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Bad Faith Claims and Bifurcation after *Bhasin v. Hrynew*: An Insurance Perspective

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Overview

With the recent Supreme Court of Canada decision in *Bhasin v. Hrynew,*[1] a fair amount of commentary has been written about the emerging importance of good faith in contractual relationships. One should not consider this decision to represent a sudden judicial pronouncement concerning entirely novel duties owed amongst contractual parties; rather, the doctrine of good faith has existed for some time for certain categories of contracting parties and the courts have adopted a distinct method for uniquely assessing the duties imposed. This article reviews the recent Supreme Court of Canada decision under the lens of the pre-existing doctrine of bad faith as it exists between contracting parties in the insurance market.

Bhasin v. Hrynew

The Supreme Court of Canada decision of *Bhasin v. Hrynew* recently established a comprehensive, overarching doctrine of good faith and a duty of honesty between contracting parties. The unanimous decision, written by Justice Cromwell, now requires that contracting parties generally must perform their contractual duties honestly and reasonably, not capriciously or arbitrarily.[2] Contracting parties are now required to have "appropriate regard" for the other party's interests. While this does not require the contracting parties to subordinate their own interests to the other party's interests, it merely requires that contracting parties do not seek to undermine those interests in bad faith.[3] In other words, the Supreme Court was not seeking to impose a duty of loyalty in contractual relationships, but instead, held that there ought to be a minimum standard of honesty between contracting parties.[4]

In *Bhasin v. Hrynew,* Mr. Bhasin was an enrollment director for one agency for Canadian American Financial Corp. ("Can-Am"). Can-Am marketed educational savings plans to investors through enrollment directors, including Mr. Bhasin. Mr. Hrynew was also the enrollment director of a separate agency, and so was in direct competition with Mr. Bhasin. Mr. Hrynew coveted Mr. Bhasin's market and approached Mr. Bhasin several times to propose a merger of their agencies. Mr. Bhasin refused Mr. Hrynew's approaches. Mr. Hrynew later became Can-Am's provincial trading officer, where he was able to audit Mr. Bhasin's level of

[1] *Bhasin v. Hrynew*, 2014 SCC 71, 2014 CSC 71.
[2] *Ibid,* at para 63.
[3] *Ibid,* at para 65.
[4] *Ibid,* at para 74.

regulatory compliance. At the same time, Can-Am was considering the restructuring of its agencies. Mr. Bhasin refused to allow Mr. Hrynew to audit his records, and Can-Am responded by threatening to and eventually terminating Mr. Bhasin's agreement by non-renewal. Once Mr. Bhasin's contract expired, he lost the value in his business in his assembled workforce, and the majority of his sales agents were successfully solicited by Mr. Hrynew.[5]

In *Bhasin v. Hrynew*, the Supreme Court held that the trial judge accurately concluded that Can-Am acted dishonestly during the time leading up to and including the non-renewal of Mr. Bhasin's contract. The failure to act honestly was generally rooted in Can-Am's actions, as they:

- Repeatedly misled Mr. Bhasin by telling him that Mr. Hrynew, as provincial trading officer, was under an obligation to treat the information confidentially, which was untrue;
- Failed to detail the role Mr. Hrynew would have as Can-Am's provincial trading officer;
- Misled Mr. Bhasin by stating that the Commission had rejected a proposal to have an outside provincial trading officer, which was untrue;
- Did not honestly inform Mr. Bhasin about the realities that Can-Am's license may be revoked by the Commission, and that Can-Am was actively trying to forestall that possibility;
- Misled Mr. Bhasin regarding the extent of Can-Am's plans for him to merge with Mr. Hrynew, which were considered to be a 'done deal'; and,
- Exercised its non-renewal clause only after Mr. Bhasin refused to allow Mr. Hrynew to conduct the audit.[6]

Can-Am was found liable for the damages sustained by Mr. Bhasin as a result of the non-renewal of his contract. The claims against Mr. Hrynew for conspiracy and inducing breach of contract were dismissed.[7]

Good Faith in Insurance Contracts

Universally recognized in the insurance industry is the mutual obligation between an insured and an insurer to act in the utmost good faith.[8] The foundation of good faith obligations on both parties derives from the dependency of knowledge present between the two parties. Each party is undertaking certain contractual commitments based on the representations of the other. As no quantifiable product is actually changing hands, the risk to either party is completely dependent upon the reliance and honesty of information from the other.

[5] *Ibid,* at paras 2-13.
[6] *Ibid,* at paras 2-13.
[7] *Ibid,* at paras 108.
[8] *Whiten v. Pilot Insurance Co.* (2002), [2002] 1 S.C.R. 595 (S.C.C.), see also *Bhasin v. Hrynew*, 2014 SCC 71, 2014 CSC 71 at para 55.

Accordingly, whenever an insurance contract is contemplated, an insured is bound to first disclose all matters relevant to the risk, regardless of any inquiries of the insurer.[9] Likewise, an insurer has an implied obligation to deal with the claims of its insureds in good faith, separate and apart from the insurer's obligation to compensate it's insured for a loss covered by the policy. An insurer also owes duties strictly summarized by commitments expressed in the insurance policy, which form the basis for the charged premium.

Thereafter, because of its acceptance of the insured's risk (in a multitude of forms), an insurer is bound to consider the interest of the insured when responding to a crystallized risk; in other words, it cannot treat its own interest as paramount to the interest of the insured.[10] This requires the insurer to assess the merits of the claim in a reasonable, balanced, and fair manner. The insurer cannot arbitrarily decide to deny coverage, or choose to deny or delay coverage in order to take advantage of the economic vulnerability of an insured, or to gain bargaining leverage in negotiating a settlement. Simply, an insurer's decision to refuse coverage should be based on a reasonable interpretation of its obligations under the policy, not using the situation of the insured to its advantage.

In Canada, a cause of action in bad faith is different from an action on the policy for damages for insured loss. Breach of an insurer's obligation to act in good faith must be sufficient to constitute a separate or independent actionable wrong for which compensation is payable.[11] Accordingly, the conduct surrounding a bad faith breach of the contract must involve a marked departure from ordinary standards of decency. A claim for bad faith can arise from the insurer's actions in the underwriting of the claim, or in the insurer's handling of the claim when the insured presents for defence or payment.

Tackling Bad Faith Claims

The litigation of insurance-based bad faith claims presents a distinct problem separate from judicial assessment of the alleged breach of the insurance contract itself. The bad faith allegation must pertain to some course of conduct distinct from the wording in the contract, or in this case, the insurance policy.

In an effort to assess the bad faith allegations against an appropriate factual background, courts have imposed upon insurers a duty to promptly disclose to the insured all material information touching upon the coverage assessment, the insured's position in the litigation and settlement negotiations.[12] It is not a matter for the insurer to pick and choose which information it discloses; all information that is relevant ought to be disclosed. Continually, an insurer's level of disclosure in a coverage dispute can itself lead to allegations that the insurer has been acting in a breach of the utmost good faith. A denial of information can

[9] *Ferme Gérald Laplante & Fils Ltée v. Grenville Patron Mutual Fire Insurance Co.* (2002), 61 O.R. (3d) 481 (Ont. C.A.); leave to appeal refused 2003 CarswellOnt 2737 (S.C.C.).
[10] *Plaza Fiberglas Manufacturing Ltd. v. Cardinal Insurance Co.* (1994), 18 O.R. (3d) 663 (Ont. C.A.).
[11] *Tembec Industries Inc. v. Lumberman's Underwriting Alliance* (2001), 52 O.R. (3d) 334 (Ont. S.C.J.); *Whiten v. Pilot Insurance Co.* (1999), 42 O.R. (3d) 641 (Ont. C.A.).
[12] *Shea v. Manitoba Public Insurance Corp.,* [1991] 55 B.C.L.R. (2d) 15, 1 C.C.L.L. (2d) 61.

happen by many means, such as: incomplete or limited affidavits;[13] insufficient evidence; questionable investigations and assessments;[14] as well as not providing documents used in assessing coverage, such as unexpurgated credit card and bank account statements.[15]

However, as we discuss below, the insurer's disclosure requirements can still remain subject to litigation and solicitor-client privilege. These privileges can then potentially run at odds with an approach to production of information based solely on relevance.[16]

The case of *Norex Petroleum Ltd. v. Chubb Insurance Co. of Canada*[17] is an example how bad faith allegations arise, and the manner in which a court may deal with these allegations. In *Norex*, the plaintiff brought bad faith claims against its insurer after claiming that its insurer denied coverage inappropriately for various reasons. In response, the insurer brought an application to sever (or bifurcate) the plaintiffs' bad faith claims from their contractual insurance claims, and to stay all proceedings in relation to bad faith claims until contractual insurance claims were determined.

Bifurcation

Bifurcation, or the severance of two separate aspects of one claim, involves a request by a party (usually the insurer) to sever the bad faith allegations from the primary question concerning the appropriate scope of coverage under the policy. In these cases, the goal of severance is to allow the coverage question to be assessed as a breach of contract issue first, without the potentially prejudicial effect of the bad faith claims being addressed at the same time. Then, if the coverage question is answered affirmatively, a separate proceeding would occur afterwards, relying upon separate evidence in order to determine whether or not the insurer acted in bad faith. In other words, if the coverage assessment determines there is no coverage, there is no longer a basis for the bad faith claim to proceed, as the insurer acted in accordance with their obligations under the policy.

Courts differ on whether or not they prefer to bifurcate coverage or contractual and bad faith claims. For instance, in the United States, many courts have held that a contemporaneous assessment of the allegations of bad faith together with the issues of insurance coverage is simply too prejudicial to the insurer's coverage defence. As a result, the bifurcation of these disputes becomes all but automatic. Conversely, Canadian courts have generally been less accepting to the theory of significant prejudice requiring bifurcation, following the decision of Tobias J. in *Bourne v. Saunby*.[18] As a result, Canadian courts have therefore been less willing to bifurcate bad faith claims from coverage claims.

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[13] *Martens v. Wawanesa Life Insurance Co.*, 2011 SKQB 448, 209 ACWS (3d) 847 at paras 27-37.
[14] *McDonald v. Insurance Corp of British Columbia*, 2012 BCSC 283, 212 ACWS (3d) 819.
[15] *Astels v. Canada Life Assurance Co.*, [2006] B.C.J. No. 1426 (B.C. S.C.) at para 24.
[16] *SNC-Lavalin Engineers & Constructors Inc v Citadel General Assurance Co*, [2003] 63 OR (3d) 226, 31 CPC (5th) 371 (Ont Master).
[17] *Norex Petroleum Ltd. v. Chubb Insurance Co. of Canada*, [2008] 444 AR 88, 167 ACWS (3d) 669.
[18] *Bourne v. Saunby*, [1993] O.J. No. 2606 (Ont. Gen. Div.).

This jurisprudential difference has led to two streams of authorities concerning the severance of bad faith insurance claims from contractual insurance claims:[19] the first originating in British Columbia with *Wonderful Ventures Ltd v. Maylam,*[20] and the second originating in Ontario with *Sempecos v. State Farm Fire & Casualty Co.*[21] The *Wonderful Ventures* line of decisions[22] suggests that western courts are fairly receptive to severing bad faith insurance claims from contractual insurance claims, while the *Sempecos* line of decisions[23] suggests that eastern courts focus on maintaining a singular action, with only one trial for all triable issues.[24]

Privilege

The differentiating factor between *Sempecos* and *Wonderful Ventures* is that of privilege. In *Wonderful Ventures*, the insurer obtained legal advice prior to denying coverage, and had its counsel review the investigations carried out by its adjusters.[25] In other words, in order to address the coverage dispute, the veil of solicitor-client privilege would have to be pierced as the lawyer would be a material witness to the bad faith claim. In *Sempecos*, despite arguing otherwise, the insurer was able to put forward affidavit evidence that did not contain legal advice.[26]

In *Wonderful Ventures*, the court held that the level of prejudice to the insurer for having to disclose privileged communications would be more significant than any prejudice the plaintiff would suffer as a result of having the contract claim and bad faith claim tried separately.[27] However, in *Sempecos*, the insurer faced no such prejudice, so the court held that bifurcation

[19] *Norex Petroleum Ltd. v. Chubb Insurance Co. of Canada*, [2008] 444 AR 88, 167 ACWS (3d) 669.
[20] *Wonderful Ventures Ltd. v. Maylam*, 91 B.C.L.R. (3d) 319, 2001 BCSC 775 (B.C. S.C. [In Chambers]).
[21] *Sempecos v. State Farm Fire & Casualty Co.* (2001), 17 C.P.C. (5th) 371 (Ont. S.C.J.), aff'd (2002), 29 C.P.C. (5th) 99 (Ont. Div. Ct.), aff'd (2003), 38 C.P.C. (5th) 64 (Ont. C.A.).
[22] *Norex Petroleum Ltd. v. Chubb Insurance Co. of Canada*, [2008] 444 AR 88, 167 ACWS (3d) 669 at para 18. The line of authorities originating in British Columbia with *Wonderful Ventures* includes the following British Columbia and Alberta authorities: *Lawrence v. Insurance Corp. of British Columbia*, 96 B.C.L.R. (3d) 375, 2001 BCSC 1530 (B.C. S.C.); *Read v. Insurance Corp. of British Columbia*, 2002 BCSC 1607 (B.C. S.C.); *Sanders v. Clarica Life Insurance Co.*, 30 C.P.C. (5th) 364, 2003 BCSC 403 (B.C. S.C. [In Chambers]); *Stuart v. Manufacturers Life Insurance Co.*, 10 C.C.L.L. (4th) 142, 2004 BCSC 501 (B.C. Master); *Stevens v. Sun Life Assurance Co. of Canada*, 9 C.C.L.L. (4th) 245, 2004 BCSC 468 (B.C. S.C.); *Kursar v. BCAA Insurance Corp.*, 17 C.C.L.L. (4th) 65, 2004 BCSC 1006 (B.C. S.C.); and *Ennis v. RBC Life Insurance Co.*, 53 C.C.L.L. (4th) 270, 2007 BCSC 1131 (B.C. Master).
[23] *Norex Petroleum Ltd. v. Chubb Insurance Co. of Canada*, [2008] 444 AR 88, 167 ACWS (3d) 669 at para 18. The line of authorities originating in Ontario with *Sempecos* includes the following Ontario and Newfoundland authorities: *SNC-Lavalin Engineers & Constructors Inc. v. Citadel General Assurance Co.* (2003), 63 O.R. (3d) 226 (Ont. Master); *Osborne v. Non-Marine Underwriters, Lloyd's London* (2003), 32 C.P.C. (5th) 345 (Ont. Master), varied on other grounds (2003), 68 O.R. (3d) 770 (Ont. S.C.J.); *Plester v. Wawanesa Mutual Insurance Co.* (2006), 269 D.L.R. (4th) 624 (Ont. C.A.), leave to appeal refused [2006] S.C.C.A. No. 315 (S.C.C.); and *Lundrigan v. Non-Marine Underwriters, Lloyd's London* (2002), 36 C.C.L.L. (3d) 263 (Nfld. T.D.).
[24] *Norex Petroleum Ltd. v. Chubb Insurance Co. of Canada*, [2008] 444 AR 88, 167 ACWS (3d) 669 at para 14.
[25] *Wonderful Ventures Ltd. v. Maylam*, 91 B.C.L.R. (3d) 319, 2001 BCSC 775 (B.C. S.C. [In Chambers]) at para 14.
[26] *Sempecos v. State Farm Fire & Casualty Co.* (2001), 17 C.P.C. (5th) 371 (Ont. S.C.J.) at paras 11-15, and 32, aff'd (2002), 29 C.P.C. (5th) 99 (Ont. Div. Ct.), aff'd (2003), 38 C.P.C. (5th) 64 (Ont. C.A.).
[27] *Wonderful Ventures Ltd. v. Maylam*, 91 B.C.L.R. (3d) 319, 2001 BCSC 775 (B.C. S.C. [In Chambers]) at para 34.

would have resulted in unfairness, inefficiency, and a potentially prejudicial result to the plaintiff.[28]

While, both lines of cases do stress the importance of solicitor-client privilege, the decision in *Sempecos*, on its face, appears to consider privilege concerns as less important in comparison to the right of the plaintiff to have a just resolution of its claim.[29]

In considering the implications of the decision in *Bhasin v. Hryne*w, bifurcation arguments may be made in order to address the contractual claim prior to the good faith claim. However, bifurcation is equally likely to be constrained in Ontario cases, following the *Sempecos* decision.

Conclusion

Insurers have long been required to deal with insureds in good faith, and the presence of "bad faith" is often raised in insurance disputes. The decision in *Bhasin v. Hrynew* expressly extends the doctrine of good faith to the behaviour of all contracting parties, such that any contracting party is now legally obliged to have appropriate regard for the interests of the other.

As *Bhasin v. Hrynew* represents a potential avenue of pleading an absence of good faith in all contracting claims (not only insurance coverage disputes), it may foster new litigation as courts and contracting parties learn the parameters of the Supreme Court of Canada's good faith doctrine. Given this advancement in the law of general contract, we await what implications the decision will have on all contracting parties, and whether courts begin to address claims alleging an absence of good faith in the contractual context similarly to claims made as the result of specific instances of bad faith in the insurance context discussed above.

Drawing from our experiences litigating insurance-based bad faith claims, it remains to be seen whether this doctrine will alter how parties deal with one another, how they engage in or out of contractual relationships, how they engage counsel for such purposes, and how damages arising from these contractual breaches are allocated. Ultimately, *Bhasin v. Hrynew* may reduce the likelihood of courts bifurcating insurance bad faith claims across Canada, as the assessment of good faith will likely become commonplace.

[28] *Sempecos v. State Farm Fire & Casualty Co.* (2001), 17 C.P.C. (5th) 371 (Ont. S.C.J.) at para 43, aff'd (2002), 29 C.P.C. (5th) 99 (Ont. Div. Ct.), aff'd (2003), 38 C.P.C. (5th) 64 (Ont. C.A.).
[29] *Sempecos v. State Farm Fire & Casualty Co.* (2001), 17 C.P.C. (5th) 371 (Ont. S.C.J.) at para 36, aff'd (2002), 29 C.P.C. (5th) 99 (Ont. Div. Ct.), aff'd (2003), 38 C.P.C. (5th) 64 (Ont. C.A.).