LAVERY, DE BILLY
BARRISTERS AND SOLICITORS

1 Place Ville Marie
Suite 4000
Montréal (Québec)
H3B 4M4
Tel. : (514) 871-1522
Fax : (514) 871-8977

925 Chemin St-Louis
Suite 500
Québec (Québec)
G1S 1C1
Tel. : 1-800-463-4002
Tel. : (418) 688-5000
Fax : (418) 688-3458

45 O'Connor Street
20th Floor
World Exchange Plaza
Ottawa (Ontario)
Tel. : (613) 594-4936
Fax : (613) 594-8783

Associated Firm:
Blake, Cassels & Graydon
Toronto, Ottawa, Calgary
Vancouver, Londres

WARNING: AN INSURER MUST INDICATE INCONSISTENCIES BETWEEN POLICY AND APPLICATION

The Quebec Court of Appeal has just rendered an important judgment in the case of *J.A. Martin & Fils Ltée.* v. *Hercules Auto Parts Inc.*, J.E. 96-899, dealing with an insurer's obligation to indicate in writing discrepancies between the policy and the application. The Court decided that an insurer cannot invoke an exclusion against an insured who has chosen an "all risks" policy unless that exclusion appeared in the application or was brought to the insured's attention in a separate document.

THE FACTS

Mr. Goldenberg, president of Hercules Auto Parts, seeing that the different insurance policies covering his business's operations were about to expire, contacted a broker, J.-A. Martin et Fils Ltée, that had been recommended to him. Mr. Tanguay, an employee of J.-A. Martin & Fils, studied Hercules' file and proposed an "all risks" insurance policy for its inventory and equipment with Continental Insurance Company of Canada. Goldenberg was satisfied with the broker's recommendations and agreed that Tanguay fill out the application. Goldenberg testified that he was not thinking specifically about the risks of flooding and sewer overflow, but felt protected by the fact that he had chosen an "all risks" policy.

Continental accepted the application and issued a provisional cover note providing an "all risks" coverage, but with the mention that "*The above coverages are subjected* (sic) *to the conditions of the policy issued by the insurer*." The policy, which was issued one month later, provided that certain risks, notably flooding and sewer overflow, were excluded. Tanguay confirmed that he delivered the policy to the insured, but Goldenberg testified that he had not received the separate booklet which included the list of exclusions.

As a result of the torrential downpour of July 14, 1987, the basement of Hercules' store was flooded and the damages were evaluated at $ 29,000. Continental refused to indemnify its insured, because of the relevant exclusion, and Hercules took action against both Continental and the broker.

THE JUDGMENT

Judge Beauregard, writing for the Court, recognized that the broker was the mandatary of the insured and that, as such, he knew perfectly well the limits of an "all risks" policy and had obtained for his client the type of policy he had

requested. Under the ordinary rules of contract law, the insurer would have had no obligation to inform the broker of the exclusions. It would have been the obligation of the latter to correctly inform his client.

The judge added that, however, the rules of formation of contract were modified in insurance law, notably, in the present case, by article 2478 *C.C.L.C.* which imposes on the insurer an obligation to indicate in writing the inconsistencies between the application and the policy. Since the application provides for "all risks" insurance and because the insured is not an insurance specialist, one can reasonably argue that for the lay person, "all risks" means "every kind of risk". Therefore, any exclusion constitutes an inconsistency for the purposes of article 2478 *C.C.L.C.* Judge Beauregard underlined that the policy itself cannot constitute the document which is supposed to indicate the discrepancies to the insured. It can also be understood from the judgment that the indication in the provisional cover note is insufficient to alert the insured.

The duty to inform rests on the insurer and it could not invoke the broker's knowledge of the exclusions as an excuse for failing to properly inform the insured. Judge Beauregard admits that it is somewhat paradoxical that the insured should receive coverage which he would not have enjoyed had he accepted the policy after being informed of the exclusions, but such is the effect of article 2478 *C.C.L.C.* and the insurer cannot avoid its obligations.

The insured's action against the broker was therefore dismissed because the insured is covered by the insurance policy, but without judicial costs because the broker recognized having omitted to properly explain the content of an "all risks" insurance policy to his client.

COMMENTARIES

This case follows the trend which began with *Robitaille* v. *Madill*, [1990] 1 S.C.R. 985 and *Groupe Commerce, Cie d'assurance* v. *Service d'entretien Ribo Inc.*, [1992] R.R.A. 959 (C.A.), in which the courts decided, in the first case, that a formal undertaking which was not brought to the attention of the insured, and, in the second case, that the "care, custody and control" exclusion, constituted inconsistencies, given the wording of the applications at issue. Similarly, in *Faubert* v. *L'Industrielle*, [1987] R.J.Q. 973 (C.A.), a narrow definition of the word "accident" was considered to be an inconsistency.

In addition, the Court of Appeal (with J. Beauregard sitting) had already decided in *Thibodeau* v. *Assurances Provencher-Verreault et Associés Inc.*, [1992] R.R.A. 381 (C.A.) that the broker's knowledge did not discharge the insurer from its obligation to indicate any inconsistency to the insured. In that case, there was a true inconsistency, since the insured had asked for a $ 60,000 policy, but was provided with a $ 48,000 policy instead. The insurer had not prepared a separate notice, which meant that even if the broker had known of the inconsistency and had not informed his client, the insurer would nonetheless have been found liable if it had been a party to the case (the plaintiff had discontinued his suit against the insurer). The action against the broker was therefore dismissed.

Although these decisions were rendered under the *Civil Code of Lower Canada*, they are still relevant because article 2400 *C.C.Q.* restates the same rule and specifies that inconsistencies must be indicated in a separate document, as the Supreme Court of Canada had decided in the *Robitaille* case.

Insurers must be especially careful in their evaluation of applications and must avoid any statement which might suggest that complete coverage is provided, without any exclusion or limitation. **In that respect, insurers should avoid the use of the "all risks" designation in Quebec**, even if its use is widespread in the industry. Detailed warnings should therefore be given with the policy when it is issued. Alternatively, insurers could require that brokers provide to prospective clients a copy of the policy with any application and indicate clearly in the text of the application that the insured has received a copy of the policy and has read its contents.

This judgment's key conclusion is that the insurer must act and cannot rely on the broker's knowledge of the policy. If the insurer can prove that the insured was informed of the policy's contents before filling out the application or that the indication of discrepancies had been sent to the broker, the insured will be bound by the contract as issued.

Odette Jobin-Laberge