



SMHI LEGAL NOTES

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A Corporate David and Goliath Story

David 1: Goliath 0 - So read the headline in the *Cobourg Daily Star*, Reg Ward's hometown newspaper. This had been an epic battle, pitting a small town insurance agent against one of Canada's largest insurance companies.

A Business is Born

In 1967, Reg Ward became an insurance agent affiliated with Monarch Life. With persistence and hard work Reg built up a solid reputation with the company and became one of Monarch's top salespeople. In 1983, Reg became associated with North America Life when it purchased Monarch.

In 1991, Reg entered into an agreement with North American Life to be paid 5% commissions on all policies he had sold from 1967 onwards. These commissions represented his retirement fund and the right to receive them had vested.

In 1996, North America Life and Manulife merged their operations and continued operating under the Manulife name. Following the merger, Reg was presented with a new agreement, entitled the Producer's Agreement, on a take it or leave it basis. Although it was a complicated agreement, it was not explained to Reg. Reg ultimately signed the agreement since he was required to have a contract with an insurer in order to keep his business. At this time he was assured that the vested premiums would continue.

The Investigation

A year after the merger, things turned sour for Reg. Without any notice, Manulife commenced an internal investigation of the Ward agency. For no reason, Manulife then gave Reg a 30-day notice terminating his Producer's Agreement.

In the months following the termination Manulife assigned Reg's clients to other agents, it sent Reg a cease and desist letter when he began contacting his clients in an attempt to salvage his business and it froze his commission account. Manulife also filed complaints with the Ontario Insurance Commission in an attempt to have Reg's licence suspended and made threats about contacting the RCMP's fraud unit.

Reg was not a young man and Manulife's actions began to take a toll on his health. Instead of looking forward to his retirement, Reg was now forced to continue working to support himself and his wife.

The Trial

This David and Goliath battle came to a head in May 2005 when the parties were able to present their respective stories and evidence at trial.

Reg accused Manulife of a number of wrongdoings, including that Manulife

- acted in a high-handed manner with disregard for his rights prior to and following his termination;
- breached their contract; and
- breached the fiduciary duty owed to him.

For its part, Manulife argued that it had acted within its contractual rights to terminate the agreement as it did and that, pursuant to the Producer's Agreement, it had the right to freeze the payment of commissions owing to Reg.

The Trial Decision

The Court's decision was a complete vindication of Reg Ward, as all major issues were decided in his favour.

Duty of Good Faith and Fiduciary Duty

The Court concluded that Manulife owed a fiduciary duty to Reg and that it had breached that duty. Although the Producer's Agreement was a commercial contract, the Court found that this was not a situation where there were two parties dealing with each other possessing equal bargaining power.

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The articles in SMHI Legal Notes are necessarily of a general nature and cannot be regarded as legal advice. Our firm will be pleased to provide additional details on request.

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In addition, the trial judge found that Manulife had acted in bad faith toward Reg and that it had breached its duty of good faith in the administration, execution, termination and post-termination of the Producer's Agreement. The reasons supporting these breaches of duty included:

- the inequality of bargaining power between the parties;
- the manner in which Manulife presented the Producer's Agreement to Reg for signature;
- Manulife's published corporate value that "all of our dealings are characterized by the highest levels of honesty and fairness. We develop trust by maintaining the highest ethical principles"; and
- the vulnerability of Reg under the agreement.

Punitive Damages

The Court characterized Manulife's conduct as self-serving, malicious, arbitrary and high-handed. These deliberate and indefensible actions deserved punishment and as such the Court awarded Reg punitive damages in the amount of \$250,000, one of the highest such awards ever in Canada.

The Award

Reg received a judgment of \$267,000 representing past earned commission income. Manulife was ordered to provide for payment of commissions in the future as per the parties' agreement. Reg was also awarded damages in the amount of \$150,000 for Manulife's breach of its fiduciary duty in addition to the \$250,000 punitive damages.

The Appeal

Despite Reg's clear victory, Manulife chose to appeal the decision, which meant that Reg could still not get his money.

This past December, the Ontario Court of Appeal handed down its decision. It found no palpable or overriding errors by the trial judge and the Court upheld the decision on all of the major points.

The Lessons

It is wise to review all contracts before signing them. Even if you are not in a position to negotiate changes to the contract it is important that you understand what you are agreeing to.

If there is a power imbalance between the parties to a contract, even in a commercial context, the stronger party will generally have an obligation to act fairly and to put the interests of the weaker party ahead of its own.

The general rule is that an agent owes a fiduciary duty to his or her principal. However, if the principal is in the stronger position, the principal may find him or herself in the role of fiduciary, along with the attendant obligations. 

New Year - New Laws

As of **January 1, 2008**, the GST is 5%.

Beginning **January 31, 2008** you require a government issued photo id and a birth certificate (or other proof of citizenship) OR a valid passport or NEXUS card to enter the United States by land or water. To find out more visit the Canada Border Services Agency website at www.cbsa.gc.ca

Ontario has a new statutory holiday called Family Day. This holiday will occur annually the third Monday in February. This year's holiday is on **February 18, 2008**.

Ontario's *Human Rights Code* has undergone substantial changes, including to the way complaints will be handled. You can learn more about these changes, which will take effect on **June 30, 2008**, by going to www.ohrc.on.ca

The federal government has created a Registered Disability Savings Plans (RDSP). The legislation has received Royal Assent, but it is **not yet in force**. 

Employer Amnesty

If you are an employer who is required to register with the Workplace Safety & Insurance Board (WSIB) and have failed to do so AND you have not yet been identified by the WSIB as a non-compliant employer, then you have an opportunity to voluntarily register and take advantage of an amnesty offered by the WSIB.

If you voluntarily register by **March 31, 2008**, you will be able to take advantage of a full amnesty pursuant to which you will be charged no arrears of premiums, interest or penalty and will not face prosecution.

If you voluntarily register by **April 1, 2008**, there will be a partial amnesty. You will not be subject to any interest, penalty or prosecution, but you will have to pay arrears of premiums back to the date that your company first hired an employee or January 1st of the year preceding your registration, whichever is later.

By taking advantage of this amnesty your company will come into compliance with the law and you will be able to provide both your company and your employees with the benefits and protections of WSIB.

When is a Car Accident Not a Car Accident?

The Supreme Court of Canada recently ruled in two cases that questioned the scope of auto insurance: *Lumbermens Mutual Casualty Co v. Herbison* and *Citadel General Assurance Co. v. Vytlingam*. Specifically, the Court was asked to consider the sufficiency of the connection between the acts that caused the plaintiffs' injuries and the use of the wrongdoers' vehicles.

The Herbison Case

The Facts

Herbison and his pal Wolfe decided to go deer hunting. Because he had a heart condition, Wolfe made the decision to drive his pick-up truck to the assigned hunting area. While driving to the hunting station, Wolfe spotted what he thought was a deer.

With the engine still running, Wolfe got out of his truck and stepped about three feet away from the vehicle. He then shot at the flash of white that he believed was a deer. Unfortunately, the deer turned out to be Herbison. As a result of being shot Herbison suffered a serious injury to his upper thigh.

Herbison sued Wolfe for damages and was awarded \$832,272.85. Herbison then went after Wolfe's automobile insurance company to recover the damage award. He argued that the insurance company should pay the damages since his loss arose from the ownership or directly or indirectly from the use or operation of Wolfe's vehicle.

Ontario Court of Appeal Decision

The Court of Appeal concluded that Wolfe's vehicle had been put to a known use, i.e. to transport people. They also found that the connection between Wolfe's truck and Herbison's injuries was sufficient to attract liability. The result was that Wolfe's insurer had to pay out to Herbison. Underlying this reasoning was the court's finding that the legislature has sought to provide injured persons with extensive vehicle liability compensation.

The Vytlingam Case

The Facts

Vytlingam, his sister and his mother were driving along the interstate in North Carolina when their vehicle was struck by a boulder thrown from an overpass by Farmer. Vytlingam suffered very serious injuries and he received no-fault benefits from his insurer. However, his insurer refused to pay benefits under the inadequately insured motorist coverage, i.e. the amount the uninsured Farmer ought to have paid by way of civil damages.

Ontario Court of Appeal

The Court of Appeal concluded that, since Farmer's car had been used to transport the rock to the scene of the crime and then to escape, the insurance company was liable to pay Vytlingam's claim.

The Supreme Court of Canada

Although the facts in these two cases are quite different, the issue raised was the same: Was the act that caused the victim's injuries sufficiently connected to the wrongdoer's use and operation of his vehicle such that the latter's auto insurance should pay benefits?

In both of these cases the Supreme Court ruled that there was not a sufficient connection between the vehicles' use and the injuries suffered.

With respect to the *Herbison* case, the Court concluded that when Wolfe stepped away from his truck and negligently shot at a target that he could not see and which turned out to be his friend, the friend's injuries did not arise "directly or indirectly from the use or operation" of the insured truck.

In the *Vytlingam* case, although Farmer used his vehicle to transport the boulder to the overpass, the Court found that Vytlingam's injuries were caused by the rock being thrown, not by it being transported in Farmer's vehicle.

In reaching the conclusion it did, the Supreme Court considered two questions.

1. Was the motor vehicle in question being used for its usual purpose?
2. Was there an unbroken chain of causation linking the injuries to the use and operation of the motor vehicle?

Although Wolfe and Farmer had indeed been using their vehicles for the usual transportation purpose, that usual purpose was interrupted. It was those interruptions, the shooting and the rock throwing, that caused the injuries, not the use of the motor vehicles. The Supreme Court found that the Court of Appeal had failed to give sufficient weight to those separate, distinct and intervening acts.

These decisions demonstrate that, when determining whether insurance coverage arises, the tragedy of the circumstances must be set aside. Instead one must look to the use that the relevant motor vehicle was put to and whether it was that use that led to the damages. 

Part 2: The Handoff

In the Spring 2007 edition of *SMHI Legal Notes*, we asked the question “Is your family’s business ready for the hand off?” If it is your hope that your business will continue to thrive when you are no longer involved, a succession plan is crucial. A succession plan will detail how the business should be managed by the next generation following your retirement. The plan will also outline strategies for reducing the future tax burden.

In our original article we provided an overview of the key steps that are involved in a successful succession plan. Those steps are:

1. Gathering the necessary information and deciding on the viability of keeping the business in the family.
2. Developing a plan for succession, which includes a timeline.
3. Implementing the plan.

Creating an effective plan is a complex process. But the experienced help of professionals can smooth the way. One of the main areas that you will want advice on is the area of tax planning.

When an individual dies, the tax laws deem that all the individual’s assets are disposed of at fair market value. If the individual’s business has been successful, the taxes that will be owing at the time of death are likely to be significant. However, there are a number of tools that can be used to reduce and/or defer the amount of taxes that will be owing.

The Estate Freeze

An estate freeze allows you to freeze or lock-in your tax liability at the time of your death as of today’s value. Any future gains will accrue to shares held by your children and these gains will not be taxable until they sell the shares.

There are a number of ways to effect an estate freeze, including transferring the

assets you wish to freeze to a holding company or to a trust. In addition, you can choose to do one or more partial freezes.

A lawyer who specializes in business law can advise you as to the best option for your particular situation. He or she can help you decide on the timing of a freeze, what to freeze and how much to freeze. Your lawyer can also advise you on such things as a shareholder agreement and a will, documents that will round out your succession planning.

Life Insurance

Life insurance is probably the most logical option for dealing with the taxes that will be payable at the time of the business owner’s death. Life insurance can also be used in situations where one or more children are not or cannot be involved in the business.

Life insurance will often be used in conjunction with an estate freeze.

Retirement

Before proceeding with an estate freeze, a business owner must project his or her future financial needs, particularly on retirement. There are a number of ways to create retirement income, including RRSP contributions, a retiring allowance and a redemption of frozen shares.

A discussion about your retirement fund should be dealt with as part of the overall succession planning exercise.

Deciding how your business will continue once you are gone can be a daunting prospect, but with proper advice it does not have to be.

Our firm has expertise in the area of family-owned businesses as well as estate planning. Our lawyers would be pleased to answer your questions and to assist you in this process. 

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