Discovery Insure Limited v Masindi

Case No 85613/2017; [2021] ZAGPPHC 145 (8 September 2021)

Short-term insurance – fraud – forfeiture of benefits

Facts

The plaintiff, Discovery Insure Limited, claimed from the defendant, Mr Tshamuwe Masindi, the repayment of benefits in the amount of R1 647 592.67, which the plaintiff paid in settlement of a claim of a loss allegedly suffered by the defendant. The plaintiff alleged that the amount was recoverable as the defendant's claim was tainted by fraud (para 1).

On 16 December 2016 the defendant lodged a claim with the plaintiff under the building section of the policy following damages to the insured residence property due to a storm and flooding. The claim included a claim for emergency accommodation (para 5). The plaintiff alleged in its particulars to have paid the defendant a total amount of R972 592.67 that was claimed in respect of the repairs to the defendant's residence and damage to household contents. In addition, the plaintiff claimed to have paid an amount of R675 000 for the defendant's emergency accommodation. This was after the defendant had provided tax invoices in respect of his accommodation at the Villa Africa Boutique Hotel during the period 20 November 2016 to 16 May 2017 (para 6).

The plaintiff averred that the defendant had in fact not used the accommodation and therefore did not incur the expenses. The plaintiff stated that two invoices (appendices C1 and C2 to the particulars of claim) were not invoiced to the defendant for any services (para 7). In addition, C3 to C6 were made out to a third party and the accommodation was not used by the defendant. It was therefore the plaintiff's case that the defendant had fraudulently provided misinformation or had misrepresented information or had provided inaccurate information when he submitted invoices for repayment and in support of his claims for accommodation (ibid). Accordingly, the plaintiff alleged that due to the defendant's fraud or misrepresentation at claim stage, the plaintiff

was entitled to claim back all the money paid to the defendant (para 8). This was a contractual right that existed in addition to the plaintiff's right to cancel the contract with retrospective effect to the date of the incident (11 November 2016). In addition, the letter demanded repayment of all amounts paid under the cancelled contract (para 12).

It further appeared that there was no dispute on the merits regarding the fraud in respect of the mentioned claim. The dispute was on the basis that there was no express provision in the policy that determined that on the retrospective termination of the policy the defendant became liable for the repayment of any/all benefits paid by the plaintiff before termination, including benefits in respect of claims not tainted by fraud (para 13). A further dispute existed regarding the actual amount that was paid to the defendant by the plaintiff.

Decision

A factual issue and a legal issue were therefore put to the court. The factual issue was that the plaintiff had to prove the actual amount that was due, or the extent of the defendant's liability (para 37). The legal issue was whether the defendant's fraud in respect of part of an otherwise valid claim did in fact result in the forfeiture of the entire claim, retrospective from the date of cancellation of the policy, and whether the plaintiff was entitled to cancellation of the policy and repayment of all the amounts paid to the defendant, regardless of whether those payments were made as a result of the defendant's fraud (para 17).

Khumalo J introduced the legal framework by stating that many short-term insurance policies contain forfeiture clauses as express terms (para 18). The judge noted that *Schoeman v Constantia Insurance Co Ltd (1)* case no 001/2002; [2003] ZASCA 48; [2003] 2 All SA 642 (SCA) (21 May 2003) was one of the cases in which a forfeiture clause came into play. In *Schoeman* the court stated that forfeiture clauses in the case of fraud were common but that it had been suggested that such clauses are unenforceable because of their penal nature (ibid).

The judge qualified *Schoeman* on the basis of that case having found that in the absence of an express term on forfeiture in the insurance policy, fraud confined to only part of a claim by an insured against an insurer did not result in the whole claim being forfeited (para 19). However, where a contract does contain an express forfeiture clause such as in *Lehmbecker's Earthmoving and Excavators (Pty) Ltd v Incorporated General Insurances Ltd* 1984 (3) SA 513 (A) at 522E–F, the SCA on the facts of that matter declined to give the forfeiture clause its wide literal meaning. Khumalo J further explained that the court was dealing with a different set of facts as there were two claims arising from two totally different insured risk events,

which was why the court upheld the 'untainted' claim (para 20). The defendant had argued like the respondent in the *Lehmbecker* matter that because the aim was to combat fraud, very wide terms were used in the policy. The judge stated at para 23:

> '[If] proper effect were given to such wide terms, the termination of the policy on the ground of the making of a fraudulent claim would affect any and all claims even if they had accrued to the appellant in terms of the policy, prior to its termination, which is indeed what the Plaintiff is advocating (however retrospective to the date of the incident) invalidation of all liability that has accrued from the risk incident.'

The plaintiff relied on *Papagapiou v Santam Ltd* case no 58/2005; [2005] ZASCA 140 (30 November 2005) and *Harikasun v New National Assurance Company Limited* case no 190/2008; [2013] ZAKZDHC 67; 2014 JDR 0009 (KZD) (12 December 2013). The latter case was one in which the bulk of the claim following a robbery at the plaintiff's house was valid but because the plaintiff had committed fraud in respect of a cell phone, which in monetary terms constituted a very small portion of the claim, the entire claim was forfeited.

Khumalo J referred to *Russell NO and Loveday NO v Collins Submarine Pipelines Africa (Pty) Ltd* 1975 (1) SA 110 (A) at 129, where the court had accepted that ultimately the problem of interpretation of an insurance policy was 'one of arriving at the intention of the parties from the terms of the contract considered as a whole', and that the intention 'was to be looked for on the face of the policy in the words which the parties themselves have chosen to express their meaning' (para 25). The court placed much reliance on the *Lehmbecker* case (paras 26–28) and finally, despite having distinguished *Lehmbecker* from the present case on the facts, at para 29 still quoted Millar JA stating as follows (at para 20 of *Lehmbecker*):

> 'A provision requiring forfeiture of honest claims made under and in terms of a valid policy of insurance and which had accrued and become due and payable prior to the subsequent breach causing the premature termination of the policy, would surely be nothing less than a penalty. And it could be a penalty grossly and intolerably disproportionate to the breach, which would be the case if the accrued, valid claims ran into hundreds of thousands of rands and the subsequent fraudulent claim was of relatively insignificant value.'

Khumalo J again distinguished the present case from *Lehmbecker* by stating that in the present case all the benefits that were paid arose from a single incident (para 30). In addition, the judge said (ibid):

> 'The breach was committed on 16 December 2016 on the submission of the claim that partly constituted of a fraudulent and partly credible claim, following the loss that ensued from the single incident of 11 November 2016. Accordingly, since avoidance of such a policy can only date from date

of the

> breach; up to that date the policy is fully effective so as to entitle the defendant to recover in respect of any loss which occurred before the breach. A breach committed when claiming benefits of a loss that has accrued prior thereto, if following the reasoning as per mentioned authorities should not taint the part of the claim that is credible since the loss (entitlement to claim/recover) accrued prior the breach.'

The judge correctly noted that clause 5.13 of the insurance policy stipulated that 'All benefits in terms of this Plan in respect of any claim will be lost and this Plan may be voided or cancelled at our discretion' (para 31). This inevitably meant that the plaintiff did have the right to cancel all the payments made to the defendant in the event of fraud. In addition, the court stated (ibid) that:

> 'The parties clearly bound themselves in clear terms to the application of forfeiture. Indeed, such words as stated in their policy were said to be clearly capable of bearing the meaning that "as from the time that the fraudulent claim is made, the insured shall have no further benefit or claim under the policy", forfeiture being applicable to all benefits in respect of the claim as at date of breach, which is the date of the fraudulent claim.'

The judge concluded that as fraud was only committed after the first payment was made, the plaintiff could only void the contract from that date onwards and not void the entire contract and claim back all valid claims paid before this date, as that would amount to a penalty clause (para 35). The court then remarked that, contrary to the defendant's argument, in terms of the Conventional Penalties Act 15 of 1962, a penalty is enforceable but in terms of s 3 of the Act, it may be revised if the amount of the penalty is out of proportion to the prejudice suffered. The court again relied on *Lehmbecker* as authority for stating that the punitive nature of forfeiture and the disproportionality thereof had occupied 'all the authorities mentioned'.

In the final instance, the court ruled that the effect of ordering a repayment of the amount paid for benefits that have rightly accrued and were due and payable at the time of payment, would seemingly be disproportionate to the breach, 'taking into consideration that the defendant has not been unjustly enriched by the payments on the valid loss since the right to compensation had already accrued prior the breach' (para 36). The court stated that the plaintiff had not shown that the amount of the valid benefits it required to be repaid was 'in any way proportional to the loss or prejudice it has suffered as a result of the breach' (ibid). The court finally ruled that the fraudulent claim was of no consequence to the accrued valid claims that were paid, and dismissed the plaintiff's reliance on *Papagapiou v Santam Ltd* case no 58/2005; [2005] ZASCA 140 (30 November 2005) at para 9, stating that the plaintiff had referred to *Papagapiou* to support its argument for the forfeiture of a benefit in the

instance of use of fraudulent means to gain a benefit, but in that case the claim upon which forfeiture was sought covered valid claims untainted by the fraud. The court thus concluded that there was no justification for the penalty as per terms of the contract to be enforced, and the plaintiff was therefore entitled to only a repayment of the amounts it paid on the fraudulent part of the claim (ibid).

Discussion

The idea of forfeiting an entire claim where only a portion of the claim was tainted by fraud was indeed raised in the *Harikasun* case. For comments on the unfairness of the forfeiture clause, see Millard '*P K Harikasun v New National Assurance Company Ltd* (190/2008) [2013] ZAKZDHC 67 (12 December 2013): Of red herrings, sardines and insurance fraud: Something's fishy' (2016) 49 *De Jure* 155–167, available at https://dx.doi.org/10.17159/2225-7160/2016/v49n1a10. It is important to note that insurance companies use forfeiture clauses to ensure that policyholders are not enriched by fraudulent actions. This is a valid objective. However, as was seen in *Harikasun*, such a forfeiture clause may have a harsh effect as some instances of fraud often are less serious than others. Van Niekerk ('Fraudulent insurance claims' (2000) 12 *SA Merc LJ* 69 71–73) divides insurance fraud into three categories and argues that the distinctions between these are important for determining fraud's effect on a claim. The first kind, fabricated claims, is where the insured suffers no actual loss, or if there is a loss, it is one that is not covered by the insurance contract (ibid). In such instances the insured would ordinarily not have been able to claim anything from the insurer. Typically, the policyholder as claimant would be 'very often causing it, and then fraudulently represents to the insured the loss was caused by a peril covered by the insurance contract' (ibid). The second type of insurance fraud is exaggerated claims (Van Niekerk 'The criminal prosecution of insurance fraud: An encouraging recent decision' (2008) 20 *SA Merc LJ* 280 281). Yet another form of fraud is where a valid claim is accompanied by fraudulent means and this is, according to Van Niekerk, 'nothing more than a technical or petty fraud designed to ensure that the insured receives that to which the insured is entitled without delay or bother' ('Fraudulent insurance claims' (2000) 12 *SA Merc LJ* 69 71–73). In these instances the policyholder does suffer a loss but in order to avoid unnecessary delays, the policyholder uses false evidence to substantiate and support the claim (ibid).

It is submitted that, *in casu*, the policyholder fabricated the claim for accommodation but not the claim for the flood damage to his property. A strict interpretation of the clause in the insurance contract does stipulate that the insurer is entitled to cancel the contract upon discovery of the

fraud and cancel all claims. In this regard the case definitely corresponds more with *Harikasun* than with *Lehmbecker* as the two major parts of the claim, namely the restoration or replacement of the property and alternative accommodation, arose from one damage-causing event. What is however different between *Harikasun* and the present case is that in *Harikasun* the claims for the stolen property were investigated one by one before any payments were made, and as one portion was found to be fraudulent, the entire claim was repudiated – or, in other words, the plaintiff in *Harikasun* forfeited the valid claims due to fraud attaching to one portion. In casu, there were also multiple portions of the claim but these were paid in stages. The court therefore found that to cancel the contract retrospectively to a time when there was no fraud amounts to a penalty and the court can decide not to enforce this due to it being too harsh.

The judgment brings a fair solution to the fore but at the same time begs the question whether it is not perhaps time to deal with insurance fraud and forfeiture clauses definitively by amending the Policyholder Protection Rules (PPRs) that were promulgated in terms of s 55 of the Short-term Insurance Act 53 of 1998. Huneberg *The Fairness of Forfeiture Clauses in Short-term Insurance Contracts* (unpublished LLD thesis, University of Johannesburg, 2018) advocates for a fairer dispensation for policyholders in instances where fraud occurs. She argues that in addition to including a statutory definition of fraud in the PPRs (Huneberg 344), these rules should also include a rule on fraud at claim stage. This will warn a policyholder in advance that any fraudulent act when they submit a claim or part of a claim will have consequences. Huneberg (346) suggests a rule that reads as follows:

> 'If a policyholder submits a valid claim but makes use of fraudulent means to substantiate/prove the claim, the policyholder will be liable to pay the insurer a penalty fee in proportion to the loss suffered by the insurer in respect of investigating such a claim.
>
> "Fraudulent means" is defined as any unlawful, deceptive or false statement given by a policyholder in order to embellish or improve the surrounding facts of a genuine claim.'

The effect of such a stipulation is first and foremost to draw a policyholder's attention to the fact that there is a forfeiture clause in the policy and to explain the exact effect of such a clause. The rationale is that applicants for insurance often do not know that their contracts, once concluded with the insurer, contain such clauses and are surprised by this. By disclosing the clause and its contents before a claim is lodged, the insurer provides the plaintiff with a fair opportunity to act honestly and to fully appreciate the consequences of any fraud. Secondly, the purpose of such a rule is to provide the insurer with a remedy in the case of fraud.

Fraudulent conduct remains rife and if fraud goes undetected, this has adverse consequences for the entire risk pool.

In the final instance, it remains problematic where a portion as opposed to an entire claim is fraudulent. There are benefits to outlawing forfeiture clauses for partial fraud and the time might be ripe for introducing such limitations in the Policyholder Protection Rules to promote legal

certainty and provide a fair dispensation for plaintiffs.