TAB 8

Common Causes of Action in Family Business Litigation

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Family-Held Business Summit
Exit and Succession Strategies

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CONTINUING LEGAL EDUCATION

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Rosanne Rocchi

TABLE OF CONTENTS

A. IMPROPER SELECTION OF PLANNING TOOLS 2
   1. Types of Trusts 2
      (a) Individual Children's Trusts 2
      (b) The Family Trust 3
   2. Treating Children Fairly – How The Trust Works 4
      (a) Balancing the Interests of Active and Non-Active 4
      (b) Evenhandedness Between Children In and Out of the Business – Redundant Assets 5
      (c) Shareholder Agreements Between Family Members 6
      (d) Independent Legal Advice 7
      (e) Equalizing Trough Trusts and Wills 7
B. FRAMEWORK OF SUCCESSION 8
   1. Sale or Succession 8
   2. Relationships Between Family Members 9
C. USE OF LIFE INSURANCE – INSUFFICIENT INSURANCE 11
D. OPTIONS TO PURCHASE 12
   1. Granting the Option 12
   2. The Purchase Price and Valuation Dates 13
   3. The Exercise Date 14
   4. What Happens to the Assets Pending the Exercise of the Option Date? 15
   5. Payment of the Purchase Price 16
   6. What Happens to the Assets Pending the Exercise of the Option? 17
E. THE SPOUSAL TRUST AND SHARES OF THE BUSINESS 17
   1. Preference Shares 18
   2. The Duties of Trustees vs. the Duties of Directors 19
   3. Which Law Governs – Trust or Corporate Law? 23
   4. The Oppression Remedy 26
F. SEMI-LITIGATION – THE MOTION FOR ADVICE AND DIRECTION 27
   1. Insufficient Directions in the Will Regarding Spousal Trusts 30
   2. Testamentary Options 30
G. MEDIATION 30

Common Causes of Action in Family Business Litigation

Rosanne Rocchi[1]

One only needs to read the newspapers to know that the best tax planning and succession planning can often go awry. The most bitter protracted litigation has its genesis in family disputes over business succession and the division of wealth. No amounts are too small to fight over.

The purpose of this paper is to highlight some of the more common causes of contentious proceedings which arise in family businesses. I have focussed principally on issues that arise following the death of the owner-operator of the businesses. In almost all situations, the dissension can be obviated by more specific directions given in the Will of the owner-operator or by securing the liquidity of the estate through the purchase of life insurance.

This paper will address the following issues:

1. Improper selection of planning tools including:
   - (a) The form of trust selected for an estate plan; and
   - (b) Options to purchase;
2. Insufficient life insurance;
3. Absence of directions respecting distributions to a spouse through a spousal trust holding shares of an active business.

These are the chief issues to be addressed. There will, of necessity, be some background information of a planning nature provided in order to place the causes of litigation in context. As well, the paper will hopefully address some methods for avoiding estate litigation and methods by which the litigation process can be streamlined or minimized.

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A. IMPROPER SELECTION OF PLANNING TOOLS

1. Types of Trusts

Many family businesses are the subject of an estate freeze. In an estate freeze, the owner-operator exchanges his or her shares in the business for preference shares and arranges for new common shares to be issued to a family trust or to children's trusts. The intent of the estate freeze is to cap the taxable capital gain accrued for the benefit of the owner-operator and to permit all future growth to grow for the benefit of the next generation.

It is possible to effect an estate freeze without the use of a trust by permitting children to subscribe for shares individually and in their own right. This course of action is rarely followed except in very specific circumstances and where the child is over the age of 18. This plan is not recommended since placing share ownership in the hands of a child without an intervening trust often leads to problems. For that reason, the paper will not consider situations where shares are transferred to children directly.

(a) Individual Children's Trusts

Individual children's trusts were in vogue to take advantage of succession duty planning. Since that time, they enjoyed a limited renaissance during the brief regime permitting use of the small business deferral. Individual children's trusts provide less planning flexibility in that each child has a specified identifiable interest with the only contingency being the vesting date. This tends to have less of a salutary effect on the behaviour of children. They know that, eventually, their interest will fall in. They need not fear being "disinherited". Their trust is theirs.

A family trust is preferred over individual children's trusts for a number of reasons. Included in this list of benefits is the avoidance of problems for matrimonial purposes where the child is a beneficiary of an individual trust. Further, the residence or non-residence of the beneficiary will become critical for tax planning purposes and is most critical where the trust is an individual trust.

Finally, in a family business enterprise, flexibility is desired and the use of individual children's trusts does not afford much flexibility.[2]

(b) The Family Trust

The conventional family trust provides for discretionary payments of income to a class of beneficiaries, usually being the taxpayer's issue. The trust may or may not provide for capital encroachment. Older varieties do not; most trusts drafted currently will include that power. This is the typical form of "sprinkling trust" and is traditionally used for income-splitting and estate freezing.

(i) Equal Distribution

Some older forms of trust may provide that on distribution, the Trustees are to divide the trust property equally among the issue of a specified class in equal shares *per stirpes*.

(ii) Discretionary Distribution

The more flexible form of family trust provides the Trustees with far more discretion. The Trustees will frequently have the ability to determine the date of distribution - a very broad and useful power. Further, the Trustees will be directed to transfer the trust property to any one or more of a specified class. Trustees will have the power to benefit disproportionately or to exclude a beneficiary altogether. This form of trust with a discretionary distribution of capital is far more flexible for all purposes and in particular where the trust is used to hold an interest in an active business where it is anticipated that one of the beneficiaries, usually a child of the taxpayer, will eventually accede to the control and ultimate ownership of the business.

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[2] The same drawbacks apply equally with respect to the retention of shares of a family business by a child who has direct ownership without the use of a trust.

Trusts which do not have this flexibility often fail to achieve the original purpose of deferral of capital gains and instead, result in the premature realization of capital gains. If there is only one successor to the family business and is a resident Canadian, the shares of the corporation can be transferred to that beneficiary on a tax-free basis and no capital gains will be realized until that beneficiary actually disposes of the shares[3]. If the trust does not permit unequal distribution, the consolidation of ownership and control of the business interests by the successor will mean that each beneficiary will have to sell shares to the successor or have the corporation redeem the shares. Each of these results in a premature realization of the gain sought to be deferred. If the trust had a discretionary distribution, the shares could be transferred to the successor on a tax-free basis and his or her position with the non-involved children could be equalized through a hotchpot clause in the Will, where the other children would benefit, usually to the exclusion of the successor.

2. Treating Children Fairly – How The Trust Works

Parents are generally inclined to treat children equally in terms of dollars and cents; they generally differentiate or distinguish between only in terms of timing. For example, a child who is financially irresponsible may find that his or her share of the estate is held in trust for a longer period of time than his brothers or sisters.

Where a business is concerned, it may not be possible to treat all children equally. When one or more children is to have an active role in the business, it is a complicated task to balance equal treatment and fairness. In that case, parents should strive to treat their children fairly rather than equally.

(a) Balancing the Interests of Active and Non-Active

What happens when one child is obviously the successor to the family business enterprise and others have absolutely no interest or inclination? The common

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[3] The *Income Tax Act*, subsection 107(2)

shares of the family business corporation are held by the family trust and the parent wishes the active child to have all the shares.

Where the trust provides that the Trustees may exercise a power in "their absolute discretion", the Trustees are not accountable to the beneficiaries unless the exercise of their discretion has been executed in a frivolous manner or for improper purposes or for an ulterior motive.[4] The decision to transfer the shares of the business to the active child to the exclusion of the others is probably quite a proper exercise of discretion by the Trustees.

(b) Evenhandedness Between Children In and Out of the Business – Redundant Assets

In any business enterprise operated for the benefit of a group where one child or perhaps more than one child will take responsibility of the business and a succession is planned, care should be taken to ensure that the business corporation does not contain redundant assets. Real estate which is not

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4 One of the more troublesome areas in advising a Trustee is the nature and extent of a Trustee's authority and the exercise of a Trustee's discretion. A Court will not direct a Trustee as to how he or she ought to exercise its discretion. While it is often observed that a Court will not interfere with a decision of a Trustee in the absence of *mala fides* (*Gisborne v. Gisborne*, (1877), 2 App. Cas, 300 (H.L.)), there have been several Canadian cases in which the Courts have in fact interfered. In all but one instance, the Trustee has been a Corporate Trustee, despite the absence of *mala fides*. There is a considerable body of jurisprudence and much writing on the exercise of a Trustee's discretion and the limits of the Court's control on the exercise of a Trustee's discretion. See for example the following: *Gisborne v. Gisborne*, (1877), 2 App. Cas, 300 (H.L.); *Brittlebank, Re, Coates v. Brittlebank* (1881), 30 W.R. 99; *Dunlop v. Ellis* [1917] O.J. no. 36, 41 O.L.R. 303; *Sievert, Re* [1921] O.J. No. 45, 51 O.L.R. 305; *Re Bell*, (1923) 23 O.W.N. 698; *Smith, Re* [1928] Ch. 915 (Ch. D.); *Halsted's Will Trusts, In re*, [1937] 2 All E.R. 570 (Ch.D.); *Re Luke*, [1939] O.W.N. 25, at 29 (H.C.J); *Re King*, [1940] O.W.N. 57 (H.C.); *Jeffrey, Re* [1948] O.R. 735, [1948] 4 D.L.R. 704; *Re Steed's Will Trusts* [1959] 1 Ch. 354; *Re Floyd*, [1961] O.R. 50 (H.C.J.); *Rutherford and Rutherford*, [1961] O.R. 108 (H.C.); *Pauling's Settlement Trusts,Re* [1964] Ch. 303 (C.A.); *Pilkington's Will Trusts, Re* [1964] A.C. 612 (H.L.); *Re Passmore Knox United Church* v. *MacLeod*, (1965), 49 D.L.R. (2d) 176 (Alta. C.A.); *National Co. v. Fleury* (1965), 53 D.L.R. (2d) 700 (S.C.C.), p. 710; *Re Mattick* (1969), 62 D.L.R. (2d) 539; *Re Blow*, (1978), 11 E.T.R. 209 Ontario High Court; *Hinton v. Canada Permanent Trust Company* (1979) 5 E.T.R. 117 (Ont H.C.); *Bond v. Pickford* (1983), 57 T.C. 301, at pages 316, 321, 323 and 326; *Re McVean*, (1985) 51 O.R. (2d) 685 (H.C.J.); *Boe v. Alexander* (1987) 15 B.C.L.R. (2d) 106, 41 D.L.R. (4th) 520, 28 E.T.R. 228; *Schipper v. Guaranty Trust Company of Canada* (1988)26 C.P.C. (2d) 218; *Fox v. Fox Estate*, (1994), 5 E.T.R. (2d) 174 (Ontario Court Gen. Div.); *Re O'Donnell (Litigation Guardian of) v. Canada Trustco* [1996] OJ 3461; *Paola v. Paola Estate* (1997) 27 R.F.L. (4d) 418, 16 E.T.R. (2d) 142, 26 O.T.C. 304; *Re Atwell Estate* (1997) 19 E.T.R. (2d) 234 (Ont. Ct., Gen. Div.); *Laird v. Mulholland* [1998] O.J. No. 855; Cullity, Maurice, *Judicial Control of Trustees Discretions*, (University of Toronto Law Journal) Vol. 25 (1975) p. 99.

necessary to the business operations can be spun out and owned in a separate corporation. In that way, the corporation's hard assets are segregated from the risks of the business operation and can be held by a different group of shareholders than the shareholders interested in carrying on the business enterprise.

One of the principal causes of dissention between and among family members is where the bulk of a person's assets are tied up in one entity which supports the family business. The most frequent area in which this is inappropriate is where real estate which is not critical to the family business is held in the same entity and is treated as an integral part of the family business. Because the value of the real estate separately is often disproportionate in value to the business on a break-up value, care should be taken during the lifetime of the business owner-operator to see if the real estate can be segregated in a separate holding corporation which can be spun-out as a separate entity or to make it clear that the real estate ought to be sold for its highest and best value in order to accommodate the non-active children, if it is impossible for the children who are actively involved in the corporation to be able to buy out the interests of the others at a valuation which ascribes to the real estate a break-up value, rather than its value in the context of a going concern of the particular business.

(c) Shareholder Agreements Between Family Members

Clients entering into estate freezes or some other form of corporate reorganization whereby any family members are to receive shares (either directly or indirectly through a trust) ought to enter into a Shareholders' Agreement. This is intended to provide a comfort level to the freezor in terms of control and to provide some restrictions on the new shareholders in terms of future expectations. Although many freezors balk at treating family like third parties, it is better to be safe than sorry.

The Shareholders' Agreement would provide restrictions on the right to transfer, so that shareholders do not have an opportunity to transfer the shares to a third party or perform some other act of family sabotage in order to effect a premature

buy-out. The Shareholders' Agreement would provide a right of first refusal and a mechanism for determining the purchase and buy-out of an interest. It would further provide for the mandatory purchase by other family members of any shares owned by the siblings. This would prevent the usual problem of being locked into a corporation in which the child has no active involvement.

The advantage of establishing these rules at the outset is to treat family members as if they were in many respects no different than third parties. Although some may believe it to be crass, we have all seen too many instances of families who eventually resort to litigation to settle their differences. When the expectations are made clear, it reduces the likelihood of litigation.

(d) Independent Legal Advice

Technically, each child should be entitled to independent legal advice and it should be recommended. In many instances, the interests of the children will be similar, but in other instances, each child may require separate representation. Clearly, the interests of a child who is actively involved in the business and those of a child who is simply an "investor" will be radically different, particularly when it comes to negotiating the terms of a buy-out, the rights of first refusal and favourable payment dates in respect of the buy-out of a child's interest.

(e) Equalizing Trough Trusts and Wills

Many individuals have their Wills split between assets which they own and assets over which they have control. A client who has undertaken an estate freeze will have future growth of the frozen assets accrued to the benefit of the beneficiaries of the freeze. Where an *inter vivos* trust holds assets for the benefit of the same class of beneficiaries that might take under the Will, there is frequently a need to equalize the interests of the beneficiaries.

For example, if the *inter vivos* trust owns common shares of an operating corporation and if it is intended that the shares of the operating corporation be transferred to the child who is determined to be the successor, that child will often obtain the lion's share of the assets in the *inter vivos* trust. Rather than

have each of the beneficiaries adjust one another's interest in the estate and the trust (which could trigger unnecessary capital gains), clients can provide for an equalizing payment in their Will so that those beneficiaries who do not share in the *inter vivos* trust take a larger percentage of the estate than the sibling who received the benefits under the *inter vivos* trust. For this reason, where there are *inter vivos* trusts and testamentary trusts and it is intended that the beneficiaries share more or less equally in the combined value of the assets of each, the Will provides an opportunity to establish trusts to permit that equalization on a tax efficient basis. Firstly, testamentary trusts will permit income splitting and income accumulation. Secondly, assets received from the trust by a capital beneficiary will be received at the cost amount to the trustees and the beneficiaries will not incur a capital gain on such property until disposed of.

The equalization of children through both *inter vivos* trusts and testamentary trusts requires very careful drafting and is an expensive procedure because of the care that needs to be taken in effecting the necessary balancing. Nevertheless, an estate plan which contains carefully drafted Will provisions to equalize children through the allocation of all assets combined in various testamentary instruments (including life insurance and insurance declarations) will pay dividends in avoiding family litigation.

B. FRAMEWORK OF SUCCESSION

1. Sale or Succession

The salient question to be asked of the client is whether or not the business is to be sold to a third party or whether the business is one which is capable of succession by family members. If the business is ultimately to be sold, a different form of estate freeze is required. Frequently, many clients are reluctant to make a determination as to whether the business will be sold or whether any one or more of his children will wish to carry on that business. In analyzing this issue, non-tax considerations come into play. The client must question whether his children are capable of carrying on the business. If so, are more than one interested and are they sufficiently co-operative? Can the business "support" all the active children and still take care of the widow while providing an

inheritance for the non-active children. One of the most difficult issues is that with a successful family business, it frequently represents the bulk of the client's estate. As a result, if the entire family is to share in the client's wealth, and if such sharing is to occur on an amicable basis, maximum flexibility is required in order to ensure that no group of beneficiaries is disadvantaged at the expense of the other.

Clients will often be reluctant to consider a sale particularly when there are children already involved in the business. However, that is often a difficult choice to make and a lawyer should at least ask a client to consider whether or not the business is of such a nature that a sale at an appropriate time might benefit the family as a whole in a more productive fashion than the continuance of the family business. Frequently, clients will decline to make such a decision. However, after the death of the owner-operator, his or her Trustees will have to ask this question unless there are specific directions in the Will which direct that the Trustees continue to carry on the business.

2. Relationships Between Family Members

The easiest form of succession, of course, is that for the client who has only one child. However, where there is more than one child, problems may result based on any one of a number of possible scenarios.

Where there are two children involved, both of whom are equally successful and interested in carrying on the business, concern should be had for which of the children will ultimately control. If it is possible to split the business into separate divisions with each having control over one division, such an organization could be the beginning of a very happy partnership. However, where there is only one business, family relations may be strained by the competition between the two children.

Further complications result if one child is particularly efficient and the other is not. Complaints are frequently heard from spouses and children of the effective child against the long hours and effort by the effective child against that of the ineffective child who simply is not capable of the same effort. In such a case, consideration should be given to rewarding the effective child by greater bonuses or financial performance. While it is an admirable thing to treat children equally, where performance levels justify different

treatment, lack of parity is the most fair approach. The rule with parents should be that children should be treated equally in terms of capital. However, that is in their position as children. As employees, they are entitled to be compensated according to their ability; to do otherwise creates problems between children and among other employees.

Another problem exists where there are children actively involved in the business and children who are not actively involved.

These problems typically arise only after the death or retirement of the freezor or when the children acquire shares or become aware of the existence of a trust established in their favour. At this point, the situation between active and non-active children will be somewhat similar to the position of the surviving shareholder and the estate of a deceased where there is a buy-sell agreement. Two parties who carry on business in partnership through a corporation will have a buy-sell agreement providing for the mandatory buy-out of one another's interest upon the death of the first to die. There are good reasons for doing so. The active surviving partner will have interests completely in conflict with those of the deceased party. The family of the deceased party will incur an obligation to pay income taxes on the deemed disposition of those shares. The estate will require the shares to be reduced to cash or liquid assets as soon as possible as they do not wish to have a significant part of the estate tied up in the hands of an asset which is basically under the control of a third party. The executors will be required to convert such assets into an investment that will produce a reasonable rate of return to support the family of the deceased. The executors will also be interested in the extraction of corporate profits by way of dividends to make up for the fact that no salary or bonus is now paid to the deceased shareholder. On the other hand, the survivor will wish to carry on as before. The survivor will be drawing a salary, receiving a bonus and having corporate benefits through the use of such perks as automobiles. His inclination will not be to declare dividends or to extract profit but rather to use surplus for legitimate corporate purposes such as expansion or replacement of assets. The surviving shareholder will not be happy to have his every expenditure scrutinized by the personal representatives of his now deceased partner.

For all these reasons, it is prudent that both parties part company as soon as possible. It is for this reason that life insurance is used to fund buy-outs so that the separation can occur as quickly as possible. The same scenario occurs when children are actively involved in the business corporation and other children have no active involvement. Their inheritance is tied up in an asset which is being used to support a lifestyle for their siblings. Family fights may occur at this point. As a result, a salient part of any succession issue involves arrangements between and among the surviving siblings as to their equity participation in the business. it is, therefore, useful to ensure that shareholder agreements are in place so that each child is aware of his or her rights and obligations so that plans can be made for the future.

C. USE OF LIFE INSURANCE – INSUFFICIENT INSURANCE

Life insurance is an integral part of every estate plan and yet is frequently neglected. In a family owned business, a large amount of life insurance received on the death of the owner-operator often provides the necessary liquidity to do the following:

1. Provide a method of equalizing active and non-active children by allocating to the non-active children the cash proceeds of the life insurance proceeds;

2. Provide a corporation with the necessary funds to redeem preference shares held by the spousal trust or to facilitate a buy-out of the shares owned by the estate;

3. Provide a spouse with sufficient capital to permit him or her to be less reliant on distributions from a business, particularly when it is anticipated that the business will not be not be sold to a third party but rather inherited by one or more members of a family.

Too frequently the critical cash is not available. Much litigation could be avoided by significant amounts of insurance at least equal to the value of the business enterprise.

Life insurance should also be reviewed in terms of the propensity of some clients to obtain joint and last survivor life insurance. In such a case, the life insurance is payable

on the death of the surviving spouse; rates for this type of insurance are generally less than other types of insurance. The conventional wisdom behind the purchase of such a policy would be that a deferral of capital gains tax would be postponed the death of a surviving spouse. However, where a spouse elects against the Will and there is a deemed disposition of such property, no insurance proceeds will be payable in order to fund the tax that will be payable at this point. Consequently, joint and last survivor insurance should be reviewed and reassessed, if there is a possibility that the spouse may elect against a Will.

As well, where it is anticipated that a child will purchase the interest of the business from the estate, the estate will incur a capital gain upon the sale of the business to the purchasing child. Recall that the capital gain on assets held in a spousal trust is only deferred until the death of the spouse or the sale of the assets, whichever first occurs. Where it is anticipated that the sale of shares to the child will occur before the death of the spouse, joint and last survivor insurance will not be the proper form of insurance to fund any tax on such a sale, particularly when the child is given a preferred arrangement in terms of the sale price or the period of time over which the payment of the purchase price may be made.

D. OPTIONS TO PURCHASE

Although it is advisable that families enter into a Shareholders' Agreement to govern the ongoing relations of the shareholders and also to provide for buy-out, it is rare that there are Shareholders' Agreements between and among family members.

As an alternative to a Shareholders' Agreement, an owner-manager of a business will often provide for an option in his or her Will to permit one or more of the children to purchase the shares. The granting of a testamentary option, however, is fraught with difficulty.

1. Granting the Option

An option to purchase is a contract and ought to be dealt with in a contract and not through a Will. Perhaps estate lawyers are not sufficiently aware of the commercial issues that ought to be addressed or perhaps the testator simply chooses to be vague

about his wishes. Whatever the reason, a testamentary option will often lead to litigation.

Many family members will want to have one of their children be permitted to purchase shares at less than fair market value. However, a purchase and sale between a Trustee and a beneficiary is generally considered to be a non-arm's length transaction particularly when the relationship is that of personal representative of the parent and the child. Consequently, if the option is to purchase the shares at 90% of the appraised fair market value, the Trustees will be deemed to have sold the shares for the fair market value even though the purchase price will only be 90% of that. That additional tax to be paid on income which is not received by the estate represents a burden to the estate as a whole and is perceived, quite rightly, to be an additional benefit to the optionee at the expense of the non-participating beneficiaries of the estate.

An option is a commercial agreement and can be the subject of an agreement itself. It is unusual to place these options in a testamentary instrument and those that appear in Wills are frequently less than complete. Nevertheless, they are sufficiently common to have given rise to a great body of jurisprudence. The fact that there is such a body of jurisprudence is sufficient reason to avoid these ventures. Typically, a parent who wishes to grant an option to a child is vague about the details and it takes a determined solicitor to insist on specificity and details. Unfortunately, many of the Wills are effected on an emergency basis and there is little time and insufficient information given to craft an appropriate option clause.

The issues which regularly arise in connection with these options are as follows:

- At what date is the purchase price for the shares to be determined?
- What is the outside time limit by which the optionee must exercise his option to purchase the shares?
- What is the basis to be used as the method of valuation?

2. The Purchase Price and Valuation Dates

The jurisprudence is clear that when an option is given, the valuation date is the date of death, unless the Will specifies a different date.[5]

When the Will sets out the mechanism for setting the purchase price of the shares, there ought to be no issue as to the method of valuation.[6] However, frequently issues will arise in family businesses where the break-up value of the business is greater than the going concern value of the business. This frequently arises where real estate forms a significant component of the family business. For example, if a manufacturing business is located on real estate which is not critical to the performance of the business but can be sold for multiples of its historical cost, the issue arises as to whether or not it is appropriate to value the business on a going concern basis or on a break-up value basis. This also occurs with family-owned real estate investment properties. Frequently, the rate of return of commercial real estate will not be as great to the family as a whole than if the buildings were sold and the assets distributed among the beneficiaries.

This is an issue not only in situations where there is only one active member of the family but also where the business assets are not being used at their highest and best use.

As a result, the testator must specify the method of valuation to be used or an issue will arise as to the method of valuation.

3. The Exercise Date

The jurisprudence is clear that an option given in the Will is open until accepted. Nevertheless, the jurisprudence also requires that the option be exercised "within a reasonable period of time".[7] There is little judicial interpretation of what constitutes a reasonable of time.

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[5] See in general Theobald on Wills, Chapter 25, Testamentary Options; Jarman, A Treatise on Wills, The Eighth Edition, Volume 2, Eight Edition, 1951, p. 1468; Halsbury's Laws of England, Fourth Edition, Volume 50, Fourth Edition,1984, p. 169 regarding Options to Purchase.

[6] *Re Rudderham* [1971] 21 D.L.R. (3d) 457; *Re Martin; Martin v. McNabb* [1981] 9 E.T.R., 28.

[7] See the discussion in chapter 25 of *Theobald on Wills*.

However, the cases are clear that the holder of an option is not required to exercise that option "blindly" or until he has received a valuation and settled the other terms of the purchase price. The courts have noted that no optionee is required to "buy the pig until they take it out of the poke".[8]

Theobald states:

> "The Will may require the grantee to exercise the option even before the price has been ascertained: but, unless the Will plainly does require this, the court adopts a construction which does not force the grantee to exercise the option blindly before the price is ascertained and communicated to him." [9]

Although those who are not purchasers may take the position that the purchase price is more or less known, *Talbot v. Talbot* cited by Theobald puts a different gloss on this. In that case, Lord Justice Russell stated that the sons who had the option were entitled to know "whether their financial situations justified them in exercising the options".[10]

Obviously, if there is a dispute as to the method of valuation, the optionee will not have to exercise his or her option until the method is settled and the valuation report is issued. This could and does take years. In the meantime, more issues arise.

The cases dealing with the expiration of options examine the cause of the delay. This issue will not arise if the delay was due to factors outside the optionee's control or by the personal representatives.[11]

4. What Happens to the Assets Pending the Exercise of the Option Date?

Unlike other beneficiaries under the Will, because an option granted by a Will is also a form of contract, different rules govern. In *Talbot v. Talbot*, it is clear that a testamentary option "potentially can become a contract on its exercise at any time by

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8 See *Talbot v. Talbot* [1967] 2 All E.R. 920.

9 Theobald on Wills, Chapter 25, Testamentary Options, p. 314.

10 *Talbot v. Talbot* [1967] 2 All E.R. 920.

11 For a discussion as to the issues of timing and expiration, see *Talbot v. Talbot* [1967] 2 All E.R. 920 at p. 16; *Re Seldon* [1970] 10 D.L.R. 3d 306, 308; *McKay v. McSparron* [1974] N.I. 137 at 144; *Re Avard* [1948] Ch. 43; *Dawson v. Dawson* (1837) 8 S.I.M. 346; *Brooke v. Garrod* [1857] 3 K.& J.608.

the person holding the option...because the person getting a property under a testamentary option gets it by exercising the option and entering into a contract in that behalf with the Executors".[12]

Normally, the beneficiaries of an unadministered estate have no right in the estate assets, even if they comprise a specific bequest because the beneficiaries have no rights other than to see to the due administration of the trust property during the executor's year.

However, the holder of an option becomes entitled to the option by way of gift under the Will. Theobald observes that "the option is enforceable in equity by the grantee who takes a beneficial interest in the property at the testator's death". What is the significance of this? From a tax perspective, this means that the business assets will not vest in the spousal trust at any time and therefore there will be a deemed disposition at the date of death. No "reserve" will be available. This is to be contrasted with the deferral available where shares may be transferred to the spousal trust subject to a right or option in a Shareholders' Agreement.

5. Payment of the Purchase Price

Many testamentary options also provide that the purchaser who accepts the option has a period of time over which to pay the purchase price. This is particularly critical in a family business because it often forms the bulk of the estate and the purchasing sibling will require some time in order to raise the necessary funds and to pay the purchase price over a period of time.

It is not unusual to see that children purchasing businesses are given anywhere from five years to ten years to pay the purchase price. As a practical matter, this is a long period of time over which to have the bulk of the estate "at risk" without any supervision or oversight by the Executors. There will, however, be a reserve for capital gains purposes and the payments should be structured to provide that some interest be payable on the outstanding amount since, once the option has been exercised, the

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[12] *Talbot v. Talbot*, Supra footnote 10.

estate will no longer be the owner of the shares and will not be entitled to any of the dividend income. Where a surviving spouse who is dependent upon the business assets for an income rate of return, this could pose some difficulty.

What if the testamentary option states that the optionee must pay the purchase price over a period of five years? When does the five year period start? Does it commence at the date of death? Does it commence at the date of acceptance of the option? Again, these are issues which ought to be covered off in the Will. They rarely are and will often necessitate a need for the Trustees to take a motion for advice and directions to interpret the Will as to when the "deferred payment" period starts.

6. What Happens to the Assets Pending the Exercise of the Option?

Let us assume that after the date of death, the Directors of a business corporation declared a dividend out of, say the capital dividend account, which was received by the estate in the six month period following the date of death.

If Theobald is correct that "the option is enforceable in equity by the grantee who takes a beneficial interest in the property at the testator's death," then the dividend technically belongs to the optionee as he or she is the beneficial owner at the date of death. Complicated? It is indeed and that is a reason why these options frequently lead to the need for access to the Courts, even on a non-contentious basis.

E. THE SPOUSAL TRUST AND SHARES OF THE BUSINESS

An owner-manager who leaves a surviving spouse often has the bulk of his or her estate tied up in preference shares of the business, if he or she has effected an estate freeze or, if no freeze has been undertaken, in common shares of the business. He or she often neglects to specify in the Will how arrangements are to be made for the surviving spouse by way of dividend or distribution where shares are being held in the spousal trust. Typically, the shares of the owner-manager will have a large accrued capital gain. For that reason, in order to defer tax on the capital gain, the shares will be held in the spousal trust, so that such shares will not be subject to the deemed disposition rules but rather, the estate will be entitled to defer taxes until the later of the

sale of the shares or the death of the spouse.[13] Under the terms of a qualifying spousal trust, all income from the trust property must be paid to the spouse and no person other than the spouse may receive any part of the income or capital while the spouse is alive.[14]

1. Preference Shares

In a typical estate freeze situation, the preference shares will provide for a discretionary dividend rate on the preference shares. That permits the Directors to declare dividends sufficient to accommodate the owner-manager, who is the owner of the preference shares and then declare a dividend on the common shares, which are typically held by a family trust, in order to achieve some income splitting.

The preference share will, in almost all circumstances, have voting control. Because the owner-operator has voting control, he or she can elect Directors to ensure that dividends are declared sufficient for his or her needs. Thereafter, the Directors can declare dividends on the common shares for the family members.

In order to fix the fair market value of the preference shares at the time of the tax planned reorganization to effect the estate freeze, these preference shares are also typically retractable at the redemption price. Consequently, at any time, the owner of the preference share may convert his or her shares into cash and invest in another investment which provides a different rate of return.

After the death of the owner-operator, the Trustees of the estate will own the preference shares or common shares and typically control the corporation. However, the spouse is generally only one of several Trustees. Frequently, one of the children, typically the successor, is another Trustee. As a result, there will almost always be tension between the surviving spouse and the successor in their capacity both as Trustees and as beneficiaries. It will fall upon the third Trustee to break the deadlock where there is a dispute as to the rate of return of income to the spousal trust. The surviving spouse will

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[13] *Income Tax Act*, 70(6).

[14] *Income Tax Act*, 70(6).

wish to be assured of an income stream sufficient to provide adequately for his or her needs. The successor will wish to retain capital and pay the minimum amount as a dividend on the shares held by the spousal trust.

In a situation where the surviving spouse believes that he or she is receiving an improper rate of return, the typical solution would be to exercise the retraction privilege attached to the preference shares to reduce the preference shares to cash, which might then be invested in investments having a more suitable rate of return. However, the retraction of preference shares in these circumstances depends upon the corporation having sufficient cash to satisfy the redemption price. This is almost always not the case and the retraction of the preference shares under such circumstances will almost certainly result in the need for a sale of the business.

2. The Duties of Trustees vs. the Duties of Directors

On the death of the owner-operator, the shares will be held in the spousal trust and the spouse will be one of several trustees. There is rarely any direction in the Will given to the trustees as to how they should exercise their discretion to vote the shares of the family business. It is, of course, the Directors of the corporation that have the right to declare dividends and the Trustees of the spousal trust are not necessarily always the same as the Board of Directors. There is a view that Trustees who have control of a corporation ought to exercise their voting control in order to ensure that they or at least one of them have representation on the Board of Directors sufficient to control the corporation.[15] This view is supported by the English decision in *Bartlett v. Barclays Bank Trust Co. Ltd.*[16]. In that case, the trust company Trustee had remained passive in the management of the family trading company. The Court of Appeal held as follows:

> It was a trustee's duty to conduct trust business with the care that a reasonably prudent businessman would extend to his own affairs, and, in the case of a private company in which he was a majority shareholder, a prudent businessman would not be content to receive only such information on that company's activities as was dispensed at annual

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[15] See *Administration of Active Business Assets in Estates*, Rosanne T. Rocchi, Law Society of Upper Canada Special Lectures, 1996 Estates, p. 447.

[16] [1980] 1 Ch. D. 139 [1980] 2 Ch. D. 92.

> general meetings....the bank, as the controlling shareholder under the settlement, was under a duty as trustee of the settlement to ensure that it received an adequate flow of information from the board on the company's activities in time to enable it to make use of the information to protect the beneficiaries' interests by protecting...the project from being commenced and later from becoming the financial disaster it did. The bank was therefore in breach of trust in neglecting to ensure that it received such information and in confining itself to the receipt of the information dispensed at the general meetings... Since the loss to the trust funds would not have occurred if the bank had intervened to prevent the company's participation in the project, as it ought to have done, it followed that the bank's breach of trust had caused the loss and that it was liable for the loss.[17]

In a paper specifically addressing these duties,[18] Wolfe Goodman suggests that it is not necessary to become a Director and cites two English cases for his proposition.[19]

A well drafted Will generally provides that the Trustees shall exercise their discretion to elect themselves to the Board of Directors and to exercise their discretion as Directors to declare dividends sufficient to generate a minimum amount of income for the benefit of the spouse, subject to the solvency and other texts set out in the corporate statute governing the corporation. However, income tax laws prohibit a testator from directing that there be a maximum amount. This information is not always contained in the Will. As a result, following the death of the owner-manager, the spouse has an interest in a trust or which owns shares entitled to a dividend at the discretion of the Directors.

Assume for example, that the Trustees own shares of a corporation, which owns marketable securities. In this context, the corporation is simply a conduit and the Trustees should declare dividends equal to those received or paid net after-tax profits of the corporation.

Obviously, a business is different, but the Trustees, acting prudently, ought to determine what amounts were taken by the testator during his lifetime. If it was the practice of the

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17 Supra, footnote 16.

18 Wolfe Goodman, *Trusts that Control Corporations; Business Issues for Fiduciaries: Conflicting Duties and Discretions*, Canadian Bar Association – Ontario, Continuing Legal Education, Friday, May 3, 1996, p. 12.

19 *Re Lucking's Will Trusts*, [1968] 1 WLR 866 and *Re Miller's Deed Trusts*, [1978] LS Gaz R 454.

testator to extract all the net after-tax income subject to a reasonable reserve, then the same rule should apply following the death of the testator.[20]

There are however, problems with this because many testator's will take their income from the corporation or the business by way of salary and bonus. It is typically for small-business owners to bonus down to the small-business limit. Following the death of the testator, there would be another active "operator" reasonably be entitled to the salary and bonus and therefore the problem will be limited to receiving income by little dividends. It is of course possible for the spouse to receive a salary in connection with the business. Properly handled, these amounts would be small, unless the surviving spouse is truly an active participant. More typically, the active participant is the successor to the owner operator, and that will be one of the children.

At that point, the funds available to the surviving spouse will be reduced because the new "operator" will receive the salary. Not only does this create problems for the active children versus the more inactive children, but it is complicated by the fact that the spouse's interest in the business is subsumed to that of the operating child, who has a "first call" on the income generated by the business in order to satisfy his or her salary.

Without specific directions from a testator in the Will as to the income of a minimum nature that ought to be generated by this business for the benefit of the spousal trust, family problems frequently arise.

The late Wolfe Goodman has addressed the proposition that an estate with an active business has an obligation to declare dividends for the benefit of the spouse and cites a U.S. case in which the Court examined the obligations to declare dividends:

> How this responsibility is to be carried out may not be an easy question to answer. Consider the New Jersey decision in *Rosencrans v. Fry*, 91 A2d 162, (1952), in which the testator at his death owned slightly less than one-half of the shares of a plumbing company. The will left these shares to Fry in trust, and directed that he be named president of the company and that he be allowed to purchase shares from the trust at a fixed price. The life beneficiary complained that Fry breached his fiduciary duty by

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[20] Supra, see Wolfe Goodman article, footnote 18.

> failing to have the company declare grater dividends, given its substantial earnings. The court recognized the conflict of interest, since accumulating funds in the company enhanced the value of Fry's stock rights, but it held that his method of dealing with earnings was consistent with the testator's practice while he was alive. In addition, it held that there was a rational basis for the level of retained earnings.
>
> Contrast this with a situation in which a corporation controlled by trustees of a single trust merely holds a portfolio of marketable securities. Unless there are minority shareholders, to whom the trustees, in their capacities as directors, owe responsibilities not to take actions which would unfairly prejudice them it would seem that it would be reasonable to conclude that the trustees would have to ensure that the whole of the corporation's after-tax income was distributed each year, in order to provide an appropriate level of income to the life beneficiary.[21]

The issues relating to the conflicting fiduciary duties between Trustees of an estate or an inactive business and the Directors of the active business are exceptionally complex. It is only by way of specific direction in the Will that these problems are obviated. Too often, the spouse is left without any comfort as to a minimum rate of return on the investment represented by the active business, which often forms the bulk of the estate.

There do not appear to have been any Canadian cases which have addressed the issue of the obligations of Trustees who have voting control of a corporation with respect to their obligations to declare dividends and how they maintain an even-hand between the income beneficiaries and the capital beneficiaries. To be sure, there have been numerous cases detailing the obligations of the Trustees both as Trustees and as Directors when they have declared dividends of an income or capital nature or where there have been stock dividends declared. These cases generally involve the characterization of the distribution from the corporation and principally focus on the form vs. substance distinction.[22]

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21 Wolfe Goodman article, footnote 18 at pp. 9-10.

22 See *Hill v. Permanent Trustee Co.*, 33 S.R. (NSW) 527, *Re Zacks Estate* [1984] 17 E.T.R. 206, *Re Welsh*, (1980) 111 D.L.R. (3d) 390, *Re Thompson* [1947] O.R. 469, Affirmed [1947] O.W.N. 907.

These issues have been canvassed by David Hughes in an article entitled "Trust Principles and the Operation of a Trust Controlled Corporation".[23]

3. Which Law Governs – Trust or Corporate Law?

It is interesting to consider whether the Trustees of a spousal trust holding shares have a greater obligation in their capacity as Trustee or in their capacity as Director. The dilemma is described by David Hughes:

> It is increasingly common for trustees to find themselves holding blocks of shares which give them complete or partial control over a corporation.[24] Trustees in such positions are potentially subject to two separate bodies of law - that relating to trusts and that relating to corporations. These two institutions have been used for substantially different purposes: 'The trust has been traditionally considered a useful device for preservation and conservation of property for the benefit of objects of the settlor's bounty. It is no less clear that the corporate form is appropriate for the risk employment of capital in commercial situations.'[25] It follows that the two bodies of law differ significantly: in general, courts are much more reluctant to intervene in the management of a corporation than in the operation of a trust. When a court is required to consider the position of a trust which controls a corporation, the two bodies of law interact, and the court has the difficult task of deciding upon an appropriate balance between the two. A trustee who finds himself in control of a corporation is faced with the far more difficult task of trying to predict in advance how a court may respond to each of the wide variety of actions he has the power to take in managing the corporation.[26]

One of the areas that could be canvassed is an oppression remedy. However, in trying to solve problems within families, the oppression remedy ought to be viewed as one of

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23 David Hughes, *Trust Principles and the Operation of a Trust Controlled Corporation*, 30 U of T Law Journal, 151.

24 Mr. Hughes cites the following in support of this: On the issue of trust-controlled corporations see the following articles in a Canadian context: Scane, *Re Fleming* (1974) 1 E.T.Q. 105; Goodman, Trusts that control corporations (1976) 3 E.T.Q. 115, at 298; in an American context: Cahn, Estate corporations (1937) 86 U.Pa L.R. 136; Durand, Changing concepts of trust investments (1956) 95 *Trusts and Estates* 907; Williams, Trusts – The fiduciary aspects of estate corporations (1959) 57 Mich. L.R. 738; Nathan, The trust corporation: Dual fiduciary duties and the conflict of institutions (1961) 109 U. Pa L.R. 713; Kresnowiecki, Existing rules of trust administration – A stranglehold on the trustee controlled business enterprise, part II – The incorporate business (1962) 110 U. Pa. L.R. 816; Younger, Death and the close corporation (1967) 24 Brook. L.R. 1; For an Australian view see Phillips, Some instances of the trustee's duty to act fairly between different classes of beneficiaries (1977) 10 U. Queensland L.R. 83.

25 Nathan, supra note 24, at 719.

26 Supra footnote 23 at p. 151.

the remedies of last resort. A more appropriate remedy in this situation would be to take a motion for advice and directions for a Court to consider the obligations of the Trustees. However, this too is fraught with problems, again as described by David Hughes:

> All too often, courts facing problems in this area will try to avoid difficult decisions by speaking of the testator's or settlor's 'intention'. In this area, as in other areas of trust law, such an approach is often not satisfactory, as the issue before the court is generally one to which the testator never addressed his mind. It is possible to argue, as courts sometimes have,[27] that a testator or settlor who leaves shares in a corporation (often one incorporated by him) must have intended that corporate law prevail. However, such an argument is met by an equally strong argument in the opposite direction: a testator or settlor who leaves property (shares) in trust must have intended trust rules to apply. Therefore (in the absence of good evidence of actual intention), any argument based on the testator's intention can lead no further than a conclusion that the testator or settlor must have intended to give his trustees some of the advantages and flexibility of corporate form while at the same time intending that some principles of trust law apply. Arguments based on surmises as to the testator's or settlor's intention do not help to resolve the more difficult question of which combination of trust and corporate law principles should apply to any given set of facts.[28]

Mr. Hughes notes in his paper that there have been no Canadian cases considering this issue but he has noted a number of cases in the United States which have considered conflicting fiduciary duties of Trustees who act as Directors of wholly owned corporations or partially owned corporations of an estate.

One of the most interesting cases cited is *In re Hubbell's Will*[29]. In that instance, the husband and wife owned shares of a corporation in equal shares. On the death of a wife, she left her shares in trust to pay the income to her husband for life with the remainder to other relatives. It was noted that her husband was to receive a minimum income of $10,000 per year and if the income generated from these shares was less

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[27] See *In re Doelger's Estate* (1938) 279 N.Y. 646, 18 N.E. 2d 42 (N.Y.C.A.) aff'g 4 N.Y.S. 2d, rev'g 164 Misc. 590, 299 N.Y.S. 565; *Boyld v John Boyle & Co.* (1910) 136 App. Div. 367 120 N.Y.S. 1048, aff'd 200 N.Y. 597, 94 N.E. 1092.

[28] Supra footnote 23 at p. 153.

[29] (1951) 302 N.Y. 246, 97 N.E. 2d 888; reversing (1949) 276 App. Div. 134, 93 N.Y.S. 2d 555, which had affirmed (1948) 90 N.Y.S. 2d 74.

than that, the Trustees could encroach upon the capital of the trust at her husband's request.

After the death of the spouse, the Trustees elected themselves as Directors and caused the shares owned by the deceased to be redeemed to produce the guaranteed $10,000, even though the shares were valued at over $200,000. No dividends were declared from the corporation. The result of this redemption was that the shares held in the spousal trust became a minority interest. As well, the capital of the trust was reduced by $10,000. The remaindermen complained. The Court held that the Trustees' conduct amounted to a breach of trust. The *Hubell* decision represents one end of the spectrum in holding that the Trustees, when acting as Director, have their role as a Director circumscribed by their primary role as Trustee. Mr. Hughes notes as follows:

> *In Hubbell*, the court placed the trustee-director under a duty to intervene on behalf of trust beneficiaries in every phase of a corporate activity: investment decisions, accounting procedures, decisions to distribute funds, even the very existence of the corporation. The court was not only prepared to require that the trustees take drastic action; it was also prepared to require one of the trustees, the husband, to use his personal shareholdings to further the ends of the trust.[30]

Nevertheless, Mr. Hughes notes that the decision of the New York Court in *Re Hubbell* is possibly at one extreme and that this view has been rejected in other states. He notes:

> Outside New York State, the notion that a court may, on trust principles, intervene in the internal management of a trust-controlled corporation has had mixed reception. The Supreme Court of Pennsylvania has emphatically rejected the notion and declared that the sole right of a life beneficiary of shares is to such dividends as the board of directors, in its discretion, chooses to declare. The court has declared, obiter, that not even clear directions by a testator who held 100 per cent of a corporation could limit the directors' discretion as to the declaration of dividends.[31]
>
> The Supreme Judicial Court of Massachusetts has been only slightly less emphatic in declaring that 'the policy of the corporation as to depreciation,

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[30] Supra footnote 23 at p. 193.

[31] Supra footnote 23 at p. 194.

reserves and dividends is largely for the determination of the directors in good faith.

On the other hand, several states have supported a more interventionist role for the courts. The Supreme Court of Missouri has allowed a life beneficiary's estate to recover dividends he should have received when a corporation retained more of its earnings than were required for the reasonable financing of its operations. The case involved trustee-directors who were also remaindermen. In the recent case of *Jennings v Speaker*, again involving trustee-remaindermen, the Court of Appeals of Kansas applied *Adler* and required a holding company to distribute all its net income as dividends.[32]

In estates matters, with the advent of mandatory mediation, there a very few cases which actually proceed to trial and it is not anticipated that there will be significant new law broken in this area, except in the most bitter of relations in family owned businesses. Indeed, since there is so little Canadian law on the issue and because many of the U.S. decisions appear to have been fact driven, it is a very risky proposition to consider litigation in this area. A motion for advice and direction might be an appropriate method by which to proceed. However, if the circumstances warrant, the shareholder oppression remedy litigation would appear to be the most effective way to proceed given that there is a considerable body of law both in Canada and in the United States dealing with oppression of family members in the context of family businesses.

4. The Oppression Remedy

Often, a surviving spouse will have no option but to pursue a remedy under the relevant business corporations statute. In Ontario, the *Ontario Business Corporations Act* provides that a complainant may pursue a shareholder oppression remedy.

Sections 248(1) and (2) of the *Ontario Business Corporations Act*, provide as follows:

(1) Oppression remedy – A complainant and, in the case of an offering corporation, the Commission may apply to the court for an order under this section.

(2) Idem – Where, upon application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates,

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[32] Supra footnote 23 at p. 195.

(a) any act or omission of the corporation or any of its affiliates effects or threatens to effect a result;

(b) the business or affairs of the corporation or any of its affiliates are, have been or are threatened to be carried on or conducted in a manner; or

(c) the powers of the directors of the corporation or any of its affiliates are, have been or are threatened to be exercised in a manner,

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of.

It had been thought that a beneficiary of a trust had no standing to take action in connection with corporate matters because the beneficiary of a trust has no interest in the underlying assets of the trust. The Trustees are the shareholders and therefore those who are entitled to exercise all rights in connection with the shares of the corporation. In this instance, the surviving spouse will often be out-voted by the successor and the third party Trustee. However, the *Ontario Business Corporations Act* does provide that one need not be a shareholder in order to exercise rights as a complainant under the oppression remedy. Section 245 defines complainant as follows:

"complainant" means,

(a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,

(b) a director or an officer or a former director or officer of a corporation or of any of its affiliates,

(c) any other person who, in the discretion of the court, is a proper person to make an application under this Part.

The commencement of this type of litigation should be considered a last resort.

F. SEMI-LITIGATION – THE MOTION FOR ADVICE AND DIRECTION

The authority of fiduciaries to bring a motion for advice and directions is found in the *Trustee Act* under section 60(1) which provides as follows:

> A Trustee, guardian or personal representative may, without the institution of an action, apply to the Superior Court of Justice for the opinion, advice or direction of the Court on any question respecting the management or administration of the trust property or the assets of a ward or a testator or intestate.

This application for advice and direction is brought under rule 14.05(2) of the *Rules of Civil Procedure*. Subparagraph 3 provides for the broad nature of relief to be claimed on such an application. Subparagraphs 2 and 3 provide as follows:

> **Application under Statute**
>
> (2) A proceeding may be commenced by an application to the Superior Court of Justice or to a judge or that court, if a statute so authorizes.
>
> **Application under Rules**
>
> (3) A proceeding may be brought by application where these rules authorize the commandment of a proceeding by application or where the relief claimed is,
>
> (a) the opinion, advice or direction of the court on a question affecting the rights of a person in respect of the administration of the estate of a deceased person or the execution of a trust;
>
> (b) an order directing executors, administrators or trustees to do or abstain from doing any particular act in respect of an estate or trust for which they are responsible;
>
> (c) the removal or replacement of one or more executors, administrators or trustees, or the fixing of their compensation;
>
> (d) the determination of rights that depend on the interpretation of a deed, will, contract or other instrument, or on the interpretation of a statute, order in council, regulation or municipal by-law or resolution;
>
> (e) the declaration of an interest in or charge on land, including the nature and extent of the interest or charge or the boundaries of the land, or the settling of the priority of interests or charges;
>
> (f) the approval of an arrangement or compromise or the approval of a purchase, sale, mortgage, lease or variation of trust;
>
> (g) an injunction, mandatory order or declaration or the appointment of a receiver or other consequential relief when ancillary to relief claimed in a proceeding properly commenced by a notice of application;

(g.1) for a remedy under the Canadian Charter of rights and Freedoms; or

(h) in respect of any matter where it is unlikely that there will be any material facts in dispute.

The motion for advice and directions has a number of advantages including the fact that it is brought in a fairly summary manner. As well, it avoids the problems that also arise in a family context in that it does not require a Statement of Claim with one party proceeding against another party. The optics of a family member commencing an action against another family member are often just as serious as the claims themselves.

However, the optics of a claim between and among family members are softened by the use of this application which permits a family simply to seek to cut the gordian knot of many family disputes by setting out the boundaries within which the parties should operate.

One should note that the Court will not assume an Executor's or Trustee's responsibilities nor will the Court exercise the Trustee's discretion. However, the jurisdiction of the Court on a motion for advice and directions will be such that a Court will interpret sections of the Will or trust which are unclear and will often state whether or not a proposed action is within the ambit or scope of a Trustee's discretion.

The process, procedure and effect of a motion for advice and directions are discussed thoroughly by Christina H. Medland in an article entitled "Protecting Fiduciaries – Motions for Advice and Directions".[33]

In her article, Ms. Medland focuses on the fact that a Trustee who wishes to obtain the protection of the Court before taking a course of action will often protect himself or herself by taking such a motion for advice and direction. However, in addition to this benefit, this action provides a useful mechanism for families to obtain a final and binding decision on issues which would otherwise lead to full blown litigation.

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[33] Christina H. Medland, *Business Issues for Fiduciaries: Conflicting Duties and Discretions*, May 3, 1996, Canadian Bar Association – Ontario, Continuing Legal Education.

If we examine the use of this tool in the context of some of the issues which have been addressed earlier, the remedy and the scope of the authority of the Court are clear.

1. Insufficient Directions in the Will Regarding Spousal Trusts

We noted earlier that part of the problem involving any family businesses was the insufficient direction given by a testator as to the levels of income to be generated by a family business for the benefit of a spouse through the spousal trust which owns the shares. The interpretation of a Will is clearly one of the issues upon which a Court is qualified to give its advice. Where there is little or no income being derived from the spousal trust and where the spousal trust owns shares having a significant value, the Court may be asked to interpret the Will as a whole as it relates to whether or not the even-handed rule applies with respect to the retention of those shares and further, whether the Trustees are obliged to maintain an even hand between the spouse as the income beneficiary and the children as the capital beneficiaries of the trust.

2. Testamentary Options

I have alluded briefly to the issue of testamentary options and some of the problems that exist with them. There is a considerable body of jurisprudence detailing when and how options should be exercised and the rights that accrue to each of the estate and to the optionee in this context. In addition, a Will which contains a testamentary option often contains an option which grants "an element of bounty" and it would be appropriate in these instances to take a motion for advice and direction to the Court on the nature and extent of the testamentary option.

G. MEDIATION

In Toronto and in several other counties, there is requirement for mandatory mediation when an action is commenced in Estates Court or in any matter touching upon trusts or estates. It is often best in family disputes to proceed directly to mediation without having to go through the debilitating process of commencing an action. Many of the best mediators are very effective and, although their daily rate is greater than most, it is still far less expensive to engage in mediation than to commence an action and proceed through to what will inevitably be the mandatory mediation stage of the litigation.

There are times when families have gone through the mediation process only to see it fail because they are still too convinced of the rightness of their position. When all else fails, an action will have to be commenced. Generally, it is only after spending extraordinary amounts on legal fees and going through the debilitating process of discoveries that a family will realize that mediation may be the best way to proceed and the exchange of pleadings and discoveries often has a salutary effect on the confidence of the parties. As well, in a mediation, the parties can craft a solution with tax effective results and a benefit for all sides. Litigation does not afford that benefit.

In the meantime, it is best to remember that many of the seeds of potential litigation are easily observed well in advance and can be avoided by careful planning and detailed attention to the proper tools of estate planning.