Agency and Mental Incompetence

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A RECENT DECISION OF the Court of Queen's Bench of Manitoba provides an opportunity for having a look at this somewhat untidy nook of the law. There are two aspects to the law; the effect on a contract made by an agent of a principal who is mentally incompetent when the agent is empowered and the effect on a contract made by an agent of a principal who becomes mentally incompetent after empowering the agent. *Hill Estate* v. *Chevron Standard Ltd.*[1] had to do with the former situation.

In *Hill* the defendants were interested in acquiring an oil and gas lease in respect of some land owned by an elderly resident of a personal care home, Mr. Hill, whose affairs were being looked after by his son-in-law. When the defendants were informed by the son-in-law that Mr. Hill could only sign a lease with an 'X' it was suggested by the defendants that the son-in-law arrange for a power of attorney to be given by Mr. Hill. This was done and the lease was executed on behalf of Mr. Hill by the attorney, Mrs. Hill. The defendants made a payment pursuant to the lease to Mr. Hill prior to his death and several payments to his estate, before the estate challenged the validity of the power of attorney and the lease on the basis of Mr. Hill's mental incompetence.

The court found that Mr. Hill was mentally incompetent to give the power of attorney and that the defendants were not aware of Mr. Hill's mental condition; the defendants thought that Mr. Hill's problem was a physical disability. While a contract made by a mental incompetent is voidable in certain circumstances, controversy exists as to whether an empowerment given by a mentally incompetent principal and a contract made pursuant to the empowerment are void or merely voidable.[2] With reference to a 1981 United States Court of Appeals decision, the *Hill* court sided with the view that a contract

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[1] (1991), 74 Man. R. (2d) 162 (Q.B.) [hereinafter *Hill*].

[2] A.H. Hudson, Case Comment (1959) 37 Can. Bar Rev. 497.

made by an agent with a third party in such circumstances is merely voidable.[3]

The grounds upon which a contract made by a mental incompetent is voidable are also controversial. Everyone agrees that such a contract is valid unless it is proved by the mentally incompetent party that the other party knew or ought to have known of the mentally incompetent party's mental condition. If this is proved there are cases which support the view that the contract is nonetheless valid if the mentally competent party proves that the contract is fair and reasonable.[4] With reference to, inter alia, a 1982 decision of a colleague, the *Hill* court agreed with this view, that in the agency context, even if it is proved that the third party knew or ought to have known of the mental incompetency of the principal, the contract made on behalf of the principal is valid if the third party proves that it is fair and reasonable.[5]

It is noteworthy that in the agency context the voidable cases do not focus on the empowerment and what the agent knew or ought to have known, but rather on the contract made by the agent and on what the third party knew or ought to have known of the principal's mental condition.

Contracts made on behalf of a mental incompetent so found at the time of the empowerment of the agent may well be void.[6] Contracts made pursuant to an empowerment given during a lucid interval should be valid, assuming the lucid interval continued to the making of the contract by the agent with the third party, regardless of what the third party knew or ought to have known of the principal's mental condition.[7] Similarly, contracts for necessaries should be enforceable, regardless of what the third party knew or ought to have known.[8]

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[3] *Supra*, note 1 at para. 84.

[4] J.V. Di Castri, *Law of Vendor and Purchaser*, 3d ed. (Toronto: Carswell, 1988) at para. 123; G.H.L. Fridman, *The Law of Contract*, 2d ed. (Toronto: Carswell, 1986) at 147; G.H. Treitel, *The Law of Contract*, 8th ed. (London: Sweet & Maxwell/Stevens & Sons, 1991) at 501; S.M. Waddams, *The Law of Contracts*, 2d ed. (Toronto: Canada Law Book, 1984) at 501.

[5] *Supra*, note 1 at para. 78.

[6] Fridman, *supra*, note 4.

[7] M.P. Furmston, ed., *Cheshire, Fifoot & Furmston's Law of Contract*, 12th ed. (London: Butterworths, 1991) at 448.

[8] *Ibid.*

The court in *Hill* did not have to dwell on whether Mr. Hill was mentally incompetent when he gave the power of attorney. On the facts it was obvious that he was. In *Godelie* v. *Public Trustee* Judge Misener of the Ontario District Court had occasion to consider the relevant criteria:[9]

> Agency is no different than contract ... The criteria here will be the capacity to understand the nature of the agency and the nature of the particular appointment under consideration ... if the particular appointment is confined to one specific act or circumstance, obviously less capacity is required than if the appointment is a general one. Indeed, if the appointment is the latter, then the capacity to appreciate the extent of the donor's estate would ... become part of the criteria [In the case of an enduring power of attorney] I would have added the requirement that the donor understand that his right to revoke the power is lost in the event that legal incapacity intervenes ...

Turning to the effect on a contract made by an agent of a principal becoming mentally incompetent after empowering the agent, but before the agent makes the contract with a third party, there is, I suspect, some uncertainty and perhaps inconsistency. It is said that when a principal becomes mentally incompetent that event terminates the agent's actual authority, unless that authority was bestowed by a valid enduring power of attorney. As well, the agent of a principal who becomes mentally incompetent may continue to have apparent authority with respect to a third party with whom the agent has dealt before the principal became mentally incompetent, unless the third party knows or ought to know of the principal's mental incompetency.[10] If the onset of mental incompetency of a principal terminates an actual authority, it is arguable that a contract made subsequently by the agent is void, regardless of what the third party knew or ought to have known of the principal's mental condition. This is consistent with the view that an empowerment given by a mentally incompetent principal and a contract made pursuant to the empowerment are void and seems to be supported by the leading case of *Yonge* v. *Toynbee*,[11] involving solicitors who, not knowing of their client's having become mentally incompetent, entered a defence on his behalf; in holding the solicitors liable to pay costs to the plaintiff on the basis of breach of warranty of authority, the court did not comment upon whether it con-

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[9] (1990), 39 E.T.R. 40 (Ont. Dist. Ct.) at 45ff.

[10] *Drew* v. *Nunn* (1879), 4 Q.B. 661 [hereinafter *Drew*].

[11] [1910] 1 K.B. 215.

sidered the agent's act to be void, although that characterization would seem to be implicit.

Re Parks[12] was a case in which the court dealt with a power of attorney given by and exercised for a period of time on behalf of a mentally competent principal who subsequently became incompetent. After the incompetency, of which the third party knew or ought to have known, the attorney continued to exercise the power of attorney. On these facts the court had no trouble concluding that the acts of the attorney after the principal became incompetent were not effective. The court's reasons are inconclusive on whether the acts of the agent were in its opinion void or merely voidable. The court quoted from Halsbury's *Laws of England*:[13]

> If the principal becomes a person of unsound mind, the agency as between the principal and agent is determined, but is not ipso facto revoked with regard to a third person dealing with the agent without knowledge of the condition of the principal.

The court read this to be in reference to a "third person who has been dealing with the agent,"[14] as in *Drew*, and presumably not a third party who has had no dealings with the agent in connection with the principal.

If an empowerment by a mentally incompetent principal and a contract made pursuant to such an empowerment are merely voidable, a contract made by an agent for a principal who has become mentally incompetent after empowering the agent should also be merely voidable on the basis of the same considerations. This is the law in provinces having legislation such as *The Powers of Attorney Act*[15] of Manitoba, s. 2(1):

> Where the authority under a power of attorney is terminated, an act in pursuance of the power of attorney in favour of a person who does not know of the termination of the authority is valid and binding in favour of the person and in favour of a person claiming under him ...

assuming that "power of attorney" includes any written empowerment and "know" includes constructive knowledge.

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[12] (1956), 8 D.L.R. (2d) 155 (N.B.C.A.).

[13] *Ibid.* at 161.

[14] *Ibid.* at 162.

[15] C.C.S.M. c. P97.

If a contract made on behalf of mentally incompetent principal is merely voidable and only at the option of the principal, then such a contract is enforceable by the principal.[16]

Incidentally, in *Hill*, with reference to a couple of agency cases, the court said that because of the receipt by Mr. Hill's agent during his lifetime and by his personal representative after his death of payments made by the defendants pursuant to the lease, the lease could be validated on the basis of implied ratification.[17] With respect, the agency concept of ratification cannot apply to the facts of *Hill*. The agency concept of ratification involves a person without actual authority purporting to act on behalf of a competent principal and that act is subsequently either expressly or impliedly ratified by the principal. On the facts of *Hill*, presumably the receipt by Mrs. Hill of the initial payment, purportedly as Mr. Hill's agent, was the act without authority because of Mr. Hill's mental incompetence when he gave the power of attorney; then this legally unauthorized act was impliedly ratified by Mr. Hill's personal representative's receiving further payments. However, because of Mr. Hill's mental incompetence at the time Mrs. Hill received the initial payment, it could not be said that she purported to act on behalf of a competent principal.

Prior to introducing the agency concept of ratification the court was on the right track in fortifying its judgment in favour of the defendants on the basis of the concept of affirmation respecting the receipt of the payments by the personal representative.

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[16] *Kerr* v. *Petrolia* (1921), 51 D.L.R. 74 at 80–83 (H.C.).

[17] *Supra*, note 1 at 173.