

A sledgehammer to crack a nut, or a charter for untruth?

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Versloot Dredging BV and another v HDI Gerling Industrie Versicherung AG and others [2016] UKSC 45

Introduction

This paper analyses the recent Supreme Court decision on collateral lies in insurance contracts. The Court by a majority held that a collateral lie is not subject to the fraudulent claims rule. The telling of a lie, if truly collateral to the claim being made, does not permit an insurer to refuse to pay. Lords Sumption, Clarke, Hughes and Toulson concurred, Lord Mance dissented.

Background

The common law fraudulent claims rule holds that there is untruth in the formation of a contract or any claim made an insurer is entitled to refuse to pay.

The rule applies to straightforwardly fraudulent claims – where there was never any valid claim at all – and claims where there is exaggeration. Public policy requires the deterrent of permitting insurers to refuse claims entirely, even for claims which are otherwise valid but exaggerated.

What about the situation where a person has a valid claim, does not exaggerate, but nevertheless tells a lie – a lie that is, or turns out to be, irrelevant to the claim made? A ‘collateral lie’. That is the question the Supreme Court has answered. If the lie is irrelevant to the claim then the fraudulent claims rule does not apply. The insurer has to pay out.

Versloot Dredging and the collateral lie

In Versloot Dredging the engine room of a ship was damaged beyond repair. The owners sued for the value of the ship. There were a number of possible explanations for the damage. If damage occurred because the owners permitted the ship to become defective then they were liable, not the insurer. While the cause of the damage remained unclear one of the owners of the vessel contended, untruthfully, that he was told by the crew that an alarm had gone off warning of possible damage to the engine. It promptly became clear this was not true. At first instance Popplewell J found the damage was caused by a peril of the seas. Hence the insurers were liable. Yet, because of the lie – a “fraudulent device” – the judge held that the insurer did not have to pay out.

The qualitative difference

Lord Sumption focussed particularly upon the contractual position. The right to an indemnity arises as soon as loss is suffered. A collateral lie is irrelevant to the existence or amount of that contractual entitlement. The insured gains nothing she was not entitled to have.

Lord Hughes held that the issue of collateral lies and the fraudulent claims rule must be considered in the context of unacceptably high levels of insurance fraud. Yet he identified a range of consequences which can follow the telling of an untruth: the threat of a criminal prosecution for fraud, a general loss of credibility within and without litigation, legal costs, and more expensive or unavailable insurance subsequently.

Lord Hughes came to the conclusion that there is “plainly a difference of quality between the insured who deals fraudulently with his insurer in an attempt to gain something to which he is not entitled, and 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”. [paragraph 100]

Thus the extension of the fraudulent claims rule to a collateral lie is disproportionate to the breach of duty involved. It is “too large a sledgehammer for the nut involved”. [100]

Collateral, but still a lie

Lord Mance focussed instead upon the state of mind of the insured when telling the lie. Why would an insured attempt to deceive? It can only be “precisely because the assured does not believe or is not confident that he has a good claim”. [126]. His Lordship thought the majority view a “charter for untruth, which overlooks (a) the obvious imperative of integrity on both sides in the claims process and (b) the obvious reality that lies are told for a purpose, almost invariably...to obtain the...advantage of having the claim...met”. [130].

The significance

Lord Mance is certainly correct in his analysis that lies are told for a reason. Yet the majority view was, as he acknowledged, nuanced.

Perhaps it is disquieting for the Supreme Court to side with those who tell lies when making insurance claims. Yet the alternative is a windfall to the insurer which is disproportionate to the effect and consequence of the lie, even when set against the macro level.

As their Lordships, particularly Lord Hughes, identified, Parliament has legislated to deal with the mischief of fraudulent claims. Section 57 of the Criminal Justice and Courts Act 2015 permits a court to dismiss a fundamentally dishonest and exaggerated claims, including dismissal of any unexaggerated part. Section 12 of the Insurance Act 2015, into force on 12 August 2016, permits an insurer to reject fraudulent claims, recover sums paid, and from the point of the dishonesty treat the contract of insurance as at an end. The Insurance Act does not define a ‘fraudulent claim’ but the decision in this case means that the scope of Section 12 does not extend to collateral lies.

Fundamentally, the Supreme Court has decided that collateral lies do not, and ought not to, materially affect genuine and unexaggerated claims.

A practical example

C, whilst making a delivery in the course of his business, is involved in a road traffic collision with D. C, believing he was only insured for social and commuting, says to his insurer he was driving to the supermarket. D denies liability. Litigation follows. C discovers he was insured for business. At the time of drafting witness statements C confesses to his insurers he was, in fact, making a delivery at the time of accident. C loses at trial. He goes back to his insurers for payout of his vehicle damage. C was dishonest with his insurer but not to the court, and the lie was collateral to the insurance claim. The insurer might want to refuse to pay out because of C's initial lie, but applying *Versloot Dredging* the insurer probably has to pay out.

Insurers probably need to amend their contracts so that insured persons who lie, whether materially or immaterially to any claim, can be denied payout.

[Click here](#) to read the full judgment.

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