Marine Insurance Claims: Fraudulent or Not?

Advising the Insurer

1.0 Introduction: Is it happening?

1.1 The Insurance Council (NZ) does not currently have comprehensive statistics available, but was able to indicate to us that anecdotal evidence from members in late 2003 (October and November) suggest that approximately $130m in general insurance fraud occurred in New Zealand each year. The best guess of the Insurance Council was in all likelihood insurance fraud was costing the industry some $150-$300m per annum for general insurance, which excluded ACC fraud. From the Insurance Bureau of Canada it was estimated that insurance fraud costs approximately $1.3 billon annually. From a recent Australian report by AIG called "*Hidden Costs – insurance fraud in Australia*" the estimated cost of fraudulent claims paid out was around AUS$2.1 billion annually, which is equivalent to AUS$73 per insurance policy. The Association of British Insurers estimates that personal life insurance fraud alone is costing UK insurers over £1 billion annually. The National Insurance Crime Bureau (NICB) in the US estimated a cost of $130 billion per year.

1.2 It is clear that the figures reveal a huge cost to the industry. The Australian report referred to above, when extrapolating figures from global sources, makes an assumption that 10% of the value of insurance claims are fraudulent in some way.

1.3 It is interesting also to look at the public attitudes towards perpetration of insurance fraud. There was a summary of these in the Australian paper referred to above, which was produced in cooperation with the Australian Economist Intelligence Unit.

1.4 In a survey by the Insurance Council of Australia in 1993, 14% of the people interviewed regarded padding a claim as acceptable. In a 2002 survey that figure had risen to 18%, with a significant 30% of people in the 18-30 year

Tel 64 9 307 2003 Fax 64 9 309 7558
PO Box 835 Auckland New Zealand Level 15 Tower Centre 45 Queen Street DX CP20526 Upper Shortland Street
email mcelroys@mcelroys.co.nz **web** www.mcelroys.co.nz

old age group agreeing that this is acceptable. The trend possibly shows an increase in younger policyholders holding the view that it is more acceptable than ever to pad out a claim.

1.5 The Association of British Insurers carried out a survey in 2002. 7% of the respondents admitted to having made a fraudulent insurance claim and most significantly, 48% did not rule out making a false claim in the future. 40% of respondents believed that it was acceptable or borderline behaviour to exaggerate a claim. 29% felt the same way about making up a claim.

1.6 The US results were similar. Accenture published a report in early 2003 which revealed that 24% of respondents thought that padding a claim was acceptable, while 11% thought it was acceptable to fabricate a claim.

1.7 Clearly, those statistics and anecdotal evidence reveal that it is not unreasonable to consider that at least 10% of the value of claims contains an element of fraud.

1.8 The results of the Australian analysis conclude that fraudulent activities tend to fall under three main categories:

(1) Opportunist padding or exaggeration of an otherwise legitimate claim, such as inventing items of property stolen in a genuine house burglary;

(2) Premeditated fabrication of a claim, such as claiming for a motor vehicle accident or theft that did not take place;

(3) Fraudulent nondisclosure or misrepresentation of facts material to the insurance policy, such as failure to disclose certain criminal convictions or giving misleading information regarding usual drivers or place of parking in the case of motor vehicle insurance.

2.0 What is Fraud in the Context of a Marine Insurance Claim?

2.1 The focus of this paper is on looking at claims made, and in particular the circumstances which may give rise to a suspicion that a claim is fraudulent.

2.2 Fraud is generally defined as:

(1) "*A method or means of deceiving*" (Oxford Dictionary)

(2) "*The use of false representations to gain unjust advantage*"

2.3 There are some useful general principles from earlier decisions which help define what insurance fraud is:

(1) A claim will be fraudulent or based on fraud, if it is false and the persons making the claim intend to deceive the insurer, by getting out of it money or some other benefit to which they have no right. Further, a claim will also be fraudulent if the person making the claim is reckless as to its truth, or if the person making it is careless whether it be true or false. See *Norton v The Royal Fire & Accident Life Assurance Co* (1885) 1 TLR 460;

(2) Therefore a claim could be considered fraudulent if the insured:

(a) Knowingly or recklessly makes a claim where it has suffered no loss under the terms of the contract of insurance;

(b) Claims an amount in excess of the damage actually suffered;

(c) Supports a claim with false evidence.

2.4 The elements of fraud to focus on in any investigation could be summarised in a short hand way as follows:

(1) The fraud must be substantial;

had not acted in good faith. See for example *McLeod v SIMU Mutual Association* (1987) 4 ANZ Insurance Cases p.60-784.

2.13 It is possible in some circumstances to show that the answer given was reckless because the insured did not make proper enquiries. As such misrepresentations made on that basis were held to be deliberately reckless or fraudulent. An interesting and extreme case on this is the *Central Bank of India Ltd v Guardian Assurance Co Ltd* (1936) 54 LILR 247, where the amount claimed in respect of a warehouse full of grain was a thousand times greater than the actual loss. The Privy Council had little difficulty in agreeing with the findings of the Court below that the claim was fraudulent.

2.14 By contrast, there have been some cases which show that in certain circumstances, the overvaluation is not wilful at all. The insured may have erroneously thought the policy would allow for the replacement at the new value of items whereas in fact the policy did not. On that basis, the claim could be well in excess of what the policy would respond to, but nevertheless such exaggeration would not be wilful and, therefore, not fraudulent.

What is Material?

2.15 This applies primarily to statements made in support of a claim. A common example is that of the claimant who presents false evidence to bolster a valid claim. It must be more than marginal, it must be material. The evidence is not material unless it has a decisive effect on the readiness of the insurer to pay either the amount payable or the person to whom it must be paid.

2.16 This can be quite problematic in that many people may make false statements in relation to a claim because they wish to conceal matters, which may in fact not be material to the claim at all. A good example is from *Guardian Royal Exchange Insurance Ltd v Ormsby* (1982) 2 ANZ Insurance Cases p.60-472 (1982) 29 SASR 498. The claim was supported by photographs of the damaged property showing damage, which had been inflicted after the insured event. A statement of this kind may make the claim

false, but it is not material fraud because the insurer would have paid the same amount anyway.

2.17 This decision has been criticised and the issue over materiality became the subject of considerable debate in a series of English decisions in which the Courts sought to formulate a test of materiality where it is clear there had been elements of fraud. The decisions also discuss the concept of a "*fraudulent device*" and appear to have developed this as a way of distinguishing between a material and non-material statement.

2.18 A fraudulent device is defined as:

> "*any lie, directly related to the claim to which it 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 better settlement, or of winning at trial*". See *Agapitos v Agnew* [2002] EWCA CIV 247 [2002] Lloyd's Rep 1R 42.

2.19 In this context, the current position appears to be that a claim is fraudulent if made knowingly:

(1) For a loss which has not occurred;
(2) For an excessive amount;
(3) Suppressing a defence to the claim;
(4) By means of a fraudulent device.

3.0 Wilful Complicity

3.1 One of the most interesting investigations of fraud can arise in circumstances where the insurer may consider whether or not the vessel has been deliberately cast away by the owner. Whilst most policies will expressly exclude loss or damage deliberately caused or for misconduct, s.55(2)(a) of

the Marine Insurance Act 1908 provides that cover is negated if the loss is attributable to the wilful misconduct of the insured. It would generally follow that complicity in the sinking means fraudulent statements have been made in support of the claim and in breach of good faith in any event. The allegation is generally described as a grave one and insurers must be prepared, in the event that they decline the claim, to support that decision through to the end of what can generally be a lengthy trial. There are numerous Court decisions which show what determined fraudsters will do to persuade a Court that they did not deliberately cast away their vessel. See for example *Gate v SunAlliance Insurance Ltd* [1995] 1LRLR 385

3.2 Insurers need to know just how strong their position is quite early on as generally an insured will be looking for prompt payment out of the policy. Proceedings can be issued very promptly once a decision is made to decline. As a preamble to how the Court will approach dealing with this allegation, very useful guidelines are set out in a recent decision of Colman J in *Northstar Shipping Ltd v Sphere Drake Insurance Plc* [2005] EWHC 665 (Comm) p.76. On p.30 of the judgement Colman J, in summarising whether complicity has been established, indicates that the Court should keep four general considerations in mind, one of them related to earlier dishonesty of the owner, which may not be relevant in all cases. These can be summarised as follows:

(1) Although the standard of proof of complicity is on the balance of probabilities, the Court must feel a high level of confidence that the allegation is true or putting it another way, it must conclude that it is highly improbable that the allegation of complicity is not true;

(2) When considering the evidence, it is essential to weigh all those matters relevant to the issue of complicity, but to avoid what may be described as the "Poppy M heresy". That is to say if two possible explanations for the loss are alleged and one can be ruled out, concluding that the remaining explanation must be the cause of loss even though it is an intrinsically improbable one;

(3) Although the owner of the vessel may have a motive this alone cannot in many cases be enough to find a conclusion of a fraudulent claim. The physical circumstances of the loss will normally be an essential part of the evidence. If they add up to motive then in the absence of other evidence pointing to fraud, a finding of a fraudulent claim will normally be unlikely;

(4) Where there is evidence of the owner's previous or subsequent dishonesty whether or not relating to insurance claims that is a matter to which at least some weight can be attached in support of a fraudulent claim. How much weight will depend upon the nature of the dishonesty and its level of gravity.

3.3 From this summary, which is a useful summary of general principles, there are clearly two elements of utmost importance in considering investigation steps. These directly impact on the evidence to be gathered and upon which much of the earlier advice to insurers focuses. These are:

(1) Owner's motive;
(2) Circumstances of the loss.

Motive

3.4 A decision will need to be made as to whether costs should be incurred in undertaking searches as to financial position of the insured following the loss. In some instances the assessors engaged, who are experts in this field, will obtain an early indication that things may be amiss and this should trigger a more comprehensive questioning process. If necessary they will request that supporting documents be produced in order that the insurers can obtain a profile of the current financial viability of the insured. We have been involved in losses of fishing vessels for example where loss occurred following poor seasons, and in the context of high finance payments being required on the vessel it might seem an obvious area for motive. If however there is any indication that the claim may involve the owner's complicity, then it may be worthwhile undertaking further investigations to determine the owner's

financial position and determine whether there could be a motive established. That motive is important is highlighted in two highly contrasting cases in terms of the ultimate result, but which contain very detailed analysis as to the financial situation of the owners in both cases. In the 2005 *Northstar* case referred to above the financial position of the owner was central to the finding. In the *Northstar*, the assured was a one ship company managed by Kent Trading. The company was beneficially owned by two brothers HP and MP Petrakakos. The vessel was purchased in a damaged condition for US$1.3m in September 1989. At the time it was 17 years old and substantial repairs were then carried out. On the basis that further works were to be carried out, an agreement was entered into to sell the vessel for US$1.4m in April 1994. In July 1994 early in the morning the vessel was damaged by an explosion at Drapetsona, near Pireus whilst moored in shallow water for the purpose of undergoing repairs to complete a special survey in order to comply with the sale agreement. The insurers had obtained a great deal of evidence pointing towards the owners having a motive. Factors included:

(1) The insured value being high relative to the market value;

(2) An extremely adverse financial situation being in existence just prior to the explosion;

(3) Evidence of their inability to pay their debts.

3.5 The Court determined that at the time the Northstar was sunk, the owner's "perception of their situation, was that it was virtually irretrievably hopeless". From evidence given by HP Petrakakos during the trial, the Judge determined although his demeanour was not generally overtly evasive, in particular in relation to the account of the financial position of the owners, the answers were clearly designed to present much greater financial strength than actually existed. In our experience it is not uncommon for the insured to paint a more optimistic picture than it often is. Interestingly, despite the owner's extremely poor and deteriorating financial position, including its inability to pay insurance premiums, the day before the loss the owners had remitted to its insurers the amount of US$10,350 including a very specific sum of

US$5,350 for war risk premiums with the balance towards a very large outstanding amount of hull and machinery premium. It seems surprising, that despite their critical situation they had paid very clear attention to payment of their insurance premiums.

3.6 The case demonstrates just how critical it can be to determine whether the owner has a financial motive due to a poor situation. This line of enquiry should therefore be pursued if there is some suspicion but an open mind needs to be kept. Its importance is also demonstrated in the earlier 2002 case involving the "Grecia Express" in *Stryth Shipping Corporation v Hellenic Mutual War Risks Association (Bermuda) Ltd* "The Grecia Express" [2002] EWHC 203 (Comm) again before Mr Justice Colman at p.669. The issue of the owner's motive became important in connection with the allegation that the "Grecia Express" had been deliberately scuttled with the complicity of the owner. Having looked in some detail at the situation of the owner, Mr Ventouris, the Court concluded that "*the detrimental effects of destruction of the vessel would not only be obvious to a typical ship-owner, but would obviously exceed any possible benefit, at least in the short term*". The Court found that the indicia of a fraudulent motive on behalf of the owner were very weak.

3.7 These decisions are therefore useful and interesting in determining the type of background information that was tested thoroughly in the course of the trial in determining whether there was a motive. In both cases the respective findings were critical to the ultimate findings. In the "Grecia Express" there was no finding of owner's complicity whereas in the "Northstar" there was.

3.8 A New Zealand decision, *Gate & Anor v Sun Alliance Insurance Ltd* [1995] Vol 1 Lloyds Reinsurance Law Reports p.385 a New Zealand decision involved the loss of a launch in the Hauraki Gulf. Justice Fisher was looking for a motive. He found that by over insuring and then scuttling the vessel Mr Gate, the owner, knew that he would not only turn the vessel into cash but would do so at a sum significantly greater than its value. He found that this was an obvious motive to have the vessel scuttled.

3.9 Generally when considering a potential fraudulent claim such as a potential scuttling there will not be direct evidence of scuttling and motive should be looked at in detail. However, as per the cautionary comments in the "Northstar" the motive alone could not in many cases be enough to find a conclusion of a fraudulent claim. It is worth bearing in mind the finds of Colena in relation to M Ventouris' motive. What do they stand to gain? It is necessary to look at the physical circumstances.

Physical Circumstances

3.10 This is where possibly a large amount of detailed work will be required by the insurance company to determine for itself whether it can establish circumstances sufficient to discharge its burden to prove the owner's complicity. The *Gate & Anor v Sun Alliance Insurance Ltd* referred to above, there was undoubtedly a fortuity in the discovery by divers in the Hauraki Gulf of the wreck of the "Altimara". Evidence found on the vessel led ultimately to the finding that the vessel had been deliberately scuttled. The circumstances again were critical to both the cases referred to above and both cases usefully show just how difficult it can be.

3.11 The facts of "Gracia Express" shows that despite no direct evidence, and the fact that the owner persistently denied ever having placed an explosive device on the vessel, that the Court found that the owner personally secured the placing of the explosive device in order to commit a fraud on the insurers. In that case the allegation had been made by the owners that the explosive device had been placed by terrorists. In the alternative they pleaded that there was some sort of commercial grudge. The Court was not persuaded at all and found a very low possibility of terrorist motivation and no real possibility of commercial grudge. It is perhaps not unsurprising that given the Court was not persuaded that any of the courses advanced by the owners had any possibility the onus fell back on the owners to explain the loss. In the absence of their two theories having any credibility and no other theory it almost lead inescapably to the conclusion they did it. In discussing the mechanism of the loss, which involved an explosive device, the Court made the finding that "*if the owners had resolved to cause the vessel to be totally*

lost, the method adopted in this case was an extremely bad way of doing it". In many cases however the insurers will not necessarily be dealing with facts which show such a poor attempt has been made.

3.12 Recovery of the wreck will clearly be of considerable advantage although it might be expected that in cases the vessel would be castaway in an area beyond photograph or diving ability.

3.13 The investigation requires a combination of gathering as much information about the circumstances of the loss and motive. Ultimately it is necessary to be confident that generally a combination of motive and circumstances will be such as to allow a finding that the vessel was deliberately cast away by the owners. The cases referred to shows just how much work is involved, and how despite what may seem as a strong suspicion it is not always enough.

4.0 Burden of Proof

4.1 Proving fraud is not straightforward. It is a serious allegation and the Courts require insurers to prove their case well in order to succeed. There have been considerable attempts made by the judiciary to determine a precise definition as to what the burden of proof in civil cases is, in respect of an act which is not dissimilar to a criminal act, such as fraud. There have been some suggestions that the standard of proof is higher than the normal "*balance of probabilities*".

4.2 A useful discussion as to what is meant by the balance of probabilities in insurance cargo is found in *Blanshard v Natural Mutual Life Insurance of Australia Ltd* (2004) 13 ANZ Insurance Cases p.61-621. This case involves a recovery of substantial sums paid out under a Health Disability cover, found to have been fraudulently claimed since the outset.

4.3 The Judge, Harrison J makes it clear that the insurer alleging fraud assumes a heavy burden of proof and confirms that the civil standard of balance of probability still applies. He then deals with the authorities which have traditionally described it as being at the high end of the scale, commensurate

with the gravity of the allegation and the seriousness with its consequences. He refers to Lord Nichols in *Re H v Ors* [1996] 1 All ER1 (HL) at p16. Speaking for the majority in that decision, he excluded a sliding scale of probabilities in civil cases governed by the seriousness of the subject matter. Whilst Lord Nichols had acknowledged the concept of a standard being commensurate with the gravity of the allegation, he doubted whether it added much to the settled civil test based on the balance of probabilities, adding that it runs the risk of adding confusion and uncertainty.

4.4 It may be recalled that Fisher J in *Gate v Sun Alliance* had however concluded that the requisite civil standard where an insurer alleges fraud "*... will differ little from proof beyond reasonable doubt...*". Reference is also made to the decision by Hammond J in *Back v National Insurance Co of New Zealand Limited* [1996] 3NZLR 363. There the Judge reasserted that the civil standard was subject to the qualification that "*clear and convincing evidence is required*". Harrison J concluded that in his judgment the difference is more semantic than real. He used the expression "*being convinced is synonymous with being sure and certain*".

4.5 The Court of Appeal had also to consider the effect of proof in civil matters in connection with allegation of sexual abuse. Chambers J in *W v W*, a 2003 decision in the High Court of Auckland referred to the House of Lords decision in *Re H & Ors* , which he held to be directly on the point. He quoted the following section from the House of Lords in *R & H:*

> "*This does not mean that where a serious allegation is an issue the standard of proof required is higher. It means only that the inherent probability or in improbability of an event is itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. The more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its occurrence will be established*".

4.6 Chambers J indicated however that *Gate* may still be the test in that field i.e. insurance. Chamber's view as to the applicability of the House of Lords test

was also reinforced subsequently by the New Zealand Court of Appeal in *Wingate v Wingate* in October 2003. It seems from these comments that there is still a possibility that a Court in New Zealand, for insurance fraud, the burden is still that as prescribed by Fisher J in "*Gate*"

4.7 A useful summary on how the burden of proof works is found in the finding made by Colman J in the "Northstar" as follows:

> "*For the reasons which I have already indicated and in particular the physical circumstances of the explosion, specifically the location of the explosive device, the character, demeanour, commercial and financial circumstances of HP and the owners, including the fact that the Kent Group was financially crippled, and the contemporaneous conduct of HP, specifically his presence in the engine room on the previous day and the delayed arrival of the vessel following the explosion and the information given to Dr Foster, I find that he personally procured the placing and detonation of the explosive in order to commit a fraud on the insurers. That finding is made with the high level of confidence necessary for allegations of this kind.*

5.0 Summary

5.1 Are there aspects of the claim which give rise to suspicion:

(1) Statements made?
(2) What are the circumstances?
(3) Is there motive?

5.2 Are you likely to be able to persuade a Judge to the extent that findings can be made with the "high level of confidence"?

Matthew Flynn