CHAPTER 7

7. NON-DISCLOSURE AND MISREPRESENTATION

CONTENTS

NON-DISCLOSURE AND MISREPRESENTATION

I. Introduction

Although types of insurance vary widely, the primary goal of any insurance is to allocate the risk of loss from the individual to the insurer. Based on information provided to it by the prospective insured, the insurer must determine whether the risk presented by the individual is an acceptable one and, if so, determine an appropriate premium. Non-disclosure or misrepresentation by an insured in an application for insurance undermines the insurer's ability to accurately assess the nature and extent of the risk and may cause an insurer to provide indemnification for a risk it did not intend to cover. Non-disclosure and misrepresentation can have a significant effect on insureds as well. The insurer may elect to avoid the contract of insurance as a result of the insured's non-disclosure or misrepresentation, thus precluding the insured from receiving indemnification for the loss.

This paper will provide a general overview of the insured's common law and statutory duty to disclose information in the insurance application process and the consequences of an insured's failure to adequately disclose material information to the insurer. The impact of the insured's non-disclosure and misrepresentation on an insurer's defence obligations will also be considered.

II. Non-Disclosure and Utmost Good Faith

A. Uberrimae Fidei

In ordinary commercial contracts, the contracting parties are not required to reveal all they know about the proposed agreement. In a contract of sale, although the seller must not misrepresent the article for sale or deceive the buyer, he is not obliged to point out all its defects and disadvantages. Although there is some consumer protection legislation available to purchasers, at common law, the principle of *caveat emptor* or "let the buyer beware," places the onus on the buyer to satisfy himself that the contract is a reasonable one.

Insurance contracts differ from ordinary commercial contracts in that an insurance contract is *uberrimae fidei* or "of the utmost good faith." The seminal expression of this principle is that by Lord Mansfield in *Carter v. Boehm* (1776), 97 E.R. 1162 at 1164:

> ... Insurance is a contract upon speculation.
>
> The special facts upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the risqué [sic] as if it did not exist.
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> The keeping back such circumstance is a fraud, and, therefore, the policy is void. Although the suppression should happen through mistake, without any fraudulent intention: yet still the under-writer is deceived and the policy is void; because the risqué [sic] run is really different from the risqué [sic] understood and intended to be run at the time of the agreement.
>
> The policy would be equally void, against the under-writer if he concealed ...
>
> The governing principle is applicable to all contracts and dealings.
>
> Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.

B. The Insured's Duty to Disclose

Along with its application form, the insurer may provide the insured with a standard questionnaire which allows the insurer to gather sufficient information to assess the risk presented by the insured.[1] To comply with the duty of utmost good faith, the insured must make full and complete disclosure of all relevant information when applying for a policy, whether the insurer requested such information or not. Where an insured misrepresents or fails to disclose material information, the insurer may elect to affirm, cancel or rescind the policy.

It does not matter whether the insured's failure to disclose material facts was deliberate or inadvertent. Under the doctrine of utmost good faith an insured is required to disclose any information material to the risk. Such disclosure must be full and accurate since disclosure of some but not all of the facts may constitute misrepresentation (*Lafarge Canada Inc. v. Little Mountain Excavating Ltd.*, 2001 BSCS 218 at para. 25).

The rule of utmost good faith applies at the time the parties enter into the insurance contract. Knowledge of risks after the expiration of the policy is not relevant to the issue of material non-disclosure (*Noranda Metal Industries Ltd. v. Employer's Liability Assurance Corp.* (2000), 23 C.C.L.I. (3d) 60 (Sup. Ct. of Justice)). In *Noranda*, the insurer declined to indemnify a claim arising from environmental contamination caused by the insured's operation of a copper tube manufacturing plant on the basis that the insureds were guilty of material non-disclosure in obtaining the insurance policies. The insureds asserted that the insurer was precluded from relying upon that defence as it knew of the risks of contamination after the policies had expired. In the context of an appeal of a document production application, the Court rejected this argument, stating (at para. 22):

> The plaintiffs contend that the knowledge of risk by the defendants after their policies have expired is relevant to the allegation of material non-disclosure. I do not agree. I do not see how the knowledge of risks after the expiration of the policy could have any relevance to whether there was material non-disclosure at the time that the policy was obtained or during its currency. The plaintiffs rely on the fact that the defendants have pleaded that there was a failure to make timely disclosure of occurrences of contamination as rendering the subsequent knowledge of risks by the defendants relevant. The flaw in that argument is that there is a very significant difference between knowledge of risks and knowledge of actual events. It is the latter knowledge that is relevant to the failure to make timely disclosure ...

The Ontario Court of Appeal in *Gregory v. Jolley* (2001), 201 D.L.R. (4th) 729 (C.A.)[2] considered whether the duty to disclose material facts extended to the situation where the insurer did not require a written application from the insured. In this case, the insured obtained disability insurance through the insurer, which eventually lapsed for non-payment of premiums. The policy was reinstated a month later upon the plaintiff's application, however, the insurer did not require the plaintiff to submit a written application for reinstatement. The insured eventually made a claim under the reinstated policy which the insurer initially approved. The insurer rescinded the policy as a result of the insured's failure to disclose material information with respect to his health and income. The trial judge found that the insured made material misrepresentations but that the insured was entitled to the benefit of the "incontestability" clause in the policy which provided that, absent fraud, the insurer could not avoid the policy for misrepresentation after two years from the application for insurance.

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1 As a matter of practice, insurers should ensure that the questions contained in its application forms and questionnaires are clear and unambiguous as before a court can find an insured misled the insurer through non-disclosure or misrepresentation, it must be shown that the insurer asked a clear question to which the insured provided a false answer (*Laio Estate v. Metropolitan Life Insurance Co.* (1995), 29 C.C.L.I. (2d) 84 (B.C.S.C.)).

2 Application for leave to appeal to the Supreme Court of Canada dismissed, [2002] S.C.C.A. No. 460.

In considering whether the trial judge erred in failing to find misrepresentation sufficient to avoid the policy, the Court of Appeal stated the following with respect to whether the insurer effectively waived any obligation of disclosure by not insisting upon a written application (at paras. 35 and 36):

> ... the failure of an insurer to insist upon a written application may have some significance. However, I do not accept the submission of the respondent that an insured is entirely absolved of the obligation of good faith where the insurer does not insist upon a written application. It would, in my view, be inconsistent with the terms of the statute and with basic common law insurance principles to allow an insured to withhold material facts that plainly bear upon insurability.
>
> ... Where, as in the present case, an insured is in possession of facts that any reasonable person would know could make him or her uninsurable, there is a duty to disclose those facts even if the insurer does not ask for a written application. ...

With respect to the consequence of the insurer's failure to require a written application, the Court stated (at para. 37):

> The significance of the insurer not insisting upon a written application, in my view, is similar to the failure of an insurer to ask a question on the application. ... the insurer's failure to inquire may provide evidence that the insurer does not consider the information relevant. Similarly, where the insurer does not insist upon a written application for reinstatement, any doubt regarding the materiality of undisclosed facts will be resolved in favour of the insured. ...

As the insured had a duty to disclose material facts on the application for reinstatement and the misrepresentation was within two years of the date of the reinstatement of the policy, the Court of Appeal held that the incontestability clause had no effect. Accordingly, the insurer was entitled to avoid the policy without having to prove fraud.

Where a policy is renewed on an annual basis, an Ontario Court has stated that it is "arguable" that the insured will have a positive obligation to advise the insurer or its agent when there is a change which is material to the risk. The Court stated that the insured's duty of disclosure reattaches each time the policy is renewed so far as the fact to be disclosed are material (*Electric ColourFast Printing Corp. v. Citadel General Assurance Co.* (1999), 88 O.T.C. 373 at para. 26 (Ont. Ct. Jus. Gen. Div.)).

1. Statutory Disclosure Obligations

In addition to consideration of the common law rules concerning an insured's duty to disclose, regard must be had for the *Insurance Act*, R.S.B.C. 1996, c. 226 (the "Act"), which applies to every insurer in B.C. and to every contract of insurance made in B.C. pursuant to s. 2 of that Act.

The Act codifies the rule of utmost good faith and the common law duty of disclosure imposed upon prospective insureds with respect various types of insurance, including life insurance, accident and sickness insurance and fire insurance.

The duty to disclose all material facts on an application for life insurance is contained in s. 41(1) of the Act:

> (1) An application for insurance and a person whose life is to be insured must each disclose to the insurer in the application, on a medical examination, if any, and in any written statements or answers furnished as evidence of insurability, every fact in his or her knowledge that is material to the insurance and is not so disclosed by the other.

Accident and sickness insurance is subject to a similar statutory duty to disclose contained in s. 97(1) of the Act, which provides:

> (1) An applicant for insurance on his or her own behalf and on behalf of each person to be insured, and each person to be insured, must disclose to the insurer in any application,

> on a medical examination, if any, and in any written statements or answers furnished as evidence of insurability, every fact within his or her knowledge that is material to the insurance and is not so disclosed by the other.

Statutory condition 1 contained within s. 126 of the Act imposes a duty to disclose on those individuals seeking fire insurance:

> 1. If any person applying for insurance falsely describes the property to the prejudice of the insurer, or misrepresents or fraudulently omits to communicate any circumstance which is material to be made known to the insurer in order to enable it to judge of the risk to be undertaken, the contract is void as to any property in relation to which the misrepresentation or omission is material.

C. Limits on the Insured's Duty to Disclose

An insured's duty to disclose relevant information to the insurer extends only to information within his or her personal knowledge. There is no duty upon an insured to inform the insurer of matters that are within the ordinary professional knowledge of an insurer and of which the insurer either knows or ought to know. As stated in *Carter v. Boehm* (at 1164-65):

> There are many matters, as to which the insured may be innocently silent-he need not mention what the under-writer knows-...
>
> An under-writer can not insist that the policy is void, because the insured did not tell him what he actually knew; what way soever he came to the knowledge.
>
> The insured need not mention what the under-writer ought to know; what he takes upon himself the knowledge of; or what he waves being informed of.

An insured is not required to communicate "notorious" facts or facts relating to the general course of a particular trade, as such facts are presumed to be within the knowledge of the insurer carrying on the business of insurance. As a general principle, an insurer is expected to know a certain amount of information regarding the activity being insured.

However, the insurer is not expected to know about special activities or risks which are not normally part of the business being insured. If an insurer was aware of a particular risk or should have been aware of that risk, it cannot later deny coverage on the basis of non-disclosure.

One of the leading cases with respect to the issue of the limits of the insured's duty to disclose is *Canadian Indemnity Co. v. Canadian Johns-Manville Co.*, [1990] 2 S.C.R. 549, which provides a general overview of the common law. However, the decision itself it is of limited authority as it was decided upon the Quebec *Civil Code*. The Court summarized the common law authorities as follows (at 587):

> The pre-codification authorities indicate that it is not a general principle of insurance that both insured and insurer must possess equal actual knowledge. On the contrary, it appears that if the insurer does not keep abreast of facts which are available and customary or well known in the field which it insures, then it ignores these facts at its peril, and the law does not require the insured to make up for the insurer's lack of diligence. Of course, the insurer is not actually engaged in the trade or activity which it insures, and there is a natural limit to that which should be well known to the insurer ... It appears to me to be quite clear that this limit includes but extends beyond that which is notorious to the general public or even to the well-informed individual. However, it stops short of information which is perhaps notorious to those within the trade, industry or activity which is being insured but not normally accessible or available to those who operate on the periphery.

The extent of the insured's duty to disclose material information was also considered in *Xcan Grain Ltd. v. Canadian Surety Co.*, [1995] 5 W.W.R. 730 (Q.B.).[3] In this case, the insured, a grain merchant, held a fidelity policy with the insurer and made a claim for losses sustained through the fraud of its employees. The insurer denied the claim on the basis that the insured breached its obligation of utmost good faith by not disclosing the existence of a prior insurer and the fact that it traded extensively in commodity futures. In an action by the insured to enforce the policy, the Court held that although the fact that the insured engaged in futures trading was material to the risk, it was a fact that the insurer should have known was an integral and necessary part of the insured's business. Accordingly, the Court did not allow the insurer to avoid the policy on the basis of the insured's non-disclosure and allowed the insured's action. The Court stated (at 749):

> These authorities indicate that, as a general principle, the underwriter is expected to know a 'certain amount of information regarding the activity' being insured ... ; also, specifically, the 'practice of the trade he insures' ... ; and also the 'general course of a particular trade' ... The underwriter would not be expected to know about special activities or risks which were not normally part of the business being insured.
>
> In my opinion based on these principles, the plaintiff was not required to disclose to the defendant that it was trading on the futures market; it was entitled to rely on the assumption that the defendant, as a reasonably competent underwriter, writing or prepared to write fidelity insurance for grain merchants, would either know, or find out about, the way in which grain merchants carried on their business.
>
> There was nothing unusual about the futures trading: It was an integral and necessary part of the plaintiff's business and it pertained not just to the plaintiff's business, but was universal in the grain trade. Moreover, it was not a practice within the peculiar and exclusive knowledge of the plaintiff, but would have been well known in the grain trade and perhaps even beyond that. ...

In *Lafarge*, the insurers sought to avoid a Comprehensive General Liability policy on the basis that the insured had failed to disclose material information about its contracting business. In its application for insurance, the insured submitted a memorandum which described its business as a contractor at a gravel site where it loaded sand and gravel onto trucks. The memorandum also detailed that the insured had been awarded a contract to decommission logging roads and perform logging road work and grounds maintenance. After learning of the insured's involvement in logging work, the insurer required the insured to complete a Logging Contractor Survey Form. That form asked the insured about welding regulations and controls to which the insured answered: "No –doesn't weld." The insured attached an additional memorandum to the survey form which described its business somewhat differently from the description provided in the original memorandum.

While working at the gravel site, employees of the insured used acetylene torches to cut through metal bolts in order to remove a screen on a water tower, which started a fire and damaged the tower. The insured submitted a claim to its insurer, which was denied on the basis that the insured had misrepresented the nature of its business operations at the time of the application for insurance.

The owner of the gravel site sued the insured. The insurer and the insured's insurance agent were named as third parties. The insurer applied for summary dismissal of the third party claim, arguing that it was not aware that the insured was involved in construction or maintenance work at the gravel site or that the insured would be involved in cutting or welding at the plant and that if it had been so informed, it would have regarded the risk as substantially different and declined the risk or, alternatively, required a higher premium. The insured argued that the insurer was not able to void the policy on the basis that it failed to disclose a material fact as the insurer must have been taken to know that the use of cutting torches and welding equipment was a normal part of the work of an excavating company. The Court rejected this

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3 Affirmed [1996] 1 W.W.R. 560 (Man. C.A.).

argument finding that the use of torch cutting equipment by a site clearing contractor would not have been within the knowledge of a prudent insurer such that the insurer must be taken to have deemed knowledge of the use of such equipment. Further, the Court found that the insurer met the onus of showing that a prudent insurer would not regard the use of a cutting torch or welding equipment to be incidental to the operation described by the insured at the time of the application for insurance.

D. Insurer's Duty to Inquire or Investigate

While the duty of utmost good faith requires an insured to disclose all facts material to the risk the insurer may have a reciprocal obligation to make further inquiries of the insured. Where the insurer has an obligation to inquire and fails to make inquiries, it may be precluded from avoiding the policy on the basis of non-disclosure or misrepresentation.

The Court in *Silva v. Sizoo* (1997), 50 C.C.L.I. (2d) 293 (Ont. Ct. Gen. Div.) conducted a review of the law and identified some instances where an insurer may be required to make further inquiries (at paras. 93 and 97):

> An insurer is not required to be a detective. It need not automatically distrust statements made on an Application so as to be required to look behind them. ...
>
> ...
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> In summary, these cases show that the rule that insureds are bound to disclose all material facts on pain of having the policy avoided is alive and well. It is, as it always has been, subject to some exceptions. An insured need not disclose what the insurer actually knows, nor that which is so notorious in the industry or place concerned that any competent underwriter in the field would know it. There is a duty on an insurer not to close his eyes to the obvious, to that which is tantamount to notice; and not to refrain from asking because he prefers not to know the answer to a question which stares him in the face. There may be others, I do not pretend to be exhaustive. But there is no general duty owed by an underwriter to an applicant for coverage to conduct a reasonable investigation or otherwise to act as a reasonably competent underwriter. 'plaintiff may not shift the burden of truthfulness which was upon the insured into a burden of distrust and additional inquiry on the part of the defendant' ...

The B.C. Court of Appeal in *Armstrong v. North West Life Insurance Co. of Canada* (1990), 48 B.C.L.R. (2d) 131 (C.A.) adopted the following test to determine when an insurer may have a duty to conduct further inquiries (at 136-37):

> ... In my opinion, the law on this is to be found in the words of Peck, P.J. in *Cherkes v. Postal Life Insurance Company*, 138 N.Y.S. 2d 788, where he said at p. 790 of the report:
>
> > Defendant's negligence in not making further inquiry may be conceded, but that is not the equivalent of knowledge, nor does it cancel out or counteract the insured's fraud. Knowledge that the insured was not a favourable risk did not cast the burden upon defendant of looking suspiciously and searchingly beyond the facts disclosed for undisclosed ailments, *Zeldman v. Mutual Life Insurance Co.*, 269 App. Div. 53, 53 N.Y.S. 2d 792. The test is not one of what prudent inquiry would have revealed. The question is whether the information given, although partial, was sufficiently indicative of something more to be tantamount to notice of the unrevealed. We hold that it was not in this case. There was no indication whatever if the kidney condition or that further inquiry might reveal more than the application disclosed. Inquiry by defendant under the circumstances was optional. It was entitled to rely upon the insured's representations. Plaintiff may not shift the burden of truthfulness which was upon the insured

> into a burden of distrust and additional inquiry on the part of defendant.

In *Armstrong*, the plaintiff owned a life insurance policy issued by the defendant insurer on the life of a man who owed the plaintiff money. After the insured died the plaintiff made a claim to the insurer. The insurer denied the claim on the basis that the insured had made material misrepresentations in the policy application. The plaintiff argued that there were warnings which should have put the insurer on notice that certain answers were not correct and that had the insurer made inquiries the true facts would have come to light. The Supreme Court held that the insurance policy was void as a result of the insured's failure to disclose the existence of other insurance policies on his life and rejected the plaintiff's argument that the insurer had a duty to investigate. The Court of Appeal affirmed the Supreme Court's decision.

In *Lafarge*, the insured attempted to prevent the insurer from avoiding the policy on the basis of its material misrepresentation by arguing that the insurer had a duty to make further inquiries because the description of the insured's business was "open-ended" and "imprecise" and that the insured had given conflicting descriptions of its business. In these circumstances, the insured argued that a prudent underwriter would have conducted further inquiries and investigations. The Court stated that an insured will have a duty to make further inquiries into the nature of the risk "if the facts disclosed by the insured are such as would alert a reasonably prudent insurer of the need to do so."[4] The Court rejected the insured's arguments and found that even though the insured had submitted two slightly varying descriptions of its business this did not place an obligation on the insurer to make further inquiries. As well, the insurer was entitled to accept the insured's statement that it did not undertake welding, the effect of which was to prevent the insurer from having to make inquiries.

The case law indicates that the circumstances in which an insurer has an obligation to make inquiries are limited, as it is against public policy to allow an insured to benefit from his or her failure to tell the truth simply because the insurer did not detect the insured's dishonesty. Generally, an insurer is permitted to accept representations made by an insured on an application form without the need to investigate them. As insurer will usually only have a duty to inquire where it is unfamiliar with the risk it intends to insure or the information received by the insured is tantamount to notice of the need to make further inquiries. However, a case decided by the Supreme Court of Canada suggests that, in certain circumstances, an insurer may have a duty to carry out an investigation into the truth of the representations made by the insured in applying for the policy.

In *Coronation Insurance Co. v. Taku Air Transport Ltd.*, [1991] 3 S.C.R. 622, the insurer sought to avoid an aviation insurance policy on the basis of the insured's misrepresentations. The insured declared that it had been involved in only one accident, rather than three and misrepresented that its plane had four passenger seats, as opposed to five. The majority of the Court, per Cory J., found that the insurer was entitled to rely on the insured's representation as to the number of passenger seats and held the policy was void *ab initio* as a result. However, with respect to the insured's misrepresentation of its accident record, Cory J. found that the insurer could not avoid the policy on that ground. Cory J. reasoned that the doctrine of utmost good faith was not applicable in the highly regulated field of aviation insurance where insurance for passengers is a condition of licensing air carriers (at 639-40)

> I would think that where the policy of insurance required by statute or regulation is primarily for the benefit of members of the flying public and not just the insured the insurer must take some basic steps to investigate the flying record of the air carrier applying for insurance. At a minimum, it should review its own files on the application.

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4 In making this statement, the Court relied upon statements made by the Manitoba Court of Appeal in *Ipapo Estate v. Citadel Life Insurance Co.* (1989), 37 C.C.L.I. 259 (Man. C.A.). The Court in *Silva* questioned the authority of the Manitoba Court of Appeal's statements given that they are *obiter* and made without any reference to authority.

> Further the insurer should make a search of the public record of accidents of the air carrier.
>
> Surely the imposition of these modest requirements on the insurer is not placing too great a burden on an insurer entering the field of aviation insurance in which the passengers will be the beneficiaries. In this case the insurers had within their own grasp information which would have provided a more accurate assessment of the risk entailed by the policy. At a minimum, the insurers should have scrutinized their own records before issuing the policy. They did not meet the standards required of an insurer operating in this field. Having failed in the exercise of due diligence, the insurers cannot escape liability to the passengers on the policy because the insured also failed in its duty.

Despite formulating what appears to be a significant exception to the doctrine of utmost good faith, the majority decision in *Coronation* has not been widely applied by the courts, but rather confined to its particular facts.

1. Consequences of Insurer's Failure to Inquire or Investigate

If the insurer failed to make further inquiries that it should have made, it may be precluded from relying upon the insured's failure to make adequate disclosure to avoid the policy.

In *Schoff v. Royal Insurance Co. of Canada*, [2003] 2 W.W.R. 502 (Alta. Q.B.), the Court found that the insured made material misrepresentations with respect to her automobile insurance policy. However, the Court found that the insurer had information which indicated the insured was not truthful in her application which was "tantamount to notice." Had the insurer taken steps to investigate once the applicant was shown to be disingenuous, it would have discovered the insured's misrepresentations. As such, the Court precluded the insurer from taking advantage of the insured's misrepresentation so as to avoid the policy.

III. Effect of Material Misrepresentation or Non-Disclosure

Upon learning that the insured made a material misrepresentation or non-disclosure prior to the issuance of the insurance policy, the insurer may exercise one of the following options:

(1) it may retain the premium and treat the contract as valid and subsisting;

(2) it may treat the contract as void ab initio and return the premium (rescission of the contract). If the insurer chooses this option, the insurance company must declare it; or

(3) it may treat the policy as valid but cancel the contract unilaterally in accordance with the statutory conditions for unilateral termination.

Cases articulating this principle include:

(1) *1126389 Ontario Ltd. (c.o.b. Drew Auto Centre) v. Dalton* (2000), 20 C.C.L.I. (3d) 68 (Sup. Ct. Jus.)

(2) *Hasra v. York Fire and Casualty Insurance Co.* (1982), 138 D.L.R. (3d) 293 (Ont. Co. Ct.)

These options are mutually inconsistent.

A. Void/Voidable – Rescission/Repudiation

There is a difference between rescinding a contract as void *ab initio* and cancelling it. When a contract is rescinded, the position is taken that there is no contract. Where a contract is cancelled, the existence of the contract is acknowledged but a power of cancellation is exercised. A voidable contract is valid until it is avoided. Once it is voided, it is deemed void *ab initio*.

The Supreme Court of Canada clarified the difference between rescission and repudiation of an insurance contract in *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423 at paras. 39-40:

> A fundamental confusion seems to exist over the meaning of the terms 'rescission' and 'repudiation.' This confusion is not a new one, as it has plagued common law jurisdictions for years. Rescission is a remedy available to the representee, *inter alia*, when the other party has made a false or misleading representation. A useful definition of rescission comes from Lord Atkinson in *Abram Steamship Co. v. Westville Shipping Co.*, [1923] A.C. 773 (H.L.), at p. 781:
>
> > Where one party to a contract expresses by word or act in an unequivocal manner that by reason of fraud or essential error of a material kind inducing him to enter into the contract he has resolved to rescind it, and refuses to be bound by it, the expression of his election, if justified by the facts, terminates the contract, puts the parties in status quo ante and restores things, as between them, to the position in which they stood before the contract was entered into
>
> ...
>
> Repudiation, by contrast, occurs 'by words or conduct evincing an intention not to be bound by the contract.' ... Contrary to rescission, which allows the rescinding party to treat the contract as if it were void ab initio, the effect of a repudiation depends on the election made by the non-repudiating party. If that party treats the contract as still being in full force and effect, the contract 'remains in being for the future on both sides. Each (party) has a right to sue for damages for past or future breaches' ... If, however, the non-repudiating party accepts the repudiation, the contract is terminated, and the parties are discharged from future obligations. Rights and obligations that have already matured are not extinguished. ...

B. Affirmation of the Contract

After discovery of the insured's non-disclosure or material misrepresentation, the insurer may elect to affirm the contract by retaining the premium and treating the contract as valid and subsisting. If the insurer elects this option, the insurer is precluded from denying a duty to defend or indemnify the insured on the basis of the insured's non-disclosure or material misrepresentation.[5]

C. Rescission of the Contract

The Supreme Court of Canada in *Guarantee Co. of North America* stated the following with respect to the effect of a material misrepresentation (at para. 47):

> In summary, a misrepresentation, even one that was incorporated into the contract, gives the innocent party the option of rescinding the contract, i.e., to have it declared void ab initio. The misrepresentation must be 'material,' 'substantial' or 'g[o] to the root of' the contract. ... In this case, because both parties agreed to the word 'rescission,' and Guarantee acted in accordance with that intention, the consequence of a valid rescission based on Gordon's misrepresentation is the avoidance of the contract, and Guarantee's release from any liability thereunder.

Where an insured is guilty of non-disclosure or misrepresentation an insurer may be most inclined to elect to rescind the contract and to treat it as void *ab initio*, as this absolves the insurer from all responsibility with respect to the policy.

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5 However, the insurer may obviously make the argument that it does not have a duty to defend or indemnify because the claim does not fall within the scope of the policy or is excluded by the policy.

In *Neepawa Yacht Ltd. v. Laurentian P & C Insurance Co.*, [1994] B.C.J. No. 3042, the insurer succeeded in avoiding a marine insurance policy due to the insured's misrepresentation of past losses resulting from theft. The Court explained the effect of non-disclosure on the policy as follows (at para. 14):

> In this case, either through inattention or lack of candour on the part of the agent, the defendant insurer did not obtain the true picture in the winter of 1990. ... this non-disclosure taints that initial policy of insurance and the succeeding renewal contracts. I find on the evidence that there was clear materiality as regards the previous losses going back to 1985 and that the failure to disclose the two additional incidents leads to the result that the defendant is properly entitled to avoid the claim advanced for the fire loss of February 1993. I believe this conclusion here to be consistent with two earlier judgments of this Court that were cited to me in argument, being *Laurentian Pacific Insurance Co. v. Halama* (1991), 7 C.C.L.I. (2d) 84 and *Wornall v. BCAA Insurance Co.* (1988), 35 C.C.L.I. 269.

See also *Lafarge*; *Perreira v. Family Insurance Corporation*, 2001 BCSC 1236; and *Vanderhoek v. Seaboard Life Insurance Company* (1998), 50 C.C.L.I. (2d) 54 (S.C.)[6] for examples of where the insurer successfully avoided the policy on the basis of the insured's non-disclosure or misrepresentation.

1. Return of Premiums

If the insurer opts to void or rescind the policy, the insured should be notified in writing of that decision and a full refund of the premium for the remainder of the policy should be made (*Tansey Estate v. Mutual Life Assurance Co. of Canada* (1999), 15 C.C.L.I. (3d) 139 (B.C.S.C.); *Lachman Estate v. Norwich Union Life Insurance Co. (Canada)* (1998), 40 O.R. (3d) 393 (Gen. Div.)). The letter should specify the grounds for the rescission and set out the statutory and/or policy provisions relied upon. The rationale behind the return of the premiums is that if the insurer was never obliged to indemnity the insured, it did not earn the premium.

(a) Return of Premiums Not Required

Where an insurer successfully avoids a contract on the basis of fraudulent misrepresentation,[7] public policy may require that the insured forfeit the premium paid to the insurer. In *Moscarelli v. Aetna Life Insurance Company of Canada* (1995), 24 O.R. (3d) 383 (Gen. Div.), the Court rejected an insured's claim for the return of premiums where the insurer avoided the policy on the basis of fraudulent misrepresentation.

Similarly, in *Ipapo v. Citadel Life Insurance Co.* (1988), 54 Man. R. (2d) 220 (Q.B.),[8] the Court held that an insurer is not obliged to return premiums paid on a voided policy when an applicant commits fraud.

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6 In this case, the Court held that the insured's misrepresentation was fraudulent.

7 A material fraudulent misrepresentation or omission provides the insurer with the right to rescind or void the policy. A discussion of fraud is beyond the scope of this paper, however, the leading case which articulates the test for fraud is *Derry v. Peek* (1889), 14 App. Case 337 (H.L.) which is referred to by the Court in *Kruska Manufacturers Life Insurance Co.* (1984), 54 B.C.L.R. 342 (S.C.).

8 Affirmed (1989), 37 C.C.L.I. 259 (Man. C.A.).

2. Loss of the Right to Rescind

In certain circumstances an insurer may be found to have waived its right to avoid the policy or be estopped from avoiding the policy.[9] Where an insurer, with full knowledge of the insured's non-disclosure of misrepresentation, continued to accept premiums, the insurer may be held to have waived reliance upon the non-disclosure or misrepresentation and treated the contract as valid and subsisting.

In *Gill v. Zurich Insurance Co.* (1999), 16 C.C.L.I. (3d) 147 (Ont. Sup. Ct. Jus.),[10] the Court found that the insurer's continued acceptance of premiums from the insured after learning of his misrepresentation indicated that the insurer had elected to treat the contract as valid and subsisting.

In *Vanderhoek*, the insurer successfully avoided a life insurance policy on the basis of the insured's fraudulent misrepresentation. The beneficiary of the policy commenced an action for policy benefits and argued that the insurer was estopped from voiding the policy on the basis that the insurer continued to accept premiums from the insured. The Court rejected the plaintiff's argument on the ground that estoppel had not been pleaded and, alternatively, even if estoppel had been pleaded the plaintiff suffered no detriment. The Court stated (at para. 22):

> Evidence provided ... establishes ... the life of Sandi Vanderhoek ... was simply not insurable. No reasonable and prudent life insurance company with knowledge of her history would have insured her life. Even with the plaintiff's stated intention of maintaining insurance coverage on her life is genuine, he could not have obtained such coverage. Therefore, the estoppel argument cannot succeed.

Also see *Blue Seal Paving Stone Inc. v. Western Union Insurance Canada Ltd.*, [2000] A.J. No. 987 (Prov. Ct.).

D. Delay

As noted, where an insurer elects to rescind a contract, it must return the premiums to the insured. An insurer may be prevented from electing to treat a policy as void where it delays in refunding the premiums, as such delay may be perceived as an affirmation of the contract.

E. Cancellation of the Contract

The statutory conditions contained within ss. 89 and 126 of the Act provide the insurer and the insured with the ability to cancel a policy of life insurance and fire insurance without any reason and specify the procedure to be followed to cancel the policy. By choosing to cancel the policy, the insurer loses its right to rescind the policy for non-disclosure or misrepresentation.

F. Statutory Considerations

The common law remedies for non-disclosure and misrepresentation have been codified within the Act. The ease with which an insurer is able to void a policy for misrepresentation depends upon the type of policy at issue, the governing sections of the Act and, perhaps, the cause of the loss.

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9 A review of estoppel and waiver are beyond the scope of this paper. Estoppel and waiver are equitable doctrines which may apply to prevent the insurer from electing to rescind the policy. Estoppel occurs when the insurer has, expressly or impliedly, made a representation of fact which has been relied on by the insured to his detriment. Waiver does not require the insured prove prejudice.

10 Affirmed (2002), 35 C.C.L.I. (3d) 329 (Ont. C.A.).

1. Life Insurance

To void a life insurance policy, the insurer needs to prove material misrepresentation pursuant to s. 41(2) of the Act:

> (2) Subject to s. 42, a failure to disclose, or a misrepresentation of, such a fact renders the contract voidable by the insurer.

Section 41(2) provides the insurer with a statutory right, it if chooses to exercise it, to rescind a contract of insurance on the basis of a material, albeit innocent misrepresentation by the insured in the original application for insurance.

However, an insurer's ability to declare a life insurance policy void is subject to s. 42 of the Act, which is known as an "incontestability" provision:

> (1) This section does not apply to a misstatement of age or to disability insurance.
>
> (2) Subject to subsection (3), if a contract has been in effect for 2 years during the lifetime of the person whose life is insured, a failure to disclose, or a misrepresentation of, a fact required to be disclosed by section 41 does not, in the absence of fraud, render the contract voidable.
>
> ...

At common law there was no time limit within which an insurer had to exercise its right to rescind a policy upon discovering that the insured misrepresented or failed to disclose a material fact in the application for insurance (*Ipapo Estate v. Citadel Insurance Co.* (1988), 37 C.C.L.I. 243 (Man. C.A.)).

The incontestability provision contained within s. 42 of the Act modifies the common law. Section 41 of the Act binds the insured to the duty of utmost good faith until the incontestability clause takes effect. After that time the insurer will no longer be able to void the policy on the basis of negligent or innocent material misrepresentations or non-disclosures; only actual fraud will suffice to avoid the policy (*Maryn v. Unum Life Insurance Co. of America* (1999), 9 C.C.L.I. (3d) 1 (B.C.S.C.)).

The policy itself may contain an "incontestability" provision limiting the insurer's statutory right to void the policy. The B.C. Court of Appeal in *Bogh v. National Life Assurance Co. of Canada* (1990), 43 C.C.L.I. 262 (B.C.C.A.) confirmed this is an acceptable practice and does not result in a conflict between the Act and the policy.

2. Accident and Sickness Insurance

The Act contains a similar statutory remedy for non-disclosure and misrepresentation with respect to accident and sickness insurance. Section 97(2) provides:

> (2) Subject to sections 98 and 101, a failure to disclose, or a misrepresentation of, such a fact renders a contract voidable by the insurer.

Like life insurance, an insurer's ability to declare an accident and sickness policy void is subject to an "incontestability" provision contained within s. 98 of the Act:

> (1) Subject to section 101 and except as provided in subsection (2),
>
> (a) if a contract, including renewals of it, except a contract of group insurance, has been in effect continuously for 2 years with respect to a person insured, a failure to disclose or a misrepresentation of a fact with respect to that person required by section 97 to be disclosed does not, except in the case of fraud, render the contract voidable, and
>
> ...

3. Fire Insurance

Fire insurance is governed by Part 5 of the Act, which, pursuant to s. 126 of the Act, incorporates the following statutory condition into all fire insurance policies:

> Misrepresentation
>
> (1) If any person applying for insurance falsely describes the property to the prejudice of the insurer, or misrepresents or fraudulently admits to communicate any circumstance which is material to be made known to the insurer in order to enable it to judge of the risk to be undertaken, the contract is void as to any property in relation to which the misrepresentation or omission is material.

4. Multi-Peril Insurance

The B.C. Court of Appeal confirmed in *KP Pacific Holdings Ltd. v. Guardian Insurance* (2001), 92 B.C.L.R. (3d) 26 (C.A.)[11] and *Churchland v. Gore Mutual Insurance Company* (2001), 92 B.C.L.R. (3d) 1 (C.A.)[12] that Part 5 of the Act applies to multi-peril insurance policies where the loss was caused by fire.

The B.C. Supreme Court in *Lohse v. Sovereign General Insurance Co.* (2002), 38 C.C.L.I. (3d) 16 (S.C.) applied the Court of Appeal decisions in *KP Pacific Holdings* and *Churchland* stating (at paras. 42-44):

> The relationship between Part 2 and Part 5 of the *Insurance Act* in regards to multi-peril policies was the subject of two recent decisions in the Court of Appeal ... *KP Pacific Holdings Ltd. v. Guardian Insurance Company of Canada et al.* ...
>
> The court had to determine whether or not Part 2 or Part 5 applied to the subject policies. The majority of the court held that in order to determine whether Part 2 or Part 5 applies it is necessary to look to the nature of the loss which has occurred. Part 5 was held to govern in KP Pacific Holdings Ltd. where the loss was caused by fire, while Part 2 governed in Churchland where the loss was by theft. ...
>
> In the result, the standard to be applied in determining whether or not an insurance policy is void for misrepresentation will depend on the type of loss that is ultimately suffered. ... I find that the misrepresentation issue must be determined by reference to Statutory Condition 1 as opposed to s. 13 of the *Insurance Act*.

In *Lohse*, the insurer sought to void the multi-peril policy on the basis of alleged misrepresentations and non-disclosures by the insureds. The insureds were claiming for a loss caused by fire. The Court found that Part 5 of the Act applied to the policy and that the insurer satisfied the statutory requirements to avoid the policy.

IV. Materiality

Not every misrepresentation by an insured will allow an insurer to elect to avoid the insurance policy. An inaccuracy in an answer on an application for insurance will only permit the insurer to avoid the policy where the information concealed or misrepresented is material to the risk and the insurer would have required a higher premium or declined the risk had the true state of facts been known before the insurance contract was concluded.

Cases articulating this principle include:

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11 Appeal to Supreme Court of Canada heard and reserved February 18, 2003.

12 Appeal to Supreme Court of Canada heard and reserved February 18, 2003.

(1) *Mutual Life Insurance Company of New York v. Ontario Metal Products Company, Limited*, [1925] A.C. 344 at 351-52 (P.C.);

(2) *548810 B.C. Inc. v. Toronto Dominion Life Insurance Company et al.* (2000), 91 B.C.L.R. (3d) 328 at para. 45 (S.C.);

(3) *Kruska Manufacturers Life Insurance Co.* (1984), 54 B.C.L.R. 343 at 350 (C.A.);

(4) *Fidelity & Casualty Co. of New York v. General Structures Inc.*, [1977] 2 S.C.R. 1098.

The requirement that the insured make a material misrepresentation or non-disclosure before the insurer can elect to avoid the contract has been specifically codified by s. 13(1) of the Act, which provides:

> (1) A contract is not rendered void or voidable by reason of any misrepresentation, or any failure to disclose on the part of the insured in the application or proposal for the insurance or otherwise, unless the misrepresentation or failure to disclose is material to the contract.

A. Determining Materiality

Section 13(2) of the Act states that "[t]he question of materiality is one of fact." The B.C. Court of Appeal in *Kehoe v. British Columbia Insurance Co.* (1993), 79 B.C.L.R. (2d) 241 at para. 7 (C.A.) accepted the following test for a material misrepresentation:

> The question of materiality is a question of fact for the court.
>
> The burden of proof of materiality is on the insurer. It is a question of fact in each case whether, if the matters misrepresented had been truly disclosed, they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline a risk or to have stipulated for a higher premium.

The B.C. Court of Appeal in *Kruska* confirmed that the test for materiality is an objective one (at 350):

> ... The test is objective in the sense that it refers to any prudent insurer in the normal practice of that sort of insurance business. The opinion or belief of the insured as to materiality is irrelevant. The reason for this is that if it were otherwise, material information could be suppressed and it would be very difficult to show that the insured thought the information to be material; whereas if the insured's belief is not relevant, it will be in his interest to disclose all information within his reach.

The relevant time for assessing materiality is the time at which the application for insurance is completed because this is the point at which the insurer assesses the risk, determines the coverage and sets the premium (*Maryn*).

1. Materiality in Fire Insurance

The Act incorporates a statutory condition into all fire insurance policies which stipulates that the contract will only be void "as to any property in relation to which the misrepresentation or omission is material" (Statutory Condition 1). The B.C. Supreme Court in *Lohse* considered whether an insured's misrepresentation with respect to a previous theft claim and property damage claim resulting from a loose horse was material to a claim under a multi-peril policy for a loss caused by fire. The Court determined that it was, stating (at para. 71):

> ... The risk to be undertaken is the totality of the risk assumed by the insurer under the provisions of the contract of insurance in question, not just the peril of fire. Questions concerning an applicant's insurance history are fundamental to an insurer in judging the risk that they are being asked to accept. A contrary interpretation would only encourage fraud and deception. In my view Statutory Condition 1 is to be interpreted and applied in the context of the policy as a whole. What is insured under the contract is not just the building and contents, but the use and occupancy of the property by these particular

> insureds. The misrepresentations in this case relate to the entire property insured. The entire policy as a result of the misrepresentations is void.

B. Proving Materiality

The onus of establishing materiality is on the insurer (*Lafarge*). The insurer must prove that in treating an insured's claim history as material to the risk of the coverage being extended, it was acting as a "reasonable or prudent" insurer. The insurer does not, however, have to demonstrate that its underwriting practices had a "reasonable basis" (*Kehoe*).

Evidence, including expert evidence, can be adduced by an insurer to demonstrate that it was acting as a "reasonable insurer" (*Henwood v. Prudential Insurance Co. of America*, [1967] S.C.R. 720 at 726):

> ... The question that remains to be determined is whether, in treating the untrue answers as material, the respondent was acting as a reasonable insurer, and whether it has sufficiently discharged the burden of proving that its actions were those of such an insurer by calling its own officials to prove the company's practice.
>
> Like the learned trial judge, I cannot escape from the fact that there is no evidence to suggest that any reasonable insurance company would have taken a different attitude, and I am also impressed by the fact that Dr. Roadhouse spoke as a medical doctor who had had 11 12 years' experience in the specialized field of underwriting in his capacity as medical director of the respondent company.
>
> Although the evidence of expert witnesses as to whether or not other insurance companies consider a question to be 'material,' is admissible and may be relevant in such a case as this, I do not think that when no evidence whatever has been adduced to suggest that the respondent's practice is anything but reasonable, it is seized with the burden of proving the practice of other insurers.

See also *Sayle v. Jevco Insurance Co. Ltd.* (1984), 58 B.C.L.R. 122 (S.C.) at 126-27[13]; *Lohse & Neepawa*.

Materiality is to be determined by reference to the insurance industry as a whole (*Lazarakis v. Saskatchewan Mutual Insurance Co.* (1996), 36 C.C.L.I. (2d) 232 (B.C.S.C.).

V. Impact on Defence Obligation

A detailed examination of the insurer's duty to defend lawsuits brought against its insureds is beyond the scope of this paper. However, the duty to defend is relevant to the issue of non-disclosure and misrepresentation insofar as an insurer may decline to defend the insured's claim on the basis that the policy is void *ab initio* as a result of the insured's concealment or misrepresentation of material information. The question of whether there has been a material misrepresentation or non-disclosure so as to render the policy void *ab initio* differs from the usual duty to defend case in that there is an issue as to whether the duty to defend arises where the claim may fall within the scope of coverage but the insurer is challenging the very validity of the policy.

The case law is divided as to whether the insurer has a duty to defend when the insurer has placed at issue the essential validity of the policy.

One line of authority articulates that the issue as to the insurer's obligation to defend or indemnify must be resolved by judgment before the insurer can be compelled to defend or indemnify the insured in the underlying action. Cases following this line of authority include:

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13 Affirmed (1985), 16 C.C.L.I. 309 (B.C.C.A.).

(1) *Continental Insurance Co. v. M.T.C. Electronic Technologies Co.* (1995), 32 C.C.L.I (2d) 102 (B.C.S.C.);

(2) *Agassiz Enterprises (1980), Ltd. v. General Accident Assurance Co. of Canada Ltd.* (1988), 49 D.L.R. (4th) 415 (Man. C.A.);

(3) *Royal & Sun Alliance Insurance Co. of Canada v. Fiberglas Canada Inc.* (1999), 12 C.C.L.I. (3d) 282 (Ont. Ct. Jus. Gen. Div.);

(4) *Comeau v. Roy* (1999), 178 D.L.R. (4th) 115 (N.B.C.A.).

Agassiz Enterprises and *Royal & Sun Alliance* concerned allegations of a breach of a policy condition, rather than an allegation of material misrepresentation or non-disclosure. However, as both situations provide grounds upon which the insurer can forfeit coverage, there is no valid basis for drawing a distinction between them insofar as the duty to defend is concerned.[14]

Another line of authority asserts that the allegation by the insurer of material misrepresentation or non-disclosure does not extinguish or suspend the insurer's duty to defend the insured in the underlying action pending the determination of the validity of the policy. Cases articulating this line of authority include:

(1) *Slough Estates Canada Ltd. v. Federal Pioneer Limited* (1994), 20 O.R. (3d) 429 (Gen. Div.);

(2) *SCS Western Corp. v. Dominion of Canada General Insurance Co.*, [1998] 7 W.W.R. 570 (Alta. Q.B.);

(3) *Canadian Linen Supply Co. v. Canadian Indemnity Co.* (1987), 27 C.C.L.I. 248 (Alta. Q.B.);

(4) *Dominion of Canada General Insurance Co. v. MacCulloch* (1991), 2 C.C.L.I. (2d) 267 (N.S.C.A.).

A. The Duty to Defend

The insurer's duty to defend is triggered by allegations made in the statement of claim that, if proven, may possibly fall within the scope of coverage provided by the policy. A duty to defend will arise where the plaintiff advances a claim that could potentially fall within the policy coverage for the purpose of indemnification. However, it is not necessary to prove that the obligation to indemnify will in fact arise in order to trigger the duty to defend. The "mere possibility" that a claim within the policy may succeed suffices.

Although the duty to defend is broader than the duty to indemnify, the insurer is not obliged to defend where the policy contains an exclusion that pertains to the acts that give rise to the claims against the insured. Where it is clear from the pleadings that the suit falls outside the coverage of the policy by reason of an exclusion clause, the duty to defend has been held not to arise.

Cases cited in support of these principles are:

(1) *Non-Marine Underwriters v. Scalera*, [2000] 1 S.C.R. 551;

(2) *Bacon v. McBride* (1984), 6 D.L.R. (4th) 96 (B.C.S.C.);

(3) *Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801;

(4) *Opron Maritimes Construction Ltd. v. Canadian Indemnity Co.* (1986), 19 C.C.L.I 168 (N.B.C.A.).

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14 G. Hilliker, *Liability Insurance Law in Canada*, 3rd ed. (Toronto: Butterworths, 2001) at 97.

B. No Duty to Defend where Insurer Alleging Material Misrepresentation or Non-Disclosure

The B.C. Supreme Court in *Continental Insurance Co. v. M.T.C. Electronic Technologies Co.* considered whether an insurer was required to provide a defence to insureds under a directors and officers liability policy where the insurer alleged the insureds made material misrepresentations as to the company's true financial position at the time the insurance policy application was made. The insurer had initially agreed to defend the New York class action lawsuit brought against the insureds, however, the insurer repudiated the insurance policy after the corporate insured issued a press release in which it admitted that its financial statements were false. The insurer commenced an action claiming rescission of the policy of insurance alleging that the policy was obtained on the basis of misrepresentation. The insureds brought an application for a mandatory injunction to compel the insurer to defend a New York action. The Court determined that the insurer did not have a duty to defend the insureds pending a determination of the validity of the policy, stating (at 110-11):

> In light of the foregoing, I am of the opinion that the weight of authority (despite *Slough Estates Canada Ltd. v. Federal Pioneer Limited, supra*) leads to the conclusion that where an insurer has placed at issue, in proceedings commenced for that purpose, the essential validity of the policy, the issue as to the obligation to defend or indemnify must be resolved within the action by judgment before the insurer can be compelled to either defend or indemnify with reference to separate proceedings.

The Court in *Continental Insurance Co.* relied upon *Agassiz Enterprises (1980), Ltd. v General Accident Assurance Co. of Canada Ltd.*, a decision of the Manitoba Court of Appeal which concerned allegations of a policy breach as opposed to claims of misrepresentation and non-disclosure. In this case, the insured failed to report an incident to its insurer in accordance with the terms of its liability insurance policy, giving notice of the incident only after an action was commenced several years later. The insurer declined to defend the insured on the basis of the policy breach. The insured sought a declaration that the policy required the insurer to defend the action. The Court rejected the insured's request for a declaration on the basis that the facts concerning the alleged breach of condition could not be resolved on affidavit evidence. The Court held that the insurer was not obliged to defend the insured in the underlying action until the issue of the insured's alleged policy breach had been determined at trial.

In *Royal & Sun Alliance*, the Ontario Court of Justice reviewed much of the case law on the subject and determined that where there is an alleged breach of a policy condition the insurer should not be compelled to defend the underlying action. The Court reached this decision despite recognition of the hardship it could cause an insured (at para. 33):

> ... the duty to defend is suspended when an allegation of breach of condition is made. While there is no suggestion in the instant case that the application of such a principle will result in hardship, I am mindful that it is not beyond the realm of the possible that allegations of breach of condition might be made capriciously, leading to mischievous results. In the absence, however, of statutory direction that liability insurers are obligated to provide defence regardless of breach of condition, I apply general contract principles in arriving at the conclusion that no order should be made requiring Halifax or Commonwealth to fund defence costs at this stage of the proceeding.

In *Comeau*, the New Brunswick Court of Appeal reversed a lower Court decision which held that an insurer had a duty to defend an insured where the insurer claimed the policy of insurance was void ab initio as a result of the insured's material misrepresentations. The Court of Appeal held that given the lower Court's findings there was no possibility that the insured's claim for indemnity would succeed against the insurer as a result of her material misrepresentations, it followed that the insurer was relieved of its duty to indemnify the insured under the terms of the policy and accordingly, relieved of its duty to defend.

The case of *East Kootenay Realty Ltd. v. Gestas Inc.* (1986), 12 C.P.C. (2d) 95 (B.C.S.C.) is somewhat different from the above noted cases in that the Court was able to determine the insurer's duty to defend

on a summary basis, thus avoiding the necessity to decide whether the insurer had a duty to defend the underlying action pending a separate trial to determine the validity of the policy. However, the Court stated that had it not been able to resolve the matter summarily, the insurer would have been released from the duty to defend.

C. Duty to Defend where Insurer Alleging Material Misrepresentation or Non-Disclosure

The B.C. Supreme Court in *Continental Insurance Co.* declined to follow *Slough Estates Canada Ltd. v. Federal Pioneer Limited*, a decision of the Ontario General Division Court. In *Slough Estates* the insurer refused to defend an action brought against its insured on the basis that the allegations, if proven, would fall outside the policy and that, in any event, the policy was void for material non-disclosure. As the allegations against the insured did raise a claim potentially falling within the scope of coverage the Court ordered the insurer to defend the insured, despite the insurer's claim that the policy was void as a result of material non-disclosure. The Court stated (at 443):

> ... The argument on behalf of S & Y. and Ancon is that if they are successful ... in establishing that the policy was void because of material non-disclosure, the obligations should be the same as if the policy never existed and accordingly the pleading of material non-disclosure (they argue) distinguishes this case from all of the cases referred to on behalf of Federal. If this argument were correct and the Federal application should be dismissed simply on the basis of the pleading of material non-disclosure, then any insurer could so plead and avoid the separate and distinct obligation to the insured to defend. That is not the law. The material non-disclosure can be part of the summary judgment motion as it is in this case or can be determined at trial as it may be if the motion for summary judgment is unsuccessful. The mere pleading of material non-disclosure should not defeat the plaintiff's right to have the insurer defend the action.

The Alberta Court of Queen's Bench in *SCS Western Corp.* followed the decision in *Slough Estates* stating that the approach taken by the Court in that decision "has much merit." The Court noted that (at paras. 38 and 45):

> ... It fulfils the insured's reasonable expectation of a defence; it avoids delaying the issue of duty to defend until after the very trial on which a defence is required, and it protects the insurer by preserving its right to assert non-coverage and material non-disclosure, assertions which could be very rarely determined in a chambers application. Without an admission of fraud, or a plea of guilty in a criminal fraud case relating to the policy, few allegations of material non-disclosure could be proven in chambers.
>
> ...
>
> This as well seems to me to be a principled approach. If the allegations in the Statement of Claim may result in damages which fall within the coverage, the duty to defend arises. Whether a policy may be void ab initio is not relevant at this stage, or at least the possibility such a finding can be protected against by a Slough order. A breach of contract by the insured can be decided in a trial for indemnification, preserving of course the insured's right to seek relief from forfeiture ...

The Alberta Court of Queen's Bench in *SCS Western Corp.* relied upon its earlier decision in *Canadian Linen Supply Co. v. Canadian Indemnity Co.*, where the insurer, relying upon an alleged breach of a policy condition, declined to defend a tort claim arising out of a motor vehicle accident. The insured applied for a declaration that the insurer had a duty to defend. The Court was unable to summarily determine whether a breach of condition had occurred and held that the insurer was required to defend the insured in the underlying action (at 249):

> ... If the insurer is entitled to refuse to defend then the only remedy for such a breach of the policy is by way of damages after the primary lawsuit is over. Such an approach would render the insurer's duty to defend meaningless and capable of being dealt with arbitrarily to the prejudice and detriment of the insured. ...

The Nova Scotia Court of Appeal in *MacCulloch v. Dominion of Canada General Insurance Co.* held that the insurer had a duty to defend the insured pursuant to a garage policy, despite allegations that the insured breached a policy condition by failing to promptly report the accident giving rise to the claim. The Court concluded that, under the policy in question, the insurer could only rely upon a breach of condition for the purpose of denying indemnity. The Court's reasoning has been criticized as being inconsistent with the policy at issue.[15]

D. A New Approach?

The Ontario Court of Appeal in *Longo v. Maciorowski* (2000), 50 O.R. (3d) 595 (C.A.)[16] declined to decide which of these competing lines of authority were correct and articulated an ad hoc approach to determining whether an insurer has a duty to defend where allegations of non-disclosure and misrepresentation are made. In this case a tort claim was brought against the insured as a result of a motor vehicle accident. The insurer declined to defend the insured, alleging that the insured had breached a number of policy and statutory conditions of the automobile policy. The insured brought a motion for an order requiring the insurer to defend the tort claim, which was dismissed by the lower Court.

The Court of Appeal dismissed the insured's appeal, noting that the authorities are divided on the question of whether an insurer's duty to defend may be suspended where it alleges a breach of condition. The Court recognized the need for flexibility (at paras. 32-34 and 36):

> ... As the division of judicial opinion makes clear, however, different fact situations raise different policy considerations that must be examined in order to determine whether, in any particular case, the insurer should be compelled to furnish, or excused from furnishing, a separate and independent defence for its insured. For that reason, I have reservations about the wisdom of establishing any hard and fast rule on the subject.
>
> Suppose, for example, that the rule would be that the insurer is never obliged to defend in any case upon the mere allegation of breach of condition. Assume, as well, an insured person who is without income and without assets. It cannot be of much comfort to that insured to be told that, while his insurer cannot be compelled to defend him and that he must provide and finance his own defence, he can-if the alleged breach of condition is not proven or if estoppel is established or relief from forfeiture is granted-sue his insurer later to recoup the costs of his defence and perhaps damages for breach of his insurer's obligation to him.
>
> Suppose, conversely, that the rule would be that the insurer is always obliged to defend, notwithstanding its allegation of breach of condition, so long as the plaintiff's claim falls within the policy coverage. Assume, again, an impecunious insured. It cannot be of much comfort to the insurer to be told that, while it is obliged to provide its insured with a defence, it can-if the alleged breach of condition is proven and if estoppel is rejected and relief from forfeiture is denied-sue its insured later to recover the costs of that defence.
>
> ...
>
> Thus, rather than establishing an immutable legal principle, I would suggest that the question should be determined upon consideration of the circumstances of each case, including the relative strength of the positions asserted by the insurer and the insured and the necessity and urgency to furnish the insured with a separate defence.

The Court rejected the idea that it was adequate if the insurer's duty to defend motion was dealt with on an expedited basis (at para. 35):

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15 G. Hilliker, *Liability Insurance Law in Canada*, *supra*, at 96.

16 Leave to appeal to the Supreme Court of Canada denied, [2000] S.C.C.A. No. 620.

> With respect, I do not place much confidence in the solution ... that the tort action should be put on hold while the breach of condition issue is decided 'on an expedited basis.' That solution may be practical where the issue admits of summary disposition: where the breach of condition is clear and the case for estoppel or relief from forfeiture unmeritorious or, conversely, where the breach of condition is technical or insubstantial and the case for estoppel or relief from forfeiture overwhelming. But in the many cases that are not clear-where the alleged breach of condition, the basis of the alleged estoppel or the grounds for relief from forfeiture are in serious dispute and require the testimony of witnesses and the resolution of conflicting evidence-there seems to me to be no justification for compelling the trial of the plaintiff's tort action to await the final disposition of the breach of condition issue.

The Court of Appeal found that in this particular case it was appropriate to hold that the insurer had no duty to defend the insured as, among other things, the insurer made allegations of clear and uncontested breaches of condition and the insured put forward no material to support a claim for estoppel or relief from forfeiture.

1. The Insurer's Obligations where Duty to Defend Denied

Once the insurer has declined to defend on the basis of the insured's non-disclosure or misrepresentation, does the insurer have any further obligations pursuant to the policy?

The New Brunswick Court of Appeal in *Comeau* was of the view that an insurer denying a duty on the basis of non-disclosure and misrepresentation to defend should seek a declaration to that effect, rather than leave it to the insured to bring a motion to resolve the issue. The Court stated (at paras. 19 and 20):

> Insurers, in my opinion, should take the initiative if they oppose any obligation or apparent obligation to defend under the terms of the policy. That is because they are the unilateral drafters of the wording, they are the insurers of the policy, and they should not delay in asserting their defences instead of forcing their insureds to take the initiative. Prompt action by the insurer is required because:
>
> 1. It quickly sets out the insurer's position vis-à-vis the insured. Each issue is identified.
> 2. The insurer has at least a moral obligation to have declared by a court the position it asserts which is contrary to the obvious undertakings in the policy.
> 3. There is an implied duty to the court to employ the best resources of the court and, therefore, not to complicate or prolong proceedings.
>
> Secondly, in this case an application ... for a declaratory order should have been brought in a timely fashion. If the insurer is able to establish misrepresentation on a material nondisclosure and the facts are undisputed then it seems to me to be in the interest of both parties and the court to have an early determination of the issue of the duty to defend. ...

VI. Summary

As stated at the outset, non-disclosure and misrepresentation can have significant effects on both the insurer and the insured. The insurer may be on for a risk it did not intend to cover or the insured may find itself without any coverage. As a result, the law imposes a duty of good faith on the insured and, in some instances, duties of due diligence on the insurer to make inquiries or conduct an investigation.