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**INTERNATIONAL SYMPOSIUM ON THE PREVENTION & CONTROL OF
FINANCIAL FRAUD**

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“ISSUES OF INSURANCE FRAUD”

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I. MISREPRESENTED AND FRAUDULENT CLAIMS - DEFINITION

According to the International Association of Insurance Fraud Agencies (I.A.I.F.A.), Insurance Fraud is recognized internationally as a multi-billion dollar problem, and Canada is no exception to this nemesis. One should ask what exactly constitutes an insurance fraud? Some circumstances where a court of law will find an insured's claim to be fraudulent include those where the insured claims for items that do not exist, increases the value of the property or goods that were damaged, claims for goods that are not damaged, falsifies documents as part of his claim, or makes false oral representation.¹

A misrepresentation has been defined as a false representation of facts, circumstances or information.² A false representation is fraudulent if made: (1) knowingly, (2) without belief in its truth, or (3) recklessly without care whether it be true or false.³

The basic common law principles governing misrepresentation and fraud in proofs of loss are summarized in *Britton v Royal Insurance Co.*:

“A [fire] insurance policy is a contract of indemnity; that is, it is a contract to indemnify the insured against the consequences of a fire, provided it is not wilful. Of course, if the insured set fire to his house, he could not recover. That is clear. But it is not less clear that, even supposing it were not wilful, yet as it is a contract of indemnity only, that is, a contract to recoup the insured value of the property destroyed by fire, if the claim is fraudulent, it is defeated altogether. That is, suppose the insured made a claim for twice the amount insured and lost, thus seeking to put the [insurer] of its guard, and in the result to recover more than he is entitled to, that would be a wilful fraud, and the consequence would be that he would not recover anything... The law is, that a person who has made such a fraudulent claim could not be permitted to recover at all.”⁴

It is therefore fraud if one makes a statement of fact about which he knows he is ignorant⁵, or if he decides to inflate the claim and make a profit out of it.

¹ Michael D. Adlem, “Fraudulent Proofs of Loss and Arson”, 3 C.I.L.R. at page 322 (1991-1992).

² Jerret E. Sale, “Misrepresentations in the Application of Insurance”, Recurring Issues in Insurance Disputes, David L. Leitner Ed., American Bar Association Publication at page 537.

³ *Derry v Peek* (1889) 14 App. Cas. 337.

⁴ (1866), 4 F.&F. 905, 176 E.R. 843 at 844.

II. *Derry v Peek (1889)* - TEST FOR DETERMINING WHETHER A CLAIM IS FRAUDULENT OR NOT

The test for determining if a claim is fraudulent or not, as it was mentioned earlier in this paper comes from the British case of *Derry v Peek*:

“Fraud is proved when it is shown that a false representation has been made: (1) knowingly, or (2) without belief in its truth, or (3) recklessly, carelessly whether it be true or false.”⁶

This test was subsequently adopted both by the Supreme Court of Canada, in the case of *Redican v Nesbitt*⁷, and courts in British Columbia in the cases of *Kruska v Manufacturers Life Insurance Co.*⁸, and recently in *McLean v Paul Revere Life Insurance Co.*⁹ and *Original Leather Factory Ltd. v Wellington Insurance Co.*¹⁰

In several cases where the insurer proved that the insured made a false or misrepresented claim, the insured could claim that the false statement or misrepresentation was not made knowingly, and therefore he could not be found guilty of fraud. This meant that the courts either had to decide on the basis of the evidence of each individual case, or find a reasonable formula that they could apply in each case.

The decision in *Derry v Peek* provided the Canadian courts with the test for determining whether a misrepresentation or a false statement was made knowingly by applying an objective test, i.e. trying to determine whether a reasonable man would actually behave in the same way as the insured. It is stated:

“Whether it is necessary to arrive at a conclusion as to the state of mind of another person, and to determine whether his belief under given circumstances was such as he alleges, we can only do so by applying the standard of conduct which our own experience of the ways of men has enabled us

⁵ *Bree v Holbech* (1781) 2 Douglas 654, 655.

⁶ (1889), 14 App. Cas. 337 at 374 (H.L.).

⁷ (1924), S.C.R. 135, (1924) 1 D.L.R. 536 at 550.

⁸ (1984), 6 C.C.L.I. 299, 54 B.C.L.R. 343 at 353 (S.C.).

⁹ (1990), 43 C.C.L.I. 273 at 288 (B.C.S.C.).

¹⁰ (1990), 43 C.C.L.I. 290 at 299 (B.C.S.C.).

to form; by asking ourselves whether a reasonable man would be likely under the circumstances so to believe.¹¹”

III. THE BURDEN OF PROOF IN A FRAUDULENT CASE

Generally, the onus of proving fraud is on the insurer¹² who must establish it on the balance of probabilities.¹³ This was clearly illustrated in the case of *Hanes v Wawanesa Mutual Insurance Co.*¹⁴, by the Supreme Court of Canada, where Ritchie J. stated:

“When a right or defence rests upon the suggestion that the conduct is criminal or quasi-criminal the Court must be satisfied not only that the circumstances are consistent with the commission of the criminal act but that the facts are such as to make it reasonably probable, having due regard to the gravity of the suggestion, that the act was in fact committed.¹⁵”

In essence, while the Court recognizes the degree of probability within the standard, depending upon the seriousness of the case, and notwithstanding that the fact alleged involves criminal conduct, the burden of proof remains on the balance of probabilities.¹⁶

However, as it was stated in *Continental Insurance Co. v Dalton Cartage Ltd.*¹⁷, it is clearly accepted that in Canada the courts are “scrutinizing evidence with greater care if there are serious allegations to be established by the proof that is offered.¹⁸” This was illustrated in an earlier case decided before the Ontario Court of Appeal. In

Adams v Glen Falls Insurance Company, Meredith C.J.O. for the Ontario Court of Appeal stated that:

¹¹ Ibid. note 9 at 380.

¹² *Roland Roy Fourroures Ltd. v Maryland Casualty Co.*, (1974) S.C.R. 52, *Regina Steam Laundry Ltd. v Sask. Govt. Ins. Office* (1972) I.L.R. 1-462 (S.C.C.).

¹³ *Direct Invs. Ltd. v Dom. Ins. Corp.* (1968) 2 O.R. 117, (1968) I.L.R. 1-199, 68 D.L.R. (2d) 278 (H.C.).

¹⁴ (1963) S.C.R. 154, 36 D.L.R. (2d) 718 at 736.

¹⁵ *Ibid.* at 734 (D.L.R.)

¹⁶ “Fraudulent Proofs of Loss and Arson”, *Ibid.* at page 324.

¹⁷ (1982) 1S.C.R., 164, 131 D.L.R. (3d).

¹⁸ *Ibid.* at 131 D.L.R. (3d) 559 at 563.

“The evidence ought, if not such as would warrant conviction for fraud and perjury, to be at least clear and satisfactory and leave no room for any reasonable inference but that of guilt.¹⁹”

In *Continental*, Laskin C.J.C. adopted the words used by Lord Denning in *Bater v Bater*²⁰:

“It is true by our law there is a higher standard of proof in criminal cases than in civil cases, but this is subject to the qualification that there is no absolute standard in either case. In criminal cases the charge must be proved beyond reasonable doubt, but there may be degrees of proof within that standard. Many great Judges have said that, in proportion as the crime is enormous, so ought the proof to be clear. So also in civil cases. The case may be proved by a preponderance of probability, but there may be degrees of probability within that standard. The degree depends on the subject-matter. A civil court, when considering a charge of fraud, will naturally require a higher degree of probability than that which it would require if considering whether negligence were established. It does not adopt so high a degree as a criminal court, even when it is considering a charge of criminal nature, but still it does require a degree of probability which is commensurate with the occasion.²¹”

This standard of proof for insurance fraud cases is therefore different from a normal criminal case where the charge must be proved beyond reasonable doubt. However, it does not mean that in insurance fraud cases there is an “infinite variety of a standard of proof²²” which varies on an *ad hoc* basis according to the subject matter at hand. What will vary is simply the amount of evidence required to satisfy the burden of proof.

In British Columbia, the approach of the Courts was summarized in *Tumbers Video Ltd. v INA Insurance Co. of Canada*²³:

“Where fraud is alleged in an insurance claim, the onus is initially on the defendant insurance company to prove fraud and the Court will require a higher degree of probability than that which it would require if considering whether negligence were established.²⁴”

¹⁹ (1916) 37 O.L.R. 1, 10 O.W.N. 171, 31 D.L.R. 166 (C.A.).

²⁰ (1950) 2 All E.R. 458 at 459 (C.A.).

²¹ *Ibid.* at 563 (D.L.R.).

²² Cross on Evidence, 4th ed. London, Butterworths (1974) at 98, 99.

²³ (1989) 40 C.C.L.I. 262 at 279 (S.C.), (1991) 62 B.C.L.R. (2d) 58 (C.A.).

²⁴ *Ibid.* at 273 (C.C.L.I.).

IV. CONSEQUENCES OF MISREPRESENTED OR FRAUDULENT CLAIMS

A finding of fraud renders a contract voidable at the option of the injured party. The injured party may rescind the contract and recover back what he gave. Even though the right to rescind cannot be exercised if the other party cannot be restored to his status quo, that does not mean that he must be placed literally in as good a position as he was at the beginning of the contract.²⁵

In Canada, where the fraud that is proved relates only to part of the claim, (and where statutory or policy provisions state that only the claim and not the whole policy is avoided,) the entire claim is vitiated.²⁶ Note that although fraud will disentitle the insured from any further compensation, if the insured has filed an interim proof of loss that was not fraudulent and the insurer pays funds on the strength of that document, subsequent fraud, even relating to the same loss, will not allow the insurer to recover the money paid.²⁷

A finding of innocent misrepresentation, will not totally preclude an insured from recovering. In the case of *Chapman v Pole* it was held that:

“A man may make a mistake in his claim and it may be quite honestly. If for instance a man either fails to recollect the precise quantity of goods he has on his premises at the time of the fire, or mistakes the value of those of which he was in possession, and thus he presses a claim according to what he believes honestly to be true, but which may, in the end, turn out to be mistaken, the only consequence which ensues is, that inasmuch as the contract of insurance is simply a contract of indemnity, he can only recover to the extent of the real value of the goods which he has actually lost.”²⁸

V. THE DOCTRINE OF *UBERRIMA FIDES*

²⁵ “Insurance Law”, MacGillivray & Parkington, Eighth Ed., London, U.K. at page 572.

²⁶ “Insurance Law in Canada”, Brown C. & Menezes J., 1982, Carswell Publication, Toronto, Canada, at page 230.

²⁷ “Fraudulent Proofs of Loss and Arson”, 3 C.I.L.R. (1991-1992) at page 328.

²⁸ *Chapman v Pole* (1870), 22 L.T. 306.

Uberrima fides is defined as “a phrase used to express the perfect good faith, concealing nothing, with which a contract must be made; for example in the case of insurance, the insured must observe the most perfect good faith towards the insurer.²⁹”

Formulated by Lord Mansfield in 1766 in the case of *Carter v Boehm*, the doctrine affirms the necessity of utmost good faith in an insurance contract:

“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 circumstances in his knowledge, to mislead the under-writer into a belief that the circumstances does not exist, and to induce him to estimate the risque as if it did not exist. The keeping back such circumstance is a fraud, and therefore the policy is void... 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.....³⁰”

The doctrine of *uberrima fides* is reciprocal, applying obligations to both the insured and insurer. The extent of the insurer’s presumed knowledge was addressed by the Supreme Court of Canada in *Canadian Indemnity Co. v Canadian Johns-Manville Co.*³¹, where it was held that an insurer could not use his own lack of due diligence as a basis for avoiding a policy. The Court held that if an insurer does not have the requisite degree of knowledge prior to considering a particular risk, then it must acquire that knowledge by means of inquiry or investigation.

The doctrine has generally been considered to apply to the claim stage and not only at the time of the contract formation. This was confirmed by the Supreme Court in *Co-operators General Insurance Co. v Porteous* where it was stated that:

“The duty to exercise the utmost good faith not only exists at the time when the contract is made but throughout the dealings between the parties both before and after the loss.³²”

²⁹ Black’s Law Dictionary, 5th ed, St. Paul, (1979).

³⁰ (1766) 3 Burr. 1905, 97 E.R. 1162, (1558-1774), All E.R. Rep. 183.

³¹ (1990), 50 C.C.L.I. 95 (S.C.C.).

³² (1986), 9 B.C.L.R. (2d) 179 at 187 (B.C.S.C.).

The British Columbia Court of Appeal recently tried to restrict the application of *uberrima fides*, as it stated in *Tumbers Video Ltd. v INA Insurance Co. of Canada*:

“The concept of *uberrimae fidei* comes into play in an insurance setting at the time of the formation of the contract of insurance. It plays no part when it comes to an allegation of fraud in the proof of loss. In this case the onus is on the insurer to prove fraud and nothing short of that will do.³³”

It seems that although the doctrine applied for many years both during the formation stage as well as the claim stage, recently the Canadian courts recognized the need to apply stricter rules in the application of the doctrine,³⁴ and in *Coronation Insurance Co. v Taku Air Transport Ltd.*³⁵ where the British Columbia Court of Appeal restricted its application even further on its application to the contract formation stage as well.

VI. STATUTORY CONDITIONS REGARDING MISREPRESENTED OR FRAUDULENT CLAIMS IN CANADA

Canadian insurance legislation has one more tool in its effort to combat insurance fraud, and this comes through statutory legislation enacted both by the Federal and Provincial Governments. Even though, the Courts usually prefer to follow the precedent set by court cases, statutory legislation exists, and although long in nature, it provides an additional help to the lawmakers. Statutory legislation covers almost every aspect of insurance legislation, but as it is the case with most common law jurisdictions it cannot change become as adoptable or as fast as a court decision.

Some examples of statutory legislation that are related to the cases that were mentioned above are the following: (1) Statutory condition 6 of the Fire Statutory Conditions set out in section 220 of the B.C. Insurance Act the information that an insured under a fire policy must provide to the insurer in a proof of loss verified by a statutory declaration.³⁶

(2) In British Columbia, as of September 1997, the Traffic Safety Statutes Amendment Act sets out stiff penalties for driving offences and insurance fraud. The Insurance Corporation of British

³³ (1991), 62 B.C.L.R. (2d) 58 (C.A.).

³⁴ *Charterhouse Properties Ltd. v Laurentian Pacific Insurance Co.* (1991), 56 B.L.C.R. (2d) 329 at 336-337 (S.C.).

³⁵ (1991) 3 S.C.R. 622

³⁶ “Canadian Insurance Law”, 3 C.I.L.R., Ibid at page334

Columbia³⁷ will level a fine of \$25,000 for a first time fraud conviction by an individual and \$100,000 for a corporation's first insurance fraud offence. The second time around brings fines of \$50,000 and \$200,000.

³⁷ "I.C.B.C."

VII. CANADIAN COALITION AGAINST INSURANCE FRAUD - STATISTICS

Finally, there are some organizations in Canada which are operated with the assistance of the public, and are proving to be of great help in the battle against insurance fraud in Canada.

The Canadian Coalition against Insurance Fraud (CCAIF), an organization consisting of insurers, adjusters and claim managers, was established mainly in order to educate insurance customers about the high cost of insurance fraud for the public at large. "Crime Stoppers" is an international, non-profit civilian program that assists police in solving crime through tips reported by citizens. The cooperation between Crime Stoppers and the Canadian Coalition Against Insurance Fraud is operational in all regions of Canada, except Quebec.

Last year, this innovative alliance between Crime Stoppers and the Canadian Coalition Against Insurance Fraud resulted in 37 arrests, 45 denied claims and has nationally provided the payment of more than \$1.1 million worth of fraudulent home, car and business insurance claims.³⁸ There are currently 104 independent Crime Stoppers units across the country. Some examples of tips received include: a backhoe that had been reported stolen, but was in fact buried in the yard of the insured; a boat, also reported stolen, was stored one block away from the insurance industry investigators' national office. Another tip led to the arrest of a man who had sold his car stereo and then reported it stolen.

Recently, the B.C. Chapter of the Canadian Coalition against Insurance Fraud was established and they estimate that approximately \$1.3 billion each year is spent on insurance fraud cases.³⁹ The message to the public is: "They Cheat/You Pay."

³⁸ Statistics provided by: [CanadaNewswire/releases/December 1997/11/c2834.html](http://CanadaNewswire/releases/December%201997/11/c2834.html)

³⁹ Statistics provided by: CanadianInsuranceNews/70/0/insur/archive/ar9709/970910.000