TAB 10

Trusts: When is a Termination a Variation

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Trusts: When is a Termination a Variation?

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We are all familiar with the *Variations of Trusts Act* (the "Act")[2]. Nothing could be simpler than a one-section act. The Act empowers of the court to approve a variation or revocation of a trust on behalf of incapable beneficiaries who have an actual or potential interest in the trust.

There are four categories of beneficiaries who are deemed to be incapacitated:

a. Minors and other persons under a legal incapacity, such as a person under mental disability;
b. Individuals who may in future become entitled to an interest if they meet a specified description or become members of a specific class (for example: "to my son and his spouse on the death of my spouse" where the spouse is still alive). The possibility of a future and currently unknown spouse of the daughter exists;
c. Unborn persons who may acquire an interest in the trust when born;
d. Any person in respect of any interest of the person that can arise by reason of a discretionary power given to anyone on the failure or determination of any existing interest that has not failed or determined (this generally refers to a discretionary interest to a person under a protective trust, a situation that is not relevant for the purpose here as this is the only category under which the court may approve a variation without finding a benefit for the first three categories as noted above).

The Act does not grant the court a power to approve a variation on behalf of capacitated beneficiaries, only those enumerated above. Accordingly, all *sui juris* beneficiaries with a vested or contingent interest must consent to the variation and execute a Deed of Arrangement before the court will consider a Variation Application.

There is no clear statement of law from the Appeal Court in Ontario as to whether or not the court, in reviewing an application to vary a trust can suggest an alternative. It would appear that the court's role is confined to either accepting or rejecting the proposed variation.[3]

What if a trustee, exercising an uncontrolled discretion, given to him by the trust instrument, pays all of the capital of the trust to a beneficiary or beneficiaries prior to the

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[2] *The Variations of Trusts Act*, R.S.O. 1990 c.V.1.
[3] *Finnell v. Schumacher Estate* (1990), 37 E.T.R. 170 (C.A.); *Coffie v. Coffie Estate* (1990), 16 E.T.R. (2d) 28 (Ont. Gen. Div.).

final distribution date? Does that constitute a variation and thus trigger the obligation to give notice to The Office of the Children's Lawyer or the Public Guardian and Trustee if there are incapacitated beneficiaries and to get court approval, or is it simply a termination of the trust?

A trustee has the authority to terminate a trust, if he has an absolute, unfettered discretionary power given to him by the trust document. Such a payment would result in a termination in accordance with the administration of the trust and would, conceptually, not require court approval on behalf of minor or unascertained beneficiaries under the variation of trust legislation. But is the trustee's discretion truly "absolute"? It is submitted that the power of the trustee is tempered by the requirement that the trustee exercise his discretion "properly". A proper exercise of discretion requires him to act honestly, in good faith, within the confines of his authority under the trust instrument, and with due consideration for whether, and if so, how, he ought to exercise his discretion. The case law suggests that where a trustee or a beneficiary seeks the payment of the whole of the trust capital, this exercise of discretion will be considered improper unless the trustee has considered the circumstances of the beneficiary, the reasons for the payment of the capital prior to the natural distribution date, and the damage done to the settlor's intention by such a payment.

Consider each of the following scenarios. Does the trustee need to bring a Variation Application or can he rely on the unlimited discretionary power given to him to simply terminate the trust "in private"?

Scenario #1
The testator left his seventy-year-old spouse a life interest in the residue of his estate. She had no income or assets of her own. The Will states that the trustee has the absolute and uncontrolled discretion to encroach on capital for the spouse's maintenance and well-being. Upon the spouse's death, the residue is to be divided equally with one share going to each of their children. If one of their children predeceased the spouse leaving issue, the deceased child's share was to be divided equally among the deceased child's issue. The estate value was $50,000.00 (Assume there is no equalization issue.).

Scenario #2
The same as in Scenario #1 except the estate value was $4,000.000.00.

Scenario #3
The testator was widowed. He directed the residue of his estate to be divided among his four sons, to be held in trust. Each son was to receive so much of the net income and so much of the capital as the trustee in his uncontrolled discretion deemed appropriate, until the son attained the age of 18 years when 10% of the then value of the share was to be paid to the son; upon attaining the age of 21 years the trustee was to pay 25% of the value of the share at that time to the son; upon the son attaining the age of 30 the trustee was to pay him 50% of the share then remaining, and at 35 years of age the trustee was to pay the balance of the share to the son. If the son died before attaining the age of 35, his share was to be held in trust for his issue. If he died without issue it was to be divided equally

among his siblings on the same terms and conditions. The sons were between the ages of 22 and 27 at the time of the testator's death (one set of twins). The estate was valued at $60,000.000.00.

Terminating a Trust: When will the Court Intervene?

The natural end of a trust is the moment when the trustee has properly transferred to the designated beneficiaries all remaining trust property and has had his final accounts passed. As noted by Waters, this statement presumes that the trust terms will run their natural course[4]. However, a trust may be terminated prematurely in two ways:

1) through the operation of the rule in ***Saunders v. Vautier***[5] and
2) under the statutory powers of the court to vary or revoke trusts.

Arguably, where a trustee has unfettered discretion under the trust instrument to pay capital to a beneficiary, the trust may also be terminated by the transfer of the whole of the capital through the exercise of the discretionary power. As argued by Waters, "assuming that the power was otherwise validly exercised, that would be a termination in accordance with the terms of the trust."[6] Where a trust is terminated prematurely in this manner, it would not, like the rule in ***Saunders v. Vautier***, require that all beneficiaries be *sui juris* and consent, nor would it require review and approval of the court pursuant to the *Variation of Trusts Act*. It is important to note that the validity of the termination through the payment of all trust capital to the beneficiary is dependant on the rationale and circumstances under which the trustee exercised the discretion given to him under the trust instrument.

Is it an improper exercise of discretion for a trustee with absolute discretion to pay out all capital to the beneficiary prior to the final distribution date given in the trust instrument? Does absolute discretion eliminate the inherent jurisdiction of the court to intervene in the administration of a trust?

The question of the degree of control that the courts can and should exercise over a trustee who holds an absolute discretion is fraught with difficulty. Historically, the courts were inclined to the view that, where a testator gives a trustee "uncontrolled or absolute" discretion, the trustee is not required to account for the exercise of his discretion provided that he acted in good faith. As Justice Cullity succinctly put it:

> You were given the power to decide the question. Exercise it.[7]

In ***Tempest v. Lord Camoys*** (1882), 21 Ch. D 571 (CA), Jessel M.R. stated, "[i]t is settled law that when a testator has given a pure discretion to trustees as to the exercise of a power, the court does not enforce the exercise of the power against the wish of the

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[4] *Waters' Law of Trusts in Canada*, 3rd Ed. (Toronto: Thomson Carswell, 2005) at p. 1174. [Waters].
[5] (1841), Cr. & Ph. 240, 41 E.R. 482.
[6] *Supra,* note 4 at p. 1200.
[7] *Martyn v. Taylor* (2003), 50 E.T.R. (2d) 220 (Ont. S.C.J.), paragraph 6.

trustees, but it does prevent them from exercising it improperly." This principle of non-interference in the absence of bad faith was further entrenched in the House of Lords decision in ***Gisborne v. Gisborne***[8]. Regarding the authority of a trustee who has been granted "uncontrollable authority" Lord Cairns stated: "Their discretion and authority, always supposing that there is no *male fides* with regard to its exercise, is to be without any check or control from any superior tribunal." In describing the extent of a trustee's discretion in determining how payments should be made, Lord Cairns asserted,

> I do not understand it to be the habit of the Court to go on and express any opinion as to whether the exercise of the discretion by the trustees is a wise or unwise exercise of that discretion. I understand that in such a case the Court of Chancery steps aside and recognizes the trustees as the persons to exercise the discretion, and in its decree does nothing more than, with regard to payments which may be necessary, act upon the exercise of the discretion of the trustees so made.

The principle in ***Gisborne*** remains the starting point for any judicial consideration of whether or not to interfere with the discretionary exercise of a power by a trustee. When reviewing the propriety of a trustee's actions, the court must look first to the terms of the instrument granting the discretionary power and second, provided the trustee was permitted by the instrument to exercise discretion in the proposed manner, examine whether the methods by which the power was exercised, or the considerations on which the exercise were based, are so improper as to indicate *male fides* or a breach of the trustee's fiduciary duties.

What is an "improper" exercise of discretion

Widdifield states "…[T]he term *male fides* has been given a liberal interpretation and has been extended beyond the mere requirement of personal honesty to justify interference with decisions which are made for an improper purpose, and with decisions that are unreasonable."[9] Widdifield also refers to a leading American text, *Scott on Trusts*, to identify several circumstances that may be considered in determining whether the trustee has acted reasonably:

1. the extent of discretion intended to be conferred upon the trustee by the terms of the trust;
2. the existence or non-existence, the definiteness or indefiniteness, of an external standard by which the reasonableness o the trustee's conduct can be judged;
3. the circumstances surrounding the exercise of the power;
4. the motives of the trustee in exercising or refraining from exercising the power;

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[8] (1877), 2 App. Cas. 300.
[9] Widdifield on Executors and Trustees at 8.2.2. (eC) [Widdifield].

5. the existence or non-existence of an interest in the trustee conflicting with that of the beneficiaries.[10]

Although these criteria were developed in the American context, Canadian case law confirms its applicability to Canadian jurisprudence.

In ***Dunlop v. Ellis***[11], the testatrix divided her estate equally between her son and daughter. The son's share was to be held by the defendant, the trustee under the will, and the income was to be paid until the son attained the age of 34 years, at which time the son was to receive the corpus. The other share for the daughter, with her receiving income, was to be held by the trustee until she reached the age of 40 years, at which time she was to receive the corpus. If either child died before the date for payment of their respective corpus, leaving issue, the issue was to take. In case either died without issue before payment of his or her share, the share of the one so dying was to form part of the share of the survivor and to be dealt with as part thereof. It was directed that where the money or income could no longer be personally enjoyed by the child, his or her right to receive the money or income should cease, but the trustee could, "in his absolute and uncontrolled discretion," pay over to or expend for the benefit of the child so much of the capital or income as he should think fit. Both children were committed to mental institutions. The trustee exercised his discretion by making *no* payments of income to the children. The son died at the age of 35 and the daughter was aged 34 at the time of the application. The application was brought by Dunlop in his capacity as executor for the son and committee of the daughter.

Justice Middleton held that the trustee had improperly exercised his discretion by placing undue consideration on maintaining the trust for remoter beneficiaries rather than carrying out the *primary intention* of the testator which was to provide for her children:

> Where there is, as here, a trust coupled with a discretionary power, the Court is entitled and bound to interfere when there is no attempt to exercise the discretion for the purpose for which it was given, but an attempt to accomplish a purpose quite alien from the intention of the testatrix, the author of the power.[12]

In ***Re Blow***[13], the court expanded the requirement of *male fides* to situations in which a court may find the failure to exercise a trustee's discretion to be improper. Here, the testator died leaving a last will and testament naming as executors and trustees his son, Joseph, Thomas (deceased) and the Canada Permanent Trust Company. The will provided that the residue of the estate was to be divided into as many equal shares as there were of the testator's surviving children to be held in trust for their benefit. The residuary clause stated that the trustees were to pay the net income derived from the trusts to the children during their lifetime. There was also a giftover to issue. The testator had,

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[10] *Ibid.*. at 8.1.2.
[11] [1917] 41 O.L.R. 303 (Ont. H.C.)
[12] *Ibid.*, at paragraph 21.
[13] (1977), 18 O.R. (2d) 516 (Ont. H.C.).

in a written memorandum to his trustees indicated that his children were likely to receive capital from other sources. Presumably, this was why he left distribution of capital to the trustees' discretion. The will also provided that the trustees could, in their "uncontrolled" discretion, make advances of capital to the income beneficiaries of the said trusts. At the time of the testator's death he was survived by two children: Joseph and Jean. Joseph was a bachelor with no issue. Jean was a widow whose only issue was her son, John. During the administration of the trust, the two surviving trustees, at Joseph's request, exercised their discretion to pay out capital by transferring the full amount of the capital from Joseph's trust to a company in which he was a 50% shareholder. Jean also requested that the trustees exercise their discretion to encroach on capital by distributing to her all or part of her trust capital. Joseph consented but the other trustee, Canada Permanent Trust Company, declined to consent. Joseph and Jean argued for payment of the capital to Jean on two grounds: 1) relying on the rule in ***Saunders v. Vautier*** and 2) the Court, in the exercise of its jurisdiction to control the discretion of trustees, ought to direct the trustees to encroach upon the capital of the trust for the benefit of Jean.

The court declined the application on both grounds. With respect to the first argument, the court found that the rule in ***Saunders v. Vautier*** did not apply because of the provision of a giftover to Jean's issue. Although John agreed to have the capital paid to his mother, the court found that there was a potential for other contingent beneficiaries in the event that either Jean had more children or in the event John predeceased her leaving issue. With respect to the jurisdiction of the court to compel the exercise of discretion to encroach on capital, the court scrutinized the ***Gisborne*** principle to determine a) whether the description of the trustee's authority as "uncontrollable" was necessary to the result, and; b) the precise meaning to be attributed to the concept of *male fides*. The court concluded on the first point that the failure to use terms such as "absolute" or "uncontrolled" did not have the impact of granting the court greater power over the exercise of discretion permitted by such trusts, and was not relevant anyway as the testator had used the phrase "uncontrolled". On the second point, the court found that the Court's intervention in cases of a *male fides* exercise of a discretionary power could be extended to cases where the trustees fail to exercise a power. Justice Rutherford stated:

> The ***Gisborne*** principle arises in respect of the exercise of discretionary power and restricts Court intervention to cases of *male fides* (whatever that term may mean in this context). In my view, where the trustees fail to exercise a power, the Court's jurisdiction is not so limited; otherwise the beneficiaries may be deprived of any effective means of compelling trustees to turn their mind to the exercise of a particular power.

The Court made two important points. Justice Middleton acknowledged that the applicants were not "collectively" entitled to the entire beneficial interest in the trust, and that anyone seeking to terminate the trust must represent "the full beneficial interests, actual and possible". It was clear that Jean, John and Joseph did not represent the interests of the remoter issue and so could not force the trustees to terminate the trust.

The Court also acknowledged that the trustees were entitled by the Will to encroach, and if their failure to do so have been motivated by improper motives, the Court had jurisdiction to intervene. However, Justice Middleton did not find it appropriate to do so based on the facts before him as there was no evidence that the trustees were acting *male fides*.

In ***Fox v. Fox***[14], the testator left a Will giving his wife Miriam a life interest in 75% of the residue of the estate and his son Walter a life interest in 25% of the residue and the whole residue on Miriam's death. The Will also gave Miriam a very wide power to encroach on capital "for the benefit of Walter's children". Miriam exercised her power by giving *all* of the residue to Walter's children, with the result that Walter was deprived of any interest in the estate, income or capital. The court was asked to examine whether the trustee had exercised her discretion improperly.

Justice Galligan held that Miriam was not entitled to exercise her discretion in the manner that she did because it could be demonstrated that, in choosing to exercising her discretion, Miriam had considered factors which were extraneous to her duty as trustee (the fact that her son intended to marry a non-Jewish woman). The court found that this extraneous consideration constituted sufficient *male fides,* and was so clearly against public policy, so as to require the intervention of the court. Justice McKinlay agreed that a person's impending marriage to a person not of the Jewish faith did not constitute a *bona fide* exercise of discretion, but preferred to review the terms of the will to determine whether there was a proper exercise of discretion.

> If the discretion of the executrix was exercised in this case because of her religious bias, then the decision of Galligan J.A., in my view, is decisive. If she had reasons in addition to the religion of her son's proposed spouse, then the meaning of the will, and the nature of her exercise of discretion should be considered.[15]

The Will provided a right of capital encroachment in the trustee's absolute discretion for the son and for his issue. However, the wording of each clause was different in one respect. While the encroachment in favour of the son was not limited in any way, the other clause read "from time to time to or for the benefit of my said son's issue or such one or more of them as my Trustee may select from time to time." Justice McKinlay found that the Will entitled the son to a total encroachment at one time but that the Will permitted only periodic encroachments in favour of his issue.

Her Honour noted that no cases were cited where the exercise of discretion would wipe out the "possibility of an encroachment in favour of another beneficiary in whose favour there is a life interest in income and a remainder interest in capital."[16] Justice McKinlay posited that surely a court would intervene if Miriam, due to incapacity, had been

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[14] [1996] O.J. No. 375 (Ont. C.A.) (leave to appeal denied by the Supreme Court of Canada [1996] S.C.C.A. No. 241, December 21, 1996).
[15] *Ibid.*, paragraph 43.
[16] *Ibid.*, paragraph 46.

replaced by another trustee and that trustee had transferred the entire corpus to Walter, thereby wiping out Miriam's life interest. As the testator's intention was clear with respect to Miriam, so too was it clear with respect to Walter.

> In my view, it was the obvious intent of the testator that his son have a life income from his estate, and the remainder outright following the death of his mother. The power to encroach must be viewed in the light of that intent.[17]

In ***Re Powles (deceased); Little v. Powles and Another***[18] the testatrix directed her trustees to pay income from a trust for the maintenance and general benefit of her son during his life or until any monies in the trust became payable to another (presumably a creditor). On that event, the trust property was to fall into and form part of the testator's residuary estate. The terms of the trust provided that the trustees could, in their uncontrolled discretion, resort to and spend any part of the capital on the maintenance and general benefit of the son. The son, who was then 70 years old, asked the trustees to transfer the capital to him under their discretionary power. He gave no reason beyond the assertion that he would like to have it. The trustees sought direction from the court as to whether they had power under the will to pay over all of the capital to the son.

Justice Harmon held that the trustees could pay the capital of the fund to the son only after inquiring as to the purposes for which he required it, and if, after making the inquiry, they considered that the transfer would be for his general benefit. Justice Harmon stated:

> In these circumstances, the trustees cannot, in my view, hand over the money to Francis without inquiring what he intends or wishes to do with it. On the other had, I am unwilling to fetter their discretion more than is proper. If they do consider it to be for the general benefit of Francis to have the capital, I think that they would be entitled to say: We think it better for him to have it than that we should keep it.", and if they come to that conclusion, who is to say to them: Nay?—not I., because the testatrix has said differently. Therefore, I propose to declare that on the true construction of the will the trustees may only resort to and spend capital of the fund by paying it to the defendant Francis if they consider that such expenditure or application will be for his general benefit.[19]

In ***Re Floyd***[20], the testator's will provided for payment to his wife of a set amount from income, and permitted the trustees to encroach on capital in their absolute discretion if there was insufficient income to meet the amount, or "in case of the illness of [the widow], to defray her hospital, nursing and medical expenses and for other expenses of a similarly emergent nature". The widow suffered from ill health and the trustees paid the

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[17] *Ibid.*, paragraph 47.
[18] [1951] 1 All ER 516 (Ch. Div.).
[19] *Ibid.*, page 519.
[20] [1961] O.R. 50.

rent for accommodation in Florida where she went on the advice of her physician. The residuary beneficiary (brother of the deceased) applied to the Court for interpretation of the encroachment clause and whether it authorized the trustees to pay for such accommodation. The court held that the trustees had acted honestly and fairly in relying on the physician's advice in exercising their discretion, and there was no ground for interference by the Court.

In ***Rutherford v. Rutherford***[21], the testator left a portion of the residue in trust for his son, his son's wife, and their children, and gave the trustee discretion to pay such portion or the whole of the income and capital to the son or his wife "for their proper support did maintenance and for the proper support, maintenance and education of their children." The trustee and the son entered into a settlement deed whereby the trustee declared that it held the entire trust fund for the son's "own use absolutely". The son then agreed to resettle the estate in trust, paying the income to himself for life with the corpus to be paid to his second wife and his two children. A few days later he died. The court found that the exercise of discretion to pay out the entire capital to the son was an invalid exercise of testamentary power. A discretion to make payments for maintenance and support does not justify paying over the entire trust fund to the son. The judge also noted that the exercise of discretion was objectionable as the two children were not parties to the resettlement agreement, although they had acquired rights under the Will and were entitled to have these rights maintained unless the Will gave the trustee power to do what he did in clear and unambiguous language.

Kmiec v. Kmiec[22] is a good example of why one needs to think carefully about the choice of an executor. The testator died in 1982 and appointed his wife Caroline as executrix of his Will. He left her the net income from his estate during her lifetime, with a power to encroach on the capital as she "in her sole and uncontrolled discretion deems necessary for her support and maintenance." Upon her death, there was a giftover to the testator's three children. One of the children brought an application seeking an accounting from Caroline, an order restraining her from dissipating assets and an order removing her as executrix. He stated she had co-mingled, dissipated and converted estate assets to her own use contrary to the Will and her duty. The son argued that Caroline had only a life interest in the estate, but acted as if she were the sole beneficiary and owner of the assets, ignoring the rights of the remaindermen. Caroline argued that a testamentary gift of income for life with a right to encroach on capital as she deemed necessary, in her sole and uncontrolled discretion for her support and maintenance, gave her an absolute right to encroach and, therefore, she did not have to account for her actions.

Justice Gautreau reviewed the principle established in ***Gisborne*** but determined that "[t]he key to resolving the dispute lies in the interpretation of the Will…Each case must be decided on its own facts. The ultimate question is what did the testator intend?" He held that the absolute discretion given to encroach for the wife was restricted by the later words in the clause. The result was that she only had discretion to encroach in relation to

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[21] [1961] O.R. 108 (Ont. H.C.).
[22] [1991] O.J. No. 2072 (Ont. Ct. Jus. Gen. Div.).

support and maintenance. The uncontrolled discretion was qualified. Despite this limitation, the court held that the will effectively gave the wife the entire residuary estate:

> To say that the life-beneficiary has an uncontrolled discretion to encroach for support and maintenance is only the first step of the inquiry. Other questions follow. What does support and maintenance cover? What do the words include? Who decides this and who decides what standard is appropriate? Is there an objective standard that should apply?
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> In the present case it is my view that such matters are within the sole and uncontrolled discretion of Caroline Kmiec, the beneficiary, subject to the requirement that she act in good faith.

The testator did not say the maintenance or support with to be consistent with the life to which she was accustomed or other words of limitation. Thus the wife was fully entitled to interpret her needs herself, as trustee,and encroach upon the full estate, though this was not the result the testator likely expected.

In ***Hunter Estate v. Holton***[23], the executors applied for the court's advice and direction as to whether they were permitted to exercise their discretion to make payments *for the benefit* of the testator's issue, by paying out all assets of the Family Fund and resettling them into two new trusts, one in favour of each of the two children of the testator and their respective issue. The trust terms were essentially the same as those in the Will, and there was no change in beneficiaries except to separate the two family branches. The stated object of the proposed transactions was so that future decisions regarding the administration of the trust could be made having regard to the specific and separate circumstances of each family.

Justice Steele identified that this matter was not a case concerning the trustees' exercise of discretion but rather required an interpretation of the Will to determine whether or not there was a power to do what was proposed. He stated:

> In construing a will, the court must ascertain the intention of the testator by looking at the whole will, and the court can look to other cases only to the extent that they explain applicable rules of construction or principles of law. In looking at the present will, it is clear that the testator gave the trustees power to encroach on the entire estate which, if done, would make the balance of the will redundant.
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> It was conceded by counsel for the Official Guardian that the clause in the will would allow the trustees to exercise their power of encroachment to pay out all the assets of the Family Fund, one-half to Donald Hunter and one-half to Margaret McCallum, but he contended

[23] [1992] O.J. No. 400 (Ont. Gen. Div.).

> that there is no power given to the trustees to resettle the assets into the new trusts.[24]

The Court held that the phrase "for the benefit of" was sufficiently broad to include the settlement of the new trusts. The terms of the new trusts were similar to those in the Will and there was no allegation that the trustees were acting in bad faith. Adopting the reasoning of Justice Middleton. in ***Dunlop v. Ellis***, there was no evidence to indicate the trustees had exercised their discretion to effect a purpose contrary to the intention of the testator, "the author of the power".[25]

It would appear clear from the case law that a beneficiary in whose favour the trustee can exercise his discretion, cannot secure a court order requiring the trustee to transfer the entire corpus to the beneficiary.

In ***Walterson v. Herriman Estate***[26] the applicant, Walterson, had been in a same-sex relationship of seven years with the deceased. In his will, the deceased directed his estate trustee to hold $50,000.00 in trust for Walterson's benefit during his lifetime and to pay the net income to Walterson, with discretion to encroach upon capital. Walterson suffered from AIDS. He wanted a payout of the entire capital amount from the estate to assist in the payment of expenses incurred as a result of developing AIDS and the continuing deterioration of his health. The trustees offered to pay Walterson $10,000.00 by way of lump sum or $500.00 per month. Walterson sought an order removing the trustees, or in the alternative, an order requiring the trustees to pay him the $50,000.00. He alleged that the trustees refused to encroach upon the capital because they disapproved of his homosexual relationship with the deceased.

The application was dismissed. The Court held that the trustees had an absolute discretion over the capital, and their exercise of discretion was not subject to review unless Walterson could establish that the trustees acted out of prejudice or malice. There was no evidence to indicate the trustees denied the request on the basis of the applicant's sexual orientation. Instead, as the applicant had provided a letter from his physician which stated that he was receiving government assistance to pay for some of his medical expenses, the Court found that it was reasonable for the trustees to take this into consideration when exercising their discretion. This was not an extraneous factor so as to constitute *male fides* and justify the intervention of the court.

Justice Ground concluded that ordering the payment of the $50,000.00:

> "...would be clearly contrary to the expressed intent of the testator, who at the time he made the will was aware of the applicant's medical condition and clearly intended to provide for the applicant by way of a life interest in the trust fund and such encroachments on the capital of

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[24] *Ibid.*, paragraphs 11-12.
[25] *Supra*, note 11 at page 307.
[26] [1997] O.J. No. 3630 (Ont. Ct. Gen. Div.).

> the trust fund for the support, maintenance and benefit of the applicant as the trustees in their absolute discretion considered appropriate."[27]

In ***Hedley Estate v. Grant***[28], the testator divided the residue in equal shares to five beneficiaries, the respondents, with direction that if a beneficiary was not then living, but left issue, his or her share should be divided among his or her issue to be held in trust until the issue attained the age of 18 years. Two of the five beneficiaries predeceased the testatrix. Both left children and grandchildren. The trustee wanted to place the shares that were due to the 11 grandchildren directly into the hands of their parents, rather than continue to hold the property in trust as the estate trustee. The Trustee submitted that her proposal was no more than a *bona fide* exercise of the powers vested in her under the terms of the will. Justice Hoilett held that the trustee was hoping to relieve herself of the obligation imposed by her under the will. The Court went on to say the relief requested was not merely an incident of the exercise of the powers vested in the trustee, it was the very purpose of her intended exercise of the power. The court quoted from ***Fox v. Fox Estate,*** which adopted the criteria in ***Re Hastings-Bass*** with respect to the current state of the law regarding the exercise of a trustee's discretion:

> [w]here by the terms of a trust ... a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended; unless (1) what he has achieved is unauthorised by the power conferred on him, or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account.[29]

Although not highlighted in most commentaries on this decision, there is a portion of the reasons which is significant. Justice Hoilett concluded:

> An affirmative answer to the question raised [whether the shares could be paid to the parents in trust] would have the result of vesting with the court's imprimatur a purported "gross" exercise of a power amounting to the abandonment of a trust rather than the proper exercise of its powers. At best, we would have the case of a delegate delegating her authority, which is not authorized in law.[30]

This concept of delegation is interesting. If you pursue the logic, the following questions would have to be addressed by the estate trustee and the court in ***Hedley*** if the trustee was entitled to transfer the corpus:

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[27] *Ibid.,* paragraph 10.
[28] *(1998)*, 74. O.T.C. 234 (Ont. Gen. Div.).
[29] *Re Hastings Bass: Hastings v. Inland Revenue Commissioners* [1974] 2 All E.R. 193 (C.A.) at page 203.
[30] *Hedley, supra,* at paragraph 10.

1. In the event any of the beneficiaries did not live to the stipulated age (in the ***Hedley*** case 18) what happens to the trust funds managed by their parents? Will the interests of the contingent beneficiaries be recognized? This is of even greater consequence if the beneficiaries are not entitled to the corpus until a later age, say 25 or 30.

2. What if the parents die or become incapable? Who will be the new trustee? The original estate trustee named in the Will? The alternate? The estate trustee of the parents?

3. If the original trust provided a discretionary power to encroach on capital in favour of the beneficiary does this power get transferred to the new trusts created as well? Or, is the new trust, with a new trustee, a bare trust?

4. Given that the estate trustee appointed by the Will, and the parents were not, are the parents required to be bonded? Can they act without bond? If so, should the parents fund the bond? Why should the trusts fund the bond when the deceased did not contemplate such a necessity?

5. Who is to account for the trust and to whom? Do the parents account to the original estate trustee? To The Children's Lawyer? Can The Children's Lawyer or the beneficiary (if over 18) compel the parents to pass their accounts? Can the estate trustee compel the parents to pass their accounts?

These are just a few issues that arise when the estate trustee, in exercising his or her unfettered discretion, fully encroaches on capital and "transfers" the capital to another trust(s). It is submitted that this is really a variation of the trust created by the testator which requires the approval of the Court, and not simply a termination of the original testamentary trust. It is clear that the testator chose his estate trustee to administer the trusts – not the parents. To cloak the variation of the trusts created by the Will in ***Hedley*** as a termination of the trust based on the broad discretionary powers given to the trustee (thus eliminating the requirement for court approval) is improper. Even if there is no *male fides* on the part of the trustee, the scheme is contrary to the intent of the testator and the trust document.

As put succinctly by Waters, "the criteria to be applied to the trustee are these: he must be honest; beyond that, if honesty has a narrow meaning, he must act within the confines of the authority that was given to him; and he must perform the duty, fundamental to the trustee's office, that he give his mind to whether and, if so, how he ought to exercise the discretion."[31]

As seen from ***Dunlop v. Ellis, Rutherford v. Rutherford*** and ***Fox v. Fox,*** it appears that payment of all of the capital of the trust to the beneficiaries is an improper exercise of discretion, where it is not in keeping with the primary intention of the settlor. However, payment of all of the capital can be justifiable where it appears that the circumstances of

[31] *Supra,* note 4 at p. 932.

the beneficiary are such that payment would further, rather than frustrate, the settlor's intentions. This arises in circumstances such as those found in ***Kmiec v. Kmiec*** **and** ***Re: Floyd*** where the testator's primary intention was the preservation and maintenance of the beneficiary and the trustee was able to demonstrate that to further this end he was required to encroach on the full corpus and prematurely terminate the trust.

It is clear that each case, and the exercise of the trustee's discretion in transferring the capital, will be examined on its own particular facts. For example, in ***Hedley Estate v. Grant*** there were eleven beneficiaries, whom the court noted ranged in age and gender, making it difficult to say that the circumstances of *all* beneficiaries justified the exercise of discretion. The fact-driven nature of the evaluation of trustee discretion was highlighted in ***Kmiec,*** where Justice Gautreau rejected reliance on case law, stating instead that "each case must be decided on its own facts." In ***Kmiec,*** it is relevant that the size of the estate was only $188,978.00 and the wife was permitted to encroach on capital for her support and maintenance for the rest of her life. As this was a smaller estate, her circumstances were such that the amount of the capital could very easily and reasonably be used up for her support. The circumstances arising in ***Kmiec*** are unlike those in Scenarios 2 or 3. In those scenarios, the capital is far in excess of what would be required for the basic support and maintenance of a beneficiary. Therefore, we may conclude that the value of the trust property, the number of beneficiaries, and the particular circumstances of the individual beneficiaries, are factors that will be relevant to a determination of whether a trustee has properly exercised his discretion in paying out all of the capital of the trust to a beneficiary or beneficiaries.

In Scenario 3, the trustee proposes to pay a substantial estate to the beneficiaries prior to the natural end of the trust. There are no words of limitation offering guidance as to the settlor's intention with respect to the use of the trust funds. One can, however, draw some conclusion about the settlor's intention from the staggered payment of the trust capital and the delay of its final distribution until the age of 35. Clearly, the settlor had put thought into these provisions and intended that they would be carried out. Where the trustee in the exercise of his discretion, and absent clear need or a stated rationale, seeks to pay out the whole capital prior to the specified date, it would *prima facie* appear to be a frustration of the settlor's intention that the funds be held until the beneficiaries turned 35 years old. This would bring the matter within the authority of ***Re Powles***, which stands for the proposition that a trustee may have sufficient authority to derogate from a settlor's primary intention only if he has made sufficient inquiry into the reasonableness of the use to which the payment will be put. In *Floyd*, the trust instrument clearly allowed the wife an annuity for her maintenance; however, where the trustees had turned their minds to the use for which the capital encroachments would be made, they were entitled to act in their discretion.

By contrast, it is easy to understand why the trust in Scenario 1 might be collapsed. The widow will likely need the capital to survive as the income generated on $50,000.00 will not provide for her needs. There may also be necessary medical or other expenses. The Will states that her "well-being" is to be considered by the trustee.

As seen from the above case law, the circumstances surrounding the exercise of discretion will have a large impact on its perceived propriety. For example, the exercise of a power of encroachment for the maintenance of a life tenant where the trust assets are quite small and the life tenant requires substantial assistance may justify the payment of all capital to the life tenant and a denial of the remainderman. However, where trust assets are substantial and there is no identifiable object which requires payment of the full funds at once, it may be that the exercise would be improper.

Unless the trustee in Scenarios 2 and 3 could demonstrate that he had made inquiry as to the use of the funds requested by the beneficiaries, and considered whether this would frustrate the testator's intentions, he would risk court intervention if he paid out all of the capital to the beneficiaries. Even if circumstances warranted such discretionary payment, the value of the residue, and in Scenario 3, the wording of the Will (including the staggered distribution of the trust and the giftover to issue) should direct the trustee to secure the approval of the *sui juris* beneficiaries and all those who have a contingent interest in the estate before making any distribution. This means those who represent incapacitated beneficiaries and the court must be served.

In such cases it is clear to the writer that what is being contemplated is a variation or change in the trust, which requires court approval and service on The Office of the Children's Lawyer on behalf of any minors or unborn. The issue which arises when a trust is collapsed in circumstances such as Scenarios 2 and 3 is that if the exercise of a trustee's discretion is improper, there is no method by which the improper exercise will be brought to the attention of the court or those who represent incapacitated beneficiaries.

Gillese notes,

> It is to be hoped that Canadian courts will openly reconsider the strict application of trust principles when they are given the opportunity. It may be that trustees ought not to have to give reasons for decisions that relate to the worthiness of given individuals (e.g., "to such of my children as my trustee deems most deserving"), but that they should do so in other cases. Justification for such a change is as simple as this: trustees ought to bear the burden of demonstrating that they have acted in the best interests of the beneficiaries. [32]

This issue has in part been addressed through legislative reforms in other jurisdictions.

Solutions from Other Jurisdictions:

The solution for avoiding situations in which a trustee could improperly exercise his or her discretion and effectively cause the premature termination of a trust may be found in the legislative schemes in provinces such as Manitoba and Alberta, which effectively limit the application of the rule in ***Saunders v. Vautier*** and ensure court oversight of any other premature terminations of a trust.

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[32] E.E. Gillese and M. Milczynski, *The Law of Trusts, Second Edition*, Part. 4, Chapter. 9(g) (eC).

In 1973, Alberta amended its legislation with respect to variations and terminations of trusts, suspending the operation of the rule in ***Saunders v. Vautier*** and replacing it with legislation that requires court approval prior to any variation of a trust or any termination prior to the date of its natural duration as indicated in the trust instrument. The relevant sections of the Alberta *Trustee Act*[33] read:

> 2) Subject to any trust terms reserving a power to any person or persons to revoke or in any way vary the trust or trusts, a trust arising before or after the commencement of this section, whatever the nature of the property involved and whether arising by will, deed or other disposition, shall not be varied or terminated before the expiration of the period of its natural duration as determined by the terms of the trust, except with the approval of the Court of Queen's Bench.
>
> (3) Without limiting the generality of subsection (2), the prohibition contained in subsection (2) applies to
>
> (a) any interest under a trust where the transfer or payment of the capital or of the income, including rents and profits
>
> (i) is postponed to the attainment by the beneficiary or beneficiaries of a stated age or stated ages;
>
> (ii) is postponed to the occurrence of a stated date or time or the passage of a stated period of time;
>
> (iii) is to be made by instalments; or
>
> (iv) *is subject to a discretion to be exercised during any period by executors and trustees,* or by trustees, as to the person or persons who may be paid or may receive the capital or income, including rents and profits, or as to the time or times at which or the manner in which payments or transfers of capital or income may be made,
>
> and
>
> (b) any variation or termination of the trust or trusts
>
> (i) by merger, however occurring;
>
> (ii) by consent of all the beneficiaries;
>
> (iii) by any beneficiary's renunciation of the beneficiary's interest so as to cause an acceleration of remainder or reversionary interests.

In 1983 Manitoba adopted legislation that is substantially similar to that in Alberta, reflected in section 59 of the Manitoba *Trustee Act*.[34]

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[33] R.S.A. 2000 c. T.8.
[34] R.S.M. 1989, c. T.160.

The purpose behind the legislative reforms in Manitoba and Alberta are succinctly discussed in the "Alberta Institute of Law Research and Reform Report #9 – The Rule in ***Saunders v. Vautier***."[35] The report identifies the problem with the rule as lying in the fact that it permits a testator's intentions to be subverted by the wishes of *sui juris* beneficiaries. The report acknowledges that a testator who wishes to avoid the rule can do so by careful drafting, but rationalizes legislative intervention by stating "The fact is that gifts are not always framed in a way to ensure this; and the law should not lay traps which require sophistication to avoid."[36]

The report identifies the best course of action as one of compromise between the application of the rule in ***Saunders v. Vautier*** and its abolition by giving the court the power to permit termination or variation of the trust. The benefit of such legislation is identified as follows:

> "This will permit the court to take cognizance of the donor's intent, which is ignored when ***Saunders v. Vautier*** applies, and also the interest of the donee. We believe the donor's wishes should be recognized. But he may not foresee the circumstances which occur and his true intention may be defeated by the establishment of a rule on the lines of the material purpose doctrine. A change in the value of money or the state of the beneficiary's health may render inadequate a provision for periodic payments which was intended to give adequate support. A spendthrift may become prudent. Thus under our proposal the court can consider the circumstances which were unforeseen by the testator."(p. 6)

It is of note that the report recommends, and the legislation now includes, specific reference to the exercise of a trustee's discretion as a matter explicitly included in the jurisdiction of court supervision. The report however is generally silent on the purpose for the inclusion of this section. The report describes discretionary trusts and powers as one of the principle dispositions under the ***Saunders v. Vautier*** rule and identifies that the rule only applies where the trustee must distribute the whole fund among specific beneficiaries or a class of beneficiaries, but not where the discretion permits the trustees to pay nothing at all. The legislation, however, applies to any interest which is subject to a discretion to be exercised during any period by executors or trustees. The question of how this section applies to the exercise of discretion of a trustee to encroach on capital has been addressed in ***Alberta (Public Trustee) v. Sabo Estate***[37].

In ***Sabo Estate***, an application was made for an order overruling an executor's decision to pay out the entire capital of a trust and thereby terminate the trust. The testator left a spousal trust. The relevant provisions of the will gave the executor absolute discretion to make advances or encroach on capital for the purpose of ensuring that the testator's spouse was maintained in her station in life and provided that, upon her death, the balance of the capital then remaining was to be held in trust for the benefit of the

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[35] http://www.law.ualberta.ca/alri/docs/fr9.pdf
[36] *Ibid.*, at p. 5.
[37] [1995] A.J. No. 14 (Alta. Q.B.).

testator's children. In the event the spouse was predeceased by any child, the children of a deceased child would take his or her share. With the consent of the adult beneficiaries, and purportedly exercising his absolute discretion under the will, the trustee paid out the entire capital of the trust to the testator's spouse, thereby terminating the trust. He did not seek and obtain the prior approval of the court. Relying on sections 42 and 43 of the *Trustee Act,* the Public Trustee sought an order quashing the decision of the trustee to terminate the trust on behalf of the contingent minor beneficiaries. (In Ontario this would be undertaken by the Children's Lawyer.)

The question to be determined in ***Sabo*** was whether sections 42 and 43 of the *Trustee Act*, requiring court approval to vary or revoke a trust, prevail over the right of an executor to effectively terminate a spousal trust by advancing to her the entire interest in the trust under the clause permitting him to make such advances in his absolute discretion?

The court found that section 42 of the *Trustee Act* prohibits the variation or termination of a trust without court approval. The Act superseded the provisions of the will insofar as the actions of the executor were concerned. The Alberta Legislature had stated that there should be no variation or termination of a trust in a will *without court approval unless the terms of the trust reserved a power to someone to revoke or vary the trust. The conferring of an absolute discretion regarding advances on the trustee did not do so*, especially in light of the provisions of section 42(3)(iv) of the *Act*. In essence, if the Will does not expressly give the executor the right to terminate or vary.

There is little case law on the provisions of either the Manitoba or Alberta legislation; however, the existing cases suggest that the focus of the inquiry of the court is substantially similar to that of the Ontario court in determining whether a trustee has acted improperly. That is, the focus of the court is on determining the intention of the testator and ensuring that the proposed termination or variation strikes a balance between those intentions and the particular circumstances of the beneficiaries.

In ***Knox United Church v. Royal Trust Corp. of Canada***[38], the court heard an appeal from a decision of a motions court judge refusing an application to vary a trust. The applicant Church was the beneficiary under a will. The testatrix directed that the monies be paid into the Winnipeg Foundation and held in trust for 20 years with interest being accumulated and added to the capital each year. Thereafter, the total amount was to be paid to the Church. With the consent of the Executor and the Foundation, the Church sought an order that the money remain in trust on a perpetual basis, with the money to be paid to the Church's Foundation on an annual basis. No one other than the Church had an interest in the trust. The motions judge denied the application on the ground that to do so was contrary to the clear intentions of the testatrix. The appeal was allowed. The Court found that the motions judge had placed undue emphasis on the intentions of the testatrix. He had failed to exercise his discretion to determine whether the variation was of a justifiable character as required under section 59(7) of the *Trustee Act*. Here, the variation

[38] [1996] M.J. No. 100 (Man. C.A.).

was of a justifiable character considering that there was but one beneficiary so that the variation had no impact on any other interests.

Further, in ***Teichman v. Teichman Estate***[39], the court heard an appeal from the dismissal of an application for a variation of a trust. The appellant's father died in 1995. He had named his son and a third party to be executors and directed the division of his estate on an equal basis between the appellant and the son. The assets intended for the son were to be turned over to him immediately as an absolute gift, but the assets intended for the appellant daughter were to be held in trust for ten years from the testator's death. She was to receive a weekly allowance from the trust, and at the end of the period the balance of the trust was to be delivered to her. If she died before the ten years there was a giftover to her issue, or failing that, to the son's issue. The appellant was unmarried and had no children. The son had one child. From time to time, the appellant had been treated for depression which may have caused the testator to have concerns about her mental health and an immediate distribution. An evaluation of the appellant indicated that she was fully capable of managing her own affairs. The appellant agreed to pay to the Public Trustee (in Ontario it would be the accountant of the Superior Court of Justice) a portion of the trust to be held in trust by it for the ten years. The son consented to these arrangements. The appeal was in these circumstances allowed.

It appears from these cases that the analysis that the courts in Manitoba and Alberta will undergo in approving a variation or termination of the trust is not dissimilar from that already required by the common law in Ontario in determining the proper exercise of trustee discretion. However, there remains the question of whether these legislative changes have had a substantial impact on the actual administration of trusts other than an increase in the level of supervision allotted and the number of matters brought before the court.

The British Columbia Law Institute, in its "Report on the Variation and Termination of Trusts,"[40] offers an interesting discussion of any benefit derived from requiring court supervision of any premature termination of trusts. The report identified the premature termination of trusts as an area of concern. It examined the legislation in Alberta and Manitoba. The report rejected the reforms noting that the basis that the legislation would likely give rise to an increase in applications to the court and the consequent expense by requiring that all proposals go through the courts. Further, the report seemed to agree that the legislation created "some ambit of paternalism" by allowing the court to withhold consent to an arrangement, even if all the beneficiaries were of full capacity and consented to it. It also concluded that where incapacitated individuals were direct or contingent beneficiaries, court approval was necessary.

OCL Policy

If there is one constant throughout, it is that each case must be determined on its own unique facts, the wording of the trust document, the needs of the particular beneficiaries,

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[39] [1996] M.J. No. 144 (Man. C.A.).
[40] BCLI Report No. 25, October 2003.

and the value of the trust. Accordingly, the trustee should not assume that because he has unfettered discretion to encroach on capital, he has absolute authority to pay out all of the capital and prematurely terminate the trust.

In ***Dunlop v. Ellis***, an Ontario decision, Justice Middleton noted at paragraph 21 that "where there is a trust coupled with a discretionary power, the Court is entitled and bound to interfere when there is no attempt to exercise the discretion for the purpose for which it was given." Given that in Ontario, in contrast to Alberta and Manitoba, there appears to be a gap in the law in that a trustee with absolute discretion can terminate the trust by prematurely paying out the funds to the beneficiaries without first obtaining court approval, The Office of the Children's Lawyer takes the position that such "terminations" are in fact "variations" if there are contingent interests involved. As such, the estate trustee does not, even if his discretion is without limitation, have the right to transfer the capital to the *sui juris* beneficiary or beneficiaries without first giving notice to The Children's Lawyer and securing court approval.