Notes of Cases

Jurisprudence

CONTRACT LAW—TERMINATION OF LONG TERM CONTRACTS OF EMPLOYMENT: *WALLACE* v. *TORONTO-DOMINION BANK*:—A large proportion of social and economic activity in the late twentieth century is carried out in the context of complex, long-term relations.[1] There has been increasing academic attention paid to the need to recognize this fact and consequently to modify the widely accepted contractual paradigm which is based on the presupposition that a contract is a discrete transaction.[2] The tendency to focus on the act of promising and relate all future conduct back to that act, fails to give sufficient weight to the many non-promissory aspects of relational activity. The act of promising is an attempt to communicate one's commitment to act in a specified way in the future. In a contractual setting the promise is given in exchange for a reciprocal commitment by the other contracting party.[3] However, when individuals and organizations are engaged in relational activity, promising is not the only means of establishing a basis for future exchange. Expectations develop from the ongoing relationship that the motivation and dependence which underlie the relationship will continue.[4] These expectations may much more accurately reflect the social, psychological and economic needs and tacit assumptions of the parties involved than the initial promises made when a person enters into the relation.

One of the primary contractual relations in our society is employment. The vast majority of Canadians exchange their labour through employment for economic benefits. However, the economic reward is only a part of the return which the individual is seeking. Integration into a work environment provides a large number of social contacts with fellow workers. It provides

[1] I. Macneil, The Many Future of Contract (1974), 47 So. Cal. L. Rev. 691.

[2] R. Brown, Contract Remedies in a Planned Economy: Labour Arbitration Leads the Way, in B. Reiter and J. Swan (eds.), Studies in Contract Law (1980), p. 93 [hereinafter cited Studies]; B. Reiter, Contracts, Torts, Relations and Reliance, in Studies, p. 235; Beattie, Labour is Not a Commodity, in Studies, p. 313; B. Reiter and J. Swan, Developments in Contract Law: The 1980-81 Term (1982), 3 Sup. Ct. L. Rev. 115.

[3] Macneil, *loc. cit.*, *supra*, footnote 1, at p. 715.

[4] *Ibid.*, at p. 718.

the opportunity for self expression through work. It satisfies the need for security. Involvement in the workplace is not a static, plannable situation. Changes occur, people react, expectations and dependencies develop. Legal regulation of the employment relationship relies heavily on contractual concepts. The analysis of the exchange of labour for economic benefits in terms of promises adheres to the transactional paradigm. Of particular concern is the method of determining the duration of the employment relation.[5] The employment relationship may be created gradually, through the use of training and probationary periods whereby the employee is evaluated and eased into the organizational structure. Alternatively, it may be created very sharply where the individual is fitted into an existing slot. Similarly, the relationship may be ended gradually, such as through retirement where the employee's right to a pension may mean the relationship is never entirely severed, or by the employer giving the employee a long period of notice and assistance in finding alternative employment. Finally, the relationship may be terminated very abruptly at the employer's insistence, with no forewarning, no help in adjusting, perhaps entirely contrary to what the employee expected or relied upon.

In analyzing the legal rights with respect to the duration of the employment contract, English and Canadian courts no longer presume contracts to be of a determinate duration. Rather, they are treated as of indefinite duration but terminable by either party on the giving of reasonable notice. This recognition of indeterminate duration and a somewhat gradual process of termination may be said to recognize to some extent the relational nature of employment. Much will of course depend on the amount of notice deemed to be reasonable. Short periods would limit future conduct only to a minimum degree[6] whereas longer periods, as Canadian courts have had a tendency to require as of late, would significantly fetter future conduct. However, in practice the termination may be much more abrupt. The employer may pay wages in lieu of notice.[7] Furthermore, the courts may defer to any agreement that may have been made by the parties respecting the duration or method of termination. In this context, the recent decision of the Ontario Court of Appeal in *Wallace* v. *Toronto-Dominion Bank*[8] will be used as a basis for discussing the problems of relying on such initial promises after a long-standing relationship has been created.

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[5] This analysis is based on Macneil, *ibid.*, at pp. 750-753.

[6] P. Atiyah, The Rise and Fall of Freedom of Contract (1979), p. 197.

[7] Consider however the circumstances of mass redundancy, where the total costs of payment in lieu may be prohibitive. Also, statutes in some jurisdictions now call on the employer to be more extensively involved in helping employees adjust to termination: see e.g. Employment Standards Act, R.S.O. 1980, c. 137, s. 40(5) as am. S.O. 1981, c. 22, s. 1(1); Canada Labour Code, R.S.C. 1970, c. L-1, ss. 60.1-60.8 as am. R.S.C. (2nd Supp), c. 17, s. 16 and S.C. 1980-81-82-83, c. 89, ss. 32, 33.

[8] (1983), 145 D.L.R. (3d) 431, 41 O.R. (2d) 161, 83 C.L.L.C. 14,031 (Ont. C.A.) rev'g in part (1981), 39 O.R. (2d) 350, 81 C.L.L.C. 14, 122 (Ont. H.C.).

The Facts

The facts in *Wallace* are not complex or unusual. The plaintiff was a university-educated chartered accountant. After six years of work with two trust companies he was looking for a new challenge, and through an employment agency came into initial contact with the defendant, a large Canadian bank. He was hired on probation and after three months was taken permanently into the fold. Shortly thereafter, he signed an employment contract which dealt with the duties owed to the bank, participation in the pension plan, and the right of either party to terminate employment upon giving four weeks notice or, in the case of the employer, by paying all salary owed for time already worked plus salary for an additional four weeks.

Wallace continued to work for the bank for eight years. He started as a systems research analyst, the field he wanted to get into. Before his probationary period had ended he transferred to the Inspection Department at the bank's request. It agreed to increase his salary and made a moral commitment to transfer him to general banking operations at the end of three years. After four years of highly evaluated performance, the plaintiff was transferred, at his request, to the general banking stream. It was necessary for him to undergo a period of training which the bank thought would take twelve to eighteen months. It in fact took him twenty-four months to complete his training; although the delay was due to circumstances not fully within his control, the bank was dissatisfied with the time it took. He was then assigned as assistant manager of a branch of the bank. His salary was at a rate higher than normal for someone in this position because he carried over his rate from his previous position. The bank continued to be dissatisfied with his progress, and finally took steps which led to the plaintiff leaving his employment. It unilaterally imposed a probationary period on Wallace, and despite the fact that his evaluation showed improvement, it went ahead with a substantial cut in salary. It was found by the trial judge that the plaintiff had not acquiesced in these changes, and that they in fact amounted to a constructive dismissal. Internal bank correspondence indicated that personnel staff within the bank were concerned about the legal ramifications of their actions. At the same time, they foresaw, and indeed expected, that the plaintiff would not remain after the reduction in salary.

The trial judge rejected the bank's allegations that the plaintiff was incompetent, and since there was a constructive dismissal, and not a resignation, he held that the employer was in breach of the employment contract. In assessing damages, the contract of employment signed by the employee was held to be unenforceable. The Court determined that Wallace was entitled to twelve months notice, and damages were measured in accordance with salary and benefits that would have been earned during that time.

The Court of Appeal accepted the trial judge's finding of constructive dismissal, but, by a majority, held that the signed contract was binding. Wallace was therefore entitled to only four weeks notice, and damages were calculated accordingly.

Analysis

An agreement between an employer and employee allowing unilateral termination by one of the parties by giving a specified, often minimal, notice is not uncommon. Should the employee (or the employer) be able to claim a number of years later that the contractually stipulated amount of notice is no longer applicable, and that a longer, more reasonable period of notice, is due? There are a number of grounds on which such an argument can be made: (1) there was no *consensus ad idem*; (2) consent was vitiated by any of a number of factors such as fraud, misrepresentation, mistake, duress, inequality of bargaining power or unconscionability; (3) there was no intention that the terms would be applicable to changed circumstances; (4) there has been a variation of the contract; (5) the employer has waived its right to terminate unilaterally by giving only minimal notice; (6) the term is no longer enforceable due to lapse of time; (7) the contractual provision should be narrowly construed; and (8) the employer, by breaching the contract, is not permitted to rely on the clause to limit damages.

Contractual analysis places heavy emphasis on the element of consent, "the great legitimizing element of private ordering".[9] Hence, if one can convince a court that there is no true consent to the arrangement whereby the employer has attempted to reduce the period of notice he would otherwise be required to give, the court will revert to an implication that reasonable notice is due. If a contract is dealing primarily with other issues, a court may, on appropriate evidence, find that there has been no agreement to the clause dealing with termination.[10] No consensus was found in a case where the employer had inserted a provision in the personnel relations handbook limiting the amounts of notice to which the employees were entitled, even though the plaintiff had become aware of the provision a short time before his dismissal.[11]

The courts have generally been willing to find that a person has not agreed to the terms of a contract where they have been contained on a ticket or notice and no reasonable effort has been made to bring them to his or her

[9] Beattie, *loc. cit., supra,* footnote 2, at p. 331.

[10] *Allison* v. *Amoco Production Co.* (1975), 58 D.L.R. (3d) 233, [1975] 5 W.W.R. 501 (Alta. T.D.); *Chadburn* v. *Sinclair Canada Oil Co.* (1966), 57 W.W.R. 477 (Alta. T.D.).

[11] *Gardner* v. *Rockwell International of Canada Ltd* (1975), 59 D.L.R. (3d) 513, 9 O.R. (2d) 105, 513 (Ont. H.C.).

attention.[12] However, it has been rather firmly established, at least until recently, that if a party has signed the contract then, in the absence of fraud, no independent evidence of assent to the terms is required.[13] In *Wallace*, the plaintiff had signed the document containing the termination provision. Here was an objective manifestation of his assent, on which, by classical analysis, the employer was entitled to rely.[14] At trial, the only evidence given by the plaintiff was that he could not recall the circumstances surrounding the signing. However, in many such situations, the document is signed without it being read. In this particular case, the contract was not the result of negotiation. No mention of termination provisions had been made when Wallace started work. The document was signed ten days after the end of his probationary period, was on a standard form, and it was admitted by a witness for the bank that employees are not usually given any time to review the contract, let alone to seek legal advice. Thus, the element of consent was marginal at best.

The Court of Appeal was unwilling to infer from the plaintiff's lack of recall that he had not considered or contemplated the terms of the document he signed, or was unaware of the future effect of those terms. The lack of evidence on this point and the failure to plead clearly and bring into contention the validity of the contract were not well received by the Court. Although the failure to plead the point properly should serve as a warning for future litigants, the Court's attitude to the lack of evidence is more troublesome. Where a contract has been signed many years earlier, it will be an employee with unusual recall who will be able to remember the exact circumstances surrounding the signing. This gives one pause to consider the weight that should be attached to the initial promise in a long-term, not entirely commercial, relational contract.

The Ontario Court of Appeal recognized in *Tilden Rent-A-Car* v. *Clendenning*[15] that a signature by a party to a contract would not be binding where it could be demonstrated that the other party clearly knew that the signer had not read the contract. The Court went further and suggested that where the contract contains unusual or onerous terms, and is in a standard form, parties:[16]

> . . . seeking to rely on the terms of the contract know or ought to know that a signature of a party to the contract does not represent the true intention of the signer, and that the party is unaware of the stringent and onerous provisions which the standard form contains.

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[12] See, e.g. *Olley* v. *Marlborough Court, Ltd.*, [1949] 1 K.B. 532, [1949] 1 All E.R. 127 (C.A.); *Thornton* v. *Shoe Lane Parking Ltd.*, [1971] Q.B. 163, [1971] 1 All E.R. 686 (C.A.).

[13] *L'Estrange* v. *Graucob Ltd.*, [1934] K.B. 394 (C.A.).

[14] *Smith* v. *Hughes* (1871), L.R. 6 Q.B. 597 (Q.B.).

[15] (1978), 83 D.L.R. (3d) 400, 18 O.R. (2d) 601, 4 B.L.R. 50 (Ont. C.A.).

[16] *Ibid.* at p. 408 (D.L.R.), at p. 609 (O.R.), at p. 64 (B.L.R.).

A party who failed to take reasonable measures to draw the attention of the signer to such terms would not be able to rely on them.

In *Wallace*, however, the Court limited the application of *Tilden* to those types of standardized agreements where the terms are hidden in a maze of fine print. It may, in the absence of express misrepresentation, be perfectly proper to prevent persons from evading the legal effect of documents which they have signed after reading. On the other hand, a signatory who is ignorant of a wide exclusion clause in a standard form[17] should also be protected. The style of the form used should be irrelevant if there is evidence which suggests that the person relying on the contract is aware or ought to know that the signing party is unaware of the terms to which he or she is apparently agreeing. No such evidence was produced in *Wallace*, although it seemed clear that the bank did not really expect the plaintiff to read the document. Nonetheless, the failure to plead and produce evidence on this point made it difficult for the plaintiff to convince the Court that the contract should not limit the bank's obligations.

Another approach to the problem of establishing consent is to accept that the signature on the document is an objective manifestation of assent, but then to allow the signer to establish that the consent is in some way vitiated by one of a host of factors: fraud, misrepresentation, mistake, duress, inequality of bargaining power or unconscionability. In *Wallace* the trial judge was particularly concerned about several aspects of the consent. First, there was the fact that what was signed was a standard form contract which the plaintiff had little choice but to sign because of an inequality of bargaining power existing between the parties. Secondly he considered the bargain to be unfair. Hence, relying on the decisions in *Schroeder* v. *Macaulay*[18] and *Lloyds Bank Ltd.* v. *Bundy*[19] he concluded the bank could not rely on the document to limit the plaintiff's damages.[20] The majority in the Court of Appeal disagreed. It was pointed out that the plaintiff had made no allegation that, in the circumstances that existed at the time the contract was signed, a mutual right to terminate with four weeks notice was unfair; nor were there any facts to support a finding of unconscionability. However, where terms are dictated by a party whose bargaining power enables it to say, "If you want this job, these are the only terms on which they are available. Take it or leave it.", then the Court may

[17] See J. Spencer, Signature, Consent and the Rule in *L'Estrange* v. *Graucob*, [1973] Camb. L.J. 104, at p. 122. The recent decision of the Supreme Court of Canada in *Marvco Color Research Ltd.* v. *Harris et al.* (1982), 141 D.L.R. (3d) 577 indicates the strict approach that is taken where parties carelessly fail to read documents which they sign and later discover to be significantly different from what they believed. Of course, the case involved a plea of *non est factum* where an innocent third party had acted in reliance on the signature.

[18] [1974] 1 W.L.R. 1308, [1974] 3 All E.R. 616 (H.L.).

[19] [1975] 1 Q.B. 336, [1974] 3 All E.R. 757 (C.A.).

[20] *Supra*, footnote 8, at p. 363 (O.R.) pp. 276-277 (C.L.L.C.).

be justified in refusing to enforce them.[21] Not even the obtaining of independent legal advice would necessarily save such a transaction.[22]

The difficulty, of course, is in determining when there is such an inequality of bargaining power or element of unconscionability that an individual should not be required to live with the agreement that is made. Factors that must be taken into account in the employment situation include levels of unemployment, mobility of workers, the number of employment opportunities available, etc. In *Wallace* it is worth noting that the plaintiff had already been working for three months with the employer before signing the contract. This created an increased sense of dependency which would reduce the options of the plaintiff when presented with the contract.[23] He may have been in a much better position to weigh the merits of the contract if its terms had been made known to him during his job search when he was still working for his former employer.

The second difficulty is to assess the fairness of the term itself. The trial judge does not indicate the basis on which he concluded the term was unfair. His only reference, an erroneous one, is to the supposed recognition by the employer that the contract was unenforceable because it unilaterally modified it to comply with the notice and severance pay provision of the Canada Labour Code.[24] The Court of Appeal points out that the contract was in fact more generous than the provisions of the Code, and a unilateral grant of additional benefits prompted by an amendment to the Code would not impair the contract. How, then, does one decide the issue of fairness? If the legislature has enacted certain minimum periods of notice as statutory requirements, can the court say that a failure to provide for greater notice is unfair? In the absence of any express stipulation, it is clear that the courts consider a reasonable period of notice to be considerably longer than the statutory minimum. Hence the statutory minimum should not be any bar to the courts holding a particular notice period to be unfair in any particular situation. The problem of course is that it may have been quite fair to dismiss the employee with only a short period of notice soon after the employment commenced, but quite unfair to do so after the relation has continued for a substantial period of time. To quote Houlden J.A. in his dissenting opinion in *Wallace*:[25]

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[21] *Schroeder* v. *Macaulay*, *supra* footnote 15, at p. 1316 (W.L.R.), 624 (All E.R.).

[22] *Lloyds Bank* v. *Bundy*, *supra*, footnote 16, at p. 339 (Q.B.), 765 (All E.R.).

[23] See *Julie's Beauty Shoppe* v. *MacDonald* (1977), 37 N.S.R. (2d) 565 (N.S. Co. Ct.).

[24] R.S.C. 1970, c. L-1, ss. 60.4-60.8 and 61-61.2, as am. R.S.C. 1970 (2nd Supp.), c. 17, s. 16.

[25] *Supra*, footnote 8, at p. 441 (D.L.R.), p. 170 (O.R.), p. 12, 135 (C.L.L.C.). See also *Allison* v. *Amoco Production Co.*, *supra*, footnote 10, where the employee had worked for eighteen years after signing an employment contract providing for termination on thirty days notice. The Court found the terms were harsh and hence unenforceable.

> If, however, to take an extreme case, the plaintiff had remained with the Bank for 20 years and had become a vice-president, I do not believe that any court would limit the plaintiff to four weeks notice of termination and 40 days severance pay, when his employment was unjustly terminated.

The majority recognized that the basis of the plaintiff's argument was not that the term was unfair at its inception, but rather that it was unfair of the bank to invoke it after eight years of employment. It was here that the Court displayed its insensitivity to the need to develop principles which account for the growing expectations and reliance which arise from a prolonged relationship.[26] Robins J.A. acknowledged that an argument might be made that circumstances have changed so much that it was not within the contemplation of the parties that the originally agreed to notice provisions would continue to apply, but seized on the fact that the plaintiff had not advanced within the bank's job classification system since the commencement of his employment, but indeed seemed to have retrogressed. The relating of reasonable notice periods to the status of the employee has been criticized, and Robins J.A.'s viewpoint on this matter fails to reflect recent court decisions that have de-emphasized that criterion.[27]

In any event, on this point the facts in *Wallace* deserved closer examination. The plaintiff had outstanding performance evaluations during his first three years while working in the Inspection Division. The bank had made what the trial judge described as a 'moral commitment' to Wallace to accommodate his wishes to get into the general banking field if he worked for three years in the Inspection Division. After the three years, and after the plaintiff requested a transfer, the bank waited eleven months before accommodating him. The plaintiff did not prove to be quite so successful in general banking, and this of course led to the constructive dismissal. But even at the end of the unilaterally imposed probationary period the evaluation showed that the plaintiff was progressing and recommended that he be promoted to a higher level. To disregard the achievements that the plaintiff had made, and to ignore the clear commitments, albeit not in promissory form, that the bank had been making to the plaintiff over the years about the role he had to play in the bank, is a most unfortunate attitude. Wallace had made just as much a commitment and could have developed just as great expectations about the continuation of the relationship as a more 'responsible' employee with greater 'status'.

Another means that may be available in some cases to an employee wishing to attack an initial agreement is to demonstrate that there has been a

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[26] See *Nardocchio* v. *Canadian Imperial Bank of Commerce* (1979), 41 N.S.R. (2d) 26 (N.S. T.D.) where it was recognized that terms which may be fair at the commencement of the relationship would be unfair where the employee has developed new skills and gained greater experience. The evidence of circumstances surrounding the signing of the contract were remarkably similar to the *Wallace* case, but the Court was willing to find that there was no consensus about the notice provisions.

[27] Swinton, Contract Law and the Employment Relationship: The Proper Forum for Reform, in B. Reiter and J. Swan (eds.), Studies, *supra*, footnote 2, p. 257.

variation of the contract or a waiver of the termination provision by the employer.[28] To demonstrate a variation it may be necessary to show consideration for the change as well as intention and consent to vary. To show that there has been a waiver, it must be shown that there is agreement, and that the employee has altered his or her position. In this case Robins J.A. regarded the termination provision of the bank's personnel manual as demonstration that the initially agreed to notice clause was not waived or varied, but remained in effect. Yet, it was clear that Wallace was not familiar with the relevant contents of the manual, even though about nine months before termination he had actually signed a declaration acknowledging that he thoroughly understood the general regulations for bank personnel in the manual, with specific reference made to the paragraph number dealing with termination of employment. In fact, the plaintiff had never looked at this paragraph, even though he had perused the manual and was familiar with other sections dealing with confidentiality and relationships with clients. In no other way was the plaintiff informed on the continuing policy of the Bank. However, traditional contractual principles would still make it difficult to demonstrate variation or waiver. The Court will look to see if there has been a promise, express or implied, to change the term with respect to termination. It may be possible to find a variation by conduct,[29] but since termination is usually a one-time event between a particular employer and employee, no past conduct with respect to the employee on that score is likely to be available. A relational approach to contract analysis might emphasize tighter limits on the rights of parties to plan for unilateral termination.[30] Hence, an initial agreement would lose much of its force as the employee becomes firmly enmeshed in the employer's organization. In the absence of clear and free consent at a later time, the Court should be free to intervene and control unilateral termination of the relationship.

Another common device used by the courts to limit an employer's right to terminate employment unilaterally with little or no notice is to construe narrowly the clause which the employer claims gives such a right. A clause entitling the employer to cease paying wages to a ship captain if he should be ordered to leave the ship while abroad did not disentitle the captain to reasonable notice when he was dismissed without cause while the ship was in an English port.[31] Similarly, a contract permitting termination without cause at any time does not prevent the implication that it can be

[28] M. Freedland, The Contract of Employment (1976), pp. 40-76. See, e.g., *Dermody* v. *Quantas Airways Limited* (1980), 22 B.C.L.R. 269 (B.C.S.C.).

[29] Freedland, *ibid.*, p. 63.

[30] I. Macneil, Contracts: Adjustment of Long-Term Relations under Classical, Neoclassical, and Relational Contract Law (1978), 72 Nw. U.L.R. 854, at pp. 882-883.

[31] *Creen* v. *Wright* (1876), 1 C.P.D. 591.

done only upon giving reasonable notice.[32] One case suggests that where a short notice period is specified, it is intended merely to be a minimum, not prohibiting the Court from finding that a longer, more reasonable notice is due.[33] However, a number of cases accept a wider interpretation of the termination clause.[34] The same inconsistent approach is demonstrated when it is the employee who is relying on a term which defines the notice due and the employer is claiming that it does not apply.[35] However, *Wallace* seems to be the first case where the employment relationship has lasted a substantial period of time and a court has been willing to uphold the written notice provision; although a commercial contract has recently been enforced allowing unilateral termination immediately upon the giving of notice, despite a long-term relationship.[36] The Court certainly could have construed the provision as defining the minimum amount of notice due, especially in light of the bank's amendment of the termination provisions in the personnel manual when the Canada Labour Code was amended. The extent to which a court is likely to be flexible in such a matter may well depend on its view of the extent to which the parties should be able to plan for unilateral termination at some distant future time.

A final argument, one that was not expressly raised in *Wallace*, concerns the right of the employer to rely on a term defining how it may perform the contract when the employer is clearly in breach by its method of terminating.[37] From one viewpoint, the termination clause can be read as an attempt to limit liability in the event of a breach.[38] This leads to the

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[32] *In Re African Association Limited and Allen*, [1910] 1 K.B. 396; *Chadburn* v. *Sinclair Canada Oil Co.*, *supra*, footnote 10.

[33] *Allison* v. *Amoco Production Co.*, *supra* footnote 10; see also *Little* v. *Laing*, [1932] 1 W.W.R. 210 (Sask. C.A.).

[34] *McRae* v. *Marshall* (1891), 19 S.C.R. 10; *Doyle* v. *The Phoenix Insurance Co.* (1893), 25 N.S.R. 436 (N.S.S.C. *in banco*); *St. Laurent* v. *Lapointe*, [1950] B.R. 229 (Cour du Banc du Roi en Appel); *Pierce* v. *Krahn et al.* (1979), 10 Alta. L.R. 49 (Alta. T.D.).

[35] *Ellis* v. *Fruchtman* (1912), 3 W.W.R. 558 (Alta S.C. *en banc*): employee entitled to $500 if dismissed before end of term; upheld. *Buxton* v. *Lowes* (1915), 31 W.L.R. 768 (Alta A.D.): in the event employee failed to faithfully carry out employment in accordance with the contract, the employer could cancel the contract by giving three months notice. See also cases where the employee is arguing that employment is permanent; e.g., *Robinson* v. *Galt Chemical Products Ltd*, [1933] O.W.N. 502 (Ont. C.A.); *McClelland* v. *Northern Ireland General Health Services Board*, [1957] 2 All E.R. 129; [1957] 1 W.L.R. 594; 101 S.J. 355 (H.L.).

[36] *Hillis Oil and Sales Limited* v. *Wynn's Canada Ltd.* (1983), 55 N.S.R. (2d) 351 (N.S. A.D.).

[37] There is also an issue whether the bank's notice to vary, by introducing probation and reducing wages, might be treated as a notice of termination if the plaintiff did not accept the variation: Freedland, *op. cit.*, footnote 28, pp. 172-173. The Court of Appeal, however, dismissed the bank's claim that notice for the purpose of assessing damages should be considered to run from the time plaintiff was informed of the planned changes.

[38] Even if the term is not considered an exclusion clause, but rather one which regulates the manner of performance, a Court in determining damages will assume that the

possibility of arguing that the breach disentitles the defendant from relying on the term. The difficulties of the area of fundamental breach have been extensively canvassed.[39] It need only be pointed out that recent doctrinal development suggests that the mere establishment of fundamental breach, or any other breach for that matter, does not serve to end the contract, but only to discharge the parties from further performance.[40] It is always necessary to construe the contract to determine whether the parties intended the provision to apply despite the breach.[41] If they did, and if the agreement is not vitiated for the reasons discussed above, it will be applied.[42]

An alternate argument is that the doctrine of fundamental breach really has no role to play in defining contractual liability. The apparently exclusionary clause is interpreted in the context of the contract as a whole to determine the extent of the contractual obligation. If the exclusion is complete, there is no contractual liability at all and the only issue between the parties would be one of restitution. However, if the primary obligation is so limited by the exclusionary clause that the Court might think it against public policy or unconscionable to enforce the contract, it will be able to intervene to limit the freedom of the parties to define their own bargain.[43] Thus, it would appear that no matter which approach is taken, one is led back inevitably to dealing with the question of under what circumstances the parties should be able to initially limit the amount of notice due before a termination which takes place at a much later date.

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party in breach would have performed in the most beneficial manner: McGregor on Damages (14th ed., 1980), pp. 637-639. This is what the Court of Appeal did in *Wallace* in limiting damages to wages in lieu of thirty days notice. See also *Pierce* v. *Bd. Trustees Mylor School Dist.*, [1929] 3 D.L.R. 49 (Sask. C.A.); *contra*: *Allison* v. *Amoco Production Co.*, *supra*, footnote 10.

[39] For an excellent recent discussion, see M. Ogilvie, The Reception of *Photo Production Ltd.* v. *Securicor Transport Ltd.* in Canada: *Nec Tamen Consemebatur* (1982), 27 McGill L.J. 424.

[40] *Photo Production Ltd.* v. *Securicor Transport Ltd.*, [1980] A.C. 827; [1980] 1 All E.R. 556 (H.L.).

[41] In *Chomedey Aluminum Co.* v. *Belcourt Construction (Ottawa) Ltd.* (1979), 97 D.L.R. (3d) 170, Ont. 24 O.R. (2d) 1 (C.A.) aff'd [1980] S.C.R 718, (1980) 116 D.L.R. (3d) 193 Wilson J.A. in the Court of Appeal propounded a test of construction which asks not whether the exclusionary clause is fair and reasonable in this contractual setting, but whether it is fair and reasonable that it survive the disintengration of the contractual setting. It is submitted that this is a sensible test in the context of long-term relational contracts; fairness and reasonableness at the beginning is not a sufficient reason for enforcing the term at a much later point in time.

[42] However, there is still a tendency by Canadian courts to refuse to enforce an exclusion clause in the face of a fundamental breach: *Chomedey*, *ibid.*; *Nikkel* v. *Standard Group Ltd.* (1982), 16 Man. R. (2d) 71 (Man. Q.B.); *Chabot* v. *Ford Motor Co. of Canada* (1982), 138 D.L.R. (3d) 417, 39 O.R. (2d) 102 (Ont. H.C.). While it is not clear that there is any need to establish a fundamental breach to apply the above analysis, it may be helpful in arousing the court's sympathy, and make it less likely that it will find the exclusion clause to be reasonable.

[43] Ogilvie, *loc. cit.*, *supra*, footnote 39, pp. 432-435.

It is easily understandable that an employer would wish to provide a mechanism at the time an employee is hired which will allow quick termination at low cost should it prove that the employee does not really fit into the organization. Hence, the use of a probationary period and the right to give a short period of notice makes sense as the relation is being created. However, once the employee has been accepted into the fold and as the whole matrix of dependencies and expectations change, it is no longer sensible to leave the mechanism for termination solely in the hands of the employer. The development of just cause provisions in collective agreements and the move towards statutory prohibitions of discharge without cause are indicative of developing attitudes. Courts, too, should demonstrate flexibility in applying contractual doctrine to employment relationships not covered by collective bargains. This comment has shown some of the arguments upon which they might rely to justify the conclusion that an initial contract defining length of notice should not limit the notice to which a long-term employee is entitled upon wrongful dismissal.

MICHAEL J. MACNEIL*

* * *

SHAREHOLDER'S INSURABLE INTEREST—ANOTHER ATTEMPT TO SCUTTLE THE *MACAURA* v. *NORTHERN ASSURANCE CO.* DOCTRINE: *KOSMOPOULOS* v. *CONSTITUTION INSURANCE CO.*—For more than fifty years, *Macaura* v. *Northern Assurance Co.*,[1] a decision of the House of Lords, has been a leading authority for two basic propositions, the one of insurance law and the other of corporations law. The insurance law proposition is that a shareholder does not have an insurable interest in the property of his corporation because he does not have a legal or equitable interest in the property. The corporate law proposition is that the assets of a corporation are not the assets of its shareholders and that a shareholder's interest is merely the right to receive a dividend if and when declared by the corporation or otherwise due, and to receive a pro rata share of the proceeds of the net assets on a winding up of the corporation. In a recent decision, *Kosmopoulos* v. *Constitution Insurance Co.*,[2] the Ontario Court of Appeal has held that these principles do not apply to a one-person corporation and the Court distinguished *Macaura* on somewhat tenuous grounds.

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[1] [1925] A.C. 619 (H.L.).

[2] [1983] I.L.R. 6375, (1983), 42 O.R. (2d) 428 (Ont. C.A.). The style of cause is taken from the Insurance Law Reports. The style of cause appearing in the Court of Appeal's xeroxed judgment is considerably fuller.

The facts in *Kosmopoulos* were uncomplicated. The plaintiff Andreas Kosmopoulos, a Greek immigrant to Canada, opened a leather goods store in Toronto in 1972 under the name of Spring Leather Goods. He leased the business premises in his own name. Part of the premises were used by him for the manufacture of the leather goods sold in the store.

On the advice of his solicitor, Mr. Kosmopoulos incorporated a one-person corporation under the Ontario Business Corporations Act[3] under the name of K Leather Goods Limited. He became its sole shareholder and director. The business continued to be conducted under the name of Spring Leather Goods and so was the corporation's bank account. The lease to the premises, however, remained in Mr. Kosmopoulos' own name.

The plaintiff retained an insurance agent, one Aristides Roussakis, to secure insurance coverage for the business. A policy of insurance was issued by the General Accident Group covering the period March 12, 1972, to March 14, 1975. The insured was shown as Andreas Kosmopoulos O/A Spring Leather Goods. The policy was subsequently replaced by two other policies issued by the defendant companies. The replacement policies continued to show the plaintiff individually as the insured. The policies were in force when, on May 24, 1977, the business premises and their contents suffered extensive damage as the result of a fire which started on adjacent premises.

The insurers originally denied liability on the grounds of fraud, misdirection of the risk, material change in the risk, and the plaintiff's lack of insurable interest.[4] All the defences, with the exception of the last, were abandoned before or during the trial. Faced with the defence of lack of insurable interest, the plaintiff added the insurance agency as a defendant alleging that it had been negligent in not ensuring that the proper person was insured. Kosmopoulos Leather Goods Limited was also added as a co-plaintiff and sought rectification of the policies to show the corporation as the true insured.

The key issue in the trial before Holland J. was whether the plaintiff had an insurable interest in the business. The learned judge held that he did.[5] He also found that the insurance agent knew, or ought to have known, that Spring Leather Goods was owned by the corporation and was negligent in failing to ensure that the policies were issued in the corporation's name. However, he found it unnecessary to give judgment against the insurance agency in view of his finding that the insurance companies were liable on the policies in their existing state. He rejected the claim for rectification of

[3] R.S.O. 1980, c. 54. The Act was first adopted in 1970 (S.O. 1970, c. 25) and has now been superseded by the Business Corporations Act, S.O. 1982, c. 4.

[4] [1981] I.L.R. 5515, at p. 5517, (Ont. H.C.).

[5] *Ibid.*, at p. 5515.

the policies on the ground that there was no mutual mistake between the parties and that the insurance companies were not aware that the business was owned by Mr. Kosmopoulos' corporation. On appeal from Holland J.'s decision, the Ontario Court of Appeal (speaking through Zuber, J.A.) focussed exclusively on the issue of whether Kosmopoulos had an insurable interest and affirmed the trial judge's conclusion that he did.

It is easy to see why both courts had little sympathy for the insurance companies' defence. The insurance agency's representative had examined the premises and was fully conversant with the risk.[6] The defendants did not argue that they were materially prejudiced by what was only a technical defect in the description of the insured party. Nor were Holland J. or the Court of Appeal much impressed by the argument that Mr. Kosmopoulos and his company constituted separate persons in contemplation of law. As Holland J. observed,[7] "Mr. Kosmopoulos considered that he owned the business and the incorporation was for his protection only". Nevertheless, there was the formidable hurdle presented by the law lords' decision in *Macaura*. How did the two Ontario courts overcome it?

Macaura v. *Northern Assurance Co.*

Macaura was the owner of the Killymoon Estate in Northern Ireland. The estate contained a large quantity of felled and standing timber. He incorporated a company, the Irish Canadian Sawmills Ltd., of which apparently he became the sole beneficial shareholder.[8] He agreed to sell the timber to the company for 42,000 pounds and received in exchange fully paid shares in the company for the same nominal amount. Subsequent to the incorporation of the company, Macaura obtained a policy of fire insurance in his own name which covered all the timber that had been sold to the company.[9] The timber was destroyed by fire and Macaura sued on the policy. At the time of the loss the company owed Macaura 19,000

[6] *Ibid.*

[7] *Ibid.*

[8] The report does not indicate how many shareholders the company had or under which Companies Act the company was incorporated. If the company was incorporated as a private company under the Northern Ireland Companies Act, the minimum number of shareholders would have been 2. The number would have been the same if the company had been incorporated under the British Companies Act. See Stat. N.I., 22 & 23 Geo. V, c. 7, s. 1(1), and The Companies (Consolidation) Acts, 1908, 8 Edw. 7, c. 69, s. 2.

Presumably the shareholders other than Macaura were nominee shareholders and merely existed to satisfy the statutory requirements. Plaintiff's counsel treated *Macaura* as being "a case of a sole shareholder dealing with property created by his money": [1925] A.C. 619, at 622; Lord Buckmaster tells us that Macaura "or his nominees" received all of the shares ever issued by the company in satisfaction of the purchase price for the timber sold by Macaura to the Company: *Ibid.*, at 624.

[9] The report gives no explanation as to why Macaura took out the policy in his own name — whether it was because he was simply renewing or replacing an older policy or because he continued to regard himself as the *de facto* owner of the timber.

pounds for the advances made by him to the company subsequent to its incorporation.

The principal defence of lack of insurable interest was sustained by the Northern Ireland Court of Appeal and affirmed on appeal by a unanimous House of Lords. In an oft cited passage, Lord Buckmaster reasoned:[10]

> The question as to the competency of the arbitrator to determine the dispute as to the insurable interest of the plaintiff only arises if no such insurable interest can be recognized by the law, and it is this point therefore that first requires consideration. It must, in my opinion, be admitted that at first sight the facts suggest that there really was no person other than the plaintiff who was interested in the preservation of the timber. It is true that the timber was owned by the company, but practically the whole interest in the company was owned by the appellant. He would receive the benefit of any profit and on him would fall the burden of any loss. But the principles on which the decision of this case rests must be independent of the extent of the interest held. The appellant could only insure either as a creditor or as a shareholder in the company. And if he was not entitled in virtue of either of these rights he can acquire no better position by reason of the fact that he held both characters. . .
>
> Turning now to his position as shareholder, this must be independent of the extent of his share interest. If he were entitled to insure holding all the shares in the company, each shareholder would be equally entitled, if the shares were all in separate hands. Now no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest therein. He is entitled to a share in the profits while the company continues to carry on business and a share in the distribution of the surplus assets when the company is wound up. If he were at liberty to effect an insurance against loss by fire of any item of the company's property, the extent of his insurable interest could only be measured by determining the extent to which his share in the ultimate distribution would be diminished by the loss of the asset — a calculation almost impossible to make. There is no means by which such an interest can be definitely measured and no standard which can be fixed of the loss against which the contract of insurance could be regarded as an indemnity. This difficulty was realized by counsel for the appellant, who really based his case upon the contention that such a claim was recognized by authority and depended upon the proper application of the definition of insurable interest given by Lawrence J. in *Lucena* v. *Craufurd* [(1806) 2 Bos & Pul, (N.R.) 269, 127 E.R. 630 (H.L.)]. I agree with the comment of Andrews L.J. upon this case. I find equally with him a difficulty in understanding how a moral certainty can be so defined as to render it an essential part of a definite legal proposition. In the present case, though it might be regarded as a moral certainty that the appellant would suffer loss if the timber which constituted the sole asset of the company were destroyed by fire, this moral certainty becomes dissipated and lost if the asset be regarded as only one in an innumerable number of items in a company's assets and the shareholding interest be spread over a large number of individual shareholders.

The following features of Lord Buckmaster's judgment deserve to be emphasized. First, he clearly embraced Lord Eldon's narrow test of insurable interest enunciated in *Lucena* v. *Craufurd*[11] rather than Lawrence J.'s much more generous benefit-detriment test.[12] Second, he distinguished[13]

[10] *Supra*, footnote 1, pp. 625-627.

[11] (1806), 2 Bos. & Pul. (N.R.) 269, 127 E.R. 630 (H.L.).

[12] *Ibid.*, at p. 302 (Bos. & Pul.), p. 643 (E.R.). The relevant passage is quoted by Zuber J.A. in the instant case, [1983] I.L.R. 6375 at p. 6376, (1983), 42 O.R. (2d) 428 at pp. 430-431.

two earlier 19th century cases, *Paterson* v. *Harris*[14] and *Wilson* v. *Jones*,[15] which appeared to conflict with the decision in *Macaura*. He distinguished the first case on the ground that the issue of the plaintiff's insurable interest had not been argued. He distinguished the second because, as construed by the Exchequer Chamber, the plaintiff had purported to insure not the company's property, but the prospective drop in value of his shares in the company if the adventure did not succeed.

The third point worthy of emphasis in Lord Buckmaster's judgment is the additional reason given by him for refusing to recognize a shareholder's insurable interest. This was the difficulty of establishing the extent of the loss suffered if the shareholder had been deemed to have had an insurable interest. It is not clear whether he meant this to be treated as a separate ground for his decision. If he did, presumably he would have reached the same result even if Macaura had only purported to insure his interest as a shareholder in the company and not as a person claiming a direct insurable interest in the assets. This feature of Lord Buckmaster's judgment remains obscure in view of the fact that in *Wilson* v. *Jones* (a case which Lord Buckmaster distinguished but did not disapprove) the Exchequer Chamber expressly affirmed the shareholder's right to insure the value of his shares in a company. Arguably *Wilson* v. *Jones* could be distinguished because the amount of the plaintiff's loss in the event that the company's venture was not successful (the laying of the transatlantic cable) was actually quantified in the policy.

Of the other law lords in *Macaura* (Lords Atkinson, Sumner and Phillimore), only Lord Sumner delivered a reasoned judgment. He rejected the plaintiff's claim to have an insurable interest in the timber on the ground that "he stood in no 'legal or equitable relation to' the timber at all. His relation was to the company, not to its goods, and after the fire he was directly prejudiced by the paucity of the company's assets, not by the fire".[16] Lord Wrenbury, in his short concurring judgment, agreed with Lord Sumner and also regarded the plaintiff's lack of property rights in the timber as fatal to his claim. He said:[17]

> My Lords, this appeal may be disposed of by saying that the corporator even if he holds all the shares is not the corporation, and that neither he nor any creditor of the company has any property legal or equitable in the assets of the corporation.

Macaura was referred to with approval in two subsequent decisions of the Supreme Court of Canada, *Guarantee Company of North America* v. *Aqua-Land Exploration Limited*,[18] and *Wandlyn Motels Limited* v. *Com-*

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[13] *Supra*, footnote 1 at pp. 627-628.

[14] (1861), 1 B. & S. 336, 121 E.R. 740 (K.B.).

[15] (1867), L.R. 2 Ex. 139 (Exch. Chamb.).

[16] *Supra*, footnote 1 at p. 630.

[17] *Ibid.*, at p. 633.

[18] [1966] S.C.R. 133, (1965), 54 D.L.R. (2d) 229.

merce General Insurance Company,[19] although the facts in both these cases were very different from the facts in *Kosmopoulos*. Not surprisingly therefore both Holland J. and the Court of Appeal recognized that they were bound by *Macaura*. How then were they able to distinguish it from the case before them?

Macaura Distinguished

Holland J. made no serious attempt to do so. He said:[20]

> I am of the opinion that Macaura can be properly distinguished, and that on the facts of this case it would be unfair to permit the insurers to succeed in their defence. I conclude that Mr. Kosmopoulos did have an insurable interest. The defence rests its argument upon a legal fiction, a fiction that has been created for purposes relating to the conduct of the business of the corporation, its management and control, and the limited liability of its shareholders, and it has nothing to do in the circumstances of this case with the risk that was underwritten.

In reaching his conclusion, he was much influenced by a leading Tennessee Supreme Court decision to which he referred, *American Indemnity Co.* v. *Southern Missionary College*[21] The American Indemnity Co. issued a policy of insurance to the Southern Missionary College indemnifying it against loss by burglary or robbery on its premises. The College incorporated a wholly owned subsidiary to operate a college store. The college store was burglarized. Cash was taken from its safe and general damage was done to the premises. The defendant's insurance company rejected the plaintiff's claim of indemnity on the ground that the loss was suffered not by the plaintiff but by an entirely different legal entity.

The Tennessee Supreme Court rejected the defence and upheld the plaintiff's claim on two grounds. The first was that the separate personality of the subsidiary company was only a legal fiction. The second ground was that Tennessee law recognized that a shareholder has an insurable interest in the assets of his company even though he has no legal claim to any specific assets of the corporation. On the latter point, the court quoted with approval the following statement from an earlier decision:[22]

> "In 29 Am. Jur., p. 293, et seq., the general rule is said to be that, 'anyone has an insurable interest in property who derives a benefit from its existence or would suffer loss from its destruction,' and it is sufficient that a loss of the property insured not only would but might subject the insured to pecuniary injury." The foregoing is cited with approval in Baird v. Fidelity-Phoenix Fire Ins. Co., 178 Tenn. 653, 669, 162 S.W. 2d 384, 391, 140 A.L.R. 1226.

The Court refused the defendant a rehearing. Justice Tomlinson, who dissented on both occasions, adopted a position evocative of the reasoning in *Macaura*. In his view,[23] the plaintiff had suffered no direct loss at all

[19] [1970] S.C.R. 992, (1970), 12 D.L.R. (3d) 605.

[20] *Supra*, footnote 4, at p. 5518.

[21] (1953) 260 S.W. (2d) 269, (1955) 39 A.L.R. 2d 714.

[22] *Ibid.*, at p. 272 (S.W.), pp. 719-720 (A.L.R.).

[23] *Ibid.*, at p. 275 *et seq.* (S.W.), p. 722 *et seq.* (A.L.R.).

since it had no legal or equitable interest in the property of its subsidiary. The only loss to which it could lay claim was the profit which it, as a stockholder, might have received from the money that was stolen or from the fact that upon a dissolution of the company the stolen money would no longer be available for distribution. He held that the policy issued by the defendant did not cover this type of loss.

From this recital of the facts it will be seen that Holland J., in relying on *American Indemnity Co.* v. *Southern Missionary College* to justify his decision, adopted a theory of insurable interest which differed from the reasoning in *Macaura* in two basic respects. In the first place, it involved lifting the corporate veil to collapse the distinction between a corporation and its shareholders. I shall return to this issue below. Suffice it to say for the moment, that the suggestion that the corporate entity created by Mr. Macaura could be ignored for the purpose of establishing his insurable interest in the timber was not even argued before, much less accepted by, the House of Lords in *Macaura* any more than it was argued in the later Canadian cases. Presumably, in the light of *Salomon* v. *Salomon*,[24] it was felt that the separate legal personalities of a company and its shareholders was too deeply rooted to be ignored merely to accommodate a negligent, forgetful, or unsophisticated incorporator.

Secondly, it is clear that the definition of insurable interest adopted by the court in *American Idenmnity Co.* followed what in American literature is described as the factual expectation test[25] as contrasted with the legal interest test embraced in *Macaura*. It may be thought that once the corporate veil is pierced, the shareholder's insurable interest is established whichever test of insurable interest is adopted. However, this does not necessarily follow. Certainly, the Tennessee court did not deny that the legal title to the property still remained with the subsidiary company. The court emphasized the subservient role of the subsidiary merely to show that the beneficial interest in the insured assets really remained with the College, and this was all that was necessary, in the court's view, to satisfy the test of insurable interest.

My conclusion therefore is that Holland J.'s attempt to distinguish *Macaura* lacks persuasiveness. Was the Court of Appeal more successful? I do not believe it was. Rather, the Court of Appeal seized upon a distinction which is analytically and functionally difficult to sustain and may come to embarass the Ontario courts in future cases where the factual matrix is different. The distinction drawn by Zuber J.A. was this. In his view,[26] *Macaura* had only been accepted by the Supreme Court of Canada in *Guarantee Company of North America* v. *Aqua-Land Exploration*

[24] [1897] A.C. 22 (H.L.).

[25] See R. Keeton, Basic Text on Insurance Law (1971), pp. 112 *et seq.*; E. Patterson, Essentials of Insurance Law (2nd ed., 1957), p. 118 *et seq.*

[26] *Supra*, footnote 2, at p. 6378 (I.L.R.), p. 434 (O.R.).

Limited[27] as authority for the proposition that one shareholder out of three has no insurable interest in the assets of the corporation. Consequently, he reasoned, the issue of whether a sole shareholder has an insurable interest in the assets of his corporation remained open for decision in Ontario.

He recognized that before 1970 the question could not have arisen in Ontario because the corporations acts required a plurality of shareholders.[28] Since 1970, Ontario law has permitted the *de jure* incorporation of one-person corporations with only one director.[29] He thought there was no reason for imposing "the rigidity" of the *Macaura* rule on "this recent development of company law". In reaching this conclusion, he too relied heavily on the Tennessee Supreme Court's judgment in *American Indemnity Co.* v. *Southern Missionary College*, both with respect to the court's liberal interpretation of what constitutes an insurable interest and with respect to the appropriateness of lifting the corporate veil to determine the true relationship between a shareholder and his corporation.

My sympathies lie very much with the result reached in *Kosmopoulos*. Nevertheless, with all respect to Zuber J.A., the ground on which he purported to distinguish *Macaura* is untenable. In the first place, it is abundantly clear from Lord Buckmaster's judgment that he saw no distinction, for the purpose of ascertaining an insurable interest, between a one-person corporation, a closely held corporation with several shareholders, and a public corporation with widely dispersed shareholders. Plaintiff's counsel in *Macaura* essentially treated the Canadian Irish Sawmill Co. as a one-person corporation, and it is clear that the law lords conceded that Mr. Macaura was substantially the beneficial owner of the company. *De facto* one-person corporations have been commonplace in Canada as well as in England since before the turn of the present century. In recommending the legal recognition of a well established business phenomenon, the Lawrence Committee[30] thought it was merely dispensing with a useless charade. Yet, if the Court of Appeal's judgment in *Kosmopoulos* is taken at face value, it may actually encourage the reintroduction of such formalistic distinctions. It cannot surely be seriously contended that a shareholder who holds all but two of the shares in his corporation should be denied an insurable interest in the corporation's assets even though he controls it as effectively as Mr. Kosmopoulos controlled his company in the present case. Or suppose that a partnership is incorporated and that, owing to an oversight, the partners fail to notify the insurance company of the change in legal status of the business. Should they be denied recovery

[27] *Supra*, footnote 18.

[28] See e.g., The Corporations Act, R.S.O. 1960, c. 71, s. 3(1).

[29] Business Corporations Act, S.O. 1970, c. 25, now Business Corporations Act, S.O. 1982, c. 4.

[30] Ont. Legis. Assembly, *1967 Interim Report of the Select Committee on Company Law*, pp. 5 et seq.

on the insurance policy because the corporate partnership has three shareholders (or five or ten) rather than one shareholder?[31]

The Search For A New Approach

Hard cases make bad law. The Court of Appeal was forced to draw its tenuous distinction between one-person corporations and corporations with a plurality of shareholders because it was repulsed by the result to which the *Macaura* doctrine would have led in the present case. The Court's task would have been much easier had it not been bound by *Macaura*. Regrettably only the Supreme Court of Canada can now release us from this unfortunate transatlantic legacy.[32]

As the Tennessee Supreme Court's reasoning shows, the change can be accomplished in two ways. The first is by piercing the corporate veil. The weakness of this approach is that the Anglo-Canadian courts have never developed a coherent theory to rationalize the circumstances when the veil will be pierced.[33] The prevention of fraud is a universally accepted ground.[34] Parent-subsidiary relationships in which the subsidiary has no genuine existence on its own and all the strings are pulled by the parent company constitute another well recognized exception, especially in tax cases.[35] Beyond this it is difficult to speak with assurance. The Ontario

[31] A substantial number of the American cases recognizing a shareholder's insurable interest involved companies with more than one shareholder. See, for example, the cases listed in 39 A.L.R. 2d 714, at 724 et seq. and (1969) A.L.R. Later Case Service Suppl. 816.

[32] In saying this I am not unconscious of the fact that its heavy and growing public law case burden will make it increasingly difficult for the Supreme Court to hear many private law appeals. See Panel Discussion, The Future of the Supreme Court of Canada as the Final Appellate Tribunal in Private Law Litigation (1982-3), 7 C.B.L.J. 389. My colleague John Swan suggests that future provincial appellate courts should render judgment on the basis of what the Supreme Court would be likely to decide if the case were to be further appealed and such appeal was likely: *Ibid.*, pp. 411-413. There are many difficulties with this suggestion. What would be the status of such a judgment, especially where there is a previously binding decision of the Supreme Court? Would the judgment remain in limbo until the Supreme Court has spoken? What would be the position if the case is not further appealed or the Supreme Court refuses leave to appeal?

Nevertheless, the role of stare decisis in Canada needs to be reconsidered. If the Supreme Court will no longer be able to handle an adequate number of private law appeals (or to give adequate consideration to those appeals that it does hear), then other solutions must be canvassed. One alternative would be to reduce substantially the Court's case load burden in criminal cases, thus freeing up a substantial block of time for other types of appeal. The other, and perhaps more appealing, alternative would be to increase the size of the Supreme Court, thus enabling the Court to field two panels if the case load requires it.

[33] The best overview is still L.C.B. Gower's Principles of Modern Company Law, (4th ed., 1979) ch. 6. A representative list of cases will be found in S. Beck, F. Iacobucci, D. Johnston & J. Ziegel, Cases and Materials on Partnerships and Business Corporations (1983), ch. II(4).

[34] See e.g., *Big Bend Hotel Ltd* v. *Security Mutual Casualty Co.*, [1979-80] I.L.R. 807, 19 B.C.L.R. 102 (B.C.S.C.).

[35] See *De Salaberry Realties Ltd* v. *M.N.R.* (1974), 46 D.L.R. (3d) 100 (F.C.T.D.) and earlier authorities referred to in Decary J.'s judgment.

courts in particular have been less than consistent in determining when it is appropriate to lift the corporate veil.[36] It may be argued that incorporation is now so simple and inexpensive[37] that a Canadian court should never hesitate to pierce the corporate veil whenever the interests of justice require it. But this argument proves too much and, if logically pursued, could undermine the very benefits which incorporation is designed to secure. Rather, it may be urged, an entrepreneur who elects to incorporate his business must abide by the consequences of his decision. He cannot blow hot and cold. In particular, there is no obvious reason of public policy which should allow the shareholder of a one-person corporation to ignore the separate legal personality of his creation whenever he finds it convenient to do so. He (or she), unlike many others, is not an involuntary creditor of the corporation.

For all these reasons it would be unwise to rest a shareholder's ability to show an insurable interest exclusively on the court's willingness to lift the corporate veil. It is true that modern business corporation statutes also freely lift the corporate veil for the purpose of protecting employees of the corporation,[38] minority shareholders,[39] and investors.[40] Here too however there emerges no coherent principle other than that the legislatures recognize the fictitious character of the corporation and deem it desirable to lift the corporate veil whenever it appears expedient to do so.[41]

The other route, open at least to the Supreme Court of Canada, to repudiate the *Macaura* doctrine, is a more attractive one. It involves the reinstatement of Lawrence J.'s factually oriented benefit-detriment test in *Lucena* v. *Craufurd*,[42] at least to the extent of recognizing a shareholder's insurable interest. This is the path that has been followed with remarkable consistency in an almost unbroken line of American decisions since the last century.[43] Other critics have noted[44] the stifling effects of Lord Eldon's

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[36] Compare for example the decision in the present case with the decision in *Rockwell Developments Ltd* v. *Newtonbrook Plaza Ltd.* (1972), 27 D.L.R. (3d) 651, [1972] 3 O.R. 199 (Ont. C.A.).

[37] *The Globe & Mail* of 10 May 1983 reports the following news item under the heading of "*15-Minute Corporations in Six Cities get Company*: Aspiring tycoons with $200 and a free quarter-hour can now get quickie incorporations from the provincial government in seven Ontario cities. . .".

[38] E.g., Business Corporations Act, S.O. 1982, s. 131.

[39] *Ibid.*, ss. 245-46 (derivative action), s. 247 (oppression remedy).

[40] *Ibid.*, s. 156 (accessibility of financial statements of subsidiaries to shareholders of parent corporations), s. 138 (definition of "Insider").

[41] Note however Dickson J.'s cautionary (and dissenting) views in *Covert* v. *Minister of Finance of the Province of Nova Scotia*, [1980] 2 S.C.R. 774, at p. 823.

[42] *Supra*, footnote 11.

[43] For two of the earliest decisions, see *Seaman* v. *Enterprise Fire & Marine Ins. Co.* (1884) 21 F. 778 (Miss. Cir. Ct. E.D.) and *Riggs* v. *Commercial Mutual Ins. Co.* (1890) 25 N.E. 1058 (N.Y.C.A.). For some recent decisions, see *Providence Washington Ins. Co.* v. *Stanley Co.* (1968) 403 F. 2d 844 (C.A., 5th Cir.), and *Booker T. Travelers Indemnity Co.*

legal interest test and the "pernicious" result to which it leads in cases such as *Macaura*.[45] As has been noted, Holland J. and the Court of Appeal were quite ready to embrace Lawrence J.'s test, even to the extent of overlooking its incompatibility with the *Macaura* doctrine. Here too it must be hoped that the Supreme Court of Canada will not be dissuaded from adopting this more liberal test because of the fear of opening the insurance gates too widely. As others have shown,[46] the danger is remote. It is most unlikely that shareholders in public companies will rush to insure their companies' assets under any new judicial dispensation entitling them to do so.

Even if the unlikely were to happen, insurance companies could protect themselves by requiring full disclosure of the nature of the insured's risk. Lord Buckmaster's concern that it would be almost impossible to quantify the shareholder's loss resulting from damage to the company's property is not borne out by practical experience. It has not apparently given the American courts any difficulty[47] nor did it give Holland J. or the Court of Appeal any difficulty in the present case. What is true of closely held corporations is no less true of the shares of public corporations. Securities markets reflect every day the changing values of listed issues in the light of developments affecting a particular corporation as well as economic and political changes of a more general character. Likewise, courts are regularly called upon to value shares where a minority shareholder exercises a statutory right of dissent and seeks to have his shares bought out by the corporation.[48]

It must be admitted however that difficulties may arise where the corporation was legally insolvent at the time of the loss. In such a case, it

v. *Israel Co.* (1965) 354 F 2d 488 (C.A., 2nd Cir.) *Washington Ins. Co.* v. *Transcontinental Ins. Co.* (1966) 263 F. Supp. 1005 (D.C. Ala.). See further G. Couch, Cyclopedia of Insurance Law, (2nd ed., by R. Anderson, 1960) sec. 24: 92.

[44] E.g. C. Brown & J. Menezes, Insurance Law in Canada (1982), p. 70 *et seq.*; Hasson, Reform of the Law relating to Insurable Interest in Property—Some Thoughts on *Chadwick* v. *Gibraltar General Insurance* (1983-4), 8 C.B.L.J. 114.

[45] The characterization is Keeton's: see *op. cit., supra*, footnote 25, at p. 117. I find no support however in the judgments in *Macaura* for the learned author's suggestion that the law lords were influenced in their conclusion by the fact that the case involved charges of fraud. For other criticisms of *Macaura*, see Brown & Menezes, *supra*, footnote 43, at pp. 82-83, and K. Sutton, Insurance Law in Australia and New Zealand (1980) p. 219, footnote 79.

[46] Hasson, *supra*, footnote 43.

[47] I have not located a modern American case in which an insured's claim was denied on this ground, and none is cited in 39 A.L.R. 2d 714, at 727. This is not to say that American courts have overlooked possible difficulties in assessing the insured's loss where the corporation was bankrupt at the time of the casualty or there were other complicating factors. See the discussion in the next paragraph of the text.

[48] See e.g., Ontario Business Corporations Act, S.O. 1982, c. 4, s. 184, and Part XV, ss. 186-189. The different methods of valuation are exhaustively discussed in Greenberg J.'s admirable judgment in *Re Domglas In.*, [1980] C.S. 925, (1980), 13 B.L.R. 135 (Que. S.C.), aff'd (1982), 138 D.L.R. (3d) 521, [1982] C.A. 377 (Que. C.A.).

may be argued, the shareholder has not been damnified since his shares were worthless anyway.[49] At first sight the logic of this argument seems irresistible, particularly if a decent respect is observed for the separate legal personality of the corporation. However, there is more than one method to value the shares of a corporation and a valuation based on the "break up" value of the corporation is only one of them. Moreover, the fact that a corporation is in serious financial difficulties does not mean that its shares are valueless.[50]

Still the difficulties exist and the question that must be asked is whether they cannot be bypassed altogether by simply ignoring the corporate veil—as was done in the present case. My own view is that they cannot, not at any rate without also ignoring the indemnity principle of property insurance and the fact that a shareholder is not liable for the debts of his corporation, but I am prepared to be persuaded to the contrary.

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[49] Cf. *Seaman* v. *Enterprise Fire & Marine Ins. Co.*, *supra*, footnote 43 per Brewer J. at p. 784:

> I do not mean to say that questions may not arise in which the value of the property destroyed may not be the measure of his damages. In the case put by the Supreme Court of Iowa, supposing the entire property was a grain elevator, which, by reason of its proximity to a railroad, had a large value, a value in excess of the cost of the elevator, they intimate that the destruction of that elevator might cause a loss to the stockholder in excess of his proportionate share of the cost of the property itself; so, on the other hand, if it appeared that a corporation was in debt largely in excess of the value of its corporate property, and that there was no personal liability upon the stockholder,—it might be that the destruction of the property would work no loss to him, because the property would not pay the debts, and he, having no personal liability, would lose nothing, whether the property was destroyed or not. So, in another case, supposing the property was fully insured by the corporation, and the loss was paid to the corporation, it might be that he would have no separate interest as a stockholder protected by insurance, but would only have recourse upon the assets of the corporation, represented by the amount paid by the insurance company to the corporation.

[50] To give but one current example, a major Canadian oil company was said to be in serious financial difficulty during much of 1983 but in the summer of 1983 its shares were trading in the range of $3 to $7. Obviously investors were optimistic about the company's chances of survival and its ability to renegotiate loan agreements with its creditors.

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