INSURANCE ALERT

SUPREME COURT UPHOLDS $1 MILLION PUNITIVE DAMAGES AWARD

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On February 22, 2002, the Supreme Court of Canada issued a decision restoring a jury's award of $1 million in punitive damages against an insurance company for bad faith in the handling of a homeowners' fire claim. *Whiten v. Pilot Insurance Co.*, 2002 SCC 18 is of enormous significance to insurers and policyholders, both because of the Court's analysis of an insurer's obligations and because of the amount awarded.

Prior to this judgment, the highest award by a Canadian court in an insurer bad faith case had been $50,000. The decision is of the most immediate significance for first party insurance in consumer areas, such as homeowners and life and disability. In light of the line of cases in the last few years awarding aggravated or punitive damages awards against disability insurers, *Whiten* will no doubt be cited to support higher awards in those and other areas.

Whether the *Whiten* decision will affect liability insurance coverage in auto and other personal lines, or commercial insurance generally, remains to be seen. Undoubtedly counsel for policyholders in all areas will invoke the decision to press insurers for the settlement of claims. For liability insurers, the law set out in *Whiten* meshes with the pre-existing law concerning the settlement of claims within the policy limit and could be taken to increase the risk of punitive damage awards in excess liability bad faith cases.

The Issues:

Mr. Justice Binnie (who wrote for the majority of six; with one judge dissenting), signalled the approach he would take in his summary of the issues before the Court:

1. This case raises once again the spectre of uncontrolled and uncontrollable awards of punitive damages in civil actions. The jury was clearly outraged by the high-handed tactics employed by the respondent, Pilot Insurance Company, following its unjustified refusal to pay the appellant's claim under a fire insurance policy (ultimately quantified at approximately $345,000). Pilot forced an eight-week trial on an allegation of arson that the jury obviously considered trumped up. It forced her to put at risk her only remaining asset (the insurance claim) plus approximately $320,000 in legal costs that she did not have. The denial of the claim was designed to force her to make an unfair settlement for less than she was entitled to. The conduct was planned and deliberate and continued for over two years, while the financial situation of the appellant grew increasingly desperate. Evidently concluding that the arson defence from the outset was unsustainable and made in bad faith, the jury added an award of punitive damages of $1 million, in effect providing the appellant with a "windfall" that added something less than treble damages to her actual out-of-pocket loss…

The Facts:

Mr. Justice Binnie summarized the basic facts as follows:

2. The appellant, Daphne Whiten, bought her home in Haliburton County, Ontario, in 1985. Just after midnight on January 18, 1994, when she and her husband Keith were getting ready to go to bed, they discovered a fire in the addition to their house. They and their daughter, who had been upstairs, fled the house wearing only their night clothes. It was minus 18 degrees Celsius. Mr. Whiten gave his slippers to his daughter to go for help and suffered serious frostbite to his feet for which he was hospitalized. He was thereafter confined to a wheelchair for a period of time. The fire totally destroyed the Whitens' home and its contents, including their few valuable antiques and many items of sentimental value and their three cats.

3. The appellant was able to rent a small winterized cottage nearby for $650 per month. Pilot made a single $5000 payment for living expenses and covered the rent for a couple of months or so, then cut off the rent without telling the family, and thereafter pursued a hostile and confrontational policy which the jury must have concluded was calculated to force the appellant (whose family was in very poor financial shape) to settle her claim at substantially less than its fair value. The allegation that the family had torched its own home was contradicted by the local fire chief, the respondent's own expert investigator, and its initial expert, all of whom said there was no evidence whatsoever of arson. The respondent's position, based on wishful thinking, was wholly discredited at trial. Pilot's appellate counsel conceded here and in the Ontario Court of Appeal that there was no air of reality to the allegation of arson.

The Supreme Court of Canada Decision:

The Ontario Court of Appeal had reduced the punitive damage award to $100,000. Mr. Justice Binnie summarized his reasons for overturning this decision and restoring the jury award:

4. …In my view, on the exceptional facts of this case, there was no basis on which to interfere with the jury award. The award, though very high, was rational in the specific circumstances disclosed in the evidence and within the limits that a jury is allowed to operate. The appellant was faced with harsh and unreasoning opposition from an insurer whose policy she had purchased for peace of mind and protection in just such an emergency. The jury obviously concluded that people who sell peace of mind should not try to exploit a family in crisis. Pilot, as stated, required the appellant to spend $320,000 in legal costs to collect the $345,000 that was owed to her. The combined total of $665,000 at risk puts the punitive damage awards in perspective. An award of $1 million in punitive damages is certainly at the upper end of a sustainable award on these facts but not beyond it. I would allow the appeal and restore the jury award of $1 million punitive damages.

Approach to Punitive Damages:

Mr. Justice Binnie explained how punitive damages should be approached:

> 94. …Punitive damages are very much the exception rather than the rule, (2) imposed 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 suffered 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 dessert (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, and (9) they are given in an amount that is 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 in our system have usually found that moderate awards of punitive damages, which inevitably carry a stigma in the broader community, are generally sufficient.

In reviewing the jury's award, Mr. Justice Binnie explained that the key question was whether the award was rational and "proportionate" in the following senses:

> (i) Proportionate to the blameworthiness of the defendant's conduct: the more reprehensible the conduct, the higher the rational limits to the potential award. (This, in turn, requires an analysis of (1) whether the misconduct was planned and deliberate; (2) the intent and motive of the defendant; (3) whether the defendant persisted in the outrageous conduct over a lengthy period of time; (4) whether the defendant conceded or attempted to cover up its misconduct; (5) the defendant's awareness that what he or she was doing was wrong; (6) whether the defendant profited from its misconduct; and (7) whether the interest violated by the misconduct was known to be deeply personal to the plaintiff);
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> (ii) Proportionate to the degree of vulnerability of the plaintiff;

(iii) Proportionate to the harm or potential harm directed specifically at the plaintiff;

(iv) Proportionate to the need for deterrence;

(v) Proportionate, even after taking into account the other penalties, both civil and criminal, which have been or are likely to be inflicted on the defendant for the same misconduct; and

(vi) Proportionate to the advantage wrongfully gained by a defendant from the misconduct.

Comments About the Decision:

The fact that the Supreme Court endorsed -- in fact, restored -- an award of $1 million for punitive damages is obviously unfavourable to insurers. An award of $1 million is now considered to be within "rational limits". Although he indicated that the ratio of punitive to exemplary damages is not determinative, Mr. Justice Binnie was not offended by a punitive damages award that amounted to three times the amount of the loss payable under the policy. There is no doubt that insurers can now expect higher demands from plaintiffs' counsel as well as higher court awards, at least in claims on consumer coverages.

Nevertheless, insurance litigants should not overstate the effect of the decision. First, as Mr. Justice Binnie observed, this award of punitive damages was "very high", and "at the upper end of a sustainable award on these facts". Given the egregious conduct summarized in the decision, few awards should approach this high end of the range.

Second, Mr. Justice Binnie expressly confirmed that punitive damages are "very much the exception rather than the rule", and will be imposed 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". His Lordship regarded the facts of this case to be "exceptional". Insurers will find it worthwhile to review the reasons for judgment in detail to understand the overzealous conduct (including the conduct of trial counsel) that was censured by the jury and ultimately by the Supreme Court.

Another point of interest to insurance litigants is that Mr. Justice Binnie considered the defendant's financial worth to be a factor of only limited importance, to be taken into account in assessing the need for deterrence. A defendant's financial power may become relevant (1) if the defendant argues that it is under financial hardship, or (2) it is directly relevant to the defendant's misconduct (e.g., financial power enables the defendant to sustain a campaign against the plaintiff) or (3) where it may rationally be concluded that a lesser award against a moneyed defendant would fail to achieve deterrence. Net worth is not, in and of itself, significant.

The decision emphasizes the importance of the "peace of mind" element in homeowners fire coverage. It remains to be seen whether commercial policyholders will be entitled to recover punitive damages on the same basis. In principle, the decision seems to give them a basis for advancing such claims. Clearly it will no longer be possible for insurers to argue that punitive

damages are unavailable simply because insurance claims are contract matters. The Court endorsed the concept that insurers owe an independent duty of good faith in handling claims, and that a breach of that duty can attract punitive damages.

Mr. Justice Binnie has also endorsed the "bifurcation" of proceedings, i.e., the separation of liability and damages proceedings, so that disclosure of information does not affect the fairness of the liability portion of a trial. His Lordship commented that disclosure of financial information "may wrongly influence the jury to find liability where none exists" and "pre-trial discovery of financial capacity would unnecessarily prolong the pre-trial proceedings" (at para. 121). We have begun to see the trial courts make orders that separate liability and damages; for example, some judges have refused to require insurers to produce financial documents until after the liability phase of a bad faith trial has occurred. Mr. Justice Binnie's reasons endorse this type of approach.

It is also worth noting that Mr. Justice Binnie cautioned against duplication of awards of damages. It is important to ensure that punitive damages are not awarded to compensate a plaintiff for emotional distress:

> 116. ...it must be kept in mind that punitive damages are not compensatory. Thus the appellant's pleading of emotional distress in this case is only relevant insofar as it helps to assess the oppressive character of the respondent's conduct. Aggravated damages are the proper vehicle to take into account the additional harm caused to the plaintiff's feelings by reprehensible or outrageous conduct on the part of the defendant. Otherwise there is a danger of "double recovery" for the plaintiff's emotional stress, once under the heading of compensation and secondly under the heading of punishment.

It will be important to analyze carefully a plaintiff's claims in order to ensure that there is no such duplication.

Conclusion:

The approach to punitive damages in claims against insurance companies has changed dramatically. The prospect of substantial punitive damages awards will undoubtedly affect the way in which insurance companies approach claims. The *Whiten* decision is a very significant step in the Supreme Court of Canada's continuing overhaul of the law of insurance. The Court has provided claimants with a very powerful weapon to secure compliance with the insurer's obligation of good faith.

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