Fraudulent Insurance Claims

Xie, Zhiyong; Jing, Zhen

Journal of Business Law

Published: 01/02/2020

Peer reviewed version

Fraudulent Insurance Claims: A Critical Analysis of Article 27 of the Chinese Insurance Law

Zhiyong Xie* and Zhen Jing**

Abstract: *A key principle of insurance law is that the insured is under a duty not to make a fraudulent claim, however, fraudulent claims are a serious problem. This article critically examines the provisions relating to fraudulent claims in art.27 of the Insurance Law to see to what extent they reflect the policy of deterring fraudulent claims and at the same time maintaining the needs of justice and fairness to the relevant parties. It is argued that the major drawback in art.27 is its lack of deterrence to fraudulently exaggerated claims. It is suggested that deterrence should be imposed on fraudsters and that the insurer be entitled to reject the entire claim where the fraudulent exaggeration is substantial.*

Introduction

Insurance underpins a healthy and prosperous society enabling businesses and individuals to protect themselves against risk. Assessment of risk and settlement of claims by the insurer are the two primary processes under an insurance contract, both of them depend on good faith and fair information on the part of the insured. Any dishonest misrepresentation or wilful concealment of information by the insured as to the risk to be covered or to the loss occurred will adversely affect these two processes, fall foul to the relationship of the parties, and must be prohibited. At the stage of making a claim, the information about the circumstances under which a claim has arisen and upon which the insurer's assessment and settlement of the claim is to be based lies more in the knowledge of the insured. Accordingly, the insured is legally bound to honestly represent to the insurer the facts and circumstances in connection with the claim. The keeping back of or falsifying such information is a fraud.

It is well established that a key principle of insurance law is that the insured is under a duty not to make a fraudulent claim.[1] However, fraudulent insurance claims are a serious problem worldwide, the cost of which ultimately falls on the population of the insureds in the form of increased premiums.[2] Insurance fraud is often regarded as a victimless crime in relation to which insurers are fair game. In China, with the rapid development of insurance industry in the last few decades, insurance frauds are also increasing

* Professor of Law, College of Comparative Law, China University of Political Science and Law, China.
** Professor of Law, School of Law, Bangor University, UK (z.jing@bangor.ac.uk).
[1] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn., Sweet & Maxwell, 2016) para.10-035.
[2] It has been estimated that insurance fraud costs policyholders up to £50 each per year in the UK (see Insurance Fraud Taskforce: final report, January 2016, p3).

significantly.[3] It is estimated that the value of fraudulent claims totaled about £2.2 bn in 2018 in China.[4] It is probable that many fraudulent claims go undetected, with them consequently settled by insurers on the basis of a false premise. Insurance frauds has been one of the most important running risks for insurance companies in China. Even in developed insurance markets, the problem of fraudulent claims has long bedeviled the insurance industry.[5]

Legal rules should be formulated on the basis which assumes they are capable of shaping social or economic behavior. Fraud distorts social and economic order and should not be tolerated in any society. To combat fraudulent insurance claims, it is important to set up clear rules to deter insureds from acting fraudulently and to prevent them benefiting from fraud. In China, the civil law approach to deal with fraudulent claims is set out in art.27 of the Insurance Law of the People's Republic of China (hereinafter, the Insurance Law). [6] The primary purpose of this paper is to critically examine the provisions in art.27 of the Insurance Law to see to what extent they reflect the policy of deterring fraudulent claims and at the same time maintaining the needs of justice and fairness to the interests of the relevant parties. In so doing, deficiencies in art.27 of the Insurance Law are identified and analyzed, and the way in which those deficiencies would be dealt with is proposed. This study takes a comparative approach, while focusing on the examination of Chinese law, approaches in relation to fraudulent claims in other jurisdictions (such as Australia, Germany, UK and USA) are also referred to where appropriate and necessary, for the purpose of seeking inspiration for resolving the issues in art.27 of the Insurance Law.

---

[3] It is reported that there were 422 insurance fraud cases tried by people's courts in 2015 in China, increased 33.54% as compared with the figure in 2014 (see *http://www.court.gov.cn/fabu-xiangqing-18362.html* , accessed on 9 November 2018).

[4] Zhaolin Zu, "Anti-fraud of insurance: what we can do and how to do?" (2018) China Insurance Newspaper (see *http://xw.sinoins.com/2018-11/22/content_277025.htm*, accessed in December 2018*).*

[5] For instance, in the UK, as reported by the Association of British Insurers (ABI), in 2016 insurers detected 125,000 dishonest insurance claims valued at £1.3 billion. It is estimated that a similar amount of fraud goes undetected each year (see *https://www.abi.org.uk/products-and-issues/topics-and-issues/fraud/*, accessed on 26 February 2019). It must be noted that according to the decision by the Supreme Court of the UK in the rent case of *Versloot Dredging BV and Another v HDI Gerling Industrie Versicherung AG and others* [2016] UKSC 45, a fraudulent device or collateral lie is no longer treated as a species of fraudulent claims. The figures on fraudulent claims as reported by the ABI do not distinguish between proper fraudulent claims and claims embellished by fraudulent devices. In other words, the use of fraudulent device to further a genuine claim had been treated as a species of fraudulent claims before *Versloot* was decided. The figures about the fraudulent claims were calculated as including the *Versloot* type of claims. It may well be that the figures of proper fraudulent claims would be significantly lower than those as reported by the ABI in 2016. Thus these figures may no longer be a reliable estimation of the scale of fraudulent claims in the UK.

In the US, the Federal Bureau of Investigation (FBI) estimates that the total cost of insurance fraud in the US is more than $40 billion per year, costing the average family between $400–$700 per annum in the form of increased premiums (see *https://www.fbi.gov/stats-services/publications/insurance-fraud*, accessed on 26 February 2019). In California, motor insurance fraud contributes substantially to the high cost of automobile insurance, i.e. fraudulent activities account for 15 to 20% of all motor insurance payments (California Insurance Code, article 1. s.1871(b)).

[6] The criminal law approach to insurance fraud in China is provided in art.198 of the Chinese Criminal Law, this criminal law approach will be discussed in a separate paper.

Article 27 of the Insurance Law and the necessity for its reform

In China, art.27 of the Insurance Law deals with different types of fraudulent insurance claims and the remedies for these claims. Since the first enactment of the Insurance Law in 1995, the provisions relating to fraudulent claims have been remained unchanged although the Law has been amended three times in 2002, 2009 and 2015.[7] There are ambiguities and deficiencies in art.27, resulting in uncertainty, lack of deterrent effect, or unfairness to the parties. Therefore, art.27 is in need of reform. For the convenience to the discussion of relevant rules, art.27 is set out as follows:

> "(1) Where no insured event has occurred, and the insured or the beneficiary fraudulently reports that an insured event has occurred and submits a claim for indemnity payment or insurance benefits, the insurer may rescind the contract and refuse to refund the premium paid.
>
> (2) Where the proposer,[8] the insured or the beneficiary intentionally causes the occurrence of an insured event, the insurer may rescind the contract, shall not be liable for indemnity payment or insurance benefits, and, except as provided under article 43 of this Law,[9] does not refund the premium paid.
>
> (3) Where the proposer, the insured or the beneficiary, following the occurrence of an insured event, fabricates false causes of the insured event or overstates the extent of loss by means of forged or altered relevant documents, information or other evidence, the insurer shall not be liable for indemnity payment or insurance benefits in respect of the false part of the claim.
>
> (4) Where the proposer, the insured or the beneficiary has any of the acts provided in the foregoing three paragraphs which leads the insurer to pay insurance benefits or incur expenses, it shall refund the insurance benefits paid or reimburse the expenses so incurred".

The critical analysis of these provisions will be carried out in the following sections of this paper, at this juncture, it is appropriate and helpful to address the necessity and importance for statutory reform of art.27 for two primary reasons. Firstly, as a civil law system, the written law is the major source of law in China. Judicial decisions on cases, even tried by the Supreme People's Court (SPC), are guiding not binding the lower courts. The same set of facts may be treated differently by different courts due to ambiguity of

[7] The wording in art.27(1) of the 2009 and 2015 versions is slightly different from that in art.28(1) of the 1995 and 2002 versions, but the meaning of the provisions in these old and new versions is the same.

[8] Article 10 of the Insurance Law defines a proposer as a party who enters into an insurance contract with the insurer and is obliged to pay the premium under the contract. The proposer can also be called the policyholder. Article 12 of the Insurance Law defines an insured as a party whose property or life or physical body is covered by an insurance contract and who is entitled to claim for insurance money. A proposer may be the insured.

[9] Article 43 of the Insurance Law concerns remedies for an insured event which is caused by the proposer or beneficiary in life insurance.

statutory provision. It is thus particularly important for the statutory provisions to be fair and clear. On the other hand, the SPC is authorised by the National People's Congress to enact judicial interpretations in respect of all questions arising from court trials concerning the specific application of laws and decrees.[10] The SPC's judicial interpretations on written laws have legal force.[11] The SPC has so far published four sets of Interpretations on certain provisions of the Insurance Law in 2009, 2013, 2015 and 2018 respectively, but none of these Interpretations provide any rules in relation to fraudulent claims. The deficiencies in art.27 must be addressed by statutory reform.

Secondly, for the sake of protection of insurance consumers, a particularly important feature of the Insurance Law is that insurers are prevented from contracting out of the legal rules as stipulated in the Law. By virtue of art.19 of the Insurance Law, which provides that two kinds of terms and conditions are invalid in an insurance contract concluded by adopting the standard-form clauses provided by the insurer: (1) those that exempt the insurer of the obligations that the insurer should have born according to law or that aggravate the obligations of the proposer and the insured; and (2) those that deny the proposer, the insured or the beneficiary the rights that they should have been entitled to according to law, any contractual terms in standard-form contracts aimed at deterring fraudulently exaggerated claims will be invalid. For example, a policy clause, which stipulates: "If any claim or part of a claim is made fraudulently or falsely, the policy shall become void and the benefit under this policy shall be forfeited", will be unenforceable, on account of the fact that it departs from the statutory rule for fraudulently exaggerated claim (art.27(3)) by which the insurer is not liable for fraudulently inflated part of the claim but still liable for the genuine part of the same claim. It is the common practice that insurance policies very often contain provisions of the Insurance Law as contract terms. For instance, all insurance policies contain a clause regarding the insured's pre-contract duty of representation of information similar to art.16 of the Insurance Law.[12] But no clause as to fraudulent claims (similar to art.27) has been found in any insurance policies. Even if an insurer includes a clause in the policy relating to fraudulent claims, the clause cannot put the insurer in a better position than that provided for in art.27. There is no doubt that industrial practice is not allowed to

[10] Resolution of the Standing Committee of the National People's Congress Providing an Improved Interpretation of the Law 1981, art.2.

[11] According to articles 5 and 6 of the Stipulation of the Supreme People's Court on the Judicial Explanation (2007 No.12), the Supreme People's Court stipulation, judicial interpretation or decision have legal force. This means that the Supreme People's Court stipulations, judicial interpretations, decisions or replies are of the legal sources in China.

[12] As an example, see clause 18 of the Home Insurance Policy of Ping An Insurance Company of China (see *http://baoxian.pingan.com/tiaokuan/jiatingcaichanbaoxiantiaokuan.shtml* , accessed on 20 December 2018).

contract out of the rules as provided for in art.27. Statutory deficiencies in art.27 cannot be resolved or bypassed by contractual clauses.

Before embarking on a comprehensive analysis of art.27, it is necessary to consider the characteristics of fraudulent insurance claims.

Characteristics of fraudulent insurance claims

To constitute a fraudulent claim, two conditions must be met: the insured has made a claim under the insurance contract and the insured has been guilty of fraudulent conduct.

The making of a claim

The insured's right to indemnity or payment under an insurance policy arises as soon as the insured loss occurs. That right exists whether or not a claim is made by the insured. On the other hand, there can be no question of a fraudulent insurance claim without a claim having been made by the insured. For first party insurance, [13] the insured's cause of action to make a claim against the insurer is accrued when the subject matter of insurance suffers a loss; while for liability insurance, [14] for a claim to be accrued, it is vital that the insured's liability to the third party is ascertained by litigation, arbitration or agreement. Article 27 of the Insurance Law is relevant only when the insured makes a claim for insurance payment. When a loss occurs, the insured is required to notify the insurer of the happening of the insured event and to follow the procedure as setting out in the insurance policy in making a claim.[15] The insured must fill up a claim form and provides the insurer with evidence and information of the losses and the documents and materials in relation to the claim.[16] When the insured has handed in to the insurer the completed claim form and the required documents, a claim is deemed to have been put forward.

The meaning of fraud

Whether one's conduct is capable of being regarded as fraudulent is a question of law. There seems no statutory definition of fraud in China. The SPC provides a judicial definition in the Notice of the Supreme

[13] First party insurance protects an insured against the risk of his own loss.
[14] Liability insurance protect an insured against the risk of his incurring a legal liability to a third party for personal injury, property damages or financial loss.
[15] The Insurance Law, art.21. For more, see Zhen Jing, *Chinese Insurance Contracts: Law and Practice* (1st edn., Informa Law from Routledge, 2017) p431.
[16] The Insurance Law, art.22.

People's Court on Issuing the Opinions on Several Issues Concerning the Implementation of the General Principle of the Civil Law of the People's Republic of China (For Trial Implementation).[17] Article 68 of the Notice states that "if a party intentionally gives the other party false information or conceals the truth, so as to induce the other party into making a wrong decision, such act shall be determined as fraudulent act." This definition of fraud sets out a number of essential elements of fraud: false representation or concealment, knowingly made, intent to deceive, reliance on or inducement, and detriment.

According to art.68 of the SPC Notice, to constitute an actionable fraud, the defendant must have made a misrepresentation with knowledge of its falsity, but it is unclear whether fraud would include the case where the representation is made in reckless disregard of the truth, or without caring if it is true or false. It seems that the phrase "intentionally gives false information" implies that a misrepresentation made recklessly may not constitute a fraud. This is in contrast to the English common law concept of fraud as formulated in *Derry v Peek,*[18] that there is a fraud where one party makes a material statement knowing it is false, or without belief in its truth, or recklessly, not caring if it is true or false. Carelessness alone is insufficient to constitute fraud,[19] nor is mere negligence.[20]

By art.68 of the SPC Notice, the fraudster must have made the misrepresentation with the intent to deceive the other party. Without proof of this intent, no fraud can be found. The phrase "to induce the other party into making a wrong decision" makes it clear that the information misrepresented or concealed must induce the other party to act on it to his detriment. The phrase of "a wrong decision" may mean that deception has induced the other party to part with property or to surrender a legal right.

But an important element of fraud is missing in art.68 of the SPC Notice, that is, the person making a dishonest misrepresentation must intend to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss. This element of intent should be added into art.68 of the SPC Notice to reflect the fraudster's intent to make the fraud. The German Criminal Code (s.263) contains this key element of fraud, i.e. "the intent of obtaining for himself or a third person an unlawful material benefit". This key element can also be seen in the definition of fraud in the Fraud Act 2006 (UK).[21] Under 2006 Act, there is fraud if a person: (a) dishonestly makes a false representation [22] or dishonestly fails to disclose

[17] It was issued by the SPC on 2 April 1988.
[18] *Derry v Peek* (1889) 14 App. Cas. 337.
[19] *Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All E.R. 573 at 587; *Yeganeh v Zurich Plc* [2010] EWHC 1185 (QB); [2011] Lloyd's Rep. I.R. 75 at 4 (reversed on the facts).
[20] *Royal Boskalis v Mountain* [1997] L.R.L.R. 523.
[21] The Fraud Act 2006, s.2**.**
[22] The Fraud Act 2006, s.2(1).

to another person information which he is under a legal duty to disclose,[23] and (b) intends, by making the representation or by failing to disclose the information, to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss.

In the context of insurance claims, by virtue of art.27 of the Insurance Law, to establish a fraudulent claim it is necessary to find the ingredients of fraud as mentioned earlier, with an exception that there seems no need to establish that the insurer has been actually induced by the misrepresented or concealed facts or suffered detriment by reason of the insured's misrepresentation or concealment. According to art.27, a claim for a loss known to be non-existent (art.27(1)) or self-inflicted (art.27(2)) is sufficient to constitute a fraudulent claim. It is irrelevant whether or not the insurer has been misled into paying indemnity to the insured, namely, proof of inducement is not required. If there is no occurrence of an insured event or the loss is caused by the insured's intentional act, or a loss is substantially and knowingly exaggerated, when the insured makes a claim for something which he knows he is not entitled to, he has to deliberately provide false information and conceal the truth in order to defraud the insurer of insurance payment. This conduct is sufficient to find a fraudulent claim.

In some states of the USA, statutory laws require proof of materiality and inducement of the insured's misrepresentation. [24] For example, Texas Insurance Code 705.003 (2010) provides that a misrepresentation or a false statement made in a proof of loss has no effect unless it is shown at trial that the misrepresentation: (1) was fraudulently made; (2) misrepresented a fact material to the question of the insurer's liability under the policy; and (3) misled the insurer and caused the insurer to waive or lose a valid defence to the policy.

According to the Insurance Law, prior to formation of an insurance contract, an intentional or grossly negligent misrepresentation or non-disclosure of material information on the part of the insured is actionable.[25] Article 68 of the SPC Notice refers to only intentional misrepresentation or concealment for a fraud, reckless or grossly negligent misrepresentation cannot constitute an element of fraud. In the context of insurance claims, art.27 of the Insurance Law does not specify whether a grossly negligent misrepresentation would find a fraudulent claim. In the case of a claim for a loss known to be non-existent or self-inflicted, it has to be made by intentional misrepresentation, there is no question of gross negligence. In the case of a claim for a loss by a fabricated false cause of the loss or for a loss substantially exaggerated,

[23] The Fraud Act 2006, s.3.
[24] See Ala. Code § 27-14-28 (2009); Ga. Code Ann. § 33-24-7(b) (2010); Tex. Ins. Code § 705.003 (2010).
[25] The Insurance Law, art.16.

the claim can be made by intentional, reckless or grossly negligent misrepresentation. But under art.27(3), there seems no need to ascertain what kind of misrepresentation is made, for the remedy available to the insurer is all the same, that is, the insurer is not liable for indemnity payment in respect of the false part of the claim but liable for the genuine part of the same claim. Article 27(3) has no deterrence at all to fraud. This is the major shortcoming of the Law and will be further critically analysed shortly.

The insured's dishonest state of mind

In the context of insurance claims, fraud connotes dishonesty.[26] A claim can only be fraudulent if the insured is dishonest. [27] Mere negligence or even gross negligence on the part of the insured does not suffice. When dishonesty is in question, the first step should be to ascertain the actual state of the insured's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence going to whether he held the belief, but an additional requirement that his belief must be reasonable may not be necessary; the question is whether it is genuinely held. When the insured's actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or otherwise must be determined by applying the objective standard of reasonable person. Under art.27 of the Insurance Law, the insured is subjectively dishonest when he makes a claim which he knows there was no loss or a self-inflicted loss, and a reasonable person (objectively) will certainly take the insured's conduct as dishonest. In the case of a claim for an exaggerated loss, the insured may be dishonest or otherwise by the objective and subjective test on the basis of the facts of the case. An honest belief in the validity of such a claim, even if the claim is otherwise false, should not be taken as fraudulent.

The question of whether a combined objective and subjective test or a sole objective test should be applied to determine dishonesty is not straightforward. In English law, the test of dishonesty was laid down by Lord Hutton in his judgement in *Twinsectra Ltd v Yardley*:[28] "there is a standard which combines an objective test and a subjective test and which requires that before there can be a finding of dishonesty it must be established that the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realized that by those standards his conduct was dishonest." However, in the recent case of *Ivey v Genting Casinos* (*UK) Ltd*,[29] the test for dishonesty is only objective for criminal cases: "although a dishonest state of mind is a subjective mental state, the standard by which

[26] Rhidian Thomas, "Fraudulent Insurance Claims: Definition, Consequence and Limitations" (2006) LMCLQ, 489.
[27] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn., Sweet & Maxwell, 2016) para.10-045.
[28] *Twinsectra Ltd v Yardley* [2002] UKHL 12; [2002] 2 AC 164.
[29] *Ivey v Genting Casinos* (*UK) Ltd* [2017] UKSC 67.

the law determines whether it is dishonest is objective. If by ordinary standards a defendant's mental state would be characterized as dishonest, it is irrelevant that the defendant judges by different standards."[30] The latest case of *Carr v Formation Group*[31] also took the objective test. It is now clear that in the criminal law an allegation of dishonesty is to be judged by applying the objective standard and there is no need for an inquiry into the defendant's appreciation of whether his conduct fell below that objective standard. However, in the context of insurance, whether or not courts will still apply both objective and subjective standards is a question waiting for answer.

Proof of fraud

According to art.64 of the Civil Procedure Law,[32] and art.2 of Provisions of the Supreme People's Court on Evidence in Civil Procedures, [33] it is the duty of a party to an action to provide evidence in support of his allegations.[34] Accordingly, the burden of proving that a claim is fraudulent rests on the insurer. For an insurer to be capable of relying on the fraudulent claim defense, he must be able to show that the insured made a claim by intentionally misrepresenting or concealing the true information as to the loss with the intention to defraud the insurer of insurance payment to which the insured is not entitled.

Types of fraudulent claims and the corresponding remedies

Four types of fraudulent claims are stipulated in art. 27 of the Insurance Law: (1) deliberately fabricating the occurrence of an insured event, in this category the insured has suffered no loss at all; (2) intentionally causing the insured event to happen, in this category the insured has incurred a self-inflicted loss; (3) fabricating a false cause of the loss where the real cause of the loss is not covered by the policy; or (4) fraudulently exaggerating the extent of the loss by means of forged or altered documents, information or other evidence. The remedies vary depending on the nature and the type of the fraud, including (i) to release the insurer from the liability for the claim; (ii) to release the insurer from the liability for the false part of an inflated claim; (iii) to allow the insurer to recover from the insured the insurance money already paid for that claim; (iv) to allow the insurer to claim the expenses incurred by the insurer for investigating the fraud; (v) to retain the premium paid; (vi) to allow the insurer to terminate the contract. These types

[30] *Ivey v Genting Casinos* (*UK) Ltd* [2017] UKSC 67, at para 62. *Barlow Clowes International Ltd v Eurotrust International Ltd* [2006] 1 WLR 1476, para 10 by Lord Hoffmann
[31] *Carr v Formation Group* [2018] EWHC 3116 (Ch), at para 21.
[32] The Civil Procedure Law of the PRC became effective on 9 April 1991.
[33] Provisions of the Supreme People's Court on Evidence in Civil Procedures were promulgated for implementation as of 1 April 2002, and was amended in December 2008.
[34] Ibid, art.2.

of fraudulent claims and the corresponding remedies are discussed below with a particular focus on the rules concerning fraudulent exaggeration.

Fabrication of the occurrence of an insured event

Fabrication of an insured event is a typical fraudulent claim where the insured event did not occur but the insured or the beneficiary claims for insurance payment for the fabricated loss. Art.27(1) of the Insurance Law deals with this type of fraudulent claim. The remedies for it are that the insurer may rescind the contract and keep the premium already paid. In a Chinese case,[35] the insured asked his friend to take away some valuable items (such as jewelry, TV and computer etc.) from his home, and then reported to the police that his home was broken in and some valuable items were stolen and made a claim for insurance payment for the loss of the items. When investigating the case, the police discovered that it was a fraud. According to art.27(1), for such kind of fraudulent claim the insurer is entitled to rescind the contract and to retain the premium paid.

Article 27(1) implies that the insurer should not be liable for a fraudulent claim for a fabricated loss. As there was no genuine loss, the insurer should not be liable for the fabricated loss. This can be seen in art.27(4), which entitles the insurer to recover the insurance money paid to the insured and to recoup expenses for investigating the fraudulent claim if there is no loss (art.27(1)), or a self-inflicted loss (art.27(2)), or a false cause of the loss (art.27(3)), or an inflated loss (art.27(3)). It is suggested that art.27(1) should make it explicit that the insurer is not liable for a fabricated losse where the insured event in fact did not happen.

There is a problem in art.27(1), that is, the insurer is entitled to rescind the contract where the beneficiary makes a fraudulent claim for a non-existent loss. An insurance contract is between the insurer and the insured, the beneficiary is a third party to the contract. If the contract is rescinded by the insurer on account of the beneficiary fraud, this is against the principle of privity of the contract and is unfair to the innocent insured. It is suggested that where the beneficiary makes a fraudulent claim, the insurer is entitled to reject the claim but not to rescind the contract. Australian law adopts this approach: if a person who is not the insured (for example, a third party) makes a fraudulent claim against an insurer, the insurer may not terminate the contract but may refuse payment of the claim.[36]

[35] See Hong Li and Zhong Xin Lao, *Cases of Insurance Frauds and Traps* (South-west University of Finance and Economics Publishing House 2007) p57.
[36] The Insurance Contracts Act 1984, s.56(1).

Self-inflicted loss

By virtue of art.27(2) of the Insurance Law, where the proposer, the insured or the beneficiary intentionally causes the occurrence of an insured event, the insurer is free from liability for that claim, and is entitled to rescind the contract and retain the premium paid. In *Mr Shen v the Property Insurance Company*,[37] Mr Shen purchased a second-hand car. He set fire to the car deliberately. He claimed for insurance payment but was rejected.

Deliberate destruction of the insured subject matter by the insured cannot be the basis for a claim for a number of reasons.[38] First, destruction is an extreme example of willful misconduct, recovery of the self-inflicted loss from the insurer is prohibited by law and public policy. Secondly, it is a fundamental requirement in insurance that the insurer will not pay for a loss unless the loss is fortuitous, any recovery for self-destruction is contrary to the nature of insurance. Thirdly, as discussed earlier, any claim submitted following deliberate destruction by the insured is of itself fraudulent. As a general practice, insurance policies exclude liability for any loss caused by intentional act. For example, clause 8(1) of the Comprehensive Property Insurance Policy of the People's Insurance Company of China states that "the insurer is not liable for any loss caused by intentional or grossly negligent conduct of the proposer, or the insured or their representative."

In addition, art.27(4) vests the insurer the right to recover the sum already paid to the insured for a fraudulent claim and to recoup expenses incurred for investigating the fraudulent claim. In *Mr Wang v the Insurance Company*,[39] Mr Wang's vehicle collided with another vehicle. Both vehicles were damaged. The insurer entrusted a loss adjuster to investigate the cause of the accident and paid ¥1,500 for the investigation. It was found that the traces of collision on the insured vehicle did not match those on the other vehicle, indicating that the damage of the vehicle was staged. The insurer rejected the claim by reason of the insured's fraud. The insurer counter claimed for the cost of the investigation of the accident and was upheld by the court.

[37] See China Insurance Newspaper, 29 May 2014 (*http://chsh.sinoins.com/2014-05/29/content_113273.htm*, accessed in December 2018).
[38] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn., Sweet & Maxwell, 2016) para.10-049.
[39] This case was cited in the book by Xiaoming Xi, *Interpretation and Application of the Provisions of the Insurance Law of the People's Republic of china* (China Legal Publishing House 2010) p185.

The rule that any loss caused by intentional act cannot be recovered is universal. For instance, in the common law jurisdictions (such as Australia,[40] the UK[41] and the USA[42]), the insured may not recover under a policy where the insured has by his own intentional act caused the loss, as such a loss is usually excluded by the policy,[43] and the insurer is entitled to cancel the contract.[44] German law provides a statutory rule that the insurer shall not be obligated to effect payment if the policyholder intentionally causes the insured event.[45] Moreover, a recently enacted statute in the State of Illinois provides insurers with a weapon to combat all kinds of fraudulent claims. Illinois Revised Statues 720 ILCS 5/17-10.5 (e) provides a civil cause of action which can brought by a defrauded insurer, and the recovery of double or treble damages based upon the value of the property. However, the insurer itself can be held liable for bring an action against its insured in bad faith and liable to the insured for twice the value of the property claimed, plus reasonable attorney's fees.[46]

Fabrication of a false cause of the loss

According to art.27(3) of the Insurance Law, where the proposer, the insured or the beneficiary fabricates false causes of the loss or overstates the extent of loss by means of forged or altered relevant documents, information or other evidence, the insurer is not liable for insurance payment in respect of the false part but still liable for the genuine part of the loss in the same claim. The insurer is not entitled to rescind the contract. Article 27(3) encompasses two situations: first, where the insured suffers a loss which is outside the policy, he fraudulently misrepresents the cause of the loss with the intent to make the insurer pay for that loss; and secondly, the insured event has occurred but the insured exaggerates the extent of the losses. It is now convenient to consider the two types of fraudulent claims in turn.

It sometimes happens that where the cause of loss is not covered under the insurance policy, but the insured fabricates a false cause to bring the loss within the scope of the cover. When an insured event occurs, by art.27(3) of the Insurance Law or by a term of the insurance policy the insurer is not liable for paying the claim if the cause of the loss is excluded by the policy. For example, in fire insurance, the insured event is fire, the insurer is liable for a loss occasioned by fire. However, the insurer's undertaking to indemnify the insured loss by fire can be qualified by the exclusions which expressly provide that the insurer is not

[40] The Insurance Contracts Act 1984, 60(1)(e).
[41] The Insurance Act 2015 (UK), s.12.
[42] For example, Texas Insurance Code 705.003 (2010).
[43] *Beresford v Royal Insurance Co Ltd* [1938] A.C. 586; *Fire & All Risks Insurance Co Ltd v Powell* [1966] V.R. 513.
[44] The Insurance Contracts Act 1984, 60(1)(e), the Insurance Act 2015 (UK), s.12.
[45] The German Insurance Contract Act 2008, s. 81(1).
[46] Illinois Revised Statues 720 ILCS 5/17-10.5 (e)(2)

liable for a loss occasioned by certain specified causes, such as explosion, riot, hostilities and etc. If the fire is caused by any of these excluded causes, the insurer is free from liability.

In the event where the loss is given rise to by an excluded cause under the policy, and the insured makes up a false cause of the loss which falls within the scope of cover, the insurer is not liable for the loss if the fraud is revealed. On the other hand, if the loss is resulted from a cause covered under the policy, the insurer is liable for the loss even if the insured has mistakenly believed that the cause is not covered and fabricated a false cause of the loss. It is a question of causation but not a question of fraud. These two situations can be explained in the following two cases.

In *Beijing Yuan Da Machinery Construction Company v China Property Insurance Company Ltd Beijing Branch*,[47] the iron horizontal beam of the insured vehicle (a heavy dump truck) was bended by overloading of stones. This damage to the vehicle was excluded from the scope of cover under the policy. The insured deliberately misrepresented the cause of the damage by lying that the horizontal beam was bended by collision with stones when reversing the vehicle which was covered under the policy. Upon investigation, it was revealed that the real cause of the damage to the vehicle was the overloading not collision. It was held that the insurer was not liable for the loss because the cause of the loss was excluded from the coverage. The insured's fraudulent claim was rejected according to art.27(3) of the Insurance Law.

This kind of loss can also be turned down by an exclusion clause in the policy. Assuming that the insured genuinely believed that the vehicle was damaged by collision and no fraud was involved in the claim, the question of whether the insurer should be liable for the loss would simply be a question of determination of the causation of the loss. In the present case, no matter whether the insured fraudulently misrepresented the cause of the loss or truthfully believed that the cause of the loss was collision, the consequence would be the same, *i.e.* rejection of the claim under the policy because of the exclusion of damages by overloading.

In the event that the damage or loss of the insured subject matter is due to a cause covered under the policy, the insurer is liable for the loss even if the insured mistakenly believed that the cause of the loss was not covered and fabricated a false cause of the loss in order to get insurance payment. In *Mr Feng v The Insurance Company*,[48] Mr Sun (the insured) had a road accident with the car driven by Mr Feng. Both cars were damaged. The traffic police found Sun fully responsible for the accident. Feng had his car repaired for the cost of ¥20,000. Sun's insurer refused to pay the cost incurred to Feng on the ground that

[47] See Jianxun Liu, *Resolutions to the Classical and Difficult Cases of Insurance Law* (Law Press China 2010) p230.
[48] See China Insurance Newspaper at *http://chsh.sinoins.com/2017-11/09/content_246960.htm* (accessed on 5 December 2018).

Sun fraudulently misrepresented the cause of the accident that his own car was damaged while parking in a car park and could not find the wrongdoer who damaged his car. The court held that Sun's fraudulent misrepresentation as to the cause of the accident was for the purpose of obtaining insurance payment for the damage of his own car, the genuine damage to Feng's car was not a part of misrepresented loss, therefore according to art.27(3) of the Insurance Law, Sun's insurer was liable for paying the full cost to Feng. In this case, the insured's lie is irrelevant to Feng's genuine loss.

Under art. 27(3) of the Insurance Law, whether fabrication of a false cause of loss is actionable largely depends on whether it affects recoverability of the claim under the policy. If the cause of the loss is covered, the insurer is liable for the loss; if the cause of the loss is not covered, the insurer is not liable. The insured's intentional act to fabricate false cause of loss to deceive the insurer is irrelevant and blameless. This approach may open the floodgate to the fraud that an insured can deliberately suppress a defense which he knows to be open to the insurer. If the fraud is unraveled the insured would lose nothing; if the fraud is not discovered the insured would gain something to which he is not entitled. As many such fraudulent claims may not be discovered, insurers have to pay the claims for which they are not liable under the policy. This approach not only lacks of deterrence to the insured's fraud but also is unfair to the insurer. The mischief to be targeted by art.27(3) should be the insured's dishonest state of mind but not simply its consequences.

Exaggeration of the extent of the loss

Fraudulent exaggeration of the extent of loss is the most widespread variety of fraudulent claims and is more common in China. When the insured event did happen and caused loss within the scope of the cover under the policy, the insured exaggerates the extent of the loss in order to get more insurance payment by fraudulently misrepresenting the real loss which may be supported by false evidence or fabricated documents etc. Chinese law relating to fraudulent exaggeration is particularly problematic and merits a more detailed analysis with reference to the approaches in other jurisdictions.

Only the fraudulently exaggerated part of the claim is forfeited: the Chinese position

Under art.27(3) of the Insurance Law, the remedy for a fraudulently exaggerated claim is that the insurer is not liable for insurance payment in respect of the part fraudulently inflated but liable for the genuine part of the claim. For example, 100 computers were destroyed by fire, the insured fraudulently claims for 150 computers. The insurer is liable to pay only the genuine part of the claim for 100 computers. If a computer is worth £500, the insured claims for £650 supported by a false receipt, the insurer is liable to pay £500 if the fraud is discovered. In *the Pacific Property Insurance Company Qinghai Branch v Xining*

City Internal Combustion Engine Maintenance Department,[49] the cargo (diesel) was lost in a road accident. The actual loss was 5.95 tons (worth of ¥55,463), the insured fraudulently exaggerated the loss of 31 tons and claimed for ¥289,943 which was paid by the insurer. Upon discovery of the fraud, the insurer claimed for repayment of ¥289,943 (which includes genuine part and the false part of the claim). The court held that according to art.27(3) of the Insurance Law, the insurer is still liable for the genuine part of the claim (¥55,463) and the insured has to repay to the insurer the exaggerated part of the claim (¥289,943 - ¥55,463 = ¥234,480). In this case, the inflated part of the claim greatly exceeded the genuine part, but the insurer had to pay the dishonest insured for his legitimate part of the claim. The Law in this regard is unbalanced and unfair to the insurer. The Law which is oriented towards protecting of the interests of insurance consumers should not go so far as to allow the fraudster to freely walk away without any penalty for his wrongdoing.

It is clear, in both the Insurance Law and judicial practice, the insured's fraudulent act to deceive the insurer for the amount of payment which he knows more than he is entitled to is forgivable. The lack of deterrence to fraudulent exaggeration in art.27(3) may encourage fraudulent claims, as the insured will lose nothing even if his fraudulent exaggeration is unsuccessful. This is a serious drawback of the law in this respect. It is submitted that for the fraudulent exaggeration of a genuine loss, deterrence should be imposed on the fraudster. To improve Chinese law in respect of fraudulent exaggeration, the solutions in other jurisdictions may be referred to.

Forfeiture of the whole claim tainted by fraudulent exaggeration: the English position

In the UK, prior to the enactment of the Insurance Act 2015, the common law rules had governed fraudulent claims. However, the law in this area was complex, convoluted and confused.[50] Fraudulent claims were characterised in several different ways, including as breaches of an implied term, breaches of the original s.17 of the Marine Insurance Act 1906, or breaches of a separate common law rule. The relationship between these was far from clear, and it was difficult to describe the law in this area with any degree of certainty. The Law Commission and Scottish Law Commission (Law Commissions) were concerned that it was not possible to justify or explain the law to an international audience. Furthermore,

[49] Qinghai Province High People's Court Civil Judgement [2015] Qing Min Ti Zi No. 37 (See *http://wenshu.court.gov.cn/content/content?DocID=84917131-b581-4bdc-a38a-3832c0bbd1c7&KeyWord=%E5%A4%B8%E5%A4%A7%E6%8D%9F%E5%A4%B1%E7%A8%8B%E5%BA%A6*, accessed on 20 January 2019).

[50] Law Commission and Scottish Law Commission, *Issues Paper 7: The Insured's Post-Contract Duty of Good Faith*, July 2010, para. S16.

confusion about the penalties reduces their deterrent effect.[51] As a result of the reform initiated by the Law Commissions in 2006, the Insurance Act 2015 was enacted, s.12 of the Act lays down clear remedies which apply to all different types of fraudulent claims.[52] Section 12 does not, however, define fraud or a fraudulent claim. Whether a claim is fraudulent is to be determined by common law.[53] It is only when it has been established that there has been a fraudulent claim that the Insurance Act 2015 comes to play.[54]

Fraudulent exaggeration is the paradigm case of fraudulent claims, since the 19th century, the courts have held that a person who fraudulently exaggerated a claim forfeited the whole claim, and not just the fraudulent element of it.[55] In *Orakpo v Barclays Insurance Services Ltd*,[56] the insured argued that "the law, in the absence of a specific clause, is that an insured may present a claim which is to his knowledge fraudulent to a very substantial extent, but may yet recover in respect of the part of the claim which cannot be so categorized". This argument was rejected on the ground that the rule would not remove any disincentive to dishonesty. Forfeiture of the entire claim was confirmed in some recent cases. In *Galloway v Guardian Royal Exchange (UK) Ltd*,[57] Mr Galloway was burgled and suffered a genuine loss of around £16,000. He claimed for a fictitious computer for around £2,000 with a forged receipt. The Court of Appeal rejected the whole claim, including the £16,000 of genuine loss.

The common law rule of forfeiture of the whole claim for all types of fraudulent claims is codified in s.12 of the Insurance Act 2015, which states that "if the insured makes a fraudulent claim under a contract of insurance: (a) the insurer is not liable to pay the claim, (b) the insurer may recover from the insured any sums paid by the insurer to the insured in respect of the claim…"

The purpose for the forfeiture of the whole claim where there is fraudulent exaggeration is to discourage fraud. The rationale can be explained by Lord Hobhouse's statement in *The Star Sea*:[58] "The fraudulent

[51] Ibid, para.1.10.
[52] Remedies for fraudulent claims in group insurance is stipulated in s.13 of the Insurance Act 2015.
[53] See, for example, *Derry v Peek* (1889) L.R. 14 App Cas 337.
[54] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn, Sweet & Maxwell, 2016) para.10-035.
[55] *British v Royal Insurance Co* (1866) 4 F&F 905 at 909. In *AXA General Insurance Ltd v Gottlieb* [2005] 1 All ER (Comm) 445, para 26, Mance LJ pointed out that the effect of a claim subsequently made for a fraudulently inflated amount is "retrospectively to remove or bar the insured's pre-existing cause of action." In other words, it is not a conditional liability but a forfeiture.
[56] *Orakpo v Barclays Insurance Services Ltd* [1995] L.R.L.R. 443.
[57] *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] 2 Lloyd's Rep I.R. 209; *Agapitos v Agnew* [2002] Lloyd's Rep. I.R. 573.
[58] *The Star Sea* [2001] Lloyd's Rep. I.R. 493.

insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing."[59]

In the case of a fraudulently exaggerated claim for personal injury by a third party against a policyholder covered by liability insurance, according to s.57 of the Criminal Justice and Courts Act 2015, where the court finds that there has been fundamental dishonesty the entire claim is struck out, not just the dishonestly exaggerated part of the claim,[60] unless it is satisfied that the claimant would suffer substantial injustice if the claim were dismissed.[61] Moreover, in the recent case of *Hayward v Zurich Insurance Company plc*,[62] the Supreme Court made the judgement that where a fraudulently exaggerated claim by the third party has proceeded to a settlement, the insurers are entitled to reopen the settlement once they have discovered proof of the fraud committed by the third party. It is noteworthy that it must be shown that the false representation caused the insurer to act to its detriment, but such inducement is always a question of fact going to the issue of causation. Mr Hayward's misrepresentation induced the insurer to enter into the settlement agreement in that case.[63] This is in contrast to the common law rule for fraudulently exaggerated claims in first party insurance where inducement is not required.[64]

It is clear that the fraudulent claims rule provides a strong deterrence against fraudulent exaggeration. However, to treat an exaggeration as fraudulent, the exaggeration must go beyond a mere "bargaining" claim[65] and the amount of the exaggeration is substantial.

(a) Substantial exaggeration of loss

The typical example of substantial exaggeration is *Danepoint Ltd v Allied Underwriting Insurance Ltd.*[66] Danepoint claimed for reinstatement costs relating to a fire at the premises. Loss adjusters appointed by Allied agreed reinstatement costs at £83,000. Allied paid £25,000 on account of reinstatement costs.

[59] Ibid, at [63].
[60] The Criminal Justice and Courts Act 2015, s.57(1)(b). What constitutes fundamental dishonesty has been left to the discretion of the court with no definition in s.57. Fundamental dishonesty must be given a contextual meaning: a mere incidental or collateral dishonesty was not fundamental; dishonesty that went to the whole or a substantial part of the claim was required. See Mills & Reeve, "An update on fundamental dishonesty: the application of QOCS" (9 June 2015), *https://www.mills-reeve.com/an-update-on-fundamental-dishonesty-the-application-of-qocs-06-09-2015/* , accessed 10 February 2019).
[61] The Criminal Justice and Courts Act 2015, s.57(2).
[62] *Hayward v Zurich Insurance Company plc* [2016] UKSC 48.
[63] *Hayward v Zurich Insurance Company plc* [2016] UKSC 48. Lord Clarke at [18]; Lord Toulson at [71].
[64] *Versloot Dredging BV and Another v HDI Gerling Industrie Versicherung AG and others* [2016] UKSC 45. Lord Sumption at paras. 29 and 34.
[65] *London Assurance v Clare* (1937) 57 Li LR 254; *Nsubuga v Commercial Union Assurance Co Plc* [1998] 2 Lloyd's Rep 682.
[66] *Danepoint Ltd v Allied Underwriting Insurance Ltd* [2005] EWHC 2318; [2006] Lloyd's Rep. I.R, 429. This was also clearly the position in the US case of *Pogo Holding Co v New York Property Insurance Underwriting Association.* 467 N.Y.S 2d 872 (1983).

Danepoint also claimed £53,000 for loss of rent, on the basis that all the tenants moved out of the premises straight after the fire. H.H. Judge Coulson Q.C. concluded: The claim for loss of rent was fraudulent because many of the tenants did not leave the flats after the fire, and those that did not leave probably continued to pay rent to Danepoint; the evidence in favour of fraud was overwhelming as the exaggerated claim for loss of rent was excessive; and Danepoint's claim for the cost of reinstatement and loss of rent amount to one claim on the policy for two different heads of loss. As the claim for loss of rent was fraudulent, the entire claim failed and Danepoint had to repay the £25,000 to Allied.

How to determine whether the fraudulent exaggeration is substantial becomes very important. In *Galloway v Guardian Royal Exchange*[67] Lord Woolf MR said that "the purpose of the law must be to discourage fraudulent claims and although the fraud must be "substantial", a fraudulent claim representing 10% of the whole, as in this case, satisfied such a test". Millet LJ went further and said that "Where a claim is partly genuine and partly fraudulent, whether the fraudulent part is substantial is to be tested by looking at it on its own, not by reference to the proportion of the entire claim which is represented by the fraudulent claim on the ground that this would lead to the absurd result that the greater the genuine loss, the more fraudulent the claim could be without penalty."[68] If a claim is partly genuine and partly fraudulent, the insured cannot recover even the honest part of the claim. The reason for this is that the law declines to sever the honest part from the invented part. The policy of deterring fraudulent claims goes to the honesty of the claim, and both are parts of a single claim.[69] This principle was confirmed by the Supreme Court of UK in *Versloot Dredging BV and another (Appellants) v HDI Gerling Industrie Versicherung AG and others*, where Lord Hughes said that severability is not possible even where the exaggerated part is eminently severable in fact.[70]

(b) Where the exaggeration is merely a "bargaining" claim

In the absence of independence evidence of the insured's state of mind, it is the extent to which the claim has been exaggerated that would be the decisive dividing fact between fraud and honesty, as the greater the exaggeration the easier it becomes to impute a fraudulent intent to the insured.[71] Exaggeration is not,

[67] *Galloway v Guardian Royal Exchange* [1997] EXCA Civ 2487; [1999] 2 Lloyd's Rep IR 209.
[68] Ibid, at 213-214.
[69] The principle is the same as that which applies in the law of illegality. The courts will not sever an agreement affected by illegality into its legal and illegal parts unless it accords with public policy to do so, even if each part is capable of standing on its own (*Kuenigl v Donnersmarck* [1955] 1 QB 515, 537. *Royal Boskalis Westminster NV v Mountain* [1999] QB 674, 693).
[70] *Versloot Dredging BV and Another v HDI Gerling Industrie Versicherung AG and others* [2016] UKSC 45. Lord Hughes at para 93.
[71] Robert Merkin, *Colinvaux's Law of Insurance* (11th edn., Sweet & Maxwell, 2016) para.10-050.

however, necessarily evidence of fraud. In *Ewer v National Employers' Mutual General Insurance Association,*[72] the contents of business premises were destroyed and the insured put in a figure of £900 as their value. Although the judge thought this "looks preposterous", in that it was well above the true value, he concluded there was no fraud because it was clear on the face of the claim that the figure had been based on the cost price of new items. The insured did not intend to defraud the company, but merely took the view that he was entitled to recover the cost of replacing the lost items. Although incorrect in law, it did not make his action fraudulent: "I do not think he was doing that as in any way a fraudulent claim, but as a possible figure to start off with, as a bargaining figure."[73] From *Ewer* it could be understood that in some situations, although the amount the insured claimed for is higher than the actual amount he suffers, it is not necessary to constitute a fraudulent claim.

The court's discretion for insignificant fraudulent exaggeration: the Australian position

Before the enactment of the Insurance Contracts Act 1984 (ICA), the Australian common law and English common law were similar in respect of remedies for fraudulent exaggeration. The ICA 1984 changed the common law approach in respect of remedy for fraudulent exaggeration.[74] Section 56(2) states: "… the court may, if only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and unfair, order the insurer to pay, in relation to the claim, such amount (if any) as is just and equitable in the circumstances". In exercising the power conferred by s.56(2), the court shall have regard to the need to deter fraudulent conduct in relation to insurance but may also have regard to any other relevant matter (s.56(3)).

Section 56(2) permits the court to grant equitable relief in respect of "little frauds", *i.e*. those where "only a minimal or insignificant part of the claim is made fraudulently" and where "non-payment of the remainder of the claim would be harsh and unfair".[75] S.56(2) indicates that "little fraud" might be forgivable and the Australian courts have a discretion to decide what fraud is a minimal or insignificant and how much the insurer should pay to the insured. To reconcile the leniency to the fraudster insured given by s.56(2) with the deterrence of fraud imposed on fraudster insured by common law, s.56(3) requires the court to exercise the power granted by s.56(2) with regard of the need to deter fraudulent

[72] *Ewer v National Employers' Mutual General Insurance Association [1937] 2 All E.R. 193;* see also *London Assurance v Clare (1937) 57 Li LR 254;* and *Nsubuga v Commercial Union Assurance Co plc* [1998] 2 Lloyd's Rep 682.
[73] *Ewer v National Employers' Mutual General Insurance Association* [1937] 2 All E.R.193, at 203 per Mackinnon J. The approach in *Ewer* was endorsed in the recent case of *Orakpo v Barclays Insurance Services* [1995] L.R.L.R. 443 at 451; [1994] C.L.C. 373.
[74] For more on fraudulent insurance claims in Australia, see Julia-Anne Tarr, "Grappling with fraudulent insurance claims and 'collateral lies': comparative insurance law developments in the United Kingdom and Australia" (2019) JBL, p44.
[75] Julie-Anne Tarr, "Fraudulent Insurance Claims: Recent Legal Developments" (2008) JBL 139, p153.

conduct. The judicial control over the scope and circumstances in which relief is granted, and in particular the statutory requirement in s.56(2) that courts must "have regard to the need to deter fraudulent conduct in relation to insurance", has ensured that this does not serve as a source of encouragement to insureds to exaggerate or "pad" claims.[76] In *Entwells Pty Ltd v National and General Insurance Co Ltd*,[77] the court held that an inflated claim of $27,000 out of a total claim worth as much as $528,000 was "relatively small" and that non-payment of the entire claim would be harsh and unfair.

In summary, these common jurisdictions do not tolerate fraudulent exaggeration, the insurer is entitled to reject the whole claim if there is a substantial fraudulent exaggeration. However, s.56(2) of the ICA 1984 confers discretionary power upon the courts to order the insurer to pay the amount of claim where only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and unfair.

Recommendation for the reform of the Chinese law regarding fraudulent exaggeration

The Chinese law does not have any deterrence to fraudulent exaggeration. Under art.27(3) of the Insurance Law, the insurer is still liable to pay the genuine part of a claim even if the insured fraudulently exaggerated the amount of loss with the intention to deceive the insurer in order to get what he is not entitled to. This is a serious flaw of the law for a number of reasons. First, the insured pursuing an exaggerated claim is allowed to tell lies with virtual impunity. This can lead to or promote the fraudulent insured to think: why no to try, if I am successful then I will gain; if I am not, I will lose nothing. This is in reality a kind of encouragement to fraud. Secondly, it is unfair to the population of the honest insureds who will ultimately be responsible for paying the fraudulently inflated claims in the form of increased premium. Thirdly, it is practically difficult to divide a fraudulently exaggerated claim into a genuine part and a false part. Therefore art.27(3) of the Insurance Law is definitely in need of amendment. It is recommended that the insurer should be entitled to reject the whole claim and to terminate the contract if the insured fraudulently exaggerated the amount of genuine loss with or without the support of false evidence. In addition, with reference to s.56(2) of the ICA 1984, it is recommended that the courts should be conferred upon discretionary power to order the insurer to pay the amount of claim where only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and unfair.

[76] See *Cugliotti v Commercial Union Assurance Co of Australia* (1992) 7 A.N.Z. Ins. Cas. 61-104; *Tiep Thi To* (2001) 161 F.L.R. 61; *Riccardi v Suncorp Metway Insurance Ltd* (2001) 11 A.N.Z. Ins. Cas. 61-493.
[77] *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 6 W.A.L. 68.

It is usually the case that fraudulent exaggeration is supported by bogus evidence of some kind, such as a forged or altered receipt. Sometimes, a fraudulent exaggeration may be made without being supported by any fraudulent evidence. For example, in a burglary case, one computer is stolen but the insured claims for two computers, this is a fraudulently exaggerated claim which may (or may not) be supported by a forged receipt for the purchase of the two computers. Under art.27(3) of the Insurance Law, the insurer is liable for one computer. If the recommendation that the insurer should be entitled to reject the whole claim where the insured fraudulently exaggerated the loss would be adopted by Chinese law, the insurer would be liable for paying nothing.

One interesting question may be raised here, that is, whether the insurer is entitled to reject a genuine claim supported by a fraudulent device or a collateral lie, if the fraudulent device was irrelevant in the sense that the claim would have been equally recoverable whether or not the fraudulent device was employed. For example, one computer worth of £1000 was stolen, when the insured was asked by the insurer to provide the receipt of the purchase, the insured forged a receipt of £1000 in support of his claim. Is the insurer entitled to repudiate the genuine claim for £1000 by reason of the fraudulent device (the forged receipt)? The Supreme Court of the UK has recently considered this question in *Versloot,*[78] which is discussed below.

Fraudulent devices or collateral lies

The expression "fraudulent device", which derives from language adopted in times past by express clauses in some policies, has been used conveniently to refer only to those cases where the underlying claim, even though supported by bogus evidence or some other fraud, is good.[79] The common law has long prohibited recovery from an insurer where the insured's claim has been either wholly invented or fraudulently exaggerated. The extension of this common law rule from dishonestly exaggerated claims to justified claims supported by fraudulent devices is a more recent and a more controversial development.[80] The most recent leading case for this type of dishonest claim is *Versloot* which has changed the previous common law position

[78] *Versloot Dredging* [2016] UKSC 45.
[79] *Versloot Dredging* [2016] UKSC 45, by Lord Hughes at para 51.
[80] See some English cases relating to fraudulent devices or means or collateral lies: *Lek v Mathews* (1927) 29 Ll L Rep 141; *Wisenthal v World Auxiliary Insurance Corporation Ltd* (1930) 38 L Rep 54; *Black King Shipping Corpn and Wayang (Panama) SA v Massie (The "LITSION PRIDE")* [1985] 1 Lloyds's Rep 437; *Agpitos v Agnew* (The "AEGEON") [2002] Lloyd's Rep. I.R. 573; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The "Start Sea")* [2003] 1 AC 469; and the most recent case of *Versloot Dredging* [2016] UKSC 45.

Before the decision of *Versloot*, in *Agapitos v Agnew*[81] Mance L.J. stated that the use of fraudulent device to further a genuine claim was a sub-species of making a fraudulent claim, at least as regards the forfeiture of the claim itself. In *Versloot* the concept of fraudulent device is replaced by the name of "collateral lie".[82] The Supreme Court drew a clear distinction between a claim that was fraudulent in that it sought to recover something to which the insured was not entitled and a claim for something to which the insured was entitled but which was supported by lies. The dishonest lie is typically immaterial and irrelevant to the honest claim: the insured gains nothing by telling it, and the insurer loses nothing if it meets a liability that it has always had. A fraudulent device is no longer treated as a species of fraudulent claims, the lie is dishonest but the claim is not. The fraudulent claims rule under which the whole of the tainted claim was forfeited does not apply to collateral lies.[83]

Whether a claim is a genuine claim supported by collateral lies or a fraudulent claim is to be determined by the particular facts and evidence of the case. The recent case of *UK Insurance Ltd v Stuart Gentry*[84] demonstrates how the court will evaluate circumstantial evidence in the absence of direct evidence of fraud. The insurer sought damages for deceit on the ground that the defendant fraudulently represented to the insurer that his vehicle had been in a collision with Mr Miller's car. Mr Gentry and Mr Miller (the insured) were friends and they had initially tried to hide that friendship from the insurers. The judge commented that " … it is possible for two friends to suffer a collision when driving their respective cars. It would however be a striking and unlikely coincidence. Another explanation for the collision is that the two friends had staged the collision; that would explain the apparent but unlikely coincidence". The defendant sought to argue that this was a case of fraudulent devices, in that he had lied for an innocent reason, namely "not to slow down the payment of a genuine claim" or because he feared that knowledge of the friendship might suggest to the insurers that the collision was not genuine because it was too much of a coincidence to be true. That argument was rejected by the judge who held that "the fact that the two drivers were friends and the circumstance that each of the persons present at the time has been reluctant

[81] *Agpitos v Agnew* [2002] Lloyd's Rep. I.R. 573.
[82] *Versloot Dredging* [2016] UKSC 45, at 36.
[83] The Association of British Insurers (ABI) has strongly criticized the decision in the *Versloot* case. The ABI Director of General Insurance Policy has commented that "the decision could be a blow for honest customers. Allowing 'collateral lies' in the course of an insurance claim flies in the face of the work that the insurance industry and Government have been doing to crack down on the cheats and the fraudsters. This decision risks pushing up the cost of insurance and prolonging the pay-out process for the vast majority of people who are honest customers. Lies are lies. Insurers will investigate all suspicious claims and we make no apology for doing so as it keeps the premium down for honest customers". See James Dalton, "Supreme Court ruling is setback in fight against fraudulent claims" (21 July 2016), (Insurance Times, *https://www.insurancetimes.co.uk/supreme-court-ruling-is-setback-inspurious-claim-fight-abi/1419111.article*, accessed in January 2019).
[84] *UK Insurance Ltd v Gentry* [2018] EWHC 37 (QB).

to disclose that friendship are matters which, in my judgment, cogently suggest that the collision was staged".

Further, in *Versloot*, a new test of materiality as to a collateral lie is established: if a collateral lie is to preclude the claim, it must be material in the sense that collateral lies uttered in the course of making a claim must at least go to the recoverability of the claim on the true facts. By that test, the fraudulent claims rule applies to a wholly fabricated claim, to a fraudulently exaggerated claim, and even to the genuine part of an exaggerated claim if the whole is to be regarded as a single claim. But it does not apply to a lie which the true facts, once admitted or ascertained, show to have been immaterial to the insured's right to recover.[85] The forfeiture of the entire claim is not a proportionate sanction for the teller of a collateral lie, who will nevertheless suffer in other ways if his lie is discovered.[86]

The collateral lie is immaterial to the liability of the insurer. There is a critical difference between the collateral lie and the exaggerated claim. The collateral lie is certainly told with the aim of improving the position of the liar, but in fact and in law it makes no difference to the validity of his claim whether it is accepted or found out. The exaggerated claim is also made with the aim of improving the position of the liar, but if accepted it provides him with something to which he is not entitled in law. [87]

If the recommendation to amend the Chinese law as mentioned above that the insurers should be entitled to reject the whole claim where the insured has fraudulently exaggerated the loss is to be introduced into the Insurance Law, it is suggested that a provision should also be added into the Law to the effect that the insurer is not entitled to reject a genuine claim with embellishments by collateral lies which are immaterial and irrelevant to the recoverability of that claim.

Termination of an insurance contract for fraudulent claims

Article 27(1) and (2) of the Insurance Law vests in the insurer the right to rescind an insurance contract for fraudulent claims but does not specify the way in which the contract can be rescinded. According to Chinese Contract Law,[88] where an insurer intends to rescind an insurance contract for a fraudulent claim, a rescission notice must be given to the insured. The rescission of the contract becomes effective at the

[85] *Versloot Dredging* [2016] UKSC 45, Lord Sumption, at 36.
[86] The Supreme Court suggests that the insured that uses fraudulent devices may face some adverse consequences. *Versloot Dredging* [2016] UKSC 45, at 108.
[87] *Versloot Dredging* [2016] UKSC 45, at 92.
[88] The Contract Law of the PRC was enacted in 1999.

time when the rescission notice arrives at the other party.[89] This indicates that all genuine claims occurring after the fraudulent claim but before the receipt of notice of rescission by the insured are recoverable. The effect of the rescission of the contract appears from the moment of rescission, not from the moment when a fraud is committed. To make it clearer, it is suggested that this rule should be added into art.27 of the Insurance Law.

Under the Insurance Act 2015, the insurer may by notice to the insured treat the contract as having been terminated with effect from the time of the fraudulent act.[90] Where the insurer does treat the contract as having been terminated, the insurer may refuse all liability to the insured under the contract in respect of a relevant event occurring after the time of the fraudulent act.[91] Thus the termination of the contract does not affect the rights and obligations of the parties to the contract with respect to a genuine claim before the time of the fraudulent act.[92] As there is no time limit within which the insurer must exercise his right of termination in the Insurance Act 2015, there would be scope for an insured to claim that the insurer had waived its right to rely on s.12(1)(c) to terminate the contract if it had not done so as soon as it discovered fraud, or had not made reasonable attempts to confirm its suspicions until a larger, genuine claim arose which the insurer did not want to pay.[93] In this situation, the normal rules for establishing waiver would apply.[94] It may be necessary to set up a time limit (say 30 days) within which the insurer may exercise its right of termination under the 2015 Act. This would give the insured sufficient time to seek an alternative cover.

In Australia, the procedure of the cancellation of an insurance contract is dealt with in s.59 and s.60 of the ICA 1984. S.60(1)(e) permits the insurer to cancel the insurance contract where the insured is the fraudulent claimant. A written cancellation notice to the insured is required in order to cancel an insurance contract (s.59(1)). Under s.59(2A)(a)(i) of the ICA 1984, termination of an insurance contract takes effect fourteen days after notice of cancellation is tendered. This leaves open the question whether a genuine claim made between the fraudulent act and termination becoming effective has to be paid.[95]

[89] The Contract Law, art.96.
[90] The Insurance Act 2015, s.12(1)(c).
[91] The Insurance Act 2015, s.12(2)(a).
[92] The Insurance Act 2015, s.12(3).
[93] The Law Commission and The Scottish Law Commission, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for fraudulent claims; and late Payment* (July 2014), para.23.40.
[94] See, for example, *Chitty on Contracts* (31st edn., 2012) paras 24-007 and 24-008.
[95] Aysegul Bugra and Robert Merkin, "Fraud and fraudulent claims" (2012) Journal of BILA, Issue 125, p3.

Conclusion

Fraudulent insurance claims are diverse and widespread. A wrongdoer should not be enabled by law to take any advantage from his wrongdoing. Ideally, the rules of law relating to fraudulent claims should operate for the purpose of deterring insureds from acting fraudulently and preventing them benefiting from fraud. Article 27(1) and 27(2) of the Insurance Law impose sufficient deterrence on the insured who makes fraudulent claims in the situations where the insured has suffered no loss at all or incurred a self-inflicted loss - the insurer is not liable for the claim and also entitled to terminate the contract and retain the premium paid. Article 27(3) totally fails in deterring the fraudulent insured and opens the floodgate for fraudulent exaggeration of loss or fraudulent fabrication of a false cause of loss, for the insurer is still liable for the genuine part of a fraudulently inflated claim, albeit not liable for the false part. This rule in fact may encourage the fraudster to try inflated claim. Not only has it no deterrence at all to fraud but also is unjust and unfair to the insurers and the honest insureds who will pick up a collective bill for fraud through increased premiums. It is recommended that the common law rule of forfeiture of the whole claim tainted by fraudulent exaggeration be introduced into art.27 where the fraudulent exaggeration is substantial; and that the courts be conferred upon discretionary power to order the insurer to pay the amount of claim where only a minimal or insignificant part of the claim is made fraudulently and non-payment of the remainder of the claim would be harsh and unfair. At the same time, two clear lines must be drawn: first, the line between a claim that is intentionally inflated by the insured so as to defraud the insurer of the amount more than the insured is entitled to and a claim that is inflated for genuine negotiation purpose where there is a reasonable basis for dispute as to value; and secondly, the line between a claim that is fraudulent in that it sought to recover something to which the insured is not entitled and a claim for something to which the insured is entitled but is embellished by collateral lies.

The ultimate purpose for reforming art.27 of the Insurance Law is to introduce deterrence to fraudulent exaggerated claims and fraudulent fabrication of cause of loss. However, for the law to have a deterring effect on a potential fraudster, the insureds must be made aware of and understand the effect of the law that is meant to influence his conduct in making a claim.[96] For this sake, it is suggested that insurers can

[96] A behavioural science investigation on the deterrence of criminal law to fraud shows that for criminal law to have an effect on a potential offender's conduct choices, three prerequisites must be met: first, the potential offender must know, directly or indirectly, and understand the implications for him, of the law that is meant to influence him. Secondly, he must bring such understanding to bear on his conduct choices at the moment of making his choice. Thirdly, his perception of his choices must be such that he is likely to choose compliance with the law rather than perpetration of the law. That is, the perceived costs of non-compliance outweigh the perceived benefits of the fraudulent conduct so as to bring about a choice to forgo the fraudulent conduct. See Paul Robinson and John Darley, "Does Criminal Law deter? A behavioral science investigation" (2004) Oxford Journal of Legal Studies, 24(2), 173-205.

print a warning on the top of the claim form to bring the claimant's attention to the consequences of making a fraudulent claim. In a broader sense, a reduction in the number of fraudulent claims will require a comprehensive public education campaign, industry-wide collaboration on the collection of intelligence and legislative reform.[97]

[97] Julie-Anne R. Tarr, "Fraudulent Insurance Claims: Recent Legal Developments" (2008) JBL 139, at 157.