

Fraud 101

CFE's address many types of fraud related activities from identity theft to healthcare fraud and everything in between. Although there are always two parties involved one is often a faceless legal entity. The perpetrators are not often psychopaths, but it takes an individual with psychopathic tendencies to be deceptive on a continuous basis.

The Canadian Oxford Dictionary defines fraud as: "the action or an instance of deceiving someone in order to make money or obtain an advantage illegally". Put another way fraud is: "A false representation of a matter of fact—whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed—that deceives and is intended to deceive another so that the individual will act upon it to her or his legal injury. (Farlex Free Dictionary)

In Duhaines Law Dictionary fraud is defined as: "Deceitful conduct designed to manipulate another person to give something of value by (1) lying, (2) by repeating something that is or ought to have been known by the fraudulent party as false or suspect or (3) by concealing a fact from the other party which may have saved that party from being cheated."

To prove fraud:

- (1) There must be a false statement of a material fact that bears on the disputed transaction.
- (2) Knowledge that the statement is designed to mislead or untrue.
- (3) An intent to deceive, or deprive the victim of a legal right.
- (4) Justifiable and reasonable reliance on the statement, and
- (5) Injury which would leave the victim worse off, as a result.

As such, section 380 of the Canadian Criminal code defines the crime of fraud as: "Everyone who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service ... (or) ... with intent to defraud, affects the public market price of stocks, shares, merchandise or anything that is offered for sale to the public."

Where there are contractual relationships "fraud will usually cause a court to void a contract and can give rise to criminal liability".

Deception itself is a cooperative act and many frauds are perpetrated under a contractual relationship between unequal parties. Victims of lies have a lapse in judgment and may unconsciously agree to be lied to; not because they are stupid but because there is a tendency to ignore signs of deception or red flags that they should be alert to because of a psychological bias to the truth.

They want to believe what they're hearing is true and tend not to read every page, even when they identify mistakes and errors. They may ask the right questions and receive answers that don't correlate or are provided with stories and "alternative facts". With deception though, there may not be a hint that they are being lied to. In our current low interest rate environment, if offered the right incentive, even astute business people can succumb to GREED.



William Vasiliou, MBA, CPA, CGA, CFE, DAC
Chapter President



“The Thorny Problem of Insurance and Releases”

by David Debenham (Co-Chair of the Fraud Law Group of McMillan LLP).

Insurance law is easy in theory, but hard in practice. The case of *Stairs v. CFM Corporation et al.*,¹ a decision of the New Brunswick Court of Appeal that reverses the lower court, is a helpful refresher on basic insurance law principles and the thorny problem of releases given in the context of third party insurance.

Third Party insurance involves an Insurer agreeing to indemnify their Insured, against losses caused by a Third Party, the wrongdoer. In exchange for such indemnification, the Insurer receives a premium from the Insured, along with a right of “subrogation” which allows the Insurer to pursue, in the name of the Insured, a claim against a Third Party in respect of a loss for which the Insured has been indemnified by the Insurer in accordance with the terms of the Insurance Contract. It follows that after the Insurer has indemnified its Insured, the real party in interest is the Insurer, who “stands in the shoes of the insured”, and whose right of entitlement to recovery can be no greater than that of the insured”. It also follows that if the Insured signed a lease that prevented it from suing its landlord for a loss, the Insurer would be similarly prevented from suing the landlord for a loss. Indeed, any valid pre-loss release of liability by the Insured in favour of any Third Party will protect the latter against any related subrogation action.

So far, so good. But what about a post-loss release of liability? Sometimes the Insured’s policy does not cover it against all losses, so he or she wants to recover the balance from the wrongdoer. Sometimes the Insurer has yet to make a decision on coverage and the Third Party offers the Insured a settlement with a release. Can the post-loss settlement of a claim, and the consequential release of liability, always be set up as a valid defence against a subrogation action arising out of the subject matter of the settled claim?

To answer this question we first look at the applicable Insurance Act of the province. Do the Insurer and the Insured both have to be parties to the release for it to be binding on them according to the statute? If the statute is silent it is the common law that governs, and, at common law, concurrence of the insurer is not a prerequisite to a valid settlement or release, which can be subsequently raised as a defence against the insurer’s subrogated rights. But what if the Insurer has paid the Insured, and the Insured subsequently provides the Third Party a release even though the Insurer’s rights of subrogation take effect upon payment to the Insured? Does it matter if the Third Party knows that the Insured has already been paid by its Insurer? The principal question of law is whether the common law recognizes an exception in cases where the insurer paid its insured before any settlement or release with the tortfeasor and where the party liable had, prior to settling with the insured, notice of the insurer’s consequential right of subrogation.

In this case subrogation rights that arose when the insurer made a significant payment to its insured under a homeowner’s insurance policy, and then, without the knowledge and consent of the insurer, the insured settled with an alleged tortfeasor and took a small amount of money, ostensibly for losses that were not otherwise covered by insurance, in exchange for: (1) a broadly worded general release; and (2) the discontinuance of an action by consent order which provided that the discontinuance would constitute a complete bar to subsequent proceedings regarding the subject matter of the claim. At the time the release and the discontinuance were obtained, the alleged tortfeasor was aware the insurer had made a significant payment to its insured and that the insurer intended to exercise its right of subrogation. When the insurer brought an action in the name of its insured pursuant to its right of subrogation, the alleged tortfeasor raised the release and the discontinuance order of the insured’s preceding lawsuit as a defence. A judge of the New Brunswick gave effect to the defence, and dismissed the insurer’s subrogated claim. The New Brunswick Court of Appeal reinstated it. The appellate court held that a settlement and a release given by an insured does not bar a subsequent subrogated claim where the releasee was aware of the insurer’s subrogated rights at the time the release was signed.

¹ 2017 NBCA 8 (CanLII),



In exercising its subrogated rights, the insurer would usually not be in any better position than its insured. Thus, if, for example, a limitation period had expired, that defence could be raised with equal force. More specifically, a settlement and a release by an insured would generally bar a subsequent subrogated action for damages arising out of the same subject matter. However, the common law recognizes an exception regarding the effect of a settlement and a release in cases where the alleged liable party had prior notice of the insurer's right of subrogation. A settlement between an injured party and a tortfeasor does not destroy the subrogation claim of the injured party's insurer if prior to the release the tortfeasor has knowledge of those rights, or if the tortfeasor's insurer has knowledge of those rights, and the insurer does not consent. If the wrong-doer pays the assured after payment by the insurer, with knowledge of the facts, it is regarded as a fraud upon the insurer, and he will not be protected from liability to the latter. The doctrine of subrogation, which is based upon principles of equity has a dual objective — It seeks, first, to prevent the insured from recovering twice for one harm, as it might if it could recover from both the insurer and from a third person who caused the harm, and second, to require the party who has caused the damage to reimburse the insurer for the payment the insurer has made. If the settlement is made before subrogation, the Insured is taken to be satisfied in full by the settlement with the Third Party, and has released his or her claim to Indemnification from his Insurer by the Insured's destruction of the the insurer's subrogation rights against the Third Party.

What kind of knowledge must there be? Actual knowledge will suffice, of course. What about constructive knowledge? In this case the Third Party knew that it has provided \$7500 for a release where (1) the explosion totally destroyed the Insured's home; (2) the Insured were totally innocent parties; (3) the cost to repair or replace the home would be \$320,000 (4) the Insurer was participating in the coordination of efforts to investigate the claim; (5) the Insurer intended to indemnify and pursue recovery pursuant to its right of subrogation; and (6) the \$7,500 paid to the Insured to settle their earlier lawsuit could not possibly include the loss of their home. This was sufficient constructive knowledge to prevent the Third Party from relying on its release from the Insured as a defence to the claim by the Insurer.

An insurer's right of subrogation attaches, by operation of law, upon its payment of an insured's loss. The thorny question becomes, what happens if the Third Party settles with the Insured without knowledge of the insurer's right of subrogation having taken place? That remains an open question.

Lesson Learned

Insurance adjusters must alert Insured and Third Parties alike of their rights of subrogation and to take steps to ensure these parties do not settle these claims between them without knowledge of the consequences.



David Debenham is Co-Chair of the Fraud Law Group of McMillan LLP

David, a lawyer with full accounting credentials and an overlay of forensics, is the author of **The Law of Fraud and the Forensic Investigator** (2nd edition) from CARSWELL.



JAMES D. RATLEY, CFE
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Interviewing Prospective Witnesses & Evaluating Deception

You cannot prepare enough for your interviews. The psychology of deception is very complex and often manifests itself through verbal and non-verbal cues. Learn why observation is critical during the entire investigation but more so during the interviewing process. You will see how the various environmental and psychological factors can enter into the simplest of interviews and also learn that developing the right questions in the right sequence can produce very beneficial results.

Association of Certified Fraud Examiners
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&

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WEDNESDAY APRIL 5, 2017 (One Day)

7:45 am (Registration) to 4:30pm

Location: BMO INSTITUTE FOR LEARNING
3550 Pharmacy Ave., Toronto, ON M1W 3Z3

For more information or to register, [click here](#)

Membership Renewal

March is membership renewal time at the ACFE Toronto Chapter. We thank all our members who have supported us throughout the years and because of it, we have been able to continue offering events such as our monthly dinner meetings, one-day fraud conference, newsletter, website, social media, and support. Don't miss out! To renew your membership:

[Click Here](#)



Stirling Man Charged With Fraud & Money Laundering in Local Insurance Fraud Scheme

Lethbridge Police have charged a 36 year old man in connection with a \$500,000 fraudulent scheme. [Read More](#)

Two firefighters charged with fraud deny allegations

Two firefighters facing a \$4 million lawsuit from their union for allegedly misappropriating parts of workers' compensation awards to widows and families of retirees have now been charged with fraud and money laundering. [Read More](#)

Insurance broker charged with \$540,000 commission fraud

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15 most famous cases of insurance fraud

Check out these famous insurance fraud cases that surely carried a huge bounty. [Read More](#)

Fraser Health revokes hospital privileges of Burnaby urologist convicted of fraud

Three hospitals where a Burnaby urologist has performed surgery for several years revoked his privileges Monday after he pled guilty to fraud in a criminal case that stemmed from over-billing taxpayers for his medical services. [Read More](#)

Romance scam leaves senior penniless

A former City of Toronto employee has gone from living comfortably in a condo to "hand-to-mouth" and penniless after falling for a West African romance scam. [Read More](#)



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The ACFE is the world's largest anti-fraud organization and premier provider of anti-fraud training and education. Together with more than 70,000 members, the ACFE is reducing business fraud world-wide and inspiring public confidence in the integrity and objectivity within the profession. Visit www.acfe.com for more details.

Upcoming Events:

-  **April 5, 2017 ACFE Toronto & CPIO presents – Fraud Investigation Technology Conference**
Venue: BMO Conference Centre, 3550 Pharmacy Avenue, Toronto, ON M1W3Z3 Canada
[More information and Registration](#)
-  **April 19, 2017 IIA Toronto presents – Auditing Data Management and Data Governance**
Venue: The Albany Club, 91 King St. E, Toronto, Ontario
Speaker: Caroline Alleslev-Cserhati, Senior Director, Risk Assurance Services, PwC
[More Information and Registration](#)
-  **May 30, 2017 ACFE Toronto presents – Employee Dishonesty and the Role of Ethics Training**
Speaker: Andrew Kautz, CFE, Manager, Special Investigations Unit, Great-West Life Assurance Company
Venue: The Royal Canadian Military Institute (RCMI) – 426 University Ave; Toronto, ON M5G 1S9
5:30 – 7:15pm
[More Information and Registration](#)