

# Deterrence, human rights and illegality: the forfeiture rule in insurance contract law

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*The forfeiture rule in insurance contract law was designed to be draconian in its effect. Such rules often generate hard cases. The challenge to the status quo in the litigation comes not only from consideration of the rule itself but also from its compatibility with the Human Rights Act 1998. The strict nature of the rule was viewed as necessary to deter insurance fraud, and to reflect the special nature of the insurance claims process. We show in this piece that both of these factors are misunderstood. First, the forfeiture rule is but a tiny piece in the market, administrative and legal processes that regulate the level of insurance fraud. Secondly, similar issues arise in other areas of contract law, and the responses there better reflect the complex interactions of contractual and non-contractual behaviours expected of sophisticated market participants. The picture that emerges of the forfeiture rule is one in which its benefits have been seriously over-estimated, without proper consideration of less intrusive approaches.*

## I. INTRODUCTION

The forfeiture rule in insurance contract law is of ancient origin and simply stated: an insured that is fraudulent in the presentation of its claim loses the entirety of the claim under an insurance policy, and not merely the dishonest part. Despite its antiquity, the limits of this principle have been the subject of considerable litigation since the turn of the millennium, with notable contributions from Lord Mance.

The recent development of the forfeiture rule is an archetype in the remaking of modern commercial law. It is a mixture of law and policy, with the policy expressed dogmatically, but with relatively limited evidence for the assertions made. Moreover, the issue is a hybrid of public policy, contractual rules and broader public law principles emanating from human rights law. It asks questions about the generality of principles such as the law's disdain for fraudulent conduct, and the role of private law in deterring such conduct.<sup>1</sup>

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1. In addition to the policy factors that shape contractual rules considered in detail in this paper, the effect of fraudulent exaggeration of a tort claim was considered in *Summers v Fairclough Homes* [2012] UKSC 26; [2013] Lloyd's Rep IR 159; [2012] 1 WLR 2004. We note this below (text to fn.44) but, for reasons of space, do

The forfeiture rule deserves reconsideration, as is happening in the related doctrine of *ex turpi causa non oritur actio*, given the considerable academic,<sup>2</sup> policymaker<sup>3</sup> and judicial<sup>4</sup> disquiet in both areas.

The current forfeiture rule retains the simple ideological basis of the nineteenth-century law-making that spawned it.<sup>5</sup> Adoption of a simple rule of thumb—such as “fraud unravels all”<sup>6</sup>—makes law prone to error. Lord Mance recognised the challenge that Daniel Kahneman’s work on behavioural heuristics poses to instinctive judicial decision-making:<sup>7</sup>

“The brocard [*ex turpi causa*], as Lord Hunter called it, is of course an invitation to fast thinking of the type that the Nobel prize-winner Daniel Kahneman has in his book *Thinking, Fast and Slow* so tellingly—and, for decision-makers like myself, alarmingly—described. [The brocard] suggests easy answers, but is entirely fallacious in so doing. The most cursory examination of case-law in which *ex turpi causa* is discussed leaves uncertainty about what the policy underlying it is or when it is engaged.”

We suggest that the forfeiture rule is problematic, with a similar uncertainty about the underlying policy and the ambit of the doctrine.

## Our approach

This piece aims to make the design of effective insurance fraud deterrence the subject of considered analysis. This follows in the tradition of the great “dissents” in insurance law, such as Harnett & Thornton’s unpicking of insurable interest: “in order to prevent... deterioration into a set of fixed and unyielding ‘principles’, constant and vigilant re-evaluation of concepts is necessary to enable legal concepts to keep pace with adjustments in external variables”.<sup>8</sup>

not deal with this in detail. See W Norris QC, “Look out: I’ve got a power ... but I am not going to use it” (2012) JPI Law 169.

2. The academic literature in both areas is voluminous, but a representative sample (excluding sources cited elsewhere in this paper) would include: B Soyer, *Marine Insurance Fraud* (Informa, London, 2014); J-A Tarr, “Fraudulent insurance claims: recent legal developments” [2008] JBL 139; G Swaby, “The Price of a Lie” [2013] JBL 77; J Hjalmarsson, “The law on fraudulent insurance claims” [2013] JBL 103 (insurance) and P Davies, “The illegality defence—two steps forward, one step back?” [2009] Conv PL 182; and H Stowe, “The ‘Unruly Horse’ has Bolted: *Tinsley v Milligan*” (1994) 57 MLR 441 (illegality).

3. Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment* (Law Com No 353, 2014) (insurance) and Law Commission, *The Illegality Defence* (LCCP 189, 2009); Law Commission, *Illegal transactions: The effect of illegality on contract and trusts* (LCCP 154, 1999) (illegality).

4. See eg the comments in *Versloot Dredging BV v HDI-Gerling Industrie Versicherung AG (The DC Merwestone)* [2013] EWHC 1666 (Comm); [2013] 2 Lloyd’s Rep 311, [145–181] (*per* Popplewell J) (insurance) and *Les Laboratoires Servier v Apotex* [2014] UKSC 55; [2015] 1 AC 430, [14], [20] (*per* Lord Sumption) (illegality).

5. *Britton v Royal Insurance* (1866) 4 F & F 905.

6. *Lazarus Estates Ltd v Beasley* [1956] 1 QB 702, 712 (Denning LJ: “No court in this land will allow a person to keep an advantage which he has obtained by fraud. No judgment of a court, no order of a Minister, can be allowed to stand if it has been obtained by fraud. Fraud unravels everything. The court is careful not to find fraud unless it is distinctly pleaded and proved; but once it is proved, it vitiates judgments, contracts and all transactions whatsoever”).

7. (Lord) J Mance, “Ex Turpi Causa—When Latin Avoids Liability” (2014) 18 Edin L Rev 175, 176.

8. B Harnett and J Thornton, “Insurable Interest in Property: A Socio-Economic Re-evaluation of a Legal Concept” (1948) 48 Col L Rev 1162, 1162.

Our primary focus in this paper is the application of the forfeiture rule to fraudulent devices, not least because *The DC Merwestone*<sup>9</sup> is shortly to be heard in the Supreme Court on this issue. However, much of our criticism would apply *mutatis mutandis* to the strict application of the forfeiture rule to other hard cases.

The judicial development of the forfeiture rule was based, in part, on a sense of control. Christopher Clarke LJ in *The DC Merwestone*<sup>10</sup> was not alone among the judiciary in referencing statistical evidence on the frequency and extent of fraudulent claims. Moreover, he reiterated the mantra that potential fraudsters must not think that there is no sanction for those who attempt, but fail, to defraud their insurers. We disagree with none of this. However, it massively overstates the effect of judicial pronouncements on the likely commission of fraudulent insurance claims. Other, more effective, mechanisms for deterrence are not routinely mentioned by the judiciary or in academic commentary. Common law judges overstate the influence of common law precedents and this is not surprising. However, in his excellent analysis of the role of law in society, David Howarth's *Law as Engineering*<sup>11</sup> reminds of the role of law beyond the courts: "judges are better seen as bricoleurs, patching up a structure designed, or at least built, by others, than as grand architects of public policy or as distant God-like defenders of abstract rights based on a timeless morality". This image captures the true role of the fraud-detering judge, who does not have jurisdiction over the true levers of control: the administration of civil and criminal justice; data-sharing within the insurance industry; insurance policy design; and claims-handling methods.<sup>12</sup>

The first part of our critical analysis (Part IV) develops this approach. We show, by reference to the sophisticated deterrence literature in behavioural economics and criminology that the levers for control of fraudulent claims fall mostly outside insurance contract law. The forfeiture rule is of marginal significance in providing effective deterrence. The purpose of this Part is to show that the benefits of the current rule are overstated. In the subsequent Part (Part V), we demonstrate that the rule is inconsistent with other branches of contract law, and fails to account for the complex and diverse nature of fraudulent claims. Our paper, then, has two focal points: (a) the mature body of empirical and theoretical analysis showing that the forfeiture rule has a much more limited effect than that imagined by the judiciary; and (b) a detailed analysis of the contractual and non-contractual nature of the claims presentation process, informed by relational contract theory, to demonstrate the inconsistency at the heart of the current forfeiture rule. Specifically, we show that the insured is expected to behave cooperatively at the same time that the underwriter is permitted to behave in a selfish, market-individualist fashion.

9. *Versloot Dredging BV v HDI-Gerling Industrie Versicherung AG (The DC Merwestone)* [2014] EWCA Civ 1349; [2015] 1 Lloyd's Rep 32, expected to be heard in the Supreme Court on this issue in early 2016.

10. [2014] EWCA Civ 1349; [2015] 1 Lloyd's Rep 32, [114–116]. See also *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209, 214, per Millett LJ; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] UKHL 1; [2001] 1 Lloyd's Rep 389; [2001] Lloyd's Rep IR 247; [2003] 1 AC 469, [62], per Lord Hobhouse of Woodborough.

11. D Howarth, *Law as Engineering* (Edward Elgar, Cheltenham, 2013), 191.

12. These institutional issues are the subject of the current Insurance Fraud Taskforce: [www.gov.uk/government/groups/insurance-fraud-taskforce](http://www.gov.uk/government/groups/insurance-fraud-taskforce).

## Structure

We begin, in Part II, by tracking the development of the forfeiture rule to date. In Part III we then set out the dispute in *The DC Merwestone* and identify the marine insurance issues that arose and the further challenge, on the basis of human rights law, that forfeiture was disproportionate. The remaining sections present our critical analysis described above:

(a) we establish the limited role that the forfeiture rule plays in the real world deterrence of fraud (Part IV); and (b) we then put the forfeiture rule in its broader civil law context, by contrasting the effects of falsification on claims in insurance and employment law in light of the cooperation expected of both parties outside of contractual duties (Part V).

## II. THE NATURAL HISTORY OF THE FORFEITURE RULE

The forfeiture rule is traced to the decision of Willes J in *Britton v Royal Insurance*,<sup>13</sup> where, in relation to a claim for a loss allegedly caused by arson, he held that the assured could not recover. The result was not dependent on the inclusion of an express term within the policy<sup>14</sup> but was, rather, “in accordance with justice, and also with sound policy. The law is, that a person who has made such a fraudulent claim could not be permitted to recover at all.”<sup>15</sup> Wholly fabricated or exaggerated claims would thus be forfeit unless the level of exaggeration could be construed as a starting point for commercial negotiation.<sup>16</sup> Later case law further clarified that the entire claim to which the fraud relates is barred, meaning that the insurer can recover interim payments but remains liable for genuine claims which pre-date the fraud.<sup>17</sup>

### The juridical basis of the forfeiture rule

There is no universally agreed basis for the forfeiture rule.<sup>18</sup> The analysis offered by Christopher Clarke LJ in the Court of Appeal in *The DC Merwestone* suggests that it is based, at least in part, on the relationship of utmost good faith between insured and underwriter.<sup>19</sup> The precise basis is not central to our analysis, but we note that this would place the rule as a positive rule of law, rather than as an implied term. As for its derivation from the doctrine of utmost good faith, this is plausible, but causes some difficulties. If we adopt the analysis offered by Malcolm Clarke, then the concept of good faith revives throughout the life of the contract at a level appropriate to the particular phase of the

13. (1866) 4 F & F 905.

14. See eg *Loseby v Price, The London Express*, 20 August 1866; *Levy v Baillie* (1831) 7 Bing 349.

15. *Britton* (1866) 4 F & F 905, 909, per Willes J.

16. *Nsubuga v Commercial Union Assurance* [1998] 2 Lloyd’s Rep 682, 686; *Orakpo v Barclays Insurance Services* [1995] LRLR 443, 451. See further J Davey, “Unpicking the fraudulent claims jurisdiction in insurance contract law: sympathy for the devil?” [2006] LMCLQ 223, 226.

17. *Axa General Insurance Ltd v Gottlieb* [2005] EWCA Civ 112; [2005] 1 Lloyd’s Rep IR 369, [31–32], per Mance LJ.

18. The juridical basis for the doctrine has come under scrutiny in the Court of Appeal when considering the relevant test for materiality. See below, in the discussion of materiality in Part IV.

19. *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [75–77].

relationship.<sup>20</sup> Case law has suggested that the claims stage is one in which the assured should observe good faith, and this was characterised in *The Star Sea*<sup>21</sup> as a duty of honesty. The difficulty with this approach is that the Marine Insurance Act 1906, s.17 provides the remedy of avoidance *ab initio* for breaches of the doctrine of utmost good faith. It is, we understand, for this reason that Mance LJ (as he then was) sought to explain the forfeiture rule as operating independently of utmost good faith.<sup>22</sup> Either way, it is agreed that this duty operates only until the commencement of litigation.<sup>23</sup>

### The policy justification(s) for the forfeiture rule

We have found three possible justifications for the doctrine. The basis for the forfeiture rule has been commonly expressed by the courts as a broadly moral purpose consistent with judicial refusal to engage with those who commit fraud. This is further strengthened by an instrumental purpose: the deterrence of would-be fraudsters. These are familiar to insurance lawyers.

Academic commentators have also suggested that pre-contractual fraud might represent a further instrumental purpose: the reduction of wasted transaction costs.<sup>24</sup> Where the defendant knows that he has no honest belief in his statement, the claimant's costs incurred in investigating and establishing the lie are socially unproductive and wasted. This has been extended from pre-contractual misrepresentation to post-contractual insurance claims processes without full consideration. Clift has usefully identified that the historic development of the forfeiture rule reflected the needs of underwriters to rely on documents and representations made by their assureds, given the (then) primitive nature of investigative techniques.<sup>25</sup> This may have been true when the rule was developed; but it is less plausible today. The "baffling array of technical wizardry"<sup>26</sup> available to a modern underwriter no longer requires him to rely wholly on the word of his assured and he may be equally well placed to investigate the validity of a claim himself, provided he has equal access to witnesses, technical reports and the like.

### The ambit of the forfeiture rule

Historically there was little consideration of the type of "fraud" we see in *The DC Merwestone*—the genuine claim supplemented by fraudulent evidence, be that a forged receipt or a misleading account of events. These are commonly referred to as claims subject to "fraudulent devices" (or "device claims"). The issue was first considered in *The*

20. M Clarke, *Law of Insurance Contracts*, 4th edn (Informa, London, 2014), [27.1A1], [27.1A2].

21. *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] UKHL 1; [2001] 1 Lloyd's Rep 389; [2001] Lloyd's Rep IR 247; [2003] 1 AC 469, [111], *per* Lord Scott of Foscote.

22. *Agapitos v Agnew (The Aegeon)* [2002] EWCA Civ 247, [2002] 2 Lloyd's Rep 42; [2002] Lloyd's Rep IR 573; [2003] QB 556, [21].

23. *Ibid*, [52].

24. D Harris, D Campbell and R Halson, *Remedies in Contract and Tort*, 2nd edn (Butterworths Tolley, Croydon, 2001), 554–557.

25. R Clift, "Fraud: Does the punishment fit the crime?", International Marine Claims Conference (24 October 2007).

26. *Ibid*, 12.

*Litsion Pride*,<sup>27</sup> where a fraudulently backdated letter was held to constitute a material fraud. The decision has since been questioned, because it took the view that the forfeiture rule was derived from the doctrine of utmost good faith.<sup>28</sup>

Despite wide-ranging definitions of fraud which extended to a misleading account of the cause of the loss<sup>29</sup> and an attempt by the assured to gain (quicker) payment through deceit,<sup>30</sup> there was no authority establishing how the type of claim we see in *The DC Merwestone* would be resolved judicially. Mance LJ advanced the position in *The Aegeon*,<sup>31</sup> whilst noting the absence of prior authority. His detailed judgment evidences a policy analysis of the forfeiture rule, “which time has done nothing to alter”.<sup>32</sup> His tentative conclusion was that forfeiture should apply to device claims where it is directly related to the claim and, “if believed, [would] tend, objectively, prior to any final determination at trial of the parties’ rights, to yield a not insignificant improvement in the insured’s prospects”.<sup>33</sup> Despite some early reservations,<sup>34</sup> post-*Aegeon* courts have generally applied Mance LJ’s extended version.<sup>35</sup>

The Insurance Act 2015 has codified and clarified the remedy that applies to fraudulent claims, but did not seek to define the limits of the doctrine. The questions that arose in *The DC Merwestone* related to the application of forfeiture to fraudulent devices, and to limits on its use (such as materiality), and these remain a matter for the courts.

### III. THE DISPUTE IN *THE DC MERWESTONE*

The factual situation that gave rise to the dispute in *The DC Merwestone* is unremarkable. A vessel, carrying a cargo of scrap iron, left Klaipeda in Lithuania for a voyage to Bilbao. During its time in port, the crew had used the high-pressure hose on deck but (negligently) failed to close the sea suction valve after use. Water remained in the system even after it was operational. Due to the cold weather conditions in Lithuania, the water expanded as it froze in the system, causing a leak into the forward bowthruster room. This leak led to entry of seawater into the vessel, but ought not to have caused any immediate loss of control. However, the bulkheads between the bowthruster room and the rest of the vessel had not been sealed properly, with the consequence that seawater was able to enter the

27. *Black King Shipping Corp v Massie (The Litsion Pride)* [1985] 1 Lloyd’s Rep 437, 519.

28. *The Star Sea* [2001] UKHL 1; [2001] 1 Lloyd’s Rep 389; [2001] Lloyd’s Rep IR 247; [2003] 1 AC 469, [71], per Lord Hobhouse: “the actual claim made was a valid claim for a loss which had occurred and had been caused by a peril insured against when the vessel was covered by a held covered clause.”

29. *Reid & Co v Employers Accident & Livestock* [1899] 1 SC 1031, 1036–1037: “fraudulent misrepresentation or misdescription of the circumstances under which the claim has arisen, or the nature and extent of the damage done, for which the claim for indemnity was made.”

30. See *Wisenthal v World Auxiliary Insurance Corp* (1930) 38 Ll Rep 54, 62. This is referred to in *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [123].

31. *Agapitos v Agnew (The Aegeon)* [2002] EWCA Civ 247; [2002] 2 Lloyd’s Rep 42; [2002] Lloyd’s Rep IR 573; [2003] QB 556, [45].

32. *Ibid*, [45].

33. *Ibid*, [45].

34. *Interpart Comercio e Gestao SA v Lexington Insurance Co* [2004] EWHC (Comm); [2004] Lloyd’s Rep IR 690, [43].

35. *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30; [2006] 1 Lloyd’s Rep IR 852, [36]; *Aviva Insurance v Brown* [2011] EWHC 362 (QB); [2012] 1 Lloyd’s Rep IR 211, [77].

engine room. The vessel left port on 27 January 2010 and water was detected in the engine room the next day. Within three hours of the leak's first being detected, the engine room had flooded and the engine was inoperative, despite attempts by the crew to discover the source of the leak and to pump out the engine room. A subsequent investigation showed that the pumps in that area of the vessel were not working efficiently. The vessel was towed to a nearby port and repaired at a total cost of around €3.2 million. The vessel was insured with the respondents on the basis of the Institute Time Clauses Hulls (1/10/83) and the Institute Additional Perils Clause Hulls, and the vessel's owners submitted a claim for indemnification.

These were the initial facts as discovered by Popplewell J at first instance,<sup>36</sup> and were generally not contested on appeal (although some further findings were disputed). This can be summarised in simple terms: we have a genuine loss, which is *prima facie* within the terms of the insurance policy.<sup>37</sup> However, the precise cause of the loss and the order of events were not obvious at the time of the loss, and this was problematic for the insured owner. Under insurance law, it is for the insured to prove at trial that the proximate cause of the loss is within the terms of the policy. It is not enough to show that a loss has occurred; it must be shown to be a loss caused by a peril insured against. Thus, in seeking indemnification for a loss by perils of the sea, the insured will have to adduce evidence as to the fortuitous nature of the loss. This may require some precision in identifying the chain of events that led to the loss.<sup>38</sup>

This additional requirement of proving the loss is perhaps not fully comprehended by insureds.<sup>39</sup> Indeed, any attempt entirely to rationalise the precise relationship between the occurrence of an insured event and the underwriter's obligation to pay the claim is problematic even for those totally familiar with insurance contract law.<sup>40</sup> It should be noted—as it is significant for the analysis to follow—that the insured did not, under the contract of insurance between these parties, owe any contractual duty to establish his claim to the underwriter. This is a pre-condition to success at trial, not the effective submission of claim. So, for example, the International Hulls Clauses 2003 contain a claims cooperation clause, but the Institute Time Clauses Hulls used here does not.

At first instance, the underwriter denied liability on a number of grounds: that the proximate cause of the loss was not perils of the sea; that it was in any case irrecoverable on the basis of unseaworthiness under the Marine Insurance Act 1906, s.39(5); and that the claim was barred because of the use of a “fraudulent device” to support the claim.

36. [2013] EWHC 1666 (Comm); [2013] 2 Lloyd's Rep 311.

37. Christopher Clarke LJ in the Court of Appeal adopted the findings of fact of Popplewell J that this was a loss by perils of the sea occasioned by crew negligence.

38. J Gilman QC *et al.*, *Arnould: Law of Marine Insurance & Average*, 18th edn (Sweet & Maxwell, London, 2013), [22.01].

39. T Baker, “Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages” (1994) 72 Tex L Rev 1395, 1408–1410 stresses the need for intermediaries to educate the insured post loss in the limits of the coverage within the contract.

40. In non-liability insurance, the insurer is commonly assumed to have (impliedly) promised to “hold harmless” the insured, ie to prevent any loss from occurring. This means that liability arises at the moment of the loss, and is technically a claim for damages for breach of contract. This artificial analysis has a number of undesirable consequences; see further J Davey, “Once more unto the breach: remedies for the non-payment of insurance claims after Blake”, in P Giliker (ed.), *Re-Examining Contract and Unjust Enrichment* (Brill, Leiden, 2007).

On appeal, two issues were contested in detail: the application of the forfeiture rule to fraudulent devices; and the compatibility of that common law rule with the Human Rights Act 1998.

### **The fraudulent device defence**

The underwriter failed to persuade the first instance court of any defence other than the fraudulent device point, and that defence was upheld only with “manifest reluctance”<sup>41</sup> by Popplewell J, and after considerable discussion of the arguments that could be made against such a ruling.

The finding of fraud depended on an assertion made by Chris Kornet, one of the managers of the vessel, that the bilge alarm on the vessel had sounded at around noon on the day of the loss and been ignored by the crew as routine. This assertion was made on 21 April 2010 as part of the evidence submitted to support the claim. It gave the false impression that Kornet had spoken to the master and received confirmation on this point. He had not. The account was plausible: the bilge alarm on the vessel did not distinguish between the forward and aft sections of the vessel, and the forward bowthruster alarm was known to give false positives when the vessel was rolling due to heavy weather. This assertion was therefore found to be speculative, although the master of the vessel was later prepared to support that description of events.<sup>42</sup> Ultimately, this is a statement in support of the claim, made recklessly, and thereby fraudulently.

The question for the Court of Appeal was whether to confirm the *obiter* comments made by Mance LJ (as he then was) in *The Aegeon* on the broad applicability of the forfeiture rule to such frauds, or to introduce some further limiting factor. Christopher Clarke LJ found a number of “powerful reasons” to apply *The Aegeon*.<sup>43</sup> The bulk of these relied on the authoritative nature of the earlier judgment and its subsequent adoption by later courts, including the Privy Council.

Having failed to persuade the Court of Appeal that their actions fell short of an actionable fraudulent device, the insured argued in the alternative that the forfeiture rule was contrary to the Human Rights Act 1998 as a disproportionate deprivation of property, and should be revised accordingly.

### **Forfeiture as a deprivation of property rights (and the “Human Rights” perspective)**

Viewing forfeiture as depriving the assured of valuable property rights enabled counsel for the owners to strengthen their case for indemnification with the aid of the Human Rights Act 1998. This was a novel argument, which followed the acceptance of similar arguments

41. As described at [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [2], *per* Christopher Clarke LJ.

42. The reported facts of the case are a construct of the process of litigation and rarely indicate the actual course of events. We suspect that the narrative here is heavily shaped by the current position of the law.

43. *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [106]. The six reasons underlying the decision are explained at length at [107–134].



by the Supreme Court in a case of personal injury fraud<sup>44</sup> and Popplewell J's comments at first instance.<sup>45</sup>

The Human Rights Act 1998 incorporates into English law the European Convention on Human Rights (1950), of which Article 1, Protocol 1 ("A1P1") provides:

"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 by the general principles of international law."

The right to an insurance indemnity arises on the occurrence of the loss.<sup>46</sup> An insurance claim, following the Supreme Court decision that contractual rights constitute "possessions",<sup>47</sup> has been duly characterised as falling within the scope of A1P1.<sup>48</sup> The forfeiture of an insurance claim is thus a potential infringement of these rights, unless it is in the public interest and achieved in a proportionate manner.

It was common ground that the deterrence of fraud fell within the public interest.<sup>49</sup> "The more difficult question"<sup>50</sup> for the court was whether the application of the forfeiture rule to device claims met the second requirement of A1P1, namely that it achieved that deterrence proportionately. The court held that it did. "Bright line rules" to counter fraud would be proportionate even where this resulted in very harsh consequences for the assured.<sup>51</sup>

We suggest that Christopher Clarke LJ's approach to the proportionality question in *The DC Merwestone* was not consistent with recent domestic litigation in this area. The approach adopted in the Court of Appeal was to consider whether the forfeiture rule was a proportionate means of deterring insurance claims fraud.<sup>52</sup> This approach rested on the case of *James v UK*,<sup>53</sup> heard by the European Court of Human Rights in the mid-1980s. Where the essence of the complaint contests a piece of legislation, the court held that attention should be focused primarily on the proportionality of the legislation as a whole and account then taken of the individual circumstances.<sup>54</sup> Christopher Clarke LJ in *The*

44. In *Summers v Fairclough Homes* [2012] UKSC 26; [2013] Lloyd's Rep IR 159; [2012] 1 WLR 2004, the claimant, who was injured at work, submitted a claim of nearly £900,000. This was substantially fraudulent: his injuries were assessed in the region of £88,000. The court recognised that it had the power to strike out claims such as these. As judgment on liability was a possession within A1P1 (see the following paragraph in the text), strike-out would deprive him of that possession and consequently would be appropriate only where it was just and proportionate in light of the circumstances: at [46–47]. Courts were to make use of other procedural techniques to deter fraud: at [50–62]. The position has now changed, following the enactment of the Criminal Justice and Courts Act 2015, s.57; see *post*, text to fn.64 and fn.119.

45. *The DC Merwestone* [2013] EWHC 1666 (Comm); [2013] 2 Lloyd's Rep 311, [171–172], [177].

46. *Firma C-Trade SA v Newcastle Protection and Indemnity Assn (The Fanti and The Padre Island) (No 2)* [1991] 2 AC 1, 35, *per* Lord Goff of Chieveley: "I accept that, at common law, a contract of indemnity gives rise to an action for unliquidated damages, arising from the failure of the indemnifier to prevent the indemnified person from suffering damage, for example, by having to pay a third party", known as the "hold harmless" doctrine (see *supra*, fn.40).

47. *Wilson v First County Trust Ltd (No 2)* [2003] UKHL 40; [2004] AC 816, [39].

48. *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd's Rep 32, [141].

49. *Ibid*, [145].

50. *Ibid*, [146].

51. *Ibid*, [154–155].

52. *Ibid*, [143].

53. (1986) 8 EHRR 123.

54. *Ibid*, [36].

*DC Merwestone*<sup>55</sup> considered that this was the correct approach when a “common law principle of general application” is contested.

Instead, the Supreme Court has, more recently, preferred to focus on whether the contested measure is proportionate in the individual case and has called for “careful consideration of the particular facts”.<sup>56</sup> There has been detailed consideration of the claimant’s position even where the compatibility of legislation is at issue.<sup>57</sup> The Supreme Court in both *Axa General* and *Barnes* made reference to the much earlier decision in *James*, but focused on a different part of the judgment, requiring that:<sup>58</sup>

“[a] ‘fair balance’... must be struck between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights... The requisite balance will not be found if the person concerned has had to bear ‘an individual and excessive burden’.”

Christopher Clarke LJ appeared to recognise these approaches as distinct<sup>59</sup> but failed to consider the consequences of forfeiture for the assureds in the context of proportionality. As such, we suggest that the correct approach remains a live issue for the Supreme Court and justifies the appeal on this basis alone. The implicit reasoning of Popplewell J and the owners’ argument in the Court of Appeal, a case-by-case approach, is preferable.<sup>60</sup>

The Court of Appeal also expressed concern that use of the Human Rights Act 1998 in this way would dramatically increase insurance litigation.<sup>61</sup> This is unconvincing, not least because an allegation of fraud is rarely the only defence an underwriter will put at trial. The Australian Insurance Contracts Act 1984 provides a useful comparison here. Forfeiture remains the primary sanction for fraudulent insureds but the statute establishes a judicial discretion to order such payment as is just and equitable “if only a minimal or insignificant part of the claim is made fraudulently”.<sup>62</sup> We have found no evidence to suggest that the floodgates fear has materialised in practice. Moreover, it is suggested that the discretion is in practice currently working well, with Michael Kirby remarking that:<sup>63</sup>

“most Australian lawyers, expert in this field, would not now want to go back to the old absolute law. And the Australian insurance industry appears to be of the same view, taking into account the actual operation of the proportionate operation of the ICA in practice.”

This floodgates argument is even less persuasive following recent UK legislation. The Criminal Justice and Courts Act 2015 requires courts to dismiss the claim of a

55. *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [143].

56. *Axa General Insurance Ltd v The Lord Advocate* [2011] UKSC 46; [2012] 1 AC 868, [128]; *Barnes v The Eastenders Group* [2014] UKSC 26; [2014] Lloyd’s Rep FC 461; [2015] AC 1, [94].

57. *Axa General Insurance v The Lord Advocate* [2011] UKSC 46; [2012] 1 AC 868, [36–41], *per Lord Reed*. This case concerned whether an Act of the Scottish Parliament, which determined that certain forms of asbestos-related harm would now be actionable, constituted an unlawful infringement of the A1P1 rights of the insurance companies.

58. *James v UK* (1986) 8 EHRR 123, [50].

59. *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [143].

60. See *The DC Merwestone* [2013] EWHC 1666 (Comm); [2013] 2 Lloyd’s Rep 311, [181], [225]; [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [136].

61. *Ibid.*, [157].

62. Insurance Contracts Act 1984 (Australia), s.56(2)–(3).

63. The Hon M Kirby, “Insurance contract law reform—30 years on” (2014) 26 ILJ 1, 17. See also R Merkin, *Reforming Insurance Law: Is there a case for reverse transportation* (Law Commissions, 2007), [6.11]. For a contrary view, see Law Reform Commission, *Insurance Contracts* (LRC CP 65, 2011), [8.24].

“fundamentally dishonest” personal injury litigant unless substantial injustice would result.<sup>64</sup> This discretion, specifically built into the Act, has not elicited the same concern as expressed in *The DC Merwestone*. In the Supreme Court case which this statute amends, fraud deterrence was a relevant concern<sup>65</sup> and the architects of this statutory discretion presumably did not think this would weaken any deterrent value of the law.

### Dissent

The assured’s account of the loss in *The DC Merwestone* was his best guess at what had happened and was (apparently) corroborated by the ship’s master shortly thereafter. We accept that its location in a section marked “facts” was fraudulent but we share the “manifest reluctance” of Popplewell J at the application of the forfeiture rule to these facts. We now offer a series of arguments against the current formulation.

## IV. A SCEPTICAL REVIEW OF “DETERRENCE”

This adherence to a single civil sanction for insurance fraud indicates law’s clear preference for deterrence at the expense of more proportionate remedies.<sup>66</sup> This has not been justified by notions of consent (“this is what the parties agreed”) but by reference to positive law rules seeking to deter dishonesty. The application of the forfeiture rule to both fabricated and device claims assumes that the same policy concerns arise, though this is questionable, given the existence of wholly genuine loss in the latter scenario. Deterrence has been emphasised in judgments since the 1860s; and a recent authoritative account is found in comments made by Lord Hobhouse of Woodborough in *The Star Sea*:<sup>67</sup>

“[The law] will not allow an insured who has made a fraudulent claim to recover. The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing.”

We do not suggest that the deterrence of fraud is not a role for the civil law but we are generally sceptical of it as an overreaching policy goal, and for a variety of reasons which we develop below:

- (a) it ignores real world costs imposed on a fraudulent insured;
- (b) it has the greatest impact on those who are least fraudulent (and vice versa);
- (c) it fails to take account of the substantial literature on the effective deterrence of fraudulent conduct;

64. Section 57. These concepts are not defined in the Act.

65. *Summers v Fairclough Homes* [2012] UKSC 26; [2013] Lloyd’s Rep IR 159; [2012] 1 WLR 2004, [51].

66. In contrast, the Insurance Act 2015 creates a default regime of proportionate remedies. Where the assured does not present the risk fairly, as required by s.3, the underwriter’s remedies in s.8 and Sch.1 are limited by what they would have done had a fair presentation been made. Section 10 provides that breach of warranty will no longer terminate the underwriter’s liability automatically but that liability is suspended on breach and will reattach where breach is remedied prior to the loss.

67. [2001] UKHL 1; [2001] 1 Lloyd’s Rep 389; [2001] Lloyd’s Rep IR 247; [2003] 1 AC 469, [62].

- (d) it lacks an effective threshold element (such as “materiality”);
- (e) the imposition of a draconian duty on the insured is not matched by a similar duty on the underwriter; and
- (f) the draconian approach to insurance fraud in the civil courts is not mirrored in other contexts.

### The real costs to the insured of proven fraud

Judges have frequently asserted that the absence of a draconian remedy for submitting a fraudulent claim (or, as extended, supporting a genuine claim with dishonest statements) would leave the fraudster in a “no lose” situation. This is a straw man. The real sanctions for breaking market norms come (as so often) not from formal legal rules, but from loss of reputation and social stigmatisation.<sup>68</sup>

First, there is the role of criminal justice: the possibility of criminal sanction for committing an insurance fraud increased significantly following changes to the specialist investigatory resources available to the police force.<sup>69</sup> Much has changed in the prosecution of insurance fraud since 2008, when, in frustration at the limited sanctions imposed by the criminal justice system, AXA Insurance sought exemplary damages against two defendants who had committed insurance fraud against them.<sup>70</sup> Funded by the insurance industry, the Insurance Fraud Enforcement Department has established a strong media presence with contributions to the BBC television series *Claimed and Shamed* and has investigated more than 1,000 suspected insurance frauds since 2012.<sup>71</sup> The BBC website for the series provides links to the City of London Police’s Insurance Fraud Enforcement Department (“IFED”), the industry’s fraud prevention bureau, and related bodies.<sup>72</sup> Moreover, IFED has expertise in recovering the proceeds of crime; it has secured nearly £190,000 worth of assets under the Proceeds of Crime Act 2002 and has restrained a further £800,000 worth.<sup>73</sup> This visible presence as a “fraud buster” is likely to be significant. Criminology suggests that an increase in the perceived risk of detection is a greater deterrent than the potential sanction.<sup>74</sup>

Secondly, there is a considerable social stigma that attaches to being convicted of insurance fraud.<sup>75</sup> The commission of fraud resembles one of the *Yes, Minister* famous

68. J Karpoff and J Lott Jr, “The Reputational Penalty Firms Bear From Committing Criminal Fraud” (1993) 36 *JL & Econ* 757.

69. City of London Police, “IFED” [www.cityoflondon.police.uk/advice-and-support/fraud-and-economic-crime/ifed/Pages/default.aspx](http://www.cityoflondon.police.uk/advice-and-support/fraud-and-economic-crime/ifed/Pages/default.aspx). We recognise that the declared focus of law enforcement is on claims that are wholly or partly dishonest, rather than the use of fraudulent evidence in support of an honest claim.

70. *AXA Insurance UK Ltd v Jensen* (10 November 2008) LawTel, [10] (cautioned, exemplary damages awarded); *AXA Insurance UK Ltd v Thwaites* (8 February 2008) LawTel, [13–14] (suspended sentence, exemplary damages refused).

71. Leading to 98 convictions and 542 months of imprisonment: DCID Wood, *IFED: The Next Chapter*, ABI Fraud Conference (17 September 2014).

72. BBC, *Claimed and Shamed* [www.bbc.co.uk/programmes/b01nhs7s](http://www.bbc.co.uk/programmes/b01nhs7s).

73. See *supra*, fn.71.

74. Discussed in detail below: see *post*, text to fn.82.

75. Economists have collated considerable evidence on the effect of conviction for serious offences on life chances: eg J Waldfoegel, “The Effect of Criminal Conviction on Income and the Trust ‘Reposed in the Workmen’” (1994) 29 *J of Hum Res* 62.

irregular verbs: “I get what I deserve after years of paying premiums without a claim. You exaggerate your claim. He is a fraudster.”<sup>76</sup> Whilst empirical evidence suggests that insurance is often viewed as a victimless crime,<sup>77</sup> this does not mean that a conviction will have only limited impact on the community or employment status of the insured.

Finally, and this applies to commercial and consumer insureds, there is a substantial effect on the market position of the insured. In addition to industry investment in IFED, the Insurance Fraud Bureau (“IFB”) operates a database of fraudulent insurance behaviour: the Insurance Fraud Register.<sup>78</sup> Moreover, the IFB encourages “whistleblowing” by the general public to its Cheatline, in a manner similar to the governmental measures on benefits fraud.<sup>79</sup> Additionally, the Government has proposed sharing fraud-related data across a broad range of public and private sectors, which would alert insurers to prior dishonest behaviour even beyond insurance claims, enabling them to decline proposals (and scrutinise claims) from those with a record of such behaviour.<sup>80</sup>

The civil law forfeiture rule, is then, of marginal significance in the deterrence of fraud. Few are likely to be aware of the rule, and its “draconian” effect is dwarfed by the other potential sanctions imposed by the justice system and market.

### **The inverse relationship between culpability and deterrent**

Our next critique of the forfeiture rule considers the inverse relationship it creates between the level of dishonesty involved and the likelihood of a deterrent effect. This does not seem to have been realised by the designers of the rule. The more dishonest the scheme, the less the forfeiture rule impacts on the rights of the fraudulent claimant.

Take at one end of the spectrum the type of organised criminality that has targeted motor insurers in recent decades: the “crash for cash”. Here there is no genuine loss, as it is deliberately orchestrated by the insured and would fall either outside the terms of the policy, or within contractual exceptions to cover. Forfeiting the remote possibility of an enforceable claim against the insurer is no real deterrent. The assumption made by many fraudsters is that the dishonesty will not be detected or will at least go unproven.<sup>81</sup> As considered above, the industry has recognised this and responded with investments in the criminal justice and administrative support for the detection and prosecution of fraud in insurance. Switch now to the least culpable end: the fraudulent device. Here there is a genuine claim, but the insured has deliberately or recklessly provided false evidence to promote the claim. The insured may not actually gain any real advantage: the claim

76. Written by Antony Jay and Jonathan Lynn, the TV series *Yes, Minister* and *Yes, Prime Minister* contained beautifully scripted dialogue such as this line from civil servant Bernard Wooley: “That’s one of those irregular verbs, isn’t it? I give confidential security briefings. You leak. He has been charged under section 2a of the Official Secrets Act.” See: [m.imdb.com/title/tt0080306/quotes?qt=qt0242452](http://m.imdb.com/title/tt0080306/quotes?qt=qt0242452).

77. S Tennyson, “Economic institutions and individual ethics: A study of consumer attitudes toward insurance fraud” (1997) 32 *J of Econ Behav & Org* 247.

78. R Davies, *Using the IFR as a front-end screening tool*, ABI Fraud Conference (17 September 2014).

79. B Fletcher, *Harnessing Industry intelligence to combat fraud: The IFB Strategy*, ABI Fraud Conference (17 September 2014).

80. L Hume, *Counter Fraud Checking Service*, ABI Fraud Conference (17 September 2014).

81. K Richards, “Deterring insurance fraud: A critical and criminological analysis of the English and Scottish Law Commissions’ current proposals for reform” (2013) 24 *Ins LJ* 16; and J Davey, “Dial M for moral hazard? Incentives to murder and the Life Assurance Act 1774” (2014) 25 *Ins LJ* 120.

might have been payable even without the lie. The insured may be reacting to perceived resistance from the underwriter to pay, and merely seeking to expedite what it views as its entitlement. Here, the possible impact on the insured is considerable, even though its level of culpability is lower.

### **No account taken of the deterrence literature**

As we have demonstrated, the forfeiture rule operates haphazardly. On the one hand, it imposes no formal sanction on the fraudster who totally invents his claim and yet visits very harsh consequences on the assured who bolsters his claim with misleading evidence. This overlooks decades of social science literature on deterrence.<sup>82</sup> Considerations of deterrence first emerged in the eighteenth century in response to the capricious legal systems of the day.<sup>83</sup> Classic theory suggested that the higher the costs associated with punishment, the less likely an offence would be committed. The costs in this equation were the certainty of detection and the severity of punishment.<sup>84</sup> On this understanding, deterrence theory relied upon setting the punishment at a level which just exceeded the benefits of offending.

Modern deterrence theory built on these early ideas and suggested that the certainty of detection was a far stronger indicator of deterrence than harsh sanctions and has been substantiated by a number of empirical methods.<sup>85</sup> The literature also indicated that social stigma and shame were more powerful deterrents to illegal behaviour than formal legal sanctions.<sup>86</sup> The media presence of IFED, discussed above, is perhaps an attempt by the industry to capitalise on these extra-legal deterrents. As the majority of would-be offenders have little knowledge of the actual likelihood of being caught and punished,<sup>87</sup> it is their perception of the costs of offending which are more relevant. Policymakers and the industry therefore need to focus on changing perceptions in addition to changing the legal framework. Modern hybrid models have sought to harness the deterrent effect of formal and informal sanctions to offer a more accurate measure of compliance with the law than earlier studies, which focused on legal sanctions alone.<sup>88</sup> The emerging field of behavioural science provides useful insights in this context, not least in demonstrating that the decision-making process is hampered by cognitive biases and the use of heuristics,

82. We have considered the deterrent effect of the forfeiture rule elsewhere: see Richards (2013) 24 *Ins LJ* 16. There is a considerable body of work in this area. A representative sample, excluding sources cited in this article, includes: M Tonry, "Learning from the limitations of deterrence research", in M Tonry (ed.), *Crime and Justice: A Review of Research, Vol. 37* (University of Chicago Press, Chicago, 2008); K Varma and A Doob, "Deterring economic crimes: The case of tax evasion" (1998) 40 *Canadian J Criminology* 165; and E Blais and JL Bacher, "Situational deterrence and claim padding: Results from a randomized field experiment" (2007) 3 *J Exp Criminol* 337.

83. R Akers, *Criminological Theories Introduction, Evaluation and Application*, 3rd edn (Roxbury Publishing, Los Angeles, 2000), 15.

84. *Ibid.*, 17.

85. S Klepper and D Nagin, "The deterrent effect of perceived certainty and severity of punishment revisited" (1989) 27 *Criminology* 721, 741.

86. *Ibid.*, 721.

87. Akers, 19.

88. D Nagin and G Pogarsky, "Integrating celerity, impulsivity, and extralegal sanction threats into a model of general deterrence: Theory and evidence" (2001) 39 *Criminology* 865, 866.

and is strongly affected by personal experience.<sup>89</sup> It is important to take account of these lessons in creating policy to ensure that deterrence is not an illusory aim.<sup>90</sup> Trials carried out by the Behavioural Insights Team<sup>91</sup> focusing on the reduction of fraud, error and debt to public bodies have highlighted the practical application of these lessons and demonstrate recognition of the utility of behavioural science by Government.<sup>92</sup>

There are two conclusions to be drawn here. First, the judicial emphasis placed on the draconian nature of the forfeiture rule as vital to deterrence is undermined by this body of work and deserves reconsideration in this broader context. Additionally, it is clear that one sanction cannot counter a spectrum of fraudulent behaviours, given that the anticipated benefits to the fraudster will vary considerably. A more proportionate framework, whatever this might look like in practice, would meet these concerns.

### Lack of an effective materiality threshold

In extending the forfeiture rule to include fraudulent devices in *The Aegeon*, the Court of Appeal recognised the need to develop a materiality requirement applicable in these circumstances. Mance LJ's 'tentative *obiter*' formulation provided that forfeiture would operate in respect of:

"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".<sup>93</sup>

Courts were initially reluctant to apply the extended version of the rule due to a lack of clarity regarding the link between the device and the claim.<sup>94</sup> The rule has since received recognition from the Privy Council,<sup>95</sup> although it is noteworthy that the Court of Appeal in *The DC Merwestone* was the first to apply it as a matter of *ratio*.<sup>96</sup> Despite this, the precise meanings of "directly related" and "not insignificant improvement" remain unsettled.

89. D Kahneman, *Thinking, Fast and Slow* (Penguin, London, 2011), 129; C Jolls, C Sunstein and R Thaler, "A behavioral approach to law and economics", in C Sunstein (ed.), *Behavioral Law and Economics* (Cambridge University Press, Cambridge, 2000), 45; P Feldman, *The Psychology of Crime* (Cambridge University Press, Cambridge, 1993), 265.

90. There is some evidence that policymakers and the industry are taking account of behavioural science. The Financial Conduct Authority indicated that behavioural science would play a major role in shaping regulation: FCA, *Applying behavioural economics at the Financial Conduct Authority* (2013), [www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-1](http://www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-1).

91. A social purpose company owned by its employees, the UK Government and Nesta (UK innovation charity) dedicated to the application of behavioural science. See [www.behaviouralinsights.co.uk/about-us](http://www.behaviouralinsights.co.uk/about-us).

92. Behavioural Insights Team, *Applying behavioural insights to reduce fraud, error and debt* (February 2012), available at: [www.behaviouralinsights.co.uk/publications/fraud-error-and-debt-behavioural-insights-team-paper](http://www.behaviouralinsights.co.uk/publications/fraud-error-and-debt-behavioural-insights-team-paper).

93. *The Aegeon* [2002] EWCA Civ 247; [2002] 2 Lloyd's Rep 42; [2002] Lloyd's Rep IR 573; [2003] QB 556, [45]

94. *Interpart v Lexington* [2004] EWHC (Comm); [2004] Lloyd's Rep IR 690, [43]; *Marc Rich Agriculture Trading v Fortis Corporate Insurance* [2004] EWHC 2631 (Comm); [2005] Lloyd's Rep IR 396, [28].

95. *Stemson v AMP* [2006] UKPC 30; [2006] 1 Lloyd's Rep IR 852, [36].

96. *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd's Rep 32, [166].

In practice, this carefully articulated formulation has proved a very low threshold. The lie in *The DC Merwestone* was the assured's best guess at what had happened and was, only a fortnight later, corroborated by the ship's master. At best this lie would have resulted in quicker payment for the assured.<sup>97</sup> This is distinct from the fraudulently backdated letter in *The Litsion Pride*,<sup>98</sup> which may have prompted the underwriter to make payment *ex gratia*, notwithstanding an earlier breach of good faith. We are not the first to voice concerns that the materiality requirement is not working effectively in practice.<sup>99</sup> Given the decisive effect of forfeiture on the assured's claim, it is concerning that the courts have not (yet) probed the individual elements of the test rigorously.

The assured's account of the loss in *The DC Merwestone* was provided in response to a request for information. This is distinct from a contractual duty to keep the underwriter informed during the claims process. On this basis we adopt the analysis favoured in *The Mercandian Continent*,<sup>100</sup> where Longmore LJ drew the same distinction in determining the scope of a post-contractual duty of utmost good faith.

"If the insurer has a right to information by virtue of an express or an implied term, there may be a duty of good faith in the giving of such information... If there is no right in the insurer to be given information but he asks for information, no duty of good faith arises as such. The only duty of the insured will be not materially to misrepresent the facts in anything he does say to insurers. If he does make any such misrepresentation, the insurer will have ordinary common law remedies for any loss he has suffered."

On this analysis, the underwriter in *The DC Merwestone* would be left to the common law to seek a remedy and Christopher Clarke LJ's assertion that the forfeiture rule operates by virtue of the doctrine of utmost good faith is unfounded.

A related issue concerns information held by the underwriter. In pre-contractual misrepresentation, courts have distinguished situations where false information was provided, but not relied upon, because the other party had a superior source of information, from those where the misrepresentee had the opportunity to verify the information but chose not to do so.<sup>101</sup> The underwriter in *The DC Merwestone* had initially gathered information from crew interviews and later sought an account of the casualty from the assured. It cannot be determined from the reported facts whether the underwriter's decision not to pursue or further investigate a due diligence defence was based on the crew interviews or the insured's response. *The DC Merwestone* may signal the development of a specialist

97. It is doubtful whether quicker payment meets the test outlined in *The Aegeon* [2002] EWCA Civ 247 [2002] 2 Lloyd's Rep 42; [2002] Lloyd's Rep IR 573; [2003] QB 556. Quicker payment had been identified as fraudulent in *Wisenthal v World Auxiliary Insurance Corp* (1930) 38 LJ Rep 54, 62 but was only deemed "of interest" by Mance LJ in *The Aegeon* [2002] EWCA Civ 247; [2002] 2 Lloyd's Rep 42; [2002] Lloyd's Rep IR 573; [2003] QB 556, [29] in developing the materiality threshold applicable to devices.

98. [1985] 1 Lloyd's Rep 437, 507.

99. A Bugra and R Merkin, "Fraud' and fraudulent claims" (2012) 125 BILA LJ 3, 6; Clarke, *Law of Insurance Contracts*, 4th edn (2014), [27.2B4]; Law Commission, *Reforming Insurance Contract Law: Issues Paper 7: The Insured's Post-Contractual Duty of Good Faith* (July 2010), [3.15].

100. *K/S Merc-Scandia XXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563, [22].

101. Contrast the cases of *Redgrave v Hurd* (1881) 20 Ch D 1 and *Atwood v Small* (1838) 6 Cl & F 232.



branch of post-contractual misrepresentation, although the precise tests applicable to issues of materiality, inducement and reliance are not yet settled comprehensively.<sup>102</sup>

In situations where the duty to provide information is contractual, Longmore LJ's later analysis is useful. In setting an overarching principle as to when avoidance would be appropriate for post-contractual breaches of good faith, the court in *The Mercandian Continent*<sup>103</sup> held *obiter* that

“the conduct of the assured which is relied upon by underwriters must be causally relevant to underwriters' ultimate liability or, at least, to some defence of underwriters before it can be permitted to avoid the policy. This is, I think, the same concept as that underwriters must be seriously prejudiced by the fraud complained of before the policy can be avoided”.

Our concern is to ensure that the lie, objectively assessed, is of sufficient magnitude to justify forfeiture of the claim. We agree with Mance LJ that this should consider the potential of the claim to influence the insurer.<sup>104</sup> The fact that a lie is disbelieved ought not to deprive the underwriter of a defence. A subjective test is inappropriate. What kinds of lies then can be assumed to break the cooperative relationship between the parties to the extent that the claim should be forfeit? Whilst Mance LJ's formulation in *The Aegeon* sought to bring clarity, we suggest that this is an area where an “open textured” test would be more suitable. We have in mind the approach in *The Mercandian Continent* of Longmore LJ, who spoke of equivalence to repudiatory breach. Given that an underwriter would often have a common law damages claim (in tort) against a fraudulent insured, we propose the test suggested by Buckley LJ in respect of innominate terms:

“Will the consequences... be such that it would be unfair to the injured party to hold him to the contract and leave him to his remedy in damages [...] ? If this would be so, then a repudiation has taken place.”<sup>105</sup>

This will need to be expressed in such a way as to encompass situations, as in *The DC Merwestone*, where the insured is not performing a contractual duty. Moreover, it needs explicitly to reflect that it is the potential of the lie, and not its actual effect, that is measured. That, we believe, is well within the capacity of the Supreme Court to ensure.

Courts have often demonstrated an aversion to extending to underwriters contractual remedies for which they could have bargained.<sup>106</sup> The International Hulls Clauses 2003 contain such a clause and were available to the parties in this dispute. They chose to contract on other terms.

102. See eg G McMeel, “The FSA's insurance conduct of business regime: A revolution in (consumer) insurance law?” [2005] LMCLQ 186, 193–194, 204 on the enforcement of ICOBS claims-handling rules by private persons under the Financial Services and Markets Act 2000, s.150.

103. [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563, [28].

104. *The Aegeon* [2002] EWCA Civ 247; [2002] 2 Lloyd's Rep 42; [2002] Lloyd's Rep IR 573; [2003] QB 556, [37].

105. *Decro-Wall International SA v Practitioners in Marketing Ltd* [1971] 1 WLR 361 (CA), 380, per Buckley LJ, approved *Federal Commerce & Navigation Co Ltd v Molena Alpha Inc (The Nanfri)* [1979] 1 Lloyd's Rep 201, 210; [1979] AC 757, 779.

106. *The Star Sea* [2001] UKHL 1; [2001] 1 Lloyd's Rep 389; [2001] Lloyd's Rep IR 247; [2003] 1 AC 469, [61], per Lord Hobhouse.

If we accept the need to create a distinct rule for judging the legal significance of fraudulent device claims, the lack of an effective materiality threshold is problematic. The judgment in *The DC Merwestone* translates a tentatively proposed *obiter* test into law with the consequence that a greater number of statements may result in the forfeiture of otherwise valid claims. This fails to recognise that misleading information may be given either in satisfaction of a contractual duty or as an indication of the assured's cooperation during the claims process. This may, in hard cases, leave the insurer with an undeserved windfall, even though the lie may have borne little or no relation to their handling of the claim.

### The lack of reciprocity

We have written elsewhere on the need for the forfeiture rule to fit within the broader context of insurance contract law, and will summarise our findings here.<sup>107</sup> There is, at present, no substantive insurance contract rule that requires insurers to handle insurance claims in a timely or professional fashion. There is consequently no orthodox remedy (beyond the award of interest) to compensate policyholders for the late (or non-) payment of an insurance claim.<sup>108</sup> There is such a duty embedded in regulation, but this is enforceable only by private parties.<sup>109</sup> In one notable case declining to create a common law rule to this effect, Mance LJ noted that such a duty would (presumably) have to be reciprocal, imposing duties on the insured.<sup>110</sup> We do accept that in later litigation<sup>111</sup> Mance LJ adopted a "minimal intervention" default in classifying claims notification duties imposed on the insured. He has not developed the "insured bad faith in claims" obligation in a similarly restrictive fashion.

Identifying an "insurer bad faith" comparator to *The DC Merwestone* is no simple task, given that there is no established cause of action for an insured to pursue. Moreover, such instances are likely to be rare. We note, however, in *Widefree Ltd v Brit Insurance Ltd*<sup>112</sup> that the insurer's claims adjuster asserted that there was a breach of the "Fidelity warranty" in the giving of false information in the presentation of the claim, although this was not pursued at trial. Leaver QC (sitting as a Deputy High Court Judge) remarked in his judgment:<sup>113</sup>

107. Davey [2006] LMCLQ 223.

108. We have argued elsewhere that an application of "*Blake*" style damages to strip the defendant of profits gained on breach might be available: see Davey, *supra* fn.41. *Cf A-G v Blake* [2001] 1 AC 268.

109. See eg McMeel [2005] LMCLQ 186, 193–194, 204 on the enforcement of ICOBS claims handling rules by private persons under the Financial Services and Markets Act 2000, s.150.

110. *Insurance Corp of the Channel Islands Ltd v McHugh* [1997] LRLR 94, 136: "If any such term existed at all, it would, presumably, have to be mutual. In other words, there would be a duty on the insured to present and progress the claim with reasonable speed and efficiency. Just as insurers would be obliged not reasonably to refuse or delay indemnity, so, presumably, the insured would be under a duty not unreasonably to delay, misstate or overstate his case."

111. *Friends Provident Life & Pensions Ltd v Sirius International Insurance* [2005] EWCA Civ 601; [2006] 1 Lloyd's Rep IR 45, [33].

112. [2009] EWHC 3671 (QB); [2011] Lloyd's Rep IR 63.

113. *Ibid*, [62–63].

“There was no basis upon which the Insurers could have concluded that that was false information. That assertion is unsupported by any evidence. ... I have to say that I find it astonishing that responsible Insurers and loss adjusters could make an allegation of Infidelity without any supporting evidence.”

We make no comment whatsoever about the state of mind of insurer (and loss adjuster) here. We do think that this is an unsupported assertion of a defence that, if believed, might have improved the insurer's position when seeking to force a settlement. We ask where is the draconian response to behaviour of this type? Either the parties are being required to act cooperatively, and in good faith, or they are permitted to act in their own selfish interests. We see no justification for forcing the insured to negotiate in good faith but leaving the underwriter to be restrained solely by reputational factors. We develop this analysis below, in Part V.

We note that the Law Commissions, and a wide range of commentators, supported the introduction of a statutory duty on insurers to handle claims without negligence or bad faith. Even this was unable to secure industry support. There have been mutterings of concern about replicating the US “bad faith” model, which stalled the legislative process.<sup>114</sup> The “bad faith” doctrine in the US was only an existential threat to insurance coverage in a very few States, for a brief period. Moreover, the US legal system utilises jury trials and exemplary damages in tort in a manner that skews any attempt at simple comparison.<sup>115</sup> Furthermore, the “bad faith” principle is now recognised by many (in its developed state) as an efficient response to the opportunistic abuses of bargaining power identified in US insurance markets.<sup>116</sup> Put simply, the UK proposals bore none of the characteristics of the problematic variants of the US approach.

Our basic question here is: what remedy (of a similarly draconian nature) does English insurance contract law impose on an underwriter who, during negotiations, recklessly asserts that facts exist that would constitute a defence to the claim? Moreover, would that draconian remedy be imposed even if the underwriter's assertion were later corroborated?

This section demonstrates that the forfeiture rule developed in a legal environment that sees English courts resisting calls to develop a cause of action for insureds whose underwriters fail to pay and where a Law Commission proposal to provide a remedy for reckless or wilful failure to pay was viewed as too controversial for inclusion in a Law Commission Bill.<sup>117</sup> Those same lawmakers have developed, and then partly codified, the forfeiture rule. This inconsistency should not go unnoticed.

114. See eg the discussion of amendments tabled to the Insurance Bill 2014: [www.parliament.uk/documents/HoL-Legislation-Office/Special-Public-Bill-Committees/Insurance-Bill/Oral-Evidence/Special-Public-Bill-Committee-transcript-15-12-14.pdf](http://www.parliament.uk/documents/HoL-Legislation-Office/Special-Public-Bill-Committees/Insurance-Bill/Oral-Evidence/Special-Public-Bill-Committee-transcript-15-12-14.pdf).

115. T Baker, *Insurance Law & Policy*, 2nd edn (Aspen Publishers, New York, 2008), 114–123. The rapid cooling of the (initially) intensely fierce debate over bad faith damages in the United States is well described by a leading commentator in K Abraham, “The Natural History of the Insurer's Liability for Bad Faith” (1994) 72 *Tex L Rev* 1295.

116. K Abraham, “Liability for Bad Faith and the Principle Without A Name (Yet)” (2012) 19 *Conn Ins LJ* 1.

### **Draconian approach not mirrored elsewhere**

The determinedly draconian nature of forfeiture is not matched elsewhere, not least in how the criminal law treats insurance fraudsters. Sentencing under the Fraud Act 2006 depends upon the culpability of the offender, degree of planning and the level of financial gain.<sup>118</sup> In the tort context, the Supreme Court has rejected the view that strike-out of exaggerated claims was the only way to deter personal injury fraud and preferred to compensate the actual harm and achieve deterrence through other means.<sup>119</sup> The approach in *Summers* has recently been replaced by the Criminal Justice and Courts Act 2015, s.57, which provides that courts must dismiss a claim where the claimant has been fundamentally dishonest, unless dismissal would result in substantial injustice. This gives courts a degree of discretion to tailor their response to the circumstances of the case. We contend that a peculiarly draconian approach is not justified by reference to policy in insurance law alone. Moreover, once it is recognised that other relationships, not “of the utmost good faith”, have issues of information asymmetry and similar information-forcing obligations to overcome the inequality, then a special insurance rule becomes unjustified.<sup>120</sup>

These critiques question the practical operation, internal coherence and wider context of the forfeiture rule. Viewed together, we suggest that this undermines the deterrence argument as a control for fraudulent insurance claims. We now seek to show that insurance contract law is not unique in facing these issues, by reference to employment law and relational contract theory.

## V. FORFEITURE AS A RULE *SUI GENERIS*? THE SPECTRUM OF FRAUDULENT INDEMNIFICATION CLAIMS

For Christopher Clarke LJ in *The DC Merwestone*, the forfeiture rule in insurance contract law was a product of the doctrine of utmost good faith and stands alone.<sup>121</sup> Our approach is different. We question the assumption that the information asymmetries that led to the development of the utmost good faith doctrine are found in insurance alone. That English law developed information-sharing duties in a haphazard fashion is well known, but this certainly does not make insurance unique in facing this policy concern.<sup>122</sup> In this piece we argue that the forfeiture rule properly conceived is merely part of a broader spectrum of rules governing the submission of a claim for contractual indemnification. Moreover, the use of fraud in the claim brings in a further neighbouring principle: the doctrine of *ex turpi causa non oritur actio*.

117. *Supra*, fn.114.

118. Sentencing Council, *Fraud, Bribery and Money Laundering Offences Definitive Guideline* (2014) available at: [sentencingcouncil.judiciary.gov.uk/docs/Fraud\\_bribery\\_and\\_money\\_laundering\\_offences\\_-\\_Definitive\\_guideline.pdf](http://sentencingcouncil.judiciary.gov.uk/docs/Fraud_bribery_and_money_laundering_offences_-_Definitive_guideline.pdf).

119. *Summers v Fairclough Homes* [2012] UKSC 26; [2013] Lloyd’s Rep IR 159; [2012] 1 WLR 2004, [50–60].

120. FD Rose, “Information Asymmetry and the Myth of Good Faith” [2007] LMCLQ 181, 194–195.

121. *The DC Merwestone* [2014] EWCA Civ 1349; [2015] 1 Lloyd’s Rep 32, [76–77], *per* Christopher Clarke LJ.

122. Rose [2007] LMCLQ 181.

When combined, this provides the obvious comparator of the submission of a fraudulently enhanced expenses claim under an employment contract. In this Part we consider the approach of the legal system to employee fraud (and its contractual consequences) and note the development of mutual duties of trust and confidence in that sphere, analogous to the doctrine of utmost good faith. In order to explain why English law has permitted these information-forcing rules, in the face of what is supposedly a free-market, capitalist model, we refer to insights from relational contract theory.

We recognise that under a formal legal analysis it is possible to differentiate insurance claims and a request for indemnification for expenses in an employment context. One obvious example is the counter-intuitive model used to explain the insurer's obligation to pay the contractual indemnity under English law—the much criticised “hold harmless” principle.<sup>123</sup> Moreover, the precise legal basis on which expense claims are recovered will vary. However, it is our view that many of these differences are historical accident and merely show the era in which the juridical basis for the indemnity first arose, and do not provide any genuine basis for differentiation. There will either be a contractual duty to cooperate in the submission of claims, or it will be a non-contractual process. Put simply, we can see no justification for the widely divergent legal response to the submission of a genuine claim for indemnification of a loss incurred, albeit one supported by fraudulent evidence (or a fraudulently incomplete account).

We begin, however, by rejecting a comparator which has been commonly used—the pre-contractual fraudulent misrepresentation—and explain why.

### **Finding analogues: distinguishing fraud in the claims process and pre-contractual fraud**

We deal here with a frequently asserted position: that the fraudulent claims jurisdiction in insurance has a reliable comparator in fraud during the negotiation of the contract.<sup>124</sup> We have chosen not to adopt this as our analogue and should explain our choice. It is not simply because the pre-contractual approach is not consistent with our preferred approach at claims. Even under the avowedly proportionate model under the Insurance Act 2015, pre-contractual fraud (whether by non-disclosure or positive misrepresentation) provides for the remedy of avoidance *ab initio*.<sup>125</sup> Moreover, under general contract law there is no statutory discretion (eg, such as that under the Misrepresentation Act 1967, s.2(2)) applicable to fraudulent misstatements.

We do not consider in detail the pre-contractual position, on the basis that the law relating to vitiating factors is not a useful guide to the law relating to contractual performance. Moreover, in many of the cases considered under the forfeiture rule, the insured is not performing a contractual duty at all. Claims cooperation clauses requiring the insured to assist the insurer in its investigation of the loss are not universal, and none appears to have been in place in *The DC Merwestone*. This was voluntary assistance, undertaken in the shadow of the law and of market norms. The insured that refuses to go beyond

123. *Supra*, fn.40.

124. This point was well made by an anonymous referee and deserves a response here.

125. Insurance Act 2015, s.8(2), Sch.1(2).

mere notice of his claim pre-trial may risk triggering suspicions from its insurer, and may affect its recovery of costs at trial, but it is not—without express contractual obligation—in breach of any duty.<sup>126</sup> The question for the court in *The DC Merwestone* is what sanction to impose on a contractual party who is fraudulent in a contract-related, but not contract-performing, situation.

In the post-contractual sphere, the parties have either provided for an express term of the contract to govern the situation or it will be answered by reference to an implied term of the contract or some positive rule of law. The reason for the dispute in *The DC Merwestone* was that the parties have not included an express fraudulent claims clause. These are not unknown in marine insurance contracts and indeed a standard form clause to that end was included in the International Hulls Clauses from 2003 onwards.<sup>127</sup>

This failure to contract, we argue, changes the nature of the situation. The court is establishing a default rule in the absence of any contractual indication from the parties. Much ink has been spilt on whether silence can be equated to consent to the default rule and we do not wish to reopen that debate.<sup>128</sup> Rather, we contend that:

- (1) the choice of a performance default rule (whether contractual or a positive rule of law) is different in nature from establishing the conditions of proper negotiation of the putative contract;
- (2) insurance contract law should therefore look to the treatment of fraudulent claims for the reimbursement of funds in other contractual arena;
- (3) in setting the default, the courts should not overlook the parties' opportunity to stipulate for a rule of their choice, and should adopt a position of minimal intervention; and
- (4) *a fortiori*, the choice of a post-contractual, performance-related (but not performance itself) default should be limited in scope and remedy.

### Fraud and the “relational” insurance contract

The concept of a relational contract is well established in contracts scholarship, but less commonly referenced in commercial law articles, so a brief introduction is given here.<sup>129</sup> The notion of a relational model of contract theory (properly understood) argues that contracts lie on an axis, with the poles represented by “discrete” and “highly relational” agreements. In truth, all contracts are relational in some sense, so it is the degree to which

126. We are grateful to Michael Davey QC for a useful discussion on this point.

127. International Hull Clauses (01/11/03), cl.45.3: “It shall be a condition precedent to the liability of the Underwriters that the Assured shall not at any stage prior to the commencement of legal proceedings knowingly or recklessly

cl 45.3.1 mislead or attempt to mislead the Underwriters in the proper consideration of a claim or the settlement thereof by relying on any evidence which is false

cl 45.3.2 conceal any circumstance or matter from the Underwriters material to the proper consideration of a claim or a defence to such a claim.”

128. See eg R Barnett, “The Sound of Silence: Default Rules and Contractual Consent” (1992) 78 Va L Rev 821.

129. A useful introduction, spanning a range of contract issues, is found in D Campbell and H Collins, “Discovering the Implicit Dimensions of Contracts”, in D Campbell, H Collins and J Wightman (eds), *Implicit dimensions of contract: Discrete, relational and network contracts* (Hart, Oxford, 2003).

they are relational that is significant. A highly relational contractual arrangement will be understood by the parties to be implemented according to a wide variety of customs and norms not referenced in the agreement itself. Indeed, the basis of the parties' mutual rights and obligations will often be the tacit norms that underpin their relationship, and not their contract itself. Highly relational agreements are often long-term and will normally require the agreement to adapt and change to circumstances. This does not mean that all agreements must be enforced or interpreted in some richly contextual, "ignore the text", fashion: often the commercial context requires us to look at the words on the page alone.<sup>130</sup> Relational contract theory is therefore a neutral tool, and is not indicative of an *a priori* preference for standards rather than strict rules.<sup>131</sup>

Let us assume that insurance contracts are best understood as lying on the "more relational" end of this axis.<sup>132</sup> Gordon has identified two key, but potentially conflicting, influences on the performance of contractual relationships: solidarity and power. First, solidarity:<sup>133</sup>

"In the 'relational' view of Macaulay and Macneil, parties treat their contracts more like marriages than like one-night stands. Obligations grow out of the commitment that they have made to one another, and the conventions that the trading community establishes for such commitments; they are not frozen at the initial moment of commitment, but change as circumstances change; the object of contracting is not primarily to allocate risks, but to signify a commitment to cooperate. In bad times parties are expected to lend one another mutual support, rather than standing on their rights; each will treat the other's insistence on literal performance as wilful obstructionism; if unexpected contingencies occur resulting in severe losses, the parties are to search for equitable ways of dividing the losses; and the sanction for egregiously bad behaviour, is always, of course, refusal to deal again."

Second, power:<sup>134</sup>

"In the messy and open-ended world of continuing contract relations, where the contours of obligation are constantly shifting, the effects of power imbalances are not limited to the concessions that parties can extort in the original bargain. Such imbalances tend to generate hierarchies that can gradually extend to govern every aspect of the relation in performance. This is the potential dark side of continuing contract relations, as organic solidarity is the bright side: what starts out as a mere inequity in market power can be deepened into persistent domination on one side and dependence on the other."

We recognise that insurance products are not homogeneous, but most disputes (and certainly the one in *The DC Merwestone*) can better be understood as a product of the tension between these norms. The insurer can persuasively argue that the insured has

130. I Macneil, "Relational Contract Theory After a Neo-Classical Seminar" in Campbell, Collins and Wightman, *ibid.*

131. D Campbell, "Arcos v Ronaasen as a Relational Contract", in D Campbell, L Mulcahy and S Wheeler, *Changing Concepts of Contract* (Palgrave Macmillan, London, 2013).

132. On insurance as a relational agreement, see J Feinman, "The insurance relationship and relational contract and the 'fairly debateable' rule for first-party bad faith" (2009) 46(3) San Diego L Rev 553.

133. R Gordon, "Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law" (1985) Wis L Rev 565, 569. To those who say that an insurance policy only operates to allocate risks, we would ask them to find an insurer that routinely enforces all legal rights against insureds irrespective of commercial and market pressures. Insurance is like a rugby scrum—there are many more offences committed than penalties.

134. *Ibid.*, 570.

the power, with control over the narrative that underpins the claim, and control over the evidence that establishes that narrative. By contrast, the insured can assert that it is the insurer who sets the rules and umpires the claims game.<sup>135</sup> Even if the insured is subject to agreed duties of cooperation during claims, its position is stark: failure to be honest deprives it of its sunk investment, the premium and the cover it obtained. The crucial loss is the cover. The insured can recover from this underwriter or none. It cannot go back into the market after the loss has occurred. Insurance law has, predominately, listened to the first argument, that from the insurer. The obligations of *mutual* utmost good faith (and many others in insurance law) are, in practice, largely designed to protect the *underwriter* from the *insured's* failing to act cooperatively.<sup>136</sup> Much of the focus of the Insurance Act 2015 was to redraw this balance.

In essence, the insured's argument is that the underwriter's strict insistence on proof, and its vigorous reliance on defences (recall that the underwriter failed at first instance to establish any of the other defences it ran) are the "wilful obstructionism" identified by Gordon as contrary to solidarity of contractual purpose. Moreover, given the human rights dimension in this case, it can argue that the insurer's claim violates wider social norms, when responding disproportionately.

What is needed then is to step away, briefly, from the insurance context, and to ask how other similar contractual conflicts are resolved. As noted above, we seek examples of fraud in performance rather than creation of agreements. In doing so, we recognise that our selection of two comparators (*ex turpi causa* and employment law) is a limited field. A broader study is beyond the scope of this paper. We would, as ever, be delighted to respond in the future to rebuttals based on other comparators and perhaps other jurisdictions. We do at least seek to show that the insurance approach is not the only viable model in English contract law.

### **Judicial consideration of a nuanced model: the illegality defence**

There are clear points of comparison between the insurance forfeiture rule and the illegality defence in general contract law. Both attempt to prevent recovery where the claimant has engaged in dishonest conduct. But the consequences of each rule's invocation varies considerably; whereas forfeiture permits the insurer to recover monies paid in connection with the fraudulent claim and refuse to pay outstanding sums, the operation of *ex turpi causa* simply leaves the loss to lie where it falls.<sup>137</sup> Both the courts and policymakers have recently engaged in discussion about the correct scope of the rules, but the themes of those (ongoing) discussions were different. What we attempt briefly to show here is that, while insurance courts consistently reaffirm the forfeiture rule, the illegality courts are much more willing to examine the policy basis for the defence.

135. For a forceful commentary in support of such a view, see J Feinman, *Delay, Deny, Defend* (Penguin, London, 2010).

136. H Cousy, "About sanctions and the hybrid nature of modern insurance contract law" [2012] *Erasmus LR* 123, 123–124.

137. This stems from a desire to protect the morality of the court, although it is a far less convincing explanation today, as argued by Lord Sumption, "Reflections on the Law of Illegality" [2012] *Restitution Law Review* 1, 2–3.



The maxim *ex turpi causa* is easily stated. The authoritative expression is located in the speech of Lord Mansfield in *Holman v Johnson*.<sup>138</sup>

“The objection, that a contract is immoral or illegal as between plaintiff and defendant sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but it is founded in general principles of policy ... No Court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act.”

The two centuries of case law which follow this exposition have given rise to a number of rules accompanied with a similar number of exceptions. The result is a body of law which is incoherent and complex.<sup>139</sup> Part of the problem lies in the simultaneous development of the maxim in different areas of the law and the fact that it asks courts to refuse a claimant remedies to which he would ordinarily be entitled. A comprehensive account of the defence is beyond the scope of this article<sup>140</sup> but this will instead chart the fluctuations of the judicial approach to the nature of the defence.

Early case law demonstrated the court's refusal to yield to circumstance. A contract which contravened statute without the knowledge of either party was unenforceable<sup>141</sup> and so too the policy of insurance following the outbreak of war due to one party's status as an enemy alien.<sup>142</sup> Both the nature of the pleadings and the substance of the dispute were relevant in the judicial recognition of the defence.<sup>143</sup>

The consequences of the maxim's invocation are problematic, as it may give an undeserving litigant a generous windfall, while his equally dishonest adversary is left without a legal remedy. There is no consideration of the claimant's degree of culpability and restitutionary claims are not permitted.<sup>144</sup>

In an effort to evade these arbitrary consequences, a series of cases in the 1980s developed the idea that the defence would be available only where enforcement of the claim would constitute an affront to the public conscience.<sup>145</sup> This was defined by the Court of Appeal

138. (1775) 1 Cowp 341, 743; 98 ER 1120, 1121. There is evidence that the maxim was in operation at least 50 years earlier. See *Everet v Williams* (1725) Unreported; noted (1893) 9 LQR 197 (commonly referred to as “The Highwayman's Case”).

139. Sumption [2012] *Restitution Law Review* 1; *Les Laboratoires Servier v Apotex Inc* [2012] EWCA Civ 593; [2013] Bus LR 80, [63], per Etherton LJ, where he held that a consideration of all the illegality cases would be “complex, very lengthy, and in large part unrewarding. The decisions inevitably turn on their own particular facts ... The jurisprudence in this areas has been an evolving one, but its evolution has not followed a consistent pattern”.

140. Readers are directed to R Buckley, *Illegality and Public Policy*, 3rd edn (Sweet & Maxwell, London, 2013) for a comprehensive account of the defence.

141. *JM Allan (Merchandising) Ltd v Cloke* [1963] 2 QB 340.

142. *Oom v Bruce* (1810) 2 East 225; 104 ER 87. Neither party was aware that war had begun.

143. Mance (2014) 18 Edin L Rev 175, 179. In *Pearce v Brooks* (1866) 1 LR Ex 213, the court refused to enforce a *prima facie* valid contract for the hire of a brougham because both parties knew that the hirer, who worked as a prostitute, would use it to attract clients. The importance attached to the substance of the dispute no longer appears to be so relevant; see the later discussion of *Tinsley v Milligan* [1994] 1 AC 340.

144. Cf the position in insurance fraud, where the insurer is entitled to reclaim interim payments made prior to the discovery of the fraud and is not liable for any genuine loss sustained. The Law Commission, *Illegal transactions* (LCCP 154, 1999), [7.69], provisionally proposed giving courts a discretion to enable a person to withdraw from an illegal contract and to bring forward a claim in restitution for benefits conferred thereunder.

145. In *Moore Stephens v Stone & Rolls Ltd* [2009] UKHL 39; [2009] 2 Lloyd's Rep 537; [2009] 1 AC 1391, [20] the public conscience test was traced to the case of *Thackwell v Barclays Bank* [1986] 1 All ER 676, although the court noted a reference 15 years earlier in *Gray v Barr* [1971] 2 QB 554, 581. In *Euro-Diam Ltd v*

as requiring the court to “weigh, or balance, the adverse consequences of granting relief against the adverse consequences of refusing relief. The ultimate decision calls for a value judgment”.<sup>146</sup> Less than a decade later, however, this flexibility was unanimously rejected by the House of Lords on the grounds that it was uncertain and unprincipled.<sup>147</sup>

A narrow majority held that the existence of an illegal contract was irrelevant if the claimant could establish an independent proprietary right without relying on his own illegality.<sup>148</sup> This reliance test has become the primary exception to the illegality defence but does nothing to answer the criticism that the maxim operates arbitrarily. The facts of *Tinsley v Milligan*<sup>149</sup> illustrate the point.<sup>150</sup> Here, a couple bought a house which was conveyed solely into the name of Ms Tinsley to enable Ms Milligan dishonestly to claim social security benefits in her apparent capacity as a lodger. When the house was sold following the couple’s separation, Tinsley sought to keep the entire price. Milligan succeeded in her claim for a proportion of the sale price, as she could establish the existence of a resulting trust, created by her contribution to the purchase price. There was no need to bring forward evidence of their illegal scheme. By way of contrast, in *Collier v Collier*,<sup>151</sup> a father conveyed valuable property into his daughter’s name with the intention to defeat claims by his creditors. Having cleared his debts independently of the intended fraud, he sought to regain control of the property but his daughter refused. His claim was unsuccessful, as he would have needed to bring evidence of his dishonest intention to defeat the presumption of advancement that the transfer was a gift. The contrasting results are further difficult to reconcile on the basis that the fraudulent scheme succeeded in *Tinsley* but was not carried out in *Collier*. The proposition that courts are concerned by the pleadings and the substance of the case is accordingly open to question in light of the result in *Tinsley*.

The reliance test was initially viewed as being of general application<sup>152</sup> but later judgments sought to confine it to cases where property was transferred pursuant to an illegal contract.<sup>153</sup> This line of cases advocated a more contextual approach in which consideration was made of the relevant policy concerns and particular circumstances of the wrongdoing.

The unhappy circumstances of *Gray v Thames Trains*<sup>154</sup> are well known and indicate a major departure from the reliance test. Although the damages claims were dismissed, Lord Hoffmann elucidated the nature of the illegality defence, citing “a group of reasons, which vary in different situations”.<sup>155</sup> The suggestion that trivial offences and those for which the

*Bathurst* [1990] 1 QB 1 a review of the case law was conducted and the court distilled a common approach: the public conscience test.

146. *Tinsley v Milligan* [1992] Ch 310, 319, per Nicholls LJ.

147. *Tinsley v Milligan* [1994] 1 AC 340, 369 (per Lord Browne-Wilkinson), 363 (per Lord Goff of Chieveley).

148. *Ibid*, 367 (per Lord Jauncey of Tullichettle), 369 (per Lord Lowry), 376 (per Lord Browne-Wilkinson).

149. [1994] 1 AC 340.

150. R Buckley, “Illegal transactions: chaos or discretion?” (2002) 20 (2) LS 155, 179.

151. [2002] EWCA Civ 1095; [2002] BPIR 1057.

152. *Standard Chartered Bank v Pakistan National Shipping Corp (No 2)* [2000] 1 Lloyd’s Rep 218, 7 (per Aldous LJ), 44 (per Evans LJ).

153. *Moore Stephens v Stone & Rolls* [2009] UKHL 39; [2009] 2 Lloyd’s Rep 537; [2009] 1 AC 1391, [21], where the reliance test was criticised as overly technical.

154. [2009] UKHL 33; [2009] 1 AC 1339; [2009] LS Law Med 409.

155. *Ibid*, [30].

offender was not personally responsible may be beyond the scope of the maxim further evidences the development of a contextual approach at this time.<sup>156</sup>

Later case law further struggled to reconcile the reliance test with Lord Mansfield's articulation of the defence.<sup>157</sup> The courts instead determined that the operation of the defence would depend on a consideration of the policy factors underlying the maxim, although there was some dispute about what these were.<sup>158</sup> The defence would be available where it was a "just and proportionate response to the illegality involved in the light of the policy considerations underlying it".<sup>159</sup> The courts eschewed the idea that this was simply a return to the public conscience test<sup>160</sup> and instead depended upon "an intense analysis of the particular facts and of the proper application of the various policy considerations".<sup>161</sup>

The development of a more nuanced defence was once again stunted by the Supreme Court in *Les Laboratoires Servier v Apotex Inc.*<sup>162</sup> Interestingly, despite attempts by the Court of Appeal to construct a test based on considerations of justice and proportionality, the Supreme Court was not asked to reconsider the law as stated in *Tinsley*.<sup>163</sup> Accordingly, the most recent exposition of the illegality defence reiterates the reliance test established some two decades previously.

The Law Commission has undertaken significant consultation in this area but decided not to recommend statutory intervention for contractual illegality.<sup>164</sup> This reversal of their previous position was heavily influenced by the incremental developments being made by case law.<sup>165</sup> This decision, however, was taken at the height of the construction of a contextual approach and before the Supreme Court decision in *Les Laboratoires Servier*. Lord Toulson, a keen advocate of the nuanced test,<sup>166</sup> recognised that in an appropriate case *Tinsley* may need to be reconsidered in light of subsequent case law and Law Commission consultation.<sup>167</sup>

We said at the outset of this section that the forfeiture rule and the illegality defence were worthy comparators. The courts have demonstrated a clear willingness to consider the circumstances of the wrongdoing in deciding whether the illegality defence applies.

156. *Ibid.*, [15] (*per* Lord Phillips of Worth Matravers), [83] (*per* Lord Rodger of Earlsferry).

157. *Moore Stephens v Stone & Rolls* [2009] UKHL 39; [2009] 2 Lloyd's Rep 537; [2009] 1 AC 1391, [23], [26].

158. *Ibid.*, [26], *per* Lord Phillips: (i) the court's refusal to enforce transactions forbidden by performance or illegal in performance; and (ii) the claimant's inability to recover a benefit following their own wrongdoing. A similar policy-based approach was taken in *Les Laboratoires Servier* [2012] EWCA Civ 593; [2013] Bus LR 80 by the Court of Appeal, which identified the relevant policies as follows: furthering the purpose of the rule which the illegal conduct has infringed, consistency of the law, deterrence, refusal to enable a claimant to profit from his own wrong and maintaining the integrity of the legal system; see *ibid.*, [73] (*per* Etherton LJ), [94] (*per* Laws LJ).

159. *Ibid.*, [73] (*per* Etherton LJ), [94] (*per* Laws LJ).

160. For the opposing view, see R Merkin, "Tort and insurance: some insurance law perspectives" (2012) JPN 194, 213.

161. *Les Laboratoires Servier* [2012] EWCA Civ 593; [2013] Bus LR 80, [73], [75].

162. [2014] UKSC 55; [2015] 1 AC 430.

163. *Ibid.*, [19].

164. Law Commission, *The Illegality Defence* (LCCP 189, 2009), [3.37–3.41].

165. *Ibid.*, [3.124]. However, note Lord Sumption's dismay at this conclusion: Sumption [2012] *Restitution Law Review* 1, 9: "I think that this retreat is extremely unfortunate, for I am not nearly as sanguine about the current state of the law as the Law Commission is."

166. *ParkingEye Ltd v Somerfield Stores Ltd* [2012] EWCA Civ 1338; [2012] 2 Lloyd's Rep 679, [52–55].

167. *Les Laboratoires Servier* [2014] UKSC 55; [2015] 1 AC 430, [64].

The recent Supreme Court judgment has put an end to this, at least for now, but it appears that a shift in approach is more likely in relation to illegality than insurance fraud. We now turn to the approach of the courts to fraudulent employment claims in search of further examples of judicial regulation of fraud beyond “utmost good faith”.

### Judicial development of a nuanced model: fraudulent conduct in the employment relationship

Employment contracts are not generally contracts of the “utmost good faith” but there are standard implied terms of “good faith” and mutual “trust and confidence”.<sup>168</sup> What these obligations have in common is an ongoing obligation to act within the terms of the relationship and not merely the express contract terms as agreed at formation— a relational contract law approach<sup>169</sup>—and a need to consider the interests of the other party in contractual decision-making (albeit one that often stops short of a fiduciary duty *per se*). The insurance-employment comparison is also made by the authors of *Tolley’s Employment Law Service* in discussion of the implied duty of fidelity:<sup>170</sup>

“Obviously an employee is required to deal honestly with his employer and to account to his employer for all property entrusted to him by his employer or by third parties for or on account of his employer. Although the employment contract is not regarded as *uberrimae fidei* at common law, an employee is nevertheless under a fiduciary duty to account to his employer in respect of any bribes, secret profits or secret commissions which arise out of the employment. The employee is also under a duty to disclose to the employer all information relevant to the employer which he obtains in the course of his employment.”

In insurance, the doctrine developed in a remarkably lop-sided fashion (as Cousy has noted, English insurance law developed to protect the underwriter from the insured<sup>171</sup>), despite the inequality of bargaining power normally running in the opposite direction. Employment law is more even-handed, with mutually significant obligations and remedies.<sup>172</sup> Moreover, insurance law has shied away from using the mutuality of the duties as a balancing factor. Thus, for example, the insurer’s right to exercise the remedy granted by the doctrine of utmost good faith (avoidance of the contract *ab initio* for pre-contractual non-disclosure) has not been treated as limited by the insurer’s own obligations of utmost good faith.<sup>173</sup> By contrast, in employment, the employer’s right to dismiss might

168. The precise relationship between the right to dismiss and the mutual duties of trust and confidence has generated considerable litigation and comment. For a recent overview, see D Brodie, “Common law remedies and relational contracting: *McNeill v Aberdeen CC (No 2)*” (2014) 43 Ind LJ 170. A useful introduction to the challenge this poses to neo-classical contract theory is found in D Brodie, “How relational is the employment contract?” (2011) 40 Ind LJ 232.

169. M Boyle, “The Relational Principle of Trust and Confidence” (2007) 27 OJLS 633.

170. R Mahal, J McMullen *et al*, *Tolley’s Employment Law Service* (Lexis-Nexis, Issue 116, Dec 2014), [C7022].

171. Cousy [2012] Erasmus LR 123, 123–124.

172. Whilst the doctrine of utmost good faith in insurance is said to be mutual, the remedy (avoidance *ab initio*) is only effective in the hands of the underwriter. For a critique of this result, albeit one overturned on appeal, see *Banque Keyser Ullman SA v Skandia Ins Co Ltd* [1987] 1 Lloyd’s Rep 69, 95–96; [1990] 1 QB 665, 704–706, *per Steyn J*.

173. *North Star Shipping Ltd v Sphere Drake Insurance Plc (The North Star)* [2006] EWCA Civ 378; [2006] 2 Lloyd’s Rep 183; *Drake Insurance Plc v Provident Insurance Plc* [2003] EWCA Civ 1834; [2004] 1 Lloyd’s

be limited by the mutual duties of trust and confidence even where the employee had been dishonest.<sup>174</sup>

In the recent case of *Cavenagh v William Evans Ltd*,<sup>175</sup> the Court of Appeal considered the effect on an employment contract, and a subsequent agreement to terminate the agreement on redundancy terms, of the employee's having "wrongfully procured" a £10,000 payment to his pension fund. The employment contract contained a termination clause for gross misconduct, but the company (unaware at the time of the misconduct) instead offered to terminate the employment on the basis of payment in lieu of notice. On discovering the illegitimate payment, the company refused to make the agreed payment in lieu of notice. The legal question was whether the debt was irrecoverable on the basis of the gross misconduct.

The relationship between company director and company contains a mixture of implied obligations to act in good faith, or its functional equivalent. There is the mutual duty of trust and confidence and, because of the management responsibilities, fiduciary duties on the director. Whilst the company did not rely on any positive duty of disclosure on the company director—eg, to reveal his self-interested procurement of the £10,000 pension provision when negotiating the terms of his dismissal—the Court of Appeal confirmed that he owed both duties to maintain trust and confidence and fiduciary obligations.<sup>176</sup> However, these were not seen as providing an effective remedy to release the company from its promise to pay the agreed sum "in lieu of notice". This debt arose on the termination of the agreement by redundancy and was not affected by the later discovery of facts that would have entitled them to terminate without compensation:<sup>177</sup>

"The contract itself did not contain any provision releasing the company from its contractual obligation to pay the debt that arose from the exercise of the contractual power on 12 March. The contractual right to payment in lieu having accrued, Mr Cavenagh was entitled to payment of it in the same way as other sums that had accrued due at the date of dismissal.

The general law did not release the company from its contractual liability on the only ground relied on by the company in this action, namely that it acquired knowledge after it had terminated the contract under clause 11.5, which would have entitled it to terminate it outside that clause and summarily without liability for pay in lieu."

The obvious comparator in the insurance realm is *Axa General Insurance Ltd v Gottlieb*,<sup>178</sup> where a genuine claim for indemnification for household property damage was tainted by the later addition of a dishonest element, for alternative accommodation whilst the property was restored. Mance LJ (as he then was) insisted that the timing of the

Rep 268, [88], *per* Rix LJ: "it may readily be appreciated that, if once an insured has been found wanting in good faith in the matter of pre-contractual non-disclosure, it is likely to be hard to conclude that the same doctrine of good faith itself prevents the insurer from exercising his right to avoid. On the whole English commercial law has not favoured the process of balancing rights and wrongs under a species of what I suppose would now be called a doctrine of proportionality. Instead it has sought for stricter and simpler tests and for certainty."

174. Brodie (2011) 40 Ind LJ 232.

175. [2012] EWCA Civ 697; [2013] 1 WLR 238. The facts are reminiscent of the actual (rather than litigated) facts of *Bell v Lever Bros Ltd* [1932] AC 161; C MacMillan, "How Temptation led to Mistake: an Explanation of *Bell v Lever Bros Ltd*" (2003) 119 LQR 625.

176. *Ibid.*, [35].

177. *Ibid.*, [38–39].

178. [2005] EWCA Civ 112; [2005] 1 Lloyd's Rep IR 369.

fraud was irrelevant and that the entire claim was tainted by the fraud, even where some elements had already been agreed and, in some cases, paid.<sup>179</sup>

Within insurance, a commercial sphere without fiduciary obligations, the act of a fraudulent claim is taken to deprive the insured of cover not only because there has been a repudiatory breach of contract (which requires a reaction—and therefore knowledge—from the innocent party to effect) but because there is the “special” rule of forfeiture of related benefits. Whether the fraud comes first (but lays undiscovered) or last does not matter. As noted above, the justification for this is the oft-stated policy basis for the forfeiture rule—the need to deter opportunistic fraud:<sup>180</sup>

“[The law] will not allow an insured who has made a fraudulent claim to recover. The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing.”

What has not been considered by the courts is why there is no similar rule for fraudulent company directors. In the situation in *Cavenagh*, the normal remedy of dismissal was ineffective because dismissal on terms had already been agreed. Moreover, even where dismissal is a potential sanction, the courts have not treated it as an absolute sanction but as part of the broader examination of the underlying relationship. On this basis, the use of a fraudulent invoice to reclaim monies from the employer might well justify dismissal, but that is dependent on the normal balancing of the nature of the employee’s breach and the effect that has on the ongoing relationship. These issues were litigated in the Scots case of *AEI Cables Ltd v M’Lay*.<sup>181</sup> Whilst the precise circumstances of the case are not well reported, it was clear that the employee had submitted a falsified invoice for reimbursement of monies purportedly spent on obtaining diesel. The discrepancy was spotted internally, and the employee dismissed. The court weighed in the balance his twelve-year history of employment with the firm, the difficult position of an employer’s having to place trust in an employee facing prosecution by the police and the seriousness of the alleged conduct, and finally concluded: “The quality of the respondent’s conduct was in this case of such gravity that the length of his prior service was of no materiality.”<sup>182</sup>

We see no conceptual difficulty in similarly recognising that an insurance contract is a relational arrangement in which the precise limits of acceptable conduct cannot be captured by the terms of the agreement.<sup>183</sup> The consequence of this analysis is that, whilst dishonesty would normally violate the norms of behaviour so as to deprive the insured of the benefit of the policy, it cannot be said to be true in all cases. On one reading of *The DC Merwestone*, the insured owner guessed (correctly) at an element in the chain of events, but was wrong to assert that he had evidence to support his view. Those owners were facing possible financial difficulties, despite having purchased insurance to cover this form of loss and having cooperated with the insurer’s own investigations. Our difficulty, then, is the application of the forfeiture principle in a draconian fashion, even though

179. *Ibid*, [28].

180. *The Star Sea* [2001] UKHL 1; [2001] 1 Lloyd’s Rep 389; [2001] Lloyd’s Rep IR 247; [2003] 1 AC 469, [62], *per* Lord Hobhouse.

181. [1980] SC 42.

182. *Ibid*, 49.

183. See Feinman (2009) 46(3) San Diego L Rev 553.

there is a broad scale of culpability, and on the claimed basis of deterrence, when no such doctrine has emerged in employment law or beyond.

### Concluding thoughts on fraud and “relational” contracts

The precise description in a contract of what must be done in the future by each party<sup>184</sup> is normally an unrealistic expectation. This is certainly true in most insurance contracts. The cost of drafting a clause that permits minor, inconsequential breaches but catches all significant failures would be vast, even if the parties had access to such an imaginative draughtsman. Many marine insurance contracts do not even try to describe the relationship during claims—they formally require only that the insured give notice of the claim, and yet honest cooperation is seemingly expected.

To the extent that the ongoing relationship between the parties is one of trust and mutual reliance, it might be thought that any lie would fracture the relationship. After all, honesty is one of few external values to have been recognised by English contract law as implicit within contractual relationships.<sup>185</sup> We suggest not, at least not in every case. Not every lie breaks a marriage. A more balanced approach, recognising that insureds often voluntarily incur expense in acting beyond their contractual duties, would weigh the causal effect of the fraud. This seems to be at the heart of Longmore LJ's approach to materiality in *The Mercandian Continent*, although not expressed in these terms. This consequentialist approach is consistent with contract law's development of the innominate term. By contrast, Mance LJ's attempt in *The Aegeon* to limit the insurer's rights by the materiality standard for fraudulent devices has provided an insufficiently high threshold. Indeed, it is difficult to see, on a wide reading (eg, by including as material anything that distracts the insurer from the genuine issues), how it could ever realistically be failed. The problem with imposing such strict duties on voluntary conduct is not simply the hard cases that ensue, but at some stage the volunteers will be advised not to cooperate, at least not on these terms.

It can be said of this paper that it does not provide a clear alternative to the forfeiture rule. Given the entrenched nature of the current rule, we have indeed set our mind to displacing that, rather than building our own version. It is a dissent. Following the enactment of the Insurance Act 2015, our preference for a statutory discretion (akin to the Australian Insurance Contracts Act 1984, s.56) now seems to be in vain. Failing that, we would settle for a materiality standard at the level envisaged by Longmore LJ in *The Mercandian Continent*: conduct sufficiently prejudicial that it would justify repudiation of a contract. To those who suggest that this provides a conduit for the enforcement of fraud by the courts, we reply: let insurers contract for explicit duties on insureds at claims and for further protection. We echo here the words of Mance LJ in *Friends Provident Life & Pensions Ltd v Sirius International Insurance*:<sup>186</sup>

184. Often referred to in the literature as “presentation”.

185. An excellent review of English contract law's troubled relationship with external values is found in D Campbell, “Good Faith and the Ubiquity of the ‘Relational’ Contract” (2014) 77 MLR 460, 481–484.

186. [2005] EWCA Civ 601; [2006] 1 Lloyd's Rep IR 45, [33] (*per* Mance LJ).

“If insurers consider that they want or need such protection, they can and should try to express it in their insurance contracts and see if insureds and the broking market will accept it. ... English insurance law is strict enough as it is in insurers’ favour. I see no reason to make it stricter.”

## VI. CONCLUSION: RECONSIDERING THE FUNDAMENTAL BASIS OF FORFEITURE

We accept that the deterrence of fraud is an important goal for courts and policymakers, and society more widely, but our scepticism lies in the fact that it appears as an overarching concern for insurance courts only. Fraudsters are in general treated much more generously in other areas of the law; compare, for example, the owners in *The DC Merwestone* with the employee who submits an inflated expenses claim or the fraudulent personal injury claimant.<sup>187</sup> In light of our critique of deterrence, the judicial sympathy for a contextual basis of the law on illegality and personal injury fraud renders the steadfast grip on the forfeiture rule difficult to justify. This, as we have explained, cannot be because deterrence is any more important in this sphere. Instead, we suggest consideration of a remedial framework which responds to the severity of the fraud, to replace the strict nature of the current model. In light of the Insurance Act 2015, the construction of a proportionate framework can now only be a matter for the courts, and we suggest that the Human Rights Act 1998 and consideration of the employment sphere each provides a sufficient means of achieving this. Given the broader role of the Supreme Court justice as “legal architect”, it is hoped that Lord Mance has given his fellow justices copies of Kahneman’s *Thinking Fast and Slow*, with its cautionary tales of “hearts ruling heads”. Perhaps then the deterrence of fraud can be informed by the wealth of social science literature on the causes of fraud, rather than bending to instinctive reactions, which do little to deter in practice.

187. See *ante*, text to fn.180, and fn.44.