Citation: Filkow et al v D'Arcy & Deacon LLP, 2019 MBCA 61
Date: 20190528
Docket: AI18-30-09086

IN THE COURT OF APPEAL OF MANITOBA

Coram: Chief Justice Richard J. Chartier
Madam Justice Diana M. Cameron
Mr. Justice Christopher J. Mainella

B E T W E E N :

KEVIN FILKOW and LAINIE FILKOW	)	***J. A. Kagan*** *and*
in their capacity as personal representatives	)	***A. M. Mariani***
of THE ESTATE OF KEN FILKOW	)	*for the Appellants*
	)	
(Applicants) Appellants	)	***S. F. Vincent***
	)	*for the Respondent*
- and -	)	
	)	*Appeal heard:*
D'ARCY & DEACON LLP	)	***January 23, 2019***
	)	
(Respondent) Respondent	)	*Judgment delivered:*
	)	***May 28, 2019***

CAMERON JA

Introduction

[1] This case considers the nature of a settlement agreement and the legal relationship between the applicants as the personal representatives of the estate of Ken Filkow (the deceased), and the respondent. At the time of his death, the deceased was a practising lawyer and partner in the respondent law firm.

[2] The applicants applied for a declaration that the respondent breached the settlement agreement by allocating partnership income to the estate in the

year following the death of the deceased (see Manitoba, *Court of Queen's Bench Rules*, Man Reg 553/88, r 14.05(2)(c)(iv)).

[3] While I agree with the applicants that the application judge erred in refusing to consider the surrounding circumstances in his interpretation of the settlement agreement, that error is not entirely determinative of the matter.

[4] In my view, at the time the respondent entered into settlement discussions, it owed an *ad hoc* fiduciary duty to advise the applicants of its intended allocation of income to the estate in the year following the death of the deceased.

[5] For the reasons that follow I would allow the appeal.

Background and Proceedings

[6] The deceased passed away in October 2014. In early November 2014, the applicants met with members of the respondent to discuss the return of the deceased's deposit account consisting of working capital invested in the respondent by the deceased (the working capital account). Also at issue was the billing of the deceased's work in progress, the collection of receivables due and owing at the time of his death and other financial issues.

[7] As part of the negotiations concerning the estate, the applicants met with the Director of Finance and Administration of the respondent (the director) relating to money owed by the respondent to the estate. It is clear from the director's affidavit that numerous contentious financial issues were

discussed between November 2014 and November 2015 regarding the amount of money owed by the respondent to the estate.

[8] The negotiations did not go well. The applicants were of the view that the respondent was not forthcoming with financial disclosure. They hired a lawyer to represent their interests in their dealings with the respondent. Through their lawyer, they requested the assistance of the Law Society in their efforts to ascertain the contact information of clients who had failed to pay statements of account of the deceased.

[9] On the other hand, the respondent felt that the deceased had overstated to the applicants the amount of working capital that he was entitled to from the respondent. The applicants had also requested additional money, such as a special payment for goodwill and unused funds from the deceased's business promotion account. These latter requests were denied by the respondent.

[10] Despite all of the above, the issue of future allocation of taxable income to the deceased after the year of his death was not discussed at any time throughout the negotiations.

[11] Eventually, each side appointed a lawyer (the settlement lawyers) in order to attempt to negotiate an agreement. More than a year after the death of the deceased, on December 18, 2015, the agreement was reduced to writing in an email that was sent by the respondent's settlement lawyer to the applicants' settlement lawyer. It stated:

> In addition to the reconciliation payments already made to date, [the respondent] will provide a further one-time and all-inclusive payment to the Estate in the amount of $20,000.00, in full and final

> satisfaction of any and all further financial entitlement claims, known or unknown.

[12] It also included a term that the "Estate and its Personal Representatives . . . provide a comprehensive Final Release, in a form satisfactory to [the respondent]."

[13] On December 23, 2015, the settlement lawyer for the respondent forwarded a trust cheque in the amount agreed upon as well as "[t]he contemplated Final Release, in required form, for execution purposes."

[14] On January 10, 2016, the applicants provided a final release in which they discharged the respondent:

> [F]rom all manner of actions, causes of actions, claims, proceedings, complaints, demands, costs or damages of any nature or kind whatsoever, known or unknown and whether at law, in equity or pursuant to any statute, which the [applicants] now have or may have or which the [applicants'] successors and assigns hereafter can, shall or may have up to the date hereof and, without limiting the generality of the foregoing, for and by reason of or in any way attributable to any past, present or future financial accounting, reconciliation or entitlement that may have been or be alleged by virtue of the [deceased's] status as a former partner and interest holder of the [respondent].

It further provided that the applicants:

> UNDERTAKE AND AGREE to indemnify and hold harmless the [respondent] from and against all claims, charges, taxes, penalties or demands which may be made by the Minister of National Revenue requiring the [respondent] to pay any income tax, charges, taxes or penalties under the *Income Tax Act* (Canada) in respect of income tax payable by the aforesaid ESTATE.

[15] Collectively, the December 18, 2015 email and the final release constituted the settlement agreement.

[16] A little more than one year after the settlement agreement was concluded, the applicants were made aware that the respondent had filed a T5013 income tax form allocating an additional $54,332 partnership income to the deceased for the 2015 taxation year (the allocation). The allocation would have resulted in an effective tax liability to the estate of approximately $26,000.

[17] In an email to the director, the applicants disputed the allocation, claiming that the deceased did not generate any income in 2015 and, upon his death in 2014, he ceased being a partner. Quoting the partnership agreement, to which the deceased was a party prior to his death, the applicants stated that the deceased's share of the profits were to be "calculated and paid in the same manner and at the same time as the other partners for the fiscal year in which the partner died".

[18] The respondent maintained that the allocation was simply part of "an approved accounting and financial statement practice that resulted in deferral of income tax for each of the partners." The affidavit of the director explained it as follows:

> At year-end, being the 31st of December of each year, the amount recorded for unbilled disbursements was split equally between all of the partners. So, for example, if there was a balance of unbilled disbursements of $1,000,000 at the end of 2014, and there were 20 partners, each partner was allocated $50,000. The allocation served as a tax deduction, or deferral, for 2014.
>
> Then, on January 1, 2015, the same $50,000 would be added back to each partner as income. So long as in each subsequent year, the

> amount of unbilled disbursements had grown, there would each year be an additional tax deduction or deferral. If, however, the amount of unbilled disbursements decreased in the following year, then each partner would potentially face an "add-back" to their taxable income.

[19] In the respondent's view, the allocation represented the deferred taxable income that the deceased had enjoyed up to December 31, 2014.

[20] The applicants filed an application seeking a declaration that the allocation constituted a breach of the settlement agreement. They argued that it was always the intent of the parties that the settlement agreement would conclude all matters between them and it was on that understanding that they executed the final release.

[21] The respondent took the position that the evidence provided in the applicants' supporting affidavit material, of their intent that the settlement agreement would conclude all matters between the parties, was inadmissible evidence of subjective intent of a party to a contract. It further argued that it did not sign a final release as part of the settlement agreement and was not subject to a condition barring it from making claims against, or allocating income to, the estate.

[22] The application judge dismissed the application. He found that the entire settlement agreement concluded by the parties was set out in the December 18, 2015 email and the final release. In his view, the evidence proffered by the applicants reflecting the parties' intent in entering the settlement agreement constituted inadmissible evidence of subjective intent.

[23] Further, the application judge held that the December 18, 2015 email describing the terms of settlement did not prohibit the allocation. Finally, he found that the final release applied only to the applicants and not to the respondent.

Issues

[24] The applicants assert that the application judge erred by conflating the issue of subjective intention evidence in the interpretation of a contract with evidence of surrounding circumstances when he refused to consider their evidence regarding the intent of the settlement agreement. They claim that the failure to consider such evidence caused him to wrongly conclude that the wording of the settlement agreement did not prohibit the respondent from allocating partnership income to the deceased for the 2015 tax year, and caused him to fail to imply a term into the settlement agreement prohibiting the allocation.

[25] At the hearing of the appeal, this Court raised a question relating to the nature of the relationship: specifically, whether a fiduciary relationship existed between the respondent and the applicants, and, if it did, whether the respondent owed a fiduciary duty to disclose the intended allocation to the applicants prior to entering the settlement agreement. After the conclusion of the oral hearing of the appeal, the Court provided the parties with written notice of the question raised by the Court and the opportunity to make written submissions in accordance with the procedure provided for in *R v Mian*, 2014 SCC 54 at paras 53-60.

[26] Thus, the issues to be determined are:

1. Whether the application judge erred in failing to consider the surrounding circumstances of the settlement agreement;

2. Whether a fiduciary relationship existed between the respondent and the applicants; and

3. Whether the respondent's failure to disclose the intended allocation before entering into the settlement agreement constituted a breach of fiduciary duty.

Ground 1—Whether the Application Judge Erred in Failing to Consider the Surrounding Circumstances of the Settlement Agreement

[27] The question of whether the application judge erred in refusing to consider the surrounding circumstances in his interpretation of the settlement agreement is a question of law to be determined on the standard of correctness (see *Sattva Capital Corp v Creston Moly Corp*, 2014 SCC 53 at para 53).

[28] The facts that the application judge relied on to determine the application were that: i) the deceased was a lawyer and partner of the respondent at the time of his death; ii) there was a dispute regarding the proper calculation of income due and owing to the deceased by the respondent; iii) there was an agreement that the respondent would pay the estate $20,000; iv) the release was executed by the applicants as part of the settlement agreement; and v) the respondent later allocated partnership income to the deceased for the 2015 tax year which resulted in a liability to the estate.

[29] As earlier indicated, the application judge found that the entire settlement agreement was set out in the email dated December 18, 2015 and the final release. After considering the law governing the admissibility of subjective intent or parol evidence in the interpretation of a contract, he held that there was "no lack of clarity or other factors identified in the case law that would justify the consideration of extrinsic material purporting to reflect the subjective intent of the parties".

[30] In my view, the application judge took too narrow a view of what was admissible evidence of surrounding circumstances in the interpretation of the settlement agreement. The settlement agreement constituted a contract that was the result of a year of discussions and negotiations between the parties. In *Sattva*, Rothstein J explained the law regarding the interpretation of contracts (at para 47).

> [T]he interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding" (*Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada*, 2006 SCC 21, [2006] 1 S.C.R. 744, at para. 27, *per* LeBel J.; see also *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, [2010] 1 S.C.R. 69, at paras. 64-65, *per* Cromwell J.). To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract. Consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning.
>
> [emphasis added]

[31] As was noted in *Elias et al v Western Financial Group Inc*, 2017 MBCA 110, "Courts are required to consider the surrounding circumstances in interpreting a contract regardless of whether the contract may be ambiguous" (at para 69).

[32] The law regarding interpretation of a release is stated by Geoff R Hall, *Canadian Contractual Interpretation Law*, 3rd ed (Toronto: LexisNexis, 2016) (at p 260):

> A release is a contract, and the general principles governing the interpretation of contracts apply equally to releases. However, there is also a special rule which is superadded onto the regular ones. This rule comes from *London and South Western Railway v. Blackmore* (1870), L.R. 4 H.L. 610 (H.L.), an 1870 decision of the House of Lords. The rule in *London and South Western Railway* holds that a release is to be interpreted so that it covers only those matters which were specifically in the contemplation of the parties at the time the release was given. The rule allows the Court to consider a fairly broad range of evidence of surrounding circumstances in order to ascertain what was in fact in the specific contemplation of the parties at the relevant time, and it is not uncommon for a significant amount of extrinsic evidence to be examined when the rule is applied. However, like the law of contractual interpretation generally, the scope of permissible extrinsic evidence does not extend to evidence of the parties' subjective intentions; such evidence is strictly inadmissible.

See also *Drader v Abbotsford (City)*, 2013 BCCA 376 at para 40.

[33] In *Sattva*, Rothstein J observed that, in considering surrounding circumstances, the meaning of words is derived from contextual factors. Importantly, this includes the purpose of the agreement and the nature of the relationship created by it (see *Sattva* para 48). In this regard, Rothstein J cited

Moore Realty Inc v Manitoba Motor League, 2003 MBCA 71, where Hamilton JA stated (at para 15):

> Surrounding circumstances are often important because, in the real world, the task of ascertaining contractual intention can be difficult as words do not have immutable or absolute meanings. Rather, words often take their meaning from a multitude of contextual factors including the nature of the relationship created by the agreement and the purpose of the agreement. This point is made in many appellate and Supreme Court of Canada decisions. For example, in *White v. Central Trust Co*. (1984), 7 D.L.R. (4th) 236 (N.B.C.A.), La Forest J.A. (as he then was), wrote (at p. 248):
>
> > (I)n determining what was contemplated by the parties, the words used in a document need not be looked at in a vacuum. The specific context in which a document was executed may well assist in understanding the words used. It is perfectly proper, and indeed may be necessary, to look at the surrounding circumstances in order to ascertain what the parties were actually contracting about.

[34] In *Sattva*, Rothstein J further explained the importance of context in interpreting the meaning of words in a contract, quoting the following from *Investors Compensation Scheme Ltd v West Bromwich Building Society*, [1998] 1 All ER 98 at 115 (at para 48):

> The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean.

[35] He continued to state that the nature of evidence of surrounding circumstances will vary from case to case, but that (at para 58):

> It should consist only of objective evidence of the background facts at the time of the execution of the contract (*King* [*King v Operating Engineers Training Institute of Manitoba Inc*, 2011 MBCA 80], at paras. 66 and 70), that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting. Subject to these requirements and the parol evidence rule discussed below, this includes, in the words of Lord Hoffmann, "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man".
>
> [emphasis added]

[36] He described the parol evidence rule as follows (at para 59):

> The parol evidence rule precludes admission of evidence outside the words of the written contract that would add to, subtract from, vary, or contradict a contract that has been wholly reduced to writing (*King*, at para. 35; and Hall [Geoff R Hall, *Canadian Contractual Interpretation Law*, 2nd ed (Markham: LexisNexis, 2012)], at p. 53). To this end, the rule precludes, among other things, evidence of the subjective intentions of the parties (Hall, at pp. 64-65; and *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, at paras. 54-59, *per* Iacobucci J.). The purpose of the parol evidence rule is primarily to achieve finality and certainty in contractual obligations, and secondarily to hamper a party's ability to use fabricated or unreliable evidence to attack a written contract.

[37] He stated that evidence of surrounding circumstances is consistent with the objective of finality underlying the rule because such evidence is an interpretive aid not intended to change or overrule the written words of the contract. Further, reliability concerns informing the rule do not arise because the "surrounding circumstances are facts known or facts that reasonably ought to have been known to both parties at or before the date of contracting" (at para 60).

[38] Thus, he concluded that the parol evidence rule "does not apply to preclude evidence of surrounding circumstances when interpreting the words of a written contract" (at para 61).

[39] In my view, the application judge conflated the issues of subjective intent and surrounding circumstances resulting in his failing to consider the surrounding circumstances regarding the formation of the settlement agreement. This approach caused him to fail to consider significant undisputed evidence regarding the nature of the relationship between the parties, the general nature of the negotiations preceding the agreement, the knowledge of the parties when they entered into it and the purpose of the settlement agreement.

[40] The affidavit evidence filed in the proceedings confirms the following matters were of concern to the parties prior to them entering into the agreement:

- The return of the funds in the working capital account invested by the deceased upon his entry into the partnership;
- The proration of the deceased's income for 2014 based on the number of months that he worked during that year;
- The billing of the deceased's work in progress;
- The collection of the deceased's accounts receivable;
- The provision by the respondent of contact information of the deceased's clients who had not paid out their accounts;

- The provision by the respondent of a special goodwill payment to the estate;

- Payment of the remaining amount of the deceased's 2014 business promotion account;

- A corresponding set-off of the deceased's 2012 business promotion account claimed by the respondent.

[41] During the process of negotiation, the respondent specifically contemplated the fact that there could be tax implications to the estate. For example, in his affidavit the director swore that, when discussing the respondent's "Capital B Account" during the negotiations with the applicants, he advised them that "there was some indication that [the deceased] may have been overpaid on this account and that there might be capital gains taxes payable as a result." In my view, this indicates that the respondent did not intend to recover the "Capital B Account" overpayment to the deceased, but that it would not be responsible for any taxation implications to the estate. Conversely, I cannot conclude that the intent of the settlement agreement was to preclude the respondent from allocating partnership income to the deceased in the taxation year after his death. That established accounting practice, which was in essence a tax deferral from which the deceased undoubtedly benefited during his lifetime, was never discussed with the applicants. Furthermore, neither the words in the settlement agreement or the final release indicate an intention to bind the respondent in such a manner.

[42] However, in my view, that does not end the matter. There remains the question of whether a fiduciary duty existed which would have obligated

the respondent to disclose the allocation to the applicants prior to executing the settlement agreement.

Ground 2—Whether a Fiduciary Relationship Existed Between the Respondent and the Applicants

New Issue on Appeal

[43] The respondent argues that the Court should not decide whether it had a fiduciary duty to disclose the intended allocation to the applicants. It submits that new issues on appeal are to be permitted only in exceptional circumstances. Moreover, the respondent asserts that the issue of whether or not it had a fiduciary duty to advise the applicants of its intention to allocate partnership income for the year 2015 raises more than simply a new argument or point of law. It contends that the issue constitutes an entirely new claim that should be subject to stringent standards prior to consideration by the Court. The respondent maintains that it would be prejudicial to the parties to decide the issue absent adequate evidence.

[44] In *Mian*, the Supreme Court of Canada affirmed that an appellate court has jurisdiction to raise a new issue. However, the Court also underscored that "not all questions asked by an appeal court will constitute a new issue" (at para 31). Of significance to this case, the Court noted (at para 33):

> [I]ssues that are rooted in or are components of an existing issue are also not "new issues". Appellate courts may draw counsel's attention to issues that must be addressed in order to properly analyze the issues raised by the parties. . . . However, where appropriate, the court may have to be prepared to grant even a brief adjournment to allow the parties to consider and canvass the issue.

[45] In my view, the question posed by this Court does not constitute a new issue as contemplated in *Mian*. In their application, the applicants claim that, because the allocation was not contemplated during the negotiations leading to the settlement agreement, the allocation constituted a breach of the settlement agreement. In support of their argument, they maintain that the application judge failed to consider the surrounding circumstances when interpreting the settlement agreement.

[46] As I earlier indicated, *Sattva* states that the nature of the relationship is a relevant factor when considering the surrounding circumstances. The question of whether the relationship is a fiduciary one does not raise a new issue; it is a component of the existing issue of whether the application judge failed to consider all of the surrounding circumstances, which includes the nature of the relationship.

[47] Alternatively, if the question—of whether a fiduciary relationship existed, along with corresponding duties—does raise a new issue, I would find that the new issue should be considered by this Court.

[48] As was noted in *Mian*, there are two competing concerns raised in the contemplation of whether to consider a new issue. First is the principle of party presentation pursuant to which the court relies on the parties to define the issues and the court remains the neutral arbiter (see para 39). Second is the court's role in ensuring that justice is done (see para 37). In order to strike a balance between these competing principles, the Court stated that the discretion to raise a new issue "should be exercised only in rare circumstances" (at para 41). It specified the test to be considered as follows (*ibid*):

> An appellate court should only raise a new issue when failing to do so would risk an injustice. The court should also consider whether there is a sufficient record on which to raise the issue and whether raising the issue would result in procedural prejudice to any party. This test is sufficiently flexible while also providing for an appropriate level of restraint to address the tensions inherent in the role of an appellate court.
>
> [emphasis added]

See also *R v Suter*, 2018 SCC 34 at para 30; and *R v Barton*, 2019 SCC 33 at paras 50-51, 151, 253-60.

[49] By definition, fiduciaries must display the utmost good faith. In light of the important role fiduciaries play in our society, to allow a fiduciary to act contrary to its duty is of significant concern to the court. As can be seen by my subsequent analysis of the nature of the *ad hoc* fiduciary relationship that existed between the parties, failure to consider the issue in this case would risk an injustice to the applicants. That is, "there is good reason to believe that the result would realistically have differed had the error not been made" (*Mian* at para 45).

[50] Regarding the sufficiency of the record, it must be noted that an application cannot generally proceed on contested facts (see Queen's Bench r 38.09; and *Garwood v Garwood Estate*, 2007 MBCA 160 at paras 30, 40, 48-58). In this case, the evidence before the Court is straightforward and complete. It addresses the relationship between the parties, the knowledge of the parties in the negotiation of the settlement agreement and the failure of the respondent to disclose.

[51] As for procedural prejudice, Moldaver J, writing for the majority of the Court in *Barton*, summarized (at para 51):

> When an appellate court decides to raise a new issue, it must give notice to the parties and provide them with an opportunity to respond ([*Mian*] para. 54). As a general rule, notice should be given "as soon as is practically possible after the issue crystallizes" (para. 57), and the notice must ensure the parties are sufficiently informed so they may prepare and respond (para. 54). The form of response required "will depend on the particular issue raised by the court. Counsel may wish to address the issue orally, file further written argument, or both" (para. 59). At the end of the day, "the underlying concern should be ensuring that the court receives full submissions on the new issue" (*ibid.*), and the primary considerations are the dictates of natural justice and the rule of *audi alteram partem* — the duty to hear the other side.

See also paras 253-60 wherein the minority of the Court emphasises that appellate courts should be accorded flexibility in determining how procedural fairness can be achieved depending on the circumstances of the case.

[52] In this case, the Court raised the fiduciary issue in oral argument. Thereafter, written notice was provided and, pursuant to the Court's invitation, each of the parties filed written submissions.

[53] In light of the above, in my view, the requirements of *Mian* have been met.

The Fiduciary Issue

Positions of the Parties

[54] The applicants submit that there existed a per se fiduciary relationship between the respondent and the deceased, which continued with

the applicants. They argue that "fiduciary duties owing by a partnership to one of its partners continues even after the death of the partner."

[55] Alternatively, the applicants argue that an *ad hoc* fiduciary relationship was created between the respondent and the estate giving rise to a fiduciary duty on the respondent to disclose the intended allocation of partnership income to the deceased prior to entering into the settlement agreement.

[56] The respondent submits that the death of the deceased terminated his inclusion in the partnership including any fiduciary duty that the respondent owed to him. It maintains that it did not have a fiduciary relationship with the estate or the applicants as its representatives. It argues that, pursuant to the partnership agreement, it owed only a limited duty to account for and pay the deceased's remaining financial entitlements.

[57] Regarding whether or not an *ad hoc* fiduciary relationship was created, the respondent argues that the nature of its relationship with the applicants did not meet the factors, which I later discuss, to be applied in the determination of whether such a relationship is created as articulated in the cases of *Rochwerg v Truster*, 2002 CarswellOnt 990 at para 36 (CA); and *Alberta v Elder Advocates of Alberta Society*, 2011 SCC 24.

Per se Fiduciary Relationship

[58] At the outset, I would dismiss the applicants' argument that the fiduciary relationship between the deceased and the respondent continued after his death. There is no question that, at the time he was a partner, the deceased and the respondent were involved in a per se fiduciary relationship.

That is, the partnership was one of a recognised category of fiduciary relationships giving rise to the obligation of one party to act for the benefit of the other (see *Elder Advocates* at para 33).

[59] The only authority that the applicants rely on to assert a continuation of the per se fiduciary relationship to the estate is the case of *Livingston v Livingston*, 1912 CarswellOnt 226 (SC (H Ct J)), aff'd in part [1914] OJ No 155 (CA), aff'd in part (1916), 26 DLR 140 (PC). In that case, Middleton J determined that a surviving partner was not a trustee. In *obiter*, he stated that, as a surviving partner "[h]is position no doubt imposes certain obligations and duties which are in their nature fiduciary" (at para 25). In my view, that statement does not stand for the proposition that the per se fiduciary duties attached to a partner in an ongoing partnership survive the death of one of the partners. On appeal, Meredith CJO clarified that the surviving partner owed a duty to the estate to account. He said (at para 13):

> It is, no doubt, clear law that a partner must account to his firm for the profits made by him in any business of the same nature as and competing with that of his firm if he carries on any such business without the consent of his partners.

[60] Section 36(1) of *The Partnership Act*, CCSM c P30 (the *PA*) specifically provides that, absent an agreement to the contrary, a partnership is dissolved by the death of a partner. In this case, the respondent's partnership agreement provided that the partnership would continue between the remaining partners in the event of the death of a partner. However, nowhere in the partnership agreement is there mention of a continuing partnership between the estate of a deceased partner and the respondent.

[61] The above is consistent with the jurisprudence summarised in *Tham v Cressey Development Corporation*, 2016 BCSC 1208 (at para 52):

> Because a partnership is a personal entitlement, on the death of a partner, it does not devolve to his or her successors or estate. Therefore, the deceased partner's personal representative (a designation that encompasses an executor/executrix of the deceased partner's will) is not entitled as a matter of right to become a partner of the surviving partner or partners: *Mills (Re)* (1912), 3 D.L.R. 614 (Ont. H.C.J.).

[62] In this case, there is no evidence that there was an agreement that the applicants be admitted in the partnership (see *Tham* at para 55).

Ad hoc Fiduciary Relationship

[63] *Ad hoc* fiduciary relationships are those not recognised by the courts as fiduciary per se, but rather, arise out of the specific circumstances of a case. In her dissenting reasons, in *Frame v Smith*, [1987] 2 SCR 99, Wilson J identified the hallmarks of a fiduciary relationship (at para 60):

> (1) The fiduciary has scope for the exercise of some discretion or power.
>
> (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
>
> (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

[64] These were later adopted by the majority of the Court in *Lac Minerals Ltd v International Corona Resources Ltd*, [1989] 2 SCR 574 at 645-46; and *Hodgkinson v Simms*, [1994] 3 SCR 377 at 408-9.

[65] Regarding the concept of vulnerability, Cromwell J, writing for a unanimous Court in *Galambos v Perez*, 2009 SCC 48, stated that, "while vulnerability in the broad sense resulting from factors external to the relationship is a relevant consideration, a more important one is the extent to which vulnerability arises from the relationship" (at para 68).

[66] In *Elder Advocates*, McLachlin CJC stipulated that, while the three "hallmarks" identified by Wilson J in *Frame* were useful in explaining the source of fiduciary duties, they were not a "complete code" (at para 29). She set out the following three elements which must be shown in addition to the vulnerability arising from the relationship as identified by Wilson J in *Frame*:

1. The evidence must show that the alleged fiduciary gave an undertaking of responsibility to act in the best interest of the beneficiary or beneficiaries (see para 30);

2. The duty must be owed to a defined person or class of persons who must be vulnerable to the fiduciary in the sense that the fiduciary has power over them (see para 33);

3. The claimant must show that the alleged fiduciary's power may affect the legal or substantial practical interests of the beneficiary (see para 34).

[67] Thus, it becomes necessary to examine the relationship between the parties pursuant to all of the above criteria. I will deal with the issue of vulnerability as identified by Wilson J in *Frame* in the second element of the *Elder Advocates* analysis.

Element One: Undertaking to Act for the Benefit of the Beneficiary

[68] I agree with the respondent that there is no evidence that it ever made an express undertaking to act for the benefit of the applicants. However, pursuant to *Elder Advocates*, such an undertaking may be express or implied (see para 30). In this regard, and as stated by the applicants in their argument, given the inherent duties of honesty, loyalty and good faith present in a partnership, it can be implied that the respondent undertook to act in the best interests of the estate of its deceased partner.

[69] As indicated in *Elder Advocates*, "The existence and character of the undertaking is informed by the norms relating to the particular relationship" (at para 31). It may be found "in the relationship between the parties . . . the result of the exercise of statutory powers, the express or implied terms of an agreement" or by an "undertaking to act" in such a manner (at para 32 quoting from *Galambos* at para 77).

[70] In this case there are a number of factors leading to the conclusion that there existed an implied undertaking pursuant to which the respondent would, in some circumstances, including the negotiation of the settlement agreement, act in the best interests of the deceased's estate.

[71] First, the former nature of the fiduciary relationship between the deceased and the respondent placed the respondent in a unique position of knowledge regarding the financial affairs of the deceased within the respondent law firm to which the applicants were not privy.

[72] Next, article 12.01 of the partnership agreement provides that in the event of a death of a partner, articles 10.03 and 10.04 of the agreement apply.

That is, the estate is entitled to payment of the working capital account (article 10.03(a)) and the deceased's share of the profits of the partnership for the year in which he died (articles 10.03(b)(i), 12.01(a)) and future income (receivables) (article 10.03(b)(ii)). Article 10.04 allows the representatives of the estate to purchase the receivables defined in article 10.03(b)(ii) from the partnership.

[73] The partnership agreement applies to the receivables and therefore evidences a continuing relationship with the estate of a partner after death. The notion of an ongoing relationship with corresponding duties is also supported by section 45(1) of the *PA*, which provides:

> **Rights of outgoing partner in certain cases**
> **45(1)** Where any member of a firm dies or otherwise ceases to be a partner, and the surviving or continuing partners carry on the business of the firm with its capital or assets without any final settlement of accounts as between the firm and the outgoing partner or his estate, then, in the absence of any agreement to the contrary the outgoing partner or his estate is entitled, at the option of himself or his representatives, to such share of the profits made since the dissolution as the court may find to be attributable to the use of his share of the partnership assets, or to interest at the rate of 5% per annum on the amount of his share of the partnership assets.
>
> [emphasis added]

[74] As conceded by the respondent, it had a duty to account to the estate (see *Tham* at para 54). While there may not have been a per se fiduciary relationship, there was an ongoing connection with the applicants, which included significant obligations and responsibilities. In my view, all of the above evidenced an implied undertaking on behalf of the respondent to act, above all other interests, in the best interests of the estate when discharging

its responsibility to the estate in providing the required information in anticipation of the settlement agreement.

Element Two: Duty to a Defined Person or Class of Persons Who Must Be Vulnerable to the Fiduciary

[75] In this case, there is no question that the applicants constitute a defined group. The issue is whether they were vulnerable to the fiduciary.

[76] The respondent argues that the relationship between it and the applicants was a standard arms-length commercial relationship of creditor and debtor, which does not attract fiduciary duties. It further argues that the applicants were not vulnerable in that they aggressively pursued their claims against the respondent, including relying on representation by experienced counsel.

[77] The applicants argue that they were vulnerable in that the respondent had the exclusive knowledge and power regarding the estate's entitlement to compensation resulting from the deceased's former status as a partner. They maintain that the only knowledge that they had regarding any counterclaims or set-offs by the respondent were those that the respondent chose to disclose prior to entering into the settlement agreement.

[78] There is a general principle that fiduciary duties or fiduciary relations should be the exception rather than the rule in commercial relations (see Angela Swan & Jakub Adamski, *Canadian Contract Law*, 3rd ed (Markham: LexisNexis, 2012) at 937). The reason is that experienced individuals of similar bargaining strength are not vulnerable because

vulnerability can be prevented by the prudent exercise of bargaining power (see *Frame* at para 63).

[79] In *Cadbury Schweppes Inc v FBI Foods Ltd*, [1999] 1 SCR 142, Binnie J, writing for a unanimous Court, recognised the above. Nonetheless, he noted that, in *Hodgkinson*, the majority of the Court "held that where the ingredients giving rise to a fiduciary duty are otherwise present, its existence will not be denied simply because of the commercial context" (at para 30). In *Hodgkinson*, the majority of the Court found a fiduciary relationship between contracting parties, stating (at p 407):

> [T]he existence of a contract does not necessarily preclude the existence of fiduciary obligations between the parties. On the contrary, the legal incidents of many contractual agreements are such as to give rise to a fiduciary duty. The paradigm example of this class of contract is the agency agreement, in which the allocation of rights and responsibilities in the contract itself gives rise to fiduciary expectations; see *Johnson v. Birkett* (1910), 21 O.L.R. 319 (H.C.); *McLeod v. Sweezey*, [1944] S.C.R. 111; P. D. Finn, "Contract and the Fiduciary Principle" (1989), 12 *U.N.S.W.L.J.* 76. In other contractual relationships, however, the facts surrounding the relationship will give rise to a fiduciary inference where the legal incidents surrounding the relationship might not lead to such a conclusion; see *Standard Investments Ltd. v. Canadian Imperial Bank of Commerce* (1985), 52 O.R. (2d) 473 (Ont. C.A.), leave to appeal refused, [1986] 1 S.C.R. vi.

[80] Furthermore, a fiduciary relationship is not precluded by the fact that the parties were involved in pre-contractual negotiations. In fact, one can exist where the parties have not reached an agreement (see *Lac Minerals* at p 667).

[81] In my view, the estate was vulnerable when negotiating the settlement agreement. The respondent had all the requisite information to factor into its decision to enter into the settlement agreement. The estate did

not. Specifically, the respondent was privy to its accounting process, its intent to allocate partnership income to the estate in the year following the death of the partner, and had the discretion to disclose this, but failed to do so. This information was not known to the applicants, was not apparent from the T5013 provided for the 2014 taxation year and not provided to them during their negotiations.

Element Three: Power to Affect the Legal or Substantial Practical Interests of the Beneficiary

[82] The respondent argues that the allocation did not affect the legal or substantial interests of the estate as the deceased enjoyed the tax deferral created by the accounting practice while he was a partner of the respondent. In his affidavit, the director states that the alternative to allocating the income for the 2015 tax year would have been to allocate it to the estate in the 2014 tax year in addition to the $46,000 it already allocated to the deceased's income in 2014, thereby creating a greater tax liability for the estate. The respondent asserts that it should not have to pay the taxes on the deceased's deferred income as he received the benefit of it while alive.

[83] However, the issue is not whether the accounting practice existed or whether the deceased took advantage of it when he was a partner. Rather, the concern is the exercise of power by the respondent in failing to disclose the accounting practice and its corresponding intent to allocate partnership income to the estate in the year after the deceased's death. That allocation caused the estate to incur a tax liability in excess of the amount received under the settlement agreement. The end result is that the allocation effectively negated the settlement. I can easily conclude that, had the applicants known

of the intended allocation of additional partnership income to the estate in the amount of $54,000, whether it be in 2014 or 2015, it would have undoubtedly affected the negotiation of the settlement agreement.

[84] Thus, in light of the above, a fiduciary relationship existed between the respondent and the applicants during the negotiation of the settlement agreement.

Ground 3—Whether the Respondent's Failure to Disclose the Intended Allocation Before Entering Into the Settlement Agreement Constituted a Breach of Fiduciary Duty

[85] In considering fiduciary relationships, it is important to remember that not every wrong done by a fiduciary will give rise to a breach of fiduciary duty. Rather, it is the betrayal of the trust or loyalty that is at the core of the fiduciary duty that constitutes a breach (see *Galambos* at paras 36-39).

[86] A failure to disclose all material information relating to a transaction may constitute a breach of a fiduciary duty. "Partners may owe duties to other partners to disclose material information both in equity and pursuant to statute" (Michael Ng, *Fiduciary Duties: Obligations of Loyalty and Faithfulness*, (Toronto: Canada Law Book, 2003) (loose-leaf updated 2013, release 11) ch 10 at para 10:20.10). In Manitoba, section 31 of the *PA* provides:

> **Duties of partners to render accounts, etc.**
> **31** Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives.
>
> [emphasis added]

[87] In my view, the above supports the conclusion that the nature of the relationship between the estate and the respondent placed a duty on the respondent to provide the applicants with complete financial disclosure regarding the deceased's financial affairs with the respondent during the negotiation process of the settlement agreement. This included the duty to disclose the intended allocation during the course of its negotiations with the applicants regarding the settlement agreement. The respondent was well aware that the estate relied on its complete disclosure of the deceased's financial information as it related to the partnership when it entered the settlement agreement. By failing to disclose this essential component of the trust relationship, the respondent breached that duty. While a benefit to the respondent need not be shown, one clearly existed in that the respondent was able to conclude the settlement agreement, thereby ending its legal and financial responsibilities to the estate by reaching a "final settlement of accounts" (*PA* at section 45(1)).

Conclusion and Decision

[88] The nature of the relationship between the estate and the respondent was an *ad hoc* fiduciary relationship, which existed until the final settlement of accounts as between them. The respondent breached its fiduciary duty to act for the benefit of the estate by failing to advise the applicants during settlement negotiations of its intention to allocate additional income to the deceased in the 2015 tax year.

[89] In their originating application, the applicants requested a declaration that the respondent was in breach of the settlement agreement. A

contextual consideration of the factors in this case leads to the conclusion that the respondent owed a fiduciary duty to the applicants to disclose all material facts relating to the situation of the deceased as it related to his financial affairs with the respondent. In light of the above, I would issue a declaration that the respondent owed a fiduciary duty to disclose to the applicants its intention to allocate $54,000 of partnership income to the estate for the 2015 taxation year, which it failed to do.

[90] In the result, I would allow the appeal with costs to the applicants in this Court and the Court below.

Cameron JA

I agree: Chartier CJM

I agree: Mainella JA