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RELIEF FROM FORFEITURE: LESSONS LEARNED FROM *MONK V. FARMERS MUTUAL INSURANCE CO. (LINDSAY)*

I. RELIEF FROM FORFEITURE - GENERALLY

Consider a breach of contract scenario where, although the breach in question is minor, the consequence of the breach is that the person stands to lose *all* of his or her benefits under the agreement. Relief of forfeiture is a remedy that refers to the power of the court to step in and protect a person from such an outcome where a strict adherence to the terms of the contract would be unfair or inequitable. Simply put, it allows the court to exercise its discretion to "relieve" a party from "forfeiting" his or her benefits under a contract following a breach in order to ensure a just and equitable result.

The remedy of relief from forfeiture is equitable in nature and is entirely discretionary. Its origin and purpose were summarized by Doherty J.A. in *Ontario(Attorney General) v. 8477 Darlington Crescent*:

> Courts of equity have always had the power to relieve against the forfeiture of property consequent upon a breach of contract. That power is now expressed in various statutes dealing with specific kinds of contracts (e.g., contracts of insurance, leases) and has been given more general expression in s. 98 of the [*CJA*]. … ***The power is predicated on the existence of circumstances in which enforcing a contractual right of forfeiture, although consistent with the terms of the contract, visits an inequitable consequence on the party that breached the contract***.[1]

In the insurance context, the purpose of the remedy is to "prevent hardship to insureds where there has been a failure to comply with a condition for receipt of insurance proceeds ***and where leniency in respect of strict compliance with the condition will not result in prejudice to the insurer***".[2] Certainly not every case will warrant relief from forfeiture: as the discussion below illustrates, the availability of this remedy is limited to cases where <u>all</u> of the following factors are present, and the court considers it just that the remedy be granted:

(i) the breach represents an imperfect compliance (as opposed to total non-compliance) with the contract;
(ii) the breach is incidental (as opposed to fundamental or integral) to the contract;
(iii) the insurer has <u>not</u> been prejudiced; and
(iv) the insured comes to court with "clean hands".

In Ontario, the equitable remedy of relief from forfeiture is codified in section 129 of the *Insurance Act* and section 98 of the *Courts of Justice Act*. Section 129 provides that**:**

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[1] *Ontario (Attorney General) v. 8477 Darlington Crescent*, [2011] ONCA 363, at paras 86-87 (ONCA).
[2] *Falk Bros. Industries Ltd. v. Elance Steel Fabricating Co.*,[1989] 2 S.C.R. 778, at p. 783 (SCC).

> ***where there has been imperfect compliance with a statutory condition as to the proof of loss*** to be given by the insured or other matter or thing required to be done or omitted by the insured with respect to the loss and a consequent forfeiture or avoidance of the insurance in whole or in part and ***the court considers it inequitable*** that the insurance should be forfeited or avoided on that ground, ***the court may relieve against the forfeiture*** or avoidance on such terms as it considers just.[3]

Section 98 of the *Courts of Justice Act* provides that "a court may grant relief against penalties and forfeitures, on such terms as to compensation or otherwise as are considered just".[4]

As directed by the Supreme Court in *Saskatchewan River Bungalows*, in exercising its discretion to grant relief from forfeiture, the court must first consider the threshold question of whether the breach constitutes ***imperfect compliance*** or ***total non-compliance*** with the contract. Relief against forfeiture is not available in cases of total non-compliance. Where there is *imperfect* compliance, the next step is to determine whether relief from forfeiture is warranted in a particular case. In this regard, the court is required to examine the following 3 factors:

1) the conduct of the plaintiff;
2) the gravity of the breach and prejudice; and
3) the disparity between the property forfeited and the damage caused by the breach.[5]

The circumstances where it would be "inequitable" to strictly enforce the terms of the contract to deny its benefits to the party in breach vary from case to case, and are not always straightforward. In this article, we examine the factors considered in the exercise of the courts' discretion to relieve a party from the consequences of his or her breach by referring to the reasons in *Monk v. Farmers Mutual* where Justice Koke declined to grant relief from forfeiture and dismissed the insured's claim accordingly.

II. *MONK V. FARMERS MUTUAL INSURANCE CO. (LINDSAY)*, 2017 O.J. NO. 4252

This action arose out of alleged property damage to the insured's log home (including stained carpets, scratched glass panes of windows and doors, and damaged exterior light fixtures), caused by the contractor retained to, among other things, restore the exterior logs and wooden surface areas of the property. During the material time, Ms. Monk was insured by an all-risk homeowner's policy arranged through her broker (the "Policy").

The insurer defended the claim on the basis that: (a) the damage was excluded; and, in the alternative, (b) that the insured breached the Policy by failing to provide notice of her loss forthwith contrary to statutory condition 6.

At trial, Justice Koke found as fact that the first time Ms. Monk spoke to her broker about the damages caused by the contractor was on September 2, 2011, being a period of ***2 years and 9 months*** after she first discovered the damage to her property. In addressing the consequences of this delay in his Reasons, Justice Koke provided an important analysis of the equitable remedy of *relief from forfeiture* and underscored the importance of the notice provisions in standard insurance policies.

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[3] *Insurance Act*, R.S.O. 1990 c. I.8 as amended, s. 129.

[4] *Courts of Justice Act*, R.S.O. 1990, c. C. 43, s. 98. Unlike s. 129 of the *Insurance Act* which provides relief *only* with respect to the failure to comply with the statutory or contractual condition as to proof of loss in an insurance policy, Section 98 of the *CJA* provides for relief from forfeiture generally.

[5] *Saskatchewan River Bungalows v. Maritime Life Assurance Co*., [1994] 2 S.C.R. 490 (SCC).

III. BREACH OF SC 6 IN *MONK*

1) Standard Notice Requirements

Statutory Condition #6 (included in Ms. Monk's home-owner's policy), provided that upon the occurrence of any loss or damage, the insured shall:

(a) give notice of the loss or damage to the insurer "***forthwith***";
(b) deliver, "***as soon as practicable***" a proof of loss verified by a statutory declaration,

(i) giving a complete inventory of the destroyed and damaged property and showing in detail quantities, costs, actual cash value and particulars of amounts claimed.

2) The Breach

It was the broker's evidence at trial that any damage to the insured's property was first reported during a meeting between the parties held in September, 2011. Since the September 2011 meeting occurred ***2 years and 9 months*** after Ms. Monk ought to have reasonably discovered damage to her property, we argued that Ms. Monk was in breach of SC6.

In an attempt to explain her delay, Ms. Monk claimed that she notified the broker of her loss on three different occasions prior to the September, 2011 meeting. She further claimed that on each of these three occasions, she was told that her loss was not covered.

Upon weighing the evidence, Justice Koke accepted our position and rejected Ms. Monk's claim that she reported her loss prior to the September 2011 meeting. In arriving at this conclusion, his Honour took several factors into account, including the following:

- the broker was thorough, conscientious and dedicated to her work, and reliable as a witness;
- the broker's lengthy, concerned email to Ms. Monk on the day following the September 2011 meeting was consistent with having just learned about the damage the day before;
- there was no evidence to support the assertion that the broker simply forgot about 3 prior conversations with Ms. Monk;
- the broker's file was thoroughly documented re: prior times Ms. Monk contacted her about potential losses;
- there was an inconsistency between Ms. Monk's position of two reports to her broker in 2009 and her statement to the insurer that she did not discover the damage until 2010;
- the evidence of the witness put forward to support Ms. Monk's position[6] was neither reliable nor believable; and
- Ms. Monk's evidence was contradictory, misleading, and plainly self-serving.

Justice Koke thus concluded that the insured failed to report property damage to her insurer "forthwith", thereby breaching the notice requirements of SC 6. Having concluded that Ms. Monk was in breach of the statutory condition, Justice Koke then considered whether she was entitled to relief from forfeiture.

IV. RELIEF FROM FORFEITURE ANALYSIS IN *MONK*

1) Threshold Issue: Imperfect Compliance vs. Non-Compliance

[6] The witness claimed to have overheard previous conversations between Ms. Monk and the broker.

Section 129 of the *Act* is consistent with well-established jurisprudence that relief from forfeiture is only available in cases of *imperfect* compliance with a statutory condition; this section does not apply where the insured has failed to comply with a statutory condition altogether.[7]

Since the language of SC 6 requires the insured to provide notice of any loss or damage to the insurer "forthwith", the threshold issue before Justice Koke whether Ms. Monk's failure to deliver timely notice to her insurer constituted "imperfect" compliance or total non-compliance.

Koke J. concluded that since the policy at issue was an "occurrence based" policy and since Ms. Monk's breach was a failure to give timely notice rather than a failure to bring an action within a prescribed time, her breach of SC No. 6 constituted imperfect compliance rather than non-compliance. She was therefore allowed to claim relief from forfeiture under section 129 of the *Insurance Act*, and the remaining question before the court was whether such relief was warranted in this case.

2) The Conduct of the Plaintiff – Was it Reasonable?

It should be recalled that relief from forfeiture is an equitable remedy. As with all equitable relief, the person seeking it must "*come to court with clean hands*". This maxim is sometimes also expressed as "*those seeking equity must do equity*". It means that equitable relief is not available to those whose conduct is tainted by bad faith or fraud in relation to the matter for which they seek relief, regardless of any improper behavior on the part of the defendant. The doctrine of clean hands is rooted in the historical origin of the court of equity as a vehicle for enforcing the values of fairness and good faith.

To determine whether the insured has come to court with "clean hands", the court needs to examine the insured's conduct, including, "the reasonableness of [the insured's] conduct as it relates to all facets of the contractual relationship, including the breach in issue and the aftermath of the breach".[8]

In this case, Justice Koke simply did not believe Ms. Monk. His Honour concluded that Ms. Monk not only failed to explain the delay in reporting her loss, but that she also attempted to mislead the insurer with respect to the date her damages were discovered. He found her evidence with respect to the discovery and reporting of her loss to be "contradictory" and "self-serving" as well as altogether inconsistent with the record. In these circumstances, Ms. Monk's conduct, including her conduct in the aftermath of the breach of SC 6 fell far short of meeting the reasonableness test.

This was not simply a case of a minor lapse in judgment. This case involved an intentional breach of the policy, compounded by falsehoods used in an effort to avoid the consequences of the breach. As she did not come to court with clean hands, Ms. Monk could not benefit from an equitable remedy, and the loss of the entirety of the benefits under the policy was justified.

3) Gravity of the Breach and Prejudice

Notice provisions in SC 6 are crucial – particularly in property damage cases, since a homeowner's failure to provide timely notice affects the insurer's ability to inspect the property, conduct an investigation and assess the

[7] For instance, in *Kozel v. Personal Insurance Co*., [2014] O.J. No. 753, at paras 33 & 34 (SCJ), no proof of loss was *ever* served, and as such, relief from forfeiture was not available. See also: *Falk Brothers*, supra and *Stuart v. Hutchins*, (1998), 40 O.R. (3d) 321 (Ont. C.A.).

[8] *Monk v. Farmers' Mutual*, supra, at para 210, citing *Buurman v. The Dominion of Canada General Insurance Company*, [2015] ONSC 6444, at para 30 (SCJ).

damage, which in turn critically impacts coverage, quantum, and any subrogation rights that may be available to the insurer.

As Koke J. correctly observed, the notice provisions have taken on an even greater significance following the 2014 decision of the Court of Appeal in *Schmitz v. Lombard.*[9] In that case, the court ruled that in the context of first party insurance claims, the limitation period pursuant to the *Limitations Act* does not begin to run until ***a day after the insured makes a claim for indemnity.*** This ruling effectively leaves the insurer without a limitation period defence, since in theory, the insured could choose to wait indefinitely to make a claim that would trigger the limitation period.

As the Court of Appeal pointed out in *Schmitz*, the insurer's only protection in case of such unreasonable delay on the part of the insured is the inclusion of the timely notice requirement in the policy. The court held:

> Furthermore, we do not agree with Lombard's submission that this interpretation prejudices underinsurers facing claims under the OPCF 44R. ***There are a number of ways in which underinsurers can protect their interests including*** those provided in s. 14 of the OPCF 44R and ***through a provision requiring the insured to provide timely notice to the insurer when he knew or ought to have known he was underinsured.***[10]

In effect, the court ruled that since notice provisions in insurance policies require the insured to give timely notice and deliver a proof of loss, these notice provisions will be sufficient to alleviate prejudice to the insurer in the event the insured choses to unreasonably delay making a claim for indemnity and thereby delay the running of the limitation period under the *Limitations Act.*

Given the importance of the notice provisions, especially in the post-*Schmitz* era, the challenge now facing the courts is to strike the appropriate balance between competing interests: that is, the insurer's right to promptly and fully investigate the loss and bring a subrogated action on the one hand, and the insured's right not be denied the benefits of an insurance policy because of an inadvertent, minor policy breach that did not prejudice the insurer.

To balance these competing interests, the court must assess "both the nature of the breach itself and the impact of that breach on the contractual rights of the other party".[11] In this case, after examining the evidence, Koke J. concluded that the insurer was in fact seriously prejudiced as a result of the insured's failure to report her loss in a timely manner. The prejudice to the insurer included the following:

- First, the insurer lost the ability to investigate the circumstances and value of the loss as of the date of the occurrence. By the time the loss was reported, Ms. Monk had already replaced the damaged carpets and light fixtures, and painted her windows.

- Second, the insurer lost the ability to take early remedial/mitigating action to reduce its potential exposure.

- Third (and perhaps most importantly), the insurer lost its right to subrogate against the contractor whose negligence caused the damage, as that action was statute-

[9] *Schmitz v. Lombard General Insurance Company of Canada*, [2014] ONCA 88.
[10] *Schmitz v. Lombard*, supra, at para 21.
[11] *Monk v. Farmers' Mutual*, supra, at para 215, citing *Buurman v. The Dominion of Canada General Insurance Company*, [2015] ONSC 6444, at para 30 (SCJ).

barred by the time the insured reported her loss.

- Finally, even if the subrogated action could have been brought, the insurer was irreparably prejudiced by the passage of time, in that the owner/principal of the contractor had passed away during the course of the delay, and would have been unable to testify.

According to Koke J., the prejudice suffered by the insurer in this case was "precisely the type of prejudice from lack of notice that the court in *Schmitz* was addressing".

Whereas pre-*Schmitz*, relief from forfeiture was more readily granted, following *Schmitz* the criteria for obtaining this relief is – not surprisingly – more stringently applied. This case thus represents the current trend in case law, one that we expect to continue, whereby: (1) the standard notice provisions are afforded greater significance; and (2) relief from forfeiture following a breach of those provisions is granted much more sparingly. This is particularly the case where, as here, the insurer's rights to investigate and subrogate have been seriously and irreparably compromised by the delay.

4) Proportionality Analysis: What is the Disparity between the value of the property forfeited and the damages caused by the breach?

Justice Koke estimated the value of the property forfeited by Ms. Monk to be approximately $100,000. While this was considerable, the prejudice to the insurer resulting from Ms. Monk's failure to provide timely notice was also significant: had it received timely notice, the insurer may well have been able to take steps to recover or mitigate its loss vis-à-vis the contractor. As it stands, it could not be said that the property forfeited would be disproportional to the damages caused by the breach.

V. CONCLUSION

In sum, Justice Koke was satisfied that relief from forfeiture was not warranted in this case and Ms. Monk's claim against the insurer was dismissed in its entirety.

So what should the insurers take away from this case?

1. The conduct of the insured, including his or her conduct following the breach – matters. Although it has now been codified by statute, relief from forfeiture originated in the courts of equity. To benefit from the exercise of the court's discretion, the insured must come to court with "clean hands". Where there is evidence that the insured has acted in bad faith, has attempted to mislead the insurer (or the court), and where the insured's evidence is inconsistent with the record or is plainly self-serving, relief from forfeiture will not be available. The insurers and their counsel are well-advised to conduct a careful investigation to determine whether the insured has acted honestly, reasonably and in good faith.

2. Documentation – matters. The key to establishing prejudice is to document it early in the proceedings. For instance, upon being notified of the damage, insurers are well advised to make immediate requests to inspect the damage, conduct a fulsome investigation, interview witnesses and/or conduct an appraisal. If these requests are denied because the property had been sold or repaired and/or witnesses are no longer available, then prejudice can be established. It is crucial for insurers not to wait until trial to raise the issue of prejudice for the first time.

3. Prejudice – matters. Delay, in and of itself, will not convince the court that relief from forfeiture should not be granted. For insurers, it is crucial to establish that delay in

reporting resulted in prejudice. Where, as in this case, during the course of the delay, (i) property damage has been repaired; (ii) the insurer is unable to conduct an independent investigation or take remedial/mitigating action to reduce its potential exposure; (iii) a witness dies or otherwise becomes unavailable; or, in particular, (iv) where a plaintiff's delay compromises the insurer's subrogation rights – the insured is highly unlikely to be granted relief from forfeiture.

4. Notice provisions – matter. Following *Schmitz*, the notice provisions in standard insurance policies have taken on a greater significance. Prior to *Schmitz*, relief from forfeiture in respect of the insured's failure to provide timely notice of his or her loss was more readily granted. Following *Schmitz*, the insurer has been effectively left without a limitation period defence in cases where the insured unreasonably delays making a claim for indemnity. As the Court of Appeal emphasized, the insurer's only protection in such circumstances remains the requirement in SC 6, that the insured give notice of the loss or damage "*forthwith*" and deliver a proof of loss "*as soon as practicable*". In light of the new legal landscape created by *Schmitz*, the courts are expected to be both more strict in the exercise of their discretion where relief from forfeiture is sought and to grant such relief more sparingly.

As illustrated by the decision in *Monk*, where a breach of SC 6 notice provisions results in actual prejudice to the insurer, the courts will be loathe to assist the insured by way of relief from forfeiture.

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