

Wilful Misconduct and Fraud – Refresher, Reflections and Legal Update
IMCC Dublin 2017 – Joe O’Keeffe – Ince & Co



Wilful Misconduct – General Principles

S. 55(2)(a): “The insurer is not liable for any loss attributable to the wilful misconduct of the assured...”

- Burden of proof – on underwriters
- Standard of proof – balance of probabilities commensurate with the seriousness of the allegation
- Absence of smoking gun: Lord Sumner (The Arnus, 1924):

“Ships are not cast away out of lightness of heart or sheer animal spirits. There must be some strong motive at work; and there is usually the hope of gain”

- But financial motive not enough - must look at **all** of the evidence

Wilful Misconduct - Loss by Sinking

- Owners have initial burden of proving the operation of an insured peril
- “Perils of the seas”: MIA 1906, Rules of construction:
 - “The term “perils of the seas” refers only to fortuitous accidents or casualties of the seas. It does not include the ordinary action of the winds and waves”*
- Need to prove a fortuity: mere sinking beneath the waves is not evidence of a loss by perils of the seas
- Option: putting the assured to proof of a fortuity/traverse: *The Popi M*, *The Marel*
- Alternative: positive plea of wilful misconduct
- Barratry (*The Michael*) [Violent Theft, Piracy and Barratry exclusion]
- The position of co-assureds (*Samuel v Dumas*)

Wilful Misconduct - Loss by Fire

- Different dynamic: fortuity is not part of the definition of the peril of fire
- So, a deliberate fire is a covered peril – unless the assured connived at the fire
- Putting the assured to proof of a covered peril not therefore an option: a positive plea of wilful misconduct is required
- Position of co-assureds (*Slattery v Mance*)

Wilful Misconduct - Loss by Fire Followed by Sinking

- Interesting scenario because it brings into play both of the above dynamics
- The assured has to prove a loss by insured peril
- Two possibilities:
 - Vessel a CTL due to fire damage prior to sinking
 - Vessel an ATL by perils of the seas (fortuitous water ingress caused by fire)
- Kastor Too: held that the vessel was a CTL due to fire damage; ATL due to sinking not proved. Total loss recovered.

Wilful Misconduct - Loss by Fire followed by Sinking (continued)

- However, what would position have been if fire damage was not sufficient to render the vessel a CTL? There would have been no recovery at all:
 - Only a partial loss in respect of fire damage;
 - However, the claim for the partial loss by fire would have “merged” into the actual total loss (i.e. would have no independent life of its own);
 - Because the assured had failed to prove the sinking was fortuitous, it could not recover the ATL caused by sinking
- Things to focus on:
 - Does the fire explain the sinking? Vessels are built to float!
 - Does the cost of repairing the fire damage exceed the CTL trigger point?
- If the answer to both is “no”; the option of putting the assured to proof is open to underwriters, and if they cannot prove the loss was fortuitous, they cannot recover

Fraud – Legal Update

- S.12 Insurance Act 2015
- Statutory remedies in respect of fraudulent claims:
 - S.12(1) underwriters not liable on the claim;
 - S.12(2) underwriters entitled to recovery of sums already paid in respect of the claim
 - S.12(3) underwriters can terminate the contract from the date of the fraudulent event
- No definition of “fraudulent claim”:
 - Deliberate loss/no loss
 - Fraudulent exaggeration
 - Dishonestly pursued claims? (Versloot Dredging v HDI Gerling (the DC Merwestone)?

Fraud – legal update

THE SUNDAY TIMES

21.08.16 / 3

When is it OK to lie to your insurer?

Small fibs won't necessarily invalidate a claim but they represent a big problem for the industry

Is it ever OK to lie? In my household, it is part of everyday life. I have gone to ridiculous lengths to persuade my four-year-old daughter that a fat man in a red suit squeezes down the chimney to bring her presents every Christmas. And over the past few weeks I have lied repeatedly to my wife while she is rising her surprise 40th birthday party.

Handily, everyone I know thinks this kind of lie is acceptable. But what about lying to your employer – by calling in sick when you're fit and healthy? One in five people apparently do that each year.

Or how about lying to your insurer? If you are looking for someone with more authority than a newspaper columnist to give you the verdict on whether this is OK, you will be pleased to know that the Supreme Court tackled the question last month. The answer was a qualified "yes".

Back in 2010, a Dutch shipping company made a £1m insurance claim after one of its vessels ran into heavy seas and its engine flooded. The crew had cleared the hatches of ice using the emergency fire pump but forgot to close the sea-latch valve when they finished. That, along with damage caused by freezing water in pipes, meant the ship took in water when it hit bad weather.

It is exactly the kind of incident the cargo company had bought cover for. Yet the insurer disagreed its feet on the payout, initially because the cause of the flood wasn't clear.

In an effort to get things moving, the shipping company's manager told the insurer the reason for the flood was that the crew hadn't responded quickly enough to an alarm that went off during the storm. He even managed to get one of the crew to back up his version of events.

In due course, however, the insurer found out the real reason for the flood. And when it discovered the company had lied, it immediately rejected the claim.

From the insurer's perspective, this was an open-and-shut case. Once its customer had lied, it had broken the good faith of

PERSONAL ACCOUNT

James Daley



lie was, in effect, irrelevant. It would have been better if the manager had told the truth, but his lie did not invalidate the amount of the payment, or serve to get a claim paid that otherwise would not have been. It was, as the Supreme Court put it last month, a "collateral lie".

Before you grab your laptop to email your insurer and report the very device you are writing from stolen, let's get one thing straight: the Supreme Court ruling does not change the rules around fraud. That is still illegal – and can land you in jail for up to 10 years.

It is not OK to fabricate a claim entirely, but to exaggerate a genuine claim, insurance fraud costs the industry hundreds of millions of pounds a year – and that cost is ultimately passed on to us, the policyholders.

What the court ruling makes clear, though, is that lying, in itself, is not good enough reason to reject a claim that is otherwise valid.

In move away from the rather abstract world of cargo ships, imagine your house has been burgled by someone who kicked in your front door and broke the lock. When you get home you realise you had left the front window at the back of the house open.

You call your insurer to make a claim, and when you are asked if all the doors and windows had been secured in the home,

Steve McQueen played a high-class robber pursued by an insurance investigator in *The Thomas Crown Affair*

paranoia that your insurer will be looking for some reason to wriggle out of paying your valid claim.

In the old world, if the insurer discovered you had left the back window open, and had lied about doing so, it might have tried to reject your claim. However, the Supreme Court ruling makes it clear that, as the liar came in through the front door, the lie is neither here nor there.

What is most interesting is the way the insurance industry reacted to the case. The Association of British Insurers (ABI) merely tweeted: "Lies are lies. Insurers will investigate suspicious claims & we made no apology for doing so as it keeps premiums down for honest customers."

It was a stiff response, and quite revealing. The insurance industry has a massive reputation problem. According to one poll, insurers are less trusted than banks, journalists and politicians.

What the industry missed was that the court case was yet another manifestation of these troubles. People expect insurers to

knows someone who has been denied money by an insurance company. So, whenever we submit a claim, we hold our breath and hope for the best while expecting the worst.

Insurers are incredulous about their ill repute and believe the way to restore their reputation is to issue press releases about how much they have paid out. Yet the small number of claims rejected for spurious reasons do more damage than they can imagine. The shipping case is a perfect example. The claim was valid but the insurer was quick to try to avoid payment by claiming that a lie – even a collateral lie – had poisoned the whole contract.

I have worked closely with a number of large insurance companies and a large theme is no complicity. These companies and all the people who work for them genuinely believe they are in the business of "pay" claims. However, they have an odd way of looking at what is valid and what is not, and it is this disconnect between their view and that of consumers that perpetuates

Customers buy insurance to protect themselves from the unexpected, but policies are riddled with increasing numbers of exclusions. One home insurance contract I looked at recently said it covered hard tennis courts but not clay ones. It covered remote-controlled toys but not ones that went over 50mph. It covered dentures but not if they are damaged while eating.

There is no way a customer can absorb all this before they buy a policy. That's why they cross their fingers when they make a claim, expecting the insurer to produce some excuse for why it won't pay. In most cases, the claims are paid. Yet for the minority of policyholders who get turned down, their views against the industry are hardened, and they tell everyone who will listen about their hard-luck story.

If insurers want people to stop lying, they need to be more willing to give customers the benefit of the doubt. It's not easy. There are commercial pressures to keep prices low – and they would go bankrupt quickly if they footed the bill for

to ensure customers have realistic expectations when they buy cover. Insurers should look at how some of the exclusions appear in the eyes of customers, for example.

If further proof was needed of how far we are from harmony in this industry, you need only look at the Financial Ombudsman Service's complaints statistics. Policyholders' contract the ombudsman once a claim has been rejected by an insurer – and the ombudsman overturns about a third of the refusals. That means insurers are getting it wrong on an average of one in every three claims. For some companies, the state is much worse.

The Supreme Court ruling should be another wake-up call for the insurance industry. Sadly, the response from the ABI suggests we are still a long way from a world where there is mutual trust between insurers and their customers.

James Daley is the founder and managing director of the consumer group Ruler Insurance.

Questions?

