IN THE MATTER OF SECTION 275 OF THE ***INSURANCE ACT,***
R.S.O. 1990, C. I.8,

AND IN THE MATTER OF THE ***ARBITRATION ACT,*** 1991
S.O. 1991, C. 17

AND IN THE MATTER OF AN ARBITRATION

BETWEEN:

ING INSURANCE COMPANY OF CANADA

Applicant

- and -

NON-MARINE UNDERWRITERS,
MEMBERS OF LLOYD'S OF LONDON, ENGLAND

Respondent

# AWARD

## Introduction

This is an arbitration to resolve a dispute between two insurers with respect to reimbursement for payment of Statutory Accident Benefits. The applicant, who now seeks recovery from the respondent, is paying those benefits. In accordance with the process set out under the Insurance Act, the parties have proceeded with arbitration governed by the *Arbitration Act*, 1991, and have selected me to be the arbitrator of this dispute.

An arbitration agreement was executed by the parties and is Exhibit 1 to this proceeding.

## The Legislative Framework of This Proceeding

The relationship between the two insurers in this case is governed by a statutory scheme created for the purpose of allocating losses between insurers when those losses arise out of the payment of Statutory Accident Benefits. This system is entirely collateral to the introduction, in 1990, of an automobile injury compensation system that placed a major emphasis on first party "no-fault" accident benefits as a method of providing compensation to injured accident victims. At the same time, legislation introduced a high verbal threshold that greatly restricted the ability of accident victims to sue, based on tort principles. The legislative scheme clearly recognized a shift in approach to compensation. The common law approach based on negligence and common law principles of damage assessment were being de-emphasized. A statutory scheme of

providing no-fault benefits, prescribed by regulation and administered under the supervision of statutory regulators, was introduced in an extensive way.

The obvious effect of changing benefits from a tort-based system to a first party system, was that payment to accident victims originated from different insurers. To the extent that benefits were paid on a no-fault basis, the victim received payment from his or her own insurance company. To the extent that payments were formerly received based on tort principles, the payment came from the insurer of the person who was at fault for an accident. Necessarily this implied a significant shift in the cost burden for compensation for motor vehicle accidents.

At the time that this change in compensation systems was introduced, it appears that legislators recognized that, in certain extreme cases, this shift in compensation source could result in unfairness. Particularly in accidents that involve motorcycles and other accidents that involve heavy commercial vehicles, there was the possibility of significant unfairness.

One could reasonably expect that a person who is the occupant of a motorcycle at the time of a motor vehicle accident might sustain significant injury. Prior to June 22, 1990 the bulk of the burden of compensation for such injury rested with the insurer of the at-fault motorist in the collision. After the amendments of June 22, 1990, the introduction of no-fault benefits, the bulk of the responsibility for compensation might fall on the insurer of the motorcyclist. Due to this shift, and because of the special vulnerability of people who are occupants of motorcycles, it appears that legislators felt that it was necessary to re-allocate losses between those classes of insurers.

Similarly, with respect to accidents that involve heavy commercial vehicles, one can see that, in the post June 22, 1990 environment, the insurers of heavy commercial vehicles were largely relieved of obligations for compensation. Not only did they have no obligation to provide compensation to third party victims whose injuries fell below the threshold, but typically heavy commercial vehicles do not have occupants, other than the driver, to present accident benefits claims. Additionally, the drivers of the vehicles who might possibly have presented accident benefits claims were frequently entitled to workers compensation benefits, which had the effect of negating access to automobile insurance benefits. Hence, with respect to heavy commercial vehicles, the changes introduced in June 22, 1990 had the effect of lessening the economic burden on the insurers of heavy commercial vehicles.

By statute, the Legislature has provided for "loss transfer" between insurers in these various scenarios. The obvious purpose of this legislation is to re-allocate the losses between insurers in specified classes of accidents, so that the losses sustained by the insurers are similar to the losses that would have been paid by the insurers in a traditional tort compensation environment, without no-fault accident benefits.

The scheme of loss transfer is enacted by section 275 of the *Insurance Act*.

**Indemnification in certain cases**

**275. (1) The insurer responsible under subsection 268 (2) for the payment of statutory accident benefits to such classes of persons as may be named in the**

**regulations is entitled, subject to such terms, conditions, provisions, exclusions and limits as may be prescribed, to indemnification in relation to such benefits paid by it from the insurers of such class or classes of automobiles as may be named in the regulations involved in the incident from which the responsibility to pay the statutory accident benefits arose. R.S.O. 1990, c. I.8, s. 275 (1); 1993, c. 10, s. 1.**

**Idem**

**(2) Indemnification under subsection (1) shall be made according to the respective degree of fault of each insurer's insured as determined under the fault determination rules. R.S.O. 1990, c. I.8, s. 275 (2).**

**Deductible**

**(3) No indemnity is available under subsection (2) in respect of the first $2,000 of statutory accident benefits paid in respect of a person described in that subsection. R.S.O. 1990, c. I.8, s. 275 (3); 1993, c. 10, s. 1.**

**Arbitration**

**(4) If the insurers are unable to agree with respect to indemnification under this section, the dispute shall be resolved through arbitration under the *Arbitrations Act*. R.S.O. 1990, c. I.8, s. 275 (4).**

**Stay of arbitration**

**(5) No arbitration hearing shall be held with respect to indemnification under this section if, in respect of the incident for which indemnification is sought, any of the insurers and an insured are parties to a mediation under section 280, an arbitration under section 282, an appeal under section 283 or a proceeding in a court in respect of statutory accident benefits. 1993, c. 10, s. 31.**

The regulatory provisions applicable to this process have been enacted as part of *Ontario Regulation* 664. Section 9 of that Regulation provides as follows:

**INDEMNIFICATION FOR STATUTORY ACCIDENT BENEFITS (SECTION 275 OF THE ACT)**

**9. (1) In this section,**

**"first party insurer" means the insurer responsible under subsection 268 (2) of the Act for the payment of statutory accident benefits;**

**"heavy commercial vehicle" means a commercial vehicle with a gross vehicle weight greater than 4,500 kilograms;**

**"motorcycle" means a self-propelled vehicle with a seat or saddle for the use of the driver, steered by handlebars and designed to travel on not more than three wheels in contact with the ground, and includes a motor scooter and a motor assisted bicycle as defined in the Highway Traffic Act;**

**"motorized snow vehicle" means a motorized snow vehicle as defined in the Motorized Snow Vehicles Act;**

**"off-road vehicle" means an off-road vehicle as defined in the Off-Road Vehicles Act;**

**"second party insurer" means an insurer required under section 275 of the Act to indemnify the first party insurer. R.S.O. 1990, Reg. 664, s. 9 (1); O. Reg. 780/93, ss. 1, 6.**

**(2) A second party insurer under a policy insuring any class of automobile other than motorcycles, off-road vehicles and motorized snow vehicles is obligated under section 275 of the Act to indemnify a first party insurer,**

**(a) if the person receiving statutory accident benefits from the first party insurer is claiming them under a policy insuring a motorcycle and,**

**(i) if the motorcycle was involved in the incident out of which the responsibility to pay statutory accident benefits arises, or**

**(ii) if motorcycles and motorized snow vehicles are the only types of vehicle insured under the policy; or**

**(b) if the person receiving statutory accident benefits from the first party insurer is claiming them under a policy insuring a motorized snow vehicle and,**

**(i) if the motorized snow vehicle was involved in the incident out of which the responsibility to pay statutory accident benefits arises, or**

**(ii) if motorcycles and motorized snow vehicles are the only types of vehicle insured under the policy. R.S.O. 1990, Reg. 664, s. 9 (2); O. Reg. 780/93, s. 1.**

**(3) A second party insurer under a policy insuring a heavy commercial vehicle is obligated under section 275 of the Act to indemnify a first party insurer unless the person receiving statutory accident benefits from the first party insurer is claiming them under a policy insuring a heavy commercial vehicle. R.S.O. 1990, Reg. 664, s. 9 (3); O. Reg. 780/93, s. 1.**

Section 1 of the *Insurance Act* defines "insurer" as follows:

**"insurer" means the person who undertakes or agrees or offers to undertake a contract;**

It is in this context that this dispute comes forward for resolution. ING, having received and processed a claim for the Statutory Accident Benefits of an insured, is pursuing its rights pursuant to section 275 of the *Insurance Act* and the Regulations thereunder. The respondent takes the position that its contract of insurance is unenforceable as a result of misrepresentations or nondisclosures in the formation of the insurance contract. The respondent argues that, in such circumstances, there is no entitlement to recover pursuant to the statutory provisions and regulations set out.

**Background Facts**

The parties state that the facts as recited in the materials before me are correct and agreed, except for the assertion in paragraph 5 of the applicant's factum, which is no longer accurate.

The record indicates that an accident took place on May 29, 2001. ING's insured, Toneguzzo, owned a 1983 Volkswagen automobile, which was insured by ING pursuant to a motor vehicle liability policy. In the accident, ING's policyholder was injured and ING has been paying benefits with respect to the insured's sustained impairment.

The second vehicle involved in the accident is a "heavy commercial vehicle" owned by 1101762 Ontario Ltd. o/a Ron Way, and operated by Cyril James Corner. The respondent issued a motor vehicle liability policy in respect of this vehicle.

The respondent denied coverage by correspondence dated December 23, 2002, citing material misrepresentations made in the application for the policy. The respondent subsequently refunded the insurance premiums received.

**The Issues**

At this stage of these proceedings, the parties have submitted two issues for determination:

1. Does a misrepresentation or nondisclosure defence negate otherwise existing obligations with respect to Loss Transfer?
2. Should I, as arbitrator in these proceedings, decide the merits of the misrepresentation defence?

**Analysis**

From the earliest days of insurance, the common law has imposed duties of good faith in connection with the formation of contracts of insurance. The law has recognized that when a contract of insurance is made, the proposed policyholder is in an advantageous situation with respect to knowledge of the risk being assumed by the insurer. Where the policyholder, as applicant for insurance, has failed to disclose material facts, or has misrepresented material facts, the courts have granted relief to the insurer.

In general, the law allows an insurer to treat the contract of insurance as void in such circumstances. The obvious effect of such disposition is that the insured person is not able to recover payment of a claim from the insurer. As between the underwriter, who was duped, and the insured who provided incomplete or misleading information to seduce the underwriter into a contract, this result is fair and just.

However, automobile insurance in present-day Ontario is a very different insurance arrangement than the early contracts of insurance that gave rise to the development of common law avoidance of coverage for misrepresentation and nondisclosure. Indeed, automobile insurance in general has parted company with common law contract principles in many respects. It is a highly regulated product. For the most part, customers are required by law to purchase the product. The terms and conditions of the

contract are set out by statute, by regulation, and by forms which are approved by regulators. In Ontario, the price that may be charged by an insurer for a policy of automobile insurance is regulated and subject to approval. Furthermore, the very criteria that insurers might apply to set a price is also regulated and restricted by regulation, and by government officials.

With respect to payment of claims, policies of automobile insurance serve diverse interests, going well beyond protecting the policyholder from loss. In this regard, modern automobile insurance protects the policyholder for loss or damage to the insured vehicle. It provides a source of compensation for third party victims who may be injured as a result of a policyholder's negligence, a protection for security holders who have financed the purchase of an automobile. Further, it funds a broad program providing "no-fault" benefits to many individuals, other than the policyholder, who may be injured in an accident. A legal rule that voids all coverage as a result of a misrepresentation or non-disclosure in the application process would be detrimental to many persons other than the person who was the applicant for insurance.

With respect to the third party liability coverage, the *Insurance Act* specifically preserves the availability of protection from the benefit of innocent victims, notwithstanding various acts or defaults on the part of the insured person. Section 258 of the *Insurance Act* creates "absolute liability" for the insurer.

**258. (1) Any person who has a claim against an insured for which indemnity is provided by a contract evidenced by a motor vehicle liability policy, even if such person is not a party to the contract, may, upon recovering a judgment therefor in any province or territory of Canada against the insured, have the insurance money payable under the contract applied in or towards satisfaction of the person's judgment and of any other judgments or claims against the insured covered by the contract and may, on the person's own behalf and on behalf of all persons having such judgments or claims, maintain an action against the insurer to have the insurance money so applied. R.S.O. 1990, c. I.8, s. 258 (1).**

**(2) Repealed: 2002, c. 24, Sched. B, s. 39 (2).**

**Other creditors excluded**

**(3) A creditor of the insured is not entitled to share in the insurance money payable under any contract unless the creditor's claim is one for which indemnity is provided for by that contract. R.S.O. 1990, c. I.8, s. 258 (3).**

**Insurer absolutely liable**

**(4) The right of a person who is entitled under subsection (1) to have insurance money applied upon the person's judgment or claim is not prejudiced by,**

**(a) an assignment, waiver, surrender, cancellation or discharge of the contract, or of any interest therein or of the proceeds thereof, made by the insured after the happening of the event giving rise to a claim under the contract;**

**(b) any act or default of the insured before or after that event in contravention of this Part or of the terms of the contract; or**

**(c) any contravention of the *Criminal Code* (Canada) or a statute of any province or territory of Canada or of any state or the District of Columbia of the United States of America by the owner or driver of the automobile,**

**and nothing mentioned in clause (a), (b) or (c) is available to the insurer as a defence in an action brought under subsection (1). R.S.O. 1990, c. I.8, s. 258 (4).**

**Section applicable to purported policy**

**(5) It is not a defence to an action under this section that an instrument issued as a motor vehicle liability policy by a person engaged in the business of an insurer and alleged by a party to the action to be such a policy is not a motor vehicle liability policy, and this section applies with necessary modifications to the instrument. R.S.O. 1990, c. I.8, s. 258 (5).**

According to these sections, the innocent victim of the insurer can recover benefits from the insurer, even if the insured contravened a term of the contract, regardless of whether the insurer entered into the contract of insurance as a result of misrepresentation and nondisclosure on the part of the policyholder.[1] In this respect, the Legislature has altered the common law, dispensing with the notion that the contract of insurance might be treated as void by the insurer, and requires the insurer to provide some measure of compensation to accident victims.

The abrogation of common law notions is not limited to claims by third parties. The Legislature has also enacted provisions that generally address the topic of misrepresentation and nondisclosure in the formation of automobile insurance contracts. Section 233 of the *Insurance Act* provides as follows:

**Misrepresentation or violation of conditions renders claim invalid**

**233. (1) Where,**

**(a) an applicant for a contract,**

**(i) gives false particulars of the described automobile to be insured to the prejudice of the insurer, or**

**(ii) knowingly misrepresents or fails to disclose in the application any fact required to be stated therein;**

**(b) the insured contravenes a term of the contract or commits a fraud; or**

**(c) the insured wilfully makes a false statement in respect of a claim under the contract,**

**a claim by the insured is invalid and the right of the insured to recover indemnity is forfeited. R.S.O. 1990, c. I.8, s. 233 (1).**

[1] A recent example of the application of this principle is found in *Campanaro v. Kim* [1998] O.J. No. 3518; (1998) 41 O.R. (3d) 545; (1998) 164 D.L.R. (4th) 400

**Statutory accident benefits protected**

**(2) Subsection (1) does not invalidate such statutory accident benefits as are set out in the *Statutory Accident Benefits Schedule*. R.S.O. 1990, c. I.8, s. 233 (2); 1993, c. 10, s. 1.**

**Use of application as defence**

**(3) No statement of the applicant shall be used in defence of a claim under the contract unless it is contained in the signed written application therefor or, where no signed written application is made, in the purported application, or part thereof, that is embodied in, endorsed upon or attached to the policy.**

**Idem**

**(4) No statement contained in a purported copy of the application, or part thereof, other than a statement describing the risk and the extent of the insurance, shall be used in defence of a claim under the contract unless the insurer proves that the applicant made the statement attributed to the applicant in the purported application, or part thereof. R.S.O. 1990, c. I.8, s. 233 (3, 4).**

Importantly, subsection 233 (2) specifically provides that subsection 233 (1) does not invalidate the statutory accident benefits available to accident victims on a "no-fault basis". To the extent that section 233 describes the defences that may be available to an insurer as a result of misrepresentation or nondisclosure, those defences do not negate access to statutory accident benefits, nor do they preclude recovery by third parties in accordance with section 258 of the *Insurance Act*.

The terms and conditions of those available "no-fault" benefits are set out by *Regulation 403/96* under the *Insurance Act*. It is instructive to note that the Regulation does provide an exclusion in section 30. The exclusion applies to claims in respect of any person who has made, or who knows of, a material misrepresentation that induced the insurer to enter into the contract of automobile insurance or who intentionally failed to notify the insurer of a change of risk material to the contract. In respect of a claim for no-fault accident benefits, the insurer is not required to pay some of the prescribed benefits in those circumstances. However, the insurer's obligation to pay medical benefits, rehabilitation benefits and certain other benefits under the schedule continues. Clearly the legislative and regulatory scheme applicable to these benefits does not contemplate the contract of insurance to be treated as "void" as a result of misrepresentation or nondisclosure on the application for insurance.

From this, one may infer that the Legislature regards section 233 of the *Insurance Act* as a complete code with respect to the effect of misrepresentation and nondisclosure in the formation of a contract of automobile insurance. If common law principles applied, the exclusion found in section 30 of *Regulation 403/96* would be redundant, and the policy of having medical and rehabilitation benefits survive the misrepresentation would be defeated. However, some of the case law with respect to this issue continues to make reference to common law principles, such as the obligation to refund premiums[2], which suggests that section 233 is not a complete code and that the common-law rules exist

[2] for example *Hansra v. York Fire* (1982) 38 O.R. (2d) 281

concurrently. In *Gill v. Zurich,*[3] Eberhard J., canvassed this issue and refers to authority that suggests that section 233 supplants the common law. On the other hand Lang J., in *Venner Woodworking v. Wawanesa,*[4] treated a section 233 defence as distinct from the insurer's declaration that the policy was void "ab initio".

I consider this issue unresolved by the totality of the case law.

It is abundantly clear, however, that an automobile insurer's obligations do not cease to exist in the face of misrepresentation or nondisclosure in the application process. For valid public policy reasons, automobile insurers are compelled by law to pay benefits in circumstances that, at common law, would have allowed the insurer to treat the contract as void.

Turning to the impact of misrepresentation and nondisclosure on the loss transfer provisions, the issue might be framed in the context of the comments of Harrison J., in *Bourgeois et al. v. Prudential Assurance Co. Ltd*[5]:

> **The principal question here is whether the action is based upon the contract contained in the policy or upon an entirely independent statutory liability imposed on insurance companies.**

Harrison J., was considering the effect of absolute liability provisions when he applied this analysis, but it is appropriate here. The obligation created by section 275 of the *Insurance Act* is not an obligation on the policyholder, for which the insurer is obliged to provide indemnity. It is an obligation imposed directly on the insurer of the involved automobiles described in the regulations. Neither the entitlement, nor the obligation, to indemnify a "first party insurer" arises from the policy terms and conditions. Indeed the policyholder cannot be held liable for loss transfer. It is solely the obligation of the insurer. Furthermore, the insured has no entitlement with respect to loss transfer. Section 233 of the *Insurance Act* does not relieve the respondent from its loss transfer obligations because it is not a "claim by the insured". I conclude that section 275 of the *Act* and the Regulations thereunder represent an "independent statutory liability imposed upon insurance companies".

The respondent further argues that, in the presence of material misrepresentations, it is not an "insurer", and therefore section 275 of the *Insurance Act* does not apply. I agree that section 275 applies only to insurers. In a general sense the respondent is an insurer. It does undertake contracts of insurance. However, in this instance, if the contract is tainted by misrepresentation, can the respondent say that it is not an "insurer"?

My conclusion is that it cannot. The respondent is an insurer in general, and in relation to this accident. It offered a contract and it undertook a contract. The definitions in the *Act* deem it to be an insurer.

Furthermore the Act and the Regulations clearly consider the position of a party that has undertaken a contract, even one based on misrepresentation and non-disclosure, to be an insurer. In section 258 of the *Insurance Act* absolute liability is created against "the

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[3] [1999] O.J. No. 3860
[4] [1996] O.J. No. 132; (1996) 33 C.C.L.I. (2d) 288; [1996] I.L.R. 1 – 3289
[5] [1946] 1 D.L.R. 139, (N.B.C.A.)

insurer". Subsection 258 (14) allows an "insurer" to be added as a statutory third party, as the respondent has done in this case. In section 30 of the Statutory Accident Benefits Regulation the exclusionary language clearly refers to "the insurer":

> **The insurer is not required to pay an income replacement benefit, a non-earner benefit or a benefit under section 20, 21 or 22,**
>
> **(a) in respect of any person who has made, or who knows of, a material misrepresentation that induced the insurer to enter into the contract of automobile insurance or who intentionally failed to notify the insurer of a change in the risk material to the contract;**

For the purposes of section 275 of the Insurance Act, I conclude that the respondent is an insurer.

In coming to my decision, I am required to weigh the interests of ING, the insurer paying the benefits, against the interests of the respondent who underwrote a policy potentially based on misrepresentation. Choosing between those interests compels me to observe that ING is remote from the underwriting transaction in question. The respondent was not remote. The respondent may well be a victim of deceit, but it had the opportunity to apply scrutiny to the representations made to it. ING has had no such opportunity to avoid the loss that the respondent says should rest with ING.

In contemporary automobile insurance a misrepresentation in the application process does not relieve an insurer of all obligations. I conclude that the obligation to respond to a loss transfer claim continues to exist.

**Conclusion**

If Lloyd's was induced into the contract of insurance by misrepresentation or non disclosure, it does not negate its obligations arising from section 275 of the *Insurance Act.*

It is uneccessary for me to consider the second issue raised by the parties, as to whether it would be appropriate to consider the merits of the misrepresentation defence in this proceeding.

The parties should make submissions with respect to costs by March 22, 2005.

Dated at Toronto this 23rd day of February, 2005.

Lee Samis

Lee Samis