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"A Trustee's Discretion to Benefit vs. A Guardian's Obligation to Support"

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When a Trustee's Discretion Meets a Guardian's Responsibility

by David M. Smith[1]

Introduction

The representation of beneficiaries presents any litigator with a wealth of law in support of his or her position. The onerous standard of care imposed upon any trustee is such that the lawyer representing beneficiaries has an immediate advantage in any contested proceeding. Simply put, the Court will seek to ensure that the beneficiaries are protected. Accordingly, the actions of the trustee in administering any trust will be carefully scrutinized.

Occasionally, the legal obligations of Trustees, Guardians of Property (or Attorneys for Property under Continuing Powers of Attorney for Property), and/or Parents may meet and come into conflict or require the Court to determine how the obligations ought to be reconciled.

A Testator may create a Testamentary Trust for the benefit of an incapable child (who may be a minor or an adult)[2]. The Testamentary Trust will generally set out the criteria that the Trustee ought to consider in exercising his or her discretion.

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[1] Partner of Hull & Hull LLP. Please note that this paper is not intended to serve as legal advice.
[2] hereinafter referred to interchangeably as "beneficiary" or "child."

Independently of the Testamentary Trust, a Guardian of Property may be appointed to manage the adult incapable child's property (in Ontario) under the provisions of the *Substitute Decisions Act.*

Both the Trustee and the Guardian of Property have a fiduciary duty to benefit a person under disability and, as such, are ultimately under the supervision of the Court. It is trite (and statutory) law that parents have a legal obligation to support their minor children.

In the case of a beneficiary who is a minor or otherwise under disability, the Trustee's discretion to provide for the needs or support of the beneficiary may be pitted against the Parent or Guardian's legal obligation to provide support for the beneficiary.

This paper considers the obligations of a Trustee in respect of the exercise of discretion, the competing obligations of others for the care of beneficiaries under disability, and how those obligations were considered in two recent cases.

The Obligations of a Guardian

A Guardian for Property appointed under the provisions of the *Substitute Decisions Act* is subject to a fiduciary duty to provide for the needs of the person for whom he or she is appointed guardian. A Guardian is obligated to realize all sources of support available to the incapable person.

It is trite law that a Guardian must not permit his or her self-interest to come into conflict with his or her duty to the incapable person.

The Duties of a Trustee

A Trustee appointed under a testamentary trust for the benefit of an incapable person may not necessarily be the guardian of that person's property.

The Trustee's authority is derived from the instrument creating the trust. In the case of a testamentary trust this instrument is the testator's Will.

More often than not, the trustee is empowered with some degree of discretion to determine how much income to pay out to the beneficiary and whether and, if so, to what extent to encroach upon the capital of the trust fund for the benefit of the beneficiary.

The Court's Review of the Exercise of Discretion

Courts are, as a general rule, wary of interfering with the exercise of discretion by a Trustee.

The Court has jurisdiction to intervene in the exercise of a Trustee's discretion where:

1. There has been a *mala fides* exercise of such a discretion;
2. There has been a failure to exercise such discretion; or

3. a deadlock between trustees as to the exercise of such discretion.[3]

The *mala* fides exercise of discretion has been interpreted to give the Court jurisdiction to intervene in the exercise of a Trustee's discretion if the exercise was based upon an improper or extraneous motivation.

In the case of a Testamentary Trust, a Trustee is to exercise his or her discretion with a view towards fulfilling the intentions of the testator. For instance, in *Re Blow*, the Court held that only in limited circumstances such as a *male fides* exercise of discretion would the Court have jurisdiction to interfere in the exercise of the trustee's discretion. Moreover, the Court held that it should not exercise its jurisdiction unless the failure to do so would be manifestly prejudicial to the interest of the beneficiary.

The Trustee, as we have noted, often has broad or even absolute discretion to determine the extent to which the beneficiary is entitled to the benefit of the trust funds.

The **failure to exercise** discretion may be viewed as being just as unfavourable as the **improper exercise** of discretion. The Court will intervene if the Trustees, in having failed to act under the terms of the Trust, cannot demonstrate that they gave proper consideration to whether they ought to exercise discretion for the benefit of any of the beneficiaries: "A Trustee, as a Trustee, has a fundamental duty to give his mind to whether he ought to exercise a power."[4].

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[3] 18 O.R. (2d) 516.
[4] Law of Trusts in Canada, Donovan Waters

Donovan Waters further suggests that the non-exercise of discretion may amount to bad faith:

> "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 the situation where the trustee abuses his discretion by exercising it in a manner, or not exercising it for a reason, which is outside the scope of his discretion." [5]

In *Boe v. Alexander*[6] the Court stated:

> "From a consideration of these cases, it is in my view clear that the jurisdiction of the Court to review the exercise of the trustee's discretion cannot be displaced by even the broadest language creating the discretion. The law imposes overriding duties on trustees, breach of which will call for the Court's intervention....A privative clause protecting the exercise of a trustee's discretion will not be effective to prevent judicial review whenever the trustees:
>
> a. have failed to exercise the discretion at all;

[5] see Waters
[6] (1985), 21 E.T.R. 246 (B.S.S.C.), affirmed (1987), 28 E.T.R. 228 (B.C.C.A.).

b. have acted dishonestly;

c. have failed to exercise the level of prudence to be expected from a reasonable businessman; and

d. have failed to hold the balance evenly between beneficiaries, or have acted in a manner prejudicial to the interests of a beneficiary."

In *Re Blow*, "absolute and uncontrolled" discretion was shown to be irrelevant where the trustee has simply failed to consider, as he should, the exercise of the power.[7]

The Court will have cause to intervene in the exercise of Trustees' discretion if the trustees, "having done nothing, cannot show that they gave proper consideration to whether they ought to exercise their discretion."[8]

[7] (1977), 18 O.R. (2d) 516.

[8] *Boucher v. Bocuher Estate* (1990) 108 NBR (2*d*) 220 (N.B.Q.B.).

The Trustee is a Proper Party to Guardianship Proceedings

When a determination is made by the Court with respect to the manner in which a Guardian of Property ought to carry out his duties, the Trustee of the testamentary trust is a proper party to the proceedings.

Rule 5.03 (1) of the *Rules of Civil Procedure* provides: "Every person whose presence is necessary to enable the court to adjudicate effectively and completely on the issues in a proceeding shall be joined as a party to the proceeding."

As the Trustee of a Testamentary Trust is the living representative of the Trust and assumes the duty of diligently protecting the assets of the Trust for the benefit of all beneficiaries thereunder[9], it is clear that such Trustee is a proper party to the proceeding.

A Trustee must follow the clearly expressed intention of the Testator when that intention is to ignore the beneficiary's means.[10]

Barnes v. Barnes [11]

In this case, Nancy Barnes ("Nancy") was an eighty-one (81) year old woman residing in a care facility who has been incapable for her entire life. Her mother and father died in 1967 and 1982 respectively. Nancy's brother was appointed as Nancy's Committee (the

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[9] Brown Estate v. Chin 2004 Carswell, Ont. 6597.
[10] *Hinton v. Canada Permanent Trust Co* [1979] O.J. No. 3451 Gen.Div.
[11] (2008) 42 E.T.R. (3d) 16.

former term for Guardian prior to enactment of the *Substitute Decisions Act*). After Nancy's brother died in 2007, his daughter (Nancy's niece) brought a guardianship application to be appointed as Nancy's Guardian of Person and Property.

There was no objection to the appointment of the Applicant as Nancy's Guardian for Personal Care and she was so appointed. The Applicant was not appointed as Nancy's Guardian of Property for reasons detailed below.

Nancy's Assets consisted of:

1. A Testamentary Trust settled by Nancy's mother in her Will which took effect on her death in 1967. This Trust originally settled with the sum of $225,000 and grew to have a value of some $1.3 million in 2008;
2. A Testamentary Trust settled by Nancy's father in his Will which took effect on his death in 1982. This second trust fund was settled with the sum of $100,000 and grew to a value of some $300,000 in 2008; and

3. Nancy inherited assets that passed to her directly from a relative ("Nancy's Personal Assets").

The Applicant (Nancy's Niece) was the sole residuary beneficiary of the estates of Nancy's mother and father. Each of Nancy's father and mother had granted a Power of Appointment respecting the residue of their estates to their son (i.e. Nancy's brother).

Nancy's brother, by his Will, exercised these Powers of Appointment for the sole benefit of his daughter (i.e. the Applicant).

There was therefore an inherent conflict of interest: the Applicant would ultimately benefit to the extent that no encroachment were made against the capital of the trust funds.

Nancy's Personal Assets (as defined above and as distinct fron her beneficial entitlement under the Testamentary Trusts) were available to her brother (as her Committee) to provide for her care. Her brother had made recourse to these funds to provide for Nancy's care and only after the income generated by these funds was exhausted did her brother look to the Testamentary Trusts created by each of Nancy's mother and father respectively.

In appointing a trust company as guardian of Nancy's property, the Court then considered the appropriate sequence of calls on the three sources of income available to fund Nancy's care. The Court considered the decision of the Court in *Hinton v. Canada Permanent Trust Co.*[12] in making the following determination:

> In a trust established for the support, care and comfort of a beneficiary, the omission of any mention in the foundation document of the income of the beneficiary, places on the fund the primary duty to support the beneficiary,

[12] [1979] O.J. No. 3451 Gen.Div.

> even when it comes to encroachment on capital. It is inappropriate for the trustee to require a means test from the beneficiary or to demand that the beneficiary's own income, such as salary, be called on first.

The Court then determined that the Guardian's management plan must provide that the costs of Nancy's support was to be paid first from the testamentary trusts set up by Nancy's parents "before recourse is had to Nancy's funds or the income derived from it."

This was, of course, the exact opposite of the previous manner in which Nancy's brother had previously managed her property.

After the Reasons of Justice Langdon were released, the Trustee of the Testamentary Trusts sought and were granted the opportunity to make submissions challenging the finding of Justice Langdon as to the sequence of calls on the three funds available to Nancy.

The submissions made by counsel for the Trustee of the Testamentary Trusts were as follows:

1. It was trite principle of estates law that the Court ought to avoid any finding that would result in an intestacy. Because Nancy was incapable and had never been capable to make a Will, recourse to

Nancy's Personal Assets should not be preferred over the income available from the Testamentary Trust. To do so would allow Nancy's estate to grow to the detriment of the Testamentary Trust;

2. The wording of the Testamentary Trusts[13] militated in favour of consideration of a "means test" by the Trustee. Such a means test would permit the Trustee of the Testamentary Trust to look to the beneficiary's own assets and means in determining the extent to which any income would be required from the Testamentary Trust to provide for the "maintenance and benefit" of Nancy.

Justice Langdon considered the competing submissions of s.3 counsel appointed for Nancy and made the following findings:

1. The wording of the Testamentary Trusts did "not admit of an interpretation that might permit the Trustee not to use the funds to support Nancy." This was a reiteration of the principle set out in *Hinton* which was followed in the initial Reasons released by his Honour;

[13] "to keep [the trust fund] invested and during the life of my said daughter, to pay so much of the net income derived therefrom and the capital thereof, having recourse first to the income therefrom, as shall be desirable or expedient, for the maintenance and benefit of my said daughter on the level of maintenance and benefit enjoyed by may said daughter during my lifetime; provided that [my trustee] shall exercise sole discretion from time to time as to the amount of income and capital to be so expended as aforesaid from time to time and the manner in which the same shall be expended."

2. "The discretion conferred on the Trustee of the Testamentary Trusts only permits the Trustee to set the amount and manner of payment of the funds but, nevertheless, the duty to support is absolute, not discretionary....While the wording of the Trust does not expressly forbid the Trustee to have reference to Nancy's own means, the principle of Interpretation that I have referred to should govern."

3. "In the instant case I am of the view, based on the preferable interpretation of the Trust, that the Trustee has achieved what is unauthorized by it. The Trustee has had recourse to the benficiary's own means when the Testator intended that the beneficiary should be wholly supported by the Trust. The discretion conferred by the Trust was not **whether** to support Nancy, it was only as to the **amount** to be used and as to the manner of payment. (emphasis added)."

4. Finally, his Honour noted that Nancy's father had delivered a "Confidential Memorandum" to his Trustee made the same date as his Last Will which established the terms of the Testamentary Trust. The memorandum provided as follows (with reference to the Testamentary Trust):

> "I have made this provision because of my daughter's health and with a view to her proper protection and *not with any thought of preserving this fund, or any income therefrom, for the benefit of*

> *any other person or persons. It is my wish therefore that when deciding from time to time as to the amount of income and/or capital that should be used for the benefit of my daughter* you should take into consideration only her interests, comfort, welfare and happiness and her reasonable protection *without regard to the interests of any other person.* (Emphasis added).

His Honour took the contents of the Memorandum as evidence that the "omission to refer to Nancy's means was clearly deliberate and that "It is likely that he knew of Nancy's means, if she then had any." As such, and in the absence of any similar memorandum in respect of the Testamentary Trust established by nancy's mother, the Court directed that the father's Testamentary truiste was to be looked to first.

Sergueeva (Succession de) v. Bedos [14]

In this case, the Deceased died in August 1996 at eighty years of age. At the time of her death, she had a son, Michel Bedos ("Michel"), and two grandchildren, Z and A, who were the children of Michel and his first wife. Z and A were 21 and 17 years of age, respectively.

One year before the death of the Deceased, Michel married his second wife, and in 1997, shortly after the Deceased's death, Michel and his second wife adopted E as an infant. The relationship between Michel and his second wife (on the one hand), and Z and A was

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[14] 2008 QCCS 503. This case was the subject of a case comment in issue 169 of *Willpower*, the monthly estate and trusts newsletter published by CCH, and grateful acknowledgement is hereby made to the author.

acrimonious. Both Z and A left Michel's home in 1993, and Z moved in with the Deceased.

In her will and codicil, the Deceased instituted a trust ("the Trust") for the support of her current and future grandchildren; Bedos was excluded. The Deceased's estate was valued at over $4 million the year following her death.

From 1996 to 2006, Royal Trust Company, as trustee ("the Trustee"), administered the Trust pursuant to the terms of the Deceased's will. Between 1997 and 2006, A and Z each received approximately $400,000 for needs that the Trustee, in its discretion, considered reasonable, even though the payments resulted in a capital encroachment of about $100,000.

In 2005, Michel made a demand for reimbursement of approximately $45,000 in school expenses he had paid from 2001 to 2004 for E. The Trustee refused Michel's claim for reimbursement for the following reasons:

1. The $45,000 claim was for an encroachment on the capital of the Trust, but such claims could not be done on a retroactive basis;

2. The Trustee had absolute discretion to distribute the income and capital of the trust; and

2. Given Michel's good financial situation and his legal obligation to support his minor daughter E (in any event), the Trustee felt that Evangeline was not in financial need.

In 2006, the Trustee instituted proceedings for a declaratory judgment and directions as to how to interpret the will of the Deceased, and to modify some of the terms of the trust.

The Trustee argued that by virtue of the discretionary powers it had under the Trust, it was not obliged to treat each beneficiary equally. Michel argued that the terms of the Trust required the Trustee to divide the Trust's capital into three separate accounts, one for each grandchild. In the alternative, Michel argued that the three beneficiaries should be treated equally in any distribution, so that if any one beneficiary received a payment from the Trust, the other two beneficiaries should receive similar payments.

The Trustee submitted that Michel's proposal to divide the capital of the trust into three separate accounts went against the terms of the trust, which provided for a capital division only at the death of the last grandchild. The Trustee argued that because it was possible that Michel would have other children during his lifetime, which would result in additional grandchildren of the Deceased, it would be premature to divide the capital of the trust before Michel's death, since only at that time would it be known how many grandchildren of the Deceased were in existence.

In her will, the Deceased left her estate in trust to the trustees:

i) "to use at their discretion for the benefit of my grandchildren all amounts which my trustees judge in their best interest, in their absolute discretion,

ii) At the death of last survivor of my grandchildren, to divide the capital of the trust into as many parts as there are grandchildren;

iii) My trustees shall have the power, if they judge it appropriate, to draw on the capital of a part held for a grandchild or his or her descendants in their respective best interests for their care, maintenance, comfort, education (including university education), or in case of accident, sickness or other emergencies;

iv) in case of the death of all the beneficiaries under the will, everything would go to Michel.

The Trustee asked the Court to determine the following issues:

1. Did the trust require the establishment of distinct accounts per beneficiary (i.e., per grandchild) at the moment the trust was established or only at the time when the last grandchild died (at which time the trust would be divided into as many accounts as there were grandchildren)?

2. If distinct accounts were to be set up immediately after the death of the Deceased, how would a new account be established for a new grandchild who came into existence after the Deceased died? Would the trustees have to take a proportional amount from each existing account? What about prior encroachments on capital by the other grandchildren? What about prior years' income paid out to the other grandchildren?

3. If there were to be only one account of the trust established prior to the death of the last surviving grandchild, did the trustee have to treat each grandchild equally without taking into account her real needs or financial situation, or was this to be left to the absolute discretion of the Trustee?

4. If the Trustee had the absolute discretion in judging the needs of each grandchild, was the Trustee justified in taking into account Bedos's legal obligation to Evangeline as well as Bedos's financial position in determining Evangeline's needs?

5. Was the trustee obliged to reimburse Bedos for the tuition fees he incurred for Evangeline's education in the United States?

The Court found as follows:

1. The intent of the Deceased was to assure the well-being of all her grandchildren and their issue, and she gave full discretion to her Trustee in this regard. The purpose of the Trust was not to substitute the obligation of the parents at the expense of the grandchildren. If this were the case (as Bedos argued), it would have the effect of increasing the wealth of the parent (Bedos) at the expense of the beneficiaries of the trust.

2. The Court noted the express exclusion of Bedos as a beneficiary under the will (except if all other beneficiaries predeceased him), and also noted the frequent reference to ''discretion'' and ''absolute discretion'' in the Trust. The Deceased intended to set up one account in the Trust until the death of the last surviving grandchild.

3. Nothing in the Trust suggested equal treatment of the grandchildren as co-beneficiaries under the Trust. On the contrary, the terms of the Trust stated that each beneficiary was to be treated based on his or her respective needs and financial situation. The Trustee had to exercise its discretion reasonably; otherwise, the assets of the Trust could be rapidly depleted to the prejudice of those beneficiaries who were in need. Thus, each beneficiary had to be treated individually and not equally. This applied to present and future beneficiaries (if any), as well as to an examination of the parents to help the beneficiaries, based on their financial capacity to do so.

4. The evidence showed that Bedos had the financial capacity to pay for Evangeline's education not to mention the legal obligation to support his minor child. Consequently, the trustee was correct in exercising its discretion to refuse Bedos a reimbursement of Evangeline's school expenses.

Summary

Barnes v. Barnes ("Barnes") and *Sergueeva (Succession de) v. Bedos ("Bedos")* demonstrate two different instances of how a Court will consider the competing obligations of Trustees and Guardian.

Barnes stands for the proposition that a Testamentary Trust providing for the maintenance of a beneficiary must be used for that person's benefit and that it is improper for the Trustee to exercise a discretion not to apply the income of the trust when the beneficiary has sufficient other means to support herself. Because the Guardian of the beneficiary was under the supervision of the Court, the Management Plan had to provide for calls upon the income of the trust before any of the benficiary's personal funds were accessed.

Bedos stands for a contrary proposition based on an admittedly different set of facts. In *Bedos*, the Court determined that it **was** appropriate for a Trustee to exercise its discretion **not** to fund the education of one of the beneficiaries of the trust when the beneficiary's parents had a legal obligation to provide for her. Of

course, the case can be distinguished from *Barnes* in that the beneficiary in *Barnes* was not a child and whose parents were not alive to support her in any event.