WeirFoulds LLP

Waiver of Tort Is Dead, Long Live Disgorgement (Maybe)

July 28, 2020

In *Atlantic Lottery Corporation Inc. v Babstock*[1] released on July 24, 2020, the Supreme Court of Canada unanimously held that "waiver of tort" was not a cause of action, and that this term was a misnomer that should not be used. In addition, the Court provided some guidance as to the availability of disgorgement as a remedy. The differences of opinion between the majority and the dissent may also indicate a loosening of the rules applicable to motions to strike, in light of the majority's willingness to reverse the lower courts' decisions and strike all of the causes of action pleaded by the plaintiffs.

Background

The plaintiffs commenced a proposed class action against Atlantic Lottery Corporation ("**ALC**") on behalf of all persons in Newfoundland and Labrador who paid to play video lottery terminal games ("**VLTs**") in the province in the six years preceding the action. The plaintiffs claimed that VLTs were inherently dangerous and deceptive, and sought a gain-based award quantified by the profit that ALC earned by licensing VLTs. By the time their case reached the Supreme Court of Canada, the plaintiffs relied on three causes of action: waiver of tort, breach of contract and unjust enrichment.

Waiver of Tort

In 2013, in *Pro-Sys Consultants Ltd. v Microsoft Corporation*,[2] the Supreme Court declined to strike a cause of action based on waiver of tort. After reviewing the contradictory law on the issue, the Court stated at the time that "this appeal is not the proper place to resolve the details of the law of waiver of tort, nor the particular circumstances in which it can be pleaded."[3]

Seven years later, the Court was ready to decide whether the novel cause of action of waiver of tort existed in Canadian law. After referring to *Hryniak v Mauldin*[4] and the need for a "culture shift" to promote timely and affordable access to the civil justice system, the majority stated that, where possible, courts should resolve legal disputes promptly, rather than referring them to a full trial.[5] While acknowledging that novel claims that might represent an incremental development in the law should be allowed to proceed to trial, the majority warned that a claim should not survive a motion to strike simply because it is novel. Writing for the majority, Brown J. stated:

If a court would not recognize a novel claim when the facts as pleaded are taken to be true, the claim is plainly doomed to fail and should be struck. In making this determination, it is not uncommon for courts to resolve complex questions of law and policy. [6]

The Court held that the term "waiver of tort" was confusing, had led to confused and confusing results and should be abandoned.[7] What the plaintiffs were really seeking was disgorgement – their claim was that they were entitled to a remedy quantified solely on the basis of the ALC's gain, without reference to damage that any of the class members may have suffered. The Court held that while disgorgement was an alternative remedy for certain forms of wrongful conduct, it was not an independent cause of action.[8]

Disgorgement as a Remedy for Tortious Wrongdoing

According to the Court, while disgorgement for tortious wrongdoing was initially applied only in the context of proprietary torts, it found broader application in the late 20th century, and the issue of whether disgorgement is available for negligence in certain circumstances remains unsettled. The Court held, however, that it was unnecessary to resolve the question in this case as the plaintiffs had not adequately pleaded a claim in negligence. In explaining why this was the case, Brown J. emphasized the importance of pleading causation when alleging negligence:

Causation of damage is a required element of the tort of negligence. As I have explained, the conduct of a defendant in negligence is wrongful only to the extent that it *causes* damage (*Clements*, at para. 16). While the plaintiffs allege that ALC had a duty to warn of the inherent dangers associated with VLTs, including the risk of addiction and suicide, those dangers are not alleged to have materialized. The plaintiffs do not allege that proper warnings would have caused them to spend less money playing VLTs or to avoid them altogether.

It follows that I respectfully disagree with [the] Court of Appeal's conclusion that the plaintiffs would not be "precluded from leading evidence that the breach of duty (assuming it can be proven) led to some form of injury" (para. 186). Again, causation of damage is a required element of the cause of action of negligence, and it must be pleaded. Here, not only have the plaintiffs *not* pleaded causation, their pleadings expressly disclaim any intention of doing so. The absence of a pleading of causation, they acknowledge, arises from an intentional litigation strategy to increase the likelihood of obtaining certification of their action as a class action by avoiding having to prove individual damage. This particular claim also has no reasonable chance of success. [9]

Thus, it remains to be determined whether disgorgement may be ordered as a remedy in a negligence case where all the necessary elements of the cause of action have been pleaded and, if so, the circumstances in which such a remedy may be appropriate.

Disgorgement for Breach of Contract

Relying on the House of Lords' decision in *Attorney General v Blake*,[10] both the majority and the dissent agreed that disgorgement may be available for breach of contract in certain exceptional circumstances, where other remedies (such as damages, specific performance and injunction) are inadequate.[11] The circumstances that should be considered by the court include the subject matter of the contract, the purpose of the contractual provision that has been breached, the circumstances in which the breach occurred, the consequences of the breach, and the circumstances in which relief is being sought.[12] The majority also emphasized that courts should in particular consider whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity.[13] According to the majority, "[w]hile the circumstances in which a gain-based award will be appropriate cannot be clearly delineated in advance [...], one would expect future legitimate interests protected by a gain-based award to resemble those interests that have been protected in the past."[14]

The majority concluded that the plaintiffs' claim for disgorgement for breach of contract was plainly doomed to fail. This was not a case where other remedies were inadequate. Brown J. stated:

Circumstances of inadequacy arise when the nature of the claimant's interest is such that it cannot be vindicated by other forms of relief. This may arise where, for example, the plaintiff's loss is "impossible to calculate" or where the plaintiff's interest in performance is not reflected by a purely economic measure [...]. Where, as here, the argument is that the quantum of loss is equal to the defendant's gain, but the plaintiff would simply rather pursue disgorgement, a gain-based remedy is inadequate.[15]

Brown J. further stated that disgorgement is not available at the plaintiff's election to obviate matters of proof. Compensatory damages are not inadequate merely because a plaintiff is unwilling, or does not have sufficient evidence, to prove loss. It is the nature of the claimant's interest, not the availability of evidence, that can establish the inadequacy of other remedies.[16]

The majority concluded that there was nothing exceptional about the breach of contract alleged by the plaintiffs, and that the

plaintiffs could not be said to have a legitimate interest in the defendant's profit-making activity. As a result, the plaintiffs' claim had no reasonable chance of achieving disgorgement for breach of contract.

The majority also found that the plaintiffs' claim for punitive damages had no reasonable chance of success, and stated that the alleged contract did not fit within any of the established categories of contracts that impose good faith obligations.

In response to the dissent's view that the claim for breach of contract should not be struck, the majority relied on the unusual nature of the plaintiffs' pleading, referred to *Hryniak* and argued that the Court should not "delay the inevitable":

The remaining question on breach of contract is whether the plaintiffs' claim should survive as a hollow cause of action that does not support any of the remedies they seek. In my view, it should not. While I agree with my colleague Karakatsanis J. that declaratory relief and nominal damages are available in theory as remedies for breach of contract, a reasonable claim is one that has a reasonable chance of achieving the outcome that the plaintiff seeks. That is not this claim. To be sure, the circumstances here are unusual. Not only did the plaintiffs plead only gain-based relief and punitive damages, both of which I have concluded are unavailable in the circumstances the plaintiffs also expressly disclaimed remedies quantified on the basis of individual loss. At no point did the plaintiffs argue that their claim should survive because nominal damages are available. In my view, the plaintiffs' breach of contract claim should be assessed on the basis of the questions put before the Court – namely, whether a gain-based remedy or punitive damages are available in the circumstances. And on that basis, it is obvious that the plaintiffs' breach of contract claim does not disclose a reasonable cause of action. To allow this claim to proceed to trial would simply be to delay the inevitable, and would not reflect a "proportionate procedure[e] for adjudication" (*Hryniak*, at para. 27).[17]

The Court also found that the plaintiffs' claim for unjust enrichment was bound to fail as there was a juristic reason, i.e. a contract, pursuant to which the defendant was justified in retaining the benefit.

Having found that all the claims pleaded by the plaintiffs were bound to fail because they disclosed no reasonable cause of action, the majority struck the statement of claim in its entirety. While it was unnecessary to deal with the issue of certification, the majority indicated that it disagreed with the dissenting judges that the plaintiffs' breach of contract claim, standing alone, would satisfy the preferability requirement for certification.[18]

The Dissent's View

Writing for the dissent, Karakatsanis J. emphasized the high threshold to strike a claim, and stated that the question to ask on a motion to strike was whether the pleadings, as they stand or may reasonably be amended, disclose a question that is not doomed to fail.[19] She then found that the plaintiffs had pleaded the necessary elements for a claim of breach of contract.

Karakatsanis J. articulated as follows her disagreement with the majority:

Brown J. concludes that the cause of action for breach of contract, as framed, must fail because it is plain and obvious that there are no available remedies for this claim. As I elaborate below, I cannot agree that there is no valid cause of action for breach of contract on the basis that there is *no* available remedy. In my view, there are several remedies that are open to the plaintiffs on their pleadings, including nominal damages, declaratory relief, disgorgement, and punitive damages.[20]

Karakatsanis J. pointed out that because breach of contract is actionable without proof of loss, it always implies nominal damages, which do not need to be pleaded.[21] Further, she found that whether disgorgement could be an appropriate remedy in this case could not be resolved on the pleadings alone, and was a matter for trial. She noted that the plaintiffs' pleading included several factors that, if established at trial, could point to a disgorgement remedy, including bad faith and vulnerability. She concluded as follows on this point:

Thus, though I agree with Brown J. that disgorgement can only be awarded in exceptional circumstances for breach of contract, in my view, whether the circumstances of this case are exceptional is clearly a determination for the trial judge alone. I am not persuaded that the trial judge will inevitably conclude that there is nothing exceptional about this case, or that the plaintiffs' claim is simply that they paid to play a gambling game and did not get exactly what they paid for. The plaintiffs pleaded that ALC, a corporation charged with managing a profit-making lottery scheme offered to the public, intentionally deceived those playing members of the public by knowingly providing an unfair game and putting them at risk of gambling addiction in order to turn a profit. They specifically pleaded that they had a legitimate interest in ALC's performance of its contractual obligation to provide safe games and that remedies other than disgorgement would be inadequate to deter ALC from misconduct. In assessing whether other remedies would be inadequate to protect their contractual rights, a trial judge may also find that ascertaining the actual amount lost is impracticable since VLTs are designed for players to have the opportunity to "win small cash prizes in exchange for small frequent cash bets" and not to create records of who uses them or how much money they have lost. The trial judge may even conclude that ALC's conduct in approving such designs may have, purposefully or not, contributed to that impracticability, such that the plaintiffs were not simply *unwilling* to prove their loss. These are matters for the trial judge. [22]

Karakatsanis J. also held that the plaintiffs had pleaded a sufficient basis to support a claim for punitive damages as their allegations of reprehensible conduct and deception in the performance of the contract had put the duty of honest performance in issue.[23]

The dissenting judges concluded that there was no basis to strike the claim for breach of contract, and that the plaintiffs' claim could be certified as a class action on the common issues of breach of contract, punitive damages and the appropriateness of a disgorgement remedy.

Conclusion

It will be interesting to see how this decision is applied by lower courts and how the law develops with respect to the availability of disgorgement as a remedy for both negligence and breach of contract. The majority's decision to deny the availability of disgorgement appears to be based on the unusual facts of the case, particularly the plaintiffs' express disclaimer with respect to remedies quantified on the basis of individual losses and their decision to plead their case in a particular way. The inclusion of the boilerplate language usually found in statements of claim, requesting "such further and other relief as to this Honourable Court may seem just", and the pleading of some damage or detriment may have been sufficient to lead to a different result.

It will also be interesting to see whether, despite the unusual facts of this case, lower courts will rely on the majority's decision and the need for a "culture shift" to expand the rules applicable to motions to strike in order to eliminate more actions at the pleadings stage and not "delay the inevitable".

[1] 2020 SCC 19 ("***ALC***").

[2] 2013 SCC 57.

[3] *Ibid.* at para. 97.

[4] 2014 SCC 7 ("***Hryniak***").

[5] *ALC*, *supra* note 1, at para. 18.

[6] *Ibid.* at para. 19.

[7] *Ibid.* at para. 23.

[8] *Ibid.* at para. 27.

[9] *Ibid.* at paras. 37-38.

[10] [2001] 1 AC 268 (HL).

[11] *ALC, supra* note 1, at paras. 52-53, 110.

[12] *Ibid.* at paras. 52-53, 113.

[13] *Ibid.* at para. 53.

[14] *Ibid.* at para. 58.

[15] *Ibid.* at para. 59.

[16] *Ibid.* at paras. 60-61.

[17] *Ibid.* at para. 67

[18] *Ibid.* at para. 68.

[19] *Ibid.* at para. 90.

[20] *Ibid.* at para. 103.

[21] *Ibid.* at paras. 105-106.

[22] *Ibid.* at para. 125.

[23] *Ibid.* at para. 129.

WeirFoulds LLP

www.weirfoulds.com

Toronto Office
4100 – 66 Wellington Street West
PO Box 35, TD Bank Tower
Toronto, ON M5K 1B7

Tel: 416.365.1110
Fax: 416.365.1876

Oakville Office
1320 Cornwall Rd., Suite 201
Oakville, ON L6J 7W5

Tel: 416.365.1110
Fax: 905.829.2035