



# BAD FAITH LITIGATION IN CANADA MUCH ADO ABOUT NOTHING?

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## A. INTRODUCTION

Many people involved in the Canadian insurance industry are alternately amazed and appalled at the bad faith punitive damage awards that occasionally emerge from the US Courts. They are amazed some states allow liability limits on auto policies less than 10% of the Canadian mandatory minimums (\$200,000), and they are astounded that a person who purchases only \$25,000 of such liability coverage can later receive a jury verdict of \$145 million in punitive damages against the auto insurer for “bad faith” handling of an excess liability claim under the policy (the *Campbell v. State Farm* saga). Some Canadian observers were similarly perplexed how a simple water leak claim on a homeowner’s policy spiralled into a “toxic mold” catastrophe and ultimately resulted in a Texas jury tagging the homeowner insurer with some \$26 million for mental anguish and punitive damages, and attorneys fees (the *Ballard v. Fire Insurance Exchange* saga).

For their part, US observers would probably be surprised to learn that the high-

est court north of the border (the Supreme Court of Canada) has effectively limited available punitive damage awards against first party insurers in that country to \$1 million and then only in cases of most egregious misconduct. With respect to liability insurance, you can literally count on one hand the number of “bad faith refusal to settle” cases in Canada and the largest such award has been a mere \$300,000.

## B. THE ORIGIN OF THE GOOD FAITH OBLIGATION

“Bad faith” litigation and run away jury awards of multi-million dollar punitive damages against insurers is strictly a North American phenomenon. There is no such cause of action in the United Kingdom, the very place where today’s modern insurance industry originated.

In the USA, the Restatement of Contracts expressly imposes upon contracting parties “a duty of good faith and fair dealing in [the contracts] performance and enforcement.” No such provision exists in

Canada nor, indeed, have the Canadian courts adopted any such general rule as a matter of common law. In addition, most US states have enacted statutes or regulations expressly governing insurance claims and proscribing certain unfair or deceptive claims handling practices. These, along with general tort law principles, form the basis for much “bad faith” litigation south of the border.

Canada, the world’s second largest country in size, comprises ten provinces and three territories, each of which has its own legislative and regulatory regime for insurance. Some, but by no means all, of these provinces/territories have legislative provisions prohibiting “unfair or deceptive practices” in the business of insurance, but none of the legislation provides any statutory cause of action for insurer “bad faith.”

However, the Canadian courts have repeatedly endorsed the concept of a duty of good faith as an implied term in every contract of insurance. The courts have also held that, generally speaking, insurance policies

are “peace of mind” contracts. These principles can form the basis in appropriate cases for both punitive and mental distress damages arising from wrongful denials of coverage.

Thus far in Canada, only one appeal court in one province (New Brunswick) has actually endorsed the concept that insurer bad faith is a tort (as opposed to merely a breach of contract claim). In that case, the court declared “it is settled law, at least in this Province, that insurers owe a duty of good faith and fair dealing to their insured, a breach of which may give rise to their liability in both contract and tort.” Opening the door to tort allows damages claims to be made not only against the insurance corporation, but also directly against its adjusters, claims managers, investigators and other individuals involved in the claims process. However, such tort suits have not in fact gained traction in Canada, and bad faith claims are still generally treated as breach of contract claims against the insurer alone.

Today, as in the USA, coverage enforcement lawsuits in Canada invariably include what have become almost standard form allegations of bad faith claims handling on the part of insurers and very often claim substantial punitive and mental distress damages on that account. Such awards are actually very rare and, in most instances, the claim is merely a litigation tactic designed to ransom settlements through a combination of:

1. the mere possibility of an award being made by a sympathetic, unsophisticated jury; and
2. the increased cost, inconvenience and, occasionally, embarrassments arising from extensive discovery into corporate finances, administration and claims handling.

### C. THIRD PARTY LIABILITY CLAIMS: WHAT ARE THE “GOOD FAITH” OBLIGATIONS?

As indicated, there have been relatively few successful bad faith lawsuits against liability insurers in Canada. Of course, like most litigation, the vast majority of such cases settle before trial. Nevertheless, the absence of reported Canadian case law in this area provides an astonishing comparison with the US experience.

Canadian courts have held that while the opportunity to settle a defensible case for the policy limits necessarily produces a conflict of interest between insurer and insured, it is not a situation where the insurer owes fiduciary duties to the insured, and the insurer is not required to abandon their separate interest simply because of the possibility of a judgment in excess of policy lim-

its. Rather, liability on that account will only flow where the defense is mishandled, where the insurer fails to consider the insured’s interests as well as its own, and where there has been poor or untimely communication to the insured of all material information touching upon their position in the litigation.

Cases involving failure to settle within limits do not usually result in punitive damage awards. Rather, the insurer becomes liable for the amount of the excess judgment. Indeed, the highest punitive damage award in Canada for wrongful denial of liability coverage was made in 2012 and was only for \$75,000.

### D. FIRST PARTY COVERAGE: WHAT ARE THE GOOD FAITH OBLIGATIONS?

By far the most common form of bad faith allegation against insurers is made in the context of first party property or disability insurance coverages. Even so, the Supreme Court of Canada has declared; “an insurer will not necessarily be in breach of the duty of good faith by incorrectly denying a claim that is eventually conceded, or judicially determined, to be legitimate...the question instead is whether the denial is as a result of the overwhelmingly inadequate handling of the claim or the introduction of improper considerations into the claims process.”

Conduct which some Canadian courts have held to constitute a breach of the duty of good faith in first party cases includes:

- Failing to provide an accurate and fair explanation of the policy terms and claims procedures;
- Failing to act with reasonable promptness during each step of the claims process, including timely payment of undisputed portions of the claim.
- Failing to undertake a competent investigation of the claim using objective unbiased experts; and
- Denials of coverage or delayed payments to take advantage of the insureds economic vulnerability or to gain bargaining leverage.

The highest punitive damage award in a first party coverage case in Canada is \$1 million. It involved a denial of coverage under a homeowners policy on grounds of alleged arson even though the insurer was told by their own investigators, they “didn’t have a leg to stand on.” The award was made by a jury and while the Supreme Court of Canada ultimately allowed it to stand, they expressed the view that the amount was extremely high.

### E. PUNITIVE DAMAGES: WHAT IS THE THRESHOLD?

While the case law establishes that the insurer’s breach of the implied duty of good faith claims handling is a necessary pre-condition for any award of punitive damages, it does not follow that such awards are automatic in all cases where there has been a breach. Rather, the Supreme Court of Canada has made it very clear there is a two-step analysis which must be undertaken namely:

1. Beyond establishing that the denial of coverage was an incorrect judgment call, was the denial also the result of both overwhelmingly inadequate claim handling or the introduction of improper considerations? and
2. If so, was the insurer’s conduct so exceptionally egregious that an award of punitive damages is warranted.

It is only in exceptional cases where both conditions are met, that punitive damages are supposed to be awarded in Canada. Some observers believe the trial courts often overlook the exceptional nature of the award and that some dilution of the threshold criteria has occurred. Still, awards of punitive damage for insurer bad faith in Canada remain relatively rare even where the denial of coverage or the handling of the claim has been judicially found wanting. Given the size of awards regularly made in US courts, observers south of the border may be inclined to think bad faith litigation in Canada is indeed much ado about nothing.



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