

## **CAPACITY ISSUES IN REAL PROPERTY TRANSACTIONS**

### **I. INTRODUCTION**

Mental capacity is an issue all lawyers need to be aware of, no matter the age or health of the client. With an elderly client base, however, the issues are somewhat more pressing.

It is certainly not the case that all older adults have mental capacity challenges, as there are many older adults who are able to consistently function at a high level. And even challenges such as dementia or Alzheimers disease do not necessarily render an individual incapable of making decisions on his or her behalf.

However, a wise lawyer turns his or her mind to the issue of capacity, looking for red flags and ensuring that he or she has satisfied him or herself that there are no questions that the client is incapable of undertaking the transaction in question. It is also well-advised for lawyers to clearly document all steps taken to address capacity issues with his or her client, as it is that evidence and information that is key if capacity is challenged at some point once the retainer has ended.

Mental capacity is a complex issue. Our legal system leans heavily in favour of autonomy and the freedom of individuals to make choices on their own behalf. All individuals at law are presumed capable of making all decisions. That presumption of legal capacity is only rebutted with evidence of incapacity that would justify interference with an individual's independence.

The definitions of capacity and incapacity can be somewhat elusive. Capacity can fluctuate over time, and with respect to different tasks, and in different situations. An individual may be capable with respect to some tasks, and incapable with respect to other tasks, or capable with respect to some tasks at certain times, and incapable of the same tasks at other times.

There is no concrete measurement of capacity as it is determined by a combination of medical and legal factors.

This paper sets out the principles underpinning the concept of capacity, and its application in a real estate lawyer's setting.

## II. CAPACITY AS A CONCEPT

There is no single legal definition of the term "capacity." The *Substitute Decisions Act, 1992*<sup>1</sup> (the "SDA") which addresses various types of capacity, simply defines "capable" as "mentally capable", and provides that "capacity" has a corresponding meaning.

Nor is there a general test to apply for establishing "capacity", "mental capacity" or "competency". Each particular task or decision has its own corresponding criteria for capacity.<sup>2</sup>

In general, all persons are deemed capable of making decisions at law. That presumption stands unless and until the presumption of capacity is legally rebutted.<sup>3</sup>

A person is not wholly "incapable." He or she may be incapable of particular decisions, but each decision entails its own specific capacity assessment.

Capacity is determined upon factors of mixed law and fact and by applying the evidence available to the applicable test or standard for decisional capacity.<sup>4</sup>

Capacity is an area of enquiry where medicine and law collide, in that legal practitioners are often dealing with clients who have medical and cognitive challenges, and medical practitioners are asked to apply legal tests in their clinical practices, or are asked to

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<sup>1</sup> S.O. 1992, c. 30 as amended [hereinafter *SDA*]

<sup>2</sup> Attached at the back of this paper is an Appendix setting out a summary of capacity standards for a range of tasks

<sup>3</sup> *Palahnuk v. Palahnuk Estate*, [2006] O.J. No. 5304 (QL), 154 A.C.W.S. (3d) 996 (S.C.J.) [hereinafter *Palahnuk Estate*]; *Brillinger v. Brillinger-Cain*, [2007] O.J. No. 2451 (QL), 158 A.C.W.S. (3d) 482 (S.C.J.) [hereinafter *Brillinger v. Brillinger-Cain*]; *Knox v. Burton* (2004), 6 E.T.R. (3d) 285, 130 A.C.W.S. (ed) 216 (Ont. S.C.J.) [hereinafter *Knox v. Burton*]

<sup>4</sup> *Starson v. Swayze*, [2003] 1 S.C.R. 722 [hereinafter *Starson v. Swayze*]

review evidence retrospectively to determine whether at a particular time an individual had the requisite capacity to complete a particular task to or make a specific decision.

The assessment of capacity is a less-than-perfect science, both from the legal and medical perspectives. Capacity determinations are often complicated: in addition to professional and expert evidence, lay evidence can be relevant and even paramount to determining capacity in some situations. The standard of assessment varies and this too, can become an obstacle that is difficult to overcome and reconcile in determining capacity. And, to add to the complexity, in contentious settings, capacity is frequently evaluated retrospectively, when a conflict arises relating to a long-past decision of an individual, alive or since deceased.

Capacity is *decision, time and situation*-specific. This means that a person may be capable with respect to some decisions, at different times, and under different circumstances. A person is not globally “incapable” and there is no test to determine general capacity. Rather, capacity is determined on a case-by-case basis in relation to a particular or specific task or decision and at a particular moment in time.

**(i) Capacity is Decision-Specific**

Capacity is *decision*-specific in that, for example, the capacity to grant a power of attorney for property differs from the capacity to grant a power of attorney for personal care, which in turn differs from the capacity to manage one’s property or personal care. Capacity to contract, testamentary capacity, or capacity to give a gift, all involve different considerations as determined at common law. As a result, an individual may be capable of making some decisions, but not others.

**(ii) Capacity is Time-Specific**

Capacity is *time*-specific in that it can vary over time. Individuals can have good days and bad days where capacity fluctuates. This can be due to the nature of an illness, addiction, medication levels, tiredness, or other factors. Courts have consistently

accepted the principle that capacity to grant a power of attorney or to make a will can vary over time.<sup>5</sup>

The issue of time-specificity and capacity means that any expert assessment or examination is necessarily specific to that time. This can mean that a lawyer's assessment of a client's capacity at the time that instructions are given may have more probative value than an assessor's report, as the assessment is most often not contemporaneous with the giving of the relevant instructions.<sup>6</sup>

**(iii) Capacity is Situation-Specific**

Capacity also can fluctuate with a person's situation or circumstances. A situation of stress or unfamiliar or intimidating circumstances may impact a person's capacity. As an example, a person may be capable of making certain decisions if at home, but have difficulty with those same decisions in a lawyer's office or a doctor's office. Also, the presence or absence of certain individuals may also impact a person's capacity.

**III. CAPACITY ASSESSMENTS**

As noted above, capacity is assessed based on legal and medical factors. In the context of a lawyer's dealings, however, a lawyer is best to keep in mind the relevant capacity standards (which are set out in more detail below) and think about applying those standards to the situation. A lawyer who has concerns about a client's ability to understand the relevant information and appreciate the foreseeable consequences of a decision would be well-minded to put those questions to the client directly and make detailed notes of such enquiry. Those notes if sufficiently fleshed out could go a long way to addressing capacity concerns should they arise in the future.

In cases where the lawyer is not satisfied of the client's capacity or has significant doubts, it may be worthwhile to send the client out to a formal assessment by a qualified capacity assessor. A capacity assessor may be a physician, social worker, nurse or

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<sup>5</sup> *Palahnuk Estate, Brillinger v. Brillinger-Cain, Knox v. Burton*, all *supra* note 4

<sup>6</sup> *Palahnuk Estate*, *supra* note 3 at para. 71

other health care professional.<sup>7</sup> In complicated cases where there may be dementia or other complex disorder, a geriatric psychiatrist well-versed in such diseases may be best-placed to conduct the assessment. Furthermore, when dealing with complicated legal issues as may arise in a real estate practice, an experienced assessor who has dealt with such matters previously may also be a good choice to enlist.

The lawyer should provide clear directions in writing to the assessor outlining the transaction in question that the client wishes to undertake, seeking an assessment of that client's capacity in that regard and setting out the appropriate legal standard. This is especially important as the assessor is not usually a lawyer, and thus requires the guidance of the lawyer on the particular issues the assessor must address and weigh.

Rights advice will be provided at the outset of the assessment to confirm that the client understands that the assessment could impact his or her rights, such that he or she has a right to refuse to undergo the assessment.

If the capacity assessment is negative, then the lawyer should not act in respect of the decision in question. Similarly, if a lawyer reaches that conclusion on his or her own, he or she should not act for the client in respect of that decision. If there is another task that the client seeks to undertake, the lawyer may undertake another capacity assessment to determine whether the client has the requisite capacity. As a result, in a single retainer there may be more than one capacity assessment.

If the assessor concludes that the client possesses capacity on the task in question, then that report will assist the lawyer in dealing with that client and taking instructions in respect of that task. Any capacity assessment obtained should be placed in the client's file in the event it is required in the future.

#### **IV. CAPACITY DEFINED**

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<sup>7</sup> The term "capacity assessor" is defined in the *Substitute Decisions Act*, Regulation 460/05 and comprises members of the following colleges: College of Physicians and Surgeons of Ontario; College of Psychologist of Ontario; Ontario College of Social Workers and Social Service Workers (while holding a certificate of registration for social work); College of Occupational Therapists of Ontario; and College of Nurses of Ontario (while holding a general certificate of registration as a registered nurse or an extended certificate of registration as a registered nurse).

Although each task has its own specific capacity standard, it is fair to say that in very broad terms, capacity to make a decision is demonstrated by (a) a person's ability to understand all the information that is relevant to the decision to be made, as well as (b) that person's ability to process the information and appreciate the potential implications of the decision in question.

To be found capable, a person must possess both the ability to understand the relevant information and the ability to appreciate the consequences of the decision in question. If an individual is able to understand the relevant information but not to process the effects of the information, then he or she lacks the requisite capacity to make the decision in question.

The 2003 Supreme Court decision in *Starson v. Swayze*<sup>8</sup> is helpful in setting out guidance on the issue of mental capacity. Although the decision dealt solely with the question of capacity to consent to treatment under the *Health Care Consent Act, 1996*<sup>9</sup> (an issue and statute which are not addressed in this paper) it is helpful in that there are similar themes applied in the context of all capacity determinations.

Writing for the majority, Major J., made several noteworthy points about capacity. First, he pointed out that the presence of a mental disorder does not equal incapacity, and that the presumption of legal capacity can only be rebutted by clear evidence.<sup>10</sup>

Major J. emphasized that the ability to understand and process information is key to capacity. The ability to comprehend the relevant information requires the "cognitive ability to process, retain and understand the relevant information."<sup>11</sup> Then, a person must "be able to apply the relevant information to one's own circumstances, and to be able to weigh the foreseeable risks and benefits of a decision or lack thereof."<sup>12</sup>

A capable person requires the "ability to appreciate the consequences of a decision", and not necessarily "actual appreciation of those consequences."<sup>13</sup> By this reasoning,

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<sup>8</sup> *Supra* note 5

<sup>9</sup> S.O. 1996, c. 2, Sched. A as amended

<sup>10</sup> *Starson v. Swayze, supra* note 5 at para. 77

<sup>11</sup> *Ibid.* at para. 78

<sup>12</sup> *Ibid.* at para. 78

<sup>13</sup> *Ibid.* at paras. 80-81

a person who possesses the ability to understand the relevant information and appreciate the consequences of a decision has mental capacity, even if he or she fails to exercise those abilities.

Major J. also pointed out that the person subjected to the capacity assessment, need not agree with the assessor on all points, and that mental capacity is not equated with correctness or reasonableness.<sup>14</sup> A capable person is entitled to be unwise in his or her decision-making.

In *Re. Koch*,<sup>15</sup> Justice Quinn emphasized the point that folly is not equated with incapacity. A person is entitled to make a less-than-wise decision so long as that person has the requisite capacity to make that particular decision. Justice Quinn wrote emphatically as follows:

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It is mental capacity and not wisdom that is the subject of the *SDA* and the *HCCA*. The right knowingly to be foolish is not unimportant; the right to voluntarily assume risks is to be respected. ...<sup>16</sup>

Therefore, it is not the decision itself which determines a person's capacity, but whether the person at the time of making the decision had the requisite capacity to do so. The folly or wisdom of the decision is not determinative of capacity.

## **V. CAPACITY IN REAL ESTATE TRANSACTIONS**

### ***What is the Relevant Capacity Standard in Real Estate Transactions?***

As noted above, capacity is decision-specific. In the context of real estate transactions, however, there is no set standard for capacity to enter into a real estate transaction.

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<sup>14</sup> *Ibid.* at para. 79

<sup>15</sup> 1997 CarswellOnt 824, 33 O.R. (3d) 485, 27 O.T.C. 161 (Gen. Div.)

<sup>16</sup> *Ibid.* at para. 69

To determine which standard is applicable it is important to consider the nature of the real estate transaction.

When determining capacity in real estate transactions, courts generally consider whether the individual in question had capacity to enter into a contract.

In cases where the person in question is undertaking a real estate transaction to make a gift, then the test for capacity to make a gift is relevant. Where that gift is substantial, or otherwise affects the individual's testamentary dispositions, then it is arguable that the test for testamentary capacity applies.

The question of which standard is applicable is relevant as the tests for each task vary.

### ***Capacity to Contract***

Most case law on the issue of real estate and capacity focuses on an individual's capacity to contract.<sup>17</sup>

The presumptions relating to capacity to contract are set out in the *Substitute Decisions Act, 1992* ("SDA").<sup>18</sup> Subsection 2(1) of the *SDA* provides that all persons who are eighteen years of age or older are presumed to be capable of entering into a contract.<sup>19</sup> Subsection 2(3) then provides that a person is entitled to rely on that presumption of capacity to contract unless there are "reasonable grounds to believe that the other person is incapable of entering into the contract."<sup>20</sup>

From the lawyer's perspective then, the statutory presumptions of capacity provide that in most cases, one can rely on such, unless there are "reasonable grounds" to think that the client lacks the capacity to contract. It is up to the lawyer then to be aware of potential instances of incapacity.

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<sup>17</sup> See for example: *Park v. Park*, 2013 ONSC 431 (CanLII); *de Franco v. Khatri*, 2005 CarswellOnt 1744, 303 R.P.R. (4th) 190; *Upper Valley Dodge v. Estate of Cronier*, 2004 ONSC 34431 (CanLII)

<sup>18</sup> *SDA*, *supra* note 2

<sup>19</sup> *SDA*, subsection 2(1)

<sup>20</sup> *SDA*, subsection 2(3)



When the issue of potential incapacity arises, one must consider what the standard for capacity to enter into a contract is. That standard is set out not in statute, but in the common law.

The test for capacity to contract was set out succinctly in the 1973 Prince Edward Island, Supreme Court decision of *Bank of Nova Scotia v. Kelly*.<sup>21</sup> In that case, the court defined capacity to enter into a contract as requiring the following:

- (a) The ability to understand the nature of the contract; and
- (b) the ability to understand the contract's specific effect in the specific circumstances.

Therefore in order to be capable of entering into a contract, a person must understand the nature and consequences of the contract contemplated. He or she requires the ability not only to understand the nature of the contract, but also the impact on his or her interests.

In *Bank of Nova Scotia v. Kelly*, the Court emphasized that a person entering into a contract must exhibit an ability to understand all possible ramifications of the contract. In the ruling, Nicholson J. concluded that the person in question was able to understand the basic facts but unable to process how those facts would affect him:

..It is my opinion that failure of the defendant to fully understand the consequences of his failure to meet his obligations under the promissory notes is a circumstance which must be taken into account. I find that the defendant was probably able to understand the terms and his obligations to pay the notes but that he was incapable, because of his mental incompetence, of forming a rational judgment of their effect on his interests. I therefore find that by reason of mental incompetence the defendant was not capable of understanding the terms of the notes *and of forming a rational judgment of their effect on his interests*.<sup>22</sup>

The standard of capacity to contract stems from the requirement that all contracting parties have full and informed consent when entering into a contract. In the 1953

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<sup>21</sup> (1973), 41 D.L.R. (3d) 273 (P.E.I. S.C.) [hereinafter *Bank of Nova Scotia v. Kelly*]

<sup>22</sup> *Ibid.* at 284 [emphasis in original]

decision of *Royal Trust Co. v. Diamant*,<sup>23</sup> the British Columbia Supreme Court emphasized that in order to be capable of entering into a contract, the person must be able to understand the “nature and effect of the transaction.” This decision also sets out the point that in order for a contract to be set aside, a contracting party must demonstrate that the party in question was not able to understand the relevant information and/or taking that information to account for how the contract would affect his or her interests.

Specifically, the Court wrote as follows:

The general theory of the law in regard to acts done and contracts made by parties affecting their rights and interests is that in all cases there must be free and full consent to bind the parties. Consent is an act of reason accompanied by deliberation, and it is upon the ground that there is a want of rational and deliberate consent that the conveyances and contracts of persons of unsound mind are generally deemed to be invalid.

**The degree of mental incapacity which must be established in order to render a transaction inter vivos invalid is such a degree of incapacity as would interfere with the capacity to understand substantially the nature and effect of the transaction.** The plaintiff here need not prove that the donor failed to understand the nature and effect of the transaction. The question is whether she was capable of understanding it: *Manches v. Trimborn* (1946), 115 L.J.K.B. 305.<sup>24</sup>

Therefore, in general, in order for an individual to be capable of entering into a real estate transaction, that person requires the capacity to enter into a contract, which means that he or she requires the ability to understand the nature of the real estate transaction, and the ability to appreciate the impact of that transaction on his or her interests.

### ***Capacity to Make A Gift***

In some instances, a real estate transaction is not contractual but is for the giving of a gift. This may be in cases where an individual transfers a property for nominal consideration, or places someone on title on their property. In such instances, the

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<sup>23</sup> [1953] 3 D.L.R. 102 (B.C.S.C.) [hereinafter *Royal Trust Co. v. Diamant*]

<sup>24</sup> *Ibid.* at 6 [emphasis added]

transaction is a gift, rather than a contract. Depending on the size of the gift, it may venture into the territory of testamentary transaction. That is to say, if the size of the gift is significant, and would affect the size of the client's estate, then arguably it is a testamentary disposition.

It is worth noting that since most real estate transactions are of significant value compared to an individual's estate, then most gratuitous transfers of real property would require testamentary capacity, which is set out in more detail below.

Starting with the premise that some real estate transactions are gifts short of a testamentary disposition, then the test for capacity to gift is similar to that as capacity to contract. As with capacity to contract, there is no statutory test for determining the requisite capacity to make a gift. The factors to consider are indeed the same as for those in ascertaining capacity to enter into a contract. Capacity to make a gift requires the following:

- (a) The ability to understand the nature of the gift; and
- (b) The ability to understand the specific effect of the gift in the circumstances.

The common law criteria on capacity to make a gift have been summarized in a number of decisions including the 1953 decision of *Royal Trust Co. v. Diamant*<sup>25</sup> (referred to above). In that case, the Court held that an *inter vivos* transfer is not valid if the donor had "such a degree of incapacity as would interfere with the capacity to understand substantially the nature and effect of the transaction."<sup>26</sup>

This test was further supported in the case of *Re Bunio (Estate of)*:<sup>27</sup>

A gift *inter vivos* is invalid where the donor was not mentally competent to make it. Such incapacity exists where the donor lacks the capacity to understand substantially the nature and effect of the transaction. The question is whether the donor was capable of understanding it...

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<sup>25</sup> *Royal Trust Co. v. Diamant*, *supra* note 24

<sup>26</sup> *Royal Trust Co. v. Diamant*, *supra* note 24 at page 6

<sup>27</sup> 2005 ABQB 137 at para. 4

Citing earlier case law on the capacity to gift, the British Columbia Supreme Court in *Dahlem (Guardian ad litem of) v. Thore*,<sup>28</sup> stated:

The transaction whereby Mr. Dahlem transferred \$100,000 to Mr. Thore is void. The Defendants have not demonstrated that a valid gift was made to Mr. Thore. **On the authority of *Kooner v. Kooner (1979)*, 100 D.L.R. (3d.) 441, a transferor must have the intention to give and knowledge of the nature of the extent of what he proposes to transfer, or a resulting trust will be presumed.**<sup>29</sup>

In his book, *Gifts: a Study in Comparative Law*,<sup>30</sup> Professor Richard Hyland of Rutgers University examines the law of gifts in the United States, England, India, Belgium, France, Germany, Italy, and Spain and addresses the factors for determining capacity in various jurisdictions.

Referring to American law, Professor Hyland outlines the following proposition on capacity to gift:

...In American law, donors generally have the capacity to make a gift only if they understand the extent of their property, the natural object of their bounty, the nature of the disposition, and the effect the gift may have on their future financial security.<sup>31</sup>

While these considerations are similar to those outlined in the cases cited, they set out a somewhat more onerous obligation to meet, than just a simple test of understanding the nature of the gift and its effect, in that it requires donors to understand the “extent of their property.” This ties into the standard for testamentary capacity which is set out below. Arguably, since most gifts of property are significant in value, the appropriate capacity standard is closer to that for capacity to make a will, which is set out below.

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<sup>28</sup> [1994] B.C.J. No. 809 B.C.S.C.

<sup>29</sup> *Ibid.* at page 9 [emphasis added]

<sup>30</sup> Hyland, R., *Gifts: A Study in Comparative Law* (Oxford: Oxford University Press, 2009)

<sup>31</sup> *Ibid.* at page 222

### ***Testamentary Capacity: Capacity to Make a Will***

In the English case of *Re. Beaney*,<sup>32</sup> the court explained the difference in the threshold of capacity to give gifts as opposed to making a will, as follows:

At one extreme, if the subject-matter and value of a gift are trivial in relation to the donor's other assets a low degree of understanding will suffice. But, at the other, if its effect is to dispose of the donor's only asset of value and thus for practical purposes to pre-empt the devolution of his estate under his will or on an intestacy, then the degree of understanding required is as high as that required to make a will, and the donor must understand the claims of all potential donees and the extent of the property to be disposed of.

While the judge in *Re. Beaney* imposed the standard of testamentary capacity for gifts that are the donor's "only asset of value" and effectively comprise most of the estate, Canadian law imposes the standard of testamentary capacity for gifts that comprise less than the majority of an estate. This proposition is not new. In an even earlier case, *Mathieu v. Saint-Michel*<sup>33</sup> the Supreme Court of Canada ruled that the standard of testamentary capacity applies for an *inter vivos* gift of real property, even though the gift was not the donor's sole asset of value. The principle appears to be that once the gift is significant, relative to the donor's estate, even if it be less than the entirety of the estate, then the standard for testamentary capacity applies for the gift to be valid.

The test for making a will is more onerous than that for entering into a contract as the former requires the testator to have an understanding not only of his or her property, but also the fact that there could be parties who would have potential claims in respect of that property, and to understand the basis of those claims.

The legal criteria to be applied in determining the requisite capacity to make a Will was established in the 1800's in the seminal English case of *Banks v. Goodfellow*.<sup>34</sup> Testamentary capacity is defined as:

- (a) The ability to understand the nature and effect of making a Will;

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<sup>32</sup> [1978] 2 All E.R. 595 (Ch.D.) [hereinafter *Re. Beaney*]

<sup>33</sup> [1956] S.C.R. 477 at 487

<sup>34</sup> (1870) L.R. 5 Q.B. 549.

- (b) The ability to understand the extent of the property in question; and
- (c) The ability to understand the claims of persons who would normally expect to benefit under a Will of the testator.

Other cases have clarified the issue of testamentary capacity, and in particular that a testator need not have a detailed understanding of these three factors. In the 1944 decision of *Leger et al. v. Poirier*,<sup>35</sup> the Supreme Court set out that the testator requires a "disposing mind and memory" which is defined as a mind that is "able to comprehend, of its own initiative and volition, the essential elements of will making, property, objects, just claims to consideration, revocation of existing dispositions, and the like."

There is a view that testamentary capacity "focuses on the testator's ability to understand the nature and effect of the act of making a Will, rather than the particular provisions of the proposed Will."<sup>36</sup> From the real estate perspective, this suggests that a client is required then to understand the nature and effect of transferring a property, short of the actual transfer itself. This distinction may be less relevant in a real estate setting, however, as there is no real distinction between the "making of the transfer" and the transfer itself.

Analogizing to the context of a real estate transaction, however, this would require the donor to have the ability to comprehend the nature and impact of making a gratuitous real estate transfer in general.

Applying the *Banks v. Goodfellow* criteria to the setting of a gratuitous real estate transfer, the relevant capacity standard would arguably require the following:

- (a) The ability to understand the nature and effect of making the transfer in question;
- (b) The ability to understand the extent of all of the donor's property; and
- (c) The ability to understand the claims of persons who would normally expect to benefit under a Will of the donor.

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<sup>35</sup> *Leger et al. v. Poirier*, [1944] S.C.R. 152 at page 153

<sup>36</sup> Robertson, G., *Mental Disability and the Law in Canada*, 2<sup>nd</sup> ed., (Toronto: Carswell, 1994) at p. 214 [hereinafter *Mental Disability and the Law in Canada*]

A solicitor who drafts a Will is obliged to assess the client's testamentary capacity when instructed to prepare the Will where circumstances warrant it. The drafting lawyer must ask probing questions and be satisfied that the testator not only can communicate clearly, and answer questions in a rational manner, but that the testator has the ability to understand the nature and effect of the Will, the extent of his or her property, and all potential claims that could be expected with respect to the estate.<sup>37</sup> Thus similarly, a lawyer taking instructions respecting the gratuitous transfer of real property ought to take steps to ascertain the client's capacity to make such a transfer on the basis of the criteria for testamentary capacity. The real estate lawyer should ask clear questions respecting the property in question, the donor's other property, and the potential beneficiaries and claimants in respect of the donor's potential estate.

Where the gift is significant in value, the onus is higher on the real estate lawyer, and clear enquiry into and well-documented notes on the issue of capacity are warranted.

### ***Capacity to Instruct Counsel***

A related issue for all lawyers is the matter of capacity to instruct counsel. As with all other decisions, an adult is presumed capable of giving instructions to his or her lawyer.

As set out by Ed Montigny, staff lawyer at ARCH Disability Law Centre, in his paper "Notes on Capacity to Instruct Counsel,"<sup>38</sup> generally, to have capacity to instruct counsel, a client must:

- (a) Understand what they have asked the lawyer to do for them and why,
- (b) Be able to understand and process the information, advice and options the lawyer presents to them; and
- (c) Appreciate the advantages, disadvantages and potential consequences of the various options.<sup>39</sup>

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<sup>37</sup> *Murphy v. Lamphier*, (1914) 31 O.L.R. 287, 6 O.W.N. 238 (Ont.H.C.) at 317, aff'd (1914), 32 O.L.R. 19, 20 D.L.R. 906 (Ont.C.A.); *Hall v. Bennett Estate*, 2003 CanLII 7157 (Ont.C.A.) at para. 58

<sup>38</sup> [www.archdisabilitylaw.ca/?q=notes-capacity-instruct-counsel-0](http://www.archdisabilitylaw.ca/?q=notes-capacity-instruct-counsel-0)

<sup>39</sup> At page 3

As with other capacity issues, lawyers must carefully ask questions and should properly document the answers when they suspect a client's (or potential client's) capacity may be compromised. As our legal system prioritizes autonomy and only provides for the curtailment of independence where there is evidence of incapacity, a lawyer must balance the priority of independence with the need to ensure that vulnerable individuals are protected.

To that end, if a lawyer is satisfied that the client (or potential client) has capacity to give instructions, he or she may act for that client, keeping in mind that with each transaction, the lawyer ought to similarly be satisfied that the client possesses that requisite capacity.

If, however the lawyer is not satisfied that the client (or potential client) has the requisite capacity to give instructions on the task in question, the lawyer should not act in that transaction.

## **VI. THE RULES OF PROFESSIONAL CONDUCT**

The Rules of Professional Conduct provide some guidance to the lawyer facing clients with potential capacity challenges.

Subrule 2.02(6) provides that a lawyer in dealing with a client who may have compromised capacity, the lawyer is required to maintain as much of a regular solicitor-client relationship as possible. This presumes that the client in question has the requisite capacity to retain and instruct counsel such that the lawyer may be retained and act on his or her behalf.

The Rules also contemplate a scenario where subsequent to the retainer, a client is no longer able to give capable instructions at which point, the lawyer ought to seek alternate representation for the incapable person by for example a litigation guardian or the Public Guardian and Trustee.

Subrule 2.02(6) and the accompanying commentary provide as follows (with emphasis added):



## 2.02 QUALITY OF SERVICE

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### ***Client under a Disability***

(6) When a client's ability to make decisions is impaired because of minority, **mental disability, or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal lawyer and client relationship.**

Commentary

**A lawyer and client relationship presupposes that the client has the requisite mental ability to make decisions about his or her legal affairs and to give the lawyer instructions.** A client's ability to make decisions, however, depends on such factors as his or her age, intelligence, experience, and mental and physical health, and on the advice, guidance, and support of others. Further, a client's ability to make decisions may change, for better or worse, over time. When a client is or comes to be under a disability that impairs his or her ability to make decisions, the impairment may be minor or it might prevent the client from having the legal capacity to give instructions or to enter into binding legal relationships. **Recognizing these factors, the purpose of this rule is to direct a lawyer with a client under a disability to maintain, as far as reasonably possible, a normal lawyer and client relationship.**

A lawyer with a client under a disability should appreciate that **if the disability of the client is such that the client no longer has the legal capacity to manage his or her legal affairs, the lawyer may need to take steps to have a lawfully authorized representative appointed, for example, a litigation guardian, or to obtain the assistance of the Office of the Public Guardian and Trustee or the Office of the Children's Lawyer to protect the interests of the client. In any event, the lawyer has an ethical obligation to ensure that the client's interests are not abandoned.**<sup>40</sup>

...

The Rule requiring maintaining a normal solicitor-client relationship with a client who may have some capacity challenges would also require that a lawyer be bound by the Rule respecting confidentiality. The Commentary in respect of Rule 2.03 (Confidentiality) provides that the duty of confidentiality is owed "to every client without exception." Rule 2.03 provides as follows:

## 2.03 CONFIDENTIALITY

### **Confidential Information**

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<sup>40</sup> The LSUC Rules of Professional Conduct, Amendments current to April 28, 2011, Rule 2.02(6) and Commentary [emphasis added]

2.03 (1) A lawyer at all times shall hold in strict confidence all information concerning the business and affairs of the client acquired in the course of the professional relationship and shall not divulge any such information unless expressly or impliedly authorized by the client or required by law to do so.

Commentary

A lawyer cannot render effective professional service to the client unless there is full and unreserved communication between them. At the same time, the client must feel completely secure and entitled to proceed on the basis that, without any express request or stipulation on the client's part, matters disclosed to or discussed with the lawyer will be held in strict confidence.

**This rule must be distinguished from the evidentiary rule of lawyer and client privilege concerning oral or documentary communications passing between the client and the lawyer. The ethical rule is wider and applies without regard to the nature or source of the information or the fact that others may share the knowledge.**

**A lawyer owes the duty of confidentiality to every client without exception** and whether or not the client is a continuing or casual client. The duty survives the professional relationship and continues indefinitely after the lawyer has ceased to act for the client, whether or not differences have arisen between them.<sup>41</sup>

...

The issue of confidentiality and older adults can be challenging. Often older adults have family members who are highly involved with and assist them. To the extent that a practitioner represents a client, whether an older adult or otherwise, he or she is required to adhere to his or her duty of confidentiality, except in cases where the client instructs the lawyer to divulge information to particular individuals. It is essential, when dealing with a client to ensure that their rights are not compromised because of their age, despite the otherwise possibly well-meaning intentions of family members or other individuals.

Rule 2.09 requires a lawyer to only withdraw from representing a client “for good cause.” If a lawyer has ascertained that his or her client is capable of instructing the lawyer, and undertaking the particular transactions, then he or she should continue to act. As for situations where capacity later becomes an issue, there are options short of

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<sup>41</sup> The LSUC Rules of Professional Conduct, Amendments current to April 28, 2011, Rule 2.03 [emphasis added]

withdrawal, including seeking a litigation guardian (as set out in Rule 2.02 (6)). Rule 2.09 provides as follows:

## **2.09 - WITHDRAWAL FROM REPRESENTATION**

### **Withdrawal from Representation**

2.09 (1) A lawyer shall not withdraw from representation of a client except for good cause and upon notice to the client appropriate in the circumstances.

#### **Commentary**

Although the client has the right to terminate the lawyer-client relationship at will, the lawyer does not enjoy the same freedom of action. Having undertaken the representation of a client, the lawyer should complete the task as ably as possible unless there is justifiable cause for terminating the relationship.

No hard and fast rules can be laid down about what will constitute reasonable notice before withdrawal. Where the matter is covered by statutory provisions or rules of Court, these will govern. In other situations, the governing principle is that the lawyer should protect the client's interests to the best of the lawyer's ability and should not desert the client at a critical stage of a matter or at a time when withdrawal would put the client in a position of disadvantage or peril.

#### **Optional Withdrawal**

(2) Subject to the rules about criminal proceedings and the direction of the tribunal, where there has been a serious loss of confidence between the lawyer and the client, the lawyer may withdraw.

#### **Commentary**

A lawyer who is deceived by the client will have justifiable cause for withdrawal, and the refusal of the client to accept and act upon the lawyer's advice on a significant point might indicate a loss of confidence justifying withdrawal. However, the lawyer should not use the threat of withdrawal as a device to force a hasty decision by the client on a difficult question.

...

#### **Mandatory Withdrawal**

“(7) Subject to the rules about criminal proceedings and the direction of the tribunal, a lawyer shall withdraw if

(a) discharged by the client,

(b) the lawyer is instructed by the client to do something inconsistent with the lawyer's duty to the tribunal and, following explanation, the client persists in such instructions,

- (c) the client is guilty of dishonourable conduct in the proceedings or is taking a position solely to harass or maliciously injure another,
- (d) it becomes clear that the lawyer's continued employment will lead to a breach of these rules,
- (d.1) the lawyer is required to do so pursuant to subrules 2.02 (5.1) or (5.2) (dishonesty, fraud, etc. when client an organization), or
- (e) the lawyer is not competent to handle the matter.<sup>42</sup>

...

Rule 4.01 requires that a lawyer act honestly and ensure fairness in representing clients. This holds for clients who have potential capacity challenges as well:

#### ***RULE 4 - ADVOCACY***

**4.01 (1) When acting as an advocate, a lawyer shall represent the client resolutely and honourably within the limits of the law while treating the tribunal with candour, fairness, courtesy, and respect.”**

Commentary

The lawyer has a duty to the client to raise fearlessly every issue, advance every argument, and ask every question, however distasteful, which the lawyer thinks will help the client's case and to endeavour to obtain for the client the benefit of every remedy and defence authorized by law. **The lawyer must discharge this duty by fair and honourable means, without illegality and in a manner that is consistent with the lawyer's duty to treat the tribunal with candour, fairness, courtesy and respect and in a way that promotes the parties' right to a fair hearing where justice can be done.**<sup>43</sup>

...

While clients with potentially compromised capacity pose challenges for their lawyers, a lawyer who acts for a client is still required to abide by all the duties as set out in the Rules of Professional Conduct.

## **VII. UNDUE INFLUENCE AND INCAPACITY**

Another related issue that lawyers ought to be aware of is the potential for undue influence in real estate transactions. As with capacity, the majority of older adults are

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<sup>42</sup> The LSUC Rules of Professional Conduct, Amendments current to April 28, 2011, Rule 2.09(1), 2.09(2), 2.09(7)

not subjected to this, but there can be a heightened risk of such situations, particularly where the older adult's capacity is potentially compromised.

Undue influence is generally defined as circumstances where one person has the ability to dominate the will of another person, whether through manipulation, coercion, or the outright but subtle abuse of power.<sup>44</sup>

There is significant interplay between undue influence and incapacity. In situations of compromised capacity, the potential for undue influence is elevated. In the 2013 decision of *Gironda v. Gironda*,<sup>45</sup> Justice Penny noted that “[w]here an individual's mental capacity is diminished, she will be more vulnerable to undue influence.”

Where capacity is at issue, “the legal threshold becomes higher and calls for more careful probing of the testator's rationale at the time of the execution of a Will in particular, where circumstances are automatically more complex and there is the added suggestion of undue influence.”<sup>46</sup>

In *Gironda*, Justice Penny set out a list of indicators of undue influence, which includes the following: “..where the testator is dependent on the beneficiary for emotional and physical needs, where the testator is socially isolated, where the testator has experienced recent family conflict, where the testator has experienced recent bereavement, where the testator has made a new will not consistent with prior wills, and where the testator has made testamentary changes simultaneously with changes to other legal documents such as powers of attorney.”<sup>47</sup>

While this list is non-exhaustive it sets out a comprehensive set of criteria that lawyers can use as guidance. From a practical perspective, a lawyer can be alert to the issue of potential undue influence by probing with the client the purpose of the transaction, ensuring that he or she meets with the client alone, and obtaining clear and independent instructions. If the lawyer is concerned about the client's vulnerability and

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<sup>43</sup> The LSUC Rules of Professional Conduct, Amendments current to April 28, 2011, Rule 4

<sup>44</sup> See *Dmyterko Estate v. Kulikovsky*, (1992) CarswellOnt 543 (S.C.)

<sup>45</sup> 2013 ONSC 4133 (CanLII) at para. 56 [hereinafter *Gironda*]

<sup>46</sup> Kenneth I. Shulman *et al.*, “Treatment in Psychiatry, Assessment of Testamentary Capacity and Vulnerability to Undue Influence,” May 2007, 164:5, *Am. J. Psychiatry*, p. 723

<sup>47</sup> *Ibid.* at para. 77

dependence on certain individuals, it may be wise to enquire into that person's relationships with others, and potential reliance on them.

Case law suggests that lawyers have a "heightened" or elevated duty to the client or disappointed beneficiaries where there are potential indicia of undue influence. In the 1997 decision of *Hussey v. Parsons*,<sup>48</sup> Justice Puddester of the Newfoundland Supreme Court (Trial Division) was asked to determine whether the lawyer who assisted the plaintiff's husband with transferring the sale proceeds of her house to her nephew had been negligent. Although Justice Puddester did not find the transfer agreement to be unconscionable, nor that there was actual undue influence, he did find that there was solicitor negligence in the actual execution of the agreement.<sup>49</sup> Justice Puddester noted that there were indicators of potential undue influence that "called for an extra degree of care and inquiry by the defendant [solicitor] in terms of exactly what were the interests, intentions and understandings of the plaintiff [client]."<sup>50</sup>

Thus lawyers when keeping in mind considerations of potential incapacity ought to also be aware of potential undue influence. In cases of older adults who are brought in by other family members or friends or caregivers, or who seek to undertake transactions that unilaterally benefit those individuals, the onus is even higher on the solicitor to ensure that the transaction is not procured through undue influence.

## **VIII. RED FLAGS AND PRACTICE TIPS**

While the vast majority of retainers with older adults will proceed without any concerns, it is important as a practitioner to keep in mind the issues of capacity, and in a similar vein, undue influence. To protect oneself as a solicitor one should spend enough time with each client to ensure that he or she is receiving capable instructions.

If there is any reason for concern then a lawyer would be well-advised to take the time and steps required to ensure that the client has the requisite capacity. These indicators can be hesitation or confusion on the part of the client, difficulty remembering details, cognitive difficulties, or any other difficulties that demonstrate the client may not

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<sup>48</sup> 1997 CarswellNfld 349 (SCTD) [hereinafter *Hussey v. Parsons*]

<sup>49</sup> *Ibid.*, para. 685

comprehend the transaction. Other indicators may be the transaction itself, or the presence or involvement of a third party who benefits from the proposed transaction. If, for instance, an older adult seeks to transfer the main asset he or she owns to a third party (whether family or otherwise), the lawyer is well-advised to ensure that the client is doing so on his or her own volition, that he or she is capable, and that he or she is even if capable, free of undue influence. This will require meeting with the client alone, without the third party, and in circumstances that make the client comfortable. This can be in the client's home and at times of the day when the client is most alert. The lawyer may have to make enquiries with the client as to the circumstances that he or she would prefer and should ask about when the client is most at ease and alert, i.e. at what time they take medications and eat meals, so that the client is best-positioned to properly instruct the lawyer. As capacity can fluctuate with the time and situation a person is in, it is good practice for a lawyer to attempt as much as possible to facilitate the person's comfort.

A lawyer can also provide a role to assist a client in understanding the relevant information and appreciating the consequences of a decision. A lawyer has in his or her possession information and expertise to assist a client in making decisions that affect their legal entitlements. That is to say that as part of the process of ensuring capable instructions, a lawyer ought to ensure that the client has all the information available so that to the extent he or she is able to, he or she can make a capable decision.

From a practical perspective, where a client attends at a lawyer's office, and wishes, for instance to place a real property in joint tenancy with another individual, it is incumbent on that lawyer to explain the ramifications of such a decision, that is, that the property may pass to the receiving party by right of survivorship,<sup>51</sup> that if the receiving party has liabilities or legal disputes, that could affect the property, and that the older adult may be limited from accessing the entire equity in the property in the future. This is apart from the implications that such a transaction could have on one's estate which ought to be probed in full.

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<sup>50</sup> *Ibid.*

<sup>51</sup> Subject to any presumption of resulting trust as per the Supreme Court decisions in *Pecore v. Pecore* (2007) SCC 17, *Madsen Estate v. Saylor* (2007) SCC 18

The lawyer should satisfy him or herself that the client has the ability to appreciate those ramifications and assist the client by explaining them to him or her. It is those ramifications that the client must have the ability to appreciate in order to have capacity.

The issue of undue influence is canvassed above, and the lawyer should also satisfy him or herself that the transaction is not being undertaken due to the undue influence of another party.

As capacity is task-specific, a lawyer must ensure that he or she receives capable instructions on each task in a retainer.

If a client lacks the requisite capacity to undertake a task, a lawyer must not act on the client's instructions in respect of that task.

With all such files, it is incumbent on a lawyer to ask thorough questions of the client and to write and keep careful notes. While in many situations, retrospective capacity assessments are often conducted, the most valuable assessment is the contemporaneous assessment conducted by the attending lawyer. Carefully documented files with evidence that the lawyer probed sufficiently into the client's capacity and the possibility of undue influence can assist a lawyer many years down the road.

## **IX. CONCLUSION**

Our legal system prioritizes the autonomy of individuals to make decisions on their own behalf. That autonomy has very limited checks that are put in place to protect those who are vulnerable. While our laws presume the capacity of individuals to make their own decisions, that presumption is set aside where there is evidence that a person does not have the requisite capacity to make that decision.



While the issue of capacity is complex, it is one that all lawyers must be aware of. A lawyer can only act on the capable instructions of a client.

Since real estate transactions usually pertain to the most valuable asset(s) held by a person, the onus is particularly high on those lawyers to ensure that they act only on capable instructions, and that the steps taken are those of the capable client and not at the behest of a third party who seeks to take advantage of a vulnerable individual.

Elder abuse frequently involves the transfer or encumbrance of real property. A real estate lawyer who is well-versed in issues of capacity and undue influence is well-positioned to prevent financial abuse of older and other vulnerable adults.

*This paper is intended for the purposes of providing information only and is to be used only for the purposes of guidance. This paper is not intended to be relied upon as the giving of legal advice and does not purport to be exhaustive.*

*Ameena Sultan, Whaley Estate Litigation,  
2014*

*May,*

### **APPENDIX: SUMMARY OF CAPACITY STANDARDS**

The following is a synopsis which attempts to summarize the various standards, factors, or tests relevant for capacity evaluation:

TASK	SOURCE	DEFINITION OF CAPACITY
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TASK	SOURCE	DEFINITION OF CAPACITY
<b>Manage property</b>	SDA, s. 6	(a) Ability to understand the information that is relevant in making a decision in the management of one's property; <u>and</u> (b) Ability to appreciate the reasonably foreseeable consequences of a decision or lack of a decision.
<b>Make personal care decisions</b>	SDA, s. 45	(a) Ability to understand the information that is relevant to making a decision relating to his or her own health care, nutrition, shelter, clothing, hygiene or safety; <u>and</u> (b) Ability to appreciate the reasonably foreseeable consequences of a decision or lack of decision.
<b>Grant and revoke a POA for Property</b>	SDA, s. 8	(a) Knowledge of what kind of property he or she has and its approximate value; (b) Awareness of obligations owed to his or her dependants; (c) Knowledge that the attorney will be able to do on the person's behalf anything in respect of property that the person could do if capable, except make a will, subject to the conditions and restrictions set out in the power of attorney; (d) Knowledge that the attorney must account for his or her dealings with the person's property; (e) Knowledge that he or she may, if capable, revoke the continuing power of attorney; (f) Appreciation that unless the attorney manages the property prudently its value may decline; <u>and</u> (g) Appreciation of the possibility that the attorney could misuse the authority given to him or her.
<b>Grant and revoke a POA for Personal Care</b>	SDA, s. 47	(a) Ability to understand whether the proposed attorney has a genuine concern for the person's welfare; <u>and</u> (b) Appreciation that the person may need to have the proposed attorney make decisions for the person.
<b>Contract</b>	Common law	(a) Ability to understand the nature of the contract; <u>and</u> (b) Ability to understand the contract's specific effect in the specific circumstances.
<b>Gift</b>	Common law	(a) Ability to understand the nature of the gift; <u>and</u> (b) Ability to understand the specific effect of the gift in the circumstances.  <i>In the case of significant gifts (i.e. relative to the estate of the donor), then the test for testamentary capacity arguably applies. Intention is a factor in determining the gift.</i>
<b>Make a will</b>	Common law	(a) Ability to understand the nature and effect of making a will; (b) Ability to understand the extent of the property in question; <u>and</u>

TASK	SOURCE	DEFINITION OF CAPACITY
		(c) Ability to understand the claims of persons who would normally expect to benefit under a will of the testator.
<b>Revoke a will</b>	Common law	(Same as above – to Make a will)
<b>Make a codicil</b>	Common law	(Same as above – to Make a will)
<b>Make a testamentary designation</b>	Common law	(Same as above – to Make a will)
<b>Create a trust</b>	Common law	(a) Ability to understand the nature of the trust; and (b) Ability to understand the trust`s specific effect in the specific circumstances.  <i>In cases of a testamentary trust, the test for testamentary capacity applies.</i>
<b>Capacity to marry</b>	Common law	Ability to appreciate the nature and effect of the marriage contract, including the responsibilities of the relationship, the state of previous marriages, and the effect on one`s children.  Also possibly required: capacity to manage property and the person  Dr. Malloy stated that for a person to be capable of marriage, he or she must understand the nature of the marriage contract, the state of previous marriages, as well as his or her children and how they may be affected.
<b>Capacity to separate</b>	Common law	Ability to appreciate the nature and consequences of abandoning the marital relationship.
<b>Capacity to divorce</b>	Common law	Ability to appreciate the nature and consequences of a divorce.

*This summary of capacity standards is intended for the purposes of providing information and guidance only. This summary of capacity standards is not intended to be relied upon as the giving of legal advice and does not purport to be exhaustive.*

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2014*

*May,*