EFFECT OF CONCEALMENT OR MISREPRESENTATION IN GUARANTEE INSURANCE

Guarantee insurance is defined as follows:

> "Guarantee insurance" means the undertaking to perform an agreement or contract or to discharge a trust, duty or obligation upon default of the person liable for such performance or discharge or to pay money upon such default or in lieu of such performance or discharge, or where there is loss or damage through such default and includes insurance against loss or liabiliay for loss due to the invalidity of the title to any property or of any instrument or to any defect in such title or instrument, but does not include credit insurance." (1)

This type of insurance is a comparatively modern innovation of insurance law. It seems to include what is known in insurance fields as "surety insurance" as well as "fidelity insurance." As the Insurance Act makes no distinction between Fidelity insurance and Surety insurance, it would appear that the same principles of law on the formation of the insurance contract would be applicable to both.

Guarantee insurance bears a close resemblence to the relationship, between a principal and a surety. One method of distinction between such an insurance contract and that of principal and surety is that an insurer does not undertake to pay the original debt but rather to pay a new debt which arises under the contract of indemnity. The essential distinction however is that the rule of uberrima fides applies to all contracts of insurance whereas the rule may or may not apply in the case of suretyship.

The leading authority on the distinction between an insurance contract and that of suretyship is Seaton v. Burnand (2) which establishes that in contracts of insurance uberrima fides is essential whereas ordinary contracts of guarantee are not amongst those requiring uberrima fides. It can readily be seen that on the formation of a contract of guarantee insurance as indeed in a case of principal and surety three persons are involved or, at least, interested, namely, the insurer and, for the want of better names, the beneficiary and the insured. It is admitted that in other types of insurance, parties other than the insured and insurer have an interest in the contract, mainly by statute, but the general rule is that such interest does not arise until the risk insured against occurs.

Claims under such a policy usually arise when the insured has violated the trust in him reposed by the beneficiary, and the latter claims the amount of the loss from the insurer. As some or all of the three parties take part in the formation of the insurance contract, the following questions may arise:

(1) **The Insurance Act of New Brunswick** 1937, Sec. 2 Sub-Sec. 24
(2) (1899) 1 Q.B. 782 at 792

1. When the insurer expressly questions the beneficiary, what is the effect on the contract of mispresentation by the latter?

2. When the insurer asks no questions of the beneficiary, what is the effect on the contract of concealment by the latter?

3. What is the effect on the contract of misrepresentation of concealment by the insured?

On the first question the authorities are quite clear. This situation could and usually does occur where the insurer has asked for certain information and the beneficiary has misrepresented certain facts to the insurance company. The general rule would appear to be that when the default occurs and there has been misrepresentation on the part of the beneficiary, the insurer can repudiate liability. In reading authorities on this subject care must be taken to ascertain whether the case is that of suretyship or a contract of insurance.

In insurance contracts of this type when an application is made to the insurer, it is the usual custom for the latter to seek from the beneficiary certain information concerning the insured. It is also usually stated that the questions asked of the beneficiary and the answers thereto form the basis of the insurance contract. If the insurer repudiates the contract on the ground of misrepresentation by the beneficiary it must be shown that such misrepresentation was material to the contract. This provision is a statutory one which provides:

> "No contract of insurance shall contain or have endorsed upon it, or be made subject to, any term, condition, stipulation, warranty or proviso to the effect that the contract is to be avoided by reason of any statement in the application therefor, or inducing the insurer to enter into the contract, unless such term, condition, stipulation, warranty or proviso is and is expressed to be limited to cases in which such statement is material to the contract; and no contract shall be avoided by reason of the inaccuracy of any such statement unless it be material to the contract." (3)

A similar provision in the Ontario Insurance Act was before the Supreme Court of Ontario in The Cornwall Township vs. Prudential Assurance Company (4) where an action was brought by the Plaintiff corporation to recover from the Defendent company on a fidelity guarantee policy whereby it agreed to pay or make good any amount not exceeding the sum of $20,000 if a tax collector of the plaintiff should commit larceny, fraud, embezzlement etc. During the time when such policy was in force the tax collector did in fact mis-appropriate

(3) **The Insurance Act of New Brunswick**, 1937 Sec. 87 Sub-Sec. 4
(4) (1947) 3 D.L.R. 189

certain funds to his own use. The Defendents disputed liability on the ground that prior to entering the contract the Plaintiff furnished to the Defendent a written application with certain questions which included:

> "Q. How often is he required to pay over amounts received by him on behalf of the Employer and what are the regulations attaching thereto?
>
> A. Every ten days."

It was alleged by the Defendent that this answer was false in that the tax collector did not pay over the amounts collected by him every ten days and was allowed to retain a substantial balance in his hand from time to time. The Trial Judge held that the answers given were true and that there was no representation and further held that in the event the answers were untrue they were not material to the contract within the meaning of the Insurance Act.

The following cases illustrate the principle that on the formation of a contract of guarantee insurance if the beneficiary has materially misrepresented facts to the insurer, the latter may successfully repudiate liability.

In Grain Claims Bureau vs. Canada Surety Co. (5) the plaintiff was engaged in the business of adjusting grain claims and employed on the staff one by the name of Peters, who applied to the Defendent for a surety bond in the sum of $5,000. As a result the Defenent asked the Plaintiff a number of questions, which included:

> "Q. Is there at present anything due or owing to you by the applicant? If so, what is the amount?
>
> A. No.

The Plaintiff brought this claim on the bond for pecuniary loss which it was alleged to have sustained by reason of acts of larceny or embezzlement on the part of Peters. The Defendent contended that the statement made by the Plaintiffs was untrue and consequently repudiated liability. Trueman, J.A. in allowing the appeal and dismissing the action quoted with approval Viscount Dunedin in Glickman vs. Lancashire & General Ass'c Co. (1927) A.C. 39 as follows:

> "The conclusion to which I have come that the bond is vitiated by fraud antecedent to its execution makes it unnecessary to consider other defences."

In Rural Municipality of Churchbridge v. London Guarantee and Acc. Co. Ltd. (6) the Plaintiff brought action on a guarantee bond issued by the Defendent company to cover loss or embezzlement etc. occasioned by the Secretary-Treasurer of the Plaintiff Municipality

(5) **The Manitoba Court of Appeal, (1928) 1 D.L.R. 677.**
(6) **(1925) 3 D.L.R. 341, The Sackatchewan Court of Appeal**

On August 15th, 1917 a bond for $2,000 on behalf of the secretary treasurer was executed by the defendent company and was renewed up to and including August 14th, 1921. A new bond for $4,000 was given in September 1921 and renewed in September 1922. In 1919 it was found that the secretary-treasurer was short $2,000 and the then reeve of the Plaintiff Municipality gave him two weeks in which to pay up, which he in fact, did. On the application for the new bond the Defendent company asked the reeve (a successor to the reeve previously referred to) for certain information in the form of questions and answers which related to the position of the secretary-treasurer. The list of questions included:

Q. Have you ever had cause to complain of his conduct while employed by you?

A. No.

The court held that the answer given by the reeve of the Municipality was false and the Plaintiff could not recover on the bond which was held void ab initio.

As to the second question, the authorities are to the effect that if the beneficary conceals any material fact from the insurer, even though no questions have been asked or information solicited of the beneficiary, the bonding company may deny liability on that account. Thus in Rural Municipality of Mayfield vs. London & Lancashire Guarantee & Fidelity Company of Canada (7) a County Treasurer applied to the Defendant for a bond in the sum of $3,000 for the purpose of indemnifying the Plaintiff against any loss which it might suffer by reason of any act of embezzlement, misappropriation or other dishonesty committed by the Treasurer. About 12 years before entering the employment of the Plaintiff Municipality the Treasurer had been convicted and sentenced to a term of imprisonment on 31 charges of embezzlement. During the currency of the bond the Treasurer embezzled a sum of money belonging to the Plaintiff; he was discharged from office and later convicted and served a term of imprisonment. The Plaintiff brought this action to recover from the Defendant the amount so embezzled. It was contended by the Defendant that the Plaintiff had knowledge of the fact that the Treasurer's previous record was not free from dishonesty and that it failed to communicate this knowledge to the Defendants. The reeve of the Plaintiff Municipality at the trial stated that he did not report the information concerning the previous acts of dishonesty to the bonding company because the company did not ask him for any information and also because he thought this information was nobody's business but his own; that he did not think there was anything serious and further that the Treasurer had lately been acting honestly and he did not think it would be fair to bring up this old affair against him. The Court held that the Plaintiff could not recover on the bond on account of non-disclosure. Lamond, J.A., at p. 405:

(7) (1927) 1 D.L.R. 463. The Saskatchewan Court of Appeal

> "The enforceability of a bonding contract whereby the beneficiary is insured against loss is founded upon a basis of utmost good faith between the contracting parties. This principle was laid down again lately in this Court in the case of Churchbridge v. London Guarantee & Acc. Co. (1925) 3 D.L.R. 341, at p. 348, 18 S.L.R. 450."

and further at pp. 405 and 406:

> "Several cases were cited to us on behalf of the plaintiffs tending to show a lesser degree of responsibility in the beneficiary of the guarantee. But care should be taken to distinguish between a suretyship in a creditor and debtor transaction and suretyship in a fidelity guarantee."

There still remains to consider the effect of misrepresentation or concealment by the insured upon the insurance contract. This situation usually if not always arises in a case of surety rather than in fidelity insurance. This may be stated thus – Will misrepresentation or concealment by the insured vitiate the contract and render a claim by the beneficiary against the insurer void?

It is stated in Rowlatt on Principal and Surety (8)

> ".....that the surety may have been induced to contract by the fraud of the principal is of course no defence unless the creditor is a party to the fraud."

However, no cases have been found which establish that this rule applies to a contract of Guarantee insurance.

A very similar situation arose under an automobile insurance policy in Bourgeois v. Prudential Assurance Co. Ltd. (9). In that case the New Brunswick Court of Appeal held that where the policy was issued on the basis of misrepresentation by the insured, an injured party had no claim thereunder as against the insurer, the policy being void ab initio. This defence has now been denied the automobile insurer by statute; however, the legal principles contained in the case are still sound, and would form a basis for the proposition that any material misrepresentation by the insured under a contract of guarantee insurance, would abrogate any claim thereunder by the beneficiary, however innocent the latter might be.

(8) 8th Edition
(9) 18 M.P.R. 334

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