Fraud, nullity and compulsory professional liability insurance: the Québec Court of Appeal rules in

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On May 16, 2016, the Québec Court of Appeal adjudicated[1] on whether a professional liability insurer can plead the nullity of a policy based on misrepresentations or concealment of facts by the insured. This decision is of interest because it addresses the novel issue of whether a liability insurer can claim the nullity of an insurance contract where it is compulsory for the insured to hold such insurance under the applicable legislation.

Facts

In preparing for their retirement, Jean-Pierre Brunet ("Brunet") and Giovanni Berretta ("Berretta") as well as their holding companies, invested more than $2.5M through a group savings plan brokerage firm, Triglobal Capital Management Inc. ("Triglobal"), and its president and director, Thémiskoklis Papadopoulos ("Papadopoulos"), who were registered with the Autorité des marchés financiers. Papadopoulos managed and invested the assets of Brunet and Berretta, as well as those of several other investors, in two offshore funds located in the Bahamas and in the Cayman Islands.

Until the beginning of 2008, Axa Assurances Inc. ("Axa") was the liability insurer for Triglobal and its 200 representatives.

In 2007, a newspaper reported that Triglobal, Papadopoulos and another shareholder had engaged in wrongdoing with respect to the offshore funds in which Brunet and Berretta had invested. A few days later, the same newspaper published a corrected version of its previous article. At that time, based on the answers provided by Triglobal and its representatives, Axa decided to extend the coverage of the insurance policies then in effect, and to renew them thereafter.

A few months after the renewal of the insurance policies, a freeze order, cease trade order and prohibition against acting as securities advisers were issued against Triglobal and Papadopoulos pursuant to certain provisions of the Act respecting the *Autorité des marchés financiers*[2] and the *Securities Act*[3] which were in force at that time. A provisional director was also appointed. A few days later, Axa informed Triglobal that it was canceling its insurance policy.

The facts adduced into evidence revealed that Papadopoulos and one of his acolytes had funnelled certain investments entrusted to Triglobal through the offshore funds with the intention of defrauding certain investors, including Brunet, Berretta and their companies through the use of a fraudulent financial operation, namely a "Ponzi Scheme". Brunet, Berretta and their companies sued Axa in its

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capacity as Triglobal's liability insurer to recover their losses.

Judgment of the Superior Court of Québec[4]

The trial judge held that Axa could seek the nullity of the policy. He found that Triglobal's officers breached their obligation to disclose circumstances which would materially influence the risk, namely, the fraudulent scheme. Axa was justified in canceling the policy because if it had known all the circumstances surrounding the risk, it would not have agreed to issue the policy.Therefore, the Court dismissed the action brought by Brunet, Berretta and their companies.

Judgment of the Court of Appeal

La Cour d'appel confirme unanimement le jugement de la Cour supérieure.

The Court of Appeal unanimously affirmed the Superior Court's judgment.

Firstly, the Court rejected the argument by Brunet and Berretta that Triglobal's insurance policy could not be canceled because provisions of public order in the *Act respecting the distribution of financial products and services* ("ADFPS")[5] and the *Regulation respecting firms, independent representatives and independent partnerships* ("RFIRIP")[6] obliged Triglobal and its brokers to hold a liability insurance policy. After reviewing the relevant provisions of the *ADFPS* and the *RFIRIP*, it held that nothing in those provisions precluded the application of the fundamental principles governing the relationship between the insurer and the insured. Thus, in accordance with article 2410 of the *Civil Code of Québec* ("C.C.Q."), a liability insurer can invoke the nullity of its own insurance policy where material circumstances were not disclosed to it that were likely to influence its decision to accept the risk. It noted that nothing in the cases of *Souscripteurs du Lloyd's* c. *Alimentation Denis & Mario Guillemette inc.*,[7] *Audet* c. *Transamerica Life Canada*[8] or *Larrivée* c. *Murphy*[9] supported the proposition that provisions of public order which require a professional to hold liability insurance should supersede the principle that the insured must disclose all of the circumstances that are relevant for the insurer's assessment of the risk.

Secondly, the Court of Appeal held that the conditions for the application of article 2410 C.C.Q. had been met. The misrepresentations and concealment of facts by Papadopoulos as to the true nature of his fraudulent activities when the disclosure of risks was made to Axa were attributable to Triglobal since, as director and president, he was its *alter ego*. In fact, the evidence showed that Triglobal communicated through him when it submitted the relevant information for the assessment of risk by Axa, while hiding the fraudulent scheme, thereby distorting the insured risk. Had the true risk been revealed to Axa, it would not have agreed to issue the insurance policy. This conclusion might have been different however if Papadopoulos had only been an employee of Triglobal. Article 2464 C.C.Q. obliges the liability insurer to pay the indemnity where the insurer covers the insured for harm caused by another person for whom the insured is responsible, such as the employer's liability for its employee.

Conclusion

This decision is the first rendered by the Québec Court of Appeal on the issue of whether an insurer can seek the annulment of a liability insurance contract where it is imposed on the insured by law. It confirms that, unless prohibited by an express provision of the legislation, the insurer may apply for the nullity of the insurance policy where the conditions for doing so are

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met.

1. *Brunet* c. *Axa Assurances inc.*, 2016 QCCA 832, juges France Thibault, Yves-Marie Morissette and Mark Schrager
2. CQLR c. A-33.2.
3. CQLR c. V-1.1.
4. *Brunet* c. *Axa Assurances*, 2014 QCCS 5227.
5. CQLR c. D-9.2.
6. CQLR c. D-9.2, r. 2.
7. 2012 QCCA 1376.
8. 2012 QCCA 1746.
9. 2014 QCCA 305.

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