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# FRAUDULENT DEVICES AND COLLATERAL LIES

## Versloot Dredging BV & Anor v HDI Gerling Industrie Versicherung AG & Ors [2016] UKSC 45 ("Versloot Dredging")

The Sun reported this Supreme Court decision as a *"shock judgment"* under the headline *"Insurance premiums set to rocket after Judge rules it's OK to LIE on your claims"*. The Director of Insurance Policy at the Association of British Insurers commented that the decision *"flies in the face"* of work by the industry and government to crack down on fraudsters.

It is an important and controversial judgment which reversed the law as it had developed, so that the use of *"fraudulent devices"* in support of otherwise valid claims no longer falls under the fraudulent claims rule.

### The Fraudulent Claims Rule

If an insured makes a fraudulent claim, Insurers' remedy is to repudiate the entire claim. Insurers can also terminate the policy prospectively from the date of the fraud. The reason for this rule was concisely stated by Lord Hobhouse in the *"Star Sea" ([2013] 1AC469)*:

*"The insured must not be allowed to think: if the fraud is successful, then I can gain; if it is unsuccessful, I will lose nothing".*

Before Versloot Dredging false claims, dishonestly exaggerated claims and the use of a fraudulent device in making a claim, all constituted fraudulent claims. This this is still the position in relation to false claims and dishonestly exaggerated claims, but not the use of fraudulent devices.

### Fraudulent devices

The inclusion of fraudulent devices in the fraudulent claims rule arose from *"The Aegeon"* )*([2002] EWCA 247*), and had been applied in various cases, including in the Privy Council. Lord Sumption in Versloot Dredging summarised a fraudulent device (which he called a collateral lie) as the dishonest embellishment to a claim that may be made:

*"…because the insured was unaware of the strength of his case or else with a view to obtaining payment faster and with less hassle - - - a lie which turns out, when the facts are found, to have no relevance to the insured's right to recover … the claim would have been equally recoverable whether it was true or false".*

Following *"The Aegeon"*, in order to repudiate a claim, insurers merely had to establish the use of a fraudulent device in the claims presentation - not its effect on the claim. In Versloot Dredging, the Supreme Court changed this so that insurers now have to look at the effect of the device/lie before deciding whether it gives rise to a right to repudiate the claim and terminate the policy.

## The Facts

A cargo ship's engine was damaged by ingress of water. The ship owners made a claim for the cost of repairs, approximately €3.2m. The Judge found that part of the vessel's manager's explanation of events was speculative and that he had recklessly supported it with an untrue statement that members of the crew claimed to have heard the alarm going off, but did not investigate because it was attributed to the rolling of the vessel.

## The Commercial Court and Court of Appeal

Both the Commercial Court and the Court of Appeal, following *"The Aegeon"*, held that this amounted to use of a fraudulent device and insurers could therefore repudiate the claim and terminate the contract, even though had the manager not made the untrue statements, the claim would have succeeded in full.

Popplewell J, at first instance, so held only reluctantly:

*"I have reached this conclusion with great regret. In a scale of culpability which may attach to fraudulent conduct relating to the making of claims, this was at the low end. It was a reckless untruth, not a carefully planned deceit …… To be deprived of a valid claim of some €3.2m as a result of such reckless untruth is, in my view, a disproportionately harsh sanction".*

Clarke L J, giving the leading judgment in the Court of Appeal, had no such qualms:

*"… the drastic effect of the forfeiture rule is what gives it its deterrent effect and its justification rests on that basis".*

## The Supreme Court decision

The Supreme Court eschewed the term *"fraudulent device"* in favour of *"collateral lie"*, thereby foreshadowing its downgrading. It found that to apply *"the fraudulent claims rule to lies which are found to be irrelevant to the recoverability of the claim is a step too far. It is disproportionately harsh to the insured and goes further than any legitimate commercial interest of the insurer can justify".*

Lord Sumption observed that the insured had not obtained anything from the collateral lie that he would not have been entitled to had he not told it. For an

insurer to be able to forfeit the claim on the basis of the insured's collateral lie, the lie must be material to the merits of the claim *"on the true facts"*. That is, on the facts as they are ultimately established, not as they are thought to be at the time the lie was told.

## Comment

Lies that go to recoverability still fall within the fraudulent claims rule. Nevertheless, the need to establish the true implications of a lie before deciding whether it does fall within the rule, or is merely collateral, may increase the time and cost of investigating claims and give rise to potential disputes (including, following the Enterprise Act 2016, as to what is a reasonable time for investigation). In addition, some claims that would not have been payable, henceforth will be. These factors give rise to concerns that premiums will increase.

Although there is now no legal remedy for the embellished presentation of an insurance claim if it is shown that the embellishment was not necessary because the claim would have been recoverable in any event (which is actually consistent with existing Financial Ombudsman Services' guidance), the court pointed to other possible sanctions:

(1) the insured will forfeit credibility of his evidence;

(2) the policy is likely to be terminated by insurers, at least prospectively; and

(3) the history will be disclosable in the claimant's future insurance proposals, as a result of which he is likely to be refused insurance or to be quoted increased premiums.

The efficacy of these factors may in practice be limited, so it is important that the courts are seen to penalise collateral lies by imposing expensive inter partes costs orders on insured's using them, as the Supreme Court also predicted.

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