Passing the Trustee's Accounts When There Are Business Assets

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At the beneficiaries' insistence, or at his own initiation, a trustee[2] may apply to court to pass his accounts. Once in court passing format, the accounts will list the deceased's assets as of date of death, and trace any subsequent disposition of those assets. However, where the estate assets include one or more businesses, the accounts may not tell the entire story of whether the administration of the trust or estate has been a successful one. Sometimes, particularly when the business is a closely held family company, the beneficiaries will be deeply concerned about how the trustee has chosen to run, transfer or dispose of the business, and these issues will be front and centre at the passing of accounts.

This paper has two parts. In the first part, I review several common topics of complaints by beneficiaries of an estate or trust holding business assets. The first section is not by any means meant to be an exhaustive list of every issue that could come up in a passing of accounts involving a business asset. Such an exhaustive review is beyond the scope of this paper. Rather, I try to provide a taste of the kinds of issues that come into play when businesses are owned or controlled by a trust or estate. In the second part of the paper, I have attempted to summarize some of the things that a litigator embarking on a passing of accounts should consider when acting for either the accounting party or the objecting party. Many, if not all, of these suggestions are equally applicable to applications to pass accounts where the assets do not include business assets. I do, however, highlight some of the steps, issues, considerations and document reviews that will be particularly important when an estate holds or controls a business.

A. Common Complaints Regarding the Handling of Business Assets by Trustees

1. Lack of Reporting

Much has been written about the broad rights of beneficiaries to receive information about estate or trust assets.[3] How does this right change when one of the estate assets is a business? In that case, the trustee may have to consider the rights of the corporation as well as the beneficiaries.

The trustee is faced with a much thornier issue when deciding the extent to which beneficiaries may have access to corporate records for an operating company owned wholly or partly by the estate. Widdifield cites *Butt v. Kelson*[4] as an answer. In that case the Court held that when shares of a private company are controlled by the estate, the beneficiaries are entitled to be treated as shareholders. The implication is that beneficiaries would be entitled to the information that would be available to a shareholder. In their paper, "Trusts and Estates that Control Corporations",[5] Elena Hoffstein and Rosanne Rocchi deal with the issue of estate trustees who are also acting as corporate directors. According to Hoffstein and Rocchi, beneficiaries who are entitled to the same information as shareholders means "that the trustee will provide the beneficiary with only the financial statements of the company."[6]

The information to be gleaned from financial statements of the company is limited and will not, in the normal course, provide an aggrieved beneficiary with all of the information relevant to a passing involving corporate assets. For example, the financial statements will not provide a breakdown of compensation paid to the trustee in his capacity as an officer or director of the company, or a breakdown of bonuses approved by the Directors. Similarly, as Hoffstein and Rocchi point out, financial statements will not reveal other benefits, such as the use of corporate assets to guarantee obligations of the trustee/director, which would put the corporate director/trustee in a conflict of interest.

Because the financial statements alone can be insufficient, Hoffstein and Rocchi suggest that one way for an aggrieved beneficiary to gain access to relevant and necessary corporate documents (including legal opinions to trustees in their capacities as directors) is to compel a passing of accounts.

> While again, a trustee may cite earlier cases which suggest that the beneficiary had no beneficial interest in the underlying assets of the trust and therefore no right to disclosure of information of a corporate nature, it is inconceivable that a court would decline to direct that the trustee produce such information, when the trustee is the same person as the director, and in particular, in a case where the income beneficiary is not receiving any income as a consequence of those actions.[7]

Hoffstein and Rocchi suggest that if a corporation is simply a passive investment corporation, the beneficiary is entitled to view the corporation as a "bare trustee."[8] Further, they posit that on a passing of accounts, the trustees ought to provide as much detail as possible about the underlying assets of the corporation, particularly when the underlying corporation is simply interposed for estate planning purposes and there is no commercial reason for its existence.[9]

But what if providing the requested information to the beneficiaries could conflict with the trustee's duties to the corporation in his capacity as a Dreictor? When a trustee becomes a director of an estate-owned corporation, his first duty is to the corporation; the beneficiaries come second.[10] Widdifield suggests that if a trustee/director is faced with a request for corporate information for which the beneficiaries made out a proper case for seeing, and there was no objection from any other beneficiary or the directors of the company, the directors ought to allow the beneficiaries to see the information.[11] However, if there is tension between or among the trustees, directors and beneficiaries, or one of the parties refused to provide his consent to the release of the information, it will be very challenging for a corporate director/trustee to strike the proper balance between his duty as a corporate director and as trustee. Absent consent of all parties, it may be that the beneficiary who is seeking corporate information will be compelled to bring an application for the trustees to pass accounts in order to obtain all the information sought.

2. Failure to Follow the "Even Hand" Rule

Consider the following typical scenario. At the time of his death, Testator held 100 common shares of RealCo. RealCo, in turn, holds three income producing apartment buildings. Testator leaves the 100 shares of RealCo in a testamentary trust, with the terms of the trust requiring the trustee to pay the income to Testator's Second Wife during her lifetime, with the capital to be split among his children from his first marriage on Second Wife's death. Testator appoints his long-time accountant, (who is very close to Second Wife and not close to the children), as Trustee of the testamentary trust. The Trustee appoints himself as a Director and Officer of RealCo. In that capacity, Trustee sells one of the apartment buildings, and chooses to dividend out all of the sale proceeds as income to Second Wife. The result of this decision, in effect, is to reduce the capital beneficiaries' inheritance by 1/3. Can the capital beneficiaries complain about the Trustee's behaviour?

The "even hand" rule provides that, absent language in the will to the contrary, the trustee must make his decisions in an even-handed manner so as to treat all classes of beneficiaries (be they income or capital beneficiaries) fairly. Even without the introduction of a corporation to hold assets, the trustee's role in balancing the interests of capital and income beneficiaries is not an easy one. But holding assets through a corporation adds a whole new layer of potential pitfalls for trustees and can lead to increased disputes between classes of beneficiaries.

The trustee's decision as to whether corporate proceeds should be categorized as income or capital receipts will affect the classes of beneficiaries differently. In addition, the decision to raise money through taking on debt will generally favour the interests of the income beneficiaries to the detriment of the capital beneficiaries. Using the example above for illustration, if all of the buildings were to be mortgaged to the full extent possible, and the mortgage proceeds paid out as income to the income beneficiaries, this could have an extremely prejudicial effect on the capital beneficiaries. But if the corporation declared no dividends and simply reinvested corporate proceeds in further capital acquisitions (such as another building), then the income beneficiaries would be left starved of income.

The recent decision in *Feinstein v. Freedman*[12] illustrates the type of disputes that can arise when a corporation is held in trust for the benefit of both income and capital beneficiaries. In *Feinstein*, the issue was whether to allow the income beneficiaries (the testator's children) to become trustees of the Riva Freedman Trust, which in turn held the voting shares of a company called Freedman Holdings Inc. ("FHI"). FHI was a real estate holding company. The corporate structure was such that whoever controlled the Riva Freedman Trust also controlled FHI. Due to infighting among the income beneficiaries years earlier, a neutral trustee had been appointed by the Court in a prior court proceedings. The Court-appointed trustee now sought to retire. Until his resignation, as a neutral trustee, Mr. Feinstein had been in a position to act as a check or balance on the actions of the Board of Directors of FHI, which included income beneficiaries.

The capital beneficiaries[13] (the testator's grandchildren) sought the appointment of another neutral trustee to enable continued oversight of FHI. On the other hand, the income beneficiaries[14] argued that they were *prima facie* entitled to act as trustees of the Riva Freedman Trust pursuant to the terms of the will and sought to exercise that right.

The capital beneficiaries opposed the appointment of the income beneficiaries as trustees of the Riva Freedman Trust. Among other things, the capital beneficiaries argued that while acting as directors of FHI, the income beneficiaries had artificially inflated the income of the corporation. For example, when one of the buildings was sold, the proceeds of sale were treated as income in the corporation rather than recapitalized. Further, the net income figures did not reflect corporate taxes payable or amortization expenses, as required by the generally accepted accounting principles ("GAAP"). All of the net income of the corporation was dividended to the income beneficiaries and no funds were maintained as retained earnings.

Relying on the cases of *Thomson v. Morrison*[15] and *Re: Zacks,*[16] the Court found that "in determining whether monies paid out in dividends are appropriately classified as income, the overriding consideration is the intention of the testator." In considering this question in *Feinstein*, the Court found that the testator had given his children, the income beneficiaries, considerable authority to make decisions regarding the running of FHI, including, significantly, permitting them to place themselves in a position of potential conflict of interest (as both Directors of FHI and as income beneficiaries). The Court considered this to be evidence of a testamentary intention to treat proceeds of the corporation as income.

Among others, the capital beneficiaries raised the following objections:

- That the income beneficiaries' decision to pay out all of the net income in dividends, as opposed to maintaining some retained earnings, benefitted the income beneficiaries (themselves) but reduced the capital in the company to the detriment of the capital beneficiaries;

- That the income beneficiaries had included income the proceeds from the sale of a building, which the Court found "unquestionably favoured the income beneficiaries over the capital beneficiaries";

- That the income beneficiaries' treatment of expenses in the corporation did not follow generally accepted accounting principles;

- That the income beneficiaries had increased the mortgage debt of the corporation by 64% without purchasing any new properties; and

- That $1.9 million of the borrowed funds had been invested in short term securities that were earning less than what the corporation was paying in interest.

Despite these complaints, the Court found that on balance, there was no evidence thus far that FHI's capital had been significantly eroded. The corporation was producing both significant income while simultaneously increasing the value of its underlying assets. In short, the Court was of the view that FHI was being "well run." The result was that, in accordance with the terms of the will, the directors/income beneficiaries were permitted to appoint themselves as the next trustees of the Riva Freedman Trust.

3. Failure to Dispose of a Business in a Timely Way

According to Feeney's Canadian Law of Wills:

> Where the estate consists of or includes a business, the position (apart from any provision in the will) is that an executor has no power by virtue of his or her office to carry on the business. The executor's duty is to sell it as soon as possible as a going concern and with only this purpose in view, he or she can run it in the interval; beyond this the executor will be personally liable for losses and for any debts or expenses. While running the business in the necessary interval before

> sale, the executor can use the assets which are in the business, including the business premises, at the testator's death, but must not invest other estate assets in the business. But a direction in the will to sell "when and as in his [or her] discretion he [or she] may deem it advisable" entitles an executor to carry on and for that purpose to use other estate assets, until an advantageous sale can be made.[17]

In other words, absent a contrary intention in the will or trust instrument, a business should only be run for as long as necessary to achieve an optimal sale. Accordingly, where the assets of an estate or trust include an operating business, the trustee would be well advised to immediately seek out the advice of a business broker or accounting firm specialized in the marketing and sale of an active business, obtain a valuation, document any advice given about how to optimize the conditions for sale, and ensure that the business is exposed to the market in a timely way.

An estate trustee who chooses to continue to operate a business without such authority from the will risks personal liability for the losses.[18] As well, absent specific authority in the will, the estate trustee should not commit further estate funds to an operating business, unless the beneficiaries acquiesce. The trustee, may, however, invest estate funds in the business if this is necessary to facilitate an advantageous sale (for example, it may be that the business could be sold for a higher price as a going concern).[19]

One can see why this is the case. An estate trustee is subject to the restrictions on investing contained in the *Trustee Act*,[20] which require him to comply with the prudent investor rule. An operating business – even a longstanding family business owned and operated by the testator – is simply not compatible with the type of investing restrictions placed on a trustee.

It must be noted that if the business is operated as a going concern by the trustee, the profits belong to the estate.[21]

4. Business Losses

Often coupled with complaints of a lack of regular reporting and a failure to dispose of the business in a reasonable timeframe, is one of the most common complaints from beneficiaries about the handling of business assets: that the business has suffered losses under the management of the trustee.

I was unable to locate any cases decided under section 49 of the *Estates Act*[22] which considers the liability of a trustee for business losses. The wording of the section is broad: it encompasses losses caused by a trustee's misconduct, default or neglect. Could a trustee who chooses to step in and manage an estate-owned or controlled business be liable to the beneficiaries for losses sustained in the company? Or could a trustee be liable for the diminution in value of the estate for failing to dispose of the estate-owned business in a timely way? There are a few cases that touch on such issues.

In *Bull-Noel v. Kebe,*[23] Master Macleod considered a motion to stay an action by a disgruntled beneficiary who sued the trustee for negligent misrepresentation, breach of fiduciary duty and gross negligence. Among her allegations were that the trustee did not promptly liquidate certain investments, causing a loss to the estate. The Master stayed the action, finding that in "pith and substance," the beneficiary's complaints amounted to an allegation that the estate had been poorly managed. Accordingly, the Master found that the proper way to address that question was to bring an application under the Estates Rules. Recognizing that the outcome of a hearing for directions may very well be a direction for a statement of claim, the exchange of pleadings, and full rights of discovery, the Master gave the plaintiff leave to reconstitute her action as an application under Rule 75.

At first blush, this decision is difficult to reconcile with the comments of the Court of Appeal in *Cheifetz*:[24]

> [A]lthough section 49(3) of the Estates Act provides statutory authority for awarding damages for "misconduct, neglect or default" on the passing of accounts, it is rare for the court to permit the parties to litigate a substantial claim for damages for breach of a trustee's duty through the medium of an audit. As Professor Waters states: ….the courts prefer to see beneficiaries bring breach of trust actions for reinstatement of loss to the trust, rather than a breach allegation being fought out through the medium of a remuneration hearing.[25]

I do not read this dictum, however, as requiring that all claims for loss or damage under section 49(3) of the Estates Act be commenced by way of action; rather, the Court is implying that a claim for damages under section 49(3) would, in most cases, require the machinery of a trial as opposed to the summary procedure that is usual for a passing of accounts. Rule 75 provides the necessary flexibility to bifurcate issues that arise during an estate's administration and determine them using the procedure that makes most sense. As a result, it seems that any review of a trustee's actions should commence by way of an application to pass accounts. More complex issues, such as of breach of trust, can then be ordered to be tried in the Order Giving Directions. The task for the judge hearing the initial motion for directions is to determine the most just and expeditious method (whether summarily, by way of application, or by trial) to determine all of the issues arising out of the estate's administration.

Another interesting issue is whether a trustee accused of mismanaging an estate-owned business would be permitted to rely on the business judgment rule as a defence. The most frequently cited articulation of the business judgment rule is set out in the following passage:

> The business judgment rule is a corporate law principle requiring courts to afford directors and officers a measure of deference in relation to their business decisions. In *Peoples Department Stores Inc. (Trustee of) v. Wise,* [2004] 3 S.C.R. 461, it was stated:
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> > Canadian courts… have tended to take an approach with respect to the enforcement of the duty of care that respects the fact that directors and officers often have business expertise that courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made... Because of this risk of hindsight bias, Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule.
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> In the *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177, Weiler J.A. stated, at p. 192:
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> > The law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. The court looks to see that the directors made a reasonable decision, not a perfect decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision. This formulation of deference to the decision of the Board is known as the "business judgment rule." The fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction.[26]

In *Laxey Partners Ltd. v. Strategic Energy Management Corp,*[27] Justice Newbould extended the business judgment rule to protect the manager of an investment trust. In *Rio Tinto Canadian Investments Ltd. v. Labrador Iron Ore Royalty Income Fund (Trustee of),*[28] Justice Farley applied the business judgment rule to trustees of an income fund. Therefore, it is difficult to imagine any reason why, assuming the trustee was otherwise entitled to run the business as a going concern, he would not be entitled to rely on the business judgment rule if his reasonable decisions resulted in business losses to the Estate.

5. Improper Oversight

In his article, "Trust Principles and the Operation of a Trust-Controlled Corporation," David Hughes discusses the interplay between trust and corporate legal principles when the trustee steps into the shoes of the testator to become shareholder of a corporation. The trustee's duty is to vote the shares of the trust in accordance with trust principles. That is, the trustee must use his voting power to benefit the beneficiaries of the trust.[29]

As shareholder of the corporation, the trustee holds the power to control the board of directors, vote the shares of the corporation, and sell or transfer the shares. But he must do all this with a view to maximizing the interests of the beneficiaries of his trust. If, as shareholder, the trustee chooses to appoint himself a director, his first duties are to the corporation. In *820099 Ontario Inc. v. Harold E. Ballard Ltd*,[30] Justice Farley observed:

> It may well be that the corporate life of a nominee director who votes against the interest of his "appointing" shareholder will be neither happy nor long. However, the role that any director must play (whether or not a nominee director) is that he must act in the best interests of the corporation…[31]

Thus, while the trustee/director's first duty is to the corporation, his tenure will likely be a short one if he does not vote in the way that his beneficiaries want.

Simone v. Cheifetz[32] provides an example of a trustee who seemed to get a little drunk on his own power, so to speak, and faced consequences for his breaches of duty to the trust beneficiaries.

Stephen Cheifetz was the sole estate trustee of the estates of Dino and Laila Simone. Cheifetz had done legal work for the Simone family business over the years and drafted the wills of Dino and Laila, under which Cheifetz himself was named one of the estate trustees. Dino, Laila and the other named estate trustee were killed in a plane crash, leaving Cheifetz the sole remaining estate trustee.

The estate held several corporate entities known as the Sifam group of companies. As estate trustee of the Simone estates, Cheifetz became a shareholder of the Sifam group of companies, which included an operating company named Active Mould & Design. Shortly after the Simones' deaths, he announced to the bank his plans to become a hands-on manager, president and director of the estate's business assets. He then, by all appearances, settled into these roles for the long term. He quit his job as a lawyer, moved into the deceased's office, and took out $5 million in key-man insurance on his own life.

The beneficiaries of the Simone estates, the two young adult daughters of Dino and Laila, quickly became dissatisfied with Cheifetz and retained counsel. On their counsel's urging, two independent directors were appointed to the Sifam group of companies. The position of the daughters and the independent directors was that Active Mould & Design and/or the Sifam group of companies should be sold as expeditiously as possible. Cheifetz resisted the sale and obtained a valuation suggesting that the value of Active Mould & Design was between $0 and $400,000. At the insistence of the daughters' lawyer, a second valuation was obtained from KPMG which concluded that the value was $4,175,000 to $5,100,000. The two outside directors favoured the KPMG valuation and proposed a sale to Cheifetz on the basis of its conclusion. In turn, Cheifetz demanded their resignation. They refused to resign. At the annual meeting of the Sifam group of companies, the two outside directors were not re-appointed, and Cheifetz voted the shares of Sifam to elect his own nominees.[33]

Unsurprisingly, the daughters responded by bringing an application to remove Cheifetz as estate trustee. Before the return of the application, Cheifetz resigned and brought an application to pass his accounts. On the passing of accounts application, the beneficiaries argued that Cheifetz had no authority to appoint himself as president and manager of the Sifam companies. The Court considered the wording of the wills, which included the following powers

- the ability of one trustee to purchase trust assets on the agreement of the other, non-purchasing trustees
- an express recognition that the trustees may from time to time be required to act as director or officer
- the power to create a new corporate entity

The Court concluded that it was not a breach of trust for Cheifetz to appoint himself as President of Sifam group of companies and Active Mould & Design. Rather, in discussing Cheifetz' actions, the Court held that "[p]erhaps it was imprudent. It led to conflicts and difficulties."[34] Earlier, the Court highlighted the types of conflicts and difficulties faced by a trustee who is also an officer/director:

> The law recognizes that there are conflicts: (a) a conflict between the estate trustee's duty as a director to act in the best interests of the corporation and his duty to the estate. Carrying out the duty as a director may not be in the best interests of the estate. (b) a conflict by the estate trustee placing himself in the position where he can direct or influence remuneration which will be paid to him as director and/or officer and thus profit from this position.[35]

For the narrow issue of whether acting as President/manager was in conflict of interest, the Court was willing to approve of Cheifetz's actions.

6. Self-dealing and Conflicts of Interest

The Court also heard evidence that Cheifetz had tried to benefit himself using another estate-owned asset, Supercart. Although the precise details of his self-dealing (or attempted self-dealing) with Supercart are not entirely clear from the reasons, the Court concluded that "the evidence positively demonstrated a corrupt intent to benefit himself". The difficult issue for the Court was how to determine compensation when, despite acting in conflict of interest, the companies, for the most part, performed well under Cheifetz' management. Active Mould & Design was ultimately sold for two-and-one-half-times the KPMG valuation. In the Court's words:

> I have wrestled with the question of his motivated self-interest and intent to profit with the recovery that the estate made on the disposition of the Sifam assets. [36]

In the end, the Court permitted him to keep compensation for his administration, but fixed it at the amount he had pre-taken as management fees ($490,000, including car rental and benefits). The Court also required him to repay, together with interest, the $512,000 that Cheifetz sought as a "premium."[37]

Steven Thompson Family Trust v. Thompson is another example of how conflict of interest issues can arise when estates hold business assets.

Thompson involved a contested passing of accounts in the context of a testamentary family trust ("Trust"). The Trust owned 50% of the shares of Thompson Fuels Ltd., a family owned business. The other 50% of the shares were owned by the deceased's brother, Paul. A dispute arose between Paul and the Trust as to how much Paul should pay the Trust for its shares, and litigation ensued by Paul against the Trust over the value of the Trust's shares. The trustee was Paul's long-time accountant, Mitchell. This placed Mitchell in a conflict position. On the one hand, Mitchell's duty was to maximize the price that Paul would pay the Trust for its shares of the business. On the other hand, Mitchell's long-time client, Paul, would naturally want to minimize the price he paid for the shares.

Mitchell openly criticized a valuation report obtained by McColl Turner for having valued the Trust's shares *too high* (a rather strange position for someone whose duty is to maximize the value of the Trust's assets). Unsurprisingly, the beneficiaries complained that Mitchell's conflict necessitated his removal as trustee. After receiving advice from a lawyer about his conflict of interest, Mitchell agreed and resigned. The parents of the deceased and Paul were appointed to take over from Mitchell as trustee of the Trust. The parents, in turn, promptly retained Mitchell as their agent, who was seemingly oblivious to the fact that his conflict should have also precluded him from acting as agent for the new trustees.

Mitchell, acting as agent, hired his former accounting firm (and the firm used by Thompson Fuels) to do a second valuation for the purpose of Paul's buyout of the Trust's shares. The Court described this move as "almost farcical." The Court held that commissioning the second valuation at a cost of $31,234.63 and paying for it out of the Trust was unnecessary. The court ordered this unnecessary expense to be repaid by the trustees, along with a portion of the legal fees paid to the lawyer for the trustees and their agent, Mitchell. In the end, it was the parents of the deceased (the trustees) who had to pay for Mitchell's bad judgment.

7. Over-Compensation and "Double Dipping"

If a Director derives his position as director by virtue of being a trustee, then the law imposes restrictions on the compensation that he can claim as director.[38] When a trustee wears multiple hats - Trustee, Director, and manager - and takes compensation in each of these roles, it is usually fruitful territory for a complaint about fees.

Returning to *Cheifetz,* Cheifetz paid himself compensation for his role as an officer and director of the Sifam companies. He also sought compensation in his capacity as trustee. The Court quoted with approval the following summary of the law regarding director's fees taken by a trustee:

> It is therefore correct to say that a fiduciary can be required to account[39] for director's fees unless he can demonstrate two things,
>
> > (a) his dictatorial position was not acquired by use of his fiduciary powers,
> >
> > (b) the quantum of the fees was set by independent third parties.[40]

Cheifetz was unable to meet these requirements.

B. Tips and Practical Considerations on a Passing of Accounts Involving Business Assets

1. Review the will or trust terms

Before launching a plethora of objections based on the trustee's actions vis-à-vis a business asset, it is necessary to carefully read all of the powers, authorities and discretions granted to the trustees in the will or trust instrument. Determine, for example, whether the will or trust instrument grants the trustees the authority to loan money from the estate to the business, the power to operate the business as a going concern, permission to act in a conflict of interest, or the ability to appoint themselves as officers and directors of the corporation.

Remember that even with a very strong privative or exculpatory clause, no discretion is absolute. As Hoffstein and Rocchi point out, "although some effect may be given to exculpatory provisions that purport to absolve a trustee from the consequences of a breach of trust or abuse of discretion, there is always the risk that a court will construe them narrowly." The practical consequence of a narrow construction is "that there is really no such thing as an absolute discretion that may be afforded to trustees."[41]

2. Obtain necessary professional advice early on

It is likely best to engage an accountant, obtain a business valuation, or hire an investment professional at the stage when you are first considering whether and how to object to the accounts. Such a person can help you determine, *inter alia:*

- whether a business was marketed and sold in a prudent fashion;
- the financial health of the company and whether it has been detrimentally affected by the trustee's actions;
- whether the business accounting records comply with GAAP; and/or
- whether, if the business is an investment holding company, the investments conformed with the prudent investor rule. (While the testator may have engaged in speculative trading during his lifetime, once those investments become trust assets, it would in most cases no longer be appropriate to continue with the testator's pattern of investing.)

Such a professional can help you at the earliest stages in determining whether a beneficiary's objections are valid and should be raised on a passing of accounts (keeping in mind that an unsuccessful beneficiary could face cost consequences if his objections are found to be invalid).

A beneficiary might believe that if a company lost money or sold for too low a price, it must have been mismanaged by the trustees. A business professional will help you determine whether there is evidence that this is the case.

3. Complete a review of the company's constating documents

You should review certificates, articles of incorporation or letters patent, articles of continuation or articles of amalgamation, and any shareholders' agreement. These documents will determine what rights are associated with the deceased's shares and what restrictions may exist with respect to their disposition.

By virtue of section 67(2) of Ontario*'s Business Corporations Act* ("OBCA"), an estate trustee, in essence, steps into the shoes of the testator as shareholder of the corporation and provides that on the death of a shareholder, the estate trustees are to be treated as the registered holder of the shares. The estate trustees, in turn, hold the shares as bare trustee for the beneficiaries of the estate.[42] If there is a shareholder's agreement, determine whether there are buy-sell provisions that dictate what is to happen to the shares on the death of a shareholder. Determine whether the articles of incorporation include any restrictions on transfer of the shares.

In *Frye v. Frye Estate*[43], the testator gifted his shares in the family business to his sister. His siblings objected to the gift on the basis that the letters patent of the company restricted the right to transfer shares without the express sanction of the board of directors. At trial, the judge found the gift of the shares was void, as it contravened the provisions of the letters patent. On appeal, the Court of Appeal found that the gift of the shares was not void; rather the gifted shares remained subject to the provisions of the shareholder's agreement and letters patent.

4. Review the applicable corporate statutes (CBCA or OBCA)

Ensure that, early on, you review the relevant provisions of the applicable statute (OBCA for a provincially incorporated company or CBCA (Canada Business Corporations Act) for a federally incorporated company) to determine what rights, if any, could or should have been exercised by the trustee in his capacity as a shareholder. If the trustee was also acting as a Director of the corporation, these statutes will also define the standard of care required by a director (s. 122 of the CBCA and s. 134 of the OBCA).

5. If objecting, think about what remedy you are seeking from the outset

Commonly, on a passing of accounts, the remedy sought will be to reduce the trustee's compensation or to seek to have the trustee repay certain improper expenses. Section 49(3) of the *Estates Act* permits the court on a passing of accounts to award damages if the trustee's misconduct, neglect or default causes a loss to the trust. However, at times, the appropriate remedy is not for the trustee to repay money but for the trustee to go out and do the thing that the beneficiaries are calling on him to do. *Waters*' *Law of Trusts* describes an aggrieved beneficiary's remedies this way: "First and primarily, his remedies lie against the trustees personally to compel them to carry out their duties in a proper manner."[44]

If the beneficiaries' complaint is that the trustee has not transferred the shares in a company to them, the remedy is for the trustee to transfer the shares. If the complaint is a lack of information, the remedy is provision of the information. It may be that if the trustee paid money to the wrong person or entity, the remedy is to go get it back from that party. The remedy is not always for the trustee to repay expenses, pay damages, or to disallow trustee compensation; often, it is simply an order that the trustee take steps to properly discharge his duty.

As discussed above, in *Bull-Noel v. Kebe,*[45] an aggrieved beneficiary launched an action against the estate trustee for damages arising out of his administration of the estate. The action was stayed on the basis that her complaints were "in pith and substance" claims that the estate trustee failed to properly discharge his duties to the estate. Recognizing that the claims may well have required pleadings and a trial to resolve, the action was stayed, with leave to reconstitute the action as application under the estates rules. In her re-constituted application, however, the applicant failed to seek the most obvious remedy: a passing of accounts. Justice Rutherford found that there was something "fundamentally wrong with [the applicant's] action plan" in that "the passing of the accounts is, it seems, the procedural key to all necessary remedies."[46]

If the complaint is that the trustee should have sold, wound up, or transferred the shares of a business to the beneficiaries, you will need to determine whether to seek that relief as part of a passing of accounts application or whether the failure to have done so in a timely way has already caused a crystallized loss to the trust or estate, such that the appropriate remedy is a damage award against the trustee.

By virtue of s. 49 (2) of the *Estates Act*, a judge can award damages against a trustee whose conduct has caused a financial loss to the estate or trust. Section 49 (2) reads:

> The judge, on a passing of accounts under this section, has power to inquire into any complaint or claim by any person interested in the taking of the accounts of misconduct, neglect, or default on the part of the executor, administrator or trustee occasioning financial loss to the estate or trust fund, and the judge, on proof of such claim, may order the executor, administrator or trustee, to pay such sum by way of damages or otherwise as the judge considers proper and just to the estate or trust funds, but any order made under this subsection is subject to appeal.

In a complex case where the allegation is that the trustee's handling of the business caused losses to the trust or estate, it will likely be advisable to seek pleadings, the exchange of documents, discoveries, and a trial of that issue.

6. Consider having your draft Notice of Objections reviewed by a solicitor

7. Ensure that your Notice of Objections (or if acting for the accounting party, your Response to Objections) includes a corporate organization chart

8. In advance of the first appearance, draft your Order Giving Directions and consider what disclosure will be necessary

If you are acting for the objecting party, consider the disclosure that your client will require to have his objections adjudicated.

In a contested passing of accounts involving business assets, you will likely need broad disclosure beyond what is set out in the accounts themselves.

Rule 74.17, which details the requirements for accounts in court passing form, refers specifically to income and disbursements *of the estate or trust* (i.e. not of the underlying business). Accordingly, the statement of assets at the date of death might have an entry indicating that the deceased held 100 common shares in the company. The statement of assets at the closing date of accounts would indicate that the estate still holds 100 common shares in the company. If there were massive losses in the business this would not be reflected in the accounting. Accounts in court passing form will often not provide you with a full picture, although arguably the requirement in Rule 74.17 (j) to provide "such other statements and information as the court requires" should mean that the accounts provide information regarding the assets, income, liabilities and value of the corporation.

You will want to ensure that the Order Giving Directions directs that you are provided with the disclosure you need. A variety of corporate documents would be relevant to allegations that the trustee, through his misconduct, neglect or default, caused a loss to the corporation (and as such, to the trust). Consider the need for documents such as minutes taken at board or shareholder meetings, quarterly management reports, quarterly financials, accounting documents, articles of incorporation, Minute Books, corporate resolutions, articles of incorporation, shareholder agreements, sales contracts, appraisals, partnership agreements, term sheets, agreements of purchase and sales, legal opinions, or offers to purchase.

9. Review the practice direction re: passing of accounts

Ensure that your Order Giving Directions provides for the matters identified in the Estates List Practice Direction that should be addressed in an Order Giving Directions on a Passing of Accounts, namely:

- The timing and conduct of a mediation;
- The issues to be tried and each party's position on each issue;
- The timing and scope of relevant disclosure;
- The witnesses each party intends to call, the issues each witness intends to address, and the anticipated length of each witness' testimony (examination-in-chief and cross-examination); and,
- The procedure to be followed at the hearing, including the method of adducting evidence-in-chief.

10. Circulate your draft Order Giving Directions well in advance of the first appearance

This will allow the parties sufficient time to determine whether all or some of the terms of the Order Giving Directions can be agreed.

11. If no agreement, file both versions of the Order Giving Directions for the judge to decide between

If the parties are unable to agree on an Order Giving Directions, comply with the Practice Direction's requirement that each side file two days prior to the initial appearance his or her own version of the Order Giving Directions. In this regard, the Practice Direction provides that:

- If the parties can agree in advance of the initial return date on the terms of an order giving directions, then parties can obtain a consent order giving directions on the scheduled initial 10 minute return date for the application.

- If the parties cannot agree on an initial order giving directions, then each party should file at least two days in advance of the initial return date, copies of their respective draft orders giving directions. If the dispute regarding the order giving directions can be resolved at the initial hearing date, the judge can issue it; if not the judge will schedule a hearing date to resolve the dispute over the order giving directions.[47]

12. Consider the applicability of section 35 of the **Trustee Act**[48]

If acting for an accounting party and one of the issues is whether the trustee should be liable for damages pursuant to section 49(2) of the *Estates Act*, ensure that the Order Giving Directions also includes the issue as to whether the trustee's actions should be excused by section 35 of the *Trustee Act*. It offers the following protection for a trustee who has acted "honestly and reasonably, though in breach of trust:

> 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.[49]

13. Consider whether the shares had a "special value" to the purposes of the trust

If you are acting for the accounting party and the objection is that the trustee impermissibly continued to run an operating business as a going concern, consider relying on section 27(5) 7 of the *Trustee Act*, which allows a trustee to consider the assets' "special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries."[50]

14. Consider the possible application of section 49(10) of the Estates Act

It reads:

> Where accounts submitted to the judge of the Superior Court of Justice are of an intricate or complicated character and in the judge's opinion require expert investigation, the judge may appoint an accountant or other skilled person to investigate and to assist him or her in auditing the accounts.

15. If acting for an accounting party, consider whether any of the objections are so frivolous and vexatious and to warrant striking them

In *Re: Bibby Estate,*[51] Justice Graesser of the Alberta Queen's Bench considered an application by the parties to determine the issues to be ordered for trial – the equivalent of an Ontario Superior Court of Justice contested hearing for an Order Giving Directions.

The objecting beneficiary had 22 complaints that she argued required a trial. The executor argued that only 5 of the complaints should be tried and that the others were either premature, frivolous, or otherwise did not necessitate a trial.

The Court in *Bibby* considered Albertan legislation[52] worded similarly to section 49(4) of Ontario's *Estates Act*. The Court concluded that the permissive wording of the statute made it clear that there is no right to have any matter ordered to be tried; the Court has the discretion to refuse or to allow any complaint to proceed further than the Order Giving Directions stage. By analogy to the rules regarding striking pleadings, the Court found that the appropriate test at this stage is that an objection should be dismissed summarily only where it is frivolous, vexatious, an abuse of process or discloses no arguable cause of action.[53] The Court went on:

> Doubtful claims, being those that are unlikely to succeed, but are not hopeless, should be allowed to proceed. If a claimant wishes to proceed despite the odds, the claimant runs the risk of costs being awarded against him or her….
>
> I am in agreement with the position taken by Mr. Belzil and Mr. Horwitz regarding s. 47 of the Administration of Estates Act. Until it has been determined that the executor has failed to call in all of the assets of the estate, and that some or all of such assets can no longer be called in (by reason of the passing of limitation periods or other impediments to recovery) there is no default on the part of the executor that should be remedied by way of a damage claim against the executor. The remedy at that stage is to require the executor to complete his or her work by calling in the asset or assets.
>
> If the executor has not erred in settling accounts or paying debts, or if there is an error but it is not irrevocable, the remedy at this stage is to deal with the debtor or creditor, not to seek damages from the executor. Only where an alleged default, neglect or misfeasance is irrevocable and can only be remedied by way of a damage claim against the executor should an issue be directed for trial at the passing of account stage.
>
> For the alleged failure to call in assets, the executor should in the first instance be required to make appropriate inquiries and take appropriate steps. For disputed accounts the executor may be required to explain the basis for settlement….The Court at the passing of accounts stage may accept the exercise of the executor's discretion so long as it was honestly made. Or the Court may, in circumstances of suspected neglect, default or malfeasance, decide to inquire further an (sic) direct the trial of an issue.[54]

The Court was able to conclude that a number of the objections which the beneficiary sought to be tried fell into the "no chance of success" category. For those, the Court found that the executors need not respond any further to those objections as they were frivolous. Those claims included an allegation arising out of "circumstances of the reading of the will."[55]

16. Don't forget about section 13 of the Evidence Act

In preparing your evidence for trial, don't forget that any evidence of statements by the deceased will require corroboration.

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[2] In this paper, I will use the term "trustee" to include a trustee of an *inter vivos* or testamentary trust, as well as an estate trustee.

[3] See, for example "The Beneficiary's Right to Know" by David Steele, LSUC Program, Fourth Annual Estates and Trusts Forum, November 2001.

[4] *Butt v. Kelson*,[1949] 2 W.W. R. 705 (Sask. K.B.).

[5] Elena Hoffstein and Roseanne Rocci, "Trusts and Estates that Control Corporations", 10th annual Estates and Trust Summit, November 2007.

[6] Hoffstein, at p. 61

[7] Hoffstein at p. 62.

[8] Hoffstein at p. 61.

[9] Hoffstein at p. 61.

[10] David Hughes "Trust Principles and the Operation of a Trust Controlled Corporation", (1980), 30 University of Toronto Law Journal at 163.

[11] Widdifield at 13-2.

[12] 2013 ONSC 1616 (CanLii) ("*Feinstein*")

[13] The capital beneficiaries, being the grandchildren of the testator/settlor, were joined by one of the income beneficiaries, one of the four children of the testator/settlor.

[14] Three of the four children of the testator/settlor were joined by their mother, also an income beneficiary, and some of the grandchildren (who were themselves capital beneficiaries) but sided with their income beneficiary parents.

[15] (1980), 28 O.R. (2d) 403 (H.C.J.)

[16] 1984 CarswellOnt 561 (H.C.J.)

[17] *Feeney's Canadian Law of Wills*, ch. 8.43 at 8.22

[18] *Widdifield on Executors and Trustees* at 2.5.1(b), 2-27

[19] Widdifield at 2.5.1(e).

[20] *Trustee Act*, R.S.O. 1990, c. J.23.

[21] Widdifield at 2-2.

[22] *Estates Act*, R.S.O. 1990, c. E.21.

[23] *Bull-Noel v. Kebe* (2009), 55 E.T.R. (3d) 175

[24] *Simone v Cheifetz* (2000), 137 O.A.C. 351, 36 E.T.R. (2d) 297 (Ont. C.A.). ("*Cheifetz*")

[25] *Cheifetz* at para. 17.

[26] As cited in *Laxey Partners Ltd. v. Strategic Energy Management Corp.* (2011), 2011 ONSC 6348 at para.74-75.

[27] 2011 ONSC 6348 ("*Laxey Partners*")

[28] *Laxey Partners*, at paragraph 77.

[29] David Hughes, "Trust Principles And the Operation of a Trust Controlled Corporation", at p. 155

[30] (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.)

[31] As quoted at para. 43 of *Cheifetz*, supra.

[32] *Simone v. Cheifetz* (1998), 24 E.T.R. (2d) 74, [1998] O.J. No. 3267 (Ont. Gen. Div.).

[33] *Cheifetz*, at para. 24.

[34] *Cheifetz*, at para. 44.

[35] *Cheifetz*, at para. 41.

[36] *Cheifetz*, at para. 107.

[37] *Cheifetz*, at paras. 106-109.

[38] Sean Graham, "Trustee, Director, Officer, Beneficiary….One Hat Too Many?" , 1 E.T.R. (3d) 158 at p. 4

[39] in other words, be required to pay back to the estate

[40] Cheifetz, at paragraph 96.

[41] Hoffstein and Rocchi, at p. 52.

[42] Widdifield at 2.5.1(c)

[43] 2008 ONCA 606

[44] *Bull-Noel v Kebe*, (2010) ONSC 1056, at para. 10.

[45] (2009) 55 E.T.R. (3d) 175 (Ontario Master)

[46] 2010 ONSC 1056 (Ont. S.C.J.)

[47] Practice Direction Concerning the Estates List of the Superior Court of Justice in Toronto, at paragraph 20.

[48] R.S.O. 1990, c. T.23, s. 35

[49] *Trustee Act*, section 35

[50] *Trustee Act*, s. 27(5) 7.

[51] 2009 CarswellAlta 767, 2009 ABQB 321, 50 E.T.R. (3d) 190, 178 A.C.W.S. (3d) 494.

[52] Section 47 of Alberta's *Administration of Estates Act,* which provides that the "court may order the trial of an issue of a complaint of claim under subsection (1)(b), and may make all necessary directions for that trial."

[53] *Bibby*, at paragraph 17

[54] *Bibby* at paragraph 20-22

[55] *Bibby*, at para. 60.