IN FACT AND IN LAW

Damage Insurance

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New Insurer; New Contract

by Cherif Nicolas

On August 16, 2007, the Court of Appeal issued a judgment, written by Mr. Justice Paul-André Gendreau, pertaining to the absence of an initial disclosure of risk to the new insurer in the context of the transfer of an insurance portfolio by a broker.[1] *An insurer who accepts the transfer of a policy without ascertaining its current exposure to risk, is deemed to have waived his right to this information.*

The Facts

In 1990, the insureds, Cantwell and Dubé, acquired a house in Rosemere and purchased a home insurance policy with The Prudential through Mr. McLeod, a broker with the firm of William A. Esber Inc.

Between 1992 and 1994, Dubé made significant changes to the garage adjoining the house. Among other things, he installed a wood stove and transformed the premises into an automobile repair shop. He equipped the shop with an air compressor and an electric lift, located near welding torches, acetylene tanks, solvents and degraded motor oil. Although not a mechanic, Dubé serviced his vehicles, those of his family members and friends and on occasion, those of other individuals.

These changes were never disclosed to the insurance broker nor to The Prudential.

In 1997, the broker removed his insurance portfolio from The Prudential and transferred it to General Accident, which later became Aviva Canada Inc. The broker repeatedly renewed the policy without asking any questions and the insureds regularly paid their premiums without ever disclosing any changes.

On January 17, 2000, a fire started in the garage causing considerable damage to the house. Aviva, paid an hypothecary creditor the amount of $22,331.51 representing the balance owed on the respondents' loan and then denied coverage to their insureds and sued to claim this amount from them on the grounds that they had failed to disclose the aggravation in risk, which voided the policy. The insureds filed a counterclaim for an amount exceeding $300,000.

The Superior Court's Judgment

The Superior Court Judge, (Casgrain, J.) dismissed Aviva's claim and granted the insureds' counterclaim for the amount of $178,000 as indemnity under the policy. The Court acknowledged that the modifications made to the garage constituted an aggravation of the risk and that the mechanic's work carried out by the respondent was partially of a commercial nature.

However, Justice Casgrain held that the failure to disclose the circumstances which aggravated the risk could not be raised by Aviva as a ground to void the policy. He held that Aviva had waived, by its own conduct, the right to require an application from the insureds, and thereby deprived itself of the necessary information to assess the risk.

The Court of Appeal's Judgment

The Court of Appeal acknowledged the insureds' good faith but concluded that it was undeniable that the installation of the wood stove was a fact which should have been disclosed to the insurer. The Court further opined that the presence of flammable and volatile substances aggravated the risk, and should have been disclosed to either the broker or the insurer. The Court added that it would be incorrect to say that the insurer was required to make inquiries or carry out an investigation and acknowledged that according to the evidence, no residential insurer would have accepted such a risk.

[1] *Aviva Canada inc. v. René Dubé et Jamie Lee Cantwell*, 2007 QCCA 1117 (C.A.)

LAVERY, DE BILLY

BARRISTERS AND SOLICITORS

Despite the foregoing, the Court dismissed the appeal on the ground that an insurer issuing a new policy following the transfer of a portfolio is party to a new contract, which cannot be considered as merely a renewal. Mr. Justice Gendreau explained as follows:

> [Translation] **"[20] In reality, when the broker sent the insurance policy to his client on behalf of the new insurer and the insured paid the premium, an altogether new legal relationship was created and that which existed with The Prudential ceased at the expiry of the contract which it had entered into."**

Mr. Justice Gendreau went on as follows:

> [Translation] **"[22] In the case at bar, it is admitted that the contract was entered into. It follows that an agreement was made between the parties on the essential aspects, especially regarding the risk. However, the clients, respondents in the present case, were not involved in the declaration of the risk. Nobody notified them of a new contract and the broker, for his part, simply assumed that the declaration of risk included in the initial 1990 proposal for The Prudential was still valid because the respondents had not given notice of any increase in the risk. In reality, the insurer knew the importance of the role of the proposal, both from the legal and economic standpoint, but the insurance company voluntarily waived the proposal, thus deliberately depriving itself of essential information to which it was entitled."**

The evidence indicated that the insurer requested new application forms where individual insurance policies were transferred, but not when acquiring bulk insurance portfolios due to the substantial investment of time and costs needed to do so.

In sum, the Court decided that, by issuing a new policy without requiring an application form, the insurer deprived the insureds of the opportunity to submit a complete and accurate insurance proposal and that it must therefore suffer the consequences of doing so. Although the practice of the insurer in this instance can easily be understood from an economic standpoint, such practice constitutes a waiver of the right to invoke any aggravation of risk prior to the issuance of the new policy, even though it should have been disclosed to the prior insurer.

Comments

The Court clearly established that Aviva's policy cannot be considered a "renewal" of The Prudential's policy given that the parties to the contract are no longer the same. This concept could also be used under other circumstances and any new insurer must be aware that by accepting the possibility that the information contained in the file might be incorrect and choosing not to verify such information, the insurer waives the right to invoke the falseness of the information contained in the file.

It is useful to recall the decision of the Supreme Court in *Turgeon* v. *Atlas Assurances Co* [2]. In that case, the highest court sanctioned the failure to disclose an aggravation of risk because the documents accompanying the renewal of the policy indicated that the insured was restating his initial declaration and that the new policy was being issued on that basis.

A prudent insurer may be able to reduce the risk of being confronted with the argument that its policy constitutes an entirely new contract agreed to, without requiring an application form, by using a cover letter accompanying the new policy indicating that the insurance policy is issued on the basis of the initial declaration. The contents of this letter may then shift the burden of proof on the insured to demonstrate that he was not required to declare any new material facts that have arisen since the initial declaration.

[2] [1969] S.C.R. 286

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