Punishing Contract Breakers: *Whiten v Pilot Insurance* and the Sea Change in Canadian Law

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I: Introduction

Until recently, there were good reasons to believe that the issue of punitive damages for breach of contract was ultimately "much ado about nothing" in a practical sense, notwithstanding the important and controversial questions of principle and public policy that it raised. Those reasons had to do with the prevailing reticence towards making punitive damages available in respect of contract actions and the undeniable parsimony of the courts in the few decisions in which punitive damages were awarded. Academic interest, to a large extent, tracks practical significance; so interest in the issue has been limited.

The decision of the Supreme Court of Canada in *Whiten v Pilot Insurance Co*[1] is part of a sea change in Canada that gives good reasons to reassess the theoretical merits and practical availability of punitive damages in New Zealand and elsewhere. In *Whiten*, the Supreme Court upheld an award of punitive damages for breach of contract. Equally as startling, the Court upheld the unprecedented quantum in that jurisdiction of $1 million. Already the effects of *Whiten* are being felt in Canada. The record $1 million has now been surpassed by a staggering $2 million punitive damages award by the jury in *Mazza v Hamilton Township Farmers' Mutual Fire Insurance Co*.[2]

This article is structured into four substantive sections. It first considers the decision in *Whiten v Pilot Insurance Co* to establish that the decision has profoundly changed Canadian law on this issue,[3] and to identify an approach to punitive damages that is preferred by this writer.

Secondly, the article briefly surveys the availability of punitive damages for breach of contract in five jurisdictions. This is designed to establish the context for the later policy arguments with respect to punitive damages, and also to

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1 (2002) 209 DLR (4th) 257 (SCC) ["*Whiten*"]; reversing (1999) 170 DLR (4th) 280 (Ont CA); varying (1996) 132 DLR (4th) 568 (Ont Gen Div).

2 (16 July 2003) unreported, Ontario Superior Court of Justice.

3 It is argued later in this article that *Royal Bank v W Got & Associates Electric Ltd* [1999] 3 SCR 408 did not decisively overturn the orthodox position.

identify a trend in several jurisdictions towards a more liberal approach to the availability of such damages in contract actions.

Thirdly, in recognition of the fact that continuing negativism towards punitive damages is based on the perceived strength of the policy reasons against them, the three main objections to punitive damages for breach of contract are set out: namely, the contract-tort distinction, the argument from efficient breach, and the windfall objection. This article then attempts to rebut the first two objections as being misconceived and argues that the third is not decisive against the availability of punitive damages in contract.

Fourthly, the article presents three objectives of punitive damages in contract: punishment, deterrence, and denunciation. It is argued that these are valid objectives of contract law and that punitive damages are a legitimate means to achieve them.

II: *Whiten v Pilot Insurance Co*

This article begins by considering the *Whiten* case for the purposes of establishing: first, that the case has effectively abolished the threshold test in Canada by which punitive damages for contract required an independent actionable wrong; and secondly, that the upholding of such a large damages award reflects an increasing judicial tolerance of substantial damages, even if this is not acknowledged in the cautious language of the courts in that country.

1. The Facts

Whiten v Pilot Insurance Co has all the ingredients of a classic "David versus Goliath" legal battle. An unemployed family (the Whitens) in a small rural community lost their home to a fire. The family lost everything: their house and contents, the family pets, and the father suffered frostbite in his attempt to put out the fire, requiring hospitalization.[4] Limited payments were made by the insurance company (Pilot Insurance) to cover the rent of the cottage into which the family moved after the accident.

The investigator came to the conclusion that the fire was accidental, but the insurance company suspected arson. The insurance company refused to pay out on the claim despite the initial investigator, the local fire chief, and the second investigator advising that there was no evidence of arson.[5] An insurance industry investigative body to which the matter was referred wrote to Pilot Insurance to report that "we wouldn't have a leg to stand on as far as [denying] the claim".[6] An engineering expert also concluded that the fire was accidental. Eventually,

4 *Whiten*, supra note 1, 264.
5 Ibid 265.
6 Ibid 267.

however, Pilot retained two experts who suggested that there was inculpatory evidence.

The family was humiliated in their small community by these allegations. Later in the Court of Appeal, and subsequently the Supreme Court, counsel for Pilot Insurance conceded that "there was no air of reality to the allegations".[7] The insurance company decided to take advantage of the Whitens' vulnerability by adopting hard-nosed tactics to force the family to accept a small settlement. This included denying the claim, alleging arson, and cancelling without notice the rent payments on the cottage.

2. The High Court

The insured, Whiten, began proceedings in the Ontario High Court claiming breach of contract.[8] Matlow J instructed the jury that it might award punitive damages if it found that "Pilot failed to deal with her claim in good faith and instead dealt with this in a malicious, high-handed, arbitrary or capricious manner, and that Pilot's conduct warrants the imposition of a penalty".[9] The jury found in favour of Whiten and awarded, inter alia, $1 million in punitive damages. Binnie J, in the Supreme Court, summarised the key conclusions drawn at first instance as follows:[10]

> The jury was clearly outraged by the high-handed tactics employed by the respondent, Pilot Insurance Company, following its unjustified refusal to pay the appellant's claim under a fire insurance policy (ultimately quantified at approximately $345,000). Pilot forced an eight-week trial on an allegation of arson that the jury obviously considered trumped up. It forced her to put at risk her only remaining asset (the insurance claim) plus approximately $320,000 in legal costs that she did not have. The denial of the claim was designed to force her to make an unfair settlement for less than she was entitled to. The conduct was planned and deliberate and continued for over two years, while the financial situation of the appellant grew increasingly desperate.

3. The Court of Appeal

Pilot appealed to the Court of Appeal on two issues: the availability of punitive damages, and the appropriateness of the quantum of damages awarded.[11] The Court of Appeal unanimously upheld the award of punitive damages. Previously, under *Vorvis v Insurance Corporation of British Columbia*, an "independent actionable wrong" had been required to award punitive damages for breach of

7 Ibid 265.
8 (1996) 132 DLR (4th) 568.
9 *Whiten*, supra note 1, 271.
10 Ibid 264.
11 (1999) 170 DLR (4th) 280.

contract.[12] In *Whiten* the plaintiff had pleaded a breach of contract, by failing to pay out on the claim, and a breach of a duty of good faith. Pilot argued that this amounted to another breach of contractual obligations rather than an independent actionable wrong. The Court of Appeal rejected this argument. The second issue, however, was answered in favour of Pilot. By a 2-1 majority, the Court held that the award of $1 million was excessive and substituted an award of $100,000.[13]

4. The Supreme Court

The Supreme Court divided 6-1. The majority judgment of Binnie J (with McLauchlin CJC, Arbour, Gonthier, L'Heureux-Dubé, Major JJ concurring; LeBel J dissenting) upheld the award of punitive damages. The general test recognized by the majority was in accordance with the prevailing orthodoxy, having been established by *Vorvis*. This test was that the Court would first look to a threshold question of whether in addition to the breach of contract there was also an "independent actionable wrong".[14] If this threshold is passed, then the test for whether the conduct merits the award of punitive damages falls to be determined in accordance with the standard rule that the behaviour must be outrageous and high-handed.

The majority then proceeded to add a judicial gloss on the meaning of "independent actionable wrong" that had the effect of changing the orthodox position of *Vorvis*. The Court unanimously agreed that Pilot Insurance had breached both a contractual duty to pay out the claim under the fire insurance policy as well as a contractual duty to act in good faith towards the insured. The same set of behaviour caused the defendant to breach both duties. The question was whether a breach of a contractual duty of good faith could amount to an "independent actionable wrong". With remarkable alacrity, the Court held that it could do so.[15] Binnie J considered that the use of the term "wrong" as opposed to "tort" by McIntyre J in *Vorvis* indicated that the requisite independent wrong need not be a tort. The majority stated that such a wrong could include the breach of a "distinct and separate contractual provision or other duty such as a fiduciary obligation".[16]

With respect, this rationale only pays lip-service to the ratio in *Vorvis*. McIntyre J expressed his position in Vorvis as being consistent with the *Restatement on the Law of Contracts*, which provides that "punitive damages are not recoverable for breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable".[17] The approach of the

12 (1989) 58 DLR (4th) 193, 206 (SCC) ["*Vorvis*"].
13 Supra note 11.
14 *Whiten*, supra note 1, 272.
15 Ibid 289-292.
16 Ibid 291.
17 American Law Institute, *Restatement of the Law, second: Contracts* (2 ed, 1981) §355 ["*Restatement*"].

majority in seizing upon the term "wrong" instead of "tort" to justify the view that a separate contractual provision qualifies under the test of McIntyre J[18] smacks of sophistry. A bad faith refusal to pay out a claim and a failure to pay out the same claim may well be conceptually distinct. However, classifying a second breach of contract as an independent actionable wrong defeats the purpose of the *Vorvis* threshold test, which was to require a further non-contractual wrong. Based on the rationale in *Whiten*, a single contractual breach does not give rise to the possibility of punitive damages. A second contractual breach is, however, an independent actionable wrong and therefore makes it possible for the Court to award punitive damages. This is a somewhat strained interpretation of a rule that has traditionally been acknowledged as requiring a breach of contract plus a tortious act.

The qualifying phrase "independent" had previously been treated as meaning that the wrong must be outside the set of contractual obligations. Furthermore, if McIntyre J had applied the interpretation that Binnie J ascribed to him, there would have been no justification for the refusal of punitive damages in *Vorvis*. *Vorvis* concerned the breach of an employment contract. Under the *Whiten* interpretation of *Vorvis*, the employer had committed an independent actionable wrong by acting in bad faith over and above the wrongful dismissal of the employee.

An objective assessment of *Whiten* and *Vorvis* leads to the proper conclusion that *Whiten*, at the least, substantially liberalized the test in Vorvis. In fact, *Whiten* in some respects renders the *Vorvis* rule almost redundant.[19] If all that is required to pass the threshold set out by Vorvis is to establish that two contractual terms were breached instead of one, then it is difficult to understand what ongoing purpose is served by the threshold. In most cases, the question will hinge on the substantive limb of the test, namely, whether the conduct is outrageous. As will be argued later, the demise of the *Vorvis* threshold was desirable, and the dubiousness of the *Whiten* judgment's apparent application of *Vorvis* should not trouble us. The foregoing criticism has been submitted to underscore the significance of the case, which might otherwise be understated due to the conventional tone of the judgments.

The true rationale of the majority, namely that the independent tort requirement was arbitrary, is found later in the judgment of Binnie J when he states:[20]

> Third, the requirement of an independent tort would unnecessarily complicate the pleadings, without in most cases adding anything of substance. ...To require a plaintiff to formulate a tort in a case such as the present is pure formalism.

In this respect, the position of the majority in *Whiten* is essentially in line with the dissent of Wilson J (and L'Hereux-Dube) in *Vorvis*. The policy discussion

18 *Vorvis*, supra note 12, 206.

19 Jones and Kleefeld, "*Whiten v Pilot*: Safe Harbour For Punitive Contract Damages?" [2002] The Advocate 507.

20 *Whiten*, supra note 1, 291.

in the majority judgment reveals sympathy with the justifications for punitive damages in a wide-ranging discussion that touches upon the history of punitive damages from the penal code of Hammurabi to the contemporary approaches in common law jurisdictions.[21] In light of the majority's support for the policy arguments in favour of punitive damages in contract actions, the majority appears to have used the "independent actionable wrong" fiction to provide cover for what is, in truth, a substantial development in the law.

With respect to the issue of quantum, the Court had divided sympathies. On the one hand, the Court was clearly sensitive to the "floodgates" argument. In the very first line of the majority judgment, Binnie J stated: "This case raises once again the spectre of uncontrolled and uncontrollable awards of punitive damages in civil actions."[22] The majority denied that the controversy over punitive damages had anything to do with the "Americanization of our law".[23] On the other hand, there was no misdirection by the trial judge, and the jury's decision, although severe, was not considered to be disproportionate to the blameworthiness of the defendant, the vulnerability of the plaintiff, the potential harm to the defendant, and the need for deterrence.[24] The Court noted sharply that, despite the defendant's concessions in the Supreme Court, it had cynically maintained unmeritorious defences at lower levels and could not call any evidence to demonstrate that it had made any changes to its internal procedures to avoid a repeat of the situation.[25] Although the $1 million award set a new record, it was not irrational in the context of this case.

III: The Approach Adopted Across Different Jurisdictions

Having identified the new approach to punitive damages for breach of contract in Canada, it is necessary for the purposes of the policy discussion in the latter half of this article to put *Whiten* in context. This section of the article examines the approach in five jurisdictions: New Zealand, England, Australia, Canada, and the United States.

1. New Zealand

There is no decisive appellate authority on the point in New Zealand. The current position that punitive damages are available is based on the High Court decision of *Tak & Co v AEL Corp Ltd.*[26] Punitive damages for breach of

21 Ibid 276.
22 Ibid 264.
23 Ibid 275.
24 Ibid 299.
25 Ibid 306.
26 (1995) 5 NZBLC 103,887 ["*Tak v AEL*"]

contract have been awarded in at least four subsequent High Court cases and one Employment Court case.[27] This article examines the reported cases in some detail for two reasons. First, notwithstanding the lack of affirmation by the Court of Appeal, there is now a significant body of case law at first instance to support the availability of punitive damages for breach of contract. It would therefore be a misconception to think of *Tak* as an isolated decision. Secondly, one of the themes of this article is that the availability of punitive damages for breach of contract is less constrained than the cautious tones of the leading judgments imply. Despite suggesting that punitive damages will only rarely be awarded in a commercial context, most of the New Zealand cases on this point have awarded damages for breaches of contracts between commercial parties.[28]

(a) Tak & Co v AEL Corp Ltd

In *Tak & Co v AEL Corp Ltd*, Hammond J held that punitive (or "exemplary") damages for breach of contract were available in New Zealand.[29] In that case, $25,000 in exemplary damages was awarded. Hammond J framed the test as being: "Can the conduct concerned be said to be 'outrageous'"?[30] Although Hammond J did not attempt to define fully what conduct would fall within the ambit of the term "outrageous", his judgment provides careful and valuable guidance as to what factors may be taken into account. First, the conduct of the defendants was found to fall into "a broad category of knowingly deceitful conduct which transcends the formal boundary between contract and tort".[31] At a minimum, this statement indicates that dishonesty or fraud will usually be an element in conduct to which the term "outrageous" attaches. There was no firm statement that dishonesty is a requisite element of outrageousness. Although the possibility that conduct falling short of dishonesty could ever suffice seems remote, some particularly obtuse failure to perform or systemic incompetence may allow negligent conduct to fall within the scope of the term "outrageous". The statement to the effect that the conduct to which the label "outrage" attaches "transcends the boundary between contract and tort" raises an important issue about the relationship between the breach of contract and the law of tort. It was held in *Tak v AEL* that the conduct of the defendant amounted to the tort of deceit under the authority of *Derry v Peek*.[32] As discussed below, the position in many states of the United States is that in order for punitive damages to be awarded the breach of contract must be linked to a tortious act for which punitive damages are

27 *Cash Handling Systems Ltd v Augustus Terrace Developments Ltd* (1996) 3 NZ ConvC 192,398 ["*Cash Handling*"]; *Cedenco Foods Ltd v State Insurance Ltd* (1997) 6 NZBLC 102, 220; *Vousden v Hirst* noted in (2001) 25 TCL 7/2; *Telecom Corp of NZ Ltd v Business Assocs Ltd* (23 June 1993) unreported, CA7/93; *Gilbert v Attorney-General* [2000] 1 ERNZ 332.

28 See especially *Tak v AEL*, supra note 26; *Cash Handling*, supra note 27.

29 Supra note 26.

30 Ibid 103,904.

31 Ibid 103,903.

32 (1889) 14 App Cas 337 ; *Tak v AEL*, supra note 26, 103,906.

recoverable. The judgment of Hammond J does not suggest that New Zealand has adopted a similar position. However, it does seem likely that linking a contractual breach to a tortious act (or if the act breaching the contract and committing a tort are the same act) the conduct can more readily be considered outrageous.

Hammond J suggested that the circumstances in which it would be appropriate to award punitive damages would be "relatively infrequent" in commercial contracts.[33] With regard to the amount of damages, it was suggested that the awards should be "modest".[34] The award of $25,000 in *Tak v AEL* certainly reduces the prospects for substantial awards in New Zealand.

(b) Cash Handling Systems Ltd v Augustus Terrace Developments Ltd

This case addressed a complex dispute between a landlord and commercial lessee. The relationship between the two parties deteriorated sharply after the lessee complained to the landlord that the landlord's development activities on the premises constituted a breach of the covenant of quiet enjoyment. The landlord responded by alleging that the lessee had breached the terms of its lease and threatened to exercise its power to re-enter. The lessee retaliated by lodging a caveat against the title. This was a breach of the lease, in which the lessee had covenanted that it would not lodge a caveat. The landlord wrote to the lessee cancelling the lease. The lessee promptly informed the landlord that an ex parte interlocutory injunction would be sought that afternoon. During the day, the landlord demolished the offices and the lessees returned the next morning, having successfully obtained an injunction, to find the offices ruined.

The plaintiff lessee, Cash Handling Systems Ltd, brought proceedings against the landlord of its premises alleging that the landlord had wrongly repudiated the lease. The case was decided primarily on contractual grounds rather than on the basis of a claim in tort for trespass. The plaintiff claimed general damages and exemplary damages.

Elias J held that exemplary damages were available for breach of contract and awarded exemplary damages of $10,000. The primary basis for the award was that the "landlord acted decisively ... to forestall the effect of an injunction".[35] Several aspects of the judgment are especially noteworthy. First, this was a commercial relationship. Secondly, the conduct of the plaintiff itself was "not ... irreproachable" because the plaintiff had breached its contractual obligations and these breaches had "contributed to the escalation of the dispute".[36] This case illustrates that the availability of punitive damages is not necessarily calibrated to the behaviour of the plaintiff. Exemplary damages are a penalty imposed by the court to punish wrongdoing by the defendant and the conduct of the defendant is

33 Ibid 103,887.
34 Ibid.
35 *Cash Handling*, supra note 27, 192,398,192,432.
36 Ibid 192,433.

therefore the focus of inquiry. As discussed below in section IV(3) of this article, this doctrinal perspective is contestable because the penalty will accrue to the successful plaintiff.

(c) Cedenco Foods Ltd v State Insurance Ltd

The *Cedenco Foods* case was a claim for damages for breach of an insurance contract.[37] The plaintiff, Cedenco Foods Ltd, was a commercial crop grower in Gisbourne that produced bulk industrial food products in its factory. The plaintiff advanced a number of causes of action. Importantly for the purposes of this article, Salmon J dismissed the cause of action brought pursuant to section 9 of the Fair Trading Act 1986. Salmon J held that the evidence did not "establish that the defendant engaged in misleading and deceptive conduct".[38] The wrongdoing by the defendant was less egregious than, for example, the defendant in *Tak v AEL* because there was no conduct that could have founded an independent cause of action in tort. Salmon J nevertheless considered that "the failure of an insurance company to pay out on a properly established claim is significant and should attract the disapproval of the Court".[39] This case is noteworthy for setting a somewhat lower standard of wrongdoing for the award of punitive damages.

(d) Gilbert v Attorney-General

The Employment Court in *Gilbert v Attorney-General* awarded $50,000 damages under the head of exemplary damages.[40] Colgan J considered that the defendant in that case was reckless in failing to provide a safe work environment for the plaintiff probation officer.[41] The Judge held that the defendant had acted outrageously and flagrantly by requiring the plaintiff to return to full duties after a period of hospitalization. The Court of Appeal in *Attorney-General v Gilbert* overturned the award of exemplary damages on the basis that it was not warranted on the facts.[42] The appellant, however, "did not seek to argue that an award of exemplary damages could not be made in a claim under an employment contract" and the Court merely accepted the appellant's argument that an award was inappropriate in the particular circumstances of the case.[43] This was regrettable in one sense, namely, that the opportunity to authoritatively rule on the point was lost. The judgment implicitly accepted the availability of exemplary damages in contract but neither unequivocally committed itself to that proposition, nor reviewed the previous High Court cases.

37 *Cedenco Foods Ltd v State Insurance Ltd* (1997) 6 NZBLC 102, 220.
38 Ibid 220, 102, 235.
39 Ibid 102, 235.
40 *Gilbert v Attorney-General* [2000] 1 ERNZ 332.
41 Ibid 395.
42 *Attorney-General v Gilbert* [2002] 2 NZLR 342, 366.
43 Ibid 365.

2. England

The English Courts have taken a conservative approach to punitive damages in general and have rejected the availability of punitive damages for breach of contract altogether. *Addis v Gramophone Co* is the leading case in England for the proposition that punitive damages cannot be awarded for claims in contract.[44] In *Addis*, the House of Lords held that damages for injury to feelings could not be recovered in contract. Only one member of the majority, Lord Atkinson, specifically stated that punitive damages could not be recovered.[45] Lord Collins, dissenting, considered that exemplary damages ought not to be limited to actions in tort.[46] This conservative approach was further entrenched by *Rookes v Barnard*, which restricted the availability of punitive damages to narrow established categories.[47] In that case, the House of Lords limited the availability of punitive damages (as distinguished from aggravated damages) to three categories: abuse of power by the government, a tort calculated to make a profit, and any situation where there is statutory authority to award punitive damages.

As noted above, this narrow approach has been rejected in New Zealand,[48] Australia,[49] Canada,[50] and Ireland.[51] In England and Wales, however, this categorical approach has persisted, despite some attempts by the courts to include additional situations at the penumbra of the existing categories.[52] The approach in England has been heavily criticized. The Law Commission for England and Wales has considered that the current categories are not based on "sound principle" or "sound policy".[53] Nonetheless, the Commission explicitly recommended no change to the rule with respect to punitive damages.[54]

3. Australia

The position that punitive damages are not available for breach of contract was made clear in Australia in *Butler v Fairclough*.[55]

Recently, the issue was indirectly touched upon by the Federal Court of Australia in *Hospitality Group Pty Ltd v Australian Rugby Union Ltd*.[56] The Australian Rugby Union, the plaintiffs, claimed injunctive relief and damages against Hospitality Group for reselling tickets for a rugby match without

44 [1909] AC 488.
45 Ibid 496.
46 Ibid 500.
47 [1964] AC 1129.
48 *Taylor v Beere* [1982] 1 NZLR 81 (CA).
49 *Uren v John Fairfax & Sons Property Ltd* (1966) 117 CLR 118 (HCA).
50 *Vorvis v Insurance Corporation of British Columbia* (1989) 58 DLR (4th) 193 (SCC).
51 *Conway v Irish National Teachers' Organisation* [1991] 11 ILRM 497 (SC).
52 *Kuddus v Chief Constable of Leicestershire Constabulary* [2001] 3 All ER 193 (HL).
53 *Aggravated, Exemplary and Restitutionary Damages* Law Commission No 247 (1997), [1.2].
54 Ibid [5.171]-[5.173].
55 (1917) 23 CLR 78.
56 (2001) 110 FCR 157 ["*Hospitality*"].

authorization. It was a condition of sale that the tickets not be re-sold at a premium or as part of a promotion without the consent of the plaintiffs. The defendants used the tickets as part of a promotional campaign. Gyles J at first instance refused to make an award for an account of profits but did award $100,000 in exemplary damages, ostensibly for the tortious conduct of the defendant.[57] On appeal Hill and Finkelstein JJ considered that Gyles J had awarded damages in both contract and tort.[58] The Court affirmed the orthodox position that punitive damages could not be awarded for breach of contract in Australia, but it was also found that on the facts there was no contractual nexus, making the comments strictly obiter.

4. Canada

As noted above, there has been a sea change in the Canadian position. Following *Addis*,[59] *Vorvis v Insurance Corporation of British Columbia*[60] and *Wallace v United Grain Growers Ltd*[61] affirmed the requirement of an "independent actionable wrong". This orthodoxy had been previously challenged by decisions to the contrary in lower courts but had not enjoyed support at Supreme Court level.[62]

This position was subsequently rejected by the Supreme Court in *Royal Bank of Canada v W Got & Associates Electric Ltd*[63] where an award of punitive damages was upheld independent of a finding that the conduct also amounted to a tort for which punitive damages would have been recoverable. The decision in *Got* did not, however, provide unequivocal support for that proposition because the Supreme Court did not consider the question of conversion and did not disturb the finding in the lower court that the tort of conversion had been committed.[64]

The decision by the Supreme Court in *Whiten v Pilot Insurance Co*[65] approved *Got* and confirmed, in a more closely reasoned judgment, that no independent tort was required. The threshold now merely requires an independent wrong, and may be satisfied by a second breach of contract. Where a sufficiently outrageous contractual breach has taken place, the Court may award punitive damages. The Supreme Court has indicated elsewhere that exemplary damages will only rarely be available in a commercial context.[66]

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57 (2000) 173 ALR 702.

58 *Hospitality*, supra note 56, 191.

59 [1909] AC 488.

60 Supra note 12.

61 [1997] 3 SCR 701 (SCC).

62 For example, *Thompson v Zurich Insurance Co* (1984) 5 CCLI 251 (Ont HC) held that punitive damages were available for a breach of contract in a proper case; *Peters v Commonwealth Insurance Co* (1990) 47 CCLI 288 (Ont HC) held that punitive damages may be awarded where: "...a breach of contract merges with and assumes the character of a willful tort, calculated rather than inadvertent and in a wanton and reckless disregard for contractual rights of others"; *Peters* was supported by the decision in *Peppiatt v Nicol* (1998) 71 OTC 321 although in that case the plaintiff failed on the facts.

63 [1999] 3 SCR 408.

64 Phang and Lee, "Restitutionary and Exemplary Damages Revisited" (2003) 19 JCL 1, 24.

65 *Whiten*, supra note 1.

66 See eg *Performance Industries Ltd v Sylvan Lake Golf & Tennis Club Ltd* (2002) 209 DLR (4^{th}) 318.

5. The United States

The general position in the United States is that punitive damages are not available for actions that are purely breaches of contract. This position is, however, subject to a complex patchwork of exceptions. In the view of some commentators, the extent of the exceptions is such that it is no longer sensible to refer to a general rule against punitive damages for actions in contract.[67]

First, where the breach of contract also amounts to a tortious act, punitive damages are available.[68] Secondly, most state jurisdictions[69] have allowed punitive damages to be awarded in respect of certain types of contract and certain types of contractual breach. These exceptions have developed in a more or less ad hoc manner, without any clear expression of a unifying principle. For example, the breach of public utility contracts has been considered an exception to the general rule against punitive damages. In *Birmingham Waterworks v Keiley*[70] an award of punitive damages against a utility company for wrongfully terminating a service was upheld. A second example is that punitive damages are not barred for breach of an employment contract.[71] Thirdly, where there is a fiduciary relationship in addition to the contractual relationship, punitive damages may be allowed. In *Alton v Rogers* punitive damages were available against an attorney who had breached the contract of retainer with a client.[72] The third "exception" is less a true exception than a loophole. The US courts tend to give juries the power to award remedies and tend to tolerate the tendency of juries to blur the lines.[73]

6. Overview

The approaches in the five jurisdictions surveyed can properly be conceived of as being points on a spectrum. At the most conservative end of the spectrum lie the English and Australian positions, which flatly bar the award of punitive damages for breach of contract. The United States position is more liberal in practice than England and Australia, owing to the various exceptions that have emerged to the rule against punitive damages for breach of contract. The New Zealand and Canadian positions stand at the other end of the spectrum, having both abandoned the rule against punitive damages for breach of contract.

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67 Sassaman, "Punitive Damages In Contract Actions – Are The Exceptions Swallowing the Rule?" (1980) 20 Washburn LJ 86.

68 *Restatement*, supra note 17.

69 With the exceptions of Louisiana, Massachusetts, Washington and Connecticut. See Fisher, "Egan v Mutual of Omaha Insurance Co: The Expanding Use of Punitive Damages In Breach of Insurance Contract Actions" (1977) 15 San Diego L Rev 288, 290.

70 2 Ala App 629 (1911).

71 *Peitzman v City of Illmo* 141 F 2d 956 (8th Cir, 1944).

72 274 P 2d 487 (1954); cert denied, 348 US 982 (1955).

73 Kirby, "Punitive Damages In Contract Actions: The Tension Between the United Nations Convention On Contracts For The International Sale of Goods And US Law" (1997) 16 JL & Com 215, 217.

IV: A Rebuttal of the Arguments Against Punitive Damages for Breach of Contract

1. The Contract-Tort Distinction

One of the central arguments against awarding punitive damages for breach of contract is that to do so would be inconsistent with the principles of contract law. This argument rests on the distinction between the respective underpinnings of duties in tort and contract. It is argued that exemplary damages are justified in tort because tortious conduct violates a standard of behaviour imposed by society. There is an element of fault and wrongdoing. The obligation to perform a contract, on the other hand, is simply a voluntarily assumed obligation to perform the contract. Oliver Wendell Holmes stated: "[T]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, and nothing else."[74]

The inferences that this argument draws from the contract–tort dichotomy are attractive at first blush but nonetheless misconceived. There is nothing inherent in the distinction that makes it unprincipled to believe that breaching a contractual duty ought to occasion punishment of the breaching party in some circumstances.

The response can be divided into four propositions. First, promise-keeping is a valuable institution.[75] This is true in an instrumental sense because society is advantaged by a collective confidence that certain duties that the law identifies as attracting the enforcement power of the state will be kept. Reciprocal performance of obligations, backed by the power of the courts, is central to our system of social cooperation.

Secondly, duties owed in contract often generate a great degree of reliance and trust, and consequently a greater sense of moral outrage when they are breached, precisely because they are voluntarily assumed duties between the parties as opposed to duties owed to a conceptual neighbourhood or strangers. Already, exemplary damages are available for breach of a fiduciary duty[76] and breach of confidence.[77] By way of concession, it is not submitted that breach of fiduciary duty or confidence can be necessarily said to be morally equivalent to a breach of contract. Nevertheless, this development recognises, in part, a willingness of the Courts in New Zealand and Canada to transcend traditional categories that restrict remedial flexibility.

74 Holmes, "The Path of the Law" (1897) 10 Harv L Rev 457, 462.

75 Phang and Lee, supra note 59.

76 *Cook v Evatt* [1992] 1 NZLR 67. The Supreme Court of Canada has also awarded such damages for breach of fiduciary duty: see *Frame v Smith* [1987] 2 SCR 99.

77 *Aquaculture Corp v New Zealand Mussel Co* [1990] 3 NZLR 299.

Thirdly, it is possible to envisage situations in which the element of moral fault will plainly be greater for a breach of contract than in a tortious situation that would potentially attract exemplary damages. One such example is negligence. The Privy Council in *A v Bottrill* held that exemplary damages could be awarded where the wrongful act was merely negligent and without any element of reckless or conscious wrongdoing.[78] Maintaining the distinction in the light of this point leads to anomalous consequences, as has been noted by a number of judgments. Wilson J in *Vorvis* stated:[79]

> It would be odd if the law required more from a stranger than from the parties to the contract. The very closeness engendered by some contractual relationships, particularly employer/employee relationships in which there is frequently a marked disparity of power between the parties, seems to me to give added point to the duty of civilised behaviour.

Cooke P (as he then was) commented in obiter in *McElroy Milne v Commercial Electronics Ltd*: [80]

> The suggestion that liability is less extensive in contract than in tort ... is not unquestionably convincing. No reason is apparent why a party who has undertaken by contract a duty of care to another should ipso facto be less at risk as to damages than one on whom a duty is imposed by the general law.

Lord Collins in his dissent in *Addis* criticized what he described as: [81]

> [A]n arbitrary and illogical limitation ... as though a breach of contract ... might not be committed with accompanying circumstances just as deserving the reprobation of a jury as those which might accompany the commission of a trespass.

Fourthly, it is an oversimplification to assert that punitive damages ought not to be available for breach of contract according to the rationale that a contract simply gives rise to expectation damages. The restitutionary remedy of account of profits is one obvious exception. Where the court considers that more conventional remedies will not suffice, and the plaintiff has a legitimate interest in preventing the profit-making activities of the defendant, the court may deprive the defendant of his profit.[82] The remedy is rarely awarded but it illustrates that the bases for awarding remedies for breach of contract are less rigid than some critiques of punitive damages would suggest. Restitutionary claims may in fact be more radical than punitive damages in the sense that "a' restitutionary claim

78 [2002] 3 WLR 1406.
79 *Vorvis v Insurance Corporation of British Columbia* (1989) 58 DLR (4th) 193, 224 per Wilson J (dissenting).
80 *McElroy Milne v Commercial Electronics Ltd* [1993] 1 NZLR 39 (CA), 43.
81 Supra note 44, 498.
82 *Attorney-General v Blake* [2001] 1 AC 268.

will lie even against an innocent wrongdoer, whereas exemplary damages can only be awarded to mark deliberate misconduct".[83] Putting aside the other salient difference that the quantum of an award of punitive damages may be greater than that in a restitutionary claim because it is not linked to gain by the wrongdoer, the point can be made that it is an oversimplification to oppose punitive damages as being a challenge to the orthodox approach to remedies for victims of contractual breach without recognizing that the orthodoxy has already been eroded in a number of other respects.

2. The Efficient Breach Argument

The efficient breach theory[84] holds that in some situations it is more efficient not to perform a contract than to perform it.[85] As a consequence, the conduct of the contract breaker is said not to be blameworthy; and it is improper to punish behaviour that is in fact beneficial. The theory is commonly explained in the following terms: if supplier C has contracted with buyer A to supply widgets but is subsequently offered a higher price by buyer B, then C should break the contract with A, compensate the loss of A and supply the widgets to B.[86] In this way, the party who most values the widgets, B, receives them and utility is maximised. Punitive damages are accordingly illegitimate because they deter efficient breaches. The point is expressed by Richard Posner in the following way: [87]

> [I]f damages are limited to loss of expected profit, there will be an incentive to commit a breach. There should be. ...The rule that contract damages are measured by the loss of expected profit to the victim of the breach thus promotes efficiency.

The theory is influential,[88] but it is flawed as an objection to punitive damages in four respects. First, the efficient breach argument by definition justifies only a limited class of breaches where wealth is maximized. As William Dodge points out, "the efficient breach argument provides no excuse for shielding opportunistic breaches of contract".[89] For example, where a party withholds payment in the hope that the other party will abandon or compromise its claim there is no increase in overall social wealth.[90] One party has simply purported to make a gain to which it was not entitled at the other party's expense. Posner himself recognizes that opportunistic breaches fall within an exception to the efficient breach theory,

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83 Waddams, *The Law of Damages* (3 ed, 1997) 489.

84 Goetz and Scott, "Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach" (1977) 77 Colum L Rev 554.

85 *Thyssen Inc v SS Fortune Star* 777 F 2d 57 (1985) 63 per Friendly J ["*Thyssen*"].

86 This example is ubiquitous. See Goetz and Scott, supra note 84.

87 Posner, *Economic Analysis of Law* (2 ed, 1972) 57.

88 See *Thyssen*, supra note 85.

89 Dodge, "The Case For Punitive Damages in Contracts" (1999) 48 Duke L J 629, 632.

90 Ibid 652.

stating that in such cases "there is no economic justification and [the breach] ought simply to be deterred".[91]

Secondly, the efficient breach argument presupposes that the breaching party will willingly pay the ordinary measure of damages to the innocent party. This assumption is unsupported by common practice. William Dodge argues that the "voluntary payer is so rare as to be an almost hypothetical figure".[92] More commonly, the breaching party will resist payment and set up defences against recovery by the innocent party.

Thirdly, the efficient breach argument does not properly take account of the effects of parties not treating their contractual obligations as side-constraints. "Efficient breach" imposes hidden costs such as the cost of commercial parties using resources to monitor compliance and litigate disputes. Resources must be expended to settle disputes and hedge against the uncertainties of the adversarial system. This has led commentators such as Ian MacNeil to conclude that efficient breach encourages "uncooperative and – ironically enough – highly inefficient human behaviour".[93] As Forrest Miller persuasively argues, "damages are designed to vindicate the plaintiff's right, they are not a complete substitute for it".[94] Efficient breaches, even when payment is made, sometimes harm the public interest by undermining contractual integrity and unjustly worsening the position of the innocent party.

Fourthly, punitive damages would not necessarily deter an efficient allocation of resources. If the widgets are more valued by B than A an efficient outcome could be achieved in a number of ways.[95] C could negotiate a release from A in order to sell them to B, or A could simply sell the goods to B. In an opportunistic sense, C is worse off than if C had broken the contract with A free from the risk of punitive damages, but it could not be said that the outcome is less efficient for society. Moreover, because punitive damages would not be awarded unless the conduct was considered outrageous, punitive damages would not lock parties in terrorem into inefficient contracts.

3. The Plaintiff's Windfall Argument

(a) The Argument

Even if an opponent were to concede that the punishment and deterrence of high-handed contract-breakers were justifiable ends meriting some form of civil sanction or fine, there is a powerful third objection that might properly be labelled the "plaintiff's windfall" objection. The argument has two limbs, but can

91 Posner, supra note 87, 130.
92 Ibid 664.
93 MacNeil, "Efficient Breach of Contract: Circles in the Sky" (1982) 68 Va L Rev 947, 969.
94 Miller, "Exemplary Damages in New Zealand: A Law and Economics Analysis" (1997) 3 NZBLQ 228, 242.
95 Dodge, supra note 89, 663.

be framed by the following question: Why should the sanction be imposed at the behest of and benefit for a private citizen through the vagaries of the civil litigation system as opposed to a democratically established regulatory framework?

Awarding punitive damages to a plaintiff is by definition "supracompensatory".[96] The first limb of this argument states that there is no justification for the plaintiff receiving a windfall. The House of Lords in *Cassell v Broome* criticized the award of punitive damages as being "palm tree justice"[97] in reference to its somewhat arbitrary characteristics, in the sense that the award is not fixed on the basis of an actual loss suffered by the recipient.

The second limb of the argument identifies an alternative enforcer and recipient of the award, namely the state. Opponents of punitive damages for breach of contract, such as the Insurance Council for Canada, which made submissions as an intervener in *Whiten*,[98] suggest that regulatory bodies established by Parliament provide a preferable system for the control of corporate behaviour than the awarding of punitive damages. The detail of this argument is discussed below, but broadly the argument sets out the claims that regulatory bodies have a democratic mandate for the ways and means by which they accomplish their functions, and are suitable for a systematic monitoring and enforcement of regulations in the market place. The Courts, on the other hand, rely on plaintiffs pressing ahead with meritorious claims, not being defeated on other issues or settling on account of the uncertainty of outcomes in the civil litigation process.

The second limb of the objection also questions to whom the damages ought to be paid. The windfall accrues to the plaintiff at the expense of the defendant. However, the award is also at the expense of the state in the sense that the state has an interest in deterrence but is not the recipient of the damages. The previously discussed *Cash Handling Systems* case[99] illustrates how such a windfall might be considered inappropriate. In that case the plaintiff was a commercial party that carried out an escalating series of legal and illegal retaliatory measures against the other party. The defendant was, quite correctly, found liable for exemplary damages. The case puts the issue of whether the state or the plaintiff should receive the award in sharp relief. There was good reason to punish the defendant. Nevertheless, the plaintiff's behaviour was also disreputable. There is a plausible intuition that the state should receive the money paid by the defendant, as opposed to the plaintiff.

(b) The Response

The argument is a powerful one and requires a multi-layered response. There is no entirely satisfying answer to the complaint that the damages should flow to

96 Sebert, "Punitive and Non-Pecuniary Damages In Actions Based Upon Contract: Towards Achieving the Object of Full Compensation" (1986) 33 UCLA L Rev 1565, 1570.

97 [1972] AC 1027, 1078 (HL) per Lord Reid.

98 *Whiten*, supra note 1.

99 *Cash Handling*, supra note 27, 398.

the coffers of the state. Three factors, however, suggest that the argument is not a knock-down objection to the case for punitive damages in contract.

First, as a preliminary observation, the complaint would apply to recovery of punitive damages in tort as well as contract.[100] A windfall will be the result of any award that focuses on the conduct of the defendant rather than the loss of the plaintiff. If one accepts that the windfall argument is decisive against punitive damages, then the argument must be taken with equal force as an objection to the general approach to punitive or exemplary damages throughout the various common law systems. It would be misconceived to reject the award of punitive damages in contract on the grounds that it provides a windfall to the plaintiff without also accepting that the conclusion undercuts the availability of punitive damages in tort as well. This, however, will not satisfy a committed opponent of punitive damages, who may nevertheless argue that punitive damages in both contract and tort are flawed because they create an undeserved windfall. To many commentators and practitioners, such a conclusion is counter-intuitive. The reasons for this belief partly consist of the second and third counter-responses set out below.

Secondly, the significance of the "windfall" ought not to be overstated. The rules relating to the awarding of damages in contract lead to the "systematic undercompensation" of plaintiffs.[101] That is not to say that punitive damages can be properly defended as a corrective influence on undercompensation (for that is a problem better solved by addressing the rules of awarding damages so as to give better effect to the principle of restitutio in integrum), but rather to put the argument in perspective. The risk of overcompensating plaintiffs in real terms is less likely to result than the "windfall" objection suggests. Some commentators have defended exemplary damages as a functional means of giving plaintiffs a full measure of compensation to overcome the defective aspects of the rules relating to compensatory damages.[102] Professor McGregor has also pointed out that, in practice, exemplary damages have sometimes been used "as a means of achieving the right financial result in a limited field where the law was otherwise inadequate to do so".[103] Professor McGregor, however, stated, quite rightly from the point of view of this article, that such usage was "somewhat makeshift and arbitrary".[104] In any event, the use of punitive damages in an instrumental way to achieve compensation is an unattractive theoretical argument and is conceded as invalid for the purposes of this article.

Thirdly, on a pragmatic level, there is a valid "bounty" argument.[105] The possibility of recovering punitive damages to some extent makes it more likely

100 Edelman, "Exemplary Damages for Breach of Contract" (2001) 117 LQR 539, 542.
101 Sebert, supra note 96, 1570.
102 Ibid 1565.
103 McGregor, *McGregor on Damages* (16 ed, 1997) 337.
104 Ibid 303.
105 Fisher, supra note 69, 289.

that a victim of an egregious contract breach will bring an action. Otherwise, the measure of damage may be too modest to justify the risk and expense of legal action notwithstanding the outrageousness of the breach. In fact, the categories of plaintiffs that the case law indicates will be most likely to recover punitive damages for breach of contract[106] are more often afflicted by impecuniousness than corporate parties.

To take the *Whiten* situation as a case in point, it may have been less likely that the Whitens would have pursued the case for eight hard-fought years without the incentive that they themselves would recover the punitive damages. Let us suppose, for the purposes of a thought experiment, that, as a rule, awards of punitive damages were to flow to the state coffers instead of the plaintiff. Punitive damages may still have been sought, but perhaps not pursued vigorously at multiple appellate levels. It is impossible to generalize about the motivations and degrees of commitment of plaintiffs[107] but it is possible to speculate about the overall effect of the "windfall". In the context of the *Whiten* case, the award of expectation damages was not contested by Pilot Insurance at the appellate hearings. It was the award of $1 million of punitive damages that induced the defendant to appeal. Having obtained judgment for expectation damages in the amount of over $318,000 in compensatory damages, it would have been an understandable human response to have capitulated on the award of punitive damages on appeal. Furthermore, once the quantum of punitive damages had been reduced by the Court of Appeal from $1 million to $100,000,[108] it would perhaps ask too much of a plaintiff to appeal that decision to the Supreme Court of Canada in order to reinstate the award at first instance. If punitive damages are to be awarded at the suit of a private plaintiff, then it follows that the plaintiffs themselves must be the recipients of the award to provide adequate incentives for pursuing them.

An opponent of punitive damages for breach of contract will at once point out that this link in the argument begs the question. If plaintiffs are unreliable agents for bringing about punishment of wrongdoers in civil proceedings due to impecuniousness or lack of commitment, then why not substitute the ample resources of state agencies for the purpose of enforcing the rules that society lays down? The answer to this question cuts to the second limb of the "windfall" argument, namely, that the creation and strengthening of appropriate regulatory institutions removes the need for punitive damages in the civil litigation process. The argument is true in one sense: a properly constituted regulatory system ought

106 The courts have indicated that punitive damages are more likely to be available in non-commercial contracts, see *Cash Handling*, supra note 27, 192,433.

107 The author notes, for example, the research which suggests that monetary compensation is sometimes a secondary priority and that plaintiffs may be primarily motivated by "therapeutic considerations" or desire for vindication. See in the context of claims for damages for sexual battery: Feldthusen, "The Civil Action for Sexual Battery: Therapeutic Jurisprudence" (1993) 25 Ottawa L Rev 203.

108 (1999) 42 OR (3d) 641.

to be part, and perhaps even the centrepiece, of the approach by which society punishes, deters and denounces high-handed and outrageous conduct, whether in contract or tort. However, the relevant question to which this article is addressed is whether a parallel system of punitive damages is also a valid response for the law. There are good reasons to believe that it should be available to litigants for the reason that regulatory agencies are imperfect. To adopt the words of Byles J out of context, "yet the justice of the common law will supply the omission of the legislature".[109]

(c) Evaluating the Responses against Counter-attacks

In many senses the "bounty" argument appears unattractive. It smacks of an opportunistic "American-like" approach to litigation and may encourage frivolous lawsuits. On the other hand, in order to create a deterrent effect there must be incentives for claimants to bring actions and in order for the damages to deter "it must be painful".[110]

Judicial discomfort with the possibility of opening the floodgates to excessive awards of punitive damages is widely expressed. Although such reservations are proper, they derogate from one of the important justifications of punitive damages, namely deterrence. This aspect of the problem is discussed below in section V(2).

The final objection to the "bounty" response against the "windfall" argument is a constitutional one. Double jeopardy results when the plaintiff can bring about the punishment of another citizen on the one hand, and the officers of the state can pursue quasi-criminal or administrative remedies against the same person, on the other hand. Moreover, why should punishment be meted out on a standard of the balance of probabilities when similar behaviour punished by the state often must be proven to a higher standard?[111] Finally, by what justification ought one citizen, in his or her relations with another, act as a "private attorney general"?[112] These constitutional objections are serious but they in fact would challenge more than simply the availability of punitive damages in contract actions. This response has been made previously in this article but applies to this objection as well. In tort actions, a private citizen effectively acts, in part, as an agent for the common good as well as seeking compensation for his own loss. The question is whether there is any principled distinction that separates this from the plaintiff in a contract action.

109 *Cooper v Wandsworth Board of Works* (1863) 14 CB(NS) 180, 194; 143 ER 414, 420.
110 Fisher, supra note 69, 297.
111 *Tak v AEL*, supra note 26, 887.
112 Dobbs, *Handbook On The Law Of Remedies* (1973) §3.9, 205.

V: Why Punitive Damages Ought to be Awarded

This article argues that punitive damages for breach of contract in proper cases serve three valid functions: punishment, deterrence, and denunciation, as expressed in the classic statement of Lofft J:[113]

> [A] jury have it in their power to give damages for more than the injury received. Damages are designed not only as a satisfaction to the injured person, but likewise as a punishment to the guilty, to deter from any such proceeding for the future, and as a proof of the detestation of the jury to the action itself.

1. Retributive Justice

The prevailing orthodoxy of the law of contract is that damages are compensatory not retributive. As discussed above with respect to the tort-contract distinction, it is misconceived to think that there can be no circumstances in which the courts ought to punish a contract breaker. This section of the article argues that punitive damages properly do so, by imposing a penalty on the contract breaker over and above the general damages required to compensate the innocent party.

The critical question with respect to this theoretical dispute is: "Who is punished?" It is often argued that the "punishment" attached to punitive damages is somewhat illusory. The criticism states that firms often pass on a substantial element of the cost of lawsuits to consumers in the form of higher prices for goods and services.[114] As Ausness puts it: "If [passing costs] occurs, the public in effect foots the bill for a penalty imposed for its own protection."[115] The criticism is relatively powerful, especially in the case of firms which either enjoy dominant positions in the market place or in markets where demand is relatively inelastic.[116] The same criticism would apply to the argument advanced below with respect to the deterrence achieved by punitive damages. Only in an idealized and perfectly competitive market would firms not be able to pass on the costs of punitive awards (hence achieving retributive effects), thus, making firms which engaged in outrageous contractual behaviour less competitive (therefore deterring the behaviour and giving a comparative advantage to firms which adhere to their contractual obligations).

A second limb of the previous criticism is that, in any event, the economy absorbs the impact of punitive damages in the form of higher insurance premiums. This phenomenon has been the cause of considerable concern in the United States

113 *Wilkes v Wood* (1763) Lofft 1; 98 ER 489, 498-499 (KB).

114 Carsey, "The Case Against Punitive Damages: An Argumentative Outline" (1975-1976) Forum 57, 60.

115 Ausness, "Retribution and Deterrence: The Role of Punitive Damages in Products Liability Litigation" (1986) 74 Ky LJ 1, 41.

116 Ibid.

in particular.[117] Some states disallow liability insurance for punitive damages on the basis that they are contrary to public policy.[118] The logic underlying such restrictions has been stated as follows: [119]

> Where a person is able to insure himself against punishment he gains a freedom of misconduct inconsistent with the establishment of sanctions against such misconduct.

Such restrictions have their own disadvantages. Vulnerability to punitive damages has a potential negative effect on business enterprise, inducing firms to act in terrorem with greater caution than is socially optimal. The position in England is not settled, largely due to the paucity of exemplary damages awards in that jurisdiction. The point was not decided in *EI du Pont Nemours v Agnew*[120] but the English Court of Appeal in *Lancashire County Council v Municipal Mutual Insurance Co*[121] held that it was not contrary to public policy to insure against exemplary damages, at least in cases where the liability is vicarious. New Zealand Courts have not considered the point but will probably prefer the emerging English approach of allowing insurance for punitive damages for which an employer is vicariously liable.[122]

In any event, the argument that insurance coverage defeats the retributive effects of punitive damages is misconceived. Insurance policies have significant deductible provisions and claims lead to higher premiums for the claiming parties.[123] Punishment does occur and accountability exists, even if economic arrangements in a complex industrial society make the "sting" of the award more diffuse.[124]

2. Deterrence

Compensatory damages for breach of contract are designed to put the plaintiff in monetary terms in the position that he or she would have enjoyed had the contract been performed.[125] Although compensatory damages may have the effect of indirectly deterring breach of contract (insofar as would-be contract breachers know that they will be liable to pay damages if they do not perform), they are neither designed for this purpose nor well-suited for it. It is not doubted

117 See for example *Roginsky v Richardson-Merrell Inc* 378 F.2d 832, 841 (2d Cir. 1967).
118 States that have put in place some form of restriction include California, Colorado, Connecticut, Illinois, Kansas, New Jersey, New York, Oklahoma, and Pennsylvania: Ausness, supra note 115, 42.
119 *Northwestern National Casualty Co v McNulty* 307 F.2d 432 (5th Cir. 1962). This was not a case involving punitive damages for breach of contract but rather an award in tort against a drunk driver.
120 [1987] 2 Lloyds Rep 585, 594.
121 [1996] 3 All ER 545.
122 See especially Miller, supra note 94, 251.
123 Ausness, supra note 115, 43.
124 See *Whiten*, supra note 1, 292.
125 *Robinson v Harman* (1848) 154 ER 363.

by commentators on either side of the debate on punitive damages[126] that in many situations a contract breaker will profit from breaking a contract, even after paying damages and entering into a second contract. The issue of whether there is anything objectionable about such conduct has already been canvassed above with respect to the efficient breach argument. The conclusion reached in that analysis was that although it will often be true that an efficient breach (which is by definition not deterred by compensatory damages) will fall short of being properly described as outrageous, there are many situations in which breaking a contract will be outrageous and contrary to the public interest, but "efficient" from the point of view of the contract breaker. These instances include where the breach is intended to opportunistically achieve a zero-sum reallocation of the benefits and burdens of the contract, or where the breach constitutes an attempt to avoid a contractual obligation rather than reallocate resources to a higher value use.

Such contractual breaches are outrageous. It follows that if contract law lacks the means of discouraging opportunistic breaches, and in fact may encourage them, then that would constitute a serious deficiency in the remedies available to the courts. As Galligan J put it in *Nantel v Parisien*:[127]

> [T]he law would say to the rich and powerful, 'Do what you like, you will only have to make good the plaintiff's actual financial loss, which compared to your budget is negligible.' ... 'Trample on the smaller person's rights, the sanction of that trampling will be only a relatively minor part of the cost of doing business.'

This article argues that deterrence is desirable in certain situations, and that punitive damages for breach of contract are a legitimate and effective means of deterring outrageous breaches. To address the first aspect of this claim, the article identifies two types of breaches that would not be deterred by compensatory damages.

(a) Calculated But Non-Efficient Breach

The classic scenario involves defendants who cynically calculate that, although a contractual breach will visit some serious harm on the innocent party, nevertheless the amount of damages payable, if at all due to the risks associated with litigation, will put the defendants in a better position than if they had performed their obligations. The element of outrageousness is especially present when the breach is not socially efficient in the sense of creating wealth but is simply opportunistic. This will be efficient neither in the Pareto sense nor the

126 For instance, the analysis underlying the efficient breach theory itself acknowledges that compensatory damages paid under the first contract in an efficient breach situation will cost the contract breaker less than the gain which will be received by entering into the second contract.

127 *Nantel v Parisien* (1981) 18 CCLT 79, 87.

Kaldor-Hicks sense.[128] This point was made by the Supreme Court of Nevada in *K-Mart v Ponsock* where the Court stated:[129]

> If all a large corporate employer had to do was to pay contract damages for this kind of contract [pretextuous termination to avoid benefits], it would allow and even encourage dismissals of employees on the eve of retirement with virtual impunity. Having to pay contract damages would offer little or no deterrent to the type of practice apparently engaged in by K-Mart in this case.

In the *K-Mart* case, the employee, Ponsock, was fired six months prior to the full vesting of retirement benefits. The pretext on which the company did so was that he had defaced company property by using a can of spray paint to cover a patch on his forklift where the paintwork had peeled off.[130]

(b) Systematic Patterns of Breach

A systematic pattern of breach is often considered punishable for a slightly different, but related, reason than what has been labelled "calculated non-efficient breach" above. A systematic pattern of breaches involves a cynical strategy of breaching multiple contracts in order to accrue advantages across the board. Awarding compensatory damages for an individual breach would nullify the advantage for the breaching party in that case (making it distinguishable from calculated non-efficient breach). The breaching party, however, relies on the plausible assumption that not all victims will fully pursue their legal rights.[131] The gains across the board will exceed the damages that will be awarded in some cases. In any event, the breaching party realizes that the award of damages may often be simply cost-neutral from his or her perspective. Strategies of this kind tend to involve large corporations or public utility bodies that enjoy superior economic and legal resources to their clients. The strategies usually consist of "stone-walling" the other party by either setting up a series of unmeritorious defences, or simply denying all liability and leaving the other parties to pursue their rights ("see you in court").[132]

Having identified the types of breaches for which it is plausible to suppose that ordinary compensatory damages will not suffice to achieve socially optimal levels of performance and breach, the question is whether punitive damages for breach of contract are an effective corrective device. Broadly speaking, there are two schools of thought on this issue. The first, held by opponents of

128 Dodge, supra note 89, 653.

129 732 P 2d 1364, 1372 (Nev, 1987) ["*K Mart*"].

130 Ibid.

131 Miner, "The Expanding Availability of Punitive Damages In Contract Actions" (1975) 8 Ind LR 668, 679.

132 *See Seaman's Direct Buying Service v Standard Oil Co. of California* 686 P 2d 1158 (1984) ["*Seaman's*"]. The rule in *Seaman's*, which is not relevant for present purposes, was overturned by *Freeman & Hills v Belcher Oil Co* 900 P 2d 669 (Cal 1995).

punitive damages, argues that punitive damages over-deter and are therefore self-defeating. The second perspective, which is favoured by this article, argues that with sufficient judicial restraint, punitive damages can effectively deter breaches. The logic underpinning the first school of thought relies on the effect of large civil "fines" on the cost-benefit calculations of parties. The imposition of sanctions on wrongdoers will send a message to other wrongdoers that the gains from outrageous contract breaking will be outweighed by punitive damages. Rational actors will, in theory, modify their behaviour to take account of the risk of punitive damages.[133] In practice, the efficacy of deterrence through punitive damages will vary according to the severity of the punishment discounted by the likelihood of the punishment being applied. Attempting to measure the extent of deterrence in the market is a difficult exercise, but many commentators argue that the spectre of punitive damages does, broadly speaking, modify behaviour.[134] By properly balancing the competing values of restraint and sufficient punishment, a sizeable proportion of the literature accepts that an optimal level of deterrence can be reached.[135]

The second school of thought holds that punitive damages tend to be arbitrary in their application and effects because they are not limited to the loss suffered by the plaintiff. As such, they may over-deter or be simply too capricious to reliably change the cost-benefit calculations of market actors. John Leslie, for instance, argues that the threshold of "outrageousness" is too vague to function as a credible deterrent or indicator of what types of contractual breach will subject to punishment.[136] Richard Ausness, in a comprehensive article examining the effects of punitive damages in the field of product liability, concludes that punitive damages do not have a worthwhile deterrent effect. As he puts it:[137]

> However well punitive damages may deter individual wrongdoers, they do not appear to operate effectively in the products liability area. Some product manufacturers will escape liability altogether by shifting it onto the public, while other companies may be overdeterred. Moreover, the social cost of achieving this suboptimal level of deterrence is likely to be much higher than any corresponding social benefit. A more efficient solution would be to identify undesirable activities and proscribe them through direct governmental regulation.

It is undeniable that the notoriously excessive awards given by some juries in the United States go far beyond any rational level of deterrence and instead constitute an inefficient, and even unfair, penalty on the productive sector of the economy. The problem, however, properly lies with the jury system for civil trials

133 Fisher, supra note 69, 301.

134 See Jones and Kleefeld, supra note 17.

135 See Cooter, "Punitive Damages for Deterrence: When and How Much?" (1988) 40 Ala L Rev 1143.

136 Leslie, "Formulating Standards for the Award of Punitive Damages in the Borderland of Contract and Tort" (1986) 74 Cal L Rev 2033, 2054.

137 Ausness, supra note 115, 92.

in the United States rather than being a problem internal to punitive damages. The problem of extravagant awards is equally acute in the United States with respect to compensatory damages. The detailed study into judicial oversight of jury awards by Baldus, MacQueen, and Woodworth reaches the following conclusion:[138]

> The problem of outlying, or inconsistent damages awards is inherent in a system that allocates responsibility for the valuation and assessment of awards to inexperienced jurors who are asked to make individualized damage assessments without reference to any external standards defining the appropriate award level.

The proper conclusion is, therefore, that because fixing the quantum of punitive damages is an exercise that requires the careful weighing of many considerations, this is best left to a judge rather than a jury. This article argues that judges can and ought to be trusted to conscientiously award punitive damages. The leading judgment in *Whiten* reflects the care taken by judges not to overstep the function of exemplary damages:[139]

> I earlier referred to proportionality as the key to the permissible quantum of punitive damages. Retribution, denunciation and deterrence are the recognized justification for punitive damages, and the means must be rationally proportionate to the end sought to be achieved. A disproportionate award overshoots its purpose and becomes irrational. A less than proportionate award fails to achieve its purpose.

The reservations as to whether the availability of punitive damages will open the floodgates are not significantly stronger[140] than the same reservations that had previously existed as to the availability of damages for pure mental harm. In that vein, the classic dissent in *Bosley v Andrews* with respect to the recoverability of damages for mental harm in tort is pertinent:[141]

> But are our Courts so naïve, are they so gullible, are they so devoid of worldly knowledge, are they so childlike in their approach to realities that they can be deceived and hoodwinked by claims that have no factual, medical, or legalistic basis? If they are, then all our proud boasts of the worthiness of our judicial system are empty and vapid indeed .... I wish to go on record that the policy of non-liability announced by the Majority in this type of case is insupportable in law, logic, and elementary justice – and I shall continue to dissent from it until the cows come home.

Numerous commentators have pointed out the comparability between the suspicion previously attaching to mental harm awards and that which now attaches

138 Baldus, MacQueen and Woodworth, "Improving Judicial Oversight of Jury Damages Assessments" (1995) 80 Iowa L Rev 1109, 1115.

139 *Whiten*, supra note 1, 299.

140 This article concedes that the argument is partially stronger because punitive damages are not based on actual loss but rather an assessment of how high a figure is required to punish, deter and denounce.

141 (1958) 393 Penn 161, 142 A 2d 263.

to punitive damages.[142] This article submits that if the threshold question of the availability of punitive damages is answered favourably, and the means and ends of deterrence are broadly accepted, then it is weak to rely on the "floodgates". An appropriate approach to fixing such awards can in principle be established, as it has been in tort and with respect to intangible compensatory damages.

3. Denunciation

A further reason to believe that punitive damages have a valid place within the remedial arsenal of the Court is to denounce conduct as antisocial and deserving of punishment. This purpose is well-established in the context of awards for tortious conduct.[143] For example, punitive damages were awarded to a rape victim despite the impossibility of executing the judgment and that there was no plausible suggestion that the award would punish that particular rapist or deter rapists in general.[144] In the contractual context, there are circumstances when the courts ought to send a message that a breach of contract was not morally neutral. The view that there are morally equivalent options available to contractual parties to either perform or pay damages for the extent of the loss of bargain that the law will recognize does not always accord with social intuitions.

Ultimately, the theoretical dispute on this point turns on competing conceptions of contract, and to some extent on human nature. It nevertheless seems unreal to deny that the courts could properly assert that it is outrageous to terminate a long-serving employee's contract on a pretext prior to retirement benefits vesting;[145] or to cynically decide not to provide proper medical attention with the result that an employee is seriously injured;[146] or to systematically humiliate an employee through inquisitorial meetings followed by abrupt termination;[147] or to adopt a "see you in court" approach to resist performance without any belief in the merits of one's position.[148] The belief that the courts should be slow to recognize the normative value in keeping a promise often stems from the desire (to adopt, conveniently but unfairly, the words of Kirby P in an entirely different context) not to substitute "lawyerly conscience for the hardheaded decisions of business people".[149] This article argues that to deny an element of moral fault in such situations privileges the dogma of amorality in commercial contracting in ways that are inconsistent with the full range of attitudes of society or business towards contracts. As Professor Roy Goode has remarked: "If commercial law had rested

142 Miller, supra note 94, 241.
143 Ontario Law Reform Commission *Report on Exemplary Damages* (1991) 34.
144 *Myers v Haroldson* [1989] 3 WWR 604.
145 *K Mart*, supra note 129.
146 See *Robitaille v Vancouver Hockey Club Ltd* [1981] 3 WWR 481.
147 *Vorvis*, supra note 12.
148 *Seaman's*, supra note 132.
149 *Austotel Pty v Franklins Selfserve Pty Ltd* (1989) 16 NSWLR 582, 585.

simply on a series of disconnected bilateral contracts it would have remained a puny child indeed."[150] It is also inconsistent with the apparent attitudes of the judiciary itself, to the extent that judicial sympathies can be gleaned from a close reading of the judgments. The sympathy for the Whitens at all levels of the Canadian court system – in contrast to the acerbic disapproval of the insurance company – can hardly be doubted. The following passage in which Binnie J sets out the facts surrounding the fire at the beginning of his judgment gives an illustration of this:[151]

> [His] daughter, who had been upstairs, fled the house wearing only [her] nightclothes. It was minus 18 degrees Celsius. Mr. Whiten gave his slippers to his daughter to go for help and suffered serious frostbite to his feet for which he was hospitalized. He was thereafter confined to a wheelchair for a period of time. The fire totally destroyed the Whitens' home and its contents, including their few valuable antiques and many items of sentimental value and their three cats.

Putting aside for present purposes the familiar adage that hard cases make bad law, the proposition that the judiciary, or at least a significant section of it, has a predilection towards recognizing the moral injustice of not performing contracts in certain circumstances seems plainly true.

There is an apparently plausible intuition that some breaches of contract are not simply a legal wrong justifying compensation but rather are actually morally offensive. Given the role of policy in shaping the development of the law, why should the courts not send messages as to which practices constitute "minimum standards of decent behaviour for contracting parties"?[152] Many of the arguments against punitive damages in contract, such as the efficient breach argument, are, quite correctly, explicitly based on the interests of society as a whole rather than simply justice as between the parties.[153] It is therefore legitimate to consider that contract law can validly perform the function of sending messages as to what constitutes desirable behaviour between contracting parties. In any event, the functions of denunciation, punishment, and deterrence do not usurp the autonomy of the contract makers themselves. Punitive damages denounce and punish to support the integrity of contractual obligations to which the parties have bound themselves.

150 Goode, *Commercial Law in the Next Millennium* (1998) 38.
151 *Whiten*, supra note 1, 264.
152 Venour, "Punitive Damages in Contract" 1 Can JL & Jurisprudence 87, 104.
153 Phang and Lee, supra note 64, 26.

VI: Conclusion

This article has argued that the *Whiten* case ought to reinvigorate interest in the availability of punitive damages for breach of contract due both to its explicit affirmation of the availability of such damages and its willingness to uphold a high quantum of damages. The article then argued that punitive damages ought to be available to judges as a means of punishing outrageous breaches of contract. Although the theoretical and policy aspects of the debate are complex, the underlying intuition is straightforward. In many cases, compensatory damages will simply not suffice to punish, deter and denounce shocking behaviour by a party to a contract. If we accept that contract law ought to respond forcefully to behaviour of this kind, then there are good reasons to believe that punitive damages provide an appropriate response.