

SOUNDINGS

Gilding the lily: will a collateral lie invalidate an insurance claim?

For over 150 years, the common law has protected insurers against paying fraudulent claims. This position is founded on a clear public policy decision to deter fraud. Should the law take the same view, however, where the insured tells a lie to his insurer which bears no relevance to the underlying validity of the claim? This is the issue which came before the Supreme Court for the first time in the recent case of *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG* [2016] UKSC 45.

The facts

Versloot Dredging BV was the owner of the DC MERWESTONE; HDI Gerling was the insurer. In January, 2010, whilst at sea the ship suffered from flooding in the engine room and the main engine became damaged beyond repair. The flood was caused by a combination of crew negligence, negligence on the part of contractors and unseaworthy pumps. The owner claimed in excess of €3million under the marine insurance policy. In the course of discussing its claim with the insurer, the insured wrongfully alleged that the bilge alarm had sounded several hours earlier than it in fact did. The allegation was made to try to move the claim forward more quickly. The fact that it was untrue did not however matter for the purposes of determining

what caused the flood and therefore whether the claim was covered under the insurance policy.

In the event, the High Court found that the claim was capable of being covered under the insurance policy. However, the insurer successfully argued that it could avoid the claim in reliance upon the fraudulent claims rule, as a result of the false statement made by the insured.

The fraudulent claims rule

The fraudulent claims rule developed through the courts in the 1800's. In short it protects an insurer from paying a fraudulent claim, thereby stopping the wrongdoer from dishonestly gaining something to which he is not entitled.

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In situations where an insurance claim is invented or its value exaggerated, it is easy to see the relevance and importance of the fraudulent claims rule. But the situation in the subject case was different. The case concerned an insurance claim which was sound in law. It had not been invented or exaggerated. The lie told by the insured had no bearing on the amount of the insurer's liability and so by telling the lie the insured stood to gain nothing more than it was already legally entitled to receive. In effect, it was simply 'gilding the lily'. This type of mistruth has come to be known as a 'fraudulent device', or a 'collateral lie'.

In the case of *The AEGEON* [2003] QB 556, the Court of Appeal suggested that an insurer could benefit from the fraudulent claims defence if there was a collateral lie. It was on the basis of this decision that the High Court found in favour of the insurer in the present case, such that the fraudulent claims rule applied and *Versloot Dredging* were unable to recover under the insurance policy.

The insured appealed to the Court of Appeal but again the decision went against it. It therefore took the appeal to the highest appellate court, the Supreme Court.

The Supreme Court's judgment

The Supreme Court was asked to determine for the first time in its history whether the insurer could rely on the fraudulent claims rule where there had been a collateral lie.

The Supreme Court overturned the earlier decisions, finding in favour of the insured by a majority of 4 to 1. The rationale behind this decision is that if a collateral lie makes no difference to the value or validity of the claim, it cannot prevent an insured from recovering something to which he is entitled. Essentially, the collateral lie merely assists the insured (albeit by dishonest means) to obtain something to which he is already entitled.

In turn, the insurer is not exposed to a greater liability than that which it had anyway.

The Supreme Court found that there is no policy justification for enabling an insurer to avoid the claim in this situation. In simple terms, an insurer does not need the law to step in to protect it since it would be suffering no harm. Were the law to do so, that would in Lord Sumption's view be "disproportionately harsh to the insured" because:

"...the fraudulent claims rule...does not apply to a lie which the true facts, once admitted or ascertained, show to have been immaterial to the insured's right to recover. It is true that the moral character of the insured's lie is in no way mitigated by the fact that it turns out to have been unnecessary. But there are principled limits to the role which a claimant's morality can play in defeating his legitimate civil claims...The extension of the fraudulent claims rule to lies which are found to be irrelevant to the recoverability of the claim is a step too far."

Conclusion

The Supreme Court's position demonstrates that the law is concerned primarily with the impact on the insured risk rather than with the punishment of misconduct.

It is to be remembered that the judgment followed years of legal battles at great expense, during which the insured's claim remained unpaid. Delays and costs of this nature will not necessarily fall away as a result of the judgment.

If Members have any queries arising out of this judgment please contact your usual contact at the Managers' offices.

The UK Defence Club

Thomas Miller Defence Ltd, 90 Fenchurch Street, London, EC3M 4ST
tel: +44 207 283 4646 fax: +44 207 204 2131
email: tmdefence@thomasmiller.com web: www.ukdefence.com

