [39]; [2002] Lloyd’s Rep. I.R. 364.

⁹ *Britton v The Royal Insurance Co.* (1866) 4 F. & F. 905 at 909. See *Ombudsman News*, 21 (Oct. 2002), available at <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/21/issue-21.htm> (last accessed 21 Jan. 2015).

even if at first the extent of the injuries was dishonestly exaggerated.¹⁰ In *Shah v Ul-Haq*,¹¹ S negligently drove into W's car. W and his wife brought a claim for genuine injuries they had suffered, and K, who was alleged to have been a passenger, also brought a claim. But K had not been in the car at the time and it was alleged that W had encouraged the fraud. The Court of Appeal pointed out that the fraudulent claim rule was applicable only to insurance, which meant W's own claim was unaffected by any fraud W committed in respect of K's claim.¹²

Aside from whether law is particularly good at deterring such behaviour, which it probably is not,¹³ and whether the civil courts are designed to punish behaviour, which they are not, there has been criticism of the inflexible nature of the fraudulent claim rule.¹⁴ The Law Commissions endorsed the rationale behind the approach taken by the courts: "It is important for the law to set out clear sanctions to deter policyholders from acting fraudulently."¹⁵ Yet, at the same time, they thought the existing law "convoluted and confused", and wanted "remedies to insurers which are principled, proportionate and reliable."¹⁶ In a similar vein, Popplewell J., at first instance in *Versloot Dredging BV v HDI-Gerling Industrie Versicherung, (The DC Merwestone)*,¹⁷ thought the rules "capable of operating to visit disproportionately

¹⁰ See the Third Parties (Rights Against Insurers) Acts 1930 and 2010. See also, *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [62]; *Versloot Dredging B.V. v HDI-Gerling Industrie Versicherung, (The D.C. Merwestone)* [2014] EWCA Civ 1349 at [76]; [2015] 1 Lloyd's Rep. 32. See further T. Wood, "Personal Injuries: Fraudulent Claims" Westlaw Insight, 19 Feb. 2014; and the Criminal Justice and Courts Act 2015, discussed below.

¹¹ [2009] EWCA Civ 542.

¹² See also, *Ombudsman News*, 21 (Oct. 2002), available at <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/21/issue-21.htm> (last accessed 21 Jan. 2015). The court is not impotent in such cases and can penalise through a costs order, reduction in interest, contempt (with imprisonment as the likely punishment), striking out for abuse of process case and reference to the Crown Prosecution Service: *Churchill Car Insurance v Kelly* [2006] EWHC 18 (QB); *Summers v Fairclough Homes Ltd* [2012] UKSC 26; *Joseph v Spiller* [2012] EWHC 2958 (QB). But extra-judicially Longmore L.J. observed that the large amount of "questionably conduct" in commercial cases meant a judge was unlikely to initiate action against an untruthful witness: Special Public Bill Committee Insurance Bill (HL) H.L. Paper 81 (2014) at 53.

¹³ P.H. Robinson and J.M. Darley, "Does Criminal Law Deter? A Behavioural Science Investigation" (2004) 24(2) O.J.L.S. 173.

¹⁴ For a thorough analysis of the consequences of fraudulent claims see, A. Bugra and R. Merkin, "'Fraud' and Fraudulent Claims" (2012) 125 Journal of the British Insurance Law Association 3.

¹⁵ The Law Commissions of England and Wales and Scotland, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment*, Law Com. No. 353/Scot. Law Com. No. 238 (2014) at 207.

¹⁶ The Law Commissions of England and Wales and Scotland, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment*, Law Com. No. 353/Scot. Law Com. No. 238 (2014) at para. 19.3.

¹⁷ [2013] EWHC 1666 (Comm).

harsh and unjust consequences upon an assured in favour of an undeserving insurer.”¹⁸ As will be seen, the Court of Appeal did not share these views.¹⁹

The fraudulent claim rule

What constitutes fraud? The classic definition, formulated over a century ago, is that there is fraud where one party, for our purposes the insured, makes a material statement knowing it is false, or without belief in its truth, or recklessly, not caring if it is true or false. The conduct must be dishonest by the ordinary standards of reasonable and honest people and the policyholder must have realised that by those standards his or her conduct was dishonest.²⁰ Carelessness alone is insufficient,²¹ but there is no need to show an intention to cause harm.²² A statement that the insured believes to be true when made may become fraudulent if the insured later discovers it is false and does not correct it.²³ Moreover, there may be fraud where the policyholder deliberately withholds information that would give the insurer a defence against a claim.²⁴ The effect of the allegation on the evidence required was explained by Lord Nicholls of Birkenhead:

“this does not mean that where a serious allegation is in issue the standard of proof required is higher. It means only that the inherent probability or improbability of an event is itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. The more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its occurrence will be established.”²⁵

¹⁸ [2013] EWHC 1666 (Comm).at [167].

¹⁹ [2014] EWCA Civ 1349, discussed below.

²⁰ *Derry v Peek* (1889) 14 App. Cas. 337 at 371; *Lek v Matthews* (1927) 29 Lloyd’s Rep. 141 at 145; *Aviva Insurance Ltd v Brown* [2011] EWHC 362 (QB); [2012] Lloyd’s Rep. I.R. 211 (applying the test in *Twinsectra Ltd v Yardley* [2002] UKHL 12; [2002] 2 A.C. 164). See A. Bugra and R. Merkin, “Fraud” and Fraudulent Claims” (2012) 125 Journal of the British Insurance Law Association 3; and G. Swaby, “Insurance Law Reform: Deterring Fraud in the Twenty-First Century” [2011] Int. J.L.M. 413.

²¹ *Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All E.R. 573 at 587; *Yeganeh v Zurich Plc* [2010] EWHC 1185 (QB); [2011] Lloyd’s Rep. I.R. 540 at [4] (reversed on the facts).

²² *KBC Bank v Industrial Steels (UK) Ltd* [2001] 1 Lloyd’s Rep 370 at 374.

²³ *Agapitos v Agnew (“The Aegeon”)* [2002] EWCA Civ 247; [2003] Q.B. 556 at 564.

²⁴ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at 564.

²⁵ *In Re H and Others (Minors) (Sexual Abuse: Standard of Proof)* [1996] A.C. 563 at 586; [1996] 1 All E.R. 1.

The Financial Ombudsman Service (FOS) requires the insurer to provide clear evidence of lies, inconsistency or deception: “The fact that members of an insurance firm’s staff are personally satisfied of the claimant’s bad faith is not sufficient proof of dishonesty.”²⁶ It is worth emphasising that none of this means the insured has a duty of disclosure analogous to that arising in the pre-contractual period, and the fact that the insured has failed to disclose all the documents the insurer might have wished to see does not necessarily mean there has been fraud.

The consequence of this view of what constitutes fraud is that the insured forfeits the entire claim, including any genuine parts, irrespective of whether the insurer was deceived.²⁷ One might add that a policyholder, whose claim has been rejected for fraud, is likely to find it impossible to obtain insurance in the future, irrespective of whether criminal charges have been brought or a civil court has ruled on the issue. The devastation that this rule might visit upon an insured will be sufficiently clear to require only one example. In *Aviva Insurance Ltd v Brown*,²⁸ the insured received a payment for a claim following subsidence at his property. This comprised £176,951.68 for repairs that were carried out and £58,500 for alternative accommodation. The court required the reimbursement of the insurer when it was discovered that the insured had engaged in fraudulent conduct in earlier seeking payment for accommodation which he owned (albeit through his own letting company), even though he decided not to move into it and did not receive any payment in relation to that accommodation. The reimbursement of the cost of repairs and the accommodation, which were genuinely incurred, were forfeited because they arose from the same claim.

While a claim for an item that the policyholder knows has not been lost is obviously fraudulent, there is also fraud if the item has been lost but its value has been exaggerated. In *Goulstone v Royal Insurance Co*,²⁹ the policyholder had stated that his goods were worth £50 when he was declared insolvent in 1854, but after fire destroyed those goods (his suggestion as to its cause was “the cat had played with

²⁶ *Ombudsman News*, 21 (Oct. 2002), available at <http://www.financial-ombudsman.org.uk/news/2012.html> (last accessed 20 Jan. 2015).

²⁷ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at 564.

²⁸ [2011] EWHC 362 (QB).

²⁹ (1858) 1 F. & F. 276.

lucifers [matches]”), he claimed £200, even though admitting that he had not added to the stock. The claim failed after Pollock CB directed the jury to determine “whether [the claim] was false in any substantial respect”.³⁰ Exaggeration is not, however, necessarily evidence of fraud. In *Ewer v National Employers’ Mutual General Insurance Association*,³¹ the contents of business premises were destroyed and the policyholder put in a figure of £900 as their value. Although the judge thought this “looks preposterous”, in that it was well above the true value, he concluded there was no fraud because it was clear on the face of the claim that the figure had been based on the cost price of new items: “It was one of those cases where the view of the assured as to what he was entitled to, or would like to recover, for the things that had been burned or damaged differed very much from the view of the insurance company as to the amount the assured would eventually be entitled to recover.” The insured did not intend to defraud the company, but merely took the view that he was entitled to recover the cost of replacing the lost items. Although incorrect in law, it did not make his action fraudulent: “I do not think he was doing that as in any way a fraudulent claim, but as a possible figure to start off with, as a bargaining figure.”³² This approach has been endorsed more recently by Hoffmann L.J.:

“One should naturally not readily infer fraud from the fact that the insured has made a doubtful or even exaggerated claim. In cases where nothing is misrepresented or concealed, and the loss adjuster is in as good a position to form a view of the validity or value of the claim as the insured, it will be a legitimate reason that the assured was merely putting forward a starting figure for negotiation.”³³

The issue of whether there was fraud is determined not by showing the claim was exaggerated but by the insurer demonstrating that the policyholder had the appropriate intention or recklessness, although gross exaggeration combined with other evidence

³⁰ (1858) 1 F. & F. 276 at 279.

³¹ [1937] 2 All E.R. 193.

³² [1937] 2 All E.R. 193 at 203, Mackinnon J.

³³ *Orakpo v Barclays Insurance Services* [1995] L.R.L.R. 443 at 451; [1994] C.L.C. 373.

as to the implausibility of the claim may be sufficient.³⁴ An honest belief in the accuracy of the claim should be sufficient to refute an allegation of fraud.³⁵

The fraud must be related to the claim, and it must be “substantially fraudulent”,³⁶ or “fraudulent to a substantial extent.”³⁷ Does this refer to the materiality of the fraud, or to the proportion that the fraudulent element bears to the whole claim? The judges disagreed on the point in *Galloway v Guardian Royal Exchange (UK) Ltd.*³⁸ Following a burglary, the policyholder submitted a claim for £16,133.94, which appeared genuine, and £2,000 for a computer, which had not been stolen. Both judges subscribed to the need to deter fraud.

“The rule which we are asked to enforce today may appear to some to be harsh, but it is in my opinion a necessary and salutary rule which deserves to be better known by the public. I for my part would be most unwilling to dilute it in any way.”³⁹

Yet, in a view that reflects the dilemma touched on by the Law Commissions, Lord Woolf MR looked at the fraud in the context of the whole claim and decided that because the fraud related to a substantial amount and was a significant percentage of the claim, the whole claim was tainted. Mustill L.J., disagreed. He looked at the fraudulent claim in isolation in order to consider whether it was “sufficiently serious to justify stigmatising it as a breach of his [the policyholder’s] duty of good faith so as to avoid the policy.”⁴⁰ On this test, where one part is fraudulent, the whole claim fails, irrespective of the amounts involved. The issue of which approach is correct has not been entirely settled because, although later courts seem to have preferred the view of Mustill L.J., there has been some support for that of Lord Woolf.⁴¹

³⁴ *Orakpo v Barclays Insurance Services* [1995] L.R.L.R. 443 at 451.

³⁵ *Piermay Shipping C.o S.A. v Chester (The Michael)* [1979] 2 Lloyd’s Rep. 1.

³⁶ *Orakpo v Barclays Insurance Services* [1995] L.R.L.R. 443 at 451, Hoffmann L.J.

³⁷ *Orakpo v Barclays Insurance Services* [1995] L.R.L.R. 443 at 452. Sir Roger Parker.

³⁸ [1999] Lloyd’s Rep I.R. 209.

³⁹ [1999] Lloyd’s Rep I.R. 209 at 214, Mustill L.J.

⁴⁰ [1999] Lloyd’s Rep I.R. 209.

⁴¹ Mummery L.J. agreed with both judgments. See also, *Versloot Dredging B.V. v HDI-Gerling Industrie Versicherung, (The D.C. Merwestone)* [2014] EWCA Civ 1349 at [109]. FOS is concerned less with the relative size of the fraudulent part and looks instead at whether the alleged fraud involves “innocent and minimal exaggeration” (*Ombudsman News*, 42/5 (Dec. 2004/Jan. 2005), available at

Where the policy is in the name of two or more people, the fraud of one will be fatal to the claim of the other, innocent party in the case of joint insurance, but not composite insurance. The reason advanced for this distinction is that joint insurance is a single policy, while composite insurance comprises distinct contracts with each of the insureds. In *General Accident Fire and Life Assurance Corporation Ltd v Midland Bank Ltd*,⁴² Sir Wilfrid Greene MR remarked:

“That there can be a joint insurance by persons having a joint interest is, of course, manifest. If A and B are joint owners of property—and I use that phrase in the strict sense—an undertaking to indemnify them jointly is a true contract of indemnity in respect of a joint loss which they have jointly suffered. Again, there can be no objection to combining in one insurance a number of persons having different interests in the subject-matter of the insurance, but I find myself unable to see how an insurance of that character can be called a joint insurance. In such a case the interest of each of the insured is different. The amount of his loss, if the subject-matter of the insurance is destroyed or damaged, depends on the nature of his interest, and the covenant of indemnity which the policy gives must, in such a case, necessarily operate as a covenant to indemnify in respect of each individual different loss which the various persons named may suffer. In such a case there is no joint element at all.”⁴³

Two contrasting cases illustrate the effect of this distinction. In *Direct Line Insurance plc v Khan*,⁴⁴ the insurance covered a house that was jointly owned by the policyholders and, following a fraud undertaken by Mr K without the knowledge of Mrs K, the court upheld the insurer’s decision not to pay either policyholder. Arden L.J. said that, “the defendants’ insurance claims were actions which Mr Khan carried out partly on his own behalf and partly as agent for Mrs Khan within the scope of Mr

<http://www.financial-ombudsman.org.uk/publications/ombudsman-news/42/42.pdf> (last accessed 22 Jan. 2015).

⁴² [1940] 2 K.B. 388; [1940] 3 All E.R. 252.

⁴³ [1940] 2 K.B. 388 at 404-405. For a summary of early cases, see *Higgins v Orion Insurance Co. Ltd* (1985) 17 D.L.R. (4th) 90.

⁴⁴ [2001] EWCA Civ 1794 (joint insurance). See also, *Arab Bank Plc v Zurich Insurance Co.* [1999] 1 Lloyd’s Rep 262; [1998] CL.C. 1351 (composite; fraud in pre-contract disclosure).

Khan's actual or apparent authority from Mrs Khan. Mrs Khan was, therefore, bound by the consequences of those fraudulent actions.⁴⁵ That case primarily turned on whether Mrs K was joint owner of the property or a tenant in common because the existence of different interests would have constituted a composite insurance. In *Parker v NFU Mutual Insurance Society Ltd*,⁴⁶ BP owned the insured house and, after MP came to live with her, she added his name to the policy, even though he had no legal interest in the property. The court held that the interests covered by the policy were not joint but different because of MP's lack of legal interest and, therefore, BP's claim was not tainted by MP's fraud or arson. It is worth adding that, even where the interests of A and B in the insured property are different, if A makes a fraudulent claim as agent of both parties, B's claim would be tainted. Furthermore, having indemnified an innocent co-assured, the insurer may be able to exercise subrogation rights against any co-assured who had wrongfully caused the loss.

One problem, as the Law Commissions recognised,⁴⁷ is that spouses, who are joint insureds, may become estranged and one may act without considering the interest of the other – or, indeed, may act to spite the other. Their proposal to give protection to an innocent joint policyholder was dropped, however, in the face of concern that the courts might find it difficult to distinguish between cases where there had been complicity and those where there had not, or to value the interest of an innocent joint policyholder, although these objections seem curious since such judgments are part of the normal function of the courts. The fraudulent party might reap some benefit if the innocent party were able to claim, but this makes a general assumption about the nature of the relationship between all joint policyholders that does not stand much scrutiny, and it hardly seems a sufficient reason to punish the latter. Moreover, the principal reason for a special rule on fraudulent claims in insurance is to deter and it is difficult to see how this is achieved by punishing innocent parties. The Law Commissions did suggest that the issue of fraud might not arise because the claim by the innocent party would be defended on the basis of a policy term, which is typically included, to the effect that the insurer is not liable if

⁴⁵ [2001] EWCA Civ 1794 at [31].

⁴⁶ [2012] EWHC 2158 (Comm).

⁴⁷ The Law Commissions of England and Wales and Scotland, *Reforming Insurance Contract Law: Issues Paper 7: The Insured's Post-Contract Duty of Good Faith* (2010) at Pt. 5, available at http://lawcommission.justice.gov.uk/docs/ICL7_Insureds_Duty_of_Good_Faith.pdf (last accessed 20 Jan. 2015).

one of the joint policyholders has brought about the loss intentionally. But in such cases the issue is not whether the fraudulent claims rule applies, but whether the insurance contract covers the loss.

Fraudulent devices

A fraudulent device refers to the situation where the loss is genuine but some fraud is used to advance the claim or conceal some defence.⁴⁸ It is said to be “a sub-species of making a fraudulent claim”,⁴⁹ and, as such, is subject to the same consequences. The law in this area is, however, newly minted, arising out of *Agapitos v Agnew (The Aegeon)*.⁵⁰ Although that case was determined by applying the ruling in *The Star Sea* that the fraudulent claim rule did not apply where litigation had commenced, Mance L.J. took the opportunity to discuss the post-contractual duty of good faith. He set out by referring to “the opacity of the relevant principles” that “is matched only by the stringency of the sanctions assigned.” He went on to observe that, while the law on fraudulent claims was settled in the nineteenth century, “The proper approach to the use of fraudulent devices or means is much freer from authority.”⁵¹

“Tentatively, I would suggest that the courts should only apply the fraudulent claim rule to the use of fraudulent devices or means which would, if believed, have tended, objectively but prior to any final determination at trial of the parties' rights, to yield a not insignificant improvement in the insured's prospects—whether they be prospects of obtaining a settlement, or a better settlement, or of winning at trial.”⁵²

He, therefore, combines the need for subjective intention (or recklessness) with an objective test of the impact of the lie, tested at the time it was made. The fraud must not be “unsubstantial” and it must “directly be related to and intended to promote the claim”.⁵³ This has since been construed as establishing a two-stage test which requires

⁴⁸ For example, a breach of warranty: *US Trading Ltd v Axa Insurance Co. Ltd* [2010] Lloyd's Rep. I.R. 505.

⁴⁹ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at 574, Mance L.J.

⁵⁰ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at 574.

⁵¹ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at 574.

⁵² *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at 575.

⁵³ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at 572. The idea of materiality has not died easily: see N. Broomfield, “B.I.L.A. Colloquium: Insurance Fraud” (2014) 127 Journal of the British Insurance Law Association.

the insurer to show: “(1) the use by the insured of some lie to seek to improve or embellish the facts surrounding the claim; and (2) that the lie would, if believed, have tended objectively to yield a not insignificant improvement in the insured's prospects of obtaining a settlement.”⁵⁴

There has been some division of opinion over whether it is necessary to show that the insurer relied on the fraud,⁵⁵ but if the policy of the law is to deter fraud, then the insured's success or failure in deceiving the insurer should be irrelevant. That was Mance L.J.'s view: “Does the fact that the lie happens to be detected or unravelled before a settlement or during a trial make it immaterial at the time when it was told? In my opinion, not.”⁵⁶ Yet, FOS has taken a different view in that it looks at whether the document was used “solely to substantiate transactions that really took place, or did the customers intend to obtain more than they were entitled to?”⁵⁷ This might seem to undermine the fraudulent device rule, which only applies if the claim is genuine, but, in practice, it reflects a more nuanced view in that FOS takes into account the nature of the fraud when determining whether the claim should be paid and the policy reinstated.⁵⁸ Finally, it is noteworthy that the fraudulent device rule only applies to claims under the policy. Where the insured reaches a settlement of the claim with the insurer and the false document is used to obtain the agreed payment, the rule does not apply.

THE REMEDY

It is clear that the insured loses all benefits if the claim is fraudulent,⁵⁹ but what is the effect of the fraud on other payments and on the policy? What happens to any interim payments made in relation to the relevant claim before the discovery of the fraud and any paid or unpaid claims that are not connected to the fraud? In *Axa General*

⁵⁴ *Sharon's Bakery (Europe) Ltd v AXA Insurance UK Plc* [2011] EWHC 210 (Comm) at [79]; [2012] Lloyd's Rep. I.R. 164, Blair J.

⁵⁵ Contrast *Interpart Comerciao e Gestao S.A. v Lexington Insurance Co.* [2004] 1 Lloyd's Rep. I.R. 690 at [42] with *Interpart Comerciao e Gestao Underwriting Insurance Ltd* [2005] EWHC 2318 (TCC); [2006] Lloyd's Rep. I.R. 690, although in the latter decision (at [51]) the judge conceded that the South African authority he uses might have been decided differently in English law.

⁵⁶ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556 at [37]; *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30 at [35]; [2006] Lloyd's Rep. I.R. 852.

⁵⁷ *Ombudsman News*, 21 (Oct. 2002) available at <http://www.financial-ombudsman.org.uk/news/2012.html> (last accessed 15 Feb. 2015).

⁵⁸ *Ombudsman News*, 42/3 and 42/4 (Dec. 2004/Jan. 2005), available at <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/42/42.pdf> (last accessed 5 Feb. 2015).

⁵⁹ *Agapitos v Agnew (“The Aegeon”)* [2003] Q.B. 556.

Insurance Ltd v Gottlieb,⁶⁰ Mance L.J. reiterated his view that the fraudulent claims rule was a special common law rule under which the whole of the tainted claim was forfeited, but added that the fraud did not have retrospective effect and so legitimate claims were not affected. Interim payments made in relation to the fraudulent claim could, however, be claimed back by the insurer, even though the payments were made before the fraudulent device was deployed.

Section 17 of the Marine Insurance Act 1906 might seem to offer a clear answer to questions about the effect of fraud on the policy: “A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.”⁶¹ Fraud might strike one as a paradigm example of what constitutes a breach of good faith, so it is surprising to find that this is not the case – at least when it comes to claims fraud. The problem is that the remedy seems harsh since allowing the insurer to avoid the contract *ab initio* obliges the insured to repay previous payments relating to genuine claims unconnected with the fraud. It might plausibly be argued that, while the fraudulent claim rule is about post-contractual issues, s.17 is confined to the pre-contractual period and acts a backstop to the specific obligations set out in the succeeding sections of the statute. Mackenzie Chalmers, the architect of the statute, explained that s.17 was included because “the special sections which follow [ss.18-20] are not exhaustive”.⁶² This view that s.17 refers to the pre-contractual period is further supported by the insertion of the word “based” rather than simply referring to “a contract of utmost good faith”, by the section being placed in that part of the statute headed “Disclosure and Representations”, and by the reference to “either party” in s.17 which remedies the omission of the insurer in ss.18-20. Yet, this is a case of what might have been and should delay us no further because, whatever Chalmers’ intention, the idea that s.17 only refers to the pre-contractual obligation, in the words

⁶⁰ [2005] EWCA Civ 112; [2005] 1 All E.R. (Comm) 445. See J. Lowry and P. Rawlings, “Fraudulent Claims: Framing the Appropriate Remedy” [2006] J.B.L. 339.

⁶¹ Notwithstanding the title of the 1906 Act, the provision applies to all insurance contracts: *Pan Atlantic Insurance Co. Ltd v Pine Top Insurance Co. Ltd* [1995] 1 A.C. 501 at 518; [1994] 3 W.L.R. 677.

⁶² Sir Mackenzie D. Chalmers and D. Owen, *The Marine Insurance Act, 1906* (London: W. Clowes, 1907) at 25.

of Lord Clyde, “now appears past praying for.”⁶³ It might be added that, as a result of this broad view of the meaning of s.17, it is probably past praying that the fraudulent claim rule is part of s.17, even though it is difficult to think of a more egregious form of bad faith.

Some judges have taken the view that s.17 created a continuing duty of utmost good faith.⁶⁴ This certainly appears to form the basis of Hirst J.’s reasoning in *The Litsion Pride*.⁶⁵ However, the case was not about fraud. Rather, it concerned a term in a marine policy that required notice to the insurer when the insured ship entered a war zone. Since notification gave rise to an additional premium and also since it could be given after entering the zone, there was a temptation on insureds to give notice only if a loss was sustained. Curiously, The judge took the view that the shipowner, although not in breach of contract by failing to notify, had not acted in good faith as required by s.17. The attempt by the shipowner to deprive the insurer of the premium was a breach of what the judge believed was a continuing duty of utmost good faith and this entitled the insurer to avoid the policy *ab initio*. The notion that good faith operates post-contractually also found favour with the majority in *Orakpo v Barclays Insurance Services*,⁶⁶ but the discussion of the scope of s.17 was *obiter* because the policy was voidable for material misrepresentation. Moreover, in argument before the court it seems to have been assumed that the duty of good faith was implied into insurance policies. In any event, Hoffmann L.J. remarked, in terms that echoed Lord Mansfield’s reasoning on the pre-contractual duty in *Carter v Boehm*:⁶⁷

“I do not see why the duty of good faith on the part of the assured should expire when the contract has been made. The reasons for requiring good faith continue to exist. Just as the nature of the risk will usually be within the

⁶³ *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 A.C. 469, at [6].

⁶⁴ *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd’s Rep. I.R. 209 at 213. See also, *Boulton v Houlder Bros. & Co.* [1904] 1 K.B. 784 at 791-92; and *Shepherd v Chewter* (1808) 1 Camp. 274 at 275. See further, M. Clarke, “Lies, Damned Lies, and Insurance Claims: The Elements and Effect of Fraud” [2000] New Zealand L.R. 233; J. Lowry and P. Rawlings, “Insurers, Claims and the Boundaries of Good Faith” [2005] M.L.R. 81.

⁶⁵ *Black King Shipping Corp. and Wayang (Panama) S.A. v Massie (“The Litsion Pride”)* [1985] 1 Lloyd’s Rep. 437. See R. Merkin, *Colinvaux and Merkin’s Law of Insurance* (London: Sweet & Maxwell, Looseleaf, 10th ed.) at paras. 6-163-164; H.N. Bennett, “Mapping the Doctrine of Utmost Good Faith in Insurance Contract Law” [1999] L.M.C.L.Q. 165.

⁶⁶ [1995] L.R.L.R. 443.

⁶⁷ (1766) 3 Burr. 1905.

peculiar knowledge of the insured, so will the circumstances of the casualty; it will rarely be within the knowledge of the insurance company. I think that the insurance company should be able to trust the assured to put forward a claim in good faith. Any fraud in making the claim goes to the root of the contract and entitles the insurer to be discharged.”⁶⁸

He added, “I think it should discharge the insurer from all liability.”⁶⁹ This leaves unclear whether the contract is voidable or the insurer merely has the right to terminate. Sir Roger Parker seemed clearer on the point because he saw no distinction between a material non-disclosure or misrepresentation at the inception of the policy and a fraud in making a claim.

Allowing the insurer to recover any genuine payments relating to earlier losses seems harsh. The justification for avoidance where there is a misrepresentation or non-disclosure in the pre-contractual period is that the risk, which is fundamental to the policy, was other than that agreed to by the insurer; but while a fraud at the claims stage may undermine the future relationship between the parties, it is hard to see how it can be said to have affected their past (prior to the fraud) relationship or undermined the foundation of the contract. A series of cases have attacked the broad view of s.17 taken in *The Litsion Pride* and *Orakpo*, and any suggestion that it gives rise to a duty to disclose facts post-contract similar to that which arises before the contract has been firmly dismissed.⁷⁰ For example, in *Royal Boskalis Westminster NV v Mountain*,⁷¹ the insured suppressed documents, but there was no allegation of fraud and so the insurer sought to argue that, following *The Litsion Pride*, there had been a culpable misrepresentation or failure to disclose. Rix J. rejected Hirst J.’s view of the post-contractual duty of good faith, pointing out that: “[a]part from *The Litsion Pride* itself, there is no authority which holds that the post-contractual duty of good faith goes wider in the claims context than a duty not to make fraudulent claims”.⁷² He added that recent cases “have shown that there is concern about the width of the principle coupled with the strength of the remedy of avoidance laid down in s. 17 of

⁶⁸ [1995] L.R.L.R. 443 at 451.

⁶⁹ [1995] L.R.L.R. 443 at 451.

⁷⁰ *Banque Financière de la Cité S.A. v Westgate Insurance Co.* [1991] 2 A.C. 249 at 282; [1998] 1 All E.R. 737, Lord Jauncey of Tullichettle.

⁷¹ [1997] L.R.L.R. 523 (reversed on other grounds: [1999] Q.B. 674; [1997] 2 All E.R. 929).

⁷² [1997] L.R.L.R. 523 at 596.

the Act".⁷³ Similarly, in the Scottish decision of *Fargnoli v GA Bonus Plc*,⁷⁴ Lord Penrose observed that, while fraudulent concealment in the pre-contractual period undermined consent and, therefore, there was little difficulty in deciding that there was no contract, fraud in making a claim does not overturn the fact that up to that point there was a binding contract: "To avoid the policy *ab initio* would defeat that reality."⁷⁵ In *Agapitos v Agnew (The Aegeon)*,⁷⁶ Mance L.J. did not conceal his dislike of the draconian consequences of s.17. He confirmed that the fraudulent claim rule arose from the common law rather than the contract and fell "outside the scope of section 17",⁷⁷ so that provision could not be used to avoid the policy *ab initio*. He added that under the fraudulent claim rule the entire claim was forfeited and, therefore, since this included any genuine part of that claim it was obviously no part of the rule that the fraud must be shown to have been material, whereas s.17 rests on a test of materiality analogous to that which applies to pre-contractual disclosure.⁷⁸

The principal conclusion of the House of Lords *The Star Sea*⁷⁹ was that any duty of good faith ceased on the commencement of litigation because from that time the relationship between the parties was governed no longer by the contract but by the Civil Procedure Rules, which contain disclosure provisions. Lord Hobhouse of Woodborough, however, also considered s.17. He thought Hirst J.'s view "should not any longer be treated as a sound statement of the law. In so far as it decouples the obligation of good faith both from s.17 and the remedy of avoidance and from the contractual principles which would apply to a breach of contract it is clearly unsound."⁸⁰ Lord Hobhouse restricted the scope of s.17 – indeed, he came close to restricting it out of existence. He made evident his dislike of the remedy of avoidance: "[f]or the defendants successfully to invoke section 17 so as to avoid the policy *ab initio* and wholly defeat the claim would be totally out of proportion to the failure of

⁷³ [1997] L.R.L.R. 523.

⁷⁴ 1997 S.C.L.R. 12; [1997] C.L.C. 653.

⁷⁵ [1997] C.L.C. 653 at 670.

⁷⁶ [2003] Q.B. 556.

⁷⁷ [2003] Q.B. 556 at 557.

⁷⁸ *Royal Boskalis Westminster N.V. v Mountain* [1997] L.R.L.R. 523 at 597-98. *K/S Merc-Scandia XXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] EWCA Civ 1275 at [35]; [2001] 2 Lloyd's Rep. 563.

⁷⁹ *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [48].

⁸⁰ *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [71].

which they were complaining.”⁸¹ It was “of disproportionate benefit” to the insurer, enabling them to “to escape retrospectively the liability to indemnify which he has previously and... validly undertaken.”⁸² He also noted the criticism of the pre-contractual duty and cautioned against its extension to the post-contractual stage by use of s.17. In relation to fraudulent claims, he did not dispute the insurer’s entitlement to be discharged from future liability because, “[t]he fraud is fundamentally inconsistent with the bargain and the continuation of the contractual relationship between the insurer and the assured.”⁸³ But he emphasised that “whether the making of a fraudulent claim would entitle the insurer to avoid the contract *ab initio*, is a point upon which the judgments in the *Orakpo* case cannot be treated as fully authoritative”.⁸⁴ This led to his conclusion that there was a distinction between the fraudulent claim rule and the duty in s.17.

Lord Scott of Foscote said in *The Star Sea*, “the content of the duty of good faith owed by an assured post-contract is not the same as the duty owed in the pre-contract stage. So what is the content of the duty owed at the claim stage? It is, at least, that of honesty in the presentation of a claim”.⁸⁵ Longmore L.J. tackled the issue at greater length in *The Mercandian Continent*,⁸⁶ which involved a forged letter provided to the insurers by the insured to assist in the defence of a claim brought by a third party. He said:

“there was a continuing duty on the assured to refrain from a deliberate act or omission intended to deceive the insurer through either positive misrepresentation or concealment of material facts and facts would only be material for the purpose if they had ultimate legal relevance to a defence under the policy... [T]he insurers cannot avoid the contract of insurance for such fraudulent conduct unless the conduct was such as to justify their terminating

⁸¹ *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [72].

⁸² *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [57].

⁸³ *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [57].

⁸⁴ *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [66].

⁸⁵ *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469 at [102].

⁸⁶ *K/S Merc-Scandia XXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] Lloyd's Rep. I.R. 802. See H.Y. Yeo, “Post-contractual Good Faith – Change in Judicial Attitude?” [2003] M.L.R. 425.

the contract in any event... [I]t seems to me that the duty not to be materially fraudulent does continue at all times after the contract has been made.”⁸⁷

Alternatively, if there were only defined categories of post-contractual good faith rather than a general duty:

“the giving of information, pursuant to an express or implied obligation to do so in the contract of insurance, is an occasion when good faith should be exercised. Since, however, the giving of information is essentially an obligation stemming from contract, the remedy for the insured fraudulently misinforming the insurer must be commensurate with the insurer’s remedies for breach of contract. The insurer will not, therefore, be able to avoid the contract of insurance with retrospective effect unless he can show that the fraud was relevant to his ultimate liability under the policy and was such as would entitle him to terminate the insurance contract.”⁸⁸

The continuing duty of good faith – such as it is – may be overridden by conflicting contractual terms, in which event any remedy is for breach of contract.⁸⁹ Professor Merkin has advanced the interesting idea that the role of this duty “is not as a free-standing obligation which gives rise to its own remedies, but rather as a factor which colours the contractual obligations of the assured”, and as such it could allow the courts to imply terms in a rather broader set of circumstances than in the general law of contract.⁹⁰ This seems more feasible in light of changes to s.17 contained – as will be seen – in the Insurance Act 2015.

The *Versloot Dredging* case

⁸⁷ *K/S Merc-Scandia XXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] Lloyd's Rep. I.R. 802 at 819-20.

⁸⁸ *K/S Merc-Scandia XXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] Lloyd's Rep. I.R. 802 at 820.

⁸⁹ *Hussain v Brown (No. 2)* [1996] 1 Lloyd's Rep. 627. See J. Lowry and P. Rawlings, “Insurers, Claims and the Boundaries of Good Faith” [2005] M.L.R. 81.

⁹⁰ R. M. Merkin, *Colinvaux and Merkin's Law of Insurance* (London: Sweet & Maxwell, Looseleaf, 10th ed.) at 6-173.

In *Versloot Dredging BV v HDI-Gerling Industrie Versicherung, (The DC Merwestone)*,⁹¹ the Court of Appeal emphatically rejected criticisms of the fraudulent claims rule. This case concerned flooding that occurred near the bow of the vessel *DC Merwestone* and resulted in major damage to the main engine, which was located towards the stern. The assured claimed on its Hull and Machinery policy for the cost of replacing the engine, some 3.2 million euros. As part of the casualty investigation process, the underwriters asked for an explanation of the ingress of water, its spread from the bow of the vessel to the engine room and why it was not controlled by using the ship's pumps. In answer, the assured's General Manager falsely claimed in a letter that the bilge alarm had gone off at around noon on the day of the incident, but that, according to the Master or crew, it had been ignored because it was attributed to the rolling of the vessel due to heavy weather, and that he had been informed of these facts by the ship's Master. In fact, the crew had not heard or, indeed, reported an alarm going off at that time and had, therefore, never given an explanation for not investigating it.

At first instance,⁹² Popplewell J. observed that, while the fraudulent claim rule has long been settled as a fundamental principle of insurance contract law,⁹³ the fraudulent device rule originated in the dicta in *Agapitos v Agnew*,⁹⁴ (for which he had argued as counsel in that case) and it was with "manifest reluctance"⁹⁵ that he felt obliged to apply this *dicta* because the General Manager's letter was a fraudulent device since it "was intended by him to promote the claim in the hope of a prompt

⁹¹ [2014] EWCA Civ 1349. At the time of writing, an application for leave to appeal to the Supreme Court has been made.

⁹² [2013] EWHC 1666 (Comm).

⁹³ [2013] EWHC 1666 (Comm) at [146]-[147]. The rule can be traced to a line of 19th century cases: e.g. *Levy v Baillie* (1831) 7 Bing. 349, *Goulstone v Royal Insurance C.o* (1866) 1 F. & F. 276 and *Britton v Royal Insurance Co.* (1866) 4 F. & F. 905. It continues to be applied by the modern courts: see, for example, *Lek v Matthews* (1927) 29 Ll. L. Rep. 141; *Orakpo v Barclays Insurance Services* [1995] L.R.L.R. 443; *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep. I.R. 209; *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2003] 1 A.C. 469; *Direct Line Insurance Plc v Khan* [2001] EWCA Civ 1794 ; and *Axa General Insurance Ltd v Gottlieb* [2005] All E.R. 163; [2005] 1 All E.R. (Comm) 445.

⁹⁴ [2003] Q.B. 556. See the decision of the Supreme Court in *Summers v Fairclough Homes* [2012] 1 W.L.R. 2004 at [29] and the Privy Council in *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30. It has been discussed or applied in *Eagle Star Insurance Co. Ltd v Games Video Co. (GVC) S.A. (The Game Boy)* [2004] EWHC 15 (Comm); [2004] 1 Lloyds 238; *Joseph Fielding Properties (Blackpool) Ltd v Aviva Insurance Ltd* [2010] EWHC 2192 (QB); [2011] 1 Lloyd's Rep I.R. 238; and *Aviva Insurance Ltd v Brown* [2011] EWHC 362 (QB).

⁹⁵ [2014] EWCA Civ 1349 at [2], Clarke L.J.

settlement”.⁹⁶ Popplewell J., therefore, upheld the insurers’ refusal of the claim. He did, however, take the opportunity to voice strong criticism of the rule, or at least its all-or-nothing effect, arguing that on “a scale of culpability which may attach to fraudulent conduct relating to the making of claims, this was at the low end. It was a reckless untruth, not a carefully planned deceit”,⁹⁷ it was told on only one occasion and had not been continued at the trial. To be deprived of a valid claim amounting to more than 3.2 million euros as a result “is, in my view, a disproportionately harsh sanction.”⁹⁸ Had he felt free of authority, he would have developed principles quite different from those advanced by Mance L.J.:

“My own view would be that if the law is to extend the draconian effect of an anomalous rule, applicable only to insurance claims, and then only prior to the commencement of litigation, to striking down wholly valid claims, the policy of the law should be to require at least a sufficiently close connection between the fraudulent device and the valid claim to make it just and proportionate that the valid claim should be forfeit. The law does not provide in this context that the end always justifies the means; but nor should it say that any dishonest means which are more than de minimis should deprive a litigant of his just ends. What will be just and proportionate will depend upon the circumstances of each case, which may vary considerably.”⁹⁹

He also pointed out that:

“whilst any fraud is reprehensible and is to be discouraged, it is not normally the function of the civil law to provide such deterrence. The fraudulent claims rule in insurance is a form of penal non-damages which, so far as I am aware, has no parallel elsewhere in the common law. Yet deliberate exaggeration of claims, for example in the context of personal injuries, occurs regularly and does not attract the sanction of loss of that part of the claim which is valid.”¹⁰⁰

⁹⁶ [2013] EWHC 1666 (Comm) at [222].

⁹⁷ [2013] EWHC 1666 (Comm) at [225].

⁹⁸ [2013] EWHC 1666 (Comm) at [225].

⁹⁹ [2013] EWHC 1666 (Comm) at [177].

¹⁰⁰ [2013] EWHC 1666 (Comm) at [169].

He favoured a materiality test allowing the court to consider “whether it was just and proportionate to deprive the assured of his substantive rights, taking into account all the circumstances of the case.”¹⁰¹

This attack stood out because it came after various cases in which the extension of the fraudulent claim rule to fraudulent devices by Mance L.J. had been assumed to be correct; but, fired by the possibility of getting the rule amended, the owners brought an appeal. It failed. The Court of Appeal agreed with Popplewell J.’s refusal of the claim, but declined to endorse his criticisms of the rule and fell back on familiar ideas. Clarke L.J. stated that the fraudulent claim rule was “designedly draconian”.¹⁰²

“It functions as a deterrent to the deception of insurers who, in the nature of things, will have no, or very little, knowledge of the incident which is said to give rise to the claim. Part of the rationale is that if lying to the insurers did not attract that sanction, the dishonest insured would enjoy a one way bet... [I]f the lie was never found out, the insurers might end up paying out... If the insured was found out there would be no effective sanction (at any rate where the claim did not come to litigation where costs penalties might apply). He would still recover the true value of his claim.”¹⁰³

He concluded that the rule was that:

“(a) the fraudulent device must be directly related to the claim, (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.”¹⁰⁴

His only doubt concerned the third part and on this he was not prepared to express a clear view as to whether the test should be objective or subjective because it would have made no difference on the facts. He was unsure of the reason for its negative

¹⁰¹ [2013] EWHC 1666 (Comm) at [171].

¹⁰² [2014] EWCA Civ 1349 at [75].

¹⁰³ [2014] EWCA Civ 1349 at [75].

¹⁰⁴ [2014] EWCA Civ 1349 at [165].

formulation and suggested instead that the device must be shown to have tended to yield “a significant improvement in the insured's prospects.”¹⁰⁵

Clarke L.J. also felt bound by earlier case law which, although not strictly binding, he regarded as authoritative. He took the view that the extension by Mance L.J. of the fraudulent claim rule to fraudulent devices had been approved by the Supreme Court in *Summers v Fairclough Homes*,¹⁰⁶ and applied by the Privy Council in *Stemson v AMP General Insurance (NZ) Ltd*,¹⁰⁷ although the statements in the Supreme Court were dicta, and in the case before the Privy Council, Lord Mance was the only judge to raise the issue. Nevertheless, as Clarke L.J. pointed out, various first instance decisions, such as *The Game Boy*,¹⁰⁸ a further Privy Council decision in *Beacon Insurance Co. Ltd v Maharaj Bookstore Ltd*,¹⁰⁹ - to which list can be added, since *Versloot Dredging, Savash v CIS General Insurance Ltd*¹¹⁰ - have applied or endorsed the dicta. Moreover, he returned to the underlying public policy interest in deterring fraud as the principal justification for applying the fraudulent claims rule to fraudulent devices.

“The harshness of the result of a fraudulent devices rule is most apparent when, as here, the Court has, in the end, determined that the claim is otherwise valid. But the rule is directed to an earlier stage. Fraudulent devices, as their definition shows, are used by those who think their use desirable in order to bolster a claim which appears to have potential weaknesses (e.g. as here Owners' possible responsibility for a deficiency in the bilge alarm system) and to avoid or cut short lines of inquiry or investigation which might prevent or postpone the payment of it. At the stage when they are used it will probably not be possible to tell whether the claim is one that will in the end be accepted, or held, to be valid. The risk to the insurer is that the device may achieve its purpose, so that the insurer fails to explore the claim properly and pays out in respect of a claim where he may have a defence. If he does do so it will never

¹⁰⁵ [2014] EWCA Civ 1349 at [165].

¹⁰⁶ [2012] 1 W.L.R. 2004.

¹⁰⁷ [2006] UKPC 30.

¹⁰⁸ *Eagle Star Insurance Co. Ltd v Games Video Co. (GVC) S.A. (The Game Boy)* [2004] EWHC 15 (Comm).

¹⁰⁹ [2014] UKPC 21; [2014] 4 All E.R. 418.

¹¹⁰ [2014] EWHC 375 (TCC), at [23].

be known whether, had he not done so, the result would have been the same.”¹¹¹

Clarke L.J. did not endorse the idea of proportionality to which Popplewell J. had been attracted because it has never been suggested with regard to fraudulent claims or fraudulent devices, but principally because of his view of the public interest in deterring fraud. Holding out the possibility that insureds might recover part of a claim in spite of fraud might encourage fraud, and in any event he was unclear how the effect of fraud on the claim would be calculated (although FOS has managed). He rejected the idea that the fraudulent claims rule breached the Human Rights Act 1998, and, in particular, Article 1 of the First Protocol, which concerns the deprivation of a person’s property. He decided that was overridden by public policy, the fraudulent claim rule was proportionate to the objective sought, and the sanction was not penal,¹¹² since a condition of indemnity was honesty.

Express terms

Insurance policies commonly include terms dealing with fraud, although these do not necessarily remove the difficulties associated with the fraudulent claim rule. A typical clause provides: “If any claim upon this Policy shall be in any respect fraudulent or if fraudulent means or devices be used by or on behalf of the insured to obtain any benefit under the Policy … all benefit under this Policy shall be forfeited”.¹¹³ The intention of the insurer in including a clause like this may merely be to bring to the policyholder’s attention the fraudulent claim rule, and, indeed, the courts typically regard them in this light.¹¹⁴ Thus, in *Fargnoli v GA Bonus plc*,¹¹⁵ a decision of the Outer House of the Court of Session, Lord Penrose thought such a clause ambiguous and ruled that it only relieved the insurer of liability for the tainted claim and did not allow avoidance *ab initio*. But, of course, clear wording may alter the scope of the clause and the remedies available.¹¹⁶ An example is:

¹¹¹ [2014] EWCA Civ 1349 at [112].

¹¹² [2014] EWCA Civ 1349 at [162]-[164]. Contrast this with the view taken by a group of Commercial Court judges mentioned below.

¹¹³ *Sharon’s Bakery (Europe) Ltd v AXA Insurance UK Plc* [2011] EWHC 210 (Comm) at [75]. For an early example, *Levy v Baillie* (1831) 7 Bing. 349.

¹¹⁴ *Galloway v Guardian Royal Exchange (UK) Ltd.* [1999] Lloyd’s Rep. I.R. 209 at 211.

¹¹⁵ 1997 S.C.L.R. 12.

¹¹⁶ *Insurance Corp. of the Channel Islands Ltd v McHugh* [1997] L.R.L.R. 94.

“We will at our option avoid the policy from the inception of this insurance or from the date of the claim or alleged claim or avoid the claim (a) if a claim made by you or anyone acting on your behalf to obtain a policy benefit is fraudulent or intentionally exaggerated, whether ultimately material or not or (b) a false declaration or statement is made or fraudulent device put forward in support of a claim.”¹¹⁷

This would seem to allow the insurer not only to refuse the claim tainted by fraud but also to demand reimbursement of earlier payments made under the policy in respect of claims unaffected by the fraud, although a court might seek to avoid this draconian consequence.

Because the fraudulent claim rule is a rule of law it seems doubtful that terms reiterating that rule are subject to the Unfair Terms in Consumer Contracts Regulations 1999,¹¹⁸ but the regulations should apply where the clause in a consumer policy goes beyond the common law. In the case of damage covered by compulsory motor insurance, the insurer will be liable even if the policy has been avoided.¹¹⁹ A consumer insured might be able to complain to FOS where such a clause is used to deny a claim. In the unlikely that the policy purports to exclude remedies for fraud, such exclusion would probably be ineffective,¹²⁰ which means that a clause can only restate the common law rule or extend the remedies available.

REFORM

As noted, the Law Commissions faced the same conundrum that had exercised Popplewell J. in the *Versloot Dredging* case:

¹¹⁷ *Joseph Fielding Properties (Blackpool) Ltd v Aviva Insurance Ltd* [2010] EWHC 2192 (QB) at [15].

¹¹⁸ *Direct Line Insurance Plc v Khan* [2001] EWCA Civ 1794 at [36]; *Direct Line Insurance Plc v Fox* [2009] EWHC 386 (QB); [2009] 1 All E.R. (Comm) 1017. But the Law Commissions of England and Wales and Scotland, *Insurance Contract Law: Insurance Contract Law: Post Contract Duties and Other Issues* (Consultation Paper No. 201 (Dec. 2011) at para. 8.28 seem to assume that a challenge to such a clause is possible; available at http://lawcommission.justice.gov.uk/docs/cp201_summary.pdf (last accessed 23 Jan. 2015).

¹¹⁹ Road Traffic Act 1988, s.151(5). See similarly, The Employers’ Liability (Compulsory Insurance) Regulations 1998 (S.I. 1998/2573), reg. 2(1).

¹²⁰ *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 1 All E.R. (Comm) 349.

“It is important for the law to set out clear sanctions to deter policyholders from acting fraudulently. Although insurance fraud is a criminal offence, prosecutions are relatively rare, meaning that the civil law has an important part to play in deterring fraud. It should also grant remedies to insurers which are principled, proportionate and reliable. However, the current law on the effect of a fraudulent claim is convoluted and confused. There is tension between the common law rule that the fraudster forfeits the fraudulent claim, and a statutory rule which allows the insurer to avoid the whole contract from the outset if the insured breaches the duty of good faith.”

In the end, however, the Law Commissions decided only on limited measures because, “Our view is that this element of the law is best left to the courts to develop, and that it does not require statutory reform.”¹²¹ This is not surprising since they started from the same characterisation of the problem as the civil courts, namely, the vulnerability of the insurers to fraud and the size of the problem.¹²² Although acknowledging that the identification of fraud is not always straightforward, the principal difficulties were regarded as arising from the nature of the issue, which, because it involves a variety of behaviours, makes it difficult to be precise and, therefore, hard to reduce to a code. They rejected the idea of a statutory threshold – for example, that the penalties should be triggered only if some specified amount or proportion of the claim were fraudulent. Similarly, they did not favour the idea that the courts be given discretion over the remedy to apply where a fraudulent device had been used. The Law Commissions did look at Australia where discretion has been conferred on the courts. Under the Insurance Contracts Act 1984, s.56(1), the general principle remains that the insurer can refuse payment of a fraudulent claim, but s. 56(2) goes on to say, “if only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and

¹²¹ Law Commissions of England and Wales and Scotland, *Reforming Insurance Contract Law: Issues Paper 7: The Insured’s Post-Contract Duty of Good Faith* (2010) at para. 3.62; available at http://lawcommission.justice.gov.uk/docs/ICL7_Insureds_Duty_of_Good_Faith.pdf (last accessed 20 Jan. 2015).

¹²² Law Commissions of England and Wales and Scotland, *Reforming Insurance Contract Law: Issues Paper 7: The Insured’s Post-Contract Duty of Good Faith* (2010) at paras. 2.1-2.6; available at http://lawcommission.justice.gov.uk/docs/ICL7_Insureds_Duty_of_Good_Faith.pdf (last accessed 20 Jan. 2015).

unfair”, the court may order such payment as is “just and equitable in the circumstances”, although in exercising this discretion “the court shall have regard to the need to deter fraudulent conduct in relation to insurance but may also have regard to any other relevant matter” (s. 56(3)). In practice, the Australian courts appear to have limited their use of this discretion to situations where the part tainted by fraud is separable from the remainder of the claim. The Law Commissions rejected this approach because of concern that it might encourage minor frauds,¹²³ and, instead, endorsed the idea of forfeiture of the entire claim, in spite of concern about the lack of proportionality and some resistance, particularly from a group of Commercial Court judges, who highlighted the curiosity of having “a policy of penal non-damages” that only applied to insurance law.¹²⁴ The issue was raised again during the passage of the Insurance Bill through the House of Lords, but the weight of opinion was in favour of the Law Commissions’ position of not legislating and leaving the development of the law, including any distinction between fraudulent claims and fraudulent devices, to the courts.¹²⁵ Significantly, perhaps, tort law is being moved closer to the fraudulent claim rule. The Criminal Justice and Courts Act, s.57, will oblige the courts to dismiss a genuine claim for damages where the claimant “has been fundamentally dishonest in relation to the primary claim or a related claim” (s.57(1)(b)). But this is not an absolute rule – as it is in insurance – because the court has a discretion where it “is satisfied that the claimant would suffer substantial injustice if the claim were dismissed” (s.57(2)).

The Law Commissions’ views meant that the Insurance Act 2015 includes just two sections on fraudulent claims. Section 12(1) states that if the insured makes a fraudulent claim the insurer is not liable to pay, may recover any sums already paid in

¹²³ Law Commissions of England and Wales and Scotland, *Reforming Insurance Contract Law: Issues Paper 7: The Insured’s Post-Contract Duty of Good Faith* (2010), para. 4.73; available at http://lawcommission.justice.gov.uk/docs/ICL7_Insureds_Duty_of_Good_Faith.pdf (last accessed 20 Jan. 2015). R Merkin, *Reforming Insurance Contract Law: Is There A Case for Reverse Transportation? A Report For The English And Scottish Law Commissions On The Australian Experience Of Insurance Law Reform* (2007) at para. 6.10 available at http://lawcommission.justice.gov.uk/docs/ICL_Merkin_report.pdf (last accessed 25 Jan. 2015).

¹²⁴ Law Commissions of England and Wales and Scotland, *Reforming Insurance Contract Law: Insurance Contract Law: Summary of Responses to Second Consultation Paper: Post Contract Duties and Other Issues: Chapter 2: Insurers’ Remedies for Fraudulent Claims* (Dec. 2012) at para. 2.13, available at http://lawcommission.justice.gov.uk/docs/insurers-remedies-for-fraud_responses.pdf (last accessed 23 Feb. 2015).

¹²⁵ Special Public Bill Committee Insurance Bill (HL) H.L. Paper 81 (2014) at 26, 53, 71.

relation to that claim and may by notice to the insured treat the contract as terminated with effect from the time of the fraudulent act. Section 12(2)(a) provides that termination allows the insurer to refuse claims (fraudulent or not) brought after the fraudulent act, even if made before notification of the decision to terminate and unconnected with the fraud, and any premium need not be returned (s.12(2)(b)). On the other hand, claims relating to events prior to, and unconnected with, the fraudulent act are not affected (s.12(3)). Section 13 clarifies the effect of fraud in group insurance and, in essence, means that the rights of the insurer under s.12 are exercisable only against the person who made the fraudulent claim. These changes raise some issues. First, the use of a fraudulent device is not mentioned but would presumably be covered by the courts continuing to adopt a broad definition of the term “fraudulent claim” to include genuine claims advanced by the use of a fraudulent device, since this has always been regarded as a sub-species of the principal rule and not a separate rule. Second, s.12 starts by referring to the remedies where the insured makes a “fraudulent claim”, but then states that the key point is “the time of the fraudulent act”. Presumably, the claim and the act are meant to be synonymous so that the making of the fraudulent claim is the fraudulent act and *vice versa*. It seems unlikely that a court would see some significance in the choice of different words, and, for example, conclude that the writing of the forged receipt is taken to be the act, even before it is used to support a claim.

The other reform concerns s.17 of the Marine Insurance Act 1906. It was accepted that this section could not be abolished because it places a pre-contractual duty of disclosure (or, under the act, a duty of fair presentation of the risk) on the insurer, and because it may have useful post-contractual functions unconnected with fraudulent claims.¹²⁶ The Law Commissions accepted that the best way forward was to remove the penalty of avoidance because this would give the courts a freer range to apply the duty of good faith to post-contractual issues. The section, as amended, now reads, “A contract of marine insurance is a contract based upon the utmost good faith.” The Law Commissions left the word “utmost” simply because of uncertainty as

¹²⁶ Law Commissions, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment*, Law Com. No. 353 (2014) at 318, available at http://lawcommission.justice.gov.uk/docs/lc353_insurance-contract-law.pdf (last accessed 22 Feb. 2015).

to whether it made any difference, and, perhaps, if it had been deleted this might have been construed as a deliberate break with earlier case law.

Other proposals, which the Law Commissions contemplated, were dropped. The idea that insurers should have a statutory right to recover the costs of an investigation where the claim was fraudulent was omitted because of practical difficulties in assessing these costs. These might not have presented a real problem for the courts, which have enormous experience in such matters, but in the end it was perhaps more significant that there seemed little demand from the insurers for such a remedy.

RECHARACTERISING THE ISSUES?

The chief justification given for the fraudulent claim rule is the assertion that it deters fraud, and this is regarded as particularly important because prosecutions are rare. The idea that the civil law should remedy the defects of the criminal law and the criminal justice system seems curious when it is normally concerned with compensating loss arising from a breach of a duty rather than the very different objective of inflicting punishment as a deterrent.¹²⁷ Moreover, there is no empirical data to show that the fraudulent claim rule does deter, and a growing literature throws serious doubts on the effectiveness of non-criminal (and even criminal) sanctions in deterring behaviour.¹²⁸ Leaving these issues aside, it is hard to see why insurance companies should enjoy special protection when similar difficulties in identifying and preventing fraud arise in relation to other types of claim. Of course, that special protection is only partial because it does not apply to third parties claiming directly from a liability insurer, although that has led the industry to press the Government for action, particularly in relation to fraudulent motor accident claims, and, among other things, prompted the reforms in the Criminal Justice and Courts Act 2015.

The need for these unusual measures rests on the apparently serious nature of the problem. The ABI has stated that, “Every hour of every day 15 fraudulent

¹²⁷ Deterrence is occasionally mentioned in other contexts, but rarely and unsystematically: see for example, *Gray v Barr, Prudential Assurance Co. Ltd (Third Party)* [1971] 2 Q.B. 554 at 581; [1971] 2 All E.R. 949.

¹²⁸ P.H. Robinson & J.M. Darley, “Does Criminal Law Deter? A Behavioural Science Investigation” (2004) 24(2) O.J.L.S. 173; W.J. Cardi, R.D. Penfield & A.H. Yoon, “Does Tort Law Deter Individuals? A Behavioral Science Study” (2012) 9(3) Journal of Empirical Legal Studies 567;

insurance claims are exposed in the UK. Insurance fraud... is a serious criminal offence that affects every honest insurance customer, adding an extra £50 a year to their premiums.”¹²⁹ As noted above, this assertion is based on figures purportedly showing that insurers detected 118,500 fraudulent claims worth £1.3bn in 2012, and, it will be recalled, recently the Insurance Fraud Bureau has stated that undetected general insurance fraud has reached an annual amount of £2.1bn.¹³⁰ Yet, these figures seem hard to reconcile with other statistics. In 2013-14, the National Fraud Intelligence Bureau recorded that 8,583 offences involving insurance fraud were reported in the year ending September 2014.¹³¹ Criminal statistics are notoriously difficult to read and comparisons are hard to make, in part because people do not report all crimes and the police fail to record all those crimes that are reported. Nevertheless, the contrast is surprising and suggests that the industry’s figures largely comprise cases where the relevant insurer believed there was fraud but did not report it to the police. This seems curious since insurers would appear to have little reason not to report, and, indeed, a report would reinforce a decision not to pay a claim. The implication is that the suspicions of fraud are not supported by sufficient evidence, although the view that no crime has occurred does not mean the claimant would succeed in making the claim because of the difference in the standard of proof. There may be some circularity here in that the insurer’s behaviour in treating claims with suspicion is legitimised and, indeed, encouraged by assertions about the prevalence of fraud, which come from the industry. All of which brings to mind a criticism made by FOS more than a decade ago about insurers refusing claims on the basis of their employees’ personal opinion as to the claimant’s bad faith without sufficient proof of dishonesty, and how insurers are “surprised that fraud must be established to a high degree of probability.”¹³² FOS urged insurers to recognise that people make mistakes, particularly since “insurers are not always clear in what they are asking the consumer

¹²⁹ A.B.I., *No Hiding Place: Insurance Fraud Exposed* (2012) <https://www.abi.org.uk/Insurance-and-savings/Topics-and-issues/Fraud> (last accessed 5 Feb. 2015).

¹³⁰ <https://www.abi.org.uk/News/News-releases/2014/05/Insurance-cheats-feel-the-heat-value-of-fraudulent-claims-uncovered-by-insurers-hits-record-level> (last accessed 5 Feb. 2015); <http://www.insurancefraudbureau.org/> (last accessed 20 Jan. 2015)..

¹³¹ *Crime in England & Wales, year ending September 2014 – Bulletin tables*, Table 21. Action Fraud recorded 895 offences in the year to March 2014: *Crime in England & Wales, year ending March 2014*, Appendix Tables, table A5, available at www.ons.gov.uk (last accessed 25 Feb. 2015).

¹³² *Ombudsman News*, 21 (Oct. 2002), available at <http://www.financial-ombudsman.org.uk/news/2012.html> (last accessed 20 Jan. 2015).

to tell them.”¹³³ The judges are not unaware of these criticisms and a few have even attacked the absolute nature of the remedy, even while, like Popplewell J. in *Versloot*, they ultimately disallow a claim. The courts have always recognised that exaggerated claims may not be fraudulent but may constitute acceptable negotiating tactics, and some have acknowledged that these tactics may be rendered necessary by the intransigence of insurers in paying legitimate claims, as one judge remarked recently when dismissing an allegation of fraud, “This is... a claim in which the Claimants clearly feel very disappointed by the insurers response to their claim and were seeking to put their claim with as much vigour as they reasonably could.”¹³⁴

The idea that insurance fraud is rife appeared to have been reinforced by the ABI’s consumer survey in 2012 which reported that 42 per cent of respondents “felt that insurance fraud was an easy way to make a quick buck” and 27 per cent thought the penalty was negligible.¹³⁵ But consumers reporting their views as to the ease with which fraud can be undertaken says nothing about the prevalence of the crime or even the likelihood that those who expressed this view would commit fraud. These may be people who simply think that is how others might behave. The survey results may cast doubt on the effectiveness of the fraudulent claim rule in conveying a message about deterrence, since it suggests people are unaware of the rule or unconvinced as to its likely success. While this might encourage stiffer penalties rather than any relaxation, it may indicate that such a rule is not going to work. This is not the place for a more thorough analysis of all the figures or the deterrent effect of the fraudulent claim rule, although it is worth reiterating that these issues are important because they are routinely used as the unchallengeable starting point for media stories, official inquiries and Government statements on fraud and, therefore, provide the foundation on which policy is built.

One feature of the recent discussion is the way the honest policyholder is presented as the beneficiary of the rule’s supposed deterrent effect and of tougher

¹³³ *Ombudsman News*, 21 (Oct. 2002), available at <http://www.financial-ombudsman.org.uk/news/2012.html> (last accessed 20 Jan. 2015).

¹³⁴ *Mandalia v Beaufort Dedicated No. 2 Ltd* [2014] EWHC 4039 (QB) at [81], McFermott Q.C. (sitting as Deputy Judge).

¹³⁵ A.B.I., *Quarterly Consumer Survey 2012 Q.4* (May 2013), available at <https://www.abi.org.uk/~media/Files/Documents/Publications/Public/2013/Consumer%20Survey/Quarterly%20Consumer%20Survey%202012%20Q4.pdf> (last accessed 15 Feb. 2015).

action on fraud. Speaking to the Association of British Insurers in 2014, Chris Grayling, the Justice Minister, said, “It is not right that people who cheat the system should get away with it and force up the price of motor insurance for honest, hardworking motorists.”¹³⁶ In welcoming the minister’s announcement of an insurance taskforce to look into fraud, the ABI declared, “the insurance industry is committed to reducing insurance fraud to protect honest customers”.¹³⁷ If one assumes, first, that substantial amounts are paid out to fraudulent claimants, and if one also assumes that were these claims not paid insurers would reduce premiums (rather than, say, increase dividend payments), then, of course, there could be great benefit to policyholders in tackling fraud. A cynic might not rush to make either of these assumptions. In any event, the focus on fraud may be drawing discussion away from issues that are of more concern to policyholders, namely, the conduct of insurers in their treatment of claims. Do some insurers pressure claimants into accepting a lower offer by excessive delays in dealing with claims?¹³⁸ Where are the figures on legitimate claims refused by insurers? They may be difficult to estimate, but that has not stopped annual figures on fraud. Presumably, the insurers, who are the only possible source for such data, have no interest in undertaking the calculation. This certainly seems an area of concern: in 2013-14 of the complaints to FOS about insurance (other than ppi), 52 per cent related to claims.¹³⁹ It might be suggested that these are different issues, but that depends on your viewpoint. The “hardworking” policyholder, whose legitimate claim is rejected, might regard the insurer’s refusal as fraudulent, whether or not this coincides with the law’s view. And the familiar tactic by which an insurer makes an offer lower than the loss in the hope that the insured will accept might seem like the mirror image of an action that if taken by an insured would be fraudulent.

The fraudulent device rule may have exacerbated the policyholders’ problems. In spite of the justifications for this rule, which were most recently repeated in

¹³⁶ Reported at <https://www.abi.org.uk/News/Speeches/2014/12/Chris-Grayling-speech-at-the-ABI-Motor-Conference-2014> (last accessed 3 February 2015); D. Barrett, “Crackdown on Insurance Fraud Will Bring Down Premiums” *Daily Telegraph*, 2 Dec. 2014 .

¹³⁷ <https://www.abi.org.uk/News/News-updates/2014/12/ABI-responds-to-Chris-Grayling-speech-at-the-ABI-Motor-Conference> (last accessed 3 Feb. 2015).

¹³⁸ For a case decided as fraud but involving lengthy delay (in the region of ten years) see, *Aviva Insurance Ltd v Brown* [2011] EWHC 362 (QB).

¹³⁹ <http://www.financial-ombudsman.org.uk/publications/ar14/about.html#product> (last accessed 4 Feb. 2015).

Versloot Dredging,¹⁴⁰ is it really too far fetched to suggest that most people would draw a distinction between an entirely fraudulent claim and one that is genuine but supported by forged evidence? Might not the insured feel justified (and not dishonest) in forging evidence when the insurer insists on a receipt that cannot reasonably be produced?¹⁴¹ It is difficult to assess whether the development of the law on fraudulent devices may have encouraged insurers to increase the demands for evidence in the hope of being able to deny the claim, terminate the policy and retain the premium, but, as has been seen, insurers may apply a definition of fraud that does not precisely reflect its legal meaning. FOS has certainly taken a slightly different view. As early as 2002 it was critical of the “overzealous” practices of insurers in insisting on receipts, which “may put customers in a position where they may be tempted to create substitutes for lost receipts”.¹⁴² Payment was ordered by FOS in one case where the insured “had been foolish to obtain a forged receipt but he was not dishonestly trying to obtain something to which he was not entitled.”¹⁴³ In a more extreme case from 2011, an insurer refused a claim for stolen jewellery because the policyholder had not provided “sufficient evidence to prove ownership”, even though he explained that receipts could not be produced because some of the items had been bought many years before and others had been received as gifts, and he supplied valuations obtained previously along with family photographs in which his wife was wearing the items. FOS found for the policyholder, pointing out “that it was not unusual for people to be unable to produce a receipt for every single possession stolen in a burglary.”¹⁴⁴

Of course, such cases do not indicate general practice, and it is difficult for insurers to prove fraud, although the fraudulent device rule has opened opportunities for them to press their suspicions and in other cases those suspicions may have led

¹⁴⁰ [2014] EWCA Civ 1349 at [112].

¹⁴¹ It is unclear if use of a fraudulent device constitutes an offence under the Fraud Act 2006 (ss.2 and 5). Does a forged receipt constitute a false representation and is there an intention to make a gain or cause a loss? A thin argument might be made that gain is “getting what one does not have” which could include a payment that otherwise would not have been made, because, even though the loss was genuine, entitlement to payment under the policy only arises if the insured can prove loss.

¹⁴² *Ombudsman News*, 21 (Oct. 2002), available at <http://www.financial-ombudsman.org.uk/news/2012.html> (last accessed 20 Feb. 2015).

¹⁴³ *Ombudsman News*, 42/3 (Dec. 2004/Jan. 2005), available at <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/42/42.pdf> (last accessed 22 Jan. 2015).

¹⁴⁴ *Ombudsman News*, 92/2 (Feb.-Mar. 2011), available at <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/92/92-insurance-claims.html#cs2> (last accessed 11 Feb. 2015).

them to pursue alternative strategies, such as refusing a claim for breach of a warranty or condition precedent, or avoiding the policy for breach of the duty of disclosure or misrepresentation or even lack of insurable interest.¹⁴⁵ Yet, insurers certainly would not recognise any characterisation of themselves as puppets able to control the direction of a debate and make the Government and the courts dance to their tune – the impositions of Solvency II indicate otherwise. But they are better able to organise than policyholders, and, while more Government and Parliamentary attention is being given to fraud (particularly in motor insurance), the provision in the Insurance Bill allowing policyholders damages for late payment of claims was dropped in the face of opposition from parts of the industry (admittedly, much of the industry saw no reason for such opposition) as was an earlier proposal to protect innocent joint policyholders.¹⁴⁶ Resolving the problems associated with claims requires a broader understanding of all sides of the issue. This means looking at the interests of the insurer, which needs protection from fraud, and the policyholder, who wants a claim paid. It does not help the industry if customers believe, rightly or wrongly, that insurers are looking for ways to avoid payment or are viewing every claim as fraudulent.

It would be foolish to deny that fraudulent claims present a problem or that insurers face difficulties in proving fraud, but it would be helpful to have better – or, at least, more transparent – statistics. It might also be useful to consider why fraud occurs because it may not be a simple matter of greed and deception by policyholders and third parties that can be deterred with severe penalties, but may be bound up with feelings of injustice among policyholders about their treatment by insurers. If the starting position is that fraud is the problem, this will naturally colour the debate and the processing of claims, making insurers more cautious and policyholders with legitimate claims more pessimistic about the likelihood of getting paid. Noise made about fraud may be justified, but it should not conceal the difficulties faced by legitimate claimants.

¹⁴⁵ *Western Trading Ltd v Great Lakes Reinsurance (UK) Plc* [2015] EWHC 103 (QB) at [60].

¹⁴⁶ For a failed attempt to reintroduce the provision in the Commons: *Commons Debates*, 3 Feb. 2015 at 148-9.