Toronto Law Journal

Insurers Over-Zealously Fighting Fraud Could Face Punitive Damages

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Last month, March 2018, was the 14th annual Fraud Prevention Month, an education and awareness campaign focusing on fraud recognition and reporting. Throughout the month, media reports circulated on how susceptible the insurance industry is to fraud. The Insurance Bureau of Canada reported that auto insurance fraud costs Ontario drivers an estimated $1.6 billion each year (translating to approximately $236 of an individual's auto insurance premium), while the insurer Aviva reported that its recent investigation into auto repair fraud confirmed that certain Ontario auto body shops were falsely inflating damages and repair costs to automobiles, costing consumers approximately $547 million annually.

Such news reports suggest that insurers are being abused while costs are being passed along to consumers. They also serve to remind us how the specter of fraud weighs heavily on the insurance industry. On a mundane level, every insured policyholder who files a claim is also indirectly facing the specter of fraud. The responding insurer must attempt to ensure that the claim is valid and that payments comply with the policy, while the claimant is tasked (and sometimes, over-tasked) with justifying its claim. Given the potentially conflicting positions, the relationship can become fractious: as the insurer struggles with the legitimacy of the insured's position and the insured becomes frustrated with the insurer's handling of the claim. As we address below, both sides often claim wrongdoing against the other, and this, in turn, has shaped the jurisprudence on punitive damages.

Recently, Aviva obtained punitive damages after advancing a summary trial against an unlicensed individual masquerading as an insurance intermediary.[2] The decision referenced *RBC General Insurance Company v. Field*, where the Court awarded the plaintiff insurer punitive damages in an action to recover accident benefits and amounts for property loss paid to the defendant insured.[3]

These insurers' entitlements to punitive damages are linked to the Supreme Court of Canada's seminal decision in *Whiten v. Pilot Insurance Company*,[4] which concerned a punitive damage award against an insurer. *Whiten* involved an insurer denying the homeowner's claim based on a perceived fraud on the claim (*i.e.*, the insurer believed the loss arose from arson). The eventual punitive damages stemmed from the insurer's combination of improper claims investigation and its reliance on obviously inadequate evidence. The insurer's conduct was designed to push the plaintiffs into an unfair economic settlement which amounted to an "independent actionable wrong" (and thus, distinguishing from a mere breach of contract)

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[2] *Aviva Insurance Co. of Canada v. Porras*, [2018] O.J. No. 1312 (S.C.J.).
[3] [2016] O.J. No. 5011 (S.C.J.).
[4] [2002] 1 S.C.R. 595.

giving rise to an award of punitive damages. *Whiten* set the high-water mark for punitive damages awards against insurers and confirmed that an implied good faith obligation exists in every insurance contract as a separate obligation from indemnity for insured losses.[5]

The Supreme Court of Canada attempted a comparative survey of punitive damages in other common law jurisdictions, ultimately suggesting that punitive damages should be awarded only in exceptional circumstances, and should generally be restricted to intentional torts or breaches of fiduciary duty.[6] The evidentiary analysis focussed on the egregiousness of the actions, while prevailing themes in awarding punitive damages include punishment and future deterrence — not compensation to a plaintiff.[7]

Several other arson cases have led to punitive damages awards.[8] While the facts obviously differ, the insurers' arson determinations were subsequently found to be unreliable, suspect, or contrary to other evidence. When punitive damages were awarded, the insurers who maintained defences of arson through to trial each demonstrated some manner of "tunnel-vision" — a singular pursuit of an outcome — that may have distracted from a more balanced claims assessment. Notably, these cases involved juries awarding punitive damages.

Yet despite *Whiten* and similar cases, it remains difficult to draw a line around the sort of insurer conduct that justifies punitive damages. Cases evaluating alleged misconduct by insurers confirm that punitive damages can arise when an insurer fails to act both promptly and fairly throughout the claims process — *i.e.*, when initially investigating, when assessing, and when settling claims. Breaches of the duty of good faith — and the resulting punitive damages — can arise where insurers unreasonably deny claims, or where insurers unreasonably delay payment. Cases of unreasonable denial generally involve insurers failing to properly investigate a claim, exhibiting a type of "tunnel-vision" or relying on obviously inadequate evidence. Cases involving unreasonable delay or withholding payment are indicative of oppressive or adversarial conduct, a lack of care for the insured's interests, and/or attempts to push the insured to an unfair economic settlement. Both types of conduct can (and often do) co-exist, and these cases suggests that insurers' underlying concerns over being defrauded spill over into investigations, and then impact the entire claim process.

The insurer's treatment of the insured is a central element to whether punitive damages may be awarded. For example, in *Haji-Fazul v. Lloyd's Underwriters*,[9] the insurer refused coverage based on alleged material misrepresentations made during the placement of insurance. At trial, the theory of material misrepresentations did not hold, and the insurer then faced a jury's

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[5] *Whiten v. Pilot Insurance Co.* (1999), 42 O.R. (3d) 641 at para. 26 (Ont. C.A.), Laskin J.A. (dissenting in part).
[6] For a critique of the decision, see Matthew P. Harrington, "'A Lawless Science': Punitive Damages for Breach of Contract in Canada" (2015) 69 S.C.L.R. (2d) 185 – 223.
[7] *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130 at 1208.
[8] See *Kogan v. Chubb Insurance Co. of Canada,* [2001] O.J. No. 1697 (S.C.J.); *Khazzaka v. Commercial Union Assurance Co. of Canada* (2002), 66 O.R. (3d) 390 (C.A.); *Plester v. Wawanesa Mutual Insurance Co.*, [2006] O.J. No. 2139 (C.A.); *J.I.L.M. Enterprises & Investments Ltd. v. INTACT Insurance*, [2017] O.J. No. 436 (S.C.J.).
[9] Endorsement of Jury Award, CV-53312/11.

punitive damages award.[10] Similarly, in an earlier decision,[11] an insurer's claim denial included alleged misrepresentations that, together with an allegation of arson, led the insurer to void the policy. Ultimately, the jury awarded punitive damages against the insurer as the latter denied the claim based on alleged misrepresentations yet did not provide the insured with the opportunity to know what facts were considered material or to provide the requisite facts.

In addition to prejudging an insured's coverage entitlement or maintaining such a position without an appropriate evidentiary basis, insurers have also been found to commit bad faith through oppressive or unnecessarily adversarial behaviour. For example, in one case the insurer did not advise the insured that the claim was being denied until after litigation was commenced, was unhelpful to the insureds in completing a proof of loss form, and further insisted that the insureds never advised that a certain item was part of the claim.[12]

The insurer's failure to process a claim in a timely manner is yet another type of conduct that may warrant an award of punitive damages in egregious situations. Recently, an Ontario court found the delay in paying an insured almost two years after completion of an arson investigation was a marked departure from what is acceptable.[13] A one-year delay would have been reasonable in order to complete investigations, but the failure to pay for another two years thereafter was not. The granted punitive damages equated to 10% of the amount payable under the policy for every year of the delay. Punitive damages have also been awarded where there was a delay in the assessment of the claim.[14]

In addition to punitive damages, cases indicate that insurers who breach the independent obligations of good faith in policies intended to protect the well-being of an individual, such as disability policies, may also be subject to additional damages for mental distress. For example, in *Clarfield v. Crown Life Insurance Co.*,[15] the insurer relied solely upon an insured's high "Global Assessment of Functioning (GAF)" scores to deny a claim, despite other medical evidence of an insured's health (including doctors' reports commenting on severe anxiety and depression). The insured was ultimately awarded $200,000 in punitive damages and $75,000 in aggravated damages for the financial loss suffered from the sale of his home due to the insurer's delayed payment.

More recently, the British Columbia case *Godwin v. Desjardins Financial Security Investments Inc.* included punitive damages along with damages for mental distress against an insurer due to its manner of claims handling.[16] Drawing from the Supreme Court of Canada's decision in *Fidler v. Sun Life Assurance*,[17] the Court recognized that damages for mental distress may be recoverable when the "… insurance contract was intended to secure a psychological benefit

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[10] See also Peter Small, "*Ruling against insurance company for punitive damages*", online: (2016) Law Times <http://www.lawtimesnews.com/article/ruling-against-insurance-company-for-punitive-damages-12619/>
[11] *Sagl v. Cosburn, Griffiths & Brandam Insurance Brokers Ltd.*, 2007 CarswellOnt 5523 (S.C.J.) [*Sagl*].
[12] *Kogan v. Chubb Insurance* (2001), 27 C.C.L.I. (3d) 16 (Ont. S.C.J.).
[13] *J.I.L.M. Enterprises & Investments Ltd. v. Intact Insurance*, 2017 ONSC 357 (S.C.J.).
[14] *Fidler v. Sun Life Assurance*, [2006] 2 S.C.R. 3 [*Fidler*].
[15] (2000), 50 O.R. (3d) 696 (S.C.J.).
[16] [2018] B.C.J. No. 96 (S.C.) [*Godwin*].
[17] *Fidler*.

that brought the prospect of mental distress upon breach within the reasonable contemplation of the parties at the time the contract was made."

The Supreme Court of Canada in *Fidler* had observed that "in normal commercial contracts, the likelihood of a breach of contract causing mental distress is not ordinarily within the reasonable contemplation of the parties."[18] However, damages for mental distress can be a foreseeable consequence of breach of contract in cases where the very contract at issue (*e.g.*, a disability policy) insured an intangible, such as mental security. As well, aggravated damages are compensatory in nature and therefore recovery depends on evidence of the aggravation and mental distress. In such cases, unlike punitive damages, it is not necessary to find an independent actionable wrong.[19] Still, it should be noted that the Court in *Godwin* conducted a review of awards for damages for mental stress in the context of a disability policy and noted that such damages have traditionally been modest, and the cases cited therein reflect cases generally well under $100,000.

It is important to note that not all impugned elements of an insurer's claims handling process will give rise to punitive damages and most cases alleging punitive claims against insurers likely do not warrant punitive damage awards. In what may be a general observation about alleged entitlement to punitive damages, we note the British Columbia Supreme Court's comment that "… [m]any of the deficiencies in the claims handling appear possibly to have arisen as a result of a lack of training or a lack of supervision."[20] Rather, we suggest that decisions in the claims handling process that are rendered without a sufficient or proper evidentiary basis, to the point of being deemed essentially arbitrary, are the type of conduct warranting punitive damages.

Finally, we note that cases suggest all manner of policies are affected, although cases awarding punitive damages appear predominantly involving smaller businesses or individuals. It may be that larger corporate insureds have sufficient resources to minimize abuse, perhaps through the involvement of professional claims assessors on both sides, or that such parties are simply more capable of protecting their interests, either at the outset of the claims process, or by advancing disputes to resolution before requiring court judgments.

In closing, we know that the contractual relationship between insurer and insured is based on duties of utmost good faith. At the same time, the existence of fraud presents a significant challenge to the ability of both consumers and insurance providers. The jurisprudence on the law of punitive damages involving insurers serves as a reminder that a careful assessment of the claim before reaching any conclusions is beneficial to all players. In short, fraud adversely impacts both consumers and providers of insurance and has lead to extensive jurisprudence while tangentially developing the law on punitive damages in Canada.

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[18] *Fidler* at para. 45.
[19] See *Saunders v. RBC Life Insurance Company*, 2007 NLTD 104 (S.C. (T.D.)).
[20] *Godwin* at para 172.