THE FRADULENT DEVICES PRINCIPLE NOW APPEARS TO BE PAST PRAYING FOR

Georgia Hicks*

"Whoever is detected in a shameful fraud is ever after not believed even if they speak the truth" – The Fables of Phaedrus, Book II

Introduction

In the recent case of *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors*,[1] the Court of Appeal confirmed the *obiter* decision in *Agapitos v Agnew ("The Aegeon")*[2] thereby extending the fraudulent claims principle to include fraudulent devices. This was despite: (i) the distinction between fraudulent claims and fraudulent devices; (ii) Popplewell J's assertions at first instance that the principle was too blunt an instrument to deal with a wide range of cases where there are many other remedies available to the court before striking out[3]; and (iii) the new argument that the principle was a disproportionate interference with the insured's rights under Article 1 of the First Protocol of the European Convention on Human Rights ("A1P1"). The Court of Appeal found that the interference was a proportionate means of achieving the legitimate aim of deterring fraud, making just one modification to the principles of *The Aegeon*: that the fraud should yield a "*significant* improvement to the insured's prospects"[4], as opposed to a "*not in*significant improvement in the insured's prospects"[5]. Other than that, the obiter findings of *The Aegeon* were upheld on all grounds so that the fraudulent claims principle now appears to be past praying for.

This article seeks to explore the history of the fraudulent devices principle, the issues that were occupying Popplewell J at first instance, how these were addressed by the Court of Appeal, and, most importantly, the public policy justification behind the extension of the fraudulent claims principle to include fraudulent devices.

The Fraudulent Claims Principle

Before turning to the vexed topic of fraudulent devices, it is worth briefly recapping on the fraudulent claims principle. It is that: "the insured who has made a fraudulent claim may not recover the claim which could have been honestly made"[6]. The logic behind the principle –

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

Whilst this principle is now well established, its origin is unclear. It has been variously treated as an implied term[7], a rule of law,[8] and an extension of the duty of good faith[9]. It appears to have developed from 19th century fire insurance contracts, where fraudulent claims clauses used to be included as a matter of course, until the principle was so well established that it was deemed to hold, even in absence of such a clause:

> "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

* Barrister, Devereux Chambers.
[1] [2014] EWCA Civ 1349.
[2] [2002] 2 Lloyd's Rep 42.
[3] See *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2013] Lloyd's Rep 131 at [117].
[4] Per Christopher Clarke LJ in *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2014] EWCA Civ 1349 at [165], emphasis added.
[5] Per Mance LJ, as he then was, in *Agapitos v Agnew* [2002] Lloyd's Rep 42 at [45(c)], emphasis added.
[6] Per Lord Hobhouse in *Manifest Shipping co Ltd v Uni-Polaris Insurance Co (The Star Sea)* (HL(E)) [2003] 1 AC 469 at [62]).
[7] In *Orakpo v Barclays Insurance Services* [1995] Lloyd's Rep IR 443.
[8] In *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209; *Agapitos v Agnew* (supra) at p.45 at G*; AXA General Insurance Ltd v Gottlieb* [2005] 1 All ER (Comm) 445 at [18]-[20], [22], [31]-[32].
[9] In *K/S Merc-Sacndia v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep 563*;* see also *Halsbury's Laws of England* (4th edn), vol. 25, para 510.

> 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 the policy" (per Willes J in *Britton v Royal Insurance Co* 4F&F 905 at p.909).

The duty of good faith, as enshrined in s.17 of the Marine Insurance Act 1906, was originally intended to govern the relationship between parties at the formation of the contract, with the result that, if good faith had not been maintained by both sides, the contract would be void *ab initio*, having been made on a false basis. Part of the reasoning behind this was the unequal knowledge of the parties and the fact that the insurer sets the premium according to risk calculated from information about the insured's circumstances. However, this duty of good faith is no longer limited to the creation of the contract; as Lord Clyde in *The Star Sea* observed, confining s.17 to the pre-contract stage "now appears to be past praying for"[10].

However, whilst the fraudulent claims principle appears to have sprung from the duty of good faith, it goes further: a material breach of the duty of good faith renders the contract void *ab initio*, whereas a 'not immaterial'[11] fraudulent claim will result in "forfeiture of 'all benefit under the policy' or 'all claim' upon it"[12].

The Aegeon: the Extension of the Fraudulent Claims Principle to Include Fraudulent Devices

In an *obiter* decision in the Court of Appeal in the case of *The Aegeon*, the court held that the fraudulent should be extended to include cases where the underlying claim was valid but a fraudulent device had been used to promote the claim. This is a significant extension because the underlying claim remains lawful and it is only the means by which it is pursued that contains a fraud:

> "Where there is a fraudulent claim, the law forfeits not only that which is known to be untrue, but also any genuine part of the claim. In contrast, where the use of fraudulent devices occurs, *the whole claim is by definition otherwise good*".[13]

The Aegeon concerned an appeal by underwriters against the Judge's decision not to grant them permission to amend their defence. They wanted to include allegations that the assured had advanced a case involving false and fraudulent misrepresentations. The background was that a passenger ferry, the Aegeon, had been destroyed by fire. The vessel was insured against hull and machinery port risks. However, the insured had warranted that hot works would not be carried out on the ship until a certificate had been obtained from the London Salvage Association ("LSA"). The insured said that hot works did not commence on the vessel until 12 February 1996. The date was important because 8 February 1996 was, on the insurer's case, the earliest date on which it would have been possible to obtain a LSA certificate. Thus if the works had taken place before then, the insured would have been in breach of warranty. During the course of disclosure in 2001, two sworn statements taken from workmen immediately after the fire were disclosed. They stated that hot works had been carried out as early as 1 February 1996. If this was correct, the insurers potentially had a complete defence to the claim for breach of warranty. However, they wanted to amend their defence to argue that the insured's claim should be dismissed on the basis that the insured, who owed them a duty of good faith, had been guilty of knowingly, falsely and fraudulently misrepresenting his case. The appeal was unsuccessful: it was held that once adversarial litigation was underway, the duty of good faith was superseded by the rules of procedure. Therefore, it was held, the same must be true of the common law duty in respect of fraudulent claims.

The Court of Appeal went on consider, at some length, the impact of such fraudulent representations, or devices, both prior to, and during, litigation. Mance LJ (as he then was) offered the following "tentative solution" to the fraudulent devices principle[14]:

---

[10] *Manifest Shipping co Ltd v Uni-Polaris Insurance Co (The Star Sea)* (HL(E)) [2003] 1 AC 469 [6], cited by Mance LJ in *Agapitos v Agnew* (supra) at [13].
[11] *The Aegeon*, per Mance LJ at [33].
[12] Per Lord Hobhouse in *Manifest Shipping Co v Uni-Polaris Insurance Co ("The Star Sea")* [2003] 1 AC 469 at [64].
[13] Per Mance LJ, *The Aegeon* at p.47, paragraph 19, emphasis added.
[14] *The Aegeon* at [45].

a) "To recognise that the fraudulent claim rule applies as much to the fraudulent maintenance of an initially honest claim as to a claim which the insured knows from the outset to be exaggerated;
b) To treat the use of a fraudulent device as a sub-species of making a fraudulent claim — at least as regards forfeiture of the claim itself in relation to which the fraudulent device or means is used. (The fraudulent claim rule may have a prospective aspect in respect of future, and perhaps current, claims, but it is unnecessary to consider that aspect or its application to cases of use of fraudulent devices);
c) To treat as relevant for this purpose any lie, directly related to the claim to which the fraudulent device relates, which 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 at trial; and
d) To treat the common law rules governing the making of a fraudulent claim (including the use of fraudulent device) as falling outside the scope of s.17... On this basis no question of avoidance *ab initio* would arise."

***Versloot*: the Application of the Fraudulent Claims Principle**

Whilst the extension of the fraudulent claims principle in *The Aegeon* was strictly speaking *obiter*, in that it was held that as the fraudulent claims principle was after the commencement of litigation it was superseded by the Civil Procedure Rules, the extension of the principle to include fraudulent devices was applied by the Privy Council in *Stemson v AMP General Insurance (NZ) Ld*.[15] The extension was, in turn, reluctantly applied by Popplewell J in *Versloot* at first instance[16], though not without a fair amount of reticence.

Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors[17] concerned a general cargo ship, named "DC MERWESTONE" ("the Vessel") whose main engine room was damaged beyond repair as a result of the ingress of water. The Defendant underwriters advanced three alternative defences to the claim, namely that: (1) the loss was not insured because it was caused by an uninsured peril of the sea; (2) the loss was caused by the unseaworthiness of the vessel; (3) the presentation of the insurance claim was supported by a fraudulent statement. If the loss had been caused by the negligence of the crew, it would have been covered by the policy. In support of the insurance claim, a crew member, Chris Kornet, gave a statement to the effect that bilge alarms had gone off, which were designed to alert the crew members to an emergency in the engine room but that these had been ignored as it was assumed they were sounding owing to the vessel rolling in heavy weather.
In relation to the fraudulent device defence, Popplewell J found that the crew member did not outright lie about the bilge alarms but that he "had convinced himself ... that there had been an alarm earlier in the day", and that he had spoken to the Master "on several occasions" to say that he could not understand how there could not have been an alarm; and that eventually the Master agreed that there must have been an earlier alarm. He found that Mr Kornet "genuinely believed that if the alarm had gone off, it would probably have been ignored as a result of weather conditions ... He genuinely believed that his account of the noon alarm and the crew ignoring it was a realistic explanation of events".[18]

Popplewell J reached two important conclusions in relation to Mr Kornet's state of mind. The first was that Mr Kornet believed that it would "assist the claim if he minimised any opportunity for attributing fault to the owners, rather than the crew, in relation to the cause of the casualty".[19] Secondly, he had become "increasingly frustrated that the Underwriters were not paying the claim".[20] Moreover, Mr Kornet's account was advanced in a letter dated 21 April, coming under the heading "Facts" and was said to be "after further internal investigation". Popplewell J found that in this respect, "Chris Kornet had no grounds to believe it was true, and was *reckless* whether or not it was true. It was an *untruth told recklessly to support the claim*".[21]

[15] [2006] Lloyd's Rep IR 252.
[16] *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2013] Lloyd's Rep 131
[17] [2013] Lloyd's Rep 131.
[18] At [214].
[19] At [210].
[20] At [211].
[21] At [221], emphasis added.

The statement was directly related to the claim and intended to promote the claim. If believed, it would yield a "not insignificant improvement in the Owner's prospects of getting the claim paid".[22] As such, it met the "objective element" of Mance LJ's materiality test. However, Popplewell J was reluctant to reach this conclusion, finding it an overly harsh sanction for a small slip:[23]

> "I have reached this conclusion with 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. It was told on one occasion, not persisted in at the trial. It was told in support of a theory about the events surrounding the casualty which Chris Kornet genuinely believed to be a plausible explanation. The reckless untruth was put forward against the background of having made the crew available for interview by the Underwriters' solicitor, who had had the opportunity to make his own inquiries of the crew on the topic. To be deprived of a valid claim of some Eur3.2 million as a result of such reckless untruth is, in my view, a *disproportionately harsh sanction*."

Why might the fraudulent devices principle be "disproportionate"?

Popplewell J was reluctant to apply the fraudulent devices principle as he deemed it too blunt an instrument to deal with all cases. He suggested a materiality test that would allow the court to assess the severity of the fraud against the validity of the underlying claim:

> "... I would be strongly attracted to a materiality test which permitted the court to look at whether it was just and proportionate to deprive the assured of his substantive rights, taking into account all the circumstances of the case. The blunt instrument of a relatively inflexible test of materiality, reminiscent of the old latin tag *'fraus omnia corrumpit'*, must surely be capable of yielding to a more proportionate response, which can meet the varying circumstances of each case".[24]

The materiality test tentatively suggested by Mance LJ in *The Aegeon* was that the fraudulent device should vitiate the whole claim where it is "not immaterial". A fraudulent device would be "not immaterial", he found, where it would tend to "yield a not insignificant improvement in the insured's prospects" in settlement or at trial.[25] This threshold is extremely low; the device probably would not have been fabricated if it led to a merely insignificant improvement. However this was amended by the Court of Appeal in *Versloot*. Now a fraudulent device is "not immaterial" where it will tend to yield "a *significant* improvement in the insured's prospects" in settlement or at trial[26].

Whilst this amendment does raise the threshold, it still remains lower than what is required to establish a breach of the duty of good faith, where in order to void the contract, the breach must be (a) material; and (b) irremediable (per Rix J in *Royal Boskalis Westminster NV v Mountain* ("*The Royal Boskalis*").[27] A breach would only be material where "the matter misrepresented or concealed a justified defence to that claim".[28] Further, it was found that "the test of materiality should depend on the ultimate legal relevance to a defence under the policy of the non-disclosure or misrepresentation relied on as a breach".[29] This test was not followed in *The Aegeon* for two reasons. Firstly, if the matter were litigated to trial the device would become inconsequential:

> "... the use of a fraudulent device would itself commonly become immaterial. With regard to the claim itself, if that was bad in any case, it would fail because it was bad, and any finding that a fraudulent device was used would add nothing".[30]

---

[22] [2013] Lloyd's Rep 131 at [223].
[23] [2013] Lloyd's Rep 131 at [225], emphasis added.
[24] [2013] Lloyd's Rep 131 at [171].
[25] See *The Aegeon* at [45].
[26] Per Christopher Clarke LJ in *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2014] EWCA Civ 1349 at [165], emphasis added.
[27] [1997] LRLR 523.
[28] *The Royal Boskalis* at p 589.
[29] *The Royal Boskalis* at p 588
[30] Per Mance LJ at [35].

Secondly, Mance LJ found that lying in a claim is always material owing to (a) its ability to alter the outcome of the case and (b) the possibility that it may never be discovered:

> "It seems irrelevant to measure materiality against what may be known at some future date, after a trial. The object of a lie is to deceive. The deceit may never be discovered. The case may then be fought on a false premise, or the lie may lead to favourable settlement before trial. Does the fact that the lie happens to be detected or unravelled before a settlement or during a trial make it immaterial at the time when it was told? In my opinion, not".[31]

Therefore, according to Mance LJ, fraudulent claims are by their nature automatically material as the fraudsters have sought to recover a non-existent or exaggerated loss. As Rix J put it, "there is no additional test of materiality or, to put the same point perhaps in another way, the test of materiality is built into the concept of a fraudulent claim".[32]

A1P1 of the ECHR

In the Court of Appeal in *Versloot*, the insurers accepted that "the amount payable under an insurance contract – a right which accrues at the time of loss – is a possession within the meaning of the Article and that forfeiture of an insurance claim is an interference that engages Article 1"[33]. Article 1 of the First Protocol provides as follows:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and the general principles of international law."

Therefore the Court of Appeal was tasked with assessing whether the interference with the insured's rights under A1P1 was justified as being a proportionate means of achieving a legitimate aim. The justification may be clear: the public interest of deterring people from using fraud to support their claims, which is a "serious and expensive problem"[34]. However, the interference must be proportionate: "this involves an assessment of whether a fair balance has been struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights: the individual should not be required to bear an individual and excessive burden: *James v United Kingdon*, 8 EHRR 123, para 50."[35]

In comparison with other areas of law, the fraudulent claims principle, unique to insurance law, visits a particularly draconian sanction on the individual. Popplewell J cited the case of *Summers v Fairclough Homes*[36] in which the Supreme Court was given the opportunity to consider whether the entirety of a claim should be struck out where the claimant had been guilty of significant fraud in the context of a personal injury case. The Court was satisfied that the fraud had been proven not just to the civil standard but beyond all reasonable doubt. The Supreme Court held that it had the power to strike out in such situations[37] but declined to do so in that present case because "as a matter of principle, it should only do so in very exceptional circumstances".[38] The Court awarded the claimant the value of the legitimate part of the claim. Lord Clarke, referring to the claimant's rights under Article 6 of the ECHR, said that it would be "very difficult indeed to think of circumstances in which such a conclusion [of strike out] would be proportionate".[39] Mrs Justice Gloster DBE and other judges of the commercial court have also drawn attention to this disparity between insurance law and personal injury law:

> "It is difficult to bring to mind any other area of law in which we have a policy of non-penal damages, ie depriving a party of the damages to which they are legally entitled as a result of some deliberately false

[31] At [37].
[32] Per Rix J in *The Royal Boskalis* case at p 599.
[33] In *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2014] EWCA Civ 1349 at [141].
[34] Law Commissions Report, Summary of Responses to Issues Paper 7: *The Insured's Post-Contractual Duty of Good Faith* (December 2010), at para 1.4.
[35] Per Lord Reed in *AXA General Insurance v AM Advocate* at [126]).
[36] [2012] UKSC 26; [2012] 4 All ER 317.
[37] Not just under the CPR but within the inherent jurisdiction of the court to control its own process (see [35(i) to (v)]).
[38] Per Lord Clarke at [33].
[39] At [49]

> aspect of the claim or evidence advanced to support it. Yet insurers are not unique in facing exaggerated claims. ... For example personal injury claimants regularly exaggerate their injuries. One wonders why an assured whose house burns down loses his buildings and contents entitlement to hundreds of thousands of pounds because he falsely claims for extra laptops, when a personal injury claimant whose dishonesty about his injuries may be grosser and more reprehensible still gets his true entitlement."[40]

What, then, might be a proportionate remedy?

Proportionate Remedies

In a recent Bracton Lecture for the Law School of the University of Exeter's 90th Anniversary Celebration, Lord Clarke gave a speech entitled "What Shall We Do About Fraudulent Claims?" in which he explored the reasoning behind the *Summers v Fairclough Homes* judgment. Importantly, he accepted as "undoubtedly correct" the policy that "fraudulent claims must be deterred" but offered alternative ways of deterring fraud "short of striking out a valid claim". They were as follows:

(1) "A party who fraudulently or dishonestly invents or exaggerates a claim will have considerable difficulties in persuading the trial judge that any of his evidence should be accepted.
(2) As to costs, in the ordinary way, one would expect the judge to penalise the dishonest and fraudulent claims in costs...
(3) There is no reason why a defendant should not make a form of *Calderbank*[41] offer in which it offers to settle the genuine claim but at the same times offers to settle the issues of costs on the basis that the claimant will pay the defendant's costs incurred in respect of the fraudulent or dishonest aspects of the case on an indemnity basis. Such an offer can be made outside Part 36.
(4) The court can also reduce interest that might otherwise have been awarded to a claimant if time has been wasted on fraudulent claims.
(5) As to contempt, we saw no reason why contempt should not be an effective sanction."

Finally, Lord Clarke even went as far as suggesting "criminal proceedings being brought for, say, perjury or fraud". In short, there is an artillery of deterrents against the use of fraud once litigation has begun and there seems to be little reason, therefore, why a claim cannot be allowed to proceed until trial where a fraudulent device has been discovered. The courts are well equipped to deal with parties in adversarial conflict:

> "it cannot be disputed that there are importance changes in the parties' relationship that come about when the litigation starts. There is no longer a community of interest. The parties are in dispute and their interests are opposed. Their relationship and rights are now governed by the rules of procedure and the orders which the court makes on the application of one or other party. The battle lines have been drawn and new remedies are available to the parties"[42]

This is the difference relied upon by the Court of Appeal in *The Aegeon* as to why, once the parties are in litigation "it is the procedural rules which govern the disclosure which should be given in the litigation, not s.17 [of the Marine Insurance Act 1906] as such"[43]. In *Versloot*, Popplewell J pointed out that fraud during the course of a trial is a far worse act as it is also made in contempt of court. Moreover, the policy concerns of commanding respect for the court system are much stronger than concerns of fair dealing in insurance law[44]. If cases should only be only be struck out in very exceptional circumstances at trial, then why should a case be so readily struck out before litigation?

---

[40] Mrs Justice Gloster DBE, Mr Justice Burton, Mr Justice Beatson, Mr Justice Christopher Clarke, Mr Justice Flaux and Mr Justice Popplewell in a Response to the Law Commissions' Consultation Paper on Post Contract Duties and other Issues (December 2012), para 2.13.
[41] [1975] Fam 93.
[42] *The Star Sea*, per Lord Hobhouse at [75].
[43] *The Aegeon* per Mance LJ at [77].
[44] See *Agapitos v Agnew* at [176].

Lord Clarke drew attention to his fiercest critic, Professor Zuckerman, the author of an article entitled, "Court protection from abuse of process – the means are there but not the will"[45]. Professor Zuckerman argues that relief through the courts should be refused where fraud has tainted a civil claim, along the same lines as principles of illegality and *ex turpi causa non oritur actio*, where relief is refused "not because of the need to deter others but because of the need to maintain confidence in the administration of justice". However, this was rejected by Lord Clarke because "the problem with the *ex turpi causa* approach is that the court has no discretion. Where the principle applies, the court has no option but to strike the whole case out, which may be too blunt an instrument to deal with the particular case".

It is for the same reason that Popplewell J was so reluctant to follow the fraudulent devices principle:

> "My own view would be that if the law is to extend the draconian effect of an anomalous rule, applicable only to insurance claims, and then only prior to the commencement of litigation, to striking down wholly valid claims, the policy of the law should be to require at least a sufficiently close connection between the fraudulent device and the valid claim to make it just and proportionate that the valid claim should be forfeit. The law does not provide in this context that the end always justifies the means; but nor should it say that any dishonest means which are more than *de minimis* should deprive a litigant of his just ends. What will be just and proportionate will depend upon the circumstances of each case, which may vary considerably".[46]

Public Policy

The public policy of deterring fraud, which supposedly costs the insurance industry £2 billion every year[47], is one of the main reasons behind the fraudulent devices principle:

> "Fraud has a fundamental impact upon the parties' relationship and raises serious public policy considerations. Remediable mistakes do not have the same character."[48]

The fraudulent claims principle thus seeks to deter people from making false claims, which, once made, are irremediable:

> "... the logic of the test is that the attempt to deceive, once committed, is irremediable. A correction or retraction would be ineffective. The assured who in a fit of exasperation tells a lie, but, having calmed down, corrects it the following day, would still forfeit his claim: see *Stemson* at 34".[49]

However, the same policy reasons do not exist for fraudulent devices. Fraudulent devices are far less dangerous to the insurance industry in that they do not alter the loss suffered and they do not hide information at the stage of the formation of the contract. For this reason, they can arguably be remedied.

In his response to the second Law Commission consultation, Professor Merkin suggested that where fraudulent devices had been retracted, the underlying claim should be allowed:

> "In *AXA General Insurance Ltd v Gottlieb* [2005] 1 All ER (Comm) 445, Mance LJ thought that this was not possible, and that the claim remained tainted. However, there might be a case for arguing that an assured who submits a fraudulent claim and then genuinely recants and comes clean should be allowed to recover the genuine part of his claim."[50]

It is important here to note the distinction between the fraudulent claims principle and the duty of good faith. In *Axa v Gottlieb*, Mance LJ did not accept counsel's suggestion that fraudulent claims broke any "relationship of trust" as

[45] (2012) 31 CLQ, Issue 4, 377
[46] [2013] Lloyd's Rep. 131 at [177].
[47] See *Versloot* at [164]
[48] Per Lord Hobhouse in *The Star Sea* at [72].
[49] Per Popplewell J in *Versloot* at [166]
[50] Law Commission Report, Summary of Responses to Issues Paper 7: The Insured's Post-Contractual Duty of Good Faith (December 2010), at para 4.11.

the fraudulent claims rule has a retrospective effect: "an insurer can recover any payments made in respect of genuine loss made between the date of the fraud and its discovery".[51] This is because fraudulent claims principle has such a far-reaching effect that it retrospectively extinguishes the insured's right to any sums already and correctly received.

In the case of fraudulent devices, however, the underlying cause of action has not been tainted by the fraud in the same manner and should not retrospectively extinguish the cause of action except in the most extreme cases. On this reasoning there would seem to be situations in which any damage caused by fraudulent devices can be remedied because (a) it cannot be said that the relationship of trust has been damaged; and (b) the underlying claim remains valid, not having been exaggerated or altered by the fraudulent device.

It is striking that the test in *The Aegeon* was based on the incorrect belief that fraudulent devices would be used to bolster an otherwise weak claim. Mr Popplewell QC, as he then was, acted for the insurers in *The Aegeon* and submitted that an insured "uses such devices, precisely because he cannot be sure that his claim is otherwise good"[52]. This was accepted by Mance LJ. On this view, the fraudulent device could be said to alter the underlying claim by strengthening it. However, as Popplewell J points out in *Versloot*, this is not always the case; often a fraudulent device is employed merely to expedite the indemnity payment for a perfectly valid claim: "he intends to persuade the insurer to pay his valid claim more promptly than the insurer otherwise might".[53] This should attract very different policy considerations, not least because the insured is merely hurrying along a payment owed to him. It is the insurer who is in breach of his duty to pay the insured under the terms of the policy:

> "Non-payment by the insurer, even during a reasonable period for investigation, is a breach of the insurer's obligation to indemnify. His failure to pay may well cause the assured to suffer consequential loss; but the assured cannot recover for losses caused by the insurer's wrongful refusal to pay a valid claim"[54].

The Law Commissions have already observed that *The Aegeon* has "led to a sudden surge in insured's lawyers pleading fraudulent means and devices as a way of deterring the insured's claim".[55] Without better safeguards, the fraudulent devices principle could be used early on in proceedings and operate as a complete defence, preventing the full trial. This would be an interference with the insured's right to trial under Article 6 ECHR, which could only be justified as a proportionate means of achieving a legitimate aim. The Court of Appeal in *Versloot* cited the views of Professor Clarke in *The Law of Insurance Contracts* 4th Ed at 27.2B; that "the recognition of the fraudulent devices rule gives rise to concerns for the interests of consumers and small businesses and would potentially encourage insurers to attempt to question the insured after the loss in the hope of obtaining misstatements".[56] However, the Court of Appeal in *Versloot* found that this concern was not deemed as important as those facing the insurance industry.

Law Commission

On 28 February 2014, the Law Commissions closed the consultation on one part of the draft Insurance Contracts Bill. However, the Law Commissions' research did not address fraudulent devices specifically. Whilst the issue was considered in the First Consultation Paper in July 2010, the paper merely summarised the case law[57]. Fraudulent devices did not constitute a separate section in the Summary of Responses, although the matter was touched upon by three consultees. RSA supported the decision in *The Aegeon*, calling for the use fraudulent devices to be included in the statutory definition of fraud, whereas the British Insurance Law Association ("BILA") argued that the rule as set out in *The Aegeon* is unduly harsh.

---

[51] *Axa v Gottlieb* at [24] and [25].
[52] *Agapitos v Agnew* at [20].
[53] Per Popplewell J in [2013] Lloyd's Rep 131 at [161].
[54] Per Popplewell J in *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2013] Lloyd's Rep 131 at p.38, [163].
[55] Law Commission Report, 'Summary of Responses to Issue Paper 7: *The Insured's Post-Contractual Duty of Good Faith*' (December 2010), [4.9].
[56] 2014] EWCA Civ 1349 at [133].
[57] Reforming Insurance Contract Law, Issues Paper 7: the Insured's Post-Contractual Duty of Good Faith (July 2010), [3.36]-[3.47]).

In the response to the second Consultation Paper, the Bar Council suggested giving courts the discretion not to impose forfeiture in every case:

> "We would wish such legislation to be framed in such a way as to enable the courts to retain a limited discretion to allow an insured to recover some of his claim where an insured has suffered a genuine loss but has done something minor to embellish or support that claim. We take the view that in those cases the courts could penalise the insured by way of costs, but still allow recovery".[58]

BILA suggested that courts should have a discretion where "the breach of the duty of good faith to assist his claim is fairly minor and which is not intended to increase his claim".[59] On 17 June 2014 the Law Commission published the Insurance Contracts Bill. In line with its research, the issue of fraudulent devices is not specifically addressed (see Part 4, ss.12-13)[60]. However in avoiding giving a definition to the word "fraud", the Law Commissions appear to be leaving the issue of fraudulent devices to the courts, as the Explanatory Notes point out: "[t]he clause does not define 'fraud' or 'fraudulent claim'. The remedies will apply once fraud has been determined in accordance with common law principles"[61].

In *The Aegeon* attention was drawn to the "dearth of convincing authority standing positively for or indeed against"[62] the fraudulent devices principle:

> "The proper approach to the use of fraudulent devices or means is much freer from authority. It is, as a result, our duty to form our own perception of the proper ambit or any extension of the common law rule".[63]

Mance LJ expressed the hope that "the House of Lords judicially or Parliament legislatively one day look at the point again".[64] Following the Law Commissions' failure to tackle the issue, it was left to the Court of Appeal in *Versloot* to consider the extension of the fraudulent claims principle and its proportionality.

Upholding the Fraudulent Devices Principle

The Court of Appeal gave six reasons for upholding the obiter decision of the Court of Appeal in *The Aegeon*. The first was that the decision, whilst not binding, is authoritative. The fifth reason similarly related to antecedent authority, "which provides some support to the application of the rule to fraudulent devices".[65] The sixth relied on the fact that *The Aegeon* has been cited without disapproval in a number of subsequent cases[66] and that most text books refer to the doctrine "without any suggestion that it is controversial".[67]

The second reason was that the rule is based on the foundation of "the obligation of utmost good faith".[68] The Court supported Mance LJ's reasoning that fraud is by its nature material[69], in finding that the duty of utmost good faith was affected by both fraudulent claims and fraudulent devices as there was little difference between the two:[70]

> "In the case of both the fraudulent claim and the fraudulent device, fraud is used to obtain something to which the insured is either not entitled or would not otherwise have received: in a fraudulent claim case, the

---

[58] *Ibid* at para 4.16.
[59] *Ibid* at para 4.17.
[60] http://lawcommission.justice.gov.uk/docs/insurance_contracts_bill.pdf
[61] Explanatory Notes, Clause 12, A.81 (http://lawcommission.justice.gov.uk/docs/insurance_contracts_bill_notes.pdf)
[62] Per Mance LJ at [22].
[63] Per Mance LJ at [45].
[64] At [13].
[65] [2014] EWCA Civ 1349 at [123].
[66] [2014] EWCA Civ 1349 at [129].
[67] [2014] EWCA Civ 1349 at [131].
[68] [2014] EWCA Civ 1349 at [109].
[69] *The Aegeon* at [37].
[70] [2014] EWCA Civ 1349 at [109].

> bogus part of the claim; and in a fraudulent device claim, earlier payment than full investigation would otherwise permit."[71]

However, this ignores the distinction between fraudulently exaggerated claims and fraudulent devices. A fraudulent part of a claim is more likely to alter the underlying claim by augmenting it. A fraudulent device, on the other hand, may well be "directly related to and intended to promote the claim", but in actual fact have little or no impact on the claim. It may not conceal a defence to the claim. The claimant is not seeking to recover non-existent or exaggerated loss. On the contrary, he "believes that he has suffered the loss claimed" (*The Aegeon* at [30]). His actions are merely serving to bring about the indemnity payment he is owed. What is more, there may be scope to remedy the fraud but this will become impossible if its mere existence is a total defence to recovery the minute it is discovered.

Like Popplewell J in *Versloot*[72], the Court of Appeal acknowledged that "the harshness of the result is most apparent when, as here, the Court has, in the end, determined that the claim is otherwise valid".[73] However, the Court went on to make the somewhat circular observation that "the rule is directed at an earlier stage", when it would not have been possible to tell whether the claim "is one that will in the end be accepted, or held, to be valid". This is apparently justified because it removes a risk to the insurer:

> "The risk to the insurer is that the device may achieve its purpose so that the insurer fails to explore the claim properly and pays out in respect of a claim where he may have a defence."

There is no immediate explanation given for why this is deemed fairer than assessing the materiality of the fraud at trial. The fact that the insured's claim is not tested at a hearing is not investigated. The alternative scenario, where the device did not conceal a defence, is not explored. The justification appears to be public policy of deterring fraud: "The importance of honesty in the claiming process is manifest. Most insurance claims get nowhere near litigation because insurers rely on their insured".[74] Owing to the dangerous nature of fraud, its ability to go undetected, and its power to alter the outcome of a case, it is clearly felt that it ought to be discouraged from the start: "The insured must not be allowed to think: if the fraud is successful, then I will gain; if it unsuccessful, I will lose nothing".[75]

The third and fourth reasons explicitly relate to public policy and the Law Commission reports respectively. The harshness of the sanction is justified as the "draconian consequence only applies to those who are dishonest".[76] This may be true but once again does not distinguish between varying degrees of fraud or dishonesty. The fraud in *Versloot* was characterised as "recklessness" as opposed to calculated deceit. The court found that the insurers, unlike the insured, are "entitled to protection... and the scope of the rule should not be determined by the fact that unscrupulous insurers might assert a fraudulent device without good reason to do so".[77] The same protection is not extended to frustrated insureds, seeking to expedite payment under the policy. The implication is that the insureds chose to be fraudulent and so visit the consequences on themselves, whereas the insurers are blameless.

The Court goes on to consider proportionality. The principle is found to be proportionate because, firstly, "the careless or forgetful insured is not affected".[78] Once again, the implication is that the insured has chosen to commit fraud and so brings the sanction on himself. The second consideration is pragmatic: it was found that an assessment of what would be "just and proportionate" to forfeit would be "problematic and its outcome difficult to predict", and that it would be "a recipe for litigation".[79] The fact that the alternative deprives the insured to his right to a fair hearing is once again not touched upon.

Thirdly, it was found that waiting until the matter had been fully litigated to assess its materiality would "reduce the deterrent effect".[80] This is a legitimate point but the very thing the Court is assessing is whether the deterring sanction is proportionate to the offence in the circumstances.

---

[71] *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2014] EWCA Civ 1349 at [109]
[72] *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG & ors* [2013] Lloyd's Rep 131 at [25].
[73] [2014] EWCA Civ 1349 at [112].
[74] Per Christopher Clarke LJ in [2014] EWCA Civ 1349 at [113].
[75] *The Star Sea* at [62].
[76] [2014] EWCA Civ 1349 at [113].
[77] [2014] EWCA Civ 1349 at [113].
[78] [2014] EWCA Civ 1349 at [155].
[79] [2014] EWCA Civ 1349 at [157].
[80] [2014] EWCA Civ 1349 at [158].

The fourth reason – the "inherent timing problem" of making the insurer wait until trial for a determination as to whether the claim is forfeit or not – only appears to consider the impact on the insurers and yet again fails to address the insured's right to have his underlying claim considered at all.[81]

Finally, the court comes to the true justification: "the [insureds] invoke the Convention not in respect of some legislative or administrative act but in relation to the operation of a common law doctrine which is an incident of a *commercial relationship of a special character*".[82] This lies at the heart of the principle and explains why the Court leans in favour of the insurer at step of its analysis. It is not the discouragement of the use of fraud that is central; it is the need to preserve of the special relationship between insured and insurer. The use of a fraudulent device "crosses a moral red line, and has, as Lord Hobhouse put it, "a fundamental impact on upon the parties' relationships".[83]

Conclusion

The duty of good faith, in and of itself, is not a justification for the extension of the fraudulent claims principle. It is the reason the duty exists that is important. The relationship between insurer and insured is governed by the duty of utmost good faith not because of the "asymmetry of information between claimant and defendant", as this is also characteristic of other legal relationships, but because the insurer is not at fault in the relationship: he has not committed a tort; he has broken no contractual term; he is merely indemnifying the insured against loss. It is for this reason that the insured owes him a duty of utmost good faith. It is for this reason that the insured should be deterred from using fraudulently exaggerated claims and fraudulent devices. Therefore the answer to the following question –

> "One wonders why an assured whose house burns down loses his buildings and contents entitlement to hundreds of thousands of pounds because he falsely claims for extra laptops, when a personal injury claimant whose dishonesty about his injuries may be grosser and more reprehensible still gets his true entitlement."[84]

– is that, contrary to the tortfeasor, the insurer has done nothing wrong yet is indemnifying the insured against loss. This is the special relationship and it needs to be protected:

> "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.[85]

If the insured has chosen to commit fraud of any kind or has been reckless enough for it to happen then according to principle he should, and now will, forfeit any right to be held harmless.

[81] [2014] EWCA Civ 1349 at [159].
[82] [2014] EWCA Civ 1349 at [160], emphasis added.
[83] [2014] EWCA Civ 1349 at [155].
[84] Mrs Justice Gloster DBE, Mr Justice Burton, Mr Justice Beatson, Mr Justice Christopher Clarke, Mr Justice Flaux and Mr Justice Popplewell in a Response to the Law Commissions' Consultation Paper on Post Contract Duties and other Issues (December 2012), para 2.13.
[85] per Willes J in *Britton v Royal Insurance Co* 4F&F 905 at p.909