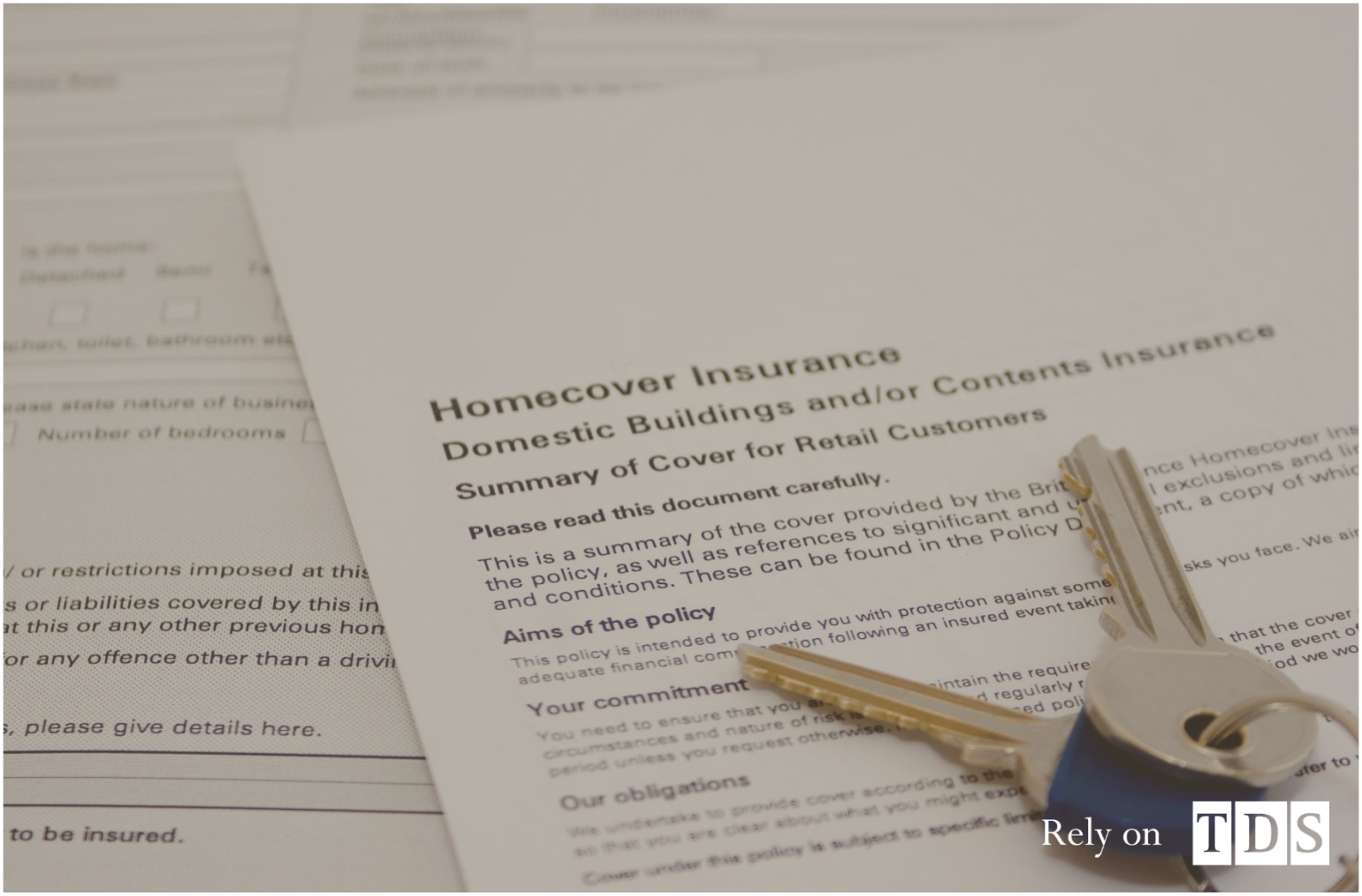

Walking the Line: Navigating Issues of Fraudulent Omission and Material Misrepresentation

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Contracts of insurance are *uberrima fides* - utmost good faith must be observed by both parties. A corollary to this principle is that, at common law, a person applying for insurance must disclose all matters within his or her personal knowledge which are relevant in determining the nature and extent of the risk to be underwritten. It was irrelevant, at common law, whether a failure to disclose was deliberate or inadvertent. Furthermore, at common law, insurers were entitled to contractually insist upon the accuracy of all representations made in an application for insurance, and any inaccuracy, however trivial, could entitle the insurer to deny coverage.[1] Language to this effect is sometimes still found in applications for certain types of insurance, including liability insurance.

The common law with respect to misrepresentations has been significantly modified by operation of *The Insurance Act,* C.C.S.M. c. I40 (the "*Act*") and its equivalents across Canada. Pursuant to the *Act,* the application of an insured must not be considered with the contract of insurance except insofar as it contains a "material misrepresentation by which the insurer was induced to enter into the contract".[2] The burden to prove material misrepresentation and inducement is on the insurer[3]. Materiality is deemed to be a question of fact, and no contract shall be voided by an inaccurate statement unless the statement is "material to the contract".[4]

Furthermore, pursuant to subsection 136.4(5) of the *Act,* all contracts for property insurance in Manitoba are subject to Statutory Condition 1, which reads as follows:

Misrepresentation

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

Statutory Condition 1 creates a distinction between a "misrepresentation" and an "omission". An omission will void the contract only if it is fraudulent, while for misrepresentations the insured's intent is irrelevant, so long as the threshold of materiality is met.[5] For an omission to be seen as fraudulent, "the insurer must prove that the customer knew the facts that ought to have been disclosed and knew, subjectively, that those facts were relevant to the insurance."[6]

In *V.K. Mason Construction Management Inc. v. Hanover Insurance Company*, [1988] 63 Alta. L.R. (2d) 277 (Q.B.) the Court described the key principles of fraudulent omission as follows:

> 39 In relying on a fraudulent omission by the insured, the insurer must prove that the insured deliberately withheld information knowing that it was material. The evidence here does not establish that. *Chenier v. Madill; Mercier v. Plant & Anderson Ltd.*, 2 O.R. (2d) 361, [1974] I.L.R. 1-585, 43 D.L.R. (3d) 28 (H.C.).

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[1] See Brown & Donnelly, *Insurance Law in Canada,* looseleaf, (Toronto: Carswell) Vol. 1 at pp. 5-2 and 5-3. [Brown]
[2] Subsection 117(3).
[3] Subsection 117(3.1).
[4] Subsections 117(4) and 117(5).
[5] Brown, *supra,* note 1 at p. 5-10.
[6] *Ibid.*

> 40 The phrase "fraudulently omits", in statutory condition 1, connotes actual fraud, and as such must be specifically pleaded by the insurer: *Taylor v. London Assur. Corp.*, [1935] S.C.R. 422, 2 I.L.R. 252, [1935] 3 D.L.R. 129 at 130 [Ont.].
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> 41 Actual fraud involves both dishonesty and an intent to deceive the insurer.[7]

Therefore, an insurer faces a significantly higher bar if they seek to void a contract for an *omission* as compared to a *misrepresentation*. As such, the distinction is often extremely important.

However, the line between a misrepresentation and an omission is extremely difficult to draw, and is the subject of surprisingly little comment in the case law.

As noted by Brown & Donnelly in *Insurance Law in Canada,* "in some cases it may be difficult to decide if the customer's default amounts to a misrepresentation or a failure to disclose. Is an incomplete statement a misrepresentation or an omission of the missing bit?"[8] Brown & Donnelly considered as helpful the dissenting reasons of Macdonnell J.A. in *Taylor v. London Assurance Corp.* [1934] 2 D.L.R. 657 (Ont. C.A.)[9], which contained an early consideration of Statutory Condition 1.

In that case, Macdonnell J.A. stated:

> 96 Apart altogether from the way in which it is used in the Statutory Condition, misrepresentation seems always to connote some positive error in thought, intimation or act. This follows from the use of the prefix 'mis' which is not negative but positive. This is evident not only in words like misfeasance and non-feasance but throughout the whole English vocabulary. Misunderstanding is not lack of knowledge but a positive adoption of a wrong meaning. Saying that a document is misdated is quite a different thing from saying that it is undated. To mislead is not mere failure to lead but actually to lead astray.
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> 97 It is true that the positive element may be found by implication. For instance, a person who has had five accidents in each of the last five years and who, on being asked if he has ever had an accident, replies, "Yes, I had one four years ago," is by implication making the positive statement that he has not had an accident in the last three years. Half a truth may be almost equivalent to a direct falsehood. Nevertheless, the positive connotation must exist or there is no misrepresentation in the proper sense of the word.

[7] *Emphasis added.*
[8] Brown, *supra,* note 1 at p. 5-10.
[9] Reversed by [1935] S.C.R. 422 (S.C.C.)

> 98 When, further, misrepresentation is found, as in the Statutory Condition, definitely contrasted with omission, the positive nature of the former obviously is emphasized. This would seem to be the justification for the different treatment of the two in the Statutory Condition as amended in 1924. The doctrine of *uberrima fides*, which has always been applied to contracts of insurance, is still left to be applied to matters of misrepresentation but so far as matters of omission are concerned has been abrogated. This seems to be the necessary conclusion if any real meaning is to be given to the insertion of the word "fraudulently" before the word "omits." And this treatment of the matter seems reasonable. If a person undertakes to make a positive statement, he may be expected to have verified its truth and may well be held responsible for a misstatement, even an honest one. In the case of omission, however, no person can be expected to canvass all the possibilities. The Statutory Condition, therefore, provides that a contract of insurance is made void by misrepresentation, even though honest, but is not made void by an omission, unless fraudulent. [emphasis added][10]

Black's Law Dictionary defines misrepresentation, generally, as "[t]he act of making a false or misleading assertion about something, usually with the intent to deceive."[11] Conversely, "non-disclosure" is defined as "[t]he failure or refusal to reveal something that either might be or is required to be revealed."[12]

The case of *Kehoe v. British Columbia Insurance Co.,* [1993] I.L.R. 1-2996 (B.C.C.A.) illustrates the fine line between an omission and a misrepresentation. In that case, the insured owned a home in Vancouver in connection with which he claimed indemnity for five losses. The insured intended to move to a new address, and the insurer refused to insure him unless he agreed to a much higher deductible and to the installation of a burglar alarm. The insured decided to seek coverage elsewhere. Over the telephone, he provided information to an employee of the new insurance company. The trial judge held that the insurance company questioned him with respect to his past claims history, and the insured replied "not here" or "not at this address". The insurance company interpreted this to mean "none" and subsequently wrote that answer on the insured's application form. The insured testified at trial that he signed that application without reading it. On appeal, the court considered whether or not this was a misrepresentation. The court held that it was, and wrote:

> 43 Furthermore, counsel asserted that the question in the application was ambiguous in referring to "losses … which could have been covered by the policy", which query might be construed as either a reference to the "kind" of loss or to the "place" of the loss. If the latter version is the appropriate meaning, the applicant answered the query correctly. Accordingly, he submits the *contra proferentum* rule of construction should apply and that Mr. Kehoe's interpretation of the ambiguous query be accepted.

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[10] On appeal at [1935] S.C.R. 422 (S.C.C.), the Supreme Court declined to resolve the differing opinions expressed by the Court of Appeal. In the reasons of the Court, Duff C.J. only stated at para. 11 that "If Mrs. Taylor's partial statement of the facts was calculated to mislead the person to whom it was addressed, then it might amount to a misrepresentation." With respect, this statement does not provide adequate guidance in determining the distinction between misrepresentation and omission. *Emphasis added.*

[11] *Black's Law Dictionary*, 3rd ed, *sub verbo* "misrepresentation."

[12] *Ibid sub verbo* "nondisclosure".

> 44 The difficulty which confronts counsel for Mr. Kehoe on these submissions is the finding of the trial judge that Mr. Kehoe knew his insurers regarded him as a high risk and he had adopted a "strategy" to make a literally correct answer hoping that BCIC would not check on his answer — that he had told a half-truth and misrepresented the true state of affairs.
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> …
>
> 46 In the circumstances, the defence of a literally true answer to an ambiguous question cannot prevail to assist an applicant for insurance who knowingly adopts a strategy of misrepresenting his claim history to obtain coverage on terms he knew would not have otherwise been available had he told the whole truth. Clearly, in such circumstances, he was not confused by any purported ambiguity in the application form, and the principle of *contra proferentum* does not arise.
>
> [Emphasis added]

In the case of *Lohse v. Sovereign General Insurance Co.,* 2002 BCSC 50, insureds made three claims on a policy held by a previous insurer - one fire, one theft, and one property damage. The previous insurer refused to renew coverage. On an application to a new insurer, the insureds disclosed only the one previous fire claim. In that case, the court held that the insureds had committed a misrepresentation and that they "deliberately choose [sic] to provide incomplete and misleading information to Mr. Vezina, in the expectation that it would reduce their insurance premiums".[13] In the result, the policy was voided.

In the case of *Evans v. State Farm Fire & Casualty Co.* (1993), 19 C.C.L.I. (2d) 76 (Ont. C.J. Gen. Div.) the court considered a case where an insured's application answered "yes" to the question "does owner occupy building" and the application indicated there were no roomers or boarders. There was some mention of the possibility of renting the premises in a conversation between the insured and the insurer. The insureds subsequently entered into rental agreements with tenants, and the application form for insurance was signed thereafter. The house was destroyed by fire while it was occupied by tenants as a result of a deficient fireplace. The court found that at the time the application was completed it was correct and there was no misrepresentation. However, the court found that there was an omission in that the insured did not advise the insurer of two rental agreements which had been entered into. The court held that this omission was not fraudulent, and so the policy was upheld as valid.

As can be seen from these decisions, the case law does not provide any clear test to differentiate between a misrepresentation and an omission.

In the writer's view, the *dicta* of Macdonnell J.A. in *Taylor v. London Assurance Corp.* is helpful in navigating this difficult question. A misrepresentation connotes some positive statement that would tend to mislead the insurer. It makes some intuitive sense that a person who undertakes to make a positive statement bears some responsibility even for an honest inaccuracy, whereas a person who simply remains silent is entitled to a higher measure of protection.

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[13] Para. 58.

In cases involving inaccurate applications for insurance, insurers would be well-advised to consider the classification of the error as a misrepresentation or an omission early on in the adjustment process, in order to have a reasoned and defensible position going forward.

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