

Aspects of Policy Wordings, namely:

- **Construing warranties and the effect of a breach**
- **Construing conditions precedent and the effect of non-compliance**
- **Differences between insuring on a “Joint” and on a “Composite” basis**
- **Differences between insuring on a “claims made” and on a “loss occurring” basis**
 - **Raising fraud in insurance claims**

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Professional Indemnity Insurance: Decisions
And Visions, Rationale and Reality
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(A) Construing Warranties and the Effect of Breach

(a) Introduction

A warranty is the most fundamental term in a contract of insurance. As a matter of construction, warranties differ from conditions, clauses descriptive of the risk and exceptions.

A warranty in insurance law is essentially a term involving a promise by the insured that controls the risk run by the insurer. In this respect, insurance law usage regarding the warranty as a fundamental term in an insurance contract differs from the position in general contract law, where a warranty is normally regarded as a relatively minor term, the breach of which only ever entitles the innocent party to damages. As discussed below, upon a breach of warranty in insurance law, the insurer is automatically discharged from all liability as from the date of the breach by operation of law.

(b) Warranties must be strictly complied with

Warranties must be strictly complied with and it is irrelevant that the breach is unconnected with a loss that occurs. *De Hahn –v- Hartley*¹ involved a marine policy covering a ship and its cargo on a voyage from Africa to the West Indies. The insured warranted that the ship sailed from Liverpool with 50 hands on board. In fact it sailed with only 46 hands although it took on an extra 6 hands in Anglesey and thereafter continued with 52 hands. It was held that the insurer was discharged from liability for breach of warranty. The following points should be noted, namely:-

- (i) this case shows that a warranty must be strictly complied with. A warranty as to 46 hands means 46 hands, no more and no less; and
- (ii) in this case the insurer was discharged from liability even though it was obvious that the breach of warranty had no connection with the loss that

¹ (1786) 1 T.R. 343.

subsequently occurred. Hence, it is not strictly necessary to establish a causal nexus between a breach of warranty and the loss that occurs. However, the strictness of this rule has since been amended by the development of the Insurance Conduct of Business (ICOB) Rules and by the Statement of Long-Term Insurance Practice.

(c) The creation of warranties

(i) Use of the word “warranty”

A warranty may be created by the express use of the word “*warranty*” in the policy document or proposal form for insurance, such as in the phrase “*the insured warrants...*”, but even this may not be conclusive if the court concludes that as a matter of construction the parties could not have intended a warranty.

A provision whereby the contract is declared to be void or voidable in certain circumstances probably has the same effect. As discussed below, the use of the words “*void*” or “*voidable*” is confusing. It used to be thought that the remedy for breach of warranty was to render the contract void or voidable but it is now clear that the remedy for breach of warranty is to discharge the insurer from liability as from the date of breach automatically by operation of law. Despite this, it is still thought that provisions declaring the contract void or voidable in certain circumstances are likely to be construed as warranties (the classic example being the increase in risk clause contained in many fire insurance policies).

As a matter of construction, it is also open to a court to conclude that on the true construction of a policy, the wording of a particular term gives rise to a warranty².

(ii) Basis of the contract clause

The most common method of creating warranties is the basis of the contract clause contained at the foot of the proposal form.

² Law Com. No. 104, 6.3.

Historically, by making the questions and answers and declarations on a proposal form the basis of the contract, and providing that in the event of any untruth the contract could be voidable, insurers succeeded in equipping themselves with a potential defence to an action on the policy much wider than that arising by virtue of the duty of disclosure.

In *Thomson –v- Weems*³ a question on a proposal form asked: (a) “*Are you temperate in your habits and (b) have you always been strictly so?*” The proposer answered “(a) *temperate; (b) yes*”. The form contained a basis clause that expressly stated that in the event of an untruth, the policy would be void. The House of Lords upheld the insurer’s repudiation of liability because the proposer was in fact a heavy drinker. Materiality was irrelevant (although the matter must have been material on the facts of this case).

A common modern wording of a “*basis clause*” is as follows: “*I / We declare that to the best of our knowledge and belief all statements and particulars contained in the proposal are true and complete and that no material fact has been withheld or suppressed. I / We agree that the statements and particulars contained in the proposal form the basis of the contract between Us and the Insurer.*”

(d) Warranties as promises

As noted above, warranties are essentially promises made by the insured relating to facts or to things that he undertakes to do or not to do as the case may be. They affect the risk to which the insurer is subject. There are essentially three types of promises and hence warranties that an insured can make, namely: warranties as to present or past facts as at the date they are made; warranties as to the future; and warranties of opinion:-

(i) Warranties as to present or past facts as at the date they are made are usually created by a basis of the contract clause contained at the foot of the proposal form for insurance (as discussed above).

³ (1884) 9 App. Cas. 671.

(ii) Warranties as to the future are known as continuing or promissory warranties. They are continuing promises by the insured that facts will or will not exist in the future or will or will not continue to exist for the future. Common examples are warranties to maintain alarms or sprinkler systems in commercial fire policies.

Whereas a breach of warranty as to past or present facts will discharge the insurer from liability *ab initio*, since inevitably the breach occurred at the commencement of the contract of insurance, breach of a promissory warranty discharges the insurer from liability as from the date of breach but the policy is valid up until that date. The insurer would thus be liable for a loss which occurred before the breach.

Continuing or promissory warranties may arise from completed proposal forms or from the body of the policy. Whether a warranty is continuing / promissory or limited to the present time is a matter of construction. There is no reason why a warranty cannot be both as to the present and the future. However, the reported cases are clear that in order for a warranty to be continuing / promissory, it has to contain a clear reference to the future. For example:-

- In ***Woolfall & Rimmer –v- Moyle***⁴, the insured warranted in a proposal form for employers’ liability insurance that its machinery, plant and ways “***are...properly fenced and guarded, and otherwise in good order and condition***” (emphasis added). The use of the present rather than future tense prevented the warranty from being construed as continuing or promissory;
- In ***Kennedy –v- Smith***⁵ a warranty in a proposal form for motor insurance which read “***I am a total abstainer from alcoholic drinks...***” (emphasis added) was construed as relating to the past and to the time it was made. The use of the present tense meant that it could not be construed as a continuing or promissory warranty;
- However, if a provision can only be read and understood as continuing then it will be construed as a continuing or promissory warranty even if the present

⁴ [1942] 1 KB 66.

⁵ 1976 S.L.T. 110.

and not future tense is used. In *Beauchamp –v- National Mutual Indemnity Insurance Co.*⁶ a builder took out insurance to cover the demolition of a mill. He had never previously done demolition work. He warranted that he did not use explosives in his business in words that were clearly in the present tense. Whilst true at the time the warranty was made, the insured did subsequently use explosives in knocking the mill down. This was held to be a breach of warranty. Given that he had not used explosives before and given that he had not done demolition work before, the warranty could only be read as referring to the future.

(iii) Warranties of opinion

Warranties of opinion are less severe than warranties of facts. If an insured warrants that a fact is true then there will be a breach of warranty if the fact is not true as an absolute state of affairs even if the insured did not know that the fact was not true.

If, however, an insured merely warrants that facts are or will be true to the best of his knowledge and belief, then there will be a breach of warranty only if he dishonestly or recklessly supplies an incorrect answer. The insured must exercise due care when making his warranty but that is sufficient. This is of particular importance in the context of consumer insurance proposal forms which are normally drafted so as to require only warranties of opinion rather than warranties of fact.

(e) The interpretation of warranties

Some of the principles concerning the construction of warranties have been addressed in the paragraphs above. Three further points need to be made here, namely:-

- Some mitigation of the strictness of the law of warranties (especially the effects of a basis clause) has been effected by the courts adopting strict rules of interpretation. Having said that, if the natural and ordinary meaning of a warranty is clear then it will be enforced;

⁶ [1937] 3 All E.R. 19.

- As it is almost invariably the insurer who formulates the wording, a warranty will be construed *contra proferentem* in the event of ambiguity; and
- An example of the reasonable interpretation of warranties is afforded by the cases concerning obligations imposed upon a liability insured to take reasonable precautions. Only recklessness or worse on the part of the insured is sufficient to constitute a breach of such a provision.

(f) The effect of a breach of warranty

It was traditionally thought that a warranty was a fundamental term of the contract of insurance and that breach of it entitled the insurer to repudiate the contract in its entirety.

However, this view is an incorrect statement of the law following the decision of the House of Lords in *Bank of Nova Scotia –v- Hellenic Mutual War Risks Association (Bermuda) Limited, The Good Luck*⁷. Here it was held that a breach of warranty in a marine insurance policy automatically discharged the insurer from liability in accordance with the literal meaning of Section 33(3) of the Marine Insurance Act 1906. It is now clear that *The Good Luck* applies to non-marine insurance policies as much as it does to marine insurance policies.

Given that the insurer is automatically discharged from liability as from the date of the breach of warranty, it follows that this makes a warranty more like an exception to the risk than a condition in the usual contractual sense, since the operation of an exception is not dependent upon a decision of the insurer.

If there is a breach of a warranty made in a proposal form at the time that it is made then the insurer will be discharged from liability as from the moment of inception of the policy. In such a case there would be a total failure of consideration and the insured would be entitled to a return of the premium.

⁷ [1991] 2 WLR 1279.

If there is a breach of a continuing or promissory warranty then the insurer is only discharged automatically by operation of law upon the breach and the policy remains valid until that date.

The contract of insurance may theoretically survive a breach of warranty in the sense of there being obligations of the insured which may survive the breach (for example, to pay a premium) but this is likely to be a rare occurrence. In practice, the contract will come to an end.

It is clear from ***The Good Luck*** that the language of repudiation is inappropriate at least in terms of repudiating or avoiding the policy. It is only in the sense of repudiating liability that it would be right to describe the insurer as being entitled to repudiate.

One of the problems that was created by the decision in ***The Good Luck*** concerned how the rule that an insurer was automatically discharged from liability as from the date of breach of warranty could be reconciled with the old rule that a breach of warranty can be waived. The solution reached by the Court of Appeal in ***HIH Casualty & General Insurance –v- AXA Corporate Solutions***⁸ was to hold that a breach of warranty can be waived only by estoppel and not by election.

⁸ [2002] EWCA Civ 1253.

(B) Construing Conditions Precedent and the Effect of Non-Compliance

In addition to warranties, insurance contracts invariably contain clauses known as “conditions”.

It is clear that an insurance contract can provide for a condition to have the same effect as a condition in general contract law, namely that on breach the insurer can treat the whole contract as repudiated. This is usually done by making performance of the condition precedent to any liability of the insurer. However, it seems clear that repudiation is allowed only if there is a causal connection between the breach and the loss for which the insured has made a claim⁹. In this respect a breach of a condition precedent differs from a breach of warranty where a breach is in law actionable regardless of any such causal connection.

A term with a slightly less significant effect is a condition that is merely precedent to the insurer’s liability to pay for a particular claim. The insurer can repudiate liability for a claim for a breach of this sort of condition while affirming the contract generally¹⁰.

A less common term is a “mere” condition, that is a condition that is not declared to be precedent to anything. On breach of such a term, the insurer is entitled only to claim damages for such loss as he has suffered.

Apart from those matters that may also be the subject of warranties (namely, those matters that affect the risk run by the insurer), the usual matters covered by conditions are duties to be performed by the insured (often upon the making of a claim).

Another term that has a similar consequence to a condition precedent, but that is conceptually different, is the suspensive condition, often known as the condition or clause descriptive of, or delimiting, the risk. This usually arises from the contents of a completed proposal form. Its effect is that the insurer is not on risk and therefore not liable for any loss whilst the term is not being complied with, but the risk reattaches

⁹ See: *W. J. Lane –v- Spratt [1970] QB 480*.

¹⁰ See, e.g., *Mint Security Ltd –v- Blair [1982] 1 Lloyd’s Rep. 188*.

when the term is being complied with. It therefore operates as an exception contained in the body of a policy. It differs from a warranty in that it cannot lead to a complete discharge of the insurer and it differs from a condition precedent in that a breach does not entitle the insurer to repudiate the contract.

An example is provided by *Farr –v- Motor Traders’ Mutual Insurance Society*¹¹ in which the question on the proposal form for motor insurance of two taxis, namely: “*State whether the vehicles are driven in one or more shifts per 24 hours*” was answered by the insurer: “*Just one*”. For a short period whilst one of the taxis was being repaired, the other taxi was driven in two shifts per 24 hours. The relevant accident occurred much later when both taxis were on the road and neither was being used for more than one shift per 24 hours. The insurer was liable in respect of this accident. The statement was not a continuing warranty. It was simply a clause descriptive of the risk. If the accident had occurred at the time that only one taxi was in use, then the insurer would not have been liable. But the risk reattached when the other taxi returned to use.

It can be particularly difficult to determine the exact status of terms requiring the insured to give prompt notice of any occurrence likely to give rise to a claim. Such terms are common but are often labelled differently. The traditional analysis of such claims conditions is that they are conditions precedent to the bringing of a claim or that they are suspensive conditions or that they are merely procedural conditions giving rise only to a claim for damages by the insurer. That said, however, it seems that such matters can be made fundamental to the validity of the contract by appropriate wording.

For example, in *Cox –v- Orion Insurance Co*¹², the Court of Appeal held that a breach of a condition relating to the furnishing of particulars of loss entitled the insurer to treat the whole contract as repudiated because the policy contained a provision making its conditions “*conditions precedent to any liability of the company to make any payment under this policy*”.

¹¹ [1920] 3 K.B. 669.

¹² [1982] RTR 1.

Often, insurance policies contain some general reference to their conditions being conditions precedent, even if they do not contain a specific reference in a particular condition. The only problem that then arises is where there is a general declaration (e.g.: that all things required by the policy to be done by the insured shall be conditions precedent to the insurer's liability), but within a particular condition there are parts that cannot conceivably be precedent to the insurer's liability, perhaps because the obligation thereunder can only be performed after the insurer has paid or because a relevant part does not actually impose an obligation upon the insured. It is probably safe to suggest that a general declaration as to conditions precedent would normally be effective in so far as particular conditions or parts of them are clearly capable of being separated.

In relation to an alleged breach of condition, "*it is axiomatic in insurance law that, as it is always for an insurer to prove an exception, so it is for him to prove the breach of a condition which would relieve him from liability for a particular loss*"¹³. Having said that, it is possible for the wording of a policy to affect this position, but very clear words would be required to place the onus of proving that he complied with a condition upon the insured.

(C) Differences between Joint and Composite Insurance

Where two or more persons are insured under a single insurance policy, it is important to determine whether the policy is joint or composite. A joint policy is construed as a single contract of insurance whereas a composite policy is construed as comprising a bundle of contracts (namely one policy each between each individual insured and the insurer).

The distinction is based upon the nature of the interests of the insureds. If the insureds share a common interest in the insured subject-matter (e.g.: where they are joint owners of property or partners) the policy is joint. By contrast, if the parties have different interests (e.g.: in the case of a landlord and a tenant) the policy is composite. Where the parties have the same interest in the insured subject-matter, it is

¹³ *Bond Air Services Ltd -v- Hill [1955] 2 QB 417* at 427 per Lord Goddard C.J.

theoretically possible for them to insure either on a joint or on a composite basis. For example, there could be no objection to a husband and wife insuring matrimonial property on a composite basis even if it most would insure on a joint basis. In the commercial context, if the partners in a partnership insure their liabilities, they can insure jointly on the basis that, as each insured is jointly and severally liable, their liabilities are the same; alternatively, they can insure under a composite policy, given that each insured potentially has a distinct claim against the insurer.

Which of these possibilities is the case depends upon the policy wording. It follows that if the parties are co-owners and are referred to jointly, the policy is joint; and if the parties have separate interests and are referred to separately, the policy is composite.

The following co-insurances have been held to be composite by their nature: mortgagor and mortgagee; owner of goods and hirer under a hire-purchase agreement; landlord and tenant; contractor and sub-contractor under a construction risks policy; the directors of a company; companies in the same group; co-habitees; cruise operators and disponent owners of vessels; members of an association who are insured under a group policy; and a husband and wife under a life policy which pays the survivor.

Rights under joint and composite policies

Where the policy is joint, the rights of the co-insureds stand or fall together. This is so because the parties, as joint tenants of the insured subject-matter, have an undivided interest in it.

Under a composite policy, however, each insured is insured in respect of his own interest only and may present an independent claim in respect of that interest. This distinction is significant in four main contexts, namely:-

- (i) utmost good faith. A composite policy is divisible for utmost good faith purposes. It is conceptually possible for an insurer to be able to avoid a contract as against one co-insured but to be bound to indemnify the

other(s). For example, in *Woolcott –v- Sun Alliance and London Insurance Ltd*¹⁴, a dwelling was insured under a building society’s block policy which covered the respective interests of the mortgagor and the mortgagee building society. The mortgagor’s criminal record had not been disclosed to the insurer and, following damage to the dwelling, the insurer sought to avoid liability. It was held that the insurer was permitted to avoid the policy *ab initio* as regards the mortgagor’s interest but that the rights of the mortgagee in respect of its own interest were unaffected. The same result would no doubt have been reached if the mortgagor had been in breach of warranty;

- (ii) wilful conduct by an insured. It is a general principle of insurance law that an insured who has by wilful misconduct brought about the event giving rise to a claim under the policy, or whose actions otherwise offend against public policy, may not mount an action upon the policy. In the case of a joint policy, given that the rights of the parties stand or fall together, wilful misconduct by one assured prevents recovery by the co-insured. By contrast, in the case of a joint policy, the wilful misconduct of one insured will be a personal bar to his recovery, but will not prevent a co-insured under the policy from recovering in his own right. For example, if two parties have insured each other’s lives under a composite policy, the murder of one party by the other prevents the guilty party from recovering but allows the estate of the innocent party to claim payment¹⁵;
- (iii) breach of condition. Breach of a policy condition by a joint insured will affect the rights of all of the other joint insureds. Thus a claim made by a husband in breach of a fraudulent claims condition will preclude recovery both by him and by his wife. A composite insured will be in a different position unless the insurer can demonstrate that the person making the claim acted as agent for the other composite insureds. Agency issues and express wordings aside, a claim made by one composite insured under a

¹⁴ [1978] 1 Lloyd’s Rep. 629.

¹⁵ See: *Davitt –v- Titcumb [1989] 3 All E.R. 417*, where the insurers did not dispute that they were liable to make payment to someone.

policy does not necessarily amount to a claim on behalf of all of the composite insureds and it may be that each of the composite insureds is required to comply with claims conditions; and

- (iv) payment under the policy. Where a loss occurs under a joint policy, the insurer meets its obligations by paying the sum due to any of the joint owners; this follows from the ordinary common law principle that a debt owed to joint creditors may be discharged by payment to one of them. The position under a composite policy is more complicated for each insured will have suffered a loss to a different type of interest (and some insureds may not have suffered a loss at all). The insurer's payment obligation under a composite policy is, in essence, a matter of contract. If the contract provides that the insurer must make payment jointly to all insureds, it must do so and it is for those insureds to allocate the payment between themselves in accordance with losses suffered. Alternatively, the policy may permit each insured to claim against the insurer in respect of his own interest.

(D) Differences between insuring on a Claims Made and on a Loss Occurring basis

Liability insurance provides cover against the risk of the insured incurring liability to third parties, rather than against the risk of damage to property as such, and is a contract of indemnity.

Liability policies may cover liability arising from the use of goods or the provision of services. Under a liability policy it is generally the case that the conduct which gives rise to liability will occur some time before the insured actually incurs liability for that conduct. It may also be the case that different policies are in force at the times of the former and latter events. It is important to determine, therefore, whether the policy covers liability flowing from the insured's conduct within the policy period, or whether it covers the establishment of the insured's liability within the policy period, as both are theoretically possibilities.

Professional indemnity insurance policies are written on a “*claims made*” basis. Under a claims made policy, the insurers face liability for any claims made by a third party against the insured during the currency of the policy, even though those claims do not result in the insured’s liability actually being established and quantified (which is the trigger for the insurers’ liability under a liability policy) for some years to come. Claims made policies typically provide an extension in the form of the right or obligation on the insured to notify to the insurers any circumstances which have occurred during the currency of the policy and which “*may*” or “*are likely*” to give rise to a claim at some point in the future: notification by the insured during the currency of the policy is then deemed to be treated as a claim made against the insured during the currency of the policy should a claim actually be made at some later date.

Policies covering liability for personal injury or damage to property may be written on a claims made basis but they are usually written on a losses occurring or events basis. There are two distinct concepts here, namely:-

- (i) a “*losses occurring*” policy is one that responds to injuries inflicted upon the third party during the currency of the policy even though the insured’s liability for those injuries is not established until a later date; and
- (ii) an “*events*” policy provides indemnity for events that occur during the currency of the policy, even though those events do not give rise to injury until a later date and so to liability at an even later date. The distinction between losses occurring and events policies is often unimportant (because the insured’s negligence and the third party’s loss are usually simultaneous, as in the case of a road traffic accident). But the distinction becomes important in exposure cases, where the third party is exposed to a harmful substance by the insured during the currency of the policy but the substance does not cause physical injury to the third party for some time afterwards.

(E) INSURANCE POLICY COVERAGE: FRAUD AT THE CLAIMS STAGE

This paper proposes to address how the law of insurance policy coverage deals with situations of fraud at the stage of a claim being made. There are three situations:

- (1) **Cases of pure fraud**. These are situations where the entire claim is fraudulent (e.g.: a claim in respect of a staged burglary);
- (2) **Cases of fraudulent exaggeration**. These are mixed claims that comprise a genuine element (e.g.: a claim for insured jewellery stolen in a burglary) together with a fraudulent element (e.g.: by adding to the genuine claim a claim for a computer that was not actually stolen); and
- (3) **Cases of fraudulent devices**. In this situation, there is a genuine claim but the insured uses fraudulent devices to advance it (e.g.: where the insured produces a forged purchase invoice to support a genuine claim).

We shall explore these three situations further below:

(1) A Fraudulent Claim

This is the situation of a wholly fraudulent claim (e.g.: a staged burglary). Insurers do not have to pay out in respect of a fraudulent claim because policies of insurance cover the risk of an uncertain event happening and do not respond to an event that is certain (for example a deliberately set fire). The risk of fraud is not an insured risk.

The ingredients of fraud are set out in **Derry –v- Peek (1889) 14App Cas 337** as “*a false statement made knowingly or recklessly, not caring whether it be true or false*”.

It is clear that the ingredients of fraud are: (a) a false statement; (b) intention; and (c) substance.

(2) Fraudulently Exaggerated Claims

These are mixed claims in which part of the claim is genuine (say, for jewellery stolen in a burglary) and part is fraudulent (because, in addition to the genuine claim, a claim is added for a computer that was not stolen). In other words, the genuine claim has been fraudulently exaggerated.

In **Orakpo –v- Barclays Insurance Services Co. Ltd [1995] L.R.L.R. 443, CA** there was a fire at Mr. Orakpo’s house. The house had 13 bedrooms available for letting. Whilst the fire was a genuine loss, Mr. Orakpo fraudulently exaggerated his claim under the relevant combined property and business interruption policy by claiming the full revenue that he would have received for more than 2 years if all 13 rooms had been let, despite the fact that there were only 3 occupants.

Unsurprisingly, his fraudulently exaggerated claim in respect of the loss of revenue failed.

However, the question that has troubled the Courts is whether the fraudulent exaggeration of a claim also taints the genuine element such that no recovery can be made by the insured at all, not even in respect of the genuine loss. It is now clear that in cases of fraudulent

exaggeration, the whole of the claim is forfeited by the fraud. It follows that Mr. Orakpo did not make any recovery, not even in relation to genuine damage caused by the fire.

In Orakpo, Sir Roger Parker asked:

“On what basis can an assured who asserts, for example, that he has been robbed of 5 fur coats and some valuable silver, when he has only been robbed of 1 fur and no silver, be allowed, when found out, to say ‘you must still pay me for the one of which I was truly robbed’? I can see none”.

Galloway –v- Guardian Royal Exchange (UK) Ltd [1999] Lloyd’s Rep. I.R. 209, CA provides a further example. It concerned a claim on a household policy following a burglary. Mr. Galloway claimed the probable true loss of c.£16,000 but also claimed c.£2,000 for a computer. The claim in respect of the computer was fraudulent because it had not been stolen. The result was that the fraudulent exaggeration of the genuine claim tainted the whole claim and Mr. Galloway recovered nothing. As Millett L.J. said:

“The making of dishonest insurance claims has become all too common. There seems to be a wide-spread belief that insurance companies are fair game and that defrauding them is not morally reprehensible”.

The only gloss on the rule that the fraudulent exaggeration of an otherwise genuine claim taints the whole is that it is necessary for the fraud to be substantial. Lord Woolf M.R. said that in determining whether or not the fraud was substantial, it was necessary to look at the whole of the claim; to see what amount the fraudulent exaggeration bore in relation to the whole claim; and to decide whether the fraud was substantial.

Since the c.£2,000 fraud in relation to the computer was c.10% of the whole claim, Lord Woolf M.R. considered that to be substantial (with the result that the fraudulent element tainted the whole claim).

It is suggested that the difficulty with this test is that if the substantial nature of the fraud is gauged by reference to the proportion of the entire claim represented by the fraudulent claim, the absurd conclusion results that the greater the genuine loss, the larger the fraudulent claim can be without it being considered substantial.

Rather, it is suggested that the better approach is that advanced by Millett L.J. in the same case, namely that it is necessary to consider the fraudulent exaggeration as if it were the only claim and to take a view as to whether, in isolation, the making of that fraudulent exaggeration is sufficiently serious to stigmatise the whole of the claim.

One of the reasons for the requirement that the fraud be substantial is the courts’ appreciation that in respect of many losses, say business interruption losses, an insured may initially seek to claim as high a figure as it can on the basis that the high figure will be treated by the insurer as a starting point for negotiations on settling the claim.

It is clear that an insured is entitled to a bit of give and take when estimating its loss in order to negotiate a settlement with insurers and such actions are not fraudulent.

It is also clear from these cases that the fraudulent claims rule is a matter of the general common law and does not depend upon there being an express contractual term in the contract of insurance addressing fraudulent claims.

This rationale was best explained by Lord Hobhouse in Manifest Shipping Co. Ltd –v- Uni-Polaris Insurance Co. Ltd, sub nom: “The Star Sea” [2001] 2 WLR 170, HL:

“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...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”.

(3) Fraudulent Devices

In this situation an insured makes a genuine claim (e.g.: for stolen jewellery) but uses fraudulent devices to advance the claim (e.g.: by submitting a forged purchase invoice to prove the value of the genuinely stolen jewellery). In other words, the insured uses a fraudulent device to advance an otherwise genuine claim.

This situation is different from the two situations discussed above because, even though fraudulent devices are used, the insurer is only being asked to make payment in respect of a genuine claim and the insurer would be expected to do this anyway.

Having said that, it may be thought objectionable for an insured to use fraudulent devices even if only to advance a genuine claim.

As a result, the following issue arises, namely whether the insurer is entitled to rely upon the fraudulent devices used by the insured to refuse payment in respect of the claim even though the claim is genuine. In short, the insurer is entitled to refuse payment in this way so long as:

- (a) the fraud is directly related to the claim to which the fraudulent device relates (say, a forged purchase invoice in respect of a claim for the theft of those goods); and
- (b) the fraud “...*is intended to improve the insured’s prospects of obtaining a settlement or winning the case, and which would, if believed, tend objectively, prior to any final determination at trial of the parties’ rights, to yield a not insignificant improvement in the insured’s prospects – whether they be prospects of obtaining a settlement, or a better settlement, or of winning that trial*” (per Mance L.J. in **Agapitos –v- Agnew, sub nom: “The Aegeon”** [2002] 3 WLR 616, CA).

In **Agapitos –v- Agnew**, the Court of Appeal made clear that the use of a fraudulent device should be treated as a sub-species of making a fraudulent claim, at least as regards forfeiture of the claim in relation to which the device is used.

Mance L.J. also addressed the situation where an insured advanced an initially honest claim (say in respect of items stolen in a burglary) but later learned that the claim was exaggerated (because, contrary to what the insured originally believed, not all of the items had been stolen). The Court made clear that the fraudulent claims rule would apply to the continued maintenance of such a claim after the time when the insured knew that the claim was exaggerated. The result would be that the insured would not be entitled to recover (a) in respect of the fraudulently exaggerated element of the claim; nor (b) in respect of the genuine element.

It is interesting to note that the Financial Services Ombudsman has made clear (in Issue 41 of the Ombudsman News, November 2004) that he considers it unduly harsh that an insured who has a genuine claim (say, in relation to a necklace stolen in a burglary) but who uses a fraudulent device to prove it (say, a forged purchase invoice) should be denied recovery:

“However, we have long considered the application of this rule to be unnecessarily harsh...where the fraudulent act or omission makes no difference to the insurer’s ultimate liability under the terms of the policy, it should not entitle the insurer to ‘forfeit’ the policy or reject the claim. In the example given above, of the forged receipt, the claim should be paid. Indeed it was the insurer’s unreasonable insistence on strict proof that caused the policy holder to act dishonestly in the first place”.

ANDREW WARD
Exchange Chambers
25th February 2013