

THE MUTUAL DUTY OF GOOD FAITH

Insurers and Insureds owe a mutual obligation to deal with each other fairly and in good faith. Breach of this duty of good faith, bad faith, invites remedies beyond those offered under ordinary contract law. This paper is intended to provide a brief insight into some of the obligations this duty of good faith places on insurers and insureds.

While case law has developed to the point where generalized comments about the basic nature of the insurer's duty of good faith can be articulated, an exact description of the scope of this duty cannot be given. This is due to the reality that determination of whether the duty of good faith was breached is subjective and fact specific. In *702535 Ontario Inc. v. Non-Marine Underwriters, Lloyd's of London*¹, the Ontario Court of Appeal acknowledged this by writing:

*What constitutes bad faith will depend on the circumstances in each case. A court considering whether the duty has been breached will look at the conduct of the insurer throughout the claims process to determine whether in light of the circumstances, as they then existed, the insurer acted fairly and promptly in responding to the claim.*²

What can be stated with certainty is that the insurer's duty of good faith is present

during every stage of the claims process. It requires the insurer to act in a timely and considered manner and not to use its position of economic power against the insured.

The duty of good faith requires that the insurer approach the investigation and the decision as to coverage in a balanced manner. An insurer must consider all pertinent evidence and not just evidence supportive of a denial. A denial of a claim must be grounded on a reasonably held belief supported by cogent evidence.

In a number of cases, insurers have been found guilty of bad faith by denying claims or terminating payments without first completing a reasonable investigation. For example, in *Evans v. Crown Life Insurance Co.*³ an insurer was found to have acted in bad faith when it abruptly terminated disability benefits without discussing the insured's condition, which was supported throughout by her treating physicians, with the insured or with her physicians and without having the insured undergo assessment or examination by a physician or a rehabilitation specialist on behalf of the insurer.

An extreme example of an insurer's failure to approach the investigation and decision as to coverage in a balanced manner can be found in *Whiten v. Pilot*⁴. In *Whiten*, the insured's house and contents were totally destroyed by a fire. There was evidence that the insured was in financial difficulty but the evidence

¹ *702535 Ontario Inc. v. Non-Marine Underwriters, Lloyd's of London* (2000), 184 D.L.R. (4th) 687 (Ont. C.A.).

² *Ibid.*, at 695.

³ *Evans v. Crown Life Insurance Co.* (1996), 25 B.C.L.R. 3(d) 234 (B.C.S.C.).

⁴ *Whiten v. Pilot* (1996), 132 D.L.R. (4th) 568 (Ont. Ct. J.(Gen. Div.)), (1999), 170 D.L.R. (4th) 280 (Ont. C.A., [2002] 1 S.C.R. 595 (S.C.C.)).

did not establish that the insured stood to gain from her house and belongings being destroyed. The insurer rejected the opinions of the firefighters, fire chief, experienced adjuster and Insurance Crime Prevention Bureau that the fire was accidental and proceeded to deny coverage on grounds of arson. There was also some influencing of the insurer's experts for the purpose of obtaining reports supportive of an arson denial.

The insured brought an action for payment on the policy and bad faith damages. A jury ruled that the fire was accidental and found the insurer liable to indemnify the insured for the house and contents. The jury also found the insurer to have acted in bad faith and awarded \$1million in punitive damages.

The punitive damages award was appealed to the Ontario Court of Appeal and then to the Supreme Court of Canada. The Ontario Court of Appeal held that the insurer had seriously breached its duty of good faith when it "...deliberately ignored any opinion, even of its own adjuster and its own experts, that would oblige it to comply with its contractual obligations to pay the claim..."⁵. The Supreme Court of Canada came to the same conclusion by commenting that an insurer is entitled to thoroughly investigate a claim but that "[t]here is a difference between due diligence and wilful tunnel vision"⁶.

However, the duty of good faith does not require that the insurer always be correct in a decision to deny a claim. In *Fidler v. Sun Life Assurance Co. of Canada*⁷, the

Supreme Court of Canada made this clear by noting that "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"⁸. As long as there are reasonable grounds to support the denial, the denial, in and of itself, is not evidence of bad faith.

It is often stated that the duty of good faith is a mutual obligation between the insurer and the insured. However, in recent years the obligation, at least at the claims stage, seemed one-sided. Yet, Courts have begun to state that an insured is under an obligation to present its claim honestly and that failure to do such is a breach of the duty of good faith.

A good example of such a case is *Andrusiw v. Aetna Life Insurance Co. of Canada*⁹. The facts in *Andrusiw* are as follows. The insured suffered a stroke and claimed total disability benefits. While the insured was receiving such benefits, the insurer obtained solid evidence that the insured was working and the insurer terminated the benefits. The insured then brought a claim for entitlement to disability benefits and punitive damages. The insurer counterclaimed for past benefits paid and punitive damages.

The Alberta Court of Queen's Bench found that the insured was not totally disabled and that the insured had lied to the insurer in order to continue to receive benefits. The Court held the contract vitiated, retroactively declared

⁵ *Ibid*, at 293.

⁶ *Ibid*, at 648.

⁷ *Fidler v. Sun Life Assurance Co. of Canada*, [2006] 2 S.C.R. 3 (S.C.C.).

⁸ *Ibid*, at 29.

⁹ *Andrusiw v. Aetna Life Insurance Co. of Canada* (2001), 33 C.C.L.I. (3d) 238 (Alta. Q.B.).

the policy terminated and ordered the insured to repay the past payments with interest. The Court also awarded punitive damages against the insured. In deciding to award punitive damages, the Court stated that the duty of good faith places on the insured "...an obligation to the insurer to put forward his claim honestly ...¹⁰". The Court also noted that the relationship between the insurer and the insured is "... a two-way street founded upon the principles of utmost good faith...¹¹".

Further insightful commentary on the insured's duty of good faith can be taken from *Haiduc v. Alberta Motor Assn. Insurance Co.*¹². This matter involved an action for coverage of a stolen car wherein the insurer counterclaimed for punitive damages. The Court determined that the insured made false statements to the insurer in respect to the claim, and therefore, dismissed the insured's action. In determining whether to award punitive damages, the Court noted that "...deceit is more than a contractual or statutory breach that results in the loss of a claim; it is a breach of an obligation of utmost good faith¹³".

In summary, the duty of good faith imposes on the insurer an obligation to undertake a timely and cogent investigation into the insured's claim. The insurer must stay open-minded and must consider all relevant information. Its investigation should not be focussed on finding evidence to support a denial, but rather, should be focussed on

determining whether the claim is supported.

The insured also has an obligation of good faith. Traditionally, this obligation was only considered at the formation of the contract. However, the Courts have begun to state that an insured breaches this duty if he provides false information at the claims stage. While traditionally, such an action would mean the contract was void due to fraud, the Courts are now saying that such an action is in bad faith, and therefore, punitive damages can be awarded.

¹⁰ *Ibid*, at 263.

¹¹ *Ibid*, at 264.

¹² *Haiduc v. Alberta Motor Assn. Insurance Co.* (2003), 47 C.C.L.I. (3d) 104.

¹³ *Ibid*, at 109.