When a lie is dishonest but a claim isn't!

by

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Learning outcomes

- Identify the key elements of the fraudulent claims rule as it relates to fraudulent devices.
- Understand and critically analyse the main aspects of the judgment of the Supreme Court in *The DC Merwestone*.
- Understand the relevant provisions of the Insurance Act 2015 and how these will impact on how an insurer may deal with fraudulent claims and the remedy available to an insurer.
- Apply the knowledge gained from the seminar to deal more effectively with, and find practical solutions to, claims involving a fraudulent device.

The scale of the problem

- The total number of detected fraudulent claims and applications in 2018 was 469,000. An increase of 3% from 2017.
- 371,000 related to application fraud. This was an increase of 5%
- Fraudulent claims fell by 6%.
- The average value of each case was around £12,000.
- The industry invested £250m fighting fraud.

How have the figures been received?

- Generally, the industry has welcomed the fall in fraudulent claims.
- The Association of Consumer Support Organisations has criticised the figures saying that not all "detected" acts may have had criminal intent, especially in application fraud.
- The Law Society Gazette states in an article titled "A fraud epidemic – when stats don´t speak for themselves":

"The figures are actually generated from cases where insurance firms report that claims have been dropped or successfully challenged, and can include those with an "innocent explanation"

Criminal law v civil law

- 1,300 fraudulent acts detected every day. But there was only 2 criminal convictions every week.
- The conviction rate is 0.0002%. This is £2.4m per conviction/caution.
- Is the civil law rather the criminal law being relied upon as a mechanism to deter and counter insurance fraud?

Are insurers fair game?

"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."

Lord Justice Millett in *Galloway v Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209

What constitutes fraud?

- Whilst they had the opportunity to do so, when making recommendations for the Insurance Act 2015, the Law Commission decided it should be left to the courts to define fraud.

- Was this the correct approach?

- The words of Lord Herschell have stood the test of time. Fraud will be proven when "a false representation has been made:

1) knowingly, or
2) without belief in its truth, or
3) recklessly, careless whether it be true or false."

Derry v Peek (1889) 14 App. Cas. 337

What about bargaining tools?

- *Ewer v National Employers' Mutual General Insurance Association* [1937] 2 All ER 193
  - Mr Justice McKinnon didn't see much wrong with a claim for the cost of new furniture to replace second-hand furniture that had been destroyed. It was part of the opening negotiations and the claimant knew their claim would be scrutinised by assessors.
- Is the modern judiciary so tolerant?

- *Orakpo v Barclays Insurance Services* [1995] LRLR 443. Lord Justice Hoffman stated:

> "In cases where nothing is ***misrepresented or concealed***, and the loss adjuster is in as good a position to form a view on the validity of the claim as the insured, it will be a legitimate reason that the insured was merely putting forward a starting figure for negotiation."

- The Financial Ombudsman Service states that for fraud to be established there should be:

> "**concrete evidence** of lies, inconsistent statements or acts of deception."
>
> *Ombudsman News,* Issue 21

How the courts have categorised claims

1) Wilful misconduct on the part of the insured, where the insured deliberately causes the loss and then makes a claim under the policy.
2) Losses which are invented by the insured when there has been no loss.
3) Presenting a claim to an insurer in a way that seeks to conceal the fact that the insurer may have a defence.
4) Exaggerating a claim that has arisen from a genuine loss.
5) Using a fraudulent device to improve the prospects of success in a claim where a genuine loss has occurred.

Source: Macdonald Eggers P., *Good Faith and Insurance Contracts*, 3rd Ed, (London: Lloyd's List Group, 2010)

When is a claim presented?

- According to one commentator, Professor D.R. Thomas, it is when a communication:

  " … represents the insured's concluded position and is an unequivocal assertion to the entitlement to an indemnity under the policy."

- What about preliminary notifications?

- The duty not to present a fraudulent claim arises at the point the claim is presented and ends when court proceedings are commenced. At this point, the court rules will apply – *The Star Sea* [2001] UKHL 1

- What about forged documents submitted after settlement terms have been agreed? See *Direct Line Plc v Fox* [2009] EWHC 386

The fraud must be substantial

- The contentious issue here is when a claim consists of a genuine part and a fraudulent component.
- *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 324 (£2,000 of an £18,000 claim)
- *Tonkin v UK Insurance Ltd [2006]* EWHC 1120 (£2,000 of a £700,000 claim).
- It's not about mathematics.

The burden of proof

- The burden of proof is on the insurer - *Lek v Mathews (1927)* 29 Lloyd's Rep 141

- The normal civil standard of "on the balance of probabilities" applies but a higher degree of probability may be required for the more serious allegations – *Hornall v Newberger Products Ltd* [1957] 1 QB 247

The insurer's remedy

- The common law remedy is forfeiture of the entire claim presented by the fraudulent insured.

- The insured is required to repay interim payments – *Axa v Gottlieb* [2005] Lloyd's Rep IR 369

Avoidance ab initio

- Think of section 17 of the Marine Insurance Act 1906.
- What about previously valid claims?
- Should a fraudulent claim tarnish previous claims made under the policy?

Self-help remedy

- Reduces the risks from the unpredictability of the common law.
- The insurer can stipulate their remedy.
- We will look at this later.

Fraudulent devices – the current battleground

- A fraudulent device is used when "the insured believes that he has suffered the loss claimed but seeks to improve or embellish the facts surrounding the claim by some lie." – Lord Justice Mance in *The Aegeon* [2002] EWCA Civ 247

- *Aviva Insurance Ltd v Brown* [2011] EWHC 362

- *Sharon's Bakery v Axa Insurance UK Plc* [2011] EWHC 210 (Comm)

- "The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing." – Lord Houbhouse in *The Star Sea* [2001] UKHL 1

The DC Merwestone

- Mr Justice Popplewell in the Commercial Court ([2013] EWHC 1666) reached the conclusion "with regret" that the claimant would lose their entire claim because they had used a fraudulent device.

- He drew a comparison with the criminal law:

  "Not all fraud attracts the same moral obloquy, as is recognised in the sentencing practice applied to criminal offences involving dishonesty and fraud."

- Mr Justice Popplewell also sought to rely on the judgment of Lord Justice Clarke from *Fairclough Homes Ltd v Summers* [2012] UKSC 26

- A distinction between first party claims and third party claims.

- Mr Justice Popplewell thought the issue was about being “just and proportionate”.

- ABI statistics – doubted whether claims based on fraudulent devices represented a significant proportion of fraudulent claims.

- Sanity was restored in the Court of Appeal. Lord Justice Christopher Clarke handed down the leading judgment on 16 October 2014 ([2014] EWCA Civ 1349).

- Fraudulent devices are a "sub-species" of the fraudulent claim rule.

- "The drastic effect of forfeiture is what gives it its deterrent effect and its justification rests on that basis."

- The Human Rights Act 1998?

- The Supreme Court handed down its judgment on 20 July 2016.

- Lord Sumption gave the leading judgment. By 4-1 the Supreme Court held that the 'fraudulent device rule' does not apply to "collateral lies". The lie must go to the recoverability of the claim on the true facts **as found by the court**.

- The opinion was that forfeiture of the entire claim is not a proportionate sanction – it is possible for there to be a situation where a lie is dishonest but a claim isn't! The Insured gains nothing by telling it, and the insurer loses nothing if it meets a liability it always had.

- Lord Mance dissented – he preferred a test of whether the lie yielded "a significant improvement of the insured's prospects" **at the time the lie was told**.

Fundamental dishonesty

- CPR 44.16 – exceptions to qualified one-way costs shifting.

- *Gosling v Screwfix Direct Ltd* – the dishonesty must go to the "whole or a substantial part of the claim". "Incidental" or "collateral" dishonesty are excluded, though it need not relate to the entire claim.

- Section 57 of The Criminal Justice and Courts Act 2015. Applies to all personal injury claims where issued after 13 April 2015 and allows a defendant to seek dismissal of a claim where the claimant has an entitlement to damages.

- The court does not have to dismiss the claim if it would result in a “substantial injustice” (not defined). However, where the case is struck out, it is the entire claim, not just the dishonest part.

- The court will assess the amount it would have awarded had the claim not been dismissed and that amount is then deducted from the defendant’s costs.

- *Ivey v Genting Casinos (UK) Limited*:

"The fact-finding tribunal must ascertain (subjectively) the actual state of the individual´s knowledge or belief as to the facts and then determine whether his conduct was honest or dishonest by the (objective) standards of ordinary decent people."

The Insurance Act 2015

- The Law Commission made clear that they did not think it right that the Act should codify the law relating to fraudulent claims but instead should be used to provide clarity regarding the insurer's remedies.

- The definition of fraud and what constitutes fraud remains at the mercy of the common law.

The insurer's remedies

- The insurer will not be liable where there is a fraudulent claim.
- Sums previously paid in respect of the fraudulent claim can be recovered.
- By serving notice, there is a remedy of prospective avoidance from the date of the fraudulent act and there is no need to return the premium.
- Previous claims are not impacted.
- Section 14 – remedy of avoidance ab initio is abolished.

- The new Act uses the term fraudulent “act” rather than claim.
- In a situation where a fraudulent act has been committed and payments are made because the insurer has not discovered it but they then go on to discover the fraudulent “act” there is no statutory remedy. The Law Commission recommend a self-help remedy of express provisions.
- Part 5 of the Act deals with contracting out – especially in consumer contracts, an insurer cannot seek to impose a harsher penalty than is provided by statute. See also the transparency requirements.
- Third party claims are still not covered by the Act.

Another option?

- *Axa Insurance Plc v Financial Claims Solutions Limited and others*

- A recent Court of Appeal decision in which Axa recovered exemplary damages relating to costs incurred unravelling a complicated and organised motor fraud scam.

In summary

- We are still at the mercy of the common law – the lie must be material (not collateral) and will be assessed on the facts as found by the court.
- Third party claims are not covered by the Insurance Act 2015 and little has changed – but remember the remedy of prospective avoidance.
- The best advice is to use a self-help remedy!

Thank you and please stay in touch

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