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DISCRETIONARY TRUSTS – WHAT IS "BAD FAITH" AND WHEN WILL THE COURT INTERFERE WITH A TRUSTEE'S DISCRETION?

By Stuart Clark

The use of a "discretionary trust" that grants a trustee the absolute discretion to determine when and if a distribution is made to a beneficiary, and in what amount, is a fairly common estate planning tool. The names associated with these trusts can be varied, some taking the form of a "Henson Trust" while others a "Spousal Trust", but the fundamental framework and principles for these trusts are more or less the same. The trustee typically has absolute discretion to determine when and if to make a distribution from the income or capital of the trust in favour of one or more of the beneficiaries prior to a final date of distribution (whether it be the beneficiary reaching a certain age or the death of a specific individual), with any amount remaining in the trust upon such a final distribution date being distributed as directed by the trust.

If you are a beneficiary of a trust which provides the trustee with such broad discretion you may question whether there is anything that you can do prior to the final distribution to question the discretionary decisions that have been made by a trustee, and whether there are circumstances in which the court will intervene to overturn a trustee's discretionary decision. As will be further explored herein, although generally speaking the court will give great deference to a trustee's discretionary authority and will not interfere, there are certain limited circumstances in which the court will interfere with a trustee's discretion. These limited circumstances require the court to find that a particular discretionary decision by the trustee was made in "bad faith".

Bad Faith

The leading decision in Ontario concerning when the court will interfere with a trustee's exercise of discretion is *Fox v. Fox Estate* (1996), 28 O.R.

(3d) 496 (ONCA). In this case, the Court of Appeal provides the following commentary:

*"The entire question of the degree of control which the courts can and should exercise over a trustee who holds an absolute discretion is filled with difficulty. The leading case, or at least the case to which reference is almost always made, is *Gisborne v. Gisborne* (1877), 2 App. Cas. 300 (H.L.). It stands for the proposition that so long as there is no 'mala fides' on the part of a trustee the exercise of an absolute discretion is to be without any check or control by the courts."* [emphasis added]

Fox v. Fox Estate cites *Gisborne v. Gisborne* for the proposition that, so long as there is no "mala fides" on the part of the trustees in exercising their discretion, the court will not interfere with a trustee's discretion. In *Gisborne v. Gisborne*, Lord Cairns states the following with respect to when the court may interfere with any discretionary decision undertaken by a trustee:

"My Lords, larger words than those, it appears to me, it would be impossible to introduce into a will. The trustees are not merely to have discretion, but they are to have "uncontrollable", that is, uncontrolled, "authority". Their discretion and authority, always supposing that there is not mala fides with regard to its exercise, is to be without any check or control from any superior tribunal." [emphasis added]

"*Mala fides*" roughly translates to "bad faith". To this respect, *Gisborne v. Gisborne* stands for the proposition that, so long as there is no "bad faith" on the part of the trustee in exercising any discretionary decision, the court will not intervene with such a decision, with the trustee's discretion to be "*without any check or control*" from the court.


While *Gisborne v. Gisborne* makes it clear that the court will not interfere with a trustee's discretion unless there is "*mala fides*", it does not provide much guidance regarding what would constitute "*mala fides*" or "bad faith" on the part of the trustee. In *Fox v. Fox Estate*, in recognizing that there is little guidance with respect to what constitutes "bad faith", the Court of Appeal cites the article "Judicial Control of Trustees' Discretions" by Professor Maurice Cullity (as he then was), in trying to provide some guidance. In summarizing his position with respect to what will constitute "*mala fides*" on the part of a trustee in exercising his or her discretionary authority, Prof. Cullity provides the following summary:

"Yet, it seems clear that the mala fides which will justify the intervention of the court must extend a considerable distance beyond the requirement of personal honesty. If the doctrine of fraud on a power permits the courts to intervene to strike down attempts to exercise a power which is vested in a person who is not a trustee, the jurisdiction over trustees must be at least as extensive. In very broad terms, that doctrine invalidates any attempt to exercise a power which is intended to achieve a purpose other than that for which the power was conferred. It is unquestionable that fraud in this sense is within the concept of mala fides." [emphasis added]

Professor Cullity's definition of "*mala fides*", whereby he advises that the court's utilization of such a doctrine is intended to invalidate "*any attempt to exercise a power which is intended to achieve a purpose other than that for which the power was conferred*", could offer some guidance on the circumstances in which the court will interfere with a trustee's discretion. It would appear that the fundamental question to be considered in determining whether a decision was

made in "bad faith" is in effect whether the decision is in keeping with the original intention of the trust. If the answer is "yes", the court will not interfere with the discretionary decision by the trustee. If the answer is "no", the circumstances may be such that the court will interfere with the decision on the grounds that it was made in "bad faith".

Closing Thoughts

The court is generally hesitant to interfere with discretionary decisions made by a trustee, with the court giving great deference to the trustee unless it can be shown that a particular decision was made with "*mala fides*" or in "bad faith". Although the court's definition of what constitutes "bad faith" is somewhat fluid and difficult to define precisely, it would appear from the Court of Appeal's analysis in *Fox v. Fox Estate* that the general question to be asked is whether the decision being made is in keeping with the original intention of the trust. If a trustee's exercise of discretion is not found to constitute "bad faith", the court will generally not interfere with the discretionary decision. 



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