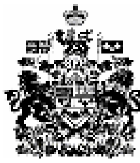

SUPREME COURT OF CANADA

CITATION: Fidler *v*. Sun Life Assurance Co. of Canada, 2006 SCC 30
[2006] S.C.J. No. 30

DATE: 20060629
DOCKET: 30464

BETWEEN:

Sun Life Assurance Company of Canada
Appellant
and
Connie Fidler
Respondent

CORAM: McLachlin C.J. and Major,* Bastarache, Binnie, LeBel, Deschamps, Fish, Abella and Charron JJ.

JOINT REASONS FOR JUDGMENT: (paras. 1 to 76)	McLachlin C.J. and Abella J. (Bastarache, Binnie, LeBel, Deschamps, Fish and Charron JJ. concurring)

* Major J. took no part in the judgment.

NOTE: This document is subject to editorial revision before its reproduction in final form in the *Canada Supreme Court Reports*.

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fidler *v*. sun life

Sun Life Assurance Company of Canada *Appellant*

v.

Connie Fidler *Respondent*

Indexed as: Fidler *v*. Sun Life Assurance Co. of Canada

Neutral citation: 2006 SCC 30.

File No.: 30464.

2005: December 6; 2006: June 29.

Present: McLachlin C.J. and Major,[*] Bastarache, Binnie, LeBel, Deschamps, Fish, Abella and Charron JJ.

on appeal from the court of appeal for british columbia

Damages — Compensatory damages — Damages for mental distress — Breach of contract — Insurer wrongly terminating insured's long-term disability

[*] Major J. took no part in the judgment.

benefits for more than five years — Whether insured entitled to damages for mental distress.

Damages — Punitive damages — Breach of contract — Insurer wrongly terminating insured's long-term disability benefits for more than five years — Whether insured entitled to punitive damages.

Insurance — Breach of contract — Damages — Insurer wrongly terminating insured's long-term disability benefits for more than five years — Whether insured entitled to damages for mental distress and punitive damages.

Contracts — Commercial contracts — Insurer in breach of disability insurance contract — Whether insured entitled to damages for mental distress.

F worked as a bank receptionist and was covered by a group policy that included long-term disability benefits. At the age of 36, she became ill, was eventually diagnosed with chronic fatigue syndrome and fibromyalgia, and began receiving long-term disability benefits in January 1991. Under the terms of the policy, she was only entitled to continued benefits after two years if she was unable to do any job. In May 1997, the insurer informed F that her benefit payments would be terminated. According to the insurer, its video surveillance detailed activities inconsistent with F's claim that she was incapable of performing light or sedentary work. The insurer's denial of benefits was followed by almost two years of correspondence with F and medical professionals. Despite the medical evidence in its possession to the effect that F was not yet capable of doing any work, the insurer, relying on its own consultants and experts, confirmed its decision to terminate benefits in December 1998. F commenced an action

and, one week before the trial was scheduled to start, the insurer offered to reinstate her benefits and to pay all arrears with interest. As a result, the only issue at trial was F's entitlement to damages. The trial judge awarded her $20,000 in aggravated damages for mental distress but, concluding that the insurer had not acted in bad faith, dismissed her claim for punitive damages. The Court of Appeal unanimously upheld the award for mental distress, and a majority of the court awarded F an additional $100,000 in punitive damages, finding palpable and overriding error on the question of bad faith.

Held: The appeal should be allowed in part.

Damages for mental distress for breach of contract may be recovered where they are established on the evidence and shown to have been within the reasonable contemplation of the parties at the time the contract was made. There is no requirement for an independent actionable wrong. In order to be successful, a plaintiff must prove his or her loss and the court must be satisfied that the degree of mental suffering caused by the breach was of a degree sufficient to warrant compensation. These questions require sensitivity to the particular facts of each case. Here, given the nature of a disability insurance contract, it would have been within the reasonable contemplation of the parties at the time the contract was made that mental distress would likely flow from a failure to pay the required benefits. An unwarranted delay in receiving the bargained for protection can be extremely stressful. The mental distress at issue here was of a degree sufficient to warrant compensation. The trial judge concluded, based on extensive medical evidence documenting the stress and anxiety that F experienced, that merely paying the arrears and interest did not compensate for the years that F was without her benefits. His award of $20,000 seeks to compensate her for the psychological consequences of the insurer's breach. [44-45] [47] [56-59]

The Court of Appeal's award of punitive damages must be set aside. Punitive damages are not compensatory. They are designed to address the purposes of retribution, deterrence and denunciation. However, an insurer will not necessarily be liable for such damages by incorrectly denying a claim that is eventually conceded, or judicially determined, to be legitimate. The question in each case is whether the denial was the result of the overwhelmingly inadequate handling of the claim, or the introduction of improper considerations into the claims process. Ultimately, each case revolves around its own facts. Here, after a thorough review of the relevant evidence, the trial judge found that the insurer had not acted in bad faith. He considered every salient aspect of how the insurer handled the claim and concluded that its denial of benefits was the product of a real, albeit incorrect, doubt as to whether F was incapable of performing any work. The termination of benefits relating to an unobservable disability in the absence of any medical evidence indicating an ability to return to work represents conduct that is troubling, but not sufficiently so as to justify interfering with the trial judge's conclusion that there was no bad faith. [61-64] [71-75]

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Applied: *Hadley v. Baxendale* (1854), 9 Ex. 341, 156 E.R. 145; **approved**: *702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters* (2000), 184 D.L.R. (4th) 687; **referred to**: *Warrington v. Great-West Life Assurance Co.* (1996), 139 D.L.R. (4th) 18; *Hobbs v. London and South Western Rail. Co.* (1875), L.R. 10 Q.B. 111; *Hamlin v. Great Northern Railway Co.* (1856), 1 H. & N. 408, 156 E.R. 1261; *Addis v. Gramophone Co.*, [1909] A.C. 488; *Eastwood v. Magnox Electric plc*, [2004] 3 All E.R. 991, 2004 UKHL 35; *Malik v. Bank of Credit and Commerce International S.A.*, [1998] A.C. 20; *Wallace v. United Grain Growers Ltd.*, [1995] 9 W.W.R. 153, var'd [1997] 3 S.C.R. 701; *Morberg v. Klassen* (1991), 49 C.L.R. 124; *Taylor v. Gill*, [1991] 3 W.W.R. 727; *Watts v. Morrow*, [1991] 1 W.L.R. 1421; *Baltic Shipping Co. v. Dillon* (1993), 176 C.L.R. 344; *Johnson v. Gore Wood & Co.*, [2001] 2 W.L.R. 72; *Peso Silver Mines Ltd. (N.P.L.) v. Cropper*, [1966] S.C.R. 673; *Jarvis v. Swans Tours Ltd.*, [1973] 1 All E.R. 71; *Farley v. Skinner*, [2001] 4 All E.R. 801, 2001 UKHL 49; *Wilson v. Sooter Studios Ltd.* (1988), 33 B.C.L.R. (2d) 241; *Wharton v. Tom Harris Chevrolet Oldsmobile Cadillac Ltd.* (2002), 97 B.C.L.R. 307; *Thompson v. Zurich Insurance Co.* (1984), 7 D.L.R. (4th) 664; *Prinzo v. Baycrest Centre for Geriatric Care* (2002), 60 O.R. (3d) 474; *Vorvis v. Insurance Corp. of British Columbia*, [1989] 1 S.C.R. 1085; *Wertheim v. Chicoutimi Pulp Co.*, [1911] A.C. 301; *Whiten v. Pilot Insurance Co.*, [2002] 1 S.C.R. 595, 2002 SCC 18; *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130.

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APPEAL from a judgment of the British Columbia Court of Appeal (Finch C.J. and Prowse and Ryan JJ.A.) (2004), 239 D.L.R. (4th) 547, [2004] 8 W.W.R. 193, 196 B.C.A.C. 130, 27 B.C.L.R. (4th) 199, 13 C.C.L.I. (4th) 25, [2004] I.L.R. I-4299, [2004] B.C.J. No. 982 (QL), 2004 BCCA 273, varying a decision of Ralph J., [2002] 11 W.W.R. 352, 6 B.C.L.R. (4th) 390, 42 C.C.L.I. (3d) 272, [2003] I.L.R. I-4139, [2002] B.C.J. No. 2209 (QL), 2002 BCSC 1336. Appeal allowed in part.

Avon M. Mersey, *William Westeringh* and *Michael Sobkin*, for the appellant.

Joseph J. Arvay, *Q.C.*, and *Faith E. Hayman*, for the respondent.

The judgment of the Court was delivered by

1 THE CHIEF JUSTICE AND ABELLA J. – For more than five years, Sun Life Assurance Company of Canada denied Connie Fidler the long-term disability benefits to which she was entitled. The trial judge found that, while there was no bad faith on the part of the insurer justifying an award of punitive damages, the denial caused Ms. Fidler significant mental distress. Sun Life was found liable to pay Ms. Fidler $20,000 in damages for mental distress resulting from Sun Life's breach of a group disability insurance contract. In the Court of Appeal for British Columbia, that award was upheld. In addition, a majority of the Court of Appeal found that, in reaching the conclusion that there was no bad faith, the trial judge had made a palpable and overriding error and awarded $100,000 in punitive damages to Ms. Fidler.

2 Since mental distress of the kind experienced by Ms. Fidler was reasonably within the contemplation of the parties when they entered into the contract of disability insurance, we see no reason to deny her compensation for the damages for mental distress directly flowing from the breach. However, the trial judge's finding that Sun Life did not act in bad faith should not be interfered with and precludes an award of punitive damages. Accordingly, we reverse the Court of Appeal's order as to punitive damages and restore the award made by the trial judge.

I. Background

3 Connie Fidler worked as a receptionist at a branch of the Royal Bank of Canada in Burnaby, British Columbia. Like other employees of the bank, Ms. Fidler was covered by a group policy which included long-term disability benefits. The insurer was Sun Life Company of Canada.

4 In 1990, at the age of 36, Ms. Fidler became ill with pyelonephritis, an acute kidney infection, resulting in her hospitalization for several days. Even when the infection ended, however, Ms. Fidler continued to suffer from fatigue. She was eventually diagnosed with chronic fatigue syndrome and fibromyalgia.

5 Under the terms of her policy with Sun Life, Ms. Fidler was eligible to receive long-term disability benefits six months after becoming totally disabled. It was a precondition of entitlement to long-term disability benefits that the insured fit within the definition of "Totally Disabled". The policy defines "Totally Disabled" as follows:

> An Employee is Totally Disabled if he is in a continuous state of incapacity due to Illness which
>
> 1. while it continues throughout the Elimination Period and during the following 24 months ... of incapacity prevents him from performing the essential duties of <u>his own job</u> at the onset of disability,
>
> 2. while it continues after such period, prevents him from engaging in <u>any occupation</u> for which he is or may become reasonably qualified by education, training or experience. [Emphasis added.]

6 Under the first clause, Ms. Fidler was entitled to receive long-term disability benefits for two years, if she was unable to do her *own job*; after two years, according to the second clause, she was only entitled to continued benefits if she was unable to do *any* job.

7 Despite some initial disputes between Ms. Fidler and Sun Life about whether she was in fact totally disabled, Ms. Fidler eventually received long-term disability benefits starting January 4, 1991.

8 Her benefits continued until, in a letter dated May 12, 1997, Sun Life informed Ms. Fidler that "as a result of a non medical investigation revealing that your activities are incompatible with your alleged disability", benefit payments would be terminated, effective April 30, 1997. At the time Sun Life terminated Ms. Fidler's benefits, it had no medical evidence indicating that she was now capable of working.

9 The "non medical investigation" consisted of video surveillance conducted in August and September 1996 by private investigators hired by Sun Life, along with a "Lifestyle Questionnaire" Ms. Fidler had completed at Sun Life's request in January 1996. In her answers to the questionnaire, Ms. Fidler described her activities as "rarely go shopping ... no hobbies ... no entertaining ... recreation limited to occasional camping". She expressed a preference not to drive "because of fatigue and pain". Her condition, she said, had "not much hope for change".

10 The surveillance video, which was the basis for Sun Life's conclusion that Ms. Fidler was not entitled to continued benefits, showed Ms. Fidler getting in and out of her vehicle, driving, shopping, and climbing into the rear of her vehicle, among other things. An internal Sun Life memorandum about the surveillance stated that Ms. Fidler was "active for 5 FULL DAYS!". The surveillance was in fact conducted for about five hours on each of three days, and for one hour on a fourth day. According to Sun Life, its surveillance impugned Ms. Fidler's credibility, leading it to doubt her assertion that she was incapable of doing *any* work.

11 Ms. Fidler asserted that what the surveillance video showed was consistent with the information she supplied in a Supplementary Statement to Sun Life on August 5, 1996, a month before the surveillance, when she said: "I feel I am doing well to take

care of myself and my daily business — i.e. paying bills, shopping, etc. and as this seems like a full time effort for me I cannot imagine trying to hold a job".

12 Sun Life's denial of benefits, effective April 30, 1997, was followed by almost two years of correspondence with Ms. Fidler, involving medical professionals, investigators, and claims examiners. The correspondence began with a letter from Ms. Fidler to Sun Life dated May 30, 1997, in which Ms. Fidler requested a copy of the surveillance video and any other evidence Sun Life had used as the basis for its decision. On June 21, 1997, Sun Life replied, through its claims administrator, that it was not prepared to disclose its investigative report (including the video), and detailed the activities it concluded were inconsistent with Ms. Fidler's claim that she was incapable of performing light or sedentary work.

13 In January 1998, Dr. Wilkinson, Ms. Fidler's doctor again confirmed the existence of Ms. Fidler's total disability and reiterated that she was not fit to return to work. An independent medical examination was recommended on March 5, 1998 by both Sun Life's claims administrator and Dr. Wilkinson. Ms. Fidler agreed to the examination readily.

14 The independent examination was conducted by Dr. John Wade on September 29, 1998. His conclusions are relied on by both Sun Life and Ms. Fidler:

> It would be my opinion that Connie Fidler is increasingly able to consider returning to work on a graduated basis. Prior to this being successful, she should embark upon a graduated training program to improve her level of physical fitness.

15 Sun Life took from this diagnosis that Ms. Fidler was "increasingly able to consider returning to work"; Ms. Fidler, for her part, emphasized the words "[p]rior to this being successful", which she said indicated that a return to work was premature and conditional on a training program.

16 Sun Life did not pursue Dr. Wade's suggestion that Ms. Fidler "embark upon a graduated training program". Sun Life's internal medical consultant, who did not see or communicate with Ms. Fidler, did not share Dr. Wade's hesitation. Based on a review of the video surveillance and Dr. Wade's assessment, on November 13,1998, the medical consultant reached a conclusion notwithstanding the opinions of both Dr. Wade and Dr. Wilkinson:

> All in all there is <u>no medical and non-medical evidence</u> to support that this lady cannot perform at a light physical, clerical or sedentary job on a regular basis since, at least, Sept. 96. [Emphasis added.]

17 This contradicted the medical evidence Sun Life had in its possession to the effect that Ms. Fidler was not yet capable of doing any work. Nonetheless, in a letter dated December 14, 1998 to Ms. Fidler, Sun Life confirmed its decision to terminate benefits. A year and a half had elapsed since its initial decision to terminate them.

18 On February 2, 1999, Ms. Fidler commenced this action.

19 In April 2002, a week before the trial was scheduled to start, Sun Life offered to reinstate Ms. Fidler's benefits and to pay all outstanding amounts along with pre-judgment interest. The total, as of April 22, 2002, was $52,516.10. The trial, as a result, dealt only with Ms. Fidler's entitlement to aggravated and punitive damages.

20 The trial judge, Ralph J., awarded Ms. Fidler $20,000 in what he termed aggravated damages ((2002), 6 B.C.L.R. (4th) 390, 2002 BCSC 1336). He applied the B.C. Court of Appeal's decision in *Warrington v. Great-West Life Assurance Co.* (1996), 139 D.L.R. (4th) 18, which held that aggravated damages can be awarded without separately actionable conduct if the contract is one for "peace of mind". In his view, a long-term disability insurance contract is such a contract.

21 On the evidence before him, including that of Ms. Fidler as well as the corroborating evidence of Dr. Wade, the trial judge was satisfied that Ms. Fidler "genuinely suffered significant additional distress and discomfort arising out of the loss of the disability coverage" (para. 30). Given the five-year duration of the cessation of payments, in his view it was appropriate to award $20,000 in aggravated damages in order to compensate Ms. Fidler for Sun Life's breach.

22 On the other hand, the trial judge concluded that, while its conduct with respect to Ms. Fidler's claim was at times "rather zealous", Sun Life had not acted in bad faith. As a result, he dismissed Ms. Fidler's claim for punitive damages.

23 Sun Life appealed the aggravated damages award and Ms. Fidler cross-appealed the denial of punitive damages. The Court of Appeal noted the "general principle" that damages for mental distress resulting from a breach of contract are not recoverable unless it is a peace of mind contract ((2004), 27 B.C.L.R. (4th) 199, 2004 BCCA 273). Concluding that the insurance contract in this case is such a contract, the Court of Appeal, affirming *Warrington*, held that "aggravated damages are available as additional compensation if the insured establishes that a breach of that [peace of mind]

contract caused her mental distress" (para. 39) and unanimously declined to interfere with the trial judge's award of aggravated damages.

24 The Court of Appeal divided, however, on whether Sun Life's conduct in dealing with Ms. Fidler's benefits rose to the level of bad faith. Writing for the majority, Finch C.J.B.C. concluded that Sun Life's conduct fell short of the duty of utmost good faith "by a very wide margin" (para. 71). He held that Sun Life's "arbitrary denial of long-term disability benefits to a vulnerable insured for over five years" (para. 74) required denunciation and deterrence. Punitive damages in the amount of $100,000 were, in his view, a rational and proportionate response to Sun Life's conduct.

25 Ryan J.A. dissented on the issue of punitive damages. She interpreted the trial judge's reasons as "conclud[ing] that Sun Life had behaved badly, but not ... maliciously" (para. 102), and that Sun Life's conduct "did not reach the depths of bad faith required for an award of punitive damages" (para. 101). In Ryan J.A.'s view, Ms. Fidler had not shown that these conclusions were palpably and overridingly wrong.

26 Sun Life's appeal seeks to have the awards for both aggravated and punitive damages set aside.

II. Analysis

(a) *Damages for Mental Distress for Breach of Contract*

27 Damages for breach of contract should, as far as money can do it, place the plaintiff in the same position as if the contract had been performed. However, at least

since the 1854 decision of the Court of Exchequer Chamber in *Hadley v. Baxendale* (1854), 9 Ex. 341, 156 E.R. 145, at p. 151, it has been the law that these damages must be "such as may fairly and reasonably be considered either arising naturally ... from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties".

28 Until now, damages for mental distress have not been welcome in the family of remedies spawned by this principle. The issue in this appeal is whether that remedial ostracization continues to be warranted.

29 In *Hadley v. Baxendale*, the court explained the principle of reasonable expectation as follows:

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. [Emphasis added; p. 151.]

30 *Hadley v. Baxendale* makes no distinction between the types of loss that are recoverable for breach of contract. The principle of reasonable expectation is stated as a

general principle. Nevertheless, subsequent cases purported to rule out damages for mental distress for breach of contract except in certain defined situations.

31 While courts have always accepted that some non-pecuniary losses arising from breach of contract are compensable, including physical inconvenience and discomfort, they have traditionally shied away from awarding damages for mental suffering caused by the contract breach.

32 This tradition of refusing to award damages for mental distress was launched in *Hobbs v. London and South Western Rail. Co.* (1875), L.R. 10 Q.B. 111, and *Hamlin v. Great Northern Railway Co.* (1856), 1 H. & N. 408, 156 E.R. 1261 (Ex.). In 1909, in the case of *Addis v. Gramophone Co.*, [1909] A.C. 488, the House of Lords "cast a long shadow over the common law" when it rejected a claim for mental distress because the conduct said to cause the distress was not actionable: *Eastwood v. Magnox Electric plc*, [2004] 3 All E.R. 991 2004 UKHL 35, at para. 1.

33 To this day, *Addis* is cited for the proposition that mental distress damages are not generally recoverable for breach of contract: see *Malik v. Bank of Credit and Commerce International S.A.*, [1998] A.C. 20 (H.L.), *per* Lord Nicholls, at p. 38; *Wallace v. United Grain Growers Ltd.*, [1995] 9 W.W.R. 153 (Man. C.A.), at para. 81, var'd [1997] 3 S.C.R. 701; *Morberg v. Klassen* (1991), 49 C.L.R. 124 (B.C.S.C.); *Taylor v. Gill*, [1991] 3 W.W.R. 727 (Alta. Q.B.); *Chitty on Contracts* (29th ed. 2004), vol. II, at p. 1468; and see S. M. Waddams, *The Law of Damages* (4th ed. 2004), at p. 222.

34 In short, the foundational concepts of reasonable expectations had a ceiling: mental distress. As Bingham L.J. said in *Watts v. Morrow*, [1991] 1 W.L.R. 1421 (C.A.), at p. 1445:

> A contract-breaker is not in general liable for any distress, frustration, anxiety, displeasure, vexation, tension or aggravation which his breach of contract may cause to the innocent party. This rule is not, I think, founded on the assumption that such reactions are not foreseeable, which they surely are or may be, but on considerations of policy. [Emphasis added.]

35 A number of policy considerations have been cited in support of this restriction. One is the perceived minimal nature of mental suffering:

> [A]s a matter of ordinary experience, it is evident that, while the innocent party to a contract will generally be disappointed if the defendant does not perform the contract, the innocent party's disappointment and distress are seldom so significant as to attract an award of damages on that score.
>
> (*Baltic Shipping Co. v. Dillon* (1993), 176 C.L.R. 344 (Austl. H.C.), at p. 365, *per* Mason C.J.)

36 Others have suggested that a "stiff upper lip" expectation in commercial life is the source of the prohibition. In *McGregor on Damages* (17th ed. 2003), the author explains:

> The reason for the general rule is that contracts normally concern commercial matters and that mental suffering on breach is not in the contemplation of the parties as part of the business risk of the transaction. [p. 63]

This resonated in *Johnson v. Gore Wood & Co.*, [2001] 2 W.L.R. 72 (H.L.), at p. 108, where Lord Cooke observed: "Contract-breaking is treated as an incident of commercial life which players in the game are expected to meet with mental fortitude".

37 This Court's jurisprudence has followed the restrictive interpretation of *Addis*, generally requiring that a claim for compensation for mental distress be grounded in independently actionable conduct. The general rule that damages for mental distress should not be awarded for breach of contract was thus preserved: *Peso Silver Mines Ltd. (N.P.L.) v. Cropper*, [1966] S.C.R. 673.

38 Without resiling from the general rule that damages for mental suffering could not be awarded at contract, the courts in the 1970s acknowledged that the reasons of principle and policy for the rule did not always apply, and began to award such damages where the contract was one for pleasure, relaxation or peace of mind. The charge was led, as so many were, by Lord Denning. In *Jarvis v. Swans Tours Ltd.*, [1973] 1 All E.R. 71 (C.A.), the plaintiff had contracted with the defendant to arrange a holiday. The defendant breached the contract by providing a terrible vacation. Acknowledging but declining to follow what he referred to as the "out of date" decisions in *Hamlin* and *Hobbs*, which had sired *Addis*, Lord Denning held that mental distress damages could be recovered for certain kinds of contracts:

> In a proper case damages for mental distress can be recovered in contract, just as damages for shock can be recovered in tort. One such case is a contract for a holiday, or any other contract to provide entertainment and enjoyment. If the contracting party breaks his contract, damages can be given for the disappointment, the distress, the upset and frustration caused by the breach. [p. 74]

39 This holding in *Jarvis* emerged from the common law chrysalis as the "peace of mind exception" to the general rule against recovery for mental distress in contract breaches. This exception was confined to contracts which had as their object the peace

of mind of a contracting party. Bingham L.J. in *Watts v. Morrow* stated: "Where the very object of [the] contract is to provide pleasure, relaxation, peace of mind or freedom from molestation, damages will be awarded" (para. 1445).

40 More recently, the House of Lords in *Farley v. Skinner*, [2001] 4 All E.R. 801, 2001 UKHL 49, loosened the peace of mind exception so as to permit recovery of mental distress not only when pleasure, relaxation, or peace of mind is "the very object of the contract", but also when it is a "major or important object of the contract" (para. 24).

41 The right to obtain damages for mental distress for breach of contracts that promise pleasure, relaxation or peace of mind has found wide acceptance in Canada. Mental distress damages have been awarded not only for breach of vacation contracts, but also for breaches of contracts for wedding services (*Wilson v. Sooter Studios Ltd.* (1988), 33 B.C.L.R. (2d) 241 (C.A.)), and for luxury chattels (*Wharton v. Tom Harris Chevrolet Oldsmobile Cadillac Ltd.* (2002), 97 B.C.L.R. (3d) 307 (C.A.)). Some courts have included disability insurance contracts: see *Warrington* and *Thompson v. Zurich Insurance Co.* (1984), 7 D.L.R. (4th) 664 (Ont. H.C.J.). The Ontario Court of Appeal has endorsed contractual damages for mental distress where peace of mind is the "very essence"of the promise: see *Prinzo v. Baycrest Centre for Geriatric Care* (2002), 60 O.R. (3d) 474, at para. 34.

42 In *Vorvis v. Insurance Corporation of British Columbia*, [1989] 1 S.C.R. 1085, this Court described the line of cases awarding mental distress damages as standing for the proposition that "in some contracts the parties may well have contemplated at the time of the contract that a breach in certain circumstances would

cause a plaintiff mental distress" (p. 1102). It is thus clear that an independent actionable wrong has not always been required, contrary to Sun Life's arguments before us.

43 The view taken by this Court in *Vorvis* that damages for mental distress in "peace of mind" contracts should be seen as an expression of the general principle of compensatory damages of *Hadley v. Baxendale*, rather than as an exception to that principle, is shared by others. In *Baltic Shipping*, Mason C.J. of the High Court of Australia questioned whether one should confine mental distress claims for breach of contract to particular categories, noting:

> ... the fundamental principle on which damages are awarded at common law is that the injured party is to be restored to the position (not merely the financial position) in which the party would have been had the actionable wrong not have taken place. Add to that the fact that anxiety and injured feelings are recognized as heads of compensable damage, at least outside the realm of the law of contract. Add as well the circumstance that the general rule has been undermined by the exceptions which have been engrafted upon it. We are then left with a rule which rests on flimsy policy foundations and conceptually is at odds with the fundamental principle governing the recovery of damages, the more so now that the approaches in tort and contract are converging. [p. 362]

Similarly, Professor J. D. McCamus in *The Law of Contracts* (2005) argues at p. 877 that once peace of mind is understood as a reflection of, or "proxy" for the reasonable contemplation of the contracting parties, "there is no compelling reason not to simply apply the foreseeability test itself". At this point, the apparent inconsistency between the general rule in *Hadley v. Baxendale* and the exception vanishes. See also: S. K. O'Byrne, "Damages for Mental Distress and Other Intangible Loss in a Breach of Contract Action" (2005), 28 *Dal. L.J.* (forthcoming), at pp. 36-37 of manuscript, and R. Cohen and S. O'Byrne, "Cry Me a River: Recovery of Mental Distress Damages in a

Breach of Contract Action – A North American Perspective" (2005), 42 *Am. Bus. L.J.* 97.

44 We conclude that damages for mental distress for breach of contract may, in appropriate cases, be awarded as an application of the principle in *Hadley v. Baxendale*: see *Vorvis*. The court should ask "what did the contract promise?" and provide compensation for those promises. The aim of compensatory damages is to restore the wronged party to the position he or she would have been in had the contract not been broken. As the Privy Council stated in *Wertheim v. Chicoutimi Pulp Co.*, [1911] A.C. 301, at p. 307: "the party complaining should, so far as it can be done by money, be placed in the same position as he would have been in if the contract had been performed". The measure of these damages is, of course, subject to remoteness principles. There is no reason why this should not include damages for mental distress, where such damages were in the reasonable contemplation of the parties at the time the contract was made. This conclusion follows from the basic principle of compensatory contractual damages: that the parties are to be restored to the position they contracted for, whether tangible or intangible. The law's task is simply to provide the benefits contracted for, whatever their nature, if they were in the reasonable contemplation of the parties.

45 It does not follow, however, that all mental distress associated with a breach of contract is compensable. In normal commercial contracts, the likelihood of a breach of contract causing mental distress is not ordinarily within the reasonable contemplation of the parties. It is not unusual that a breach of contract will leave the wronged party feeling frustrated or angry. The law does not award damages for such incidental frustration. The matter is otherwise, however, when the parties enter into a contract, an

object of which is to secure a particular psychological benefit. In such a case, damages arising from such mental distress should in principle be recoverable where they are established on the evidence and shown to have been within the reasonable contemplation of the parties at the time the contract was made. The basic principles of contract damages do not cease to operate merely because what is promised is an intangible, like mental security.

46 This conclusion is supported by the policy considerations that have led the law to eschew damages for mental suffering in commercial contracts. As discussed above, this reluctance rests on two policy considerations – the minimal nature of the mental suffering and the fact that in commercial matters, mental suffering on breach is "not in the contemplation of the parties as part of the business risk of the transaction": *McGregor on Damages*, at p. 63. Neither applies to contracts where promised mental security or satisfaction is part of the risk for which the parties contracted.

47 This does not obviate the requirement that a plaintiff prove his or her loss. The court must be satisfied: (1) that an object of the contract was to secure a psychological benefit that brings mental distress upon breach within the reasonable contemplation of the parties; and (2) that the degree of mental suffering caused by the breach was of a degree sufficient to warrant compensation. These questions require sensitivity to the particular facts of each case.

48 While the mental distress as a consequence of breach must reasonably be contemplated by the parties to attract damages, we see no basis for requiring it to be the dominant aspect or the "very essence" of the bargain. As the House of Lords noted in *Farley*, the law of contract protects all significant parts of the bargain, not merely those

that are "dominant" or "essential". Lord Steyn rejected this kind of distinction as "a matter of form and not substance" (para. 24). Lord Hutton added:

> I can see no reason in principle why, if a plaintiff who has suffered no financial loss can recover damages in some cases if there has been a breach of the principal obligation of the contract, he should be denied damages for breach of an obligation which, whilst not the principal obligation of the contract, is nevertheless one which he has made clear to the other party is of importance to him. [para. 51]

Principle suggests that as long as the promise in relation to state of mind is a part of the bargain in the reasonable contemplation of the contracting parties, mental distress damages arising from its breach are recoverable. This is to state neither more nor less than the rule in *Hadley v. Baxendale*.

49 We conclude that the "peace of mind" class of cases should not be viewed as an exception to the general rule of the non-availability of damages for mental distress in contract law, but rather as an application of the reasonable contemplation or foreseeability principle that applies generally to determine the availability of damages for breach of contract.

50 One further point should be added.

51 It may be useful to clarify the use of the term "aggravated damages" in the context of damages for mental distress arising from breach of contract. "Aggravated damages", as defined by Waddams (*The Law of Damages* (2nd ed. 1983), at pp. 562-63), and adopted in *Vorvis*, at p. 1099

> describ[e] an award that aims at compensation, but takes full account of the intangible injuries, such as distress and humiliation, that may have been caused by the defendant's insulting behaviour.

As many writers have observed, the term is used ambiguously. The cases speak of two different types of "aggravated" damages.

52 The first are true aggravated damages, which arise out of aggravating circumstances. They are not awarded under the general principle of *Hadley v. Baxendale*, but rest on a separate cause of action – usually in tort – like defamation, oppression or fraud. The idea that damages for mental distress for breach of contract may be awarded where an object of a contract was to secure a particular psychological benefit has no effect on the availability of such damages. If a plaintiff can establish mental distress as a result of the breach of an independent cause of action, then he or she may be able to recover accordingly. The award of damages in such a case arises from the separate cause of action. It does not arise out of the contractual breach itself, and it has nothing to do with contractual damages under the rule in *Hadley v. Baxendale*.

53 The second are mental distress damages which do arise out of the contractual breach itself. These are awarded under the principles of *Hadley v. Baxendale*, as discussed above. They exist independent of any aggravating circumstances and are based completely on the parties' expectations at the time of contract formation. With respect to this category of damages, the term "aggravated damages" becomes unnecessary and, indeed, a source of possible confusion.

54 It follows that there is only one rule by which compensatory damages *for breach of contract* should be assessed: the rule in *Hadley v. Baxendale*. The *Hadley* test

unites all forms of contractual damages under a single principle. It explains why damages may be awarded where an object of the contract is to secure a psychological benefit, just as they may be awarded where an object of the contract is to secure a material one. It also explains why an extended period of notice may have been awarded upon wrongful dismissal in employment law: see *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701. In all cases, these results are based on what was in the reasonable contemplation of the parties at the time of contract formation. They are not true aggravated damages awards.

55 The recognition that *Hadley* is the single and controlling test for compensatory damages in cases of breach of contract therefore refutes any argument that an "independent actionable wrong" is a prerequisite for the recovery of mental distress damages. Where losses arise from the breach of contract itself, damages will be determined according to what was in the reasonable contemplation of the parties at the time of contract formation. An independent cause of action will only need to be proved where damages are of a different sort entirely: where they are being sought on the basis of aggravating circumstances that extend beyond what the parties expected when they concluded the contract.

56 Turning to the case before us, the first question is whether an object of this disability insurance contract was to secure a psychological benefit that brought the prospect of mental distress upon breach within the reasonable contemplation of the parties at the time the contract was made? In our view it was. The bargain was that in return for the payment of premiums, the insurer would pay the plaintiff benefits in the case of disability. This is not a mere commercial contract. It is rather a contract for benefits that are both tangible, such as payments, and intangible, such as knowledge of

income security in the event of disability. If disability occurs and the insurer does not pay when it ought to have done so in accordance with the terms of the policy, the insurer has breached this reasonable expectation of security.

57 Mental distress is an effect which parties to a disability insurance contract may reasonably contemplate may flow from a failure to pay the required benefits. The intangible benefit provided by such a contract is the prospect of continued financial security when a person's disability makes working, and therefore receiving an income, no longer possible. If benefits are unfairly denied, it may not be possible to meet ordinary living expenses. This financial pressure, on top of the loss of work and the existence of a disability, is likely to heighten an insured's anxiety and stress. Moreover, once disabled, an insured faces the difficulty of finding an economic substitute for the loss of income caused by the denial of benefits. See D. Tartaglio, "The Expectation of Peace of Mind: A Basis for Recovery of Damages for Mental Suffering Resulting from the Breach of First Party Insurance Contracts" (1983), 56 *S. Cal. L. Rev.* 1345, at pp. 1365-66.

58 People enter into disability insurance contracts to protect themselves from this very financial and emotional stress and insecurity. An unwarranted delay in receiving this protection can be extremely stressful. Ms. Fidler's damages for mental distress flowed from Sun Life's breach of contract. To accept Sun Life's argument that an independent actionable wrong is a precondition would be to sanction the "conceptual incongruity of asking a plaintiff to show *more* than just that mental distress damages were a reasonably foreseeable consequence of breach" (O'Byrne, at p. 24 of manuscript (emphasis in original)).

59 The second question is whether the mental distress here at issue was of a degree sufficient to warrant compensation. Again, we conclude that the answer is yes. The trial judge found that Sun Life's breach caused Ms. Fidler a substantial loss which she suffered over a five-year period. He found as a fact that Ms. Fidler "genuinely suffered significant additional distress and discomfort arising out of the loss of the disability coverage" (para. 30 (emphasis added)). This finding was amply supported in the evidence, which included extensive medical evidence documenting the stress and anxiety that Ms. Fidler experienced. He concluded that merely paying the arrears and interest did not compensate for the years Ms. Fidler was without her benefits. His award of $20,000 seeks to compensate her for the psychological consequences of Sun Life's breach, consequences which are reasonably in the contemplation of parties to a contract for personal services and benefits such as this one. We agree with the Court of Appeal's decision not to disturb it.

(b) *Punitive Damages*

60 Ms. Fidler also seeks punitive damages. The trial judge declined to award them, citing no bad faith, but the Court of Appeal reversed this aspect of his judgment and awarded Ms. Fidler an additional $100,000 as punitive damages.

61 While compensatory damages are awarded primarily for the purpose of compensating a plaintiff for pecuniary and non-pecuniary losses suffered as a result of a defendant's conduct, punitive damages are designed to address the purposes of retribution, deterrence and denunciation: *Whiten v. Pilot Insurance Co.*, [2002] 1 S.C.R. 595, 2002 SCC 18, at para. 43.

62 By their nature, contract breaches will sometimes give rise to censure. But to attract punitive damages, the impugned conduct must depart markedly from ordinary standards of decency – the exceptional case that can be described as malicious, oppressive or high-handed and that offends the court's sense of decency: *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130, at para. 196; *Whiten*, at para. 36. The misconduct must be of a nature as to take it beyond the usual opprobrium that surrounds breaking a contract. As stated in *Whiten*, at para. 36, "punitive damages straddle the frontier between civil law (compensation) and criminal law (punishment)". Criminal law and quasi-criminal regulatory schemes are recognized as the primary vehicles for punishment. It is important that punitive damages be resorted to only in exceptional cases, and with restraint.

63 In *Whiten*, this Court set out the principles that govern the award of punitive damages and affirmed that in breach of contract cases, in addition to the requirement that the conduct constitute a marked departure from ordinary standards of decency, it must be independently actionable. Where the breach in question is a denial of insurance benefits, a breach by the insurer of the contractual duty to act in good faith will meet this requirement. The threshold issue that arises, therefore, is whether the appellant breached not only its contractual obligation to pay the long-term disability benefit, but also the independent contractual obligation to deal with the respondent's claim in good faith. On this threshold issue, the legal standard to which Sun Life and other insurers are held is correctly described by O'Connor J.A. in *702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters* (2000), 184 D.L.R. (4th) 687 (Ont. C.A.), at para. 29:

> The duty of good faith also requires an insurer to deal with its insured's claim fairly. The duty to act fairly applies both to the manner in which the

> insurer investigates and assesses the claim and to the decision whether or not to pay the claim. In making a decision whether to refuse payment of a claim from its insured, an insurer must assess the merits of the claim in a balanced and reasonable manner. It must not deny coverage or delay payment in order to take advantage of the insured's economic vulnerability or to gain bargaining leverage in negotiating a settlement. A decision by an insurer to refuse payment should be based on a reasonable interpretation of its obligations under the policy. This duty of fairness, however, does not require that an insurer necessarily be correct in making a decision to dispute its obligation to pay a claim. Mere denial of a claim that ultimately succeeds is not, in itself, an act of bad faith.

64 The proper characterization of Sun Life's conduct on the "good faith" issue requires a careful consideration of the evidence. The trial judge concluded that Sun Life did not act in bad faith. He heard the evidence over nine days. He had an opportunity to observe the witnesses, who included James Craig, a representative of Sun Life's disability management unit, and Ms. Fidler herself. Bearing in mind the subjective element of the duty of good faith, the trial judge's assessment of Mr. Craig's credibility in particular takes on some significance in determining whether Sun Life acted with an improper purpose in denying Ms. Fidler's claim.

65 Having heard and considered the evidence, the trial judge rejected Ms. Fidler's punitive damages claim. In his reasons, the trial judge noted the following evidence: Sun Life's surveillance recorded activities that were not inconsistent with Ms. Fidler's self-reporting; an internal memorandum exaggerated the nature of Ms. Fidler's activities; a claims administrator with Sun Life had written a memorandum

contemplating the successful denial of Ms. Fidler's claim in the event of litigation; and Sun Life's medical consultant was wrong in concluding that there was no medical or non-medical evidence that Ms. Fidler could not perform light work.

66 On the other hand, he took into consideration that the medical reports about Ms. Fidler's condition were inconclusive; that Sun Life acted in reliance on its own consultants and experts; that Ms. Fidler's condition was contracted at a young age; and that her previous experience was in sedentary work. He summarized his considerations and conclusions as follows:

> I must recognize, however, that after two years of benefits had been paid to Ms. Fidler, the test for continued coverage was whether Ms. Fidler could perform any work at all. Given the fact that the nature of Ms. Fidler's illness is of a type that is not demonstrated by indicators such as an x-ray or MRI, I do not think that Sun Life's conduct should be characterized as an act of bad faith. I say this even though Sun Life carried out what would appear to be at times a rather zealous approach to refuting Ms. Fidler's entitlement to the long term disability benefits despite strong medical evidence that she continued to be disabled. [para. 38]

67 The majority of the Court of Appeal, *per* Finch C.J.B.C., found palpable and overriding error on the question of bad faith. Finch C.J.B.C. relied in particular on three aspects of the record: first, the absence of medical evidence to justify a denial of Ms. Fidler's claim; second, Sun Life's internal memoranda exaggerating the surveillance results and indicating an intention to avoid looking "bad" in the event of litigation; and third, Sun Life's failure to disclose to Ms. Fidler the surveillance video on which it relied in denying her claim.

68 The surveillance team's observations were, arguably, consistent with the information provided by Ms. Fidler in her supplementary answers to the questionnaire.

Moreover, Sun Life's internal memoranda, such as the surveillance summary and the medical consultant's report, reveal bald factual misstatements that weigh against a finding that Sun Life fairly and carefully considered the insured's claim.

69 On the other hand, the fact that Ms. Fidler's behaviour in the course of the surveillance seemed to demonstrate an ability to engage in some activities, taken with the ambiguity of the IME assessment, helps reduce the force of a conclusion that Sun Life had an improper purpose in denying Ms. Fidler's claim.

70 Except for the matter of disclosure, this evidence was expressly considered by the trial judge. And the disclosure issue is significantly tempered by the fact that Sun Life set out in a letter to Ms. Fidler the specific activities observed in the surveillance and the conclusions Sun Life drew as a consequence.

71 We share Finch C.J.B.C.'s concerns about Sun Life's decision to terminate benefits relating to an unobservable disability in the absence of any medical evidence indicating an ability to return to work. And we appreciate that the facts in this case represent conduct that is extremely troubling – the five-year denial by Sun Life of disability benefits without medical support for the denial is, to say the least, inappropriate. But 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. In this respect, we respectfully part company with Finch C.J.B.C. who, in awarding punitive damages, characterized Sun Life's concession that Ms. Fidler was entitled to benefits as "the civil equivalent of [a] 'guilty plea'" (para. 78). The question instead is whether the denial was the result of the overwhelmingly inadequate handling of the claim, or the introduction of improper considerations into the claims process.

72 Ultimately, each case revolves around its own facts. As O'Connor J.A. stated in *702535 Ontario*:

> 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. [para. 30]

73 The trial judge's conclusion that Sun Life did not act in bad faith was the product of a thorough review of the relevant evidence, and depended heavily on his appreciation of the basis on which Sun Life denied Ms. Fidler's claim. He considered every salient aspect of how Sun Life handled Ms. Fidler's claim, including those features that might be relied upon to suggest that Sun Life approached the claim obstructively or dismissively, but made no such finding.

74 Nor did the trial judge find an improper purpose on the part of Sun Life. The trial judge's reliance, in particular, on the difficulty Sun Life had in ascertaining whether Ms. Fidler was actually disabled supported his conclusion that Sun Life did not act in bad faith and that, instead, its denial of benefits was the product of a real, albeit incorrect, doubt as to whether Ms. Fidler was incapable of performing *any* work, as required under the terms of the policy.

75 Sun Life's conduct was troubling, but not sufficiently so as to justify interfering with the trial judge's conclusion that there was no bad faith. The trial judge's reasons disclose no error of law, and his eventual conclusion that Sun Life did not act in

bad faith is inextricable from his findings of fact and his consideration of the evidence. As Ryan J.A. concluded in dissent:

> The trial judge saw and heard the witnesses. He examined the written material filed as exhibits. It was for him to assess the evidence and to determine its weight and effect. In my view Ms. Fidler has not been able to demonstrate that the conclusions of the trial judge were unreasonable or palpably wrong. [para. 104]

The award of punitive damages, of course, does not depend exclusively on the existence of an actionable wrong. In *Whiten*, the Court clearly established the relevant factors to consider in determining whether or not an award of punitive damages is warranted. Absent bad faith in this case, however, there is no need to go further.

76 Ms. Fidler is entitled to $20,000 for mental distress, but her claim for punitive damages is dismissed. Accordingly, we would allow the appeal in part, set aside the Court of Appeal's award of punitive damages and restore the order of Ralph J., with costs to Ms. Fidler throughout.

Appeal allowed in part, with costs to the respondent throughout.

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