**Assurances**

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Volume 46, Number 3, 1978

URI: https://id.erudit.org/iderudit/1103981ar
DOI: https://doi.org/10.7202/1103981ar

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Publisher(s)

HEC Montréal

ISSN

0004-6027 (print)
2817-3465 (digital)

Explore this journal

Cite this document

Robey, C. (1978). IV – Punitive Damages in Canada. *Assurances*, *46*(3), 234–241. https://doi.org/10.7202/1103981ar

# IV – Punitive Damages in Canada

*by*

CHRISTOPHER J. ROBEY [1]

### *Definition of terms*



Damages are the amount of money, or other consideration, paid to a person as a result of injury caused by the negligence of another.

Damages may be compensatory, that is, designed to reimburse the injured party for expenses, loss of income and the like. Aggravated damages, payable in compensation for pain and suffering and the like, are a subdivision of compensatory damages.

Damages may also be non-compensatory, designed more to punish the negligent party for the heinousness of his conduct. These are variously referred to as punitive damages, exemplary damages and moral damages, amongst other possible terms. In this text, non-compensatory damages will be referred to as punitive damages.

### *Origins*

For the English-speaking world, punitive damages have their origins in English common law and date from the middle of the eighteenth century. The first recorded case appears to be Wilkes v. Wood in 1763; the same year saw the case of Huckle v. Money, in which the plaintiff was held in prison for six hours; he suffered no physical injury and very little

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pecuniary loss, but in an action for false imprisonment, he was awarded £ 300 by the jury.

The principle of punitive damages developed gradually from this point to include other cases of wanton interference with the plaintiff's rights, such as seduction, assault and trespass to land. It came to be applicable in any case within the law of torts where the judge or jury felt it necessary to punish and deter the defendant, where his wrong had been committed with the utmost degree of malice or vindictively, arrogantly or high-handedly. The principle was well expressed by the Appeal Court in Merest v. Harvey, in 1814, in the following comment:



> "I wish to know in a case where a man disregards every principle which actuates the conduct of a gentleman, what is to restrain him except large damages ?"

The English common law is the basis of law in most of North America and, consequently, the same principle has been applied in most North American jurisdictions.

However, doubts began to be expressed in the 20th century in Great Britain concerning the scope and function of punitive damages, to the point in 1964 when the House of Lords made a landmark decision in Rookes v. Barnard; the judgment written by Lord Devlin, with which, in this respect, the other law-lords concurred, limited the award of punitive damages to the following three circumstances:

1) where there has been oppressive, arbitrary or unconstitutional action by the servants of the Government;

2) where the defendant's conduct has been calculated by him to make a profit which may well exceed the compensation payable to the plaintiff;

3) where such damages are expressly authorized by statute.

The principles of Rookes v. Barnard were applied by the English Courts from 1964 on, until 1971, when the Court of Appeals heard the case of Broome v. Cassell and Co. Ltd. et al, in which Lord Denning stated that the decision in Rookes v. Barnard was not justified and declined to follow it, awarding punitive damages to the plaintiff.



The defendant appealed this case to the House of Lords which affirmed the decision of the lower court, but on the basis that the case fell within one of the categories laid down in Rookes v. Barnard. The House of Lords then took the opportunity to castigate the Court of Appeal for not having upheld the decision of the higher court. Rookes v. Barnard was thus confirmed as being the law of Britain.

### *In Canada*

While, at the time of the development of the theory of punitive damages in the British courts, Canada was subject to the same hierarchical court system, by 1964 the decisions of the House of Lords no longer had the same binding power on Canadian jurisprudence and since 1964, courts in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and New Brunswick have all held that Rookes v. Barnard is not binding on them. The situation in Quebec is substantially different, because of the existence of the Civil Code, under which it would seem that punitive damages may not be awarded following a tort.

The final word on the application of Rookes v. Barnard to Canada will come from the Supreme Court of Canada, which has not yet specifically been called upon to make a decision on the matter. To endeavour to foresee what decision

it would take therefore, it is necessary to look to another part of the former British Empire, Australia.

Rookes v. Barnard was rejected by the Australian High Court as having no application in that jurisdiction; this decision was appealed to the Privy Council in Great Britain, which acts as the Supreme Court of Australia, and the Privy Council upheld it. This suggests that the Supreme Court of Canada would do the same.



### *Effect on Insurance*

It is the opinion of the Insurance Bureau of Canada that punitive damages awarded against an insured are covered by a standard liability policy unless the policy is specifically worded to prevent their recovery. It has therefore modified its coverage riders to include the word "compensatory" preceding the word "damages", in all cases where the word "damages" appears.

Although I.B.C. forms are used generally, their use is not compulsory and it cannot therefore be assumed that all companies are defining damages covered in this way. Indeed, some companies may feel that the previous wording successfully excluded punitive damages, whereas such a modification now implies that they were previously covered; others may wish to continue using the old forms on the basis that they have always covered punitive damages and intend to continue doing so. In any case, I.B.C. has no control over automobile forms, which can only be specifically limited to compensatory damages with permission of the appropriate government authorities, permission which does not seem likely to be forthcoming in the immediate future.

### *Effect on Reinsurance*

Punitive damages can affect reinsurance in two ways:

— when awarded against an insured of the cedant and recoverable under the policy issued.

— when awarded to the insured against the cedant in tort.

In the first case, where punitive damages are awarded against an insured in favour of a third party and are held to be recoverable under the insurance policy issued by the cedant
238 to that insured, it seems logical that the reinsurance should follow, since it is normally worded to apply to any amounts which the cedant is legally liable to pay under policies it has issued. To prevent such recovery under reinsurance treaties would probably require a specific exclusion.

The second possibility presents considerably more difficulties.

On the one side, it can be held that the punitive damages paid by the cedant to the insured are not amounts which the cedant is legally liable to pay under an insurance policy it has issued, but rather the result of its own negligence in its dealings with its insured. In this case, since there is no insurance, there can be no reinsurance.

On the other hand, it can be argued that damages arose from the normal operations of the company, to which its reinsurance is negotiated to apply and, indeed, may well have been incurred where the cedant was endeavouring to protect the interests of its reinsurers by keeping a loss to the minimum. Since most excess of loss treaties include a claim's co-operation clause, under which the reinsurer is kept informed of the actions the cedant is taking, it can be argued that the reinsurer is as liable for the damages as is the cedant; this is particularly applicable where the reinsurer has participated in the handling of the claim.

The ideal solution would seem to be for the insurance company to purchase a liability policy covering its own operations, which would include protection against awards of this type and, indeed, the American International Group, through its subsidiary the National Union Fire Insurance Company, introduced an insurance company's professional liability policy in the United States, although this is not as yet available in Canada. However, this solution, to be practical, will require the willingness of more than just one company to issue this type of policy, in order to make available sufficient capacity at a reasonable cost, and it will still have to deal with conflicts which will undoubtedly arise between the cedant's professional liability insurer and its reinsurers over the handling of claims.



It should be mentioned here that it would seem inadvisable for a cedant to issue such a professionnal liability policy to itself and rely on the "cedant as insured" clause which is in most reinsurance contracts, since, although this may technically provide protection, it would not be in the spirit in which reinsurance contracts are negotiated.

### *Excess of Policy Limits Clause*

Although allied in many ways to the question of punitive damages, and frequently considered to be the same subject, this clause is in fact a separate matter and should be dealt with separately. It is designed to cover circumstances where the cedant must pay an amount in excess of its policy limits because of some statutary provision or where it is held liable to compensate an insured for the insured's loss which exceeds policy limits because of the insurers' actions. The principle is that it should involve only amounts the insured is liable to pay as damages to a third party.

The following is an example of such a case.

The policy limit is $100,000 and the third party is claiming $200,000. After negotiation, the third party indicates a willingness to settle for $100,000, but the insurance company decides that the insured should contest the case and deny all liability. When the case is heard the insured is held liable and the award is for $200,000, as originally claimed by the third party. In these circumstances, the insured finds himself liable to pay $100,000 out of his own pocket, whereas if the insurance company had accepted the third party's offer to settle for the policy limit, the insured would have been liable to pay nothing. In such circumstances, the Court may well hold the insurance company liable to pay the full amount, regardless of the policy limit.



### *Conclusion*

It will be noted from the above that there is as yet no satisfactory solution to the question of punitive damages. It willl also be realized that the question is not so much punitive damages themselves, since they have been in existence for two hundred years without causing much concern; the question arises more because of the size of third party awards generally, including punitive damage awards, particularly in certain United States' jurisdictions. That the legal system in Canada is different from that in the United States in ways which suggest that similar huge awards are unlikely in Canada is no reason to ignore the question, since many Canadian insureds find themselves in the United States and their liability coverage is portable. It is necessary, therefore, to provide for this question in reinsurance contracts now and, in view of the different opinions already existing on the matter, the only adequate way to deal with them is by specific mention in the contract.

As with any question of this type, a solution acceptable to all parties is more likely to evolve over a period of time than burst upon the scene; it is to be hoped therefore that it will be the result of negotiations between reinsurers and cedants and their representatives, with minimum reference to the courts. The discussions will undoubtedly focus on the United States where the problem is much more acute, with the approach eventually adopted there being adapted to Canadian circumstances.



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**Binding Authorities.** A report by a Sub-Committee of the Reinsurance Offices Association. Aldermary House, Queen Street, London EC4N 1ST.

L'agent ou le courtier d'assurance peut obtenir le droit de lier un assureur ou un réassureur dans certains cas prévus et à des conditions précises. Il doit s'en tenir strictement à son mandat. Qu'arrive-t-il s'il s'en écarte ? C'est le sens de cette brochure de la Reinsurance Offices Association de Londres. On y trouve le rapport d'un sous-comité de l'Association, dans lequel la question est exposée sous ses divers angles. À consulter aussi bien par ceux à qui le droit de lier est accordé que par ceux qui savent qu'en acceptant un risque, l'agent ou le courtier agit en vertu d'une responsabilité bien délimitée. Il y a là un document fort bien fait, mis à la disposition des membres de l'Association.