

**BAD FAITH AND GOOD FAITH CLAIMS:
THE ROAD TO PUNITIVE DAMAGES**

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Bad Faith and Good Faith Claims: The Road to Punitive Damages

Introduction

Historically, it was a general rule that punitive damages were not available for breach of contract. As S.M. Waddams points out:

This rule is based on the assumption underlying much of contract law that a breach of contract, coupled with an offer to pay just compensation does no harm to the plaintiff, is not morally wrong and may be desirable on the grounds of efficiency.¹

However, in recent years, Canadian courts have indicated a greater willingness to award punitive damages as a means of censuring defendants whose breach of contract involves conduct that is particularly reprehensible.

In *Vorvis v. Insurance Corporation of British Columbia*², a 1989 decision of the Supreme Court of Canada, McIntyre J., writing for a 3-2 majority, declined to make an award of punitive damages in favour of an employee who was badly treated by his employer. He did not, however, endorse an absolute prohibition against punitive damage awards in cases of breach of contract, stating instead:

...In my view, while it may be very unusual to do so, punitive damages may be awarded in cases of breach of contract. It would seem to me, however, that it will be rare to find a contractual breach which would be appropriate for such an award... In an action based on breach of contract, the only link between the parties for the purposes of defining their rights and obligations is the contract. Where the defendant has breached the contract, the remedies open to the plaintiff must arise from that contractual relationship, that “private law”, which the parties agreed to accept. The injured plaintiff then is not entitled to be made whole; he is entitled to have that which the contract provided for him or compensation for its loss. The distinction will not completely eliminate the award of punitive damages but it will make it very rare in contract cases.³

¹ *The Law of Damages*, looseleaf (Aurora, Ont.: Canada Law Book, 2001)

² (1989), 58 D.L.R. (4th) 143, [1989] 1 S.C.R. 1085, cited to D.L.R.

³ *Ibid* at 207.

To respect this doctrinal distinction, McIntyre J. endorsed the restriction of punitive damage awards to cases in which the impugned conduct constituted an “independent actionable wrong.” There was some suggestion in the decision that an independent actionable wrong needed to be an independent tort for which punitive damages were available. As a result, insurance litigation frequently involved the plaintiff’s argument that an insurer’s breach of contract also constituted an independent tortious wrong.

In 2002, the Supreme Court of Canada revisited the issue in *Whiten v. Pilot Insurance Co.*⁴ clarifying that, at least in the case of insurance contracts, a breach of good faith dealing could be an actionable wrong founding a claim for punitive damages whether or not it could be classified as tortious. What is required is that the wrong be sufficiently reprehensible that punitive damages are necessary to achieve retribution, deterrence and denunciation of the impugned conduct.

In *Whiten*, a 6-1 majority restored a jury award of \$1,000,000 in punitive damages to an insured injured by the bad faith conduct of its insurer. The decision represents the ‘high-water’ mark in Canada in terms of a first-party insurer being ordered to pay punitive damages for bad faith conduct in dealing with its insured. The Supreme Court of Canada has also provided a framework for the courts to deal with claims for punitive damages in the future. A number of issues have already arisen from the reasons for judgment.

In this paper, we will consider the following points:

- how punitive damages are defined;
- the duty of good faith as it relates to the relationship between the insurer and its insureds;
- examples of good and bad faith in the insurance context;
- the concept of an independent actionable wrong;
- a brief overview of the *Whiten* decision; and

⁴ (2002), 209 D.L.R. (4th) 257(S.C.C.), rev’g 170 D.L.R. (4th) 280, (Ont. CA).

- a summary of cases that have arisen since the *Whiten* decision.

Defining Punitive Damages

General and aggravated damages are compensatory in nature. Punitive damages, in contrast, are not designed to compensate the plaintiff but to punish the wrongdoer.⁵ In *Vorvis, supra*, Mr. Justice McIntyre explained the nature of punitive damages as follows:

... punitive damages may only be awarded in respect of conduct which is of such nature as to be deserving of punishment because of its harsh, vindictive, reprehensible and malicious nature. I do not suggest that I have exhausted the adjectives which could describe the conduct capable of characterizing a punitive award, but in any case where such an award is made the conduct must be extreme in its nature and such that by any reasonable standard it is deserving of full condemnation and punishment.⁶

Similarly, in the context of a defamation action in *Hill v. Church of Scientology of Toronto*, Mr. Justice Cory, stated as follows:

Punitive damages may be awarded in situations where the defendant's misconduct is so malicious, oppressive and high-handed that it offends the court's sense of decency. Punitive damages bear no relation to what the plaintiff should receive by way of compensation. Their aim is not to compensate the plaintiff, but rather to punish the defendant. It is the means by which the jury or judge expresses its outrage at the egregious conduct of the defendant. They are in the nature of a fine which is meant to act as a deterrent to the defendant and to others acting in this manner. It is important to emphasize that punitive damages should only be awarded in those circumstances where the combined award of general and aggravated damages would be insufficient to achieve the goal of punishment and deterrence.⁷

The Court in *Whiten, supra*, reiterated the importance of the limiting the award of punitive damages to cases where it is necessary to achieve "retribution, deterrence and denunciation," of the impugned conduct.⁸

⁵ *Vorvis, supra* note 2 at 201.

⁶ *Vorvis, supra* note 1 at 208.

⁷ [1995] 2 S.C.R. 1130, 126 D.L.R. (4th) 129 at paras. 196-197.

⁸ *Supra* note 4 at 277.

Duty of Good Faith

In contracts of insurance, there are corresponding duties of good faith on the part of insurer and the insured. In the disability insurance context, “the insurer owes a duty of good faith in handling the insured’s claim. There is a corresponding duty of good faith on the insured, for instance to tell his or her insurer the complete truth about capabilities and activity levels.”⁹

In *Fredrikson v. ICBC*, Chief Justice Esson (as he then was) explained the basis of the duty of good faith as follows:

Insurance contracts are said to be contracts *uberrimae fidei*. Although that language is often used in the most general way, the obligation of utmost good faith has historically been imposed only upon the insured at the point of formation of the contract. Because the material facts are entirely within the knowledge of the applicant for insurance, and because the insurer is therefore vulnerable to any concealment, the law imposes a duty of full disclosure. Because of the power reposed in the insurer by its control over the question whether to settle, and the potential vulnerability of the insured, there is a basis for imposing a somewhat analogous duty upon the insurer.¹⁰

There have been difficulties establishing the exact nature and scope of the duty of good faith as is evident from the following comments of Mason J. in *Adams v. Confederation Life Insurance Co.*:

The duty of good faith is founded on the principle of *uberrimae fides* which Mr. Matthews defines as “a curious animal: arising from an indefinite source, with an undetermined content” of “considerable flexibility and versatility”... However, defined at this time, it is clear from these authorities that an insurer owes a yet undefined duty of good faith to its insured. It is a duty which in certain circumstances, resembles a fiduciary duty but is always governed by fair play in every dealing.¹¹

⁹ Buller, R., *The Rainmaker Revisited: Punitive and Aggravated Damages in the Real World of Disability Insurance*, (2001) 79 Can. Bar Rev. 201 at 204.

¹⁰ [1990] 4 W.W.R. 637 (B.C.S.C.) at 672.

¹¹ (1994), 25 C.C.L.I. (2d) 180, [1994], 6 W.W.R. 662 (Alta.Q.B.), cited to W.W.R. at 685.

In *702535 Ontario Inc. v. Non-Marine Underwriters, Lloyd's of London*, O'Connor J.A. gave a more specific explanation of an insurer's duty of good faith as follows:

The first part of this duty speaks to the timeliness in which the claim is processed by the insurer. Although an insurer may be responsible to pay interest on a claim paid after delay, delay in payment may nevertheless operate to the disadvantage of an insured. The insured, having suffered a loss, will frequently be under financial pressure to settle the claim as soon as possible in order to redress the that underlies the claim. The duty of good faith obliges the insurer to act with reasonable promptness during each step of the claims process. Included in this duty is the obligation to pay a claim in a timely manner when there is no reasonable basis to contest coverage or to withhold payment. *Bullock v. Trafalgar Insurance Co. of Canada*, [1996] O.J. No. 2566 (Quicklaw) (Gen Div.), *Labelle v. Guardian Insurance Co. of Canada. et al.* (1989), 38 C.C.L.I. 274 (Ont. H.C.J.); *Jauvin v. L'Ami Michel Automobile Canada Ltée et al* (1986), 57 O.R. (2d) 258 (H.C.J.).

The duty of good faith also requires an insurer to deal with its insured's claim fairly. The duty to act fairly applies both to the manner in which the insurer investigates and assesses the claim and to the decision whether or not to pay the claim. In making a decision whether to refuse payment of a claim from its insured, an insurer must assess the merits of the claim in a balanced and reasonable manner. It must not deny coverage or delay payment in order to take advantage of the insured's economic vulnerability or to gain bargaining leverage in negotiating a settlement. A decision by an insurer to refuse payment should be based on a reasonable interpretation of its obligations under the policy.

This duty of fairness, however, does not require that an insurer necessarily be correct in making a decision to dispute its obligations to pay a claim. Mere denial of a claim that ultimately succeeds, is not, in itself, an act of bad faith: *Palmer v. Royal Insurance Co. of Canada* (1995), 27 CCLI (2d) 249 (Ont. Gen. Div.)

What constitutes bad faith will depend on the circumstances in each case. A court considering whether the duty has been breached will look at the conduct of the insurer throughout the claims process to determine whether in light of the circumstances,

as they then existed, the insurer acted fairly and promptly in responding to the claim.¹²

While the cases provide some instructive examples, the precise scope of an insurer's duty of good faith remains uncertain in Canada. According to a recent article in the *Federation of Defense & Corporate Counsel Quarterly*, the American courts and commentators are in general agreement that an insurer's duty of good faith continues even after the insured commences litigation against the insurer. Since there remains, however, uncertainty as to the nature of the duty as well as the admissibility at trial of evidence of the insurer's conduct during litigation, including privileged documents, the authors suggest that the impact may have is a chilling effect on the insurer's ability to defend itself.¹³

Examples of good and bad faith

The specific content of an insurer's duty of good faith will vary according to the circumstances of each case, including the type of insurance being provided. However, in general terms, the duty of good faith requires that the insurer must not use the power imbalance between the parties to force or compel the insured to agree to an unfair settlement or to deny coverage. The following cases are illustrative.

Disability Insurance Claims

In *Warrington v. Great-West Life Assurance Co.*, the plaintiff sought recovery of benefits under two disability insurance policies. As well, he sought aggravated and punitive damages. Despite medical evidence that he was totally disabled, the defendant had been denied his entitlement to benefits. Mr. Justice Josephson, of the British Columbia Supreme Court, stated:

A lack of "good faith and fair dealing" necessarily implies something more than mere failure to pay. In the context of this case, the alleged bad faith is the discontinuance of benefits after two weeks when the defendant was aware, or ought reasonably to

¹² 184 D.L.R. (4th) 687, [2002] O.J. No. 866 at paras. 29-31.

¹³ Christian, D.L. & N.D. Meyer, "Continuing Bad Faith: Theory of Liability or Rule of Evidence?", 52 *FDCC Quarterly* 245 (Winter, 2002).

have been aware, that the plaintiff was entitled to benefits under the terms of the policy.¹⁴

In *Ferguson v. National Life Assurance Co. of Canada*¹⁵, the insured sued after being denied long term disability benefits. The court found that the insurer deliberately sent the insured, knowing he suffered from agoraphobia, for a “medical examination” in another city. The insurer misrepresented the qualifications of the examiner as a medical doctor and denied benefits on the basis of the examiner’s conclusion that the insured was malingering. This was in contrast to the opinions of the medical doctors that has seen him. The court found that the insurer’s conduct was a breach of good faith, characterising it as, “harsh calculated, reprehensible, malicious and extreme as to be deserving of full condemnation and punishment.”¹⁶

In *Milbury v. Imperial Life Assurance Co. of Canada*, Mr. Justice Molloy, of the Ontario Superior Court of Justice, granted summary judgment in a motion to dismiss a claim for punitive damages, stating:

Punitive damages are not available merely because an insurer terminates benefits and later concedes this to have been in error. Likewise, the fact that the insurer did not give the insured advance notice of the decision to terminate is not sufficient to attract punitive damages. That is the only conduct alleged by the insured to give rise to punitive damages. The insurer acted on its good faith belief that Mr. Milbury was not entitled to continuing benefits. That belief was based on compelling evidence from a variety of reliable sources. There is no obligation on an insurer to give an insured a formal right to be heard before termination of benefits. Insurers are entitled to be wrong without attracting punitive damages. They will be liable for breach of contract if they cancel benefits for reasons that turn out to be incorrect. However, conduct warranting punitive damages must consist of actions that go well beyond breach of contract. In this case, the insurer acknowledges breach of contract and has reinstated the benefits. In my opinion, even taking the plaintiff’s allegations at their highest, the conduct alleged cannot be characterized as bad faith, reprehensible or malicious. This claim has no real chance of success at trial. It is simply not the kind of conduct that could

¹⁴ (1995), 7 B.C.L.R. (3d) 43 (SC) at 56, var’d by 139 D.L.R. (4th) 18, but not on this point.

¹⁵ (1996), 36 C.C.L.I. (2d) 95 (Ont. Gen. Div.); aff’d. (1997), 102 O.A.C. 239 (Ont. CA).

¹⁶ *Ibid*, para. 147, (Ont. Gen. Div).

possibly, as a question of law, warrant an award of punitive damages.¹⁷

Other Insurance Claims

In *702535 Ontario Inc.*¹⁸, the Ontario Court of Appeal held that, where the insurance policy provided that fire losses were to be recoverable 60 days after the insurer receives proof of loss, the insurance companies failure to pay within that time was bad faith conduct. That was so notwithstanding that there was a dispute as to the amount to be paid out. The nature of the dispute was such that the insurance company was in any case liable for at least 50% of the amount claimed and should have paid that amount within the 60 day period.

In *R.B. Williams Industrial Supply Ltd. v. Dominion of Canada General Insurance Co.*,¹⁹ the Alberta Court of Queen's Bench held that, although the insurer had failed to adequately indemnify the insured's business losses and had an unfulfilled duty to defend, its conduct did not amount to bad faith. Subsequent to a fire, the insurer had promptly settled the property damage claim but had legitimate concerns about the scope of its obligation to indemnify against business interruption losses. It also had an arguable case that it had no duty to defend. At trial the content and interpretation of the insurance contract was in dispute.

It is clear from these examples that a breach of the duty of good faith involves something more than mere error. The cases reference the insurer's knowledge and or what the insurer reasonably ought to have known. The insurer is may wrongly refuse claims in good faith provided that they have a reasonable or "arguable" case. On the other hand, conduct that has the effect of exacerbating the loss suffered by the insured, especially if deliberately designed to manipulate the insured to settle or abandon the claim, is likely to be labelled bad faith.

The Need for an Independent Actionable Wrong

In *Vorvis, supra*, Mr. Justice McIntyre held that, for punitive damages to be awarded as a result of a contractual breach, it was necessary that there be an independent actionable wrong that was

¹⁷ 2002 Carswell Ont 1588 (Ont. Sup. Ct. Jus.) at para. 11.

¹⁸ *Supra* note 11.

¹⁹ [2002] A.J. No. 834, 2002 ABQB 600.

capable of supporting such a claim.²⁰ In that decision, McIntyre J. seemed to restrict the concept of an independent actionable wrong to a tortious wrong that is present alongside a contractual breach. He also stated that punitive damages for breach of contract would be rare, as opposed to non-existent, which implied that a tortious wrong was not always necessary. This tension was resolved by Binnie J. in *Whiten*, where the requirement for an independent tortious wrong was abandoned in favour of an independent actionable wrong which need not be tortious.

In an insurance context, the duty of good faith arises out of the contractual relationship between insurer and insured because of the nature of the contract and has been said to be an implied term of the contract. The insured is buying peace of mind and will call upon the insurer at a time of great vulnerability. Bad faith in handling the insured's claim is additional and independent of a wrongful denial of the claim. In *Whiten*, the Court makes it clear that a breach of the insurer's obligation of good faith may be an actionable wrong sufficient to found a claim for punitive damages.

The following cases were decided after the Ontario Court of Appeal decision in *Whiten*; in that decision Laskin J.A. (in dissent, but not on this point) offered the same analysis of independent actionable wrong as was eventually enunciated by the Supreme Court of Canada.

In *Clarfield v. Crown Life Insurance Co.*²¹, the defendant denied the insured's claim for disability benefits, in spite of medical evidence of total disability. Mr. Justice Juriansz, of the Ontario Superior Court of Justice, found that the insurer's breach of the duty of good faith constituted an independent actionable wrong. The defendant failed to assess the plaintiff's claim in a balanced and reasonable manner, and failed to act fairly in dealing with the claim. As a result of the defendant's rejection of his claim and subsequent delay in dealing with it, the plaintiff suffered increased stress, anxiety and financial pressure. He was awarded \$75,000 in aggravated damages. It was further held that the defendant's conduct was reprehensible, and there was evidence that it was not confined to this case. The defendant had a policy of denying similar claims when claimants had no income at the time of disability. The plaintiff was awarded \$200,000 in punitive damages.

²⁰ *Vorvis*, *supra* note 2 at 206-7.

In *Wachal v. Crown Life Insurance Co.*²², the insurer terminated payment of long term disability benefits after two years, and the insured brought an action for a declaration of entitlement to those benefits. Mr. Justice Duval, of the Manitoba Court of Queen's Bench, held that the insured had exaggerated her disability and thereby significantly contributed to the insurer's decision to terminate disability benefits. In his view, that conduct seriously undermined her credibility. The insurer could have arranged for an independent psychiatric opinion about the insured's complaints of depression and migraines, but, under the circumstances, its failure to do so was not considered an actionable wrong. The insured's claim for punitive damages, based on breach of a duty of good faith, was dismissed.

A breach of good faith by the insured may also constitute an actionable wrong founding a claims for punitive damages, as was the case in *Andrusiw v. Aetna Life Insurance Co. of Canada*.²³ In that case, the insured suffered a stroke in 1986, resulting in a permanent partial disability. He began to receive long term disability benefits in 1987. In 1996, the insurer received information that the insured was working. After an investigation, the insurer ceased paying benefits in 1997 and the insured brought an action claiming entitlement to total disability benefits. The insurer counterclaimed for reimbursement of benefits paid to the insured from 1987 through 1997. Mr. Justice Murray, of the Alberta Court of Queen's Bench, dismissed the action and allowed the counterclaim. Punitive damages were awarded against the insured for breach of his corresponding duty of good faith to the insurer. Murray J. stated as follows:

The contract of insurance between an insurer and an insured is one of utmost good faith. Implicit is a term of the contract that the insurer has an obligation to deal with the claims advanced by an insured in good faith and an insured has an obligation to the insurer to put forward his claims honestly and in good faith. As such, breach of that obligation on the part of either party constitutes a separate and independent wrong for which compensation is paid. Thus, if either party acts in bad faith toward the other, that is an independent actionable wrong as contemplated by McIntyre, J. in *Vorvis*. I agree with Laskin, J.A. in the case of *Whiten v. Pilot Insurance Co.* (1999), 42 O.R. (3d) 641, where His Lordship concluded that though a good case can be made out that an insured or insurer has a duty in tort of good faith toward the other because the relationship is sufficiently proximate to give rise to a concurring duty in tort alongside the implied

²¹ 50 O.R. (3d) 696, [2000] OJ No. 4074 (Sup. Ct. Jus.).

²² (1999), 48 C.C.E.L. (2d) 181, 14 C.C.L.I. (3d) 284 (Man. QB).

²³ [2001] A.J. No. 789, 33 C.C.L.I. (3d) 238 (QB).

contractual obligation, one need not go this far. The breach by one party or the other to a contract of insurance of the implied term of good faith meets the *Vorvis* requirement of an independent actionable wrong.

In this case the Plaintiff was in breach of that implied term of his contract of insurance with the Defendant. Indeed, the Plaintiff was deceitful which is an actionable tort.

A great deal has been made in the case law, to which this Court was referred, of the fact that insurers vis à vis their insureds are in a superior bargaining position and one which places the insureds in positions of dependency and vulnerability. Equally, insurers must not be looked upon as fair game. It is a two-way street founded upon the principle of utmost good faith arising from the very nature of the contract. Thus, it is appropriate that punitive damages be awarded and I do so in the sum of \$20,000.²⁴

Whiten v. Pilot Insurance Co.

The facts of this case are well known by now, so we will not set them out in detail. The insured's home was destroyed by a fire in January, 1994. The insurer made a single payment of \$5,000 for living expenses, and covered the cost of the insured's rental accommodations for a short period of time. The insurer alleged that the insured was guilty of arson, even though there was no evidence in support of that allegation and considerable evidence suggesting it was not arson. At trial, the insurer's position was discredited and a jury awarded the insured compensatory damages, plus one million dollars in punitive damages. The Court of Appeal reduced the punitive damages award to \$100,000. On appeal to the Supreme Court of Canada, Mr. Justice Binnie, for the majority, held that the insurer's conduct towards the insured was exceptionally reprehensible. The majority reinstated the jury's award of one million dollars in punitive damages. LeBel J., in dissent, agreed that an award of punitive damages was warranted in this case but stated that \$1,000,000 was neither rational nor appropriate.

In his Reasons, Mr. Justice Binnie confirmed that the insurer's breach of the contractual duty of good faith is independent of and in addition to the breach of contractual duty to pay the loss. A breach of the implied obligation of good faith was held to constitute an independent actionable wrong that can support a claim for punitive damages whether or not it is capable of being classified as a tort.

In response to concerns about the possibility of excessively large punitive damage awards, Mr. Justice Binnie specified that awards must be both rational and proportionate as detailed below.

Rationality

In *Whiten, supra*, Binnie J. adopted the following passage from *Hill, supra*, as the applicable standard of review of punitive damage awards:

Unlike compensatory damages, punitive damages are not at large. Consequently, courts have much greater scope and discretion on appeal. The appellate review should be based upon the courts estimation as to whether the punitive damages serve a rational purpose. In other words, was the misconduct of the defendant so outrageous that punitive damages were required to act as deterrence.²⁵

This “rationality” test applies to both the question of whether punitive damages should be awarded and to the quantum of the award.²⁶ Mr. Justice Binnie formulated the appellate standard as follows:

If the award of punitive damages, when added to the compensatory damages, produces a total sum that is so “inordinately large” that it exceeds what is “rationally” required to punish the defendant, it will be reduced or set aside on appeal.²⁷

Proportionality

As Binnie J. noted, the concept of rationality is fairly straightforward (an award is irrational if it is higher than required to fulfil its purpose). However, the determination of whether an award is “inordinate” is more problematic. To flesh the concept out, Binnie J. states that an award must be “rationally proportionate to the end sought to be achieved,” and concluding that a, “proper award must look at proportionality in several dimensions.”²⁸ The following are six non-exhaustive dimensions of proportionality that His Lordship suggested a proper award must be proportional to:

²⁴ *Ibid.* at paras. 82-3 & 85.

²⁵ *Hill, supra* note 7 at para. 197, qt’d in *Whiten, supra* note 4 at 296-7.

²⁶ *Whiten, supra* note 4 at 297.

²⁷ *Ibid.* at 299.

²⁸ *Ibid.*

1. the blameworthiness of the defendant's misconduct;
2. the vulnerability of the plaintiff;
3. the harm or potential harm directed specifically at the plaintiff;
4. the need for deterrence;
5. other penalties, both civil and criminal, that have been or are likely to be inflicted upon the defendant for the same misconduct; and
6. the advantage wrongfully gained by a defendant as a result of the misconduct.²⁹

Although he did not suggest that punitive damages should be measured in relation to the amount of compensatory damages awarded, Mr. Justice Binnie did say that the relationship between the two may be a factor in considering the appropriateness of the award of punitive damages.

The Minority Judgment

Mr. Justice LeBel, alone in dissent, agreed with the majority's analysis of the use punitive damages, but would have affirmed the judgement of the Ontario Court of Appeal in this case because he considered the jury's award of one million dollars to be irrationally high. He stated:

Despite the moral satisfaction we may derive from giving a good whack to an insurance company and some misguided middle managers, the verdict of the jury dose not much advance the case of sound and fair management in the insurance industry... Its sole purpose remains to punish adequately bad faith and unfair dealing by employees of Pilot and its counsel. It does not address any widespread practice in the insurance industry. It does not pretend to effect a disgorgement of unfairly acquired profit. The punishment far exceeds whatever property or economic losses may have been caused by the nonperformance of the contract.³⁰

²⁹ *Ibid.* at 299-304.

³⁰ *Ibid.* at 316.

LeBel J. felt that the Court of Appeal's award of \$100,000 adequately met the requirements of rationality and proportionality by imposing significant punishment without upsetting the balance between the compensatory and punitive functions of tort law.

Substantive Implications

In a recent article, entitled "The Supreme Court in *Whiten v. Pilot Insurance: Judicial Rationality or Supreme Outrage?*", G.E. Kruk is critical of the majority's reluctance to impose a formula for determining the quantum of punitive damage awards. In Kruk's view, that approach will prove to be both impractical and ineffective as a means of control. Further, he argues that the approach taken is unsustainable because it does not adequately balance competing public and private interests.

The court's refusal to impose a cap or ratio to achieve more effective control is impractical because the guiding principle of "rationally proportionate" is so inherently subjective and vague as to provide little clear direction to future courts. Nor do the dimensions of proportionality identified by the Court offer much practical assistance. Concepts such as "proportionate to the defendant's blameworthiness", "proportionate to the plaintiff's vulnerability", and "proportionate to the need for deterrence" are so uncertain they cannot be relied upon to consistently control the quantum of punitive damage awards.³¹

To some extent, this problem may be exacerbated by the court's refusal to require that juries be given a range within which they may award punitive damages. Binnie J. allows only that such a range may be given if counsel agrees.³²

It is of note, however, that the rationality an award of punitive damages is to be assessed taking into account the amount of compensatory damages, which, according to Binnie J., "also punish" and may in many cases, "be all the punishment required."³³ That may be particularly relevant where there is no evidence that the defendant is engaged in a widespread or systematic bad faith conduct.

³¹ 35 C.C.L.I. (3d) 112 at 132.

³² *Whiten*, supra, note 4 at 296.

³³ *Ibid.* at 303.

Procedural Implications

The Supreme Court's decision in *Whiten, supra* raises a number of procedural implications. First, the Court held that pleadings with respect to punitive damages must contain adequate particularity to protect the interests of the defendant.³⁴

Second, the Court provided eleven points as a guide to trial judges when charging a jury with respect to punitive damages.³⁵

Third, the Court encouraged closer supervision by courts of appeal with respect to punitive damage awards to ensure that such awards are rational and proportionate to the harm against which they are directed.³⁶

Fourth, the Court indicated that discovery should not be focused on evaluation the defendant's financial capacity. However, it remains unclear whether evidence can be led on the issue of the defendant's net worth for the purposes of determining quantum.³⁷

Fifth, it is likely that plaintiff's counsel will now want to examine a representative of the insurer with respect to the manner in which the claim was handled. In a recent article in the Canadian Bar Review, entitled *The Rainmaker Revisited: Punitive and Aggravated Damages in the Real World of Disability Insurance*, the author suggests:

Even where there is nothing remotely punitive about how a claim has been handled, plaintiffs' counsel, as a tactical device, are claiming punitive damages, in the hope that the insurer will pay the claim in full before trial to avoid the prospect of an award of punitive damages being awarded. The tactic is continued at trial to give the judge a way of "sawing off" the action, i.e. find for the plaintiff on the issue of punitive damages. Obviously, these tactics and the other developments just mentioned, along with their

³⁴ Ibid. at 293.

³⁵ Ibid. at 295.

³⁶ *Whiten, supra* note 4 at 298.

³⁷ There are a number of cases, prior to *Whiten, supra*, finding for and against the production of the insurer's financial records. Cases where applications for production were dismissed include *Kelly v. Unum Life Insurance Co. of America*, 2000 BCCA 667 and *Cloutier v. Canada Life Assurance Co.*, [2000] N.B.J. No. 477 (QB). For a recent case where production was ordered, see *Freise v. Citadel Life Assurance Co.*, [2000] O.J. No. 2365 (Sup. Ct. Jus.).

obvious spin-offs (as in acrimonious contested motions) are increasing the time and cost of litigating disability claims.³⁸

Finally, the Court in *Whiten, supra*, did not specify the circumstances in which it would be appropriate to bifurcate or separate the proceedings to deal with aggravated or punitive damage claims based on bad faith conduct, stating only that:

Where a trial judge is concerned that the claim for punitive damages may affect the fairness of the liability trial, bifurcated proceedings may be appropriate.

Bifurcation

Where the plaintiff claims aggravated or punitive damages in addition to a claim for breach of contract, the defendant may move to have the proceedings bifurcated (separated into two parts). In the context of a first party insurance claim, the plaintiff would first have to prove that he or she is entitled to the benefits that have been denied. In a second, separate proceeding, the plaintiff would have to prove bad faith, plus any aggravated and punitive damages claimed.

In British Columbia, the Supreme Court recently decided in favour of bifurcating proceedings in *Wonderful Ventures Ltd. v. Maylam*.³⁹ In that case, the insured brought a claim for indemnification under a fire insurance policy, plus a claim for bad faith. The defendant insurer brought a motion to sever the two claims. Madam Justice Garson accepted the defendant's argument that protection of privileged communications between solicitor and client is fundamental and the prejudice to the insurer in having to disclose solicitor-client communications was greater than the inconvenience to the plaintiff in having the proceedings bifurcated. She held:

I find that the prejudice to CNS of having the contract claim and the bad faith claim tried together overrides any inconvenience, cost or expense which may be suffered by Wonderful Ventures as a result of my severing paragraphs 67 to 70 of the Amended Statement of Claim. As noted in *R. v. McClure (supra)* the protection of privileged communications is fundamental to the legal system and in my view should not be interfered with lightly.

³⁸ Buller, R., *supra*, note 9 at 213.

³⁹ (2001), 91 B.C.L.R. (3d) 319 (S.C.).

If there is any prejudice to Wonderful Ventures that would arise from having two trials, it is on balance less significant than the prejudice to CNS in having to disclose privileged communications. With severance, if Wonderful Ventures does not succeed on the contract claim, there will be no subsequent trial on the bad faith claim. If Wonderful Ventures succeeds on the contract claim, it will recover the insurance moneys found due under the contract, and possibly, damages. Wonderful Ventures will not have to await the outcome of the subsequent bad faith trial before being made whole, at least with respect to pecuniary losses.⁴⁰

This approach has been followed in British Columbia in *Lawrence v. ICBC*.⁴¹ In that case, Mr. Justice Taylor noted that where the claims are heard together, the defendant may be required to disclose communications considered privileged with respect to the entitlement claim in order to defend the bad faith claim. His Lordship also referred to *R. v. McClure*, where the Supreme Court of Canada emphasized the importance of upholding the concept of solicitor-client privilege:

Solicitor-client privilege is part of and fundamental to the Canadian legal system...

The important relationship between a client and his or her lawyer stretches beyond the parties and is integral to the workings of the legal system itself.⁴²

Wonderful Ventures, supra has also been followed in Alberta in *Sovereign General Insurance Co. v. Tanar Industries Ltd.*⁴³ However, it has been rejected in Ontario in *Sempecos v. State Farm*⁴⁴ and in Newfoundland in *Lundrigan v. Non-Marine Underwriters, Lloyd's London*.⁴⁵

Cases after *Whiten*

The Supreme Court of Canada handed down its reasons in *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*⁴⁶ on the same day as those in *Whiten, supra*. In this companion

⁴⁰ *Wonderful Ventures, supra*, note 32 at paras. 33-34.

⁴¹ (2001), 91 B.C.L.R. (3d) 375 (S.C.).

⁴² [2001] 1 S.C.R. 445, 2001 SCC 14 at paras. 17 & 31.

⁴³ 2002 ABQB 101, [2002] 3 W.W.R. 340.

⁴⁴ [2001] O.J. No. 4887 (Sup. Ct. Jus).

⁴⁵ [2002] N.J. No. 30, 210 Nfld. & P.E.I.R. 77 (S.C.).

⁴⁶ (2002), 209 D.L.R. (4th) 318, 2002 SCC 19.

case, Mr. Justice Binnie, for the majority, held that the decision in *Whiten, supra*, affirms that the rationality test applies equally to the question of whether an award of punitive damages should be made at all, as well as to the question of its quantum.

The trial judge in *Sylvan, supra*, found that punishment above and beyond the payment of generous compensatory damages was appropriate for two reasons. First, the appellant's actions demanded an award that would stand as an example to others; and second, to ensure that the appellant did not unduly profit from his conduct.

Mr. Justice Binnie held that these are both legitimate objectives for the award of punitive damages. However, he reiterated that an award of punitive damages is rational only if compensatory damages do not adequately achieve the objectives of retribution, deterrence and denunciation.

Further, Mr. Justice Binnie confirmed that punitive damages are not "at large", and both the award and the assessment of quantum must meet the test of rationality. In this case, it was held that neither the punitive damages award nor the \$200,000 assessment survived that test.

In *Harris v. Canada Life Assurance Co.*⁴⁷, the defendant was paying benefits to the plaintiff under a long term disability policy. After a certain medical examination, the defendant ceased making payments to the plaintiff. The plaintiff commenced an action for past and future benefits. She also sought damages for bad faith. This was an application for an order that the plaintiff undergo two medical examinations. The defendant submitted that, in light of the recent decision in *Whiten, supra*, insurers should be afforded more scope to conduct medical examinations. The rationale offered was that since *Whiten, supra*, insurers may be exposed to significant awards if they are found to have acted improperly in dealing with their insureds. Nordheimer J. granted the order and held:

I must say that I do not see how that issue relates to the considerations applicable to the granting or refusal of an order under section 105. The facts that will determine whether the insurer has or has not acted in good faith towards its insured will

⁴⁷ [2002] O.J. No. 1123 (Sup. Ct. Jus.).

have occurred by the time that the litigation is commenced. I cannot see how a subsequent medical examination could, in the normal situation, be of any relevance as to whether the insurer had undertaken the proper investigations, and otherwise acted fairly, before determining not to pay benefits to an insured. In other words, I do not see how subsequently acquired medical information could make right a decision that was wrongly taken because the insurer had insufficient information to justify the decision. At least for the purposes of this case, therefore, the defendant's submission in this regard would not provide sufficient reason for the order if the facts otherwise did not do so.⁴⁸

In *Bassett v. Maritime Life Assurance Co.*⁴⁹, Mr. Justice Blair of the British Columbia Supreme Court allowed in part a claim against the defendant insurers for income allegedly covered by a disability policy. In this case, the plaintiff physician received disability benefits for five months for depression and its physical effects. Upon learning that the plaintiff was being investigated by the College of Physicians and Surgeons ("the College") for allegations of sexual misconduct, the defendant discontinued the payment of benefits. The plaintiff brought an action for the benefits that had been denied (over approximately a one-year period) as well as consequential, aggravated and punitive damages. It was held that the plaintiff's depression and disability was caused only in part by the College's investigation and proceedings. As a result, he was entitled to benefits for an additional five months. The plaintiff's claim for consequential, aggravated and punitive damages was dismissed. With respect to the claim for punitive damages, Mr. Justice Blair concluded that there was no evidence to show that the defendant's conduct in dealing with this claim attracted punitive damages.

In *Milbury v. Imperial Assurance Co. of Canada*,⁵⁰ the Ontario Superior Court of Justice declined to award punitive damages because the insurer had terminated disability benefits in error and without notice. Neither of these events was considered to be sufficient to attract punitive damages. The insurer had acted on a good faith belief, based on compelling evidence, that the insured was no longer entitled to benefits.

⁴⁸ *Ibid.* at para. 20.

⁴⁹ [2001] B.C.J. No. 1520 (S.C.).

⁵⁰ *Supra* note 17.

In *Cross v. The Canada Life Assurance Company*,⁵¹ the insured sued for punitive or aggravated damages after suffering some delay in receiving long-term disability benefits. The insurer at no time denied benefits to the insured. Roberts J., referring only to the C.A. decision in *Whiten*, concluded that the insurer had breached its duty of good faith to the insured by failing to process the claim in a timely manner (this being in part because of the adversarial tactics of the insured's counsel) but declined to award punitive damages because the breach fell short of malicious, oppressive or highhanded behaviour. The insured was, however, awarded aggravated damages in the amount of \$18,000 for emotional suffering and was compensated for diminution in the value of RSPs she cashed during the delay.

In *Fowler v. Manufacturers Life Insurance Co.*,⁵² the insurer terminated disability benefits after taking an adversarial approach with the insured, demanding that he provide his income tax returns without offering justification and terminating his benefits when the insured's doctor failed to submit a report in a timely manner. The company later sought to recover the \$42,000 it had already paid out to the insured on the basis of an unreasonable interpretation of ambiguous provisions in the contract. The insured suffered from a psychiatric disability related to stress and the court determined that the additional stress occasioned by the insurer's conduct warranted aggravated damages in the amount of \$75,000. The court declined to award punitive damages on the basis that the large award of aggravated damages was sufficient to serve the purposes of retribution, deterrence and denunciation.

In *Khazzaka (c.o.b. E.S.M. Auto Body) v. Commercial Union Assurance Co. of Canada*,⁵³ the Ontario Court of Appeal considered a jury award of \$200,000 in punitive damages in addition to \$157,000 in general damages for the insurer's refusal to cover fire damage to the insured's auto repair shop. Subsequent to the jury's decision, the trial judge heard and rejected a motion for non-suit of the issue of punitive damages.⁵⁴ The insurer had denied coverage on the basis of arson and maintained that position throughout the trial. The Court of Appeal relied heavily on the trial judge's reasoning that, although he would not have awarded punitive damages, the evidence entitled the jury to make the necessary findings of fact to conclude that the defendant's

⁵¹ [2002] I.L.R. I-4044 (Ont Sup. Ct. Jus.).

⁵² [2002] N.J. No. 217. (Nfld. S.C.(T.D.)).

⁵³ [2002] O.J. No. 3110 (C.A.)

adjuster and fire-cause expert had acted unreasonably and in bad faith. There was evidence that the insurer had resisted for three years honouring what it should have known was a valid claim. The insured was dependant on the building and the equipment in the building (which was not insured) for his livelihood. The allegation of arson has a negative effect on the insured's reputation. Talking that into account, the Court of Appeal held that the award was, "proportionate and fits in the rational limits within which a jury should be permitted to operate."⁵⁵

In *Insurance Corp. of British Columbia v. Hoang*,⁵⁶ Madame Justice Sinclair Prowse assessed damages against 14 insureds pursuant to previously obtained default judgements. The insureds were alleged to have conspired to defraud the insurer by staging motor vehicle accidents and making claims for personal or property damage arising from the accidents. Claims against a further 21 defendants were proceeding to trial. At the hearing to assess damages, Sinclair Prowse J. awarded punitive damages against all 14 defendants but set the quantum in only four cases (the other cases were to await further facts to be found at the subsequent trial.) The awards ranged from \$1000 to \$5000, taking into account the proportionality of the award to the factors listed in *Whiten, supra*. In particular, she considered the financial circumstances of the defendants.

Conclusion

There is no doubt that the Supreme Court's decision in *Whiten, supra* has changed the way counsel for both plaintiffs and defendants in insurance matters will approach claims for punitive damages. The Court has confirmed that both the insurer and the insured owe corresponding duties of good faith to the other party the breach of which can constitute an "independent actionable wrong" capable of supporting a claim for punitive damages. There remains, however, considerable uncertainty in the law, particularly in regards the following issues:

- the amount of detail required in pleading punitive damages;

⁵⁴ Reported at [1999] O.J. No. 3583 (Ont. Sup. Ct. Jus.)

⁵⁵ *Supra* note 53 at para 20.

⁵⁶ [2002] B.C.J. No. 1818, 2022 BCSC 1162.

- how the courts will apply the rationality and proportionality test with respect to quantum of punitive damage awards;
- whether an award, if it is considered rationally proportionate, can be successfully challenged on the basis that the jury was not properly charged;
- whether evidence can be led with respect to the insurer's net worth for the purposes of assessing quantum of punitive damages;
- in what circumstances courts will find it appropriate to bifurcate proceedings in which punitive damages are claimed;
- the implications of bifurcation with respect to disclosure of privileged communications; and
- whether punitive damages can be awarded where bad faith is established but no damage results.⁵⁷

Clearly, there remain a few bumps as we make our way along the road to punitive damages.

⁵⁷ In *Whiten*, supra note 4, the Court failed to address whether damage was an essential component to a claim in punitive damages. However, in the case of *702535 Ontario Inc.*, supra, it was held that there could be no recovery for a breach of duty of good faith because such breach caused no damage to the appellants.

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