Supreme Court considers fraud – two cases concerning lies and insurance come along at once

Two claims came before the Supreme Court during July 2016 dealing with issues of fraud in the context of insurance:

1) *Versloot Dredging BV v HDI Gerling*: considered the issue of ‘collateral lies’ in support of genuine claims
2) *Hayward v Zurich Insurance Co plc*: considered reliance upon fraudulent representations when seeking to set aside a settlement agreement

The outcome of these claims and the judicial discussion reveals the approach of the Supreme Court to fraud in insurance claims. Arguably the two judgments do not sit comfortably together and may even be seen as inconsistent. For insurers, it was a case of one result good, one result bad.

**Versloot v HDI Gerling**

It was held (by a 4:1 majority) that the use of ‘collateral lies’ in support of genuine claims will not result in the claim being disallowed.

The owners of a vessel, DC Merestone, suffered a loss of EUR 3.2 million when its engine room was flooded in January 2010. The crew had been negligent in failing to close a sea inlet valve and omitting to drain the hose system. The loss resulting from the crew’s negligence was covered under the ship’s insurance policy. However, one of the vessel’s managers had lied during the insurance investigation, claiming that the crew had been unable to respond to a ‘bilge alarm’ because of the rolling of the ship in heavy weather.

At first instance and in the Court of Appeal, it was held that this ‘reckless untruth’ meant that the entire insurance claim should be forfeited, notwithstanding that the sounding of the ‘bilge alarm’ and the crew’s response was in fact irrelevant to the insurance policy response.

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The Supreme Court reversed this outcome, allowing the claim, holding that in claims where ‘the lie is dishonest but the claim is not’, forfeiting the entire claim would be a disproportionately harsh result. In other words, a ‘collateral lie’ brings the insured nothing to which it was not already entitled under the policy. In that sense, the lie is considered irrelevant to the entitlement to an indemnity. Lord Sumption gave the leading judgment and observed that there is no other context in which the civil law avoids a transaction based upon a fraud that has no impact upon its target.

Lord Hughes distinguished between “the insured who dishonestly gilds the lily with a lie or falsified evidence, but stands thereby to obtain nothing more than was his legal due” and the insured who lies “in an attempt to gain something to which he is not entitled”.

It is important to make clear that this decision is based on a relatively rare set of facts, where the sum due to the insured was unaltered by the inventing of supporting evidence. It is distinct from:

i. Cases where the value of a claim is dishonestly exaggerated
ii. Cases where part of the claim is genuine and part false

In either of the above scenarios, the dishonesty will result in the entire claim being disallowed.

In light of this ruling, a valid concern for insurers is that the insured may now have a ‘one-way bet’ if he lies in support of a genuine claim, because there will be no sanctions even if the lies are exposed. However, the lie would still be a prosecutable criminal offence, the claimant’s credibility would suffer, costs sanctions could be imposed and insurance premiums could increase significantly.

**Hayward v Zurich**

The Supreme Court clarified the extent to which a party to settlement in litigation needs to have relied upon fraudulent representations in order to ‘untie’ the settlement at a later date. It was held that if a materially false representation was made, inducing the other party to act to its detriment, then that would constitute grounds for setting aside the settlement.

Mr Hayward suffered a workplace accident in 1998 injuring his back. He pursued a personal injury claim against his employer, insured by Zurich. The claim was settled for £134,973 in October 2003, notwithstanding that Zurich suspected (but could not prove) that the claim was fraudulently exaggerated.
In 2005, Mr Hayward’s neighbours contacted Zurich providing evidence that he had indeed exaggerated his injuries. Zurich applied to the Court for the original settlement agreement to be set aside. Zurich were successful at first instance, but lost in the Court of Appeal which found that because Zurich had suspicions about Mr Hayward’s evidence prior to settling with him they could not have relied on his fraudulent misstatements and so the settlement could not be set aside.

The Supreme Court disagreed with this analysis. Inducement is a question of fact. It was held that although Zurich may have disbelieved Mr Hayward’s representations, it did not have proof of their falsity at the time. Thus it was not unreasonable for Zurich to conclude that the misrepresentations might be believed by a judge at trial. Accordingly, Zurich entered into a settlement at a higher value than it would have but for the misrepresentations. Thus, mere suspicion of falsehood is not enough to preclude the setting aside of a settlement.

Conclusions

Versloot is a concerning judgment for insurers, as it does not do much to deter potential insurance fraud and is seen, by some (including the dissenting Lord Mance), to represent a ‘charter for untruth’. Insurers may now consider including express clauses in policies stating that an indemnity will not be paid in the event that a fraudulent device/collateral lie is used to support an otherwise genuine claim.

On the other hand, Hayward provides some comfort for insurers, who will be able to challenge settlements where clear evidence of fraud comes to light at a later date. Insurers will not be fettered in this by having had a mere suspicion of deceit at the time of settlement. In contrast to Versloot, therefore, Hayward is a welcome decision for insurers.

Insurance fraud is commonplace and is not new. These two judgments of the highest Court represent the latest instalments in the battle between insurers and those who seek to deceive them.

For more information on the cases discussed in this article, please click on the below links:


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