

FRAUDULENT DEVICE: ENTIRE CLAIM FORFEITED

The law of England and Wales has long made it clear, by applying the “fraudulent claim rule”, that an insured who fraudulently exaggerates his claim forfeits any lesser claim which he could otherwise properly make.

In *Versloot v HDI Gerling*, the Court of Appeal has provided further warning of the serious consequences of acting fraudulently by confirming that if an insured uses a “fraudulent device” the entire insurance claim will also be forfeited, even if the claim is otherwise valid. Although similar to the “fraudulent claim rule”, the “fraudulent device rule” applies where an insured genuinely believes he has suffered the full loss claimed but seeks to embellish the claim with a lie rather than exaggerate the amount of the claim.

The Background Facts

The insured owned a vessel which was damaged by flooding in the engine room whilst at sea.

Prior to the claim incident, when the vessel was in a Lithuanian port in freezing conditions, the crew had used an emergency fire pump to clear ice from cargo hatches in order to enable cargo to be loaded. However, the crew then negligently failed to drain seawater from the pump and did not close a sea inlet valve. The seawater in the pump then froze and cracked the pump. When the vessel sailed, the ice in the pump melted and sea water leaked into the engine room damaging the engine beyond repair. The insured claimed approximately £2.5m under a Hull and Machinery policy due to crew negligence.

The insured used a fraudulent device to embellish the claim. The device was a letter from the insured’s General Manager embellishing the claim by telling insurers investigating the claim that the crew had reported hearing a “bilge alarm” at noon on the day of the flooding (i.e. whilst at sea) but they did not act on it as they had negligently attributed the alarm to the rolling of the vessel

The First Instance Decision

The Court found that the General Manager’s statement was a reckless misrepresentation as the crew had not heard any alarm. There was no basis to make such a representation as the General Manager had consciously decided not to ask the crew whether it was correct. The aim of the statement was held to be to tilt the evidence to establish crew negligence because flooding due to a different cause such as a lack of seaworthiness might have given insurers a defence.

The judge found that the insured had to forfeit its otherwise valid and recoverable claim because of its use of a fraudulent device. He was, however, concerned by the harsh effect that the rule had on the insured and leave to appeal was given.

The Court of Appeal's decision

The Court of Appeal did not share the judge's degree of sympathy with the insured and upheld the position that an insured who uses a fraudulent device will forfeit its claim. The main reasons given were:

- 1) The rule is consistent with insurance contracts being subject to a continuing duty of good faith.
- 2) There is a public policy justification as insurers are entitled to protection from fraud.
- 3) Whilst the effect on an insured may be draconian it only applies to those who are dishonest.

The Court was also asked to consider whether the forfeiture of an insurance claim due to a fraudulent device breached the European Convention on Human Rights by violating an insured's right to "peaceful enjoyment of possessions" (the possession here being the entitlement to an indemnity under the policy). Whilst the Court agreed that the rule did interfere with this right, it considered that the interference was justified as it was in pursuit of the legitimate aim of deterring fraud.

Insurance Bill 2014

The Insurance Bill, which is now awaiting Royal Assent having been passed by Parliament, contains a set of forfeiture rules which will apply where a fraudulent claim has been made. However, it remains to be seen whether these extend to the use of fraudulent devices in otherwise valid claims. The Bill provides that where the insured submits a fraudulent claim the insurer will not be liable to pay that claim, can recover sums previously paid in relation to that claim and can also choose to treat the contract as terminated with effect from the fraudulent act. The Courts may have to determine whether these new rules should apply to the use of fraudulent devices.

Summary

The decision will be welcome news to insurers but also serves as a salutary warning to insureds of the need for honesty when making a claim.

The fraudulent embellishment of an insured's claim has dire consequences for an insured.

If a Member has concerns about an inability to substantiate a claim it should raise them with its client. If, having done this, the Member suspects a claim is being fraudulently exaggerated and/or embellished with a lie, then it should contact us for guidance.

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