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# Considerations in Negotiating the Removal and/or Replacement of a Trustee

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**Criag Vander Zee**

Direct Dial: (416) 369-0316  
Fax: (416) 369-1517  
Email: [cvanderzee@hullandhull.com](mailto:cvanderzee@hullandhull.com)

**HULL & HULL LLP**  
Barrister and Solicitors

## **TORONTO**

141 Adelaide Street West, Suite 1700  
Toronto, Ontario M5H 3L5  
TEL: (416) 369-1140  
FAX: (416) 369-1517

## **OAKVILLE**

228 Lakeshore Road East  
Oakville, Ontario L6J 5A2  
TEL: (905) 844-2383  
FAX: (905) 844-3699

[www.hullandhull.com](http://www.hullandhull.com)  
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## CONSIDERATIONS IN NEGOTIATING THE REMOVAL AND/OR REPLACEMENT OF A TRUSTEE

*Craig Vander Zee (Hull & Hull LLP)<sup>1</sup>*

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### OVERVIEW

There are a variety of reasons for the removal and replacement of a trustee, some voluntary on the part of the departing trustee, others involuntary. A trustee might decide to retire or resign from his or her position. On the other hand, a trustee may need to be changed as a result of, amongst other reasons, the trustee's death, incapacity, bankruptcy, the conduct of the trustee or the relationship of the trustee and the beneficiaries of the trust. Depending on the circumstances, the removal and replacement of the trustee may be done by way of deed or by way of court order.

The transition of the outgoing trustee and of an incoming trustee may be critical to each trustee as well as the beneficiaries of the trust, perhaps for very different reasons. The requirement (or not) to apply to Court to change trustee(s), the satisfaction of the administration of the trust to date, the outgoing trustee's accounts, a passing of accounts, the vesting of the trust's assets in the new trustee and/or any co-trustees, the trustee's compensation, and the provision of releases and the indemnification of the trustees involved are all considerations, amongst others, for those involved.

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<sup>1</sup> Craig Vander Zee can be reached at (416) 369-0316 or email at [cvanderzee@hullandhull.com](mailto:cvanderzee@hullandhull.com); See Craig Vander Zee, "Changing Trustees: Voluntary, Involuntary Changes and Negotiating the Removal and Replacement of a Trustee", (2007) Ontario Bar Association Continuing Legal Education Program, Trusts, Trustees and Trusteeships II.

It is noteworthy to distinguish between the removal and replacement of a trustee and the removal and replacement of a personal representative of a deceased person's estate because of the different ways that they are treated. Generally, sections 2 to 8 of the *Trustee Act*<sup>2</sup> (the "Act") apply to the removal and replacement of trustees, while section 37<sup>3</sup> of the Act relates to the removal and replacement of personal representatives. While the principles involved with the removal of personal representatives and trustees are similar, the focus of this paper is on negotiating the removal and replacement of a trustee.

### **CONSIDERATIONS IN NEGOTIATING THE REMOVAL AND/OR REPLACEMENT OF A TRUSTEE**

The transition of an outgoing trustee and incoming trustee is, as noted above, critical to the respective trustees and the beneficiaries of the trust.

In considering such a transition, the terms of the trust shall, to the extent it provides for the retirement, removal and replacement of a trustee, govern. The trustees and the beneficiaries should, however, consider to differing degrees the importance of the following factors to each of them (this list is not meant to be exhaustive):

- (i) is there a requirement to proceed to Court for the retirement, removal and/or replacement of the Trustee?; if so, will it be contested? what materials will need to be prepared, what evidence will be required, how may the evidence best be marshalled, will there be examinations?

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<sup>2</sup> R.S.O., 1990 c. T. 23.

<sup>3</sup> Section 37(1) of the Act states, "The Superior Court of Justice may remove a personal representative upon any ground upon which the court may remove any other trustee, and may appoint some other proper person or persons to act in the place of the executor or administrator so removed."

- (ii) is there someone other than the trustees empowered under the trust instrument to appoint trustees?;
- (iii) who needs to be involved in the process?;
- (iv) do the beneficiaries all consent to the retirement, removal and/or replacement of the outgoing trustee and new trustee? do all of the trustees? have they received legal advice? is a corporate trustee involved, should one be?;
- (v) the satisfaction of the administration of the trust to date (has the trust been administered properly and with the standard of care required?);
- (vi) the potential liability of the outgoing trustee (and continuing trustees) for, and in respect of, the past acts, conduct, and administration of the trust;
- (vii) what risks, if any, is the new trustee taking on with the appointment;
- (viii) have the accounts of the trustees been prepared, have any accounts been passed to date, or at all;
- (ix) what is the make-up of the assets within the trust, is it complex or simple;
- (x) is there litigation by or against the trust? to what extent was the outgoing trustee involved?;
- (xi) the vesting of the assets in the co-trustees and/or new trustee;
- (xii) is the proposed trustee qualified to take on the appointment?;
- (xiii) what evidence is there to remove the trustee (is the welfare of the beneficiaries in jeopardy?), will the removal be hard fought? what were the intentions of the settler re the trustee?;
- (xiv) has the outgoing trustee been reimbursed expenses incurred by him or her on behalf of the trust?;

- (xv) has the outgoing trustee received compensation? will the incoming trustee wish to negotiate his/her/its compensation, or the pre-taking of same?;
- (xvi) are the trustees and/or beneficiaries providing releases/indemnification?;
- (xvii) should money be paid into Court pursuant to section 36 of the Act?;

and

- (xviii) the costs associated with the above.

### **Who should be involved?**

An Application to the Court must be served on any co-trustee, and on anyone having a financial interest in the trust.

It may be that a litigation guardian may need to be appointed for a minor(s) and/or for an incapable party. In such a case, the Office of the Children's Lawyer or the Office of the Public Guardian and Trustee may need to be served with the Application materials so that they may have the opportunity to respond or become involved, as appropriate.

Rule 7 of the *Rules of Civil Procedure* regulates the bringing of proceedings by or against parties under disability. As set out in the preamble to the Rule, "its central requirement is that persons under disability must be represented by a litigation guardian (except where the party under disability is a respondent to an application under the *Substitute Decisions Act*, 1992: Rule 7.01(2))". A litigation guardian for a plaintiff may act without Court appointment so long as they file the required affidavit with the Court. "Rule 7.02 creates a presumptive right for a mentally incapable person's guardian or attorney under power of attorney to act as litigation guardian, so

long as the guardian or attorney has the authority to act by the terms of his or her appointment as guardian or attorney.”

However, a litigation guardian for such a defendant must be appointed by the Court. The procedure for same is set out in Rule 7.03. Unless there is some other proper person willing to act as litigation guardian, the Court is to appoint the Children’s Lawyer or the Public Guardian and Trustee as applicable.

Rule 7.03(2), specifically requires, however, that where a proceeding is against a minor in respect of the minor’s interest in an estate or trust, the Children’s Lawyer shall act as the litigation guardian of the minor defendant or respondent, unless the Court orders otherwise.

It may also be that a representation order, pursuant to Rule 10 of the *Rules of Civil Procedure* is required. As set out in the preamble to Rule 10, “Situations can arise where the outcome of litigation (of the type described in Rule 10.01) may have an impact on persons who are not before the Court and who cannot be brought into the litigation because they are unborn or unascertained, or because they cannot be readily found or served.”<sup>4</sup>

Where the retirement and replacement of a trustee is taking place by way of deed, all of the co-trustees and those with a financial interest should be served with a copy of the deed.

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<sup>4</sup> Craig Vander Zee, “The First Court Appearances and Orders,” (2007) Ontario Bar Association Continuing Legal Education Program, *The Will Challenge: From the Notice of Objection to Trial*, at p. 13-15.

## Liability/Accounting

Whether a trustee or co-trustees have properly administered a trust is obviously a crucial factor in negotiating the removal and replacement of a trustee, and will effect the manner in which a new trustee may be appointed.

In considering a trustee's potential liability in respect of his or her administration of the trust, the trustees and beneficiaries ought to consider the trustee's conduct and whether that conduct, met the standard of care required, and if not, whether the conduct is exonerated by statute or the terms of the trust.

"The general rule is that when a trustee breaches his duty, he will be liable to the beneficiaries for any losses that occur as a result of the breach. However, as a way of balancing the rights of beneficiaries with the interest to not overburden trustees, s.35 of the Trustee Act holds that when a breach occurs, the Court has the discretion to relieve the trustee of liability in cases where it believes that the trustee acted "honestly and reasonably and ought fairly to be excused."<sup>5</sup>

Section 35(1) of the Act does not apply, however, to liability for a loss to the trust arising from the investment of trust property.

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<sup>5</sup> Justin de Vries, "Trustee Liability: When Will a Trustee Be Excused? (Section 35 of the Trustee Act), OBA 2007 Institute of Continuing Legal Education. Section 35 of the Act provides:

35. (1)— If in any proceeding affecting a trustee or trust property it appears to the court that a trustee, or that any person who may be held to be fiduciarily responsible as a trustee, is or may be personally liable for any breach of trust whenever the transaction alleged or found to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust, and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach, the court may relieve the trustee either wholly or partly from personal liability for the same.

(2) Subsection (1) does not apply to liability for a loss to the trust arising from the investment of trust property.

The trustees, outgoing and incoming alike, ought also to carefully review the terms of the trust as the trust may contain provisions that limit the liability of the trustee.

For comprehensive articles on exculpatory clauses/ trustee exemption clauses in trust instruments, see "Exculpatory Clauses in Trust Instruments" by David Steele, 14 E.T.J. 216 (1995), and "Trustee Exemption Clauses: Redundant or Required", by Archie Rabinowitz (2007).

Exculpatory clauses can protect the trustee by raising the level of culpability required to be found personally liable. The clause may also limit the extent of the trustee's personal liability to the value of the assets of the trust instrument.

A trustee should be cautious, however, if he or she is relying on an exculpatory clause in a trust to exonerate him or her from liability as such clauses can be held to be invalid, especially where they are broad, or attempt to completely exonerate any and all conduct of the trustee. While there is little Canadian caselaw on the issue, it has been suggested that the following principles might be adhered to by Canadian Courts:

- (i) an exculpatory clause cannot excuse liability for acts of gross negligence;
  - (ii) an exculpatory clause cannot excuse liability for willful defaults or intentional wrongdoing;
  - (iii) an exculpatory clause cannot excuse liability for acts of fraud or dishonesty;
- and



- (iv) an appropriately drafted exculpatory clause will be effective to relieve a trustee from liability for breaches of trust of lessor culpability than acts of gross negligence, intentional wrongdoing or bad faith.<sup>6</sup>

The best way for an outgoing trustee (and new trustee) to limit any liability that may be visited upon him/her/them as a result of the administration of the trust to the date of the retirement, removal and replacement is for the outgoing trustee and his or her co-trustees, if any, to pass their accounts. Assuming the accounts are passed, not only will the new trustee know the “starting numbers” and assets/liabilities for the future administration of the trust (that is start with a clean slate), but the outgoing trustee will have been afforded the proper protection of the Court order.

Requiring an accounting may also be the only way that the beneficiaries can review the administration of the trust and determine whether the administration has been proper or whether misconduct has occurred, negligent or otherwise.

If a corporate trustee is resigning, being removed or replaced (perhaps with another corporate trustee), the corporate trustee may simply proceed to pass its accounts. Indeed, if the replacement trustee is also a corporate trustee, the new trustee may require that the accounts be passed before it accepts, and consents to, its appointment.

Releases may be sought by the trustee and provided by the beneficiaries in conjunction with a Court order.

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<sup>6</sup> David Steele, “Exculpatory Clauses in Trust Instruments”, 14 E.T.J. 216 (1995) at p. 239, and Archie Rabinowitz, “Trustee Exemption Clauses: Redundant or Required”, (2007) at p. 15.

Alternatively, the beneficiaries may provide the trustee with a release in lieu of compelling the trustee to pass his or her accounts in Court. The trustee should recommend that the beneficiary receive independent legal advice prior to signing the release. When seeking a final release from the beneficiary, a copy of the accounts should be included, either in court format or informal format, for the beneficiary's benefit. In order for a release to be valid, the beneficiary should have as much information as possible before them.

The parties may also agree by way of a release, deed or agreement to the indemnification of the outgoing and incoming trustees in respect of certain liabilities of the trust.<sup>7</sup> The trustee may incur personal liability in tort, in contract, or under statute within the context of administering a trust. If the terms of the trust do not provide for an indemnification of such liabilities (and there has been no improper or wrongful conduct on the part of the outgoing trustee in respect of these liabilities of the trust), the trustees should consider the nature and extent of the indemnification necessary, whether out of the trust, or possibly the estate property, or from the beneficiaries. It may also be that the trustee may need to obtain a release or indemnification from third parties (perhaps third parties who the trustee properly contracted with in respect of trust assets).

If the parties cannot agree upon an appropriate indemnification of the trustees, an Order of the Court may be necessary to afford the outgoing trustee with protection.

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<sup>7</sup> See Cullity, Maurice C. "*Personal Liability of Trustees and Rights of Indemnification*", 16 E.T.J. 115 at p. 115; See Suzana Popovic-Montag, "Revisiting a trustee's Right to Indemnification", (2003) 50 E.T.R. (2d) 161.

### **Compensation/Expenses of the Outgoing Trustee**

Absent an express provision in the trust, a trustee is typically only entitled to receive compensation when:

- (i) the amount of compensation has been agreed to by all beneficiaries of the trust; or
- (ii) a Court order fixes the amount of compensation pursuant to section 61 of the Act.<sup>8</sup>

The statutory basis for the trustee's compensation is section 61(1) of the Act, which entitles a trustee to compensation based on a "fair and reasonable allowance for his care, pains, and trouble, and his time expended in or about the estate."<sup>9</sup> Section 61 (5) confirms, however, that nothing in section 61 of the Act applies where the allowance is fixed by the instrument creating the trust.

Where an outgoing trustee has yet to receive compensation, he or she may want to address the payment of his or her compensation before retiring, being removed or replaced, especially if same is consented to by all co-trustees and the beneficiaries.

An incoming trustee may wish to negotiate the terms of compensation prior to being appointed and perhaps have the compensation agreement ordered as apart of a, and attached to the, Court order.

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<sup>8</sup> Jordan Atin, "Compensation for Other Fiduciaries".

<sup>9</sup> There are differing views as to the approach in calculating compensation, based on the tariff guideline or criteria set out in the caselaw. See Atin, Ibid.

A trustee is generally entitled to be indemnified or reimbursed for expenses that are properly incurred in carrying out the trust from the trust property. Section 23.1 of the Act states:

23.1 (1) A trustee who is of the opinion that an expense would be properly incurred in carrying out the trust may,

- (a) pay the expense directly from the trust property; or
- (b) pay the expense personally and recover a corresponding amount from the trust property.

(2) The Superior Court of Justice may afterwards disallow the payment or recovery if it is of the opinion that the expense was not properly incurred in carrying out the trust.

As a result, if the trustee has incurred expenses in carrying out the trust and same have not been reimbursed, he or she can address the payment of same when he or she retires, is removed or is being replaced. Conversely, the beneficiaries may seek to have the outgoing trustee pay to the trust the amount of any expenses (reimbursed to him or her) that were not properly incurred in carrying out the trust.

### **Structure of the Removal and/or Replacement of a Trustee**

The structure of the removal and/or replacement of a trustee will depend on the circumstances of the retirement, removal and replacement of the trustee.

A situation where a trustee wishes to retire and the administration of the trust has been simple, straightforward and has been substantially completed by three trustees to the satisfaction of all beneficiaries, who are sui juris, and there are no outstanding liabilities of the trust, will be completely different than one where beneficiaries are seeking to remove and replace a trustee for misconduct and in the context of a very complex administration.

The structure of the former might be a deed with an appropriate release (if an accounting by all three co-trustees has been provided to the beneficiaries who, with the benefit of counsel all consent and approve same in writing).

The structure of the latter might include an Application to remove and replace the trustee on notice to all co-trustees and those with a financial interest. As part of the Application the order would require that the outgoing trustee pass his accounts within a certain time period of the date of the order.

An order removing the trustee (and where applicable as executor/estate trustee of the applicable estate) should set out, amongst other things, the following:

- (i) the individual (s) being removed and the capacity being removed from;
- (ii) the appointed substitute trustee or, alternatively, confirm that the remaining trustees will continue;
- (iii) that all trust property vests in the new trustee or the continuing trustees;
- (iv) that the outgoing trustee shall prepare formal accounts in accordance with the Rules of Civil Procedure and file those accounts and an Application to pass accounts within a certain period of the date of the order as to the date of removal;
- (v) the manner of compensating the new trustee;
- (vi) any directions required, if necessary, to facilitate any of the above (for instance, if the outgoing trustee is a sole trustee, an order directing the production and disclosure by the trustee or financial institutions); and
- (vii) how the costs of the Application are to be dealt with.

Where disputes arise in such circumstances with the Application to remove a trustee or in the context of an accounting by the outgoing trustee, those disputes may be resolved by way of Minutes Settlement (Agreement) with documents such as a deed, draft judgment, draft order and release attached as schedules, conditional on obtaining certain court orders. A motion may then be brought on notice to all to address the terms of settlement.

In the end, negotiated structures dealing with the retirement, removal and replacement of a trustee may include, or be a combination of, a deed, court order, preparation of accounts, a passing of accounts application, a release, indemnification, Judgment on the passing and Minutes of Settlement (Agreement) dealing the resolution of the disputes arising therefrom. The circumstances of each particular case will dictate which structure is best.