

## **Hull on Estates Podcast #44**

### Trustee Obligations to Beneficiaries

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Jason Allan: Hello and welcome to Hull on Estates. You're listening to Episode #44 on Tuesday, January 30<sup>th</sup>, 2007.

*Welcome to Hull on Estates, a series of podcasts for the Canadian legal community dealing with issues and insights surrounding estate planning in Canada. Hosted by the lawyers of Hull & Hull, the podcast will touch on some key considerations when planning estates and Wills. Now, here are today's hosts.*

Jason Allan: Hello David.

David Smith: Good morning Jason. I thought today we'd pick up a little bit on our last topic when we talked about claims against trustees when you're acting on behalf of beneficiaries. And today you and I discussed this and we're going to talk in more general terms about trustee obligations to beneficiaries. Jason, the framework I think we'll use for today, will turn on a fact situation and the fact situation will be pretty simple. And what it basically entails is a situation where somebody creates a trust but doesn't advise the trustees that he appoints that they are in fact obligated to act under the trust for the beneficiaries. And in our fact situation, the beneficiaries, after the death of the settlor of the trust, discover that they had an entitlement to a trust and received no benefits under that trust, and met with a lawyer and decided to litigate. And in our fact situation, what are the two options procedurally that a beneficiary has in this case when it comes to litigation?

Jason Allan: Well David, I think the beneficiaries in those circumstances would have two options available. One would be to bring an application to compel the estate trustee to pass his or her accounts and the second option would be to commence a Statement of Claim, essentially seeking the same relief.

David Smith: That's right Jason, and certainly there's differences between a Statement of Claim and a Notice of Application and we want to talk not too much about those procedural differences. But certainly whenever you claim rather than proceed by way of application, it's really a signal that you're seeking damages, isn't it?

Jason Allan: Yes, that's right David. I think in particular a Statement of Claim allows you to claim for punitive damages against the estate trustee.

David Smith: And we'll talk about that a little bit more Jason but that's something not necessarily unique, but certainly a feature of any claim against a trustee is that if their negligent and in breach of their duties, they are exposed to a claim for punitive damages. Because the courts want to send a signal that breach of trust is of the highest order of wrongdoing, short of criminal activity and should attract some kind of punishment, if you

will, in the manner of a punitive award of damages. So we'll get into that in some more detail. Now Jason, if proceeding by way of Statement of Claim on behalf of a beneficiary, who would you name as the defendants to that claim?

Jason Allan: Well you would name the estate trustees, anyone who has received trust property, as well as the settlor of the trust.

David Smith: The thinking there, of course, being Jason, that depending on the fact situation, you can recover damages, not only against the trustees for breach of trust, but also, and we'll discuss this a little bit later, you can also trace the trust property in the hands, into the hands of others and you can also claim against the settlor in circumstances where the settlor him or herself have received the benefit of the funds that were otherwise to go to the beneficiary. And in our fact situation, if we've got an irrevocable trust where the trustee has to benefit the beneficiaries only, and if the settlor in fact intervenes and takes some of the trust money for him or herself, the settlor, and in this case, the settlor's estate, would also be exposed to the claim made by the beneficiaries.

Jason Allan: That's actually, I think, a unique aspect of the trust is that once the settlor creates the trust, it really becomes a distinct entity. And they really don't, even though it's their money that they've used to create this trust, they really no longer have access to it and they can't access the funds the same they would if the money was, say, held in their bank account.

David Smith: That's right Jason, and so in our fact situation, just sort of proceeding along with the procedural issues, if we want to proceed against the settlor's estate, what Rule of Civil Procedure do we have to be cognizant of?

Jason Allan: Well I believe that falls under Rule 9, David of the Rules of Civil Procedure. Rule 9 states that a proceeding commenced by or against the estate of a deceased person may be made by naming the estate of the deceased person in the Statement of Claim.

David Smith: That's right Jason, what if we don't know the identity of the estate trustee, can we still claim against the estate?

Jason Allan: Well David, Rule 9 also says that if you do not know the name of the estate trustee, you can simply commence a proceeding against the estate to the deceased person and then later, the court can appoint an administrator who is essentially responsible for taking charge of the litigation.

David Smith: That's right, and defending the claim on behalf of the estate. So Rule 9 is an important rule for any litigator to be aware of when claiming against an estate and so we obviously want to be cognizant of that. And so if we move along and consider the claim itself, and again, the focus here is on a claim for damages, the cause of action giving rise to the damages would be the breach of trust, wouldn't it?

Jason Allan: Yes, it's a breach of trust. Now the powers and duties under which trustees must operate are set out both in common law and in statute. And they are essentially a trustee must acquaint themselves with the terms of the trust. They are obliged to bring the trust property under their control, and to deal with it in strict accordance with the terms of the trust instruments. As well, in dealing with the trust property, the trustee must act with reasonable diligence and conduct the trust affairs as, to use the standard line, an ordinary prudent man of business would conduct his own affairs. So that's the standard at which a trustee is held to.

David Smith: Right Jason, and I think in our fact situation, again let's revisit our fact situation, which in very simple terms had beneficiaries who had no idea that they were even beneficiaries of a trust. And I presume then Jason, a trustee must have an obligation to advise beneficiaries that they have an entitlement, doesn't he?

Jason Allan: Yes, and that would fall under, I believe, the duty of the trustee to familiarize him or herself with the terms of the trust and the property that constitutes the trust, as well as obviously the beneficiaries who are ultimately entitled to the trust.

David Smith: And in this situation, again we've got a settlor who sets up a trust but doesn't really instruct the trustees of their obligations and they're acting, in a sense, in the dark. They're just simply told by the settlor in our fact situation that this is a tax vehicle and that their role is merely to do what they're told by the settlor. And clearly, the trustees in such a fact situation and in response to the claim against them are going to point a finger at the settlor and say, well hold on a second, the settlor created this trust but didn't give us an understanding of what our obligations were. We didn't have any independent legal advice and in all of those circumstances, we should be relieved from liability. And, I think Jason, I'd like to just touch briefly on the issue of relief from liability. Can you tell me a little bit about what authority there is and statute to provide for that in this circumstance?

Jason Allan: Well David, the trustees are not without available defences. For instance, Section 35 of the *Trustee Act* states that a trustee may be relieved of liability where they have acted honestly and reasonably, and ought fairly to be excused for the breach of trust.

David Smith: That's right Jason, and I think in that situation that they're going to try and say we're just doing what we're told. The settlor in this case exercised some control and influence over them, and let's presume for the sake of argument that the settlor was their employer. In that situation, they may feel compelled to do what they were told to do by the settlor, without really giving any consideration to the needs of the beneficiaries.

Jason Allan: That defence really turns on whether or not the trustee has done anything to better themselves. In other words, have they benefited in any way by the alleged breach of trust. For instance, if not acting has created a gain to the trustee, he'll be held liable for that gain or if not acting has somehow benefited him, the trustee will be responsible as well. So I think the court will really look at, to what extent has the trustee really benefited from their alleged failure to act in a certain capacity.

David Smith: I think that's a really good point, Jason, especially when the court is being asked to consider that. I think the court will also consider the nature of and sophistication of the trustee, if the trustee is a lawyer, I think it's going to be a lot more difficult for the trustee to make that argument. But certainly the court will look at that, if the trustee didn't take compensation, didn't do anything to better himself as you have said and really seemed to be completely ignorant for lack of a better term of their duties, then the court may consider relief from liability. Now I think, just to bring this discussion to a conclusion, let's talk very briefly about the exercise of discretion or, in our case, the non-exercise of discretion. Here we've got a trust and let's presume, for the sake of argument, that the trust provides that the trustees have a discretion to make payments to the beneficiaries. If we proceed on the basis that these trustees didn't know about their duties to the beneficiaries, whether or not that was acceptable, and as a result, did not exercise that discretion, is there anything wrong with not failing to exercise discretion reasonably but completely refusing or failing to exercise discretion in any way whatsoever?

Jason Allan: David, I think it depends on the scope of discretion available. Donovan Waters, a scholar in this area, has pointed out a trustee is in bad faith if he intentionally exercises a discretionary power for his own benefit. But it could be argued that bad faith includes a situation where the trustee abuses his discretion by exercising it in a manner for a reason, which is outside the scope of his discretion.

David Smith: That's right, and really if the scope of discretion requires the trustee to consider circumstances under which that discretion should be exercised, it follows that if you completely fail to even consider exercising that discretion, then you're really acting outside of the scope of your discretion, aren't you? And if you're failing to even consider making a payment, I, as a beneficiary, am going to say that I've suffered damages because you know, you trustee have had your head in the sand. And as we discussed earlier, the trustee can say, well I had a very good reason for having my head in the sand. No one ever told me I had an obligation here to benefit the beneficiaries and I think that ties into the argument you made that the court will consider whether or not the trustees received any personal benefit and what have you.

Jason Allan: Now turning back to the settlor himself, what obligation, David, does the settlor have to inform the trustee that they are named as trustee in the trust instrument?

David Smith: That's a very good question, Jason, and I think certainly it's going to receive some sympathy from the court if the trustees say we didn't understand and know of our obligations. And I think it's really common sense to think that if I as a settlor create a trust, I've got to inform the trustees of their obligations under that trust. The fact that they've been appointed, so that they have an opportunity to either decide to accept the appointment or not accept the appointment. So Jason, I think it's been an interesting discussion for sure and I mean we've touched on some really complex issues in very simple terms. But I think the important thing for our purposes, is flagging again what we said at the outset, which is, trustee obligations to beneficiaries and how those obligations

can give rise to remedies when the obligations are not fulfilled and the beneficiaries suffer damages.

Jason Allan: Thanks David, I look forward to touching on these issues again in a future podcast.

David Smith: That'll be great Jason, take care.

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