QBE Business Insurance

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Introduction

A warm welcome to the August edition of Property Matters

After the footballing disappointment of Euro 2016 (unless you are Welsh), the Olympics in Brazil has provided a much needed injection of "feel-good factor". As team GB struck gold across-the-board, the sheer magnitude of their success underlines what can be achieved when you truly commit to something. Our Olympians have raised Great British morale and provided compelling viewing into the early hours. The fact that their achievements were 'clean', against the backdrop of the doping scandal, supports the proposition that "cheats never prosper". With that in mind, this month's edition focuses on two key Supreme Court judgments, which consider the effect of dishonesty on an insurance claim.

The issue of insurance fraud continues to receive widespread media attention – justifiably so. The government has intervened recently by passing the Criminal Justice and Courts Act 2015, which enables the court to dismiss the entire claim in the event of fundamental dishonesty. Much of the focus remains on motor and liability claims, and the recent Insurance Fraud Taskforce report highlighted the particular problem of fraud in low value personal injury claims. The government looked set to take action (by removing compensation for sub-£5k whiplash claims), but the Brexit referendum may well lead to a delay. Insurance fraud may be less prevalent in commercial property insurance, but it still exists and presents different challenges for insurers in the fight against fraudulent claims.

Over the last 20 years fraudsters have undoubtedly become more sophisticated and insurers face a constantly evolving battle. QBE welcomes the support of the government and the judiciary. Along with the assistance of the ABI, the insurance industry has been successful in exposing the size of the problem, and the impact for honest policyholders. The public policy arguments regarding deterrence, and broad agreement that suitable punishment must be available to the courts, has led to a number of custodial sentences for fraudsters and this can only help deliver the message that insurance fraud is unacceptable. Against this backdrop, it is interesting to consider the impact of the two Supreme Court judgments on the insurance industry, and in particular the commercial property sector.

Lies, damn lies and collateral lies – the rule of fraudulent devices

The Supreme Court has ruled that a lie told by an insured during the course of a claim presentation will not necessarily invalidate their right to recover under the insurance policy.

The law in relation to dishonest insurance contract claims is dependant on the nature of the dishonesty. Fabricated and exaggerated claims – the fraudulent claims rule – are not recoverable against the insurer, primarily due to breach of the duty of utmost good faith. The other category relates to lies told in the claims presentation process – previously called fraudulent devices or collateral lies – and the Supreme Court has now taken the opportunity to clarify this area. It will not have been lost on the judges that the Insurance Act 2015 came into force on 12 August 2016, which provides statutory guidelines for fraudulent claims.

In the case of *Versloot Dredging BV v HDI Gerling Industrie Verischerung AG*, the Supreme Court decided by a 4:1 majority that the use of collateral lies (as the court preferred to call them) in support of a genuine claim, does not necessarily result in forfeiture of cover. This is the first time the House of Lords or Supreme Court has had the opportunity to resolve this question.

The claim in question involved the flooding of the vessel "DC MERWESTONE", resulting in the vessel's main engine being damaged beyond repair. In the claim presentation, the vessel's manager made a statement that he had been told by the crew that they had activated the bilge alarm during the flooding, but they had been unable to deal with the leak due to the rolling of the ship in heavy weather.

When the claim was first heard by the court, it was decided that the vessel manager's statement was a reckless untruth and was only put forward to fortify the claim and accelerate payment. The lie had no effect on the insurer – they did not believe it and did not act upon it. Ultimately, the lie was irrelevant to the merits of the claim as it was decided that the loss was proximately caused by perils of the sea, namely fortuitous entry of seawater. It was concluded that the insured had a valid insurance claim for €3.1m, but the claim was forfeited as a result of the collateral lie. The Court of Appeal reached the same decision and thought there were good public policy grounds for this approach, namely the deterrence of dishonest insurance claims.

The Supreme Court disagreed. The collateral lie was immaterial to the insured's right to recover under the policy – whilst the lie was dishonest, the claim was not. The insured gained nothing from the lie, as they were entitled to recover under the insurance policy in any event, albeit the vessel's manager wouldn't have known that when he told the lie. The court thought that the application of hindsight was necessary under these circumstances, which should be applied to the insurer's decision once they have ascertained the full facts.

It could be a fine-line to tread (and a costly one) for an insured that embellishes their claim presentation, is caught out, but then seeks to rely upon this judgment, as opposed to forfeiting the entire claim due to exaggeration. Whilst the Supreme Court did not consider a collateral lie as a fraudulent or dishonest claim, it made the point that the discovery of the lie will most likely bring other sanctions against the insured – loss of credibility, costs penalties, insurance cancellation and renewal difficulties.

This is an important decision for commercial property insurers and a timely one with the introduction of the Insurance Act 2015. The judgment helpfully defines what a 1st party fraudulent claim is (where the Act doesn't), and by excluding collateral lies, it is aligned with the proportionate remedies for non-disclosure and misrepresentation.

The right result in the end. Insurers can set aside agreed settlement of a claim

In the case *Hayward v Zurich Insurance Company plc* [2016] the Supreme Court had to decide whether the insurer should be allowed to set aside an agreed settlement, even though they suspected the claim was fraudulent at the time it entered the agreement.

Mr Hayward brought a claim following a workplace injury in 1998. Liability was admitted and the claim was pleaded at £419,000. Zurich suspected the claim was exaggerated and began to gather surveillance evidence to verify the veracity of Mr Hayward's alleged incapacity. The decision was taken to compromise the claim, rather than risk a court finding in favour of the claimant. Settlement was agreed for just under £135,000, in 2003.

In 2005, Zurich were tipped-off by Mr Hayward's neighbours regarding the true extent of his alleged injuries and after gathering yet more counter-fraud evidence, they were confident that the evidence was sufficient to show Mr Hayward had fully recovered from his injuries a full year before the time of the settlement (contrary to Mr Hayward's evidence). Zurich sought to set aside the settlement and claimed damages for deceit. Mr Hayward cross-applied for summary judgment on the basis that the claim had already been compromised in the previous proceedings. His application for summary judgment was successful before the County Court, but overturned by the Court of Appeal. The insurer's claim was therefore allowed to proceed to trial.

On the claim itself, the judge found that Mr Hayward had deliberately exaggerated the effects of his injury, set aside the settlement agreement, and awarded Mr Hayward a much reduced sum of £14,720. A second Court of Appeal decision then allowed Mr Hayward's appeal, holding that the insurer could not be allowed to set aside the settlement agreement since it was aware of Mr Hayward's fraud at that time.

Unsurprisingly, Zurich appealed to the Supreme Court, who had to decide the significance of the misrepresentation on Zurich's decision to enter the settlement and/or whether they should have fought the case to trial, on the basis of their suspicions rather than compromising the claim.

The Supreme Court unanimously decided that the lies told by Mr Hayward had induced Zurich into settling the claim and could not be said to be irrelevant. Importantly, the insurer was not under a duty to investigate their suspicions further and fight the case at trial. Mr Hayward could therefore not retain the agreed settlement and was only entitled to £14,720, circa 4% of his original exaggerated claim.

A key point from the judgment clarifies that an insurer will not have to show that they believed the misrepresentation, but must continue to prove it was at least one cause which induced settlement. Zurich had suspicions about Mr Hayward's statements in 2003, but compromised the claim on the basis that they were unable to prove the full extent of the deliberate exaggeration and therefore settled the claim to their detriment.

Whilst the judgment relates to a 3rd party personal injury claim, it is interesting to note the different approach between this decision and the Supreme Court judgment in Versloot. The Supreme Court dealt with the public policy issue of deterrence and did not believe it was just to deny a valid claim by reason of a collateral lie.

The lies told by Mr Hayward were not believed by Zurich – similarly with HDI – but the absence of an insurance contract (to determine policy cover and limits) between Mr Hayward and Zurich, meant his compensation had to be determined on his evidence (witness and expert) and it would be for the court to decide that the claim was deliberately exaggerated. That is an important distinction. Under similar circumstances to *Hayward*, there would appear to be no bar to an insurer revisiting a 1st party claim settlement, upon receipt of evidence of fraud or exaggeration.

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