

Fraudulent Insurance Claims

By

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1. Preamble

- 1.1 This main subject of this paper is fraudulent claims on marine insurance policies under English law. But much of which I set out below is equally applicable to all types of insurance. I will address the general shape of English law with regard to fraud in the presentation of insurance claims, and the way in which the law works in practice.
- 1.2 This paper has been prepared so that, broadly, you can dip in or out of it at any particular point of interest; or read the whole narrative.
- 1.3 This paper is divided into 8 sections:-
 - 1.3.1 Introduction; the extent and types of fraud.
 - 1.3.2 The general attitude to “civil” fraud (by way of contrast) page 6.
 - 1.3.3 Insurance claims: pleading and proving fraud page 8.
 - 1.3.4 Does Section 17 MIA 1906 apply? page 12.
 - 1.3.5 The Fraudulent Claims Rule page 15.
 - 1.3.6 Insurance Claims and Implied Terms and developing fields page 19.
 - 1.3.7 Threats to the Fraudulent Claims Rule? page 24.
 - 1.3.8 Conclusions page 27.
- 1.4 In this paper I have set out certain key propositions of law and suggest how certain themes might be developed as the law progresses. I have not attempted to analyse each question down to the last detail nor have I set out a catalogue of authorities and references. I have only touched upon some which might be of particular interest and relevance.
- 1.5 I hope you find this paper of interest and of use.

2. Introduction

The extent of fraud

- 2.1 What is the extent of fraud? I do not have figures for the value of fraud on marine insurance policies worldwide, but purely by way of illustration I have a couple of figures, confined to the United Kingdom.
- 2.2 You may know that a new statute dealing with fraud, the Fraud Act, 2006 finally came into force fully on 15th January 2007. In 1998 the English Home Secretary asked the Law Commission to examine the existing law on fraud. The Law Commission conducted consultations and made final recommendations in 2002. The new Fraud Act is designed to implement some of the recommendations of the Law Commission. In a report for the Home Secretary (Home Office) and the Serious Fraud Office published in 2000, National Economic Research Associates estimated that the annual economic cost of fraud in the UK was about **£14 billion**. This is a monumental figure; a startling estimation of the extent of dishonesty, given opportunity and inclination.
- 2.3 But what about fraud confined to insurance? As you may be aware the English Law Commission and the Scottish Law Commission have jointly issued a Scoping Paper as part of the process of setting up a joint review of insurance contract law. In the context of that review they have issued further papers, including those addressing non-disclosure and warranties. The Law Commissions are seeking feedback on proposed amendments to the law, both in England and Wales and in Scotland. The English Law Commission last considered insurance contract law in 1980 when it looked in particular at non-disclosure and breach of warranty. You may remember that its conclusion then was that the law was “*undoubtedly in need of reform*” and that such reform had “*been too long delayed*”. Certain recommendations were made but not implemented.
- 2.4 The new Law Commissions’ Scoping Report identifies a whole catalogue of possible areas for review or reform. This includes post-contractual good faith and fraud (which are touched on in this paper). In any event, in the section on fraud it is reported that in March 2005 the Association of British Insurers estimated the average total value of dishonesty in claims detected per week was £3.5 million, or £180 million per annum.

Methods of detecting fraud

- 2.5 These are no doubt many and various. Tackling fraud requires specialist knowledge and advanced technical capabilities. Our firm has a contribution to make in this. We operate NETFOIL which is a counter fraud solution designed to identify and tackle fraud and to provide security and financial savings for businesses. In a nutshell, NETFOIL holds details of about 20 million claims across all sectors and classes of claims and is continually updated by data providers. Mass Data Analysis (MDA) enables NETFOIL to cross reference claims data against a very large database looking for matches against known fraudsters and fraud indicators. The purpose of this is to allow insurers (and other organisations) to have their claims portfolio analysed to identify high risk claims. We currently operate NETFOIL for a number of UK insurers.
- 2.6 This brings me to types of fraud, particularly in the maritime context.

Deliberate Loss: Scuttling

- 2.7 The most obvious example of a fraudulent claim is where the assured procures a loss in order to claim upon the policy. Paul Todd, in his book *Maritime Fraud*¹ says that scuttling is “*probably quite common*”.² The same might also be true for arson and, perhaps, in such circumstances it might be easier for an assured to demonstrate loss by an insured peril.
- 2.8 In the shipping market the market value of a ship may fluctuate. A ship may be mortgaged for an amount which was less than her value when bought, but is now greater than her present value. And that ship will be insured on a valued policy for at least the amount of the mortgage. There are good business reasons why vessels may be insured on valued policies for more than they are presently worth. However, when this occurs the temptation to scuttle her or cast her away her may appear. And wherever there is temptation, there will be those who yield to temptation.

Exaggeration

- 2.9 There is another clear example of a fraudulent claim, which may occur when there is not a total loss but a particular average loss.
- 2.10 A householder who has genuinely suffered a burglary and genuinely lost some of the contents of his house, may exaggerate his claim by pretending that items he never actually had had been stolen. By contrast a shipowner should find it more difficult to allege that his ship had items of equipment which she never had, and these items had been lost or damaged. This is because the ship’s documents amount to a sort of inventory of all the pieces of equipment on board. Nor is it likely that a shipowner should find it easy to allege that repairs had been done which were not done. Repairs are (generally) done by shipyards which are usually quite large businesses, and it might be thought necessary for the shipyard to co-operate in the fraud by issuing a fraudulent invoice. Further since repairs are often followed by surveyors from Class, it might also be thought necessary for the shipowner to collude with them (and I am not for one moment suggesting they do). This is where, for example, photocopy documents can present risks.
- 2.11 But let’s look at a theoretical example. Let’s say a shipowner alleges that, when carrying out work on the vessel’s main engine, as part of a larger repair the crew drained the whole system of lubricating oil and subsequently replaced the whole charge (at a cost of several thousand dollars). The owner then produces what appears to be fraudulent invoices from a bunker supplier to support the allegation that a complete fresh charge of lubricating oil had been supplied, he might do this because he feels his claim might be “***beaten down***” anyway and is hoping by this means to reach the “***right number***”. But plainly, this is not permitted; and can have devastating consequences as we shall see.
- 2.12 One must distinguish this sort of exaggerated claim from the sort of negotiation which naturally takes place when there is an insurance claim in respect of repairs to a vessel.

¹ Lloyds of London Press, 2003

² Paragraph 6.38, page 125

- 2.13 For example, when the facts as to repairs, and the other work which has been done in a shipyard, are out on the table between the Salvage Association/Underwriters' surveyors and the owners' Adjusters, there may then be a debate as to the allocation of the yard's general account between the insurance claim and "Owners' work". The owners' Adjusters may start off by maintaining that the whole of the general account should be allocated to the insurance claim. If the facts are out on the table, there can be no fraud in adopting a negotiating position and attempting to argue for a higher claim amount.
- 2.14 So, there has to be a distinction between the situation where:-
- 2.14.1 what is put forward is put forward as a fact on which the insurers are invited to rely (as with the allegation that the complete charge of lubricating oil was disposed of and replaced), and
- 2.14.2 the situation where what is put forward is a negotiating position, which the insurers are well able to recognise and respond to.

"Fraudulent Devices"

- 2.15 This brings me to what the English Courts call a "fraudulent device". This is the situation where a claim, which may in itself be genuine and not exaggerated, is supported by fraudulent evidence. It is possible that a shipowner may in fact have been in compliance with the terms of his insurance on their true construction, but he may have been afraid (say) that he might have been in breach of warranty, and may have produced fraudulent evidence that the warranty had been complied with. This is a hazardous path.
- 2.16 The most obvious practical significance of the law with regard to "fraudulent devices", is that it may be possible to show quite cheaply:-
- 2.16.1 that **fraudulent evidence** has been produced in support of a claim; but
- 2.16.2 not possible to show (or at least, not without the much greater expense of a full trial) that **the claim itself** is not genuine.
- 2.17 Obviously, it is not possible to infer, merely because fraudulent evidence has been produced in support of a claim, that the claim itself is not genuine. However, if the assured produces false evidence in support of a claim, he will forfeit the claim even if the claim is genuine. Insurers can in these circumstances have the claim dismissed without incurring the risks and expense of a full trial.

Non-disclosure?

- 2.18 A final type of situation: suppose that a vessel had sustained damage which was genuinely covered by her hull insurance, and had been in the yard for repairs, and that there is no falsification or exaggeration in the yard's invoice, which the assured (with the assistance of a payment on account from underwriters) pays and then claims by way of a final adjustment of the claim. But, the fact which appears nowhere in the adjustment, and which the assured never mentions, is that when the assured company (the Registered Owners of the vessel) pays to the yard its invoice for (say) \$300,000 the yard then pays its representative in the Owners' home country a commission of 5% on the amount received. The representative then pays the Managers of the Owners (a separate legal person,

although let's say it is another company belonging to the same individual) most of this commission. By this means the shipowner receives a small sum of (say) US\$10,000 effectively at the Insurers' expense. This is not precisely "fraud". Neither the Owners nor their representatives on their behalf have said anything at all which was not strictly and literally true. Rather, it is only a case of the non-disclosure of a fact which might have been of interest to the Insurers in their consideration of the claim.

- 2.19 The latest set of Hull Clauses promulgated by the London Market (the "International Hull Clauses (1/11/03)") include an attempt by the market to deal with some of these problems by way of express contractual provisions, to the effect that a claim will be forfeit if the assured knowingly presents false evidence in support of it, or fails to disclose matters which are relevant to underwriters' proper consideration of the claim.³
- 2.20 However, I understand that the take-up of these new clauses has (as yet) been rather limited. The London Market does not refuse to write insurance on the previous versions of the Institute Time Clauses (1983 and 1995). The market of brokers and shipowners appears, thus far, to have preferred the previous versions. One can only speculate as to why. Perhaps one reason is the reluctance of shipowners (indeed insureds generally) to be the "guinea-pigs" for new clauses. No-one would wish to be the owner whose claim depends on the precise meaning of a new wording, so that his claim turns into the "test case" on the meaning of a particular wording, with the resulting legal expenses (risk and delay). Indeed, I have heard a well-respected broker say in a public lecture that one reason why the new "International Hull Clauses" are slow in gaining acceptance is precisely these provisions with regard to fraudulent evidence and non-disclosure in the claims process.
- 2.21 The broker said very clearly that he would not defend for one moment anyone who contemplated knowingly making use of fraudulent evidence in support of a claim. However, there was a wide "gray" area with regard to non-disclosure of relevant information.
- 2.22 Let's take an example. Say there is a claim for unrepaired damage. The amount of the indemnity will depend on the market value of the vessel in her unrepaired state, as distinct from what her market value would have been if she had not been damaged. The assured's representatives may consult a number of sale and purchase brokers, seeking opinions on these questions of valuation, and may then present to the underwriters (obviously) the opinion which was most favourable to a claim. Imagine how the shape of negotiations would change if the assured were compelled to disclose **every single opinion** which had been requested.⁴

³ International Hull Clauses (1/11/03) clause 45.3. These provisions are made somewhat less stringent, because they only attempt to deal with the situation before Court proceedings have been commenced, and also (by clause 45.4) do not require the disclosure of documents which are protected by "privilege" under English Law. Thus, these provisions (like the principle of law with regard to fraudulent claims, which I will discuss below), have nothing to say about the assured who first begins to concoct false evidence in support of his claim after Court proceedings have been commenced. Also, since in many cases of total loss of a vessel, solicitors are involved from the beginning of the investigation, and the evidence of the vessel's personnel will be in the form of witness statements taken by the solicitors, much of the relevant evidence may be protected by "privilege" and not have to be disclosed under these provisions.

⁴ This example also shows that the necessary distinction which I drew above between matters of fact and negotiating positions, is not entirely clear. It may well be said that the broker's opinion evidence as to the value of a vessel is not exactly fact, and perhaps lies somewhere in between "facts" and "negotiating position". (After all, where a sale and purchase broker is not engaged in giving opinion evidence, he may be professionally engaged in "talking up" or "talking down" the values of vessels).

2.23 As a result, insurers writing hull policies (as distinct from other classes of cover) and which are governed by English law are unlikely to be able to rely on express contractual provisions dealing with such issues. They may have to continue to rely instead upon the general principles of English law with regard to fraud in the presentation of insurance claims, to which I will turn to shortly below

3. The attitude of the English Courts to fraudulent claims in general – not insurance claims

3.1 Before turning to the specifics of English law on fraud in the presentation of **insurance claims**, it might be worthwhile (by contrast) to look at how English law generally treats fraudulent claims; which are **not insurance claims**.

Exaggeration

3.2 With regard to **exaggerated** claims, there are many cases before the Courts in which claimants who have genuinely suffered personal injuries deliberately exaggerate the extent of the resulting disability, and are simply pretending that they are incapable of activities of which they are in fact perfectly capable.⁵ With such claims, I need only quote from an article by the Vice President of the Forum of Insurance Lawyers:

3.2.1 ***“Under the current system, a claimant who brings an exaggerated claim and is unsuccessful will have the exaggerated elements disregarded and still recover legitimate elements of the claim ...”***⁶
(my emphasis).

3.3 The only consequence for the personal injury claimant who has exaggerated his claim may be in terms of the recovery of legal expenses. A claimant who has exaggerated his claim may not recover his legal expenses from the defendant; at least not in the way (or amount) that a successful claimant would normally recover legal expenses under English law and practice.

3.4 For example, in a recent case which came before the English Court of Appeal, the claimant had served a schedule of damages claiming more than GBP1m, and this was reduced by negotiation between the parties to GBP240,000. But, the claimant recovered at trial only GBP55,000, and the Judge specifically found that in the claimant’s evidence given at the trial he had exaggerated his disability. The claimant received, in place of the usual order for 100% of his legal expenses as “assessed”, an order for 75% of his legal expenses as “assessed”.⁷

However, it is a matter of fact that the various brokers whose opinions the assured’s representatives obtained, held the various opinions which they did hold.

⁵ I should emphasise that I am not meaning to speak about those individuals who have a physical disability, and in addition to that are affected psychologically in such a way that there are activities of which they might be physically capable, but which they genuinely believe that they are not capable of and do not even attempt to perform. In my text, I am meaning to speak about those individuals who are, quite straightforwardly, pretending that the extent of their disability is greater than it really is.

⁶ Lea Brocklebank, in *Legal Week* 3 August 2006.

⁷ *Jackson –v- Ministry of Defence* [2006] EWCA Civ 46, summarized in *Civil Procedure News* 14 March 2006.

Fraudulent Devices

- 3.5 With regard to “***fraudulent devices***”, there is an interesting case with a maritime background proceeding before the Scots Courts. It relates to a claim following the pollution resulting from the wreck of the “***Braer***” off the Shetland Islands, and the resulting fishing exclusion zone along the West coast of Scotland. A group of companies (all owned by one individual, and including a company named Shetland Sea Farms Ltd), would appear to have suffered a genuine loss. The group had intended to place salmon smolt (which the group bred in the South of Scotland) into fish farms in the area of the Shetland coast, which was prohibited because of the pollution, and to grow them to maturity there. Because of the prohibition (exclusion zone) they were unable to do so. The claim was not paid by the International Oil Pollution Compensation Fund. The Fund took the view that the amount to be paid should take into account the extent to which the group of companies as a whole had been able to mitigate their losses, by growing some of the smolt intended for Shetland in its other fish farming facilities elsewhere in Scotland.
- 3.6 Shetland Sea Farms Ltd presented a claim before the Scots Courts, treating the arrangements between the companies within the group as if they were contracts made at arm’s length. Shetland Sea produced ***falsified letters*** as purported evidence of the alleged contracts. There were two trials before the Scottish equivalent of the English High Court, at the first it was held that the letters had been falsified.⁸ At the second it was held that the witnesses from Shetland Sea Farms had been involved in a fraudulent scheme. The Judge requested the Scottish prosecuting authorities to consider bringing criminal proceedings against three of the witnesses.⁹ Nonetheless, the Scots Courts allowed the civil claim to proceed on the basis that there were no legally-binding contracts, but that there was indeed a genuine lost opportunity to make a profit by rearing salmon smolt in Shetland.
- 3.7 In one of the judgments in this case, the Judge in the Court of first instance said:
- “in my opinion, the court’s disposal of the matter must depend on the question whether the dishonesty has made a fair trial of the issue impossible. If it has, the court has a duty to stop the proceedings in order to protect the innocent party from an injustice. But if the dishonesty is found out and desisted from and if, in consequence, a fair trial of the essential claim remains possible, the court ought not to stop the proceedings. To do so in such circumstances would simply be judicial retaliation for the affront to the court”.***¹⁰
- 3.8 Although this is a Scottish judgment, almost all the authorities referred to by the Judge are English decisions. I have no reason to suppose that the law as stated in this judgment is not also the law in England.

⁸ [2001] Scot CS 178.

⁹ *Assuranceforeningen Skuld –v- International Oil Pollution Compensation Fund* (Court of Session, Outer House, Lord Hardie, 28 May 2003), www.scotcourts.gov.uk/opinions/o76_95.

¹⁰ *Shetland Sea Farms Ltd –v- Assuranceforeningen Skuld* [2001] ScotCS 178, at paragraph [146]; [2004] SLT 30 at page 32.

4. The attitude of the English Courts to fraudulent claims in general – pleading and proving fraud

4.1 What about insurance claims? In an insurance case (just as in any other civil case) it is difficult to plead and prove fraud. What is required?

Pleading fraud

4.2 It is not a simple matter for one party taking proceedings before the English Courts to allege that the other party has committed fraud. This point applies to every sort of fraud, in the strict sense. Accordingly, it applies when an insurer wishes to allege:-

4.2.1 that the assured has cast away the vessel, or

4.2.2 that the assured has fraudulently exaggerated a claim, or

4.2.3 that the assured has bolstered his claim by a “fraudulent device”.

4.3 However, it may not apply to an allegation simply of non-disclosure, because non-disclosure is not fraud in the strict sense.

4.4 One cannot simply allege, in general terms, that the assured has committed fraud. There must be particulars, and these must include particulars of every element legally necessary to constitute the fraud alleged. There must therefore be particulars:-

4.4.1 Of who made the representation;

4.4.2 Of when and how they made it;

4.4.3 Of the falsity of the representation; and

4.4.4 Of the knowledge of the person who made it that the representation was false. (or, particulars of the evidence to show that the mental state of the person who made the representation was that he **did not care** whether what he was saying was true or false - recklessness.)

4.5 In England the legal profession remains divided into two, with separate qualifications and separate governing bodies for barristers (to speak broadly, the trial lawyers) and solicitors (to speak broadly, those who do all the rest of the work). In practice, the written Statements of Case of the parties (their “*pleadings*”) will be drafted by barristers. It is a professional rule of conduct for barristers that they must not allege fraud against a party, whether in a written Statement of Case or in argument at trial (for example, by way of a line of questioning in cross-examination), unless they have in their hands some *prima facie* evidence of the fraud which they would be alleging. This evidence has to amount to a *prima facie* case.

4.6 In practice, the combination of the need for full particulars and the need for *prima facie* evidence before pleading those particulars, can make it extremely difficult to plead fraud.

Practical conduct in absence of plea of fraud

- 4.7 As a result of this difficulty in pleading fraud, there is a whole sub-branch of English insurance law, which deals with the situation where insurers have not advanced a positive defence, but have simply not admitted the case alleged by the assured as to the cause of the loss, and have formally put the assured to proof (there was previously another avenue available, now closed: see section 5 below).
- 4.8 In all (or practically all) of these cases, the real issue between the parties is that the insurers suspect that the assured has willfully caused the loss himself (for example, by casting away the vessel in question) but the insurers cannot plead this case, and instead the trial must be conducted on the basis that the real issue between the parties is not mentioned out loud. The suspected fraud is the elephant in the room that no one mentions.
- 4.9 The rules of this specialised little sub-branch of the law specify the way the insurers' counsel can conduct the trial: thus, if the assured is a jeweler who says that he has suffered an armed robbery and lost US\$ 3m in goods, Counsel can put it to the assured that he has not proved that he suffered a robbery. But he cannot put to the assured what the insurers actually believe (or rather strongly suspect), which is that the assured received a visit by prior arrangement from a group of his friends wearing masks and carrying guns in order to terrify the assured's staff (who were not in the conspiracy) and who removed the stock, which was subsequently disposed of for the assured's benefit.

Proving fraud: What is the standard of proof?

- 4.10 Under English law, there are two different standards of proof, one in the case of civil proceedings and the other in the case of criminal prosecutions. Thus:-
- 4.10.1 in the case of a criminal prosecution, the charge must be proved "***beyond reasonable doubt***";
- 4.10.2 whereas in a civil case the allegations against the defendant need only be established "***on the balance of probabilities***".
- 4.11 In this way, it is perfectly possible for a ***criminal*** charge of murder brought against a person to result in acquittal; whereas in a ***civil*** case the same person might be found to have murdered the victim and may be held liable in damages to the victim's relatives.
- 4.12 However, under English law, where the allegation in a civil case is that a party has committed a crime, then the standard of proof seems to shift, and becomes something rather more than the ordinary civil "***on the balance of probabilities***", although it is still something less than the criminal standard "***beyond reasonable doubt***". English judges refuse to admit in plain words that there is an intermediate standard of proof here, and say that the standard is still the civil standard of the "balance of probabilities". However, they also say that where a crime is alleged against a party, the evidence needs to be "clear" in proportion to the seriousness of the crime alleged.
- 4.13 Roughly speaking, the effect of this requirement for "clear" evidence may be that an English judge trying a civil case will only find that a party has committed a serious crime if there is before him *no other reasonable explanation* of the evidence and of the party's conduct.

This may not be quite the same as “beyond reasonable doubt”, because with “beyond reasonable doubt”, one may be not just looking at the explanations presented, but thinking in more absolute terms; that is to say, asking not just whether the explanations presented were “unreasonable”, but whether one is sure that they are false. But conversely it may not be quite the same as the ordinary civil standard of proof, in that one may be thinking whether the explanation presented by a party is “reasonable”, as distinct from asking whether it is overall more probable than the alternative.

- 4.14 Despite difficulties in pleading and proving fraud, it is noticeable from the Law Reports that English judges do quite often find allegations of scuttling proved to the necessary standard. Obviously we do not see in the Law Reports all those cases where the insurers may have suspected scuttling (or other fraud). The explanation is obvious: the only cases of scuttling which come to trial are those where the insurers think (even if they are not always right) that they have sufficient evidence of the right sort to satisfy the “mindset” of an English judge and to satisfy the judge to the requisite standard of proof.
- 4.15 English judges do from time to time say things about the sort of evidence which is required to satisfy them on an allegation of scuttling (or on some other allegation of fraud) which are quite robust and revealing, in the sense of saying that they do not require special sorts of evidence, and in particular, do not require evidence which is particularly direct. An example is the view of Mr Justice Aikens said in *The “Milasan”*. I am setting out a longish section of the judgment because it illustrates the judicial approach clearly.

“(4) if a defendant insurer is to succeed on an allegation that a vessel was deliberately cast away with the connivance of the owner, then the insurer must prove both aspects [that is, both that the vessel was cast away deliberately and that the owner was a party to this] on a balance of probabilities. However as such allegations amount to an accusation of fraudulent and criminal conduct on the part of the owner, then the standard of proof that the insurer must attain to satisfy the Court that its allegations are proved must be commensurate with the seriousness of the charge laid. Effectively the standard will fall not far short of the rigorous criminal standard;

(5) although there is no “presumption of innocence” of the owners, due weight must be given to the consideration that scuttling a ship would be fraudulent and criminal behaviour by the owners;

(6) when deciding whether the allegation of scuttling with the connivance of the owners is proved, the Court must consider all the relevant facts and take the story as whole. By the very nature of these cases it is usually not possible for insurers to obtain any direct evidence that a vessel was wilfully cast away by her owners, so that the Court is entitled to consider all the relevant indirect or circumstantial evidence in reaching a decision;

(7) it is unlikely that all relevant facts will be uncovered in the course of investigations. Therefore it will not be fatal to the

insurers' case that "parts of the canvas remain unlighted or blank";

- (8) *ultimately the issue for the Court is whether the facts proved against the owners are sufficiently unambiguous to conclude that they were complicit in the casting away of the vessel;*
- (9) *in such circumstances the fact that an owner was previously of good reputation and respectable will not save him from an adverse judgment;*
- (10) *the insurers do not have to prove a motive if the facts are sufficiently unambiguously against the owners. But if there is a motive for dishonesty then it may assist in determining whether there has been dishonesty in fact.*¹¹ (My emphasis)

4.16 However, on one point, it does seem that English Judges are reasonably easily convinced on the balance of probabilities. If a Judge has been satisfied (to the requisite standard of proof, (which may be "no other reasonable explanation") that a vessel has been deliberately cast away by members of the crew, then he may well be satisfied by the smallest of indications together with evidence of some motive, that the vessel was cast away with the complicity of the assured shipowner.

4.17 It may be that the Judges are permitting themselves the thought that some shipowners (even those who are otherwise respectable people of good reputation) do indeed commit this type of crime from time to time. Alternatively, it may be that Judges consider, that in most cases it will not be a "reasonable explanation" to suggest that the crew may have decided to cast away the vessel (barratrously) on a whim. By and large, people do not do such things without a motive, and, realistically, the assured is likely to be the only person with a motive.¹²

4.18 In general, despite robust remarks such as those made by Mr Justice Aikens, it is worth bearing in mind the closeness of the relationship between the mindset of barristers and the mindset of judges within the English system. On the one hand, judges are former barristers, who have learned to think in the way that barristers think. Thus, the judges who put forth such robust remarks were previously barristers with the barrister's reluctance to plead fraud. On the other hand, barristers think in the way in which they do because they have learned not to think the things which judges do not wish to hear: if barristers are reluctant to allege fraud, this is because the judges before whom they appear do not wish to hear allegations of fraud unless they can be supported by evidence to the high standard which these judges require.

¹¹ *The "Milasan"* [2000] 2 Lloyd's Rep 458 at page 468

¹² The "exception which proves the rule" is the one case in which the English Courts have held that a vessel was cast away by a member of the crew "for fun" and without the complicity of the owner – *The "Michael"* [1979] 1 Lloyd's Rep 55 (Kerr, J); [1979] 2 Lloyd's Rep 1 (Court of Appeal).

5. Principles of English law on the presentation of insurance claims – Marine Insurance Act 1906, section 17

5.1 Given these difficulties in the way of pleading and proving fraud, it is not surprising, as I have suggested, that insurers confronted by claims which they believe to be fraudulent, have found it attractive to do something other than pleading the fraud which they suspect. A plea of fraud is often the last weapon out of the armoury.

The “old” approach

5.2 About 15 years ago trainee barristers were taught as a matter of routine to plead that:-

5.2.1 the assured owed to the insurers a duty of utmost good faith in the presentation of the claim; and

5.2.2 that in pursuance of this duty the assured was obliged to disclose certain facts; and

5.2.3 that these facts were not disclosed.

5.3 Following through on the routine, the trainee barrister was taught to plead that:-

5.3.1 the insurers were therefore entitled to avoid the policy of insurance; and

5.3.2 the insurers had avoided it alternatively now were avoiding it, and therefore were not liable in respect of any claim.

5.4 As you will know, under English law the duty of disclosure which rests on a proposer for insurance (prior to the making of the insurance contract) is extraordinarily strict. The proposer must disclose not only facts which he **actually knows** but facts which in the ordinary course of his business **he ought to have known** (so called constructive knowledge), and he must disclose not only facts which he realizes are relevant or which a reasonable person in the position of the proposer would realise were relevant, but any facts which a reasonable underwriter would wish to know about the risk.

5.5 I suspect that the idea of “utmost good faith in the presentation of a claim” was never pleaded with quite this (pre-placement) degree of strictness: I think that it was always supposed that the assured had in some sense to be aware of the facts in question, and had to be in a position to realize that they were relevant to the claim. However, it was thought that it would probably be enough to show that the assured had been aware of these facts at some relevant time, without needing to show that he was consciously aware of them at the precise moment when he authorised the presentation of the claim, still less needing to show a conscious intention to mislead the underwriters. Thus, although some “particulars of knowledge” might be required, this line of pleading was much more attractive (and easier) than pleading fraud.

5.6 This line of pleading also had some interesting ramifications. There is one case in the Law Reports where the assured did not present a claim to the underwriters at all but simply commenced proceedings on the claim. The underwriters responded by pleading a breach of the duty of utmost good faith in the presentation of a claim, simply on the basis that by

not presenting a claim and not disclosing any facts or documents, the assured was in breach of a duty of good faith.¹³

- 5.7 This whole line of pleading was based upon section 17 of the Marine Insurance Act 1906 which is as follows:

“Insurance is uberrimae fidei

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”.

- 5.8 This line of pleading, relying on Section 17, arises from the judgment of the High Court in *The “Litsion Pride”* in 1985.¹⁴
- 5.9 However, the one point in English law in the insurance claims field which seems absolutely clear is that since the decision of the House of Lords in *The “Star Sea”* (which my firm took successfully to the House of Lords)¹⁵, *The “Litsion Pride”* is no longer good law. Section 17 of the Act cannot now be applied to the presentation of claims in the way envisaged by that line of pleading. There is therefore no duty of full disclosure in the presentation of a claim and thus no remedy of avoiding the policy for a failure to make such full disclosure.

The “new” position

- 5.10 But, it is much less clear what the law on the topic now is. There are a number of reasons for this confused state of the law. Perhaps the main one is simply that the law is in the process of shaking itself up, and has not yet settled down into a new position. There are also more detailed points, for example that in *The “Star Sea”* counsel for *both parties* argued the case on the basis of a duty of utmost good faith, as set out in section 17 of the Act, did continue to apply after the contract had been formed, and the two sides argued the case simply over the question what would be the **content** of that duty after the contract had been formed, in the presentation of a claim (rather than whether the duty **existed** at all). It seems that the Judges in the House of Lords did not thoroughly shake themselves free of the way in which the case was argued by counsel before them.
- 5.11 I am not intending here to embark on an analysis of the judgment in *The “Star Sea”* and of the two or three leading judgments from the Court of Appeal which have followed it, one of which (*The “Mercandian Continent”*)¹⁶ may or may not have been superseded completely by the subsequent judgment of the Court of Appeal in *The “Aegeon”*¹⁷
- 5.12 Instead, I will try to set out in this section of this paper, and the following two sections, where I think English law on this topic seems to be going. Even if I am right, I cannot

¹³ *The “Sagheera”* [1997] 1 Lloyd’s Rep 160

¹⁴ *The “Litsion Pride”* [1985] 1 Lloyd’s Rep 437

¹⁵ [2001] UKHL 1, [2001] 1 Lloyd’s Rep 389

¹⁶ [2001] EWCA Civ 1275, [2001] 2 Lloyd’s Rep 563

¹⁷ *Agapitos –v- Agnew* [2002] EWCA Civ 247, [2002] 2 Lloyd’s Rep 42

predict how quickly the development of the law in decided cases would reach the position which I am suggesting. Indeed, the development may be delayed because when parties can see the direction in which the wind is blowing, they may settle their cases rather than incur the expense of taking a case to the House of Lords so as to give their Lordships the opportunity of issuing a judgment which has been “in the pipeline” for some time. Also, this process of development may be interrupted: some new set of ideas may come onto the scene and influence the development of the law.¹⁸ I can only say what the effect of the ideas present in the recent judgments of the House of Lords and Court of Appeal would be, if these ideas were to come to their full development.

- 5.13 The first of these ideas, when fully developed, is that section 17 of the 1906 Act has application only to the **formation** of a contract of insurance. This is not to say that it applies only when a person is proposing for a fresh policy. It will also apply in the case of amendments, variation or renewals. It may also, possibly, apply to the situation in which the assured is “held covered” and is required to give information to the underwriters in order for them to agree an adjustment to the premium. However, section 17 will have no application at all to the presentation of an insurance claim.
- 5.14 This is not to say that there is no place at all for any idea of “good faith” in relation to the **performance** of insurance contracts (as distinct from the **formation** of them) and in particular in relation to claims. On the contrary, it is appropriate to think in terms of an overarching idea of “good faith”, which distinguishes insurance contracts from most other contracts under English law. This idea, however, when considered as an overarching, general, idea, is rather unfocused. It is brought into focus, first, in the principle enacted in section 17 of the 1906 Act, which governs the formation of an insurance contract, and secondly (separately) in separate principles (which I will discuss in the next two sections of this paper) dealing with the presentation of claims and with the performance of the contract in general.
- 5.15 To conclude and recap this section: section 17 is dealing not with such a general, unfocused, idea of good faith, but with a specific principle. It has been established by the decisions of the English Courts that the:-
- 5.15.1 the principle in section 17 of the Act is to be viewed as a principle of law coming from **outside** the agreement between the parties, as distinct from an implied term which would be a part of the agreement between the parties; and
 - 5.15.2 following the wording of the Marine Insurance Act, the remedy in relation to this principle of law is always and only the avoidance of the insurance contract *ab initio*; and finally
 - 5.15.3 this specific principle, as enacted in section 17 of the Act, will apply only in relation to the formation of insurance contracts, and not to the presentation of claims.

¹⁸ In particular, through the process instigated by the Joint Law Commissions, which may possibly present fresh ideas

6. Principles of English law on the presentation of insurance claims – the fraudulent claims rule

- 6.1 There is a specific, draconian and anomalous rule of law with regard to the making of a fraudulent claim upon insurers; the fraudulent claims rule. This rule was set out (reiterated) authoritatively by Lord Hobhouse, who gave the leading judgment in the House of Lords in *The “Star Sea”*: It is helpful to set out the full quotation.

“Where an insured is found to have made a fraudulent claim upon the insurers, the insurer is obviously not liable for the fraudulent claim. But often there will have been a lesser claim which could properly have been made and which the insured, when found out, seeks to recover. The law is that the insured who has made a fraudulent claim may not recover the claim which could have been honestly made. The principle is well established and has certainly existed since the early 19th century. This result is not dependent upon the inclusion in the contract of a term having that effect or the type of insurance; it is the consequence of a rule of law. Just as the law will not allow an insured to commit a crime and then use it as a basis for recovering an indemnity, so it will not allow an insured who has made a fraudulent claim to recover. 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.

In Goulstone v. Royal Insurance Co. (1858), which concerned a fire policy and a plea that the claim was fraudulently exaggerated, Pollock, C.B. directed the jury that if the claim “was wilfully false in any substantial respect”, they should find for the defendant as the plaintiff had in that case “forfeited all benefit under the policy”. In Britton v. Royal Insurance Co. (1866), also a fire insurance case where it was alleged that the insured took advantage of the fire to make a fraudulent claim, Mr Justice Willes directed the jury:

The law upon such a case is in accordance with justice and also with sound policy. The law is, that a person who has made such a fraudulent claim could not be permitted to recover at all. The contract of insurance is one of perfect good faith on both sides, and it is most important that such good faith should be maintained. It is the common practice to insert in fire policies conditions that they shall be void in the event of a fraudulent claim; and there was such a condition in the present case. Such a condition is only in accord with legal principle and sound policy. It would be most dangerous to permit parties to practise such frauds, and then, notwithstanding their falsehood and fraud, to recover the real value of the goods consumed. And if there is wilful falsehood and fraud in the claim, the insured forfeits all claim whatever upon the policy. This, therefore, was an independent defence; quite distinct from that of arson.

Mr Justice Willes stressed to the jury that it was of the utmost moment that insurances should be enforced fairly and protected from fraud.

These authorities link the defence to the observation of good faith but are specifically based upon the actual fraud of the insured in making the claim. These judgments do not use the language of avoidance of the policy ab initio but refer to the forfeiture of “all benefit under the policy” or “all claim” upon it. It seems that the language used at the time in express clauses was similar.¹⁹

- 6.2 From the recent authorities, there are three particular points I should make about the application of this fraudulent claim rule.

Fraud

- 6.3 First, to apply to a claim this rule requires fraud. So, taking a representation made by the assured (or by a person who can be identified with the assured) as an example it must be not only false but known by the person making it to be false (or at least, the person making it did not care whether it was true or false, and in that demanding sense was “reckless” as to its truth).²⁰ Within this rule of law, there is no escape from the difficulties of pleading fraud and providing particulars of fraud (described above).
- 6.4 This specific rule embraces not only claims which are as a whole fraudulent (where the assured has scuttled his ship, or committed arson upon his building), but also claims which are fraudulently exaggerated (as discussed in section 1 of this paper)²¹ and claims which are promoted by “fraudulent devices”.²²
- 6.5 It has been suggested that for the purposes of the fraudulent claim rule there are four separate types of fraud: claims which are fraudulent as a whole, claims which are fraudulently exaggerated, claims where the assured makes fraudulent representations concealing the existence of a defence to the claim, and “fraudulent devices”.²³ I do not

¹⁹ *The “Star Sea”* [2001] UKHL 1 at paragraphs [62] – [64]; [2001] 1 Lloyd’s Rep 389 at page 403, with citations omitted.

²⁰ However, there is an authority, which is helpful for insurers, which establishes that if the presentation of a claim is entrusted to somebody as the assured’s agent, then a fraudulent representation by that agent will count as fraud by the assured - *Direct Line –v- Khan* [2001] EWCA Civ 1794; [2002] Lloyd’s Rep IR 364.

²¹ There is a qualification that the exaggeration must be “not insignificant”, and there may be a little doubt as to exactly how this is to be worked out. It seems clear that a claim for US\$300,000 for repairs to a ship will not be defeated because the assured fraudulently claimed US\$500 as the cost of garbage disposal, when the amount actually paid was US\$300. However, it is not quite clear whether the amount has to be significant in relation to the rest of the claim, or rather significant in “itself”. Presumably, the words “in itself” cannot be taken literally: presumably, an amount of US\$2,000, which would certainly be significant in the context of an individual’s travel insurance, and would probably be significant in the context of an individual’s insurance of the contents of his house, may not be significant in the context of the insurance of a vessel which may be valued at US\$50m.

²² Once again, there is a qualification, in that the fraudulent device must have not only been intended by the assured to assist this claim, but must have been such that on a reasonable view, at that stage of the presentation of the claim, it would tend to improve the chances of a more favourable outcome for the assured.

²³ Peter Macdonald Eggers, Simon Picken and Patrick Foss *Good Faith and Insurance Contracts* (2nd edition, Lloyds of London Press, 2004) paragraph 11.42, page 263.

think that the most recent authorities deal directly with the third of these categories, of fraudulent representations concealing the existence of a defence to the claim. But it may not matter whether this is a separate category, since any such fraudulent representation should be a “fraudulent device”.

- 6.6 Perhaps the cruelest lies are told in silence. But I anticipate that when this principle is fully developed, it will be absolutely established that it requires a fraudulent representation, and that a mere non-disclosure (however deliberate, and however much it intended to mislead) does not fall under this rule.

Timing: When will the duty end?

- 6.7 The second point to emphasise is the time during which this rule applies. Following *The “Star Sea”* and *The “Aegeon”*, it is clearly established that this rule only applies **before** commencement of Court or arbitration procedures.
- 6.8 The reason given for this is that after the commencement of proceedings, the rights and obligations of the parties are governed by the rules of Court (or by the rules of the arbitration to which they have agreed) and there is no need for an additional obligation governing the conduct of the assured during Court proceedings. However, I suspect that the judges from the nineteenth century, whose judgments were quoted by Lord Hobhouse in *The “Star Sea”*, might have been surprised to hear that it was considered that this rule of law did not apply to the presentation of a claim by way of court proceedings.

Forfeiture of “the claim”: What exactly is forfeit?

- 6.9 The third point which I should emphasise from the recent authorities is the extent of what is “forfeited” by the assured who has committed a fraud to which this rule applies.
- 6.10 I suspect that the nineteenth-century judges who used the language of “*forfeiting all benefit under the policy*” would have meant the words “*all benefit*” quite literally, so that as from the moment when the assured committed a fraud, the assured would have no further right to any payment under the policy. Therefore, as from the moment when the assured committed the fraud, the insurers would be entitled to have nothing further to do with this assured. If for example, there was a previous unpaid loss occurring before the moment when the assured committed the fraud, and which was completely unrelated to the claim in relation to which the assured or the assured’s agents committed the fraud, then the assured would forfeit the benefit of that claim also. On the other hand, I would expect that the nineteenth-century judges might have considered that this “forfeiture” only entailed the loss of right to future payment from the insurers. So, where the assured had suffered a genuine loss, and had been **previously** paid for this in respect of the assurers **before** he committed the fraud, the assured would not have to repay the amount which he had received in respect of the genuine loss.
- 6.11 In effect, this would have been a division up of the “territory” of the assured’s rights to indemnity according to **time of payment** by insurers, with the dividing line being drawn at the moment when the assured committed the fraud.

- 6.12 However, in ***Axa –v- Gottlieb***²⁴ the Court of Appeal has decided that the territory of the assured’s rights to an indemnity should be divided up in a different way. The rule of law with regard to fraudulent claims should lead to the forfeiture of the whole of the claim in relation to which the fraud was committed, but this rule should not lead to the forfeiture of any other claim. This means, on the one hand, that where a claim was initially presented on an entirely genuine basis, and a payment on account was made, but then in the final presentation of the claim there was a fraudulent element (for example as “fraudulent device” is presented), the whole of this claim would be forfeited and the insurers would be entitled to recover back the payment on account from the assured.
- 6.13 However, if the assured has an entirely separate claim, in relation to which there has been no fraud committed, and in respect of which he has not yet been paid at the time when the fraud was committed in relation to another claim, then (so far as the rule of law in relation to fraudulent claims is concerned) the assured will remain entitled to payment in respect of the “honest” claim. Indeed, it appears that if the assured suffers a genuine loss even in the period after the commission of the fraud, then provided the assured commits no fraud in relation to the claim for this separate loss, the assured will still be entitled (so far as the fraudulent claims rule is concerned) to recover in respect of this separate loss.²⁵
- 6.14 Lord Justice Mance, who gave the leading judgment in ***Axa –v- Gottlieb***, laid down the extent of the forfeiture in this way, because of the application of a separate rule of English insurance law, which is this: as a matter of the theory of the law, the obligation of an insurer to “indemnify” the assured is treated *not* (as common sense might dictate):-
- 6.14.1 as an obligation to pay a sum by way of indemnity within a reasonable time after the happening of a loss, but (rather crazily)
- 6.14.2 as an obligation to prevent the harm from happening to the assured; so that as soon as the harm has happened the insurer is technically in breach of contract.
- 6.15 If the insurer’s obligation was (in accordance with common sense) treated as an obligation to pay within a reasonable time, then fraud by the insured before the insurer had paid might have been treated as meaning that the insurer was no longer obliged to pay. However, under the (perhaps rather odd) theory the insured’s right to an indemnity is “complete” at the moment when the loss occurs, it cannot be treated as forfeited by an act of fraud, simply as such. Instead, Lord Justice Mance develops the different division of the territory, by which the assured retrospectively forfeits rights to an indemnity which were already “complete”, but only forfeits these rights to the extent that they are part of “the same claim”. It is perhaps regrettable that the law with regard to fraudulent claims has been developed on the basis of this separate rule which is not in accordance with common sense, and which has other inconvenient consequences, so that it might well in due time be swept away.

²⁴ *Axa General Insurance Ltd –v- Gottlieb* [2005] EWCA Civ 112; [2005] Lloyd’s Rep IR 369.

²⁵ This will be the position so far as the fraudulent claims rule is concerned, but there may also be other rules, which I will discuss in the next section. These other rules may well mean that the assured is not entitled to recover in respect of losses occurring after the commission of a fraud on the insurers. These rules will almost certainly mean that at the time when the insurers discover the fraud they are entitled to treat this as a “repudiatory breach” of the insurance contract, and terminate the contract on that basis, so that at least the insurers will not be liable in respect of any loss occurring after the time when they discover the fraud and take action in response to it.

- 6.16 The *Axa –v- Gottlieb* division up of the territory of the assured’s rights to indemnity may have interesting consequences for hull insurers, besides the possibility (which I have mentioned already) of recovering back a payment on account. Obviously, a great deal will depend on the definition of what is “the same claim” for the purposes of this rule.
- 6.17 In *Axa –v- Gottlieb* the event which was the operation of an insured peril was physical damage to the Gottliebs’ house, which led to claims for two types of loss. One was the cost of repairs (and in relation to this there appears to have been no fraud), while the other was a claim for alternative accommodation (and in relation to this the fraud was committed). The Court of Appeal confirmed that because of the fraud in relation to the alternative accommodation claim, the insurers were entitled to recover back the amounts which they had paid in respect of the cost of repairs. Thus, it appears that where there are losses of two insured types resulting from one operation of an insured peril, and fraud is committed in relation to the claim for one of the two losses, the claim in respect of the other loss also will be forfeited.
- 6.18 How should this apply to hull policies? I would speculate that this would mean, for example, that if damage to a ship on a voyage results both in a claim for salvage to bring the vessel from the place where the damage occurred to a place of safety, and in a claim for the cost of repairs, and there is a fraud committed in relation to the claim for repairs, then the insurers will be entitled to recover back from the insured whatever amount they may have paid in respect of the salvage claim.

7. Principles of English law on the presentation of insurance claims – possible contractual terms

- 7.1 In *The “Star Sea”* Lord Hobhouse said:

“Having a contractual obligation of good faith in the performance of the contract presents no conceptual difficulty in itself. Such an obligation can arise from an implied or an inferred contractual term . .

A coherent scheme can be achieved by distinguishing a lack of good faith which is material to the making of the contract itself (or some variation of it) and a lack of good faith during the performance of the contract which may prejudice the other party or cause him loss or destroy the continuing contractual relationship. The former derives from requirements of the law which pre-exist the contract and are not created by it although they only become material because a contract has been entered into. The remedy is the right to elect to avoid the contract. The latter can derive from express or implied terms of the contract; it would be a contractual obligation arising from the contract and the remedies are the contractual remedies provided by the law of contract. This is no doubt why Judges have on a number of occasions been led to attribute the post-contract application of the principle of good faith to an implied term”.²⁶

²⁶ [2001] UKHL 1 at paragraphs [50] and [52]; [2001] 1 Lloyd’s Rep 389 at page 400.

How are terms implied?

- 7.2 In general, English law is not very accommodating towards the introduction of implied terms into a contract. There are two possible bases for introducing them: one by reference to what is required to make the particular contract “work”, and the other by reference to the legal nature of the relationship between the parties to the contract. When dealing with the first of these bases in particular, English judges quite frequently say that the Courts will not introduce an implied term simply because it would be **reasonable**, but only if it is **absolutely necessary** to make the transaction work, or if a “bystander” would have said that this implication was **absolutely obvious**, as distinct from merely being something to which the parties would have agreed if they had been acting reasonably.
- 7.3 But, in the case of insurance contracts, there is at present a wide opportunity for the Courts to introduce terms as based upon the legal nature of the relationship between the parties. There is absolutely undeniable authority that the language of “good faith” is appropriate not only when an insurance contract is being formed, but when the contract is being performed, and it will be natural to derive from the unfocused, overarching, idea of “good faith”, specific rules applying to the performance of an insurance contract which may take effect as implied terms of the contract.
- 7.4 In general, one might think that it was rather late in the day for the Courts to start discovering the implications of a long-established type of legal relationship. However, in the case of insurance contracts the field was for a long time occupied by what is now considered an erroneous application of the principle stated in section 17 of the Marine Insurance Act (see above). Now that this erroneous principle has been cleared out of the way, the field is open for the Courts to “discover” the true implications of the legal relationship between an assured and an insurer. Indeed, the language used by Lord Hobhouse in *The “Star Sea”* is an invitation to Judges to devise such implied terms.

What would be the character of the terms?

- 7.5 I have deliberately used the expression “implied terms”, and not of a single implied term of “good faith”. I am indebted here to a very helpful paper by David Foxton “*the post-contractual duties of good faith in marine insurance policies: the quest of elusive principle*”. Mr Foxton says:

“A number of commentators have supported an approach which recognizes a number of different duties of good faith in the post-contractual context, in which both the nature of the duty and the remedy are ‘moulded to the moment’.”²⁷

- 7.6 Thus, the way may be open for an implied contractual term which would require of the assured something more than merely abstaining from fraud, and more like a full disclosure of information.
- 7.7 However, the implied terms which may be derived from the nature of the relationship between the assured and the insurer may impose duties upon the insurer as well as upon the assured. And these duties may relate not only to “good faith” understood in terms of honesty and in terms of the disclosure of information, but also to other ideas which may be

²⁷ At paragraph 6 of his paper prepared for a Symposium at Swansea University in 2005.

brought under the heading of “good faith”. It may be said that in the relationship between the assured and the insurer, the insurer has (even after the contract has been formed) to continue to rely upon the assured for information, and this aspect of the relationship will give rise to duties upon the assured to disclose information and to do so honestly. On the other hand, the nature of the relationship is such that the assured has to rely upon the insurer for things quite different from information.

7.8 There is a very helpful discussion in Mr Foxton’s paper of the application of the concept of “good faith” to the post-contractual relations of insureds and insurers *“in situations in which one party is exercising rights in which the other has a legitimate (but antithetical) interest, in order to ensure that those rights are exercised fairly as between the two parties”*.²⁸ Under this heading, Foxton speaks about:-

7.8.1 the insurer’s right to control the defence of a claim in liability policies;

7.8.2 the insurer’s exercise of rights of subrogation (in circumstances where the assured may have its own interest, because the policy has a deductible, or because there is a possibility of recovering uninsured heads of loss);

7.8.3 “follow the settlements” clauses in reinsurances, where the reinsurer has to rely upon the reinsured to act in a businesslike way; and

7.8.4 claims control clauses where the reinsured may have to rely upon the reinsurer not to refuse consent to a settlement arbitrarily or by reference to considerations which are extraneous to the claim which the reinsured wishes to settle.

7.9 However, the main way in which insureds have to rely upon insurers follows from the fundamental purpose of insurance, which was classically stated in the marine insurance context as being that the misfortune which may occur to one individual should not be the ruin of that individual, but rather should fall upon many. The assured has to rely upon the insurers to prevent him from being ruined and enable him to continue his business. Given the way in which the field is open for the Courts to “discover” implied terms, and given the way in which debate in England is tending, I believe it is very likely that within a few years English law will include implied terms requiring insurers:-

7.9.1 not to refuse to pay claims except on the basis of a reasonable suspicion; and

7.9.2 to decide within a reasonable time whether to refuse claims or pay them.

Damages for breach?

7.10 This whole process of the development of implied terms may prove more beneficial to assureds than to insurers. Under English Law with regard to contracts in general, it is entirely straightforward for any term of the contract (including an implied term which is “discovered” by the Court) to give rise to a claim for damages by the injured party. In the case of breaches by the insurer of implied terms with regard to the handling and payment of claims, in particular, it may well be that damages are an adequate remedy for the assured, (even though English law will normally allow only compensatory damages, and not any sort of punitive damages). Also (and even if compensatory damages are not an

²⁸ Paragraph 60 of Mr Foxton’s paper

entirely adequate remedy for the injured assured) the prospect even of such damages may deter any insurers who might be tempted to act unfairly in handling claims.

- 7.11 However, it may appear that obligations upon the assured to disclose information when presenting a claim may not be of much use to insurers, if the only sanction is that where the assured has a claim against the insurers in respect of his loss, then the insurers will have a counterclaim for damages against the assured for whatever losses they have suffered as a result of the assured's failure to provide information. The burden would be on the insurers to prove and to quantify the losses for which they would be counterclaiming. If, at the end of the day, the assured's claim proves to be genuine, precisely what losses will the insurers have suffered as a result of the assured's failure to provide full and honest information when he first presented his claim?
- 7.12 The situation is to an extent parallel with express provisions in policies requiring the assured to give notice within a certain time of a claim or of circumstances which may give rise to a claim. Insurers may well feel that these provisions are not of much use if the situation is that the insurers have to pay the claim, and counterclaim for any losses which they can prove resulted from the failure to give timely notice. Insurers may well feel that such provisions only have a serious point if it is possible for the insurers to refuse to pay a claim if there is a serious failure to give notice.

Other consequences of breach of terms?

- 7.13 In principle, terms to be implied into contracts should not be restricted to terms giving rise to claims for damages. Logically, if a provision can be an express contractual term, then the same provision can also be implied. So all the types of term which are recognized by the law as possible types of express contractual term, should also be available as possible types of implied contractual terms. Would it assist the development of insurance law to fish in the common law contract pond for suitable terms and further remedies? Perhaps not.
- 7.14 Under the English law of contract in general, the types of terms available fall into three classes This is where insurance law diverges from the general law of contract. Contract law terms are:-
- 7.14.1 **“conditions”** [this is not the same use of the word “condition” as in relation to a “condition precedent” under insurance law] any breach of which gives rise to a right to terminate the contract;
- 7.14.2 **“innominate terms”**, where a sufficiently serious breach gives rise to a right to terminate the contract, but a less serious breach gives rise only to a claim in damages; and
- 7.14.3 **“warranties”** [this is not the same use of the word “warranty” as in English insurance law] which give rise only to claims in damages.
- 7.15 But, these notions of “[non-insurance] condition” and “innominate term” are not attractive for insurers as ways of handling a duty upon the assured in relation to the presentation of a claim, for two reasons.
- 7.15.1 First, in relation to both “[non-insurance] conditions” and “innominate terms”, the right of the injured party to terminate the contract does not operate retrospectively: the injured party's termination of the contract only takes effect:-

- 7.15.1.1 from the time when the injured party **discovers** the other party's breach and acts to terminate the contract; or (at best)
- 7.15.1.2 only with effect from the time when the other party **committed** the breach.
- 7.15.2 Under the peculiar rule of English insurance law, by which the assured's right to an indemnity is "complete" when the loss occurs, any breach of "[non-insurance] condition" by the assured in relation to a claim would **not** affect the assured's right to indemnity in respect of the loss which had already occurred and in relation to which the assured was claiming, but only in relation to any **future** losses which might occur.²⁹
- 7.15.3 Secondly, in relation to "innominate terms", the test imposed by English law for whether a breach is sufficiently "**serious**", is very stringent. It is said that in order for a breach to be (as it is called) "**repudiatory**", the breach must deprive the injured party of "**substantially the whole benefit of the contract**". In practice, it might be very difficult for any breach by the assured of an implied term relating to the disclosure of information on a claim to satisfy this test.

What about warranties and condition precedent?

- 7.16 But, there are further possible types of terms which are made available by English insurance law rather than by the English law of contract in general. In the same way as there may be express warranties (in the specific sense of insurance law) so may there also be implied warranties. Also, in the same way as there may be express "conditions precedent" to claims, so might there also be implied "conditions precedent".
- 7.17 With regard to possible warranties, David Foxton in his paper "*Fraudulent Claims: the law in eight principles*" suggests that it might be a warranty of the insurance that the assured should not commit fraud towards the insurer,³⁰ and in relation to fraud specifically, this is a very attractive suggestion.
- 7.18 However, in general (that is, apart from the specific case of fraud) it may be difficult for insurers to persuade the Courts to "discover" implied terms as warranties (in the sense of insurance law) or as "conditions precedent" to claims. If a term is a warranty, then it must be complied with exactly, or cover terminates as from the moment when the warranty is not complied with. If a term is a "condition precedent" to a claim, then any failure to comply with the condition, however small and however venial, leads to the loss of the claim. At present, such stringent concepts are not attractive to the English Courts.
- 7.19 Therefore, insurers would stand much more chance of persuading the Courts to discover implied terms with regard to the presentation of claims which the insurers might feel to be

²⁹ It is generally accepted as an implied "condition" (in the sense of general contract law, as distinct from insurance law) or at least an implied "innominate term" of an insurance contract that the assured will not commit fraud against the insurers, so that the insurers will have a right to terminate the contract for any fraud by the assured, or at least any "serious" fraud. However, it is generally considered that this analysis will mean that the contract is only terminated as from the time when the insurers discover the loss and take a step to terminate the contract, so that (as far as this right for the insurers is concerned) the assured will still be entitled to be paid in respect of genuine losses which occur before the time when the insurers discover the fraud.

³⁰ Paragraph 41 of Foxton's "*Fraudulent Claims*" paper for the Symposium at Swansea University in 2005.

useful, if there were some “half-way house” between a condition precedent and a term which would only give rise to a claim for damages. Logically, it would seem that in the same way as general contract law recognizes a “half-way house” between “conditions” (in the non-insurance sense) and “warranties” (in the non-insurance sense) and so allows there to be “innominate terms”, so insurance law should recognize a “half-way house” between “conditions precedent” (any breach which results in a loss of a claim) and terms which can only give rise to a claim for damages. With such a “half-way house”, any serious breach (but only a (very) “serious” breach) would give rise to the loss of the claim. If this less stringent type of term were available, then it might be much easier to persuade the Court to “discover” implied terms which would not only give rise to counterclaims for damages. In 2000, it appeared that the English Courts were allowing this as a possible type of term.³¹ However, this possibility has now been definitely rejected by the Court of Appeal under the leadership of Lord Justice Mance.³²

7.20 Overall, I suspect that the process of development of implied terms in insurance contracts will be of benefit to assureds, but will not be of assistance to insurers who wish to resist paying claims which they suspect to be dishonest. If I am right, Underwriters should persist in seeking to impose express terms, but only, of course, if the market will purchase such cover.

8. “Good faith”, the relationship between insurers and the assured, and the fraudulent claims rule

8.1 In sections 5, 6 and 7 of this paper, I have been looking at the likely development of the ideas present in the recent judgments of the House of Lords and the Court of Appeal in England. In this final section I want to look briefly beyond the ideas which are already present in the leading judgments, and consider a possible further development, which may present a threat to the fraudulent claims rule which I explained above.

8.2 In the context of English law and practice in general, the fraudulent claims rule is anomalous. It only applies to claims by party A against party A’s own insurers. Also, it only applies before the commencement of court or arbitration proceedings. It may seem that there is no explanation or justification for the law adopting a different attitude to fraud at one time rather than another and by one type of party only, and that this rule is supported only by authority, as distinct from any explanation or justification. In general, where rules of law are supported only by authority, they are in danger of being swept away.

8.3 There has already been judicial comment on one aspect of this apparent anomaly. In *The “Game Boy”*, Mr Justice Simon said:

“What is said by the insurer is that, even if the assureds had a valid claim, the claim must fail because the assureds have used fraudulent devices to promote the claim. The rule is in some ways anomalous since it only applies between the making of the claim and the start of litigation. After litigation has commenced an insured may advance false documentation and lie without the drastic consequences which follow if the deployment of false documentation and lies are less well timed. Nevertheless, the rule is presently well-established”³³

³¹ *Alfred McAlpine Plc –v- BAI (Run-Off) Ltd* [2000] Lloyd’s Rep IR 352.

³² *Friends Provident Life & Pensions Ltd –v- Sirius International Insurance* [2005] EWCA Civ 601; [2005] 2 Lloyd’s Rep 517.

³³ [2004] EWHC 15 (Comm) at paragraph [150]; [2004] 1 Lloyd’s Rep 238 at page 258.

- 8.4 One way of eradicating this “anomaly” would be for English law and practice to “harmonise up”; that is:-
- 8.4.1 to get “tougher” on fraud outside the relationship between an assured and an insurer; and
 - 8.4.2 “tougher” on fraud committed during the course of court proceedings.

Compare fraud to delay

- 8.5 With regard to fraud in the course of court proceedings, in particular, the present position appears quite extraordinary. Following the recent reforms to the English Rules of Court Procedure (the “Woolf reforms”) the English Courts have changed their attitude towards excessive delay in the course of court proceedings. The position used to be that a claim would only be struck out if there was not only “***inordinate and excusable delay***” by the claimant, but also that a fair trial was now impossible by reason of the delay, or that there had been prejudice to the defendant. However, the English Courts now seem willing to take a more aggressive attitude, and strike out claims for delay without requiring it to be shown that a fair trial is not now possible, or that there has been prejudice of some other kind to the defendant. The Courts seem to be willing to act in this way, in order to protect themselves from parties who clog up the system and waste the Court’s time by bringing claims and then failing to pursue them.
- 8.6 It appears extraordinary then that if the Courts are prepared to deal aggressively with parties who merely waste the Court’s time by failing to prosecute claims, they do not (yet?) act aggressively towards parties who waste the Court’s time by fraudulently exaggerating their claims or producing fraudulent evidence in support of them. After all, is not fraud much more culpable than simple delay?

Underwriters’ reliance on the assured?

- 8.7 How can the current fraudulent claims rule be explained / justified, and can we find in this the threats to its continued existence?
- 8.8 Part of the justification for the rule will have to be that just as in the context of a proposal for insurance the underwriter has to rely on the information supplied by the proposer, so equally in the context of claims also the insurer has to rely to some extent upon the information provided by the assured. But, the extent of the reliance may be greater with a proposal (where it is unrealistic to expect the underwriter to check the proposer’s information in many respects) than it is in the context of claims (where it is not so unrealistic to expect the insurer’s claims department to do some checking). For this reason, perhaps, the duty of disclosure upon a proposer is far more stringent than anything imposed by the fraudulent claims rule. Nevertheless, the justification for the fraudulent claims rule is that in this context also the insurer has to be relying on the information provided by the assured.³⁴

³⁴ If this is the basic justification for the fraudulent claim rule, then perhaps it may not be so “anomalous” that it does not apply in the same way after court proceedings have commenced, since in the context of court proceedings, the insurer is no longer relying in the same way upon information provided by the assured.

- 8.9 If that is indeed the justification for the fraudulent claims rule, then the rule itself may be under threat, because the insurer is (often) not in any real sense relying upon the information provided by the assured who handles claims.
- 8.10 In the context of hull insurance, in very many cases of total loss of vessels, the insurers conduct their own complete investigation into the cause of the loss and, for example, very often the surviving members of the crew are interviewed together by the solicitors for the owners and by the solicitors for the hull insurers.³⁵ In this context, it is not so easy to say that the insurers are relying on information provided by the assured.
- 8.11 There may be a parallel threat to the fraudulent claims rule (which is at present an overall rule applying to every type of insurance under English law) from the practice of insurers in relation to some types of “personal lines” insurance. For example, many insurers on travel insurances, in order to prevent fraudulent claims, insist that they will not accept the mere statement of the assured that he possessed an item which he alleges was lost, but require him to produce documentary evidence that he possessed it in the form of a receipt. When the insurer is not willing to rely at all on what is said by the assured, how can it be said that the nature of the relationship is that the insurers are relying on the information provided by the assured?³⁶

Lack of reciprocity?

- 8.12 Therefore, one threat to the continued existence of the fraudulent claims rule may lie in the attitudes and conduct of insurers themselves. If they change the relationship so that in the context of claims they are no longer relying upon information from the assured, then perhaps it would not be surprising if the fraudulent claims rule were swept away.
- 8.13 A further potential threat arises from considerations about the relationship between the assured and the insurer as a whole. The insurer relies upon the assured for information, both at the stage of proposing for insurance and (to some extent) at the stage of claims. The assured relies upon the insurer to pay claims promptly and honestly. It may well be said that at present English insurance law protects the ways in which the insurer relies upon the assured, but does not give protection to the principal way in which the assured has to rely upon the insurer. At present, with no duty of “good faith” upon the insurer in the handling and payment of claims, there is perceived to be a lack of reciprocity in the rules of English insurance law, and this perceived lack of reciprocity may be a threat to those rules which protect the insurer. (This idea may perhaps be expressed by saying that if the relationship is one of “good faith”, then the general overarching idea of “good faith” should give rise both to duties upon the assured and to duties upon the insurer.³⁷)

³⁵ Compare the express provisions in the International Hull Clauses (1/11/03) at clause 45.1 and 45.2.

³⁶ In particular, where the assured on a travel policy which by its wording only requires evidence of loss “to the insurers’ reasonable satisfaction” is confronted by demands for receipts for the purchase of a suitcase which he bought (or perhaps, was given as a present) twelve years ago, or for the foreign currency which he drew out of an ATM abroad the previous year, and decided to keep for his next holiday rather than exchange back into his “home” currency, it may well be felt that the assured who then produces a falsified receipt ought not to be punished for a “fraudulent device” which was provoked by the insurer’ unreasonable and non-contractual insistence on receiving evidence other than the assured’s own statement that he had such a suitcase, or such foreign currency.

³⁷ This idea is expressed by James Davey in an article “*Unpicking the fraudulent claims jurisdiction Insurance contract law: Sympathy for the devil?*” in [2006] *Lloyd’s Maritime and Commercial law Quarterly* 223. However, Mr Davey presents the argument in a way which I think mistaken, in that he seems to me to fail to distinguish between, on the one hand, the fraudulent claims rule and on the other hand those duties which should be analysed as complied contractual terms.

- 8.14 However, this potential threat to the existence of the fraudulent claims rule would be removed, if (as I expect) the English courts “discover” implied contractual terms by which the insurer is obliged to consider claims reasonably and pay them with reasonable promptness.
- 8.15 Therefore, the likely development in English law of duties of “good faith” upon insurers should perhaps not be altogether unwelcome to insurers, if it contributes to preserving the special rules which protect insurers in relation to proposals for insurance and in relation to claims.

9. Conclusions

- 9.1 At present, Underwriters on marine insurance policies have the benefit of an anomalous and draconian Fraudulent Claims Rule.
- 9.2 By virtue of this rule, if fraud is pleadable and can be proven, the assured will forfeit all right to the relevant claim (but not necessarily all benefit under the policy in respect of other genuine claims).
- 9.3 On recent authority, it appears that if two claims arise from the same event (for example a claim for salvage and repairs) then if there is any fraud in relation to one of those claims then the assured may forfeit one and be required to repay the other.
- 9.4 It is now clear that an assured is not required to disclose documents and information in relation to a claim to the standard required at the time of placement, nor therefore is there a right to avoid for such non-disclosure.
- 9.5 Otherwise, the state of the law, post placement is unclear. There is certainly a duty to desist from fraud but the precise scope of insured’s duties in presentation of claims is still evolving.
- 9.6 The duties of insureds and insurers in relation to claims may be founded upon implied contractual terms. The precise nature of those terms and the consequences of their breach need to be worked out. To the extent that breach would only entitle an injured party to damages this might be beneficial for insureds but the benefit to insurers would be questionable.
- 9.7 The likelihood of the English Courts implying terms with draconian remedies (for example conditions precedent or warranties) is small.

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This paper is a general review of the law and is not a substitute for nor should it be relied on for legal advice in any particular case. To the extent that it expresses opinions, these are the view of the writers only.

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