IN FACT AND IN LAW

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Damage Insurance

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The Supreme Court of Canada Upholds an Order of $1 Million in Punitive Damages Against an Insurer Found to Be In Bad Faith

By Odette Jobin-Laberge

The Supreme Court of Canada rendered a decision on February 22, 2002 in the matter of *Whiten* v. *Pilot Insurance Co.*[1]

The decision is important in that the Court sets out the governing principles for determining what constitutes reprehensible conduct justifying an order for punitive damages and the criteria for establishing the quantum of such damages.

The Court's statements are obviously guided by the applicable *common law* rules, but the underlying reasoning may also be relevant to a comparative law analysis in cases in which Quebec law provides that punitive damages may be awarded.[2]

The Facts

On January 18, 1994, just after midnight, the appellant and her husband discovered a fire raging in an addition at the back of their house. After alerting their daughter, who was also on the same floor, the Whitens fled the house in their night clothes. It was minus eighteen degrees Celsius.

The origin of the fire was never discovered, but everyone who investigated the fire in the six months after it occurred concluded that it was accidental.

Indeed, Pilot retained an experienced independent insurance adjuster to investigate the loss. The adjuster inspected the site and interviewed the Whitens, who freely acknowledged that they were both unemployed and had financial difficulties. He also interviewed the firefighters about the speed at which the fire spread, a key indicator of arson. Both the physical evidence and the Whitens' conduct satisfied the insurance adjuster that the fire was accidental. On February 3, 1994, he reported to Pilot that there was no suspicion of arson on behalf of the insured (Mrs. Whiten) or any member of her family.

Pilot did not agree with this opinion. It refused to accept the insurance adjuster's recommendations and decided to deny the claim. It did not tell the insurance adjuster why it would not pay the claim and he in turn obviously did not advise the Whitens of what was happening.

Pilot also requested that the Insurance Crime Prevention Bureau review the analysis of its investigator. The Bureau responded: "*We wouldn't have a leg to stand on as far as declining the claim*." No one from the insurance company testified as to why the claims examiner and, subsequently, Pilot's branch manager rejected this advice as well.[3]

Pilot also retained an engineering expert who also concluded that the fire was accidental.[4]

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[1] 2002 SCC 18.

[2] Article 1621 C.C.Q.

[3] Paragraph 9.

[4] Paragraph 13.

In its factum before the Supreme Court, Pilot conceded that in addition to the senior claims examiner and the branch manager, the latter's superior, who reported to the Executive Vice President and Secretary of the company, was copied with all of the material on the file. Mr. Justice Binnie therefore inferred that the misconduct was not restricted to middle level management but was made known to the directing minds of the respondent company.[5]

Thereafter, Pilot retained a forensic engineer, a fire investigator and a firefighter. Pilot did not disclose the first expert's exculpatory reports to any of these individuals, but instead, through its attorney, it furnished them with information about the speed of the fire that the trial judge characterized as misleading if not inaccurate. The firefighter insisted that the fire was likely accidental but the other two experts gave opinions that provided some support for an arson defence.[6]

At the Court of Appeal, Pilot conceded that these inculpatory opinions were influenced by its attorney.[7] The trial judge commented unfavourably about the attorney's role in this litigation. He felt that his "*enthusiasm for his client's case appears to have caused him to exceed the permissible limits which ought to confine a lawyer in the preparation of witnesses*." At the Court of Appeal and at the Supreme Court, Pilot conceded that these comments were justified, but took full responsibility therefor.[8]

Consequently, the Whitens claimed not only the indemnity relating to their property loss, but also punitive damages based on the insurer's bad faith.

The Decision At First Instance - Ontario Court (General Division)[9]

After having instructed the jury as regards the indemnity, the trial judge told the jurors that the issue of punitive damages was entirely in their discretion.

The jury awarded $318,252.32 in compensatory damages and $1 million in punitive damages.

The trial judge then made a number of observations about the jury's award of punitive damages. He said that although it was "*very high and perhaps without precedent, [it] is not perverse but is entirely reasonable in light of all of the evidence*." He noted that the defendant continued to deny the claim even after its own adjuster recommended that it be paid. The Whitens, who were already in poor financial condition, were required to endure the indignity of having to make temporary living arrangements without the benefit of the insurance coverage for which they had paid premiums. They were also required to undertake litigation to secure the relief to which they were entitled, including a trial which took approximately two months to complete.[10]

As regards the quantum of damages, Pilot had admitted that its net worth was approximately $231 million, and the trial judge stated that he could not "*take issue with the jury's conclusion that a very substantial award for punitive damages was required to punish the defendant and to effectively send the implied reminder to the defendant and to other insurers that they owe their insured a duty of good faith in responding to claims made under policies of insurance issued by them.*"[11]

Decision of the Ontario Court of Appeal[12]

Mr. Justice Finlayson agreed with Mr. Justice Laskin's reasons and conclusions on the first issue, namely, whether Mrs. Whiten was entitled to an award of punitive damages. However, he did not agree with Mr. Justice Laskin that the $1 million award was not excessive. Mr. Justice Finlayson found that, while he was not entirely happy with the trial judge's charge to the jury, he did not propose to justify his intervention on any other basis than his belief that the award "*is simply too high.*"[13]

According to Mr. Justice Finlayson, there was no evidence that Pilot's unacceptable conduct was the product of a corporate strategy nor that it profited from its actions: "*Rather, it appears to have been an isolated instance for which the appellant's trial counsel should take full responsibility, both for the manner in which the claim was processed and because of the way that the trial was conducted*."[14]

[5] Paragraph 16.

[6] Paragraph 21.

[7] Paragraph 21.

[8] Paragraph 22.

[9] (1996), 132 D.L.R. (4th) 568.

[10] Paragraph 30.

[11] Paragraph 30.

[12] (1999), 42 O.R. (3d) 641.

[13] Paragraph 33.

[14] Paragraph 34.

Mr. Justice Finlayson concluded that an award of $100,000 would be a sufficient deterrent to Pilot and other insurers and would cause Pilot to take the steps necessary to ensure that "*in future it is properly apprised of the nature and kind of the defence its claims adjusters and counsel are advancing*".[15]

Decision of the Supreme Court

Writing for the majority, Mr. Justice Binnie recalled that punitive damages are awarded against a defendant in exceptional cases for "*malicious, oppressive and high-handed misconduct that offends the court's sense of decency*."[16] The test thus limits the award to misconduct that represents a marked departure from ordinary standards of decent behaviour. Because their objective is to punish the defendant rather than compensate a plaintiff (whose just compensation will already have been assessed), punitive damages straddle the frontier between civil law (compensation) and criminal law (punishment).[17]

Punishment is a legitimate objective not only of the criminal law but of the civil law as well. Punitive damages are hybrid by nature and serve a need that is not met either by the pure civil law or the pure criminal law.

Some would argue that plaintiffs recover punitive awards which are disproportionately high in comparison with just compensation such that they benefit from a system of "primitive justice." They are awarded a financial windfall serendipitously simply because, coincidentally with their claim, the court seeks to punish the defendant and deter others from similar outrageous conduct.[18] On the other hand, others would argue that defendants suffer out of all proportion to the actual wrongs committed because the punishment is tailored to fit not only the "crime" but the financial circumstances of the defendant; therefore, they are being punished for who they are rather than for what they have done. The critics of punitive awards refer *in terrorem* to the United States experience.[19]

Faced with this controversy, Mr. Justice Binnie carried out a comparative law analysis of the reaction of *common law* countries such as England, Australia, New Zealand, Ireland and the United States to the problem of disproportionate punitive damages.

He concluded that the experience in other *common law* jurisdictions is consistent with Canadian practice and precedent. **He adopted the tests of rationality, deterrence and proportionality**. He recognized that the primary vehicle of punishment is the criminal law. He noted that the incantation of the time-honoured pejoratives ("high-handed", "oppressive", "vindictive", etc.) provides insufficient guidance (or discipline) to the judge or jury setting the amount. The court should relate the facts of the particular case to the underlying purpose of punitive damages and determine how an award of punitive damages would further one or other of the objectives of the law, and what is the lowest award that would serve the purpose, i.e., because any higher award would be irrational. It is rational to use punitive damages to ensure that a wrongdoer does not profit from its wrongful act where compensatory damages would amount to nothing more than a licence fee to earn greater profits through outrageous disregard of the rights of others. None of the *common law* jurisdictions has adopted (except by statute) a formulaic approach such as a fixed cap or fixed ratio between compensatory and punitive damages.

With the benefit of these general principles, Mr. Justice Binnie turned to the specific issues raised by the Whiten case.

In his view, the correct approach is to assess the conduct in the context of all the circumstances and determine whether it is deserving of punishment because of its shockingly harsh, vindictive, reprehensible or malicious nature. Undoubtedly some conduct found to be deserving of punishment **will constitute an actionable wrong** but other conduct might not.

[15] Paragraph 35.

[16] Paragraph 36.

[17] Paragraph 36.

[18] Paragraph 39.

[19] Paragraph 39.

However, the breach of the contractual duty of good faith is independent of and in addition to the breach of contractual duty to pay the loss.[20] Furthermore, the circumstances that would justify punitive damages for breach of contract in the absence of actions also constituting a tort are rare. Rare they may be, but such cases do exist and thus confirm that punitive damages can be awarded in the absence of an accompanying tort.[21] Finally, the requirement of an independent tort would unnecessarily complicate the pleadings and, in most cases, would add nothing of substance to the proceedings. An independent actionable wrong is required, but it can be found in a breach of a distinct and separate contractual provision or other duty such as a fiduciary obligation.[22]

Was the Jury Charge Adequate?

According to Mr. Justice Binnie, the trial judge must be sure that the jury fully understands the following points.

"*(1) Punitive damages are very much the exception rather than the rule, (2) they are awarded only if there has been high-handed, malicious, arbitrary or highly reprehensible misconduct that departs to a marked degree from ordinary standards of decent behaviour. (3) Where they are awarded, punitive damages should be assessed in an amount reasonably proportionate to such factors as the harm caused, the degree of the misconduct, the relative vulnerability of the plaintiff and any advantage or profit gained by the defendant, (4) having regard to any other fines or penalties imposed on by the defendant for the misconduct in question. (5) Punitive damages are generally given only where the misconduct would otherwise be unpunished or where other penalties are or are likely to be inadequate to achieve the objectives of retribution, deterrence and denunciation. (6) Their purpose is not to compensate the plaintiff, but (7) to give a defendant his or her just desert (retribution), to deter the defendant and others from similar misconduct in the future (deterrence), and to mark the community's collective condemnation (denunciation) of what has happened. (8) Punitive damages are awarded only where compensatory damages, which to some extent are punitive, are insufficient to accomplish these objectives. (9) The amount should be no greater than necessary to rationally accomplish their purpose. (10) While normally the state would be the recipient of any fine or penalty for misconduct, the plaintiff will keep punitive damages as a "windfall" in addition to compensatory damages. (11) Judges and juries have usually found that moderate awards of punitive damages, which inevitably carry a stigma in the broader community, are generally sufficient."*[23]

The Court of Appeal was unanimous that punitive damages in some amount were justified and Mr. Justice Binnie agreed with that conclusion. Nonetheless, he was of the opinion that the jury must be given some leeway to do its job. To reverse the quantum of punitive damages awarded, the amount must be so inordinately large as obviously to exceed the maximum limit of a reasonable range within which the jury may properly operate. Putting these two notions together, the test is whether a reasonable jury, properly instructed, could have concluded that an award in that amount, and no less, was rationally required to punish the defendant's misconduct.[24] An award that is higher than required to fulfil its purpose is, by definition, irrational.

According to Mr. Justice Binnie, **proportionality** is the key to determinate the appropriate quantum of punitive damages. The more reprehensible the conduct, the higher the rational limits to the potential award.

The level of blameworthiness may be influenced by many factors:

- whether the misconduct was planned and deliberate;
- the intent and motive of the defendant;
- whether the defendant persisted in the outrageous conduct over a lengthy period of time;

[20] Paragraphs 78 and 79, emphasis added.

[21] Paragraph 81, emphasis added.

[22] Paragraph 82, emphasis added.

[23] Paragraph 94.

[24] Paragraph 107.

- whether the defendant admitted or attempted to cover up its misconduct;
- the defendant's awareness that what it was doing was wrong;
- whether the defendant profited from its misconduct;
- whether the interest violated by the misconduct was known to be deeply personal to the plaintiff or a thing that was irreplaceable.[25]

Based upon all of these criteria, Mr. Justice Binnie examined the proportionality of the award.

- *Proportionate to the Degree of Vulnerability of the Plaintiff*

The financial or other vulnerability of the plaintiff, and the consequent abuse of power by a defendant, is highly relevant where there is a power imbalance.[26]

Emotional distress is relevant to assess the oppressive character of the respondent's conduct, but constitutes aggravated moral damage compensable as such and not as punitive damages.[27]

- *Proportionate to the Harm or Potential Harm Directed Specifically at the Plaintiff*

It would be irrational to provide the plaintiff with an excessive windfall arising out of a defendant's scam of which the plaintiff was but a minor or peripheral victim. On the other hand, malicious and high-handed conduct which could be expected to cause severe injury to the plaintiff is not necessarily excused because fortuitously it results in little damage.[28]

- *Proportionate to the Need for Deterrence*

A defendant's financial capability may become relevant: (1) if the defendant chooses to argue financial hardship; (2) if it is directly relevant to the defendant's misconduct; or (3) if there are other circumstances where it may rationally be concluded that a lesser award against a wealthy defendant would fail to achieve deterrence.[29]

It was not helpful to mention the fact that the respondent's assets were $231 million and that the damages awarded represented only ½ of 1% of this amount. Disclosure of detailed financial information **before liability is established** may wrongly influence the jury to find liability where none exists. Moreover, pre-trial discovery of financial capacity would unnecessarily prolong the pre-trial proceedings and prematurely switch the focus from the plaintiff's claim for compensation to the defendant's capacity to absorb punishment.[30]

- *Proportionate After Taking Into Account the Other Penalties, Both Civil and Criminal, Which Have Been or Are Likely to be Imposed on the Defendant for the Same Misconduct*

To the extent a defendant has suffered other retribution, denunciation or deterrence, either civil or criminal, for the misconduct in question, the need for *additional* punishment is lessened and may be eliminated. Such other punishment is relevant but it is not necessarily a bar to the award of punitive damages. The key point is that punitive damages are awarded if, but only if all other penalties have been taken into account and found to be inadequate to accomplish the objectives of retribution, deterrence, and denunciation.[31]

- *Proportionate to the Advantage Wrongfully Gained by a Defendant from the Misconduct*

A traditional function of punitive damages is to ensure that the defendant does not treat compensatory damages merely as a licence to get its way irrespective of the legal or other rights of the plaintiff.[32]

On the other hand, care must be taken not to employ the "wrongful profit" factor irrationally. In the case at bar, the effort to force the appellant into a disadvantageous settlement having failed, it is not alleged that Pilot profited from its misconduct.[33]

[25] Paragraph 113.

[26] Paragraph 114.

[27] Paragraph 116.

[28] Paragraph 117.

[29] Paragraph 119.

[30] Paragraph 121.

[31] Paragraph 123, emphasis added.

[32] Paragraph 124.

[33] Paragraphs 125 and 126.

- *The Usefulness of Ratios*

Proportionality is a much broader concept than the simple relationship between punitive damages and compensatory damages. That relationship, moreover, is not the most relevant because it puts the focus on the plaintiff's loss rather than where it should be, on the defendant's misconduct. In addition, ratios are wholly inadequate, for example, in a case where outrageous misconduct has fortuitously (and fortunately) resulted in a small financial loss. Potential, as well as actual, harm is a reasonable measure of misconduct, and so are the other factors, already mentioned, such as motive, planning, vulnerability, abuse of dominance, other fines or penalties, and so on. None of these features are captured by the ratio of punitive damages to compensatory damages. Adoption of such a ratio, while easy to control, would do a disservice to the unavoidable complexity of the analysis.[34]

As Applied to the Facts

Mr. Justice Binnie concluded that he would not have awarded such high punitive damages in this case, but in his judgment the award was within the rational limits within which a jury must be allowed to operate.

While, as stated, he did not consider the "ratio" test to be an appropriate indicator of rationality, the ratio of punitive damages to compensatory damages in the present case would be either a multiple of three (if only the insurance claim of $345,000 is considered) or a multiple of less than two (if the claim plus the award of solicitor-client costs is thought to be the total compensation). Either way, the ratio is well within what has been considered "rational" in decided cases.[35]

Partial Dissent of Mr. Justice LeBel

Although Mr. Justice LeBel agreed that the bad faith of the Pilot Insurance Company in its handling of the claim, up to and during the trial, amply justified awarding punitive damages, an award of $1 million goes well beyond a rational and appropriate use of this kind of remedy, especially in what began as a problem of contract law.[36]

The award of punitive damages in the case at bar tends to turn tort law upside down. It places what should have remained an incident of a contracts case into the central issue of the dispute. The main purpose of the action becomes the search for punishment, not compensation.

Mr. Justice LeBel agreed with Mr. Justice Binnie on the core principles governing the award of punitive damages. The key considerations remain the **rationality and proportionality** of the award, but the assessment of damages should not lead, in some cases, to a confusion of criminal law and private law principles, given that punitive damages and criminal punishment target primarily the conduct of the defendant or accused and are not primarily concerned with making good the loss or harm suffered by victims. The main concern of punitive damages remains the preservation of public order, and the assuaging of such harm as may have been done to the public good and to the social peace.[37]

An overriding objective of general deterrence remains problematic, if punitive damages are to remain a useful incident of tort law. Otherwise, their use may turn some parts of the law of tort into a sort of private criminal law, devoid of all the procedural and evidentiary constraints which have come to be associated with the criminal justice system.[38]

[34] Paragraph 127, emphasis added.

[35] Paragraph 132.

[36] Paragraph 143.

[37] Paragraph 151.

[38] Paragraph 158.

The Scope of This Judgment as Applied to Quebec Law

Although the judgment of the Supreme Court was rendered under the common law, it is highly interesting as regards the severity of the fault needed to give rise to punitive damages. Indeed, the notion of "*malicious, oppressive and high-handed misconduct (...) that offends the court's sense of decency*" refers to conduct whose requirements are similar to those under section 49 of the *Charter of Human Rights and Freedoms*, namely "*unlawful and intentional interference*", as such requirements were analyzed by the Supreme Court in the *Gosset*[39] and *St-Ferdinand* cases.[40] Nonetheless, the symmetry between the two legal systems is not perfect; conduct justifying an award of punitive damages under Quebec law must satisfy the requirements of each statute allowing such damages to be granted. A few statutes require only that the act have been carried out, regardless of malicious intent!

As a second step, article 1621 C.C.Q. provides a framework for assessing the punitive damages awarded:

> **"Where the awarding of punitive damages is provided for by law, the amount of such damages may not exceed what is sufficient to fulfil their preventive purpose.**
>
> **Punitive damages are assessed in the light of all the appropriate circumstances, in particular the gravity of the debtor's fault, his patrimonial situation, the extent of the reparation for which he is already liable to the creditor and, where such is the case, the fact that the payment of the damages is wholly or partly assumed by a third person." (Emphasis added)**

In contractual matters, including contracts of insurance, Quebec law recognizes that bad faith on the part of an insurer in handling a file may give rise to liability (articles 6, 7 and 1375 C.C.Q.). However, such a fault will generally only give rise to compensatory damages (bodily, property or moral) since civil law does not include a general principle giving the right to punitive damages. In contrast to the *common law*, the plaintiff will therefore have to allege and prove facts giving rise to the application of one of the statutes allowing the awarding of such damages.

The most likely allegations in matters between insurers and their insureds will probably rely on violations of rights protected under the *Charter of Human Rights and Freedoms*,[41] primarily interference with the right to inviolability of the person, the right to one's reputation, the right to privacy or the right to peaceful enjoyment of one's property. Absent such interference, Quebec law does not allow the awarding of punitive damages.

In those cases in which punitive damages may be awarded, the tests set out by the Supreme Court regarding deterrence, rationality and proportionality of the amounts awarded partially tie in with the criteria set out in article 1621 C.C.Q., namely those based upon gravity of the fault and the defendant's patrimonial situation.

Finally, we believe that the suggestion to refrain from providing evidence of the patrimonial situation of the defendant until after a fault has been established is wise and can validly be raised before the courts in Quebec. Under Quebec law, it would also be possible to raise factors such as the existence of a direct link between the defendant's financial resources and its misconduct, as well as the weight to be given to other sanctions aimed at the same act. The Supreme Court's statements on proportionality as regards the deterrent effect of a court award on the defendant itself and on the industry as a whole should also prove useful.

It will be interesting to see how caselaw changes as regards these issues and what solutions are adopted under Quebec law to sanction such misconduct.

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[39] *Augustus* v. *Gosset*, [1996] 3 S.C.R. 268.

[40] *Quebec (Public Curator)* v. *Syndicat national des employés de l'Hôpital St-Ferdinand*, [1996] 3 S.C.R. 211.

[41] R.S.Q., c. C-12.

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