

NOTE AND COMMENTS

THE DISCLOSURE DUTY IN FIRE INSURANCE: HEREIN OF INSINCERE APPLICANTS, OF APATHETIC AGENTS AND OF UNWISE JUDICIAL EXPATIATION

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Schmidt v. Aetna is a quite unremarkable recent judgment of the Alberta Court of Queen's Bench.¹ The facts of the case are like those of dozens of fire insurance disputes. Hubert and Mary Margaret Schmidt were joint owners of residence premises which included a detached garage. In 1976 and 1977 the premises were covered by a Western Union Insurance Company policy obtained through Rosalind Lubky who was employed by an insurance agency styled Edelson Leipsic Insurance Limited. In June, 1978, Rosalind Lubky contacted Mrs. Schmidt to advise that better coverage and rates could be obtained from Aetna Casualty Company of Canada. Over the telephone, Lubky took an application from Mrs. Schmidt. Aetna issued a policy for one year from August 1, 1978. On October 17, 1978, a fire in the garage caused about \$38,000 damage to the garage and to various personal effects, including taxidermy supplies.

It then came to the insurer's attention that Hubert Schmidt carried on a commercial taxidermy business in his garage, that the garage had been constructed and enlarged to accommodate the taxidermy business, that Hubert Schmidt advertised the business in the phone directory, that a very large part of his income was produced by the business, and that he had reduced to twenty hours per week his employment as a meat cutter for Safeway. The fire in the garage was caused by overheating of a wax mixture used in the taxidermy business.

Aetna refused to pay the claim, alleging a breach of Statutory Condition 1 and of Statutory Condition 4 of the *Insurance Act*.² The Schmidts sued Aetna and Edelson Leipsic Insurance Limited, the claim against the second defendant being founded upon the alleged negligence of Rosalind Lubky in discharging her duty to obtain fire insurance coverage.

It is familiar scenario indeed; not depressing, just tedious because so familiar, the tedium slightly relieved by the somewhat novel feature of the taxidermy activity. On these facts, it is a case which barely deserves to be reported and certainly does not merit comment.

However, the case is an appropriate vehicle for commenting on languid insurance agents and on judges who feel compelled to offer some doctrinal bulk to support a result determined by the facts. Indeed, the case merits comment precisely because sloppy agency practices are so prevalent and because so many judgments which reach a fair result do terrible violence to the fabric of the law, and worse still, do it quite unnecessarily. *Schmidt v. Aetna* is not an example of a hard case making bad law. Rather, it is an example of something far more common — an easy case in which the judge gratuitously muddles some legal doctrine which he could safely have left alone.

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1. *Schmidt and Schmidt v. Aetna Casualty Co. of Canada and Edelson Leipsic Insurance Ltd.* (1982), 37 A.R. 394; 20 Alta. L.R. (2d) 307 (Q.B.).

2. *Insurance Act* R.S.A. 1980, c. I-5, s. 235.

The action against the insurance agency was dismissed. Lubky had known the Schmidts for six years, and knew of the taxidermy activity at least as a "hobby" of Mr. Schmidt. Lubky had arranged automobile insurance for Mr. Schmidt, a policy which the insurer declined to renew when it learned that he had three driving convictions rather than the one disclosed to Lubky. In 1976 Lubky had obtained a quotation from Western Union for coverage in respect of pelts and furs brought by third parties to the residence premises. Western Union would have insured subject to a number of conditions concerning record keeping, a fire-proof cabinet, and bars on the windows. The premiums would have been high. When they decided not to take the coverage, the Schmidts advised Lubky that they had decided against carrying on a commercial taxidermy business and in favour of continuing it as a "hobby".

Mr. Justice Kryczka noted that when the Aetna application was written two years later by telephone, Mrs. Schmidt did not volunteer any information about the taxidermy business. Such information might have prompted Ms. Lubky to ask further questions and might have led to a "suspicion or a concern that something more than a normal Homeowner's policy was required. . . ."³ Here the scenario is not just tedious, but is depressing in its familiarity. An application is taken by telephone for premises known to harbour at least a taxidermy "hobby". It does not seem unreasonable to expect an experienced agent to form her own "suspicion or concern" about the required coverage and to at least ask a few questions designed to illuminate some of the fire risks associated with a taxidermy hobby.

One cannot feel that justice miscarried. The evidence does suggest that the Schmidts consciously attempted to deceive both Lubky and Aetna. Nevertheless, one does fervently wish that insurance agents would read and follow some advice from *Fine's Flowers*⁴ quoted by Kryczka, J. Speaking of the agent's duty to his client, and of the problems presented by the unique circumstances associated with the property of a particular client, Wilson, J.A. suggested that at least part of the solution "lies in the intelligent insurance agent who inspects the risks when he insures them."⁵ Observation suggests that insurance arranged by telephone, and a settled practice of declining to stir from the office, are singular features of insurance agency in Western Canada. An exhortation to conduct an inspection before taking an application, while sensible, is probably vain. One is left with the rather jaundiced view that, as between the somewhat larcenous insured and the rather torpid insurance agent, there is very little to choose and they both deserve the pain of litigation.

So much for languid insurance agents; now a comment on judicial style.

It is well to begin with the observation that the claim against Aetna was probably quite properly dismissed. The evidence disclosed an earlier misrepresentation by Hubert Schmidt concerning his driving record. The evidence also tended strongly to confirm that Schmidt and his wife were well aware of the

3. *Supra* n. 1, at 400 (A.R.), at 314 (Alta. L.R.).

4. *Fine's Flowers Ltd. v. The General Accident Assurance Co.*, [1978] 1 L.R. 1-937, (1977), 81 D.L.R. (3d) 139 (Ont. C.A.).

5. Wilson, J.A. quoting Justice Haines in *Lahey v. Hartford Fire Insurance Company*, [1968] 1 O.R. 727; varied by [1969] 2 O.R. 833.

materiality of the taxidermy activity and that they consciously concealed it from Lubky, and thus from Aetna. On this evidence, it would be quite unexceptionable to find a breach of Statutory Condition 1. Kryczka, J. could quite satisfactorily have reached that conclusion and saved himself five or six pages of somewhat dubious ratiocination.

It is also well to note that a judge's lot is not a happy one. If he too readily arrives at a conclusion without any apparent process of reasoning he may run the risk of being lumped with the law school examination candidates, all too numerous, who seem to operate on the basis of divine inspiration — it may not be possible to say that they are wrong in their conclusions, but some insight into the mental process would be a great improvement.

However, like the examination candidate, if the judge sets out on a process of reasoning which includes explication of the law, he runs the risk of embarrassment if he gets it wrong. Unfortunately, this has happened to Kryczka, J. Rather than making a finding of knowing concealment by the plaintiffs, His Lordship concluded that they could, and did, breach Statutory Condition 1 merely by failure to volunteer information about the taxidermy operation, even though they might be quite unaware of its materiality to the insurance underwriter.

Kryczka, J. begins his statement of this very doubtful proposition with the following quote from Lord Blackburn: "... the concealment of a material circumstance known to you, whether you thought it material or not, avoids the policy."⁶

On its face, this seems strong authority. However, the statement is 102 years old, and a great deal has happened in insurance law in the interval. One of the most important developments is the introduction, in respect of fire insurance policies, of Statutory Condition 1 which reads as follows:

If any person applying for insurance falsely describes the property to the prejudice of the insurer, or misrepresents or fraudulently omits to communicate any circumstance which is material to be made known to the insurer in order to enable it to judge of the risk to be undertaken, the contract shall be void as to any property in relation to which the misrepresentation or omission is material.⁷

Another very important development which occurred since Lord Blackburn spoke is nicely described by Scrutton, L.J. in the leading case, *News-holme Brothers v. Road Transport and General Insurance Company Ltd.*⁸ Contrasting marine underwriters with life and accident insurers, Scrutton, L.J. noted that the former sits still, does not solicit business, and asks no questions. In that context it may be quite fair to adhere to a rule that the insurance applicant must volunteer all material information. The rule may be seen as fair particularly when one notes that such applications are made by brokers acting for the prospective insured and that such brokers should have a keen appreciation of what is material and why it must be disclosed. Scrutton, L.J. contrasted insurance business carried on through soliciting agents who have a prepared

6. From *Brownlie v. Campbell* (1880), 5 App. Cas. 925 at 954 (H.L.).

7. *Insurance Act* R.S.A. 1980, c. 1-5, s. 235.

8. [1929] 2 K.B. 356 (C.A.).

list of questions about the risk. In that setting, it is not nearly so clearly fair to expect an applicant to know what is material and to volunteer information not sought by the agent.

This is in fact a problematic area of insurance law. There is much to be said for the view that an applicant should be able to rely on an inference that the underwriter and the agent know what is material to the risk. By putting a series of questions, the agent implies that he has dealt with those matters on which the underwriter requires information, and the applicant should be able to assume that he is not expected to imagine what additional matters might possibly be relevant. Of course, this would not exonerate the applicant who knows of matters which he knows to be material and which are not elicited by the prepared list of questions.

*Taylor v. London Assurance Corp.*⁹ is a case of critical importance to this question. In that case, in the Ontario Court of Appeal and in the Supreme Court of Canada, extensive judicial attention was given to determining the applicant's disclosure duty pursuant to Statutory Condition 1. Although *Taylor* is not an easy case, nor an entirely satisfactory one, it does strongly tend to support the proposition that the Statutory Condition has significantly altered the old law and that the insurer no longer has a defence based on a deficiency in disclosure which is truly innocent.

It is quite apparent, without reading *Taylor*, that Statutory Condition 1 is directed at *fraudulent* non-disclosure. Thus, it simply is not any longer the law, as it may once have been, that an applicant for fire insurance is obliged to volunteer information about matters which he does not know to be material and which the agent has not asked about.

The *Taylor* case included some extensive discussion of the difference between "misrepresentation" and "non-disclosure" (an "omission to communicate" in the language of Statutory Condition 1.) Some of the judges considered that "misrepresentation" involves some degree of active misleading of the insurer, such that misrepresentation could never be said to be truly innocent.

Kryczka, J. cites *Smith v. Cooperative Fire and Casualty Co.*¹⁰ as authority for the proposition that, in Alberta, "in any given circumstance, an innocent misrepresentation material to the risk, might void the insurance coverage." With respect, a District Court judgment would be rather flimsy authority for such a proposition at best. In fact, Belzil, D.C.J. asserted no such proposition in *Smith* and it would have been *obiter* if he had done so. Although Co-op relied on a plea of misrepresentation, judgment was given in favour of Mrs. Smith.

How then did *Smith* commend itself to Kryczka, J. as authority for the proposition that an innocent material misrepresentation may avoid the contract? Only God, and presumably Kryczka, J. know the answer. His Lordship's quotation from the *Smith* case is entirely a non-sequitur dealing with the applicant's responsibility for false answers in a signed application form.

9. [1935] 3 D.L.R. 129 (S.C.C.) (herein after referred to as *Taylor*).

10. (1977). 5 A.R. 116 (Dist. Ct.), (herein after referred to as *Smith*).

Kryczka, J. also held that the plaintiffs were in breach of Statutory Condition 4, a holding that seems insupportable on the facts. The use of the garage, not to park cars but as premises for the taxidermy business, was not shown to have changed in any particular after the issue of the Aetna policy. Hubert Schmidt's employment as a meat cutter was terminated between August and October, 1978, but that surely is not a change in any way material to the risk, despite Aetna's argument on the point. Hubert Schmidt might have exchanged his job as a meat cutter for that of a bomb disposal expert or a manufacturer of explosives. So long as the new and dangerous job was carried on at a safe distance from his home it would in no way affect the risk under the Aetna policy. Aetna's complaint was not about a change in Schmidt's occupation *per se*; rather, it was about the undisclosed use of the garage.

It is well to reiterate that Mr. and Mrs. Schmidt appear on the evidence, to have consciously concealed from Aetna a matter which they knew to be of importance to an insurance underwriter. Their claim would appear to have been properly dismissed on the basis of a breach of Statutory Condition 1.

It would appear that there was no breach of Statutory Condition 4, and Kryczka, J. should have resisted the all-too-common judicial temptation to render the result somehow more convincing by adding a second nail to the plaintiffs' coffin.

As to his treatment of Statutory Condition 1, Kryczka, J. may have experienced the qualms which most judges seem to suffer when called upon to declare a finding of fraud, suicide, arson, or even as in this case, deliberate concealment short of fraud. The evidence would appear to support such a finding. If Kryczka, J. quailed before asserting conscious misconduct by the Schmidts, it would have been better if he had simply pronounced that, on the evidence, he was satisfied that a breach of Statutory Condition 1 had been proven.

It is true that Kryczka, J. might then be charged with a lack of reasoning to support his conclusion. That is not a very serious charge. Many cases are decided, and are declared to be decided, on their facts. That would be greatly preferable to muddling around with some insurance doctrine and spreading confusion for later counsel and judges.

