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Newsletter

Insurance Law

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Testing nullity *ab initio* in the context of a professional liability insurance policy for a financial products broker

On May 16, 2016, the Court of Appeal had the chance to revisit this notion in *Brunet* v. *AXA Assurance Inc.*, 2016 QCCA 832 (CanLII). The facts, as stated in the trial and appeal judgements, are the following:

The plaintiffs had invested certain sums through brokerage firm Capital Triglobal Inc. ("**Triglobal**") starting in 2002. Triglobal was registered with the relevant authorities, first with the *Commission des valeurs mobilières* ("**Commission**") and then with the *Autorité des marchés financiers* ("**AMF**").

Triglobal's president ("**Papadopoulos**") and another person ("**Bright**") were the only two shareholders of the holding company, itself the sole shareholder of Triglobal. Papadopoulos held certificates with both the Commission and the AMF, but none which allowed him to act as a securities broker or adviser, from 2001 to 2005.

Prior to 2008, AXA Assurance Inc. ("**AXA**") insured Triglobal, as well as its 200 representatives, through separate liability policies. These policies were of the "claims made" type.

On May 18, 2007, an article published in *La Presse* reported on several worrisome rumours regarding the funds in which the plaintiff's assets had been placed by Triglobal. On the same day, AXA communicated with Triglobal's broker in order to inquire into the situation, especially since the insurance policies were expiring on June 1st. In a long email on May 22nd, Papadopoulos called the article in *La Presse* a "complete fabrication" and refuted each of the compromising allegations one by one.

On May 24th, Triglobal's lawyers sent a demand letter to Dale Parizeau instructing them to find a solution to the potential non-renewal of the insurance policies.

Following the publication, on June 8th, of an article correcting or mitigating certain facts reported on in the May 18th article and the insertion of certain new exclusions to the policy, some of which had been announced in early May, AXA renewed the insurance policies.

On December 21, 2007, a blocking order was issued by the *Bureau de décision et de révision en valeurs mobilières* against Triglobal, Papadopoulos and Bright, and a temporary administrator was named. Finally, on January 8, 2008, AXA cancelled Triglobal's insurance policy *ab initio*.

It turned out that the plaintiffs, Triglobal's clients, had been the victims of a "Ponzi" type scheme. Considering that Triglobal was insolvent and that its officers had not been located, the plaintiffs instituted proceedings against Triglobal's insurer, AXA.

In this context, the Court had to determine whether AXA was bound to indemnify the plaintiffs despite the existence of a fraud.

At trial, the plaintiffs invoked the fact that the *Loi sur la distribution des produits et services financiers* (the "**Act**"), and its associated regulations, prohibit insurers or brokerage firms subject to the Act from excluding the faults, errors, negligence or omissions of their representatives in the performance of their duties, since the Act aims to protect consumers.

The plaintiffs more specifically argued that since the Act imposes on insurance companies an obligation to inform the AMF of their intention to rescind the insurance policy emitted or not to renew it, a similar obligation should also apply to cases of nullity *ab initio*.

In addition, the plaintiffs claimed that the fraudulent investments were only one part of Triglobal's activities and that the company's conduct must be dissociated from that of its officers.

Finally, the plaintiffs alleged that AXA could have detected the fraud in the course of the contract due to the information it had received and, as such, could not invoke said fraud.

The trial judge, on the basis of articles 2408 and 2466 of the *Civil Code of Quebec*, considered that no insurer would have accepted to issue an insurance policy to Triglobal if they had been informed of the fraudulent structure offered to its

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clients, that the company and its officers could not be dissociated, since the officers had themselves answered the questions asked by AXA, and that the evidence did not establish that AXA could have detected the fraud. Therefore, the Court denied the plaintiffs' claim.

However, the trial judge did not award costs to defendant AXA since it had kept the premiums paid by Triglobal despite the policy's nullity *ab initio*.

The plaintiffs appealed. The Court of Appeal identified the issue as such: Did the trial judge err in law in declaring the insurance policy required by the Act null *ab initio* due to the applicant's false declarations?

The Court of Appeal first referred to plaintiffs' contention that the rules of nullity *ab initio*, as well as concealment, should be interpreted differently due to the fact that the Act requires obtaining a professional liability insurance policy in order to be registered with the AMF. As such, the recourse of a third party against the insurance should have priority in a case such as this one.

In its analysis, the Court of Appeal referred to article 2410 of the *Civil Code of Quebec* regarding misrepresentation and concealment. It then confirmed that no insurer would have accepted to cover Triglobal if it had known of its fraudulent activities.

The court then proceeded to determine whether Triglobal's president, while making false representations to the insurer, had the "directing authority" required to bind the company.

The Court noted that, in order to decide this issue, it was necessary to go beyond the person's title or financial ownership of the company and examine the directing mind concept.

The Court concluded that Triglobal expressed itself through Papadopoulos, its president, and that he was involved in the fraudulent operations of the company. As such, the Court considered his representations as those of Triglobal. Hence, the Court of Appeal concluded that the policy was null *ab initio* and confirmed the trial judgment.

In its analysis, the Court noted that the Act and its associated regulations cannot be interpreted in such a way as to supersede article 2410 of the *Civil Code of Quebec* absent any specific provision to that effect.

We note that the Court also stated that the outcome could have been different if the fraud had been committed by a simple Triglobal employee.

In addition, the judgement suggests that a specific mention in the Act could potentially have barred the application of article 2410 of the *Civil Code of Quebec*.

Finally, we note that, despite the policy's nullity *ab initio*, AXA appears to have kept the payment of the insurance premiums despite Triglobal's insolvency. The absence of reimbursement of said premiums was however not specifically addressed by the Court of Appeal and could be analysed in another case.

The content of this newsletter is intended to provide general commentary only and should not be relied upon as legal advice.

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