

Report

FEATURE

Minimum Capital Requirements On Target

This year the Insurance Corporation reached a Minimum Capital Test (MCT) score of 247, only a few points short of hitting the target range (see *Figure 1*). This is an important target for the Insurance Corporation as it is a measure of solvency. The MCT score is a risk-based formula used by regulators to calculate the total capital an insurer has available as a percentage of the minimum capital the insurer requires to remain solvent. Although the minimum or supervisory level is 150, the Directors have set a target range of 250 to 350, based on the advice of the Insurance Corporation’s actuary. This provides the needed cushion or margin of error in the event of unexpected losses.

The Insurance Corporation recorded comprehensive net income this year of \$2.4 million and increased the accumulated surplus from \$8.7 million to \$11.2 million (see *Financial Statements* on page 2). This 29% increase in surplus was a major contributor to the increase in the MCT score.

The value of the investments in the Insurance Fund increased from \$32.8 million to \$36.6 million. These investments are managed by professional investment managers pursuant to a written investment management agreement setting out clear investment objectives. These investment objectives are consistent with the “Prudent Investor” rule as required by the Insurance Corporation’s enabling legislation, the Real Estate Services Act. The investment objectives are reviewed annually and the performance of the portfolio

REEOIC Minimum Capital Test Results

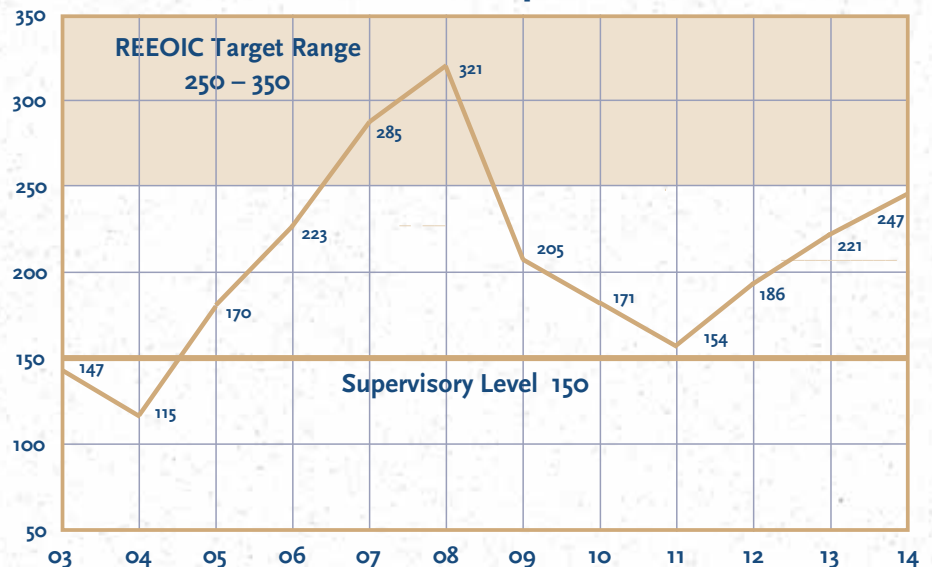


Figure 1

is monitored on an ongoing basis by comparison to established benchmarks. In September 2013, the Directors retained an independent investment advisor to review the Insurance Fund, investment managers and investment policies.

There were 283 claims reported in the policy year that ended February 28, 2014, just one less than the prior year. Despite this being the slowest claims year since 2003, claims liabilities rose by 10% from \$15.7 million last year to \$17.3 million this year. Reasons for this increase include the fact that claims have trended towards being more expensive and a larger number of claims have moved into the over \$100,000 level. The healthy surplus and nearing

the MCT target range means that the Insurance Corporation expects to have the necessary buffer in the event of market volatility or unexpected risks not accounted for in the calculation of policy liabilities.

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New Chair Elected

The Directors of the Insurance Corporation have elected **Judi Whyte** as Chair of the Board effective February 1, 2014. Ms. Whyte is licensed as an Associate Broker with Prudential Sussex Realty in West Vancouver and has been active in the real estate industry for over 37 years. She is a Past President of both the Kootenay Real Estate Board and the Real Estate Institute of B.C., as well as a Past Chair of The Real Estate Council of B.C.

Also elected, as Vice Chair, was **Rosemary Barnes**, licensed as an Associate Broker with Park Georgia Realty Ltd. in Coquitlam. She is a Past President of both the Real Estate Board of Greater Vancouver and the B.C. Real Estate Association as well as a Past Chair of The Real Estate Council of B.C.

New Chair, Judi Whyte

Real Estate Errors and Omissions Insurance Corporation

Statements of Financial Position

	February 28 2014	February 28 2013
ASSETS		
Real Estate Errors and Omissions Insurance Fund Investments (Note 7)	\$ 36,614,034	\$ 32,768,480
Cash	649,302	375,871
Deductibles and accrued interest receivable	204,278	192,539
Prepaid expenses	34,357	33,556
Equipment (Note 8)	81,695	87,830
Deferred income taxes (Note 9)	219,892	186,417
Total assets	\$ 37,803,558	\$ 33,644,693
LIABILITIES		
Accounts payable and accrued liabilities	\$ 211,012	\$ 150,553
Income taxes payable	178,392	479,747
Reserves for policy and claims liabilities (Note 10)	17,293,000	15,724,000
Unearned premiums (Note 11)	8,533,416	8,064,299
Total liabilities	26,215,820	24,418,599
EQUITY		
Accumulated surplus	11,240,585	8,677,095
Accumulated other comprehensive income	347,153	548,999
Total Equity	11,587,738	9,226,094
Total liabilities and equity	\$ 37,803,558	\$ 33,644,693

Commitments (Note 13)

The financial statements were approved by the Board of Directors and authorized for issue on May 9, 2014.

Statements of Operations and Comprehensive Income (Loss)

Year ended	February 28 2014	February 28 2013
REVENUE		
Earned premiums	\$ 8,536,919	\$ 8,214,955
EXPENSES		
Claims and underwriting expenses	4,453,717	5,357,661
Increase in reserve for unpaid claims and adjusting expenses	1,569,000	214,000
Administrative expenses	962,831	1,015,356
Policy acquisition expenses	227,342	197,684
	<u>7,212,890</u>	<u>6,784,701</u>
Operating underwriting income (loss)	1,324,029	1,430,254
Other income (expense)		
Investment income (Note 6)	2,156,561	799,054
Investment management fees	(155,177)	(162,688)
	<u>2,001,384</u>	<u>636,366</u>
Earnings before income taxes	3,325,413	2,066,620
Income tax expense (Note 9)	761,923	434,930
Net earnings	2,563,490	1,631,690
Unrealized gain (loss) on the Real Estate Errors and Omissions Insurance Fund, net of income tax expense of \$95,600 (2013: expense of \$136,400)	271,767	409,201
Reclassification adjustment for realized gains/losses included in net earnings, net of income taxes of \$163,866 (2013: \$30,568)	(473,613)	(84,783)
Comprehensive income	\$ 2,361,644	\$ 1,956,108

These financial statements are excerpts from our complete audited financial statements, which are available on our webpage at www.reeoi.com (password = eno) or by contacting REEOIC's office at 604 669-0019.



Subject Clauses: Let's Make a Deal

SCOTT TWINING, WHITELAW TWINING

Of the various services licensees perform during the course of a real estate transaction, the most important is ensuring that the client's expectations are adequately represented in the contract of purchase and sale. Although licensees are not solicitors, and typically do not have legal training, they are expected to be able to draft legally enforceable documents and may be exposed to liability if a transaction fails to complete owing to inaccurate, confusing or unenforceable contract language. There are resources, such as the *Professional Standards Manual*, which provide licensees with guidance on how to draft standard subject conditions, but these resources may be of limited value in complex transactions where the parties are insisting on unusual terms. In transactions like these, the ability to draft clear and binding contract terms is critical.

A licensee is often called upon to demonstrate his or her drafting skills when the parties are negotiating the subject conditions in a contract of purchase and sale. Typically, the subject condition is intended to be a "condition precedent" to the parties' respective obligations to complete the purchase and sale of property. The licensee drafting the subject condition (usually the buyer's agent) will want the other party to be bound to the agreement, but to suspend his or her client's obligation to perform the contract until the parties know whether the condition precedent is fulfilled. An improperly drafted subject condition, however, may actually result in the contract being construed as merely a "standing offer," with no enforceability. In such a case, the opposing party (generally, the seller) may be free to

walk away from the agreement without legal consequence.

The law in BC recognizes three different "classes" of conditions precedent each of which has a different legal effect. These classes are as follows:

1. Entirely subjective. An entirely subjective clause is one which depends entirely on the subjective state of mind of the purchaser. An example would be "subject to the purchaser obtaining satisfactory financing." Some cases have held that such a clause does not create a binding agreement, but rather constitutes a standing offer. If there is no binding contract, both parties are free to walk away from the agreement at any time until the condition has been removed or waived and acceptance has been communicated to the other party.

PAY CLOSE ATTENTION TO THE WAY SUBJECT CONDITIONS ARE DRAFTED

2. Clear, precise and objective. A clause which is clear, precise and objective is a "true condition precedent." These clauses are entirely dependent on the happening of an event that is in the sole power of an uninterested third party to perform. An example might be "subject to John Smith being elected as Mayor in the municipal election of October 15, 2014." In this scenario, there is a binding contract but no obligation on either party to perform until the condition precedent is fulfilled. If the condition is not fulfilled, then the contract is at an end and both parties may walk away from the agreement.

3. Partly subjective and partly objective. Most subject clauses fall into this category. An example is "subject to the seller obtaining third reading approval for rezoning to Commercial use by November 1, 2014." This clause is dependent on the subjective action of the seller in applying for zoning approval and the objective action of the municipality in granting approval. In this case, the law implies an additional term that the parties will take all reasonable steps to cause the subject condition to be fulfilled. Where the subject condition is partly subjective and partly objective, the parties are bound to the agreement but have no obligation to perform until the subject condition is fulfilled or waived.

Licensees should be aware of the risk that a purely subjective subject condition may result in the entire contract being deemed unenforceable. This is what happened in *Kitsilano Enterprises Ltd. v. G & A Developments Ltd.* (1990), 48 B.C.L.R. (2d) 70 (S.C.), where one of the conditions was that the offer was subject to the "Purchaser's review of all leases, contracts, plans and surveys and the state of title to the Lands, and any existing easement agreements, such review to be to the sole satisfaction of the Purchaser."

The Court held that this subject clause and other vague conditions indicated that the agreement was only an offer, and therefore not binding on the seller. The Court considered the subject clauses to be "entirely subjective" in nature, and subject to the whim of the particular purchaser. Accordingly, "there [was] no mutuality of

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intention [as between buyer and seller] to support a binding agreement” and the contract was deemed to be unenforceable. In order to be enforceable as a subject clause, the wording should have included reference to objective criteria on which the buyer’s review of the records could be assessed.

Occasionally, poor drafting can cause confusion and thus lawsuits. In *Gulston v. Aldred*, 2010 BCSC 241, the Court was faced with considering whether the following clause amounted to a condition precedent or a seller’s warranty:

“The seller shall, at the seller’s expense, remedy the soil contamination caused by the underground oil storage tank in compliance with current environmental standards as overseen by the municipal authorities and obtain a certificate of approval from the municipal authorities on or before May 28, 2008.”

As a result of the wording used, it was open to interpretation as to whether the above clause was a condition precedent or a warranty.

In *Gulston*, the remediation work was completed by May 28, 2008 but the seller did not obtain the required certificate until June 4, 2008. While the buyer initially took no issue with the late delivery of the certificate, the buyer subsequently used the delay to justify walking away from the contract. The buyer argued that the seller’s obligation to obtain a certificate of approval from the District of West Vancouver was a condition precedent to the contract and the contract came to an end when the seller failed to satisfy the condition within the time provided. The seller argued that the clause was not a true condition precedent but rather a warranty which imposed on the seller an obligation to remediate the soil *at some point in time* and that the buyer had waived the time is of the essence clause in the contract by accepting the late delivery of the certificate. The fact that the seller had not fulfilled the warranty by May 29 did not cause the parties’ respective contractual obligations to come to an

end, and the buyer was consequently in breach for failing to complete.

The trial judge held that the clause was a warranty rather than a true condition precedent since there was nothing in the wording of the clause to indicate that the buyer’s obligation to fulfill his end of the bargain was triggered only if the remediation had been completed by May 29. The Court observed that if the parties had intended such a result, they could have done so by using language indicating that the performance of the contract was conditional on the remediation having occurred. The Court found that the use of the mandatory word “shall” was indicative of the clause being a warranty rather than a condition precedent. This case is an example of the importance of drafting clauses clearly and in accordance with your client’s intentions.

Whether acting for buyers or sellers, licensees should be aware of the potential problems that come from contracts that are vague, ambiguous or subjective. Licensees who see a contract that may contain terms like that should suggest that their clients get legal advice before entering into the contract.

The take home message for licensees is to pay close attention to the way subject conditions are drafted. Although BCREA’s standard form contract of purchase and sale does contain a safety net (clause 21) that mitigates the risk that a subject clause that is too subjective will result in an unenforceable contract, as a rule of thumb, avoid drafting subject conditions that are entirely subjective or are so vague that they may permit the buyer wide latitude to walk away on a whim. Plain language should be used which makes it clear that the subject clause is intended to be a condition precedent to the buyer’s obligation to complete and provides objective criteria on which to assess whether the condition has been fulfilled. Finally, if you are unsure about how to draft clauses that reflect your client’s interest in the transaction, take the opportunity to speak to your managing broker or legal counsel before putting pen to paper.

RiskReport

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BOARD OF DIRECTORS

Judi Whyte
Chair

Rosemary Barnes
Vice Chair

Bryon Brandle

Peter Oswell

Liz Tutt

Scott Veitch

Dave Watt

Suite 1604
700 West Pender Street
Vancouver, BC
Canada V6C 1G8

Tel 604-669-0019

Fax 604-669-0021

Leslie Howatt
Executive Officer

Email lhowatt@reeoic.com

www.reeoic.com

(password = eno)

MISSION STATEMENT

Our mission is to provide cost-effective professional liability insurance for the protection of the real estate industry and thereby the public.