JONES & CO

Insurance and Commercial Litigation

A Clear Case of Fraud on an Insurance Claim

In brief:

- Luxury home with structural defects destroyed by fire
- Insurer's investigations reveal non-disclosures and misrepresentations when policy first taken out
- Avoidance of the policy upheld but only after a trial in which the insurer called 8 witnesses.

Cases in which an insurer successfully runs a fraudulent non-disclosure defence are few and far between. The recent decision of the Supreme Court of Victoria in *Kalabakas v Chubb Insurance Company of Australia Ltd* [2015] VSC 705 and (2016) 19 ANZ Insurance cases 62-088 reinforces the nature and extent of the evidence an insurer will need to call to succeed with a fraudulent misrepresentation or non-disclosure defence.

K's claim for over AUS$1,500,000 was declined and the policy avoided following fraudulent non-disclosure and misrepresentation prior to the initial policy being issued. The fraud was repeated on renewal of the policy as the false information was not corrected.

Facts

K was a property developer. His large residential property was destroyed by fire. When Chubb investigated they discovered that K had given the broker incorrect information when he first took out the policy. He said the house had been constructed by 2007 when in fact it was only at the lock-up stage and still under construction in 2010. K had purchased the house at a discount in late 2010 to take into account future construction costs to complete the house and remedy defects. There had also been a civil claim by the previous owner that resulted in a recommendation that the house be demolished due to structural issues. This was not disclosed, nor the fact that a structural engineer had not been engaged to address the defects in the property after K bought the property.

Decision

The court accepted the insurer's evidence (from 8 witnesses) and found that K had made positive representations that were false and that K knew, or a reasonable person would have known, that the issues were material to the insurer's assessment of risk. The knowledge of K's broker as to what was relevant to the insurer's decision was treated as K's knowledge for the purpose of disclosure. That controversial aspect of the decision may have played out different in New Zealand as a result of section 10 of the Insurance Law Reform Act 1997.

McMillan J found that there had been a fraud on the basis of the clear and cogent evidence called by the insurer. He noted that a court must be actually persuaded that the insured has deliberately given a false account of matters relevant to the risk before fraud will be established.

Comment

Evidence - The court was convinced of the insurer's witness recollection of events as there was documentary evidence to support the insurer's position, whereas K's witnesses were reliant on memory for details of conversations. Where one might expect K's evidence to have some documentary support, none was found.

The legislative framework of the Australian Insurance Contracts Act 1984 ("ICA") governed this decision. The insurer relied on the evidence of 3 underwriters in its employ to show that if full disclosure had been given the policy would not have been issued/renewed. Interestingly, no independent underwriting evidence was called, something an insurer in New Zealand would do as a matter of course. The ICA provides that in those circumstances if the policy is not avoided an insurer's liability can be reduced to nil. Had the insurers not avoided, they could have done so in this case.

In the New Zealand context, to avoid a policy for material non-disclosure, the insurer must show that if it had known the fact it would not have offered the policy at all, or not on the same terms; and that a prudent insurer would not have entered into the contract on the same terms if it had known immediately before the contract was concluded[i]. The latter point calls for evidence from an expert witness on the practice of underwriters in the appropriate jurisdiction.

Unlike Australia, the insurer does not need to show that the insured knew information was material, there being no equivalent to ICA section 21. Just as well, as the insurers will often not be able to impute the knowledge of the broker to the insured as in many cases the broker would be the insurer's agent under section 10 Insurance Law Reform Act 1977. However for fraud, as opposed to innocent non-disclosure, the New Zealand insurer will still have to show dishonesty, which would be easier if the broker's knowledge could be imputed in the same way as in this case.

Standard of proof - The issue of standard of proof was dealt with very briefly and McMillan J was not specific as to the standard being applied. He does not use the term "balance of probabilities" but refers to the court being reasonably satisfied and actually persuaded that a fraud has occurred. This is unfortunate in an area where there has been some confusion in recent years to the extent that insurers can be unduly reluctant to allege fraud, preferring to rely on other defences. McMillan J's reference to clear and cogent evidence calls to mind the US interim standard of proof that uses that terminology. Such a standard has not been adopted in the UK where in a series of child law cases the House of Lords[ii] debunked such a notion in preference for the flexible application of the balance of probabilities. In New Zealand the Court of Appeal has found that there is no interim standard even where there are serious allegations.[iii] However the approach in this case is consistent with an earlier Victorian Court of Appeal decision where the judge's use of the words "comfortably satisfied" by a "tipping of the scales" was found to be the application of the balance of probabilities test rather than an interim standard.[iv]

Whatever the standard, insurers must continue to look for clear evidence of fraud supported by documentary evidence where possible to successfully avoid a policy for fraud.

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[i] Following the UK HL case *Pan Atlantic Insurance Company Limited v Pine Top Insurance Company Limited* [1991] 1 AC 501
[ii] *Re H (Minors)* [1996] AC 563; *Re B (Children)* [2008] UK HL 35; *Re S-B (Children)* [2009] UK SC 17
[iii] *AMI Insurance Ltd v Devcich* [2011] NZCA 266
[iv] *Westpac Life Insurance Services Limited v Guirgis* [2015] VSCA 239