Raising Prejudice to Resist Amendments of Pleadings

A Commentary on
1588444 Ontario Ltd. v. State Farm Fire and Casualty Company

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On Jan. 18, 2017, the Ontario Court of Appeal released its decision in *1588444 Ontario Ltd. v. State Farm Fire and Casualty Company,* 2017 ONCA 42, an interesting case on the issue of raising prejudice to resist a motion to amend pleadings.

This case involves a claim on a fire insurance policy by the plaintiffs arising from the destruction of their restaurant by fire on June 4, 2006. The fire insurance policy was underwritten by the defendant State Farm. State Farm initially defended the action on the basis that the plaintiffs had failed to cooperate with the investigation of the fire and failed to produce relevant documentation. Then, in January 2015, eight years after their initial statement of defence was delivered, State Farm brought a motion to amend its pleading to abandon the defence of non-cooperation and instead to plead that the fire was set by or at the direction of the respondents.

The motions court judge, Justice H.K. O'Connell, dismissed the motion on three grounds:

1. The plaintiffs had suffered actual prejudice in that the proposed amendments would have the effect of restarting the litigation process and the plaintiffs had now lost the ability to marshal evidence to counter a claim of arson.
2. Sufficient time had passed that the prejudice was presumed to have occurred and the presumption had not been rebutted by State Farm.
3. State Farm had failed to provide a reasonable excuse to explain its delay.

The Actual Prejudice Issue

With respect to the actual prejudice issue, the Court of Appeal noted that in order for a motion to amend to be defeated by proof of actual prejudice, the responding party must show non-compensable prejudice as follows:

1. "The non-compensable prejudice may be actual prejudice, i.e. evidence that the responding party has lost an opportunity in the litigation that cannot be compensated as a consequence of the amendment. *Where such prejudice is alleged, specific details must be provided*." [emphasis added]
2. "There must be a causal connection between the non-compensable prejudice and the amendment. In other words, the prejudice must flow from the amendments and not from some other source."
3. "The onus to prove actual prejudice lies with the responding party"

In response to the motion, the plaintiffs' solicitor filed an affidavit that the delay in pleading arson had deprived the plaintiffs of the "opportunity to fully investigate the fire and attempt to ascertain the identity of the potential suspects." The affidavit further stated that the respondents had lost the opportunity to interview potential suspects and review their personal records, canvass the neighbourhood for video evidence, and conduct forensic analysis of a broken window at the plaintiffs' premises and of Mr. Spartaco's clothing.

This was sufficient for the motions court judge to find actual prejudice. To that extent, the Court of Appeal found the judge had made a palpable and overriding error.

The Court of Appeal noted that the affidavit did not state that any *specific* witnesses are no longer available. Rather, it said that interviews of available witnesses "will be hindered by the inevitably faded memories".

In the view of the Court of Appeal, that was not sufficient to establish actual prejudice. The Court held:

> "[31] To meet their onus, the respondents were obliged to adduce specific evidence of actual prejudice. For example, such evidence could include details of witnesses who were available previously but are no longer available. Noting that witnesses' memories may have faded is really just a generalized description of presumed prejudice. Such evidence lacks the required degree of specificity to qualify as evidence of actual prejudice.
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> "[32] I agree with the observation of William J. Poulos in his article *Prejudice: Taking a Hard Look at the Merits* (1999), 22 C.P.C. (4th) 366, at p. 379, that when it comes to alleging actual prejudice in response to a motion to amend:
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> > 'The specific allegation of prejudice should be detailed in sufficient particularity in evidence to allow the opposing party to respond to the allegation and to allow the court to take a hard look at the merits of the allegation.'"

Further, with respect to the argument that the delay in pleading arson had prejudice the plaintiff in that it deprived them of an opportunity to do a timely forensic investigation, the Court held that the plaintiff had failed to demonstrate the causal connection between the delay and the lost opportunity to do the investigation.

The Court noted:

> "34] It is clear that the respondents were put on notice within days of the fire that there was a possibility that the appellant would deny coverage on the basis that Mr. Spartaco set the fire. That potential was certainly alive during the course of the approximately fifteen months between the date of the fire and the service of the statement of defence. Given the warning they received, had the respondents wished to protect themselves from an allegation that they were responsible for the fire, they could have taken steps to conduct forensic investigations. To the extent that they chose not to do so, that was a deliberate choice on their part, wholly unconnected to the appellant's delay in moving to amend the statement of defence. Thus the necessary nexus between the delay and the prejudice has not been established.

> "[35] To be clear, in reaching this conclusion I am not suggesting that an insured in a fire claim is obliged to conduct its own investigation of the cause of the fire. However, where an insured is put on notice that a claim may be denied on the basis that the arson was caused by the insured and chooses not to investigate, the insured cannot later rely on its failure to investigate as an example of actual prejudice. This is because the decision not to investigate is wholly unrelated to the delay by the insurer."

The Presumed Prejudice Issue

With respect to the presumed prejudice issue, the Court of Appeal stated the law to be as follows:

> "[36] …at a certain point after an exceptional delay, non-compensable prejudice will be presumed absent evidence to the contrary. In other words, after inordinate delay, the presumption in favour of granting leave shifts to a presumption that non-compensable prejudice will result if leave is granted. This makes sense as a matter of fairness. It would be very difficult for a responding party to prove, for example, the generalized prejudice that witnesses' memories will be diminished after a lengthy passage of time.

> "[37] The presumption of prejudice is rebuttable. Where the moving party provides an adequate explanation for the delay or tenders evidence that there is no non-compensable prejudice, the presumption will be rebutted."

The Court noted that no fixed time frame has been set as to when prejudice is to be presumed because of delay.

The plaintiffs urged the Court, following the Divisional Court decision in *Ontario (Securities Commission) v. McLaughlin*, 2009 CarswellOnt 2694 (Div. Ct.), to adopt a three part test that the moving party must satisfy as follows: "(i) an explanation for the delay; (ii) the absence of non-compensable prejudice to the responding party; and (iii) a nexus between newly

discovered information and the proposed pleading". The plaintiffs took the position that the moving party must satisfy all three parts of the test to rebut the presumption of non-compensable prejudice.

The Court of Appeal agreed with the motions court judge that the 8 year time lapse between the initial pleading and the motion to amend was sufficient to raise the presumption of prejudice, however the Court of Appeal did not agree that *OSC v McLaughlin* stands for the proposition that a rigid three part test should be applied. Rather, the Court held as follows:

> [41] I would not adopt the rigid test urged upon us by the respondents. In my view, the Divisional Court in *OSC* did not purport to establish a stringent test for rebutting the presumption. Rather, they were simply referencing the types of evidence that might be adduced by a moving party to rebut the operation of the presumption.
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> [42] In any event, such a rigid test is contrary to the fairness considerations that underlie the court's recognition of the concept of presumed prejudice in Family Delicatessen. It would be inequitable to require a moving party to satisfy all three parts of the proposed test in all cases. For example, if a moving party were able to establish that the responding party would suffer no non-compensable prejudice by reason of the amendment, then it would be an odd result if the presumption was not rebutted simply because an adequate explanation for the delay had not been established.

Nevertheless, the Court of Appeal found that, even without such a rigid three-part test, State Farm had failed to rebut the presumption of prejudice, stating:

> [46] The appellant did not adduce any evidence to establish that the respondents would not suffer prejudice by reason of the amendment. For example, the appellant did not show that through its own investigation it had retained key pieces of evidence or taken witness statements at a time closer to the fire, before the passage of time is presumed to have caused evidence to disappear and

> memories to fade. Nor did it explain how information discovered through the litigation process resulted in the proposed amendments.

The Court of Appeal also stated that although some of the delay may have been attributable to the plaintiffs, it was for the most part due to positions taken by State Farm and that State Farm had unreasonably delayed moving to amend.

In the result, the Court upheld the motion court judge's decision to refuse leave to amend.

The lesson to be garnered from this is that vague generalized allegations of prejudice or the lack of prejudice are insufficient either to establish actual prejudice or to rebut the presumption of prejudice. In either case specific particulars must be put in evidence on the motion.