

Wills, Trusts & Estates

When can beneficiary of a trust enforce rights of trustee in equity?

By **Matthew Stroh**



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(November 20, 2019, 8:26 AM EST) -- Subject to certain exceptions, as a general rule, only an executor, administrator and/or trustee of an estate or trust has standing to commence proceedings on behalf of the estate or trust (*Joncas v. Pennock and Durstling*, 1959 A.J. No. 48; *Maddess v. Racz et al.*, 2006 BCSC 642 at para. 15).

While this general rule is one of long-standing, in some situations it may effectuate an inequitable result. For example, if the trustee decides not to pursue a valid claim on behalf of the estate or trust or is unable to do so for some other reason, to the detriment of the beneficiaries (in such a case, the trustee may also be found liable for breach of trust).

In equity, a beneficiary may seek relief against a third party if the trustee is unable or unwilling to act. However, before a beneficiary may do so, he or she must have exhausted every reasonable avenue of relief to force the trustee to act (*Mayer v. Osborne Contracting Ltd.* [2012] BCCA 77 at para. 241; *Testa v. Testa*, 2015 ONSC 2381 at para. 31). In *Hayim v. Citibank NA* [1987] A.C. 730 (Hong Kong P.C.), the Judicial Committee of the Privy Council, in a decision arising out of Hong Kong, explained this principle as follows:

"[A] beneficiary has no cause of action against a third party save in special circumstances which embrace a failure, excusable or inexcusable, by the trustees in the performance of the duty owed by the trustees to the beneficiary to protect the trust estate or to protect the interests of the beneficiary in the trust estate."

Decision in *McDowell v. Fortress Real Capital Inc.*

This principle was recently addressed by the Court of Appeal for Ontario in *McDowell v. Fortress Real Capital Inc.* 2019 ONCA 71, in the context of an investor class action. In that case, the appellants were a class of small investors who were allegedly induced to invest in four syndicated mortgages. Two of the mortgages fell into default and the other two were removed from title through power of sale proceedings and proceedings commenced under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36. The investors commenced class proceedings against the promoters of the syndicated mortgages and others. One of the issues on appeal was whether the sealed contract rule prevented the appellants from enforcing the syndicated mortgages at common law.

At common law, only the signatories to a contract under seal may sue or be sued on it (*Friedmann Equity Developments Inc. v. Final Note Ltd.*, 2000 SCC 34). In *McDowell*, s. 13 of the *Land Registration Reform Act*, R.S.O. 1990, c. L.4, deemed the syndicated mortgages to be contracts under seal. Importantly, none of the investors was signatories to those contracts. Although the investors argued that the syndicated mortgages were being held for their benefit by the trustees, the Court of Appeal for Ontario found that at common law, the sealed contract rule prevented the investors from suing to enforce the syndicated mortgages.

Yet, the Court of Appeal for Ontario also found that it was not plain and obvious that the investors could not enforce the syndicated mortgages in equity in spite of the common law sealed contract rule. As explained by Justice Kathryn Feldman, in writing for the appellate panel:

"The motion judge acknowledged that in circumstances where a trustee who is a party to a sealed contract takes no steps to enforce the contractual obligations of the other party, the beneficiaries of the trust may enforce the rights of the trustee in equity by bringing the action and including the trustee as a party to the action.

"This right was recognized by the Supreme Court in *Friedmann*, where the court discussed the decision of the English Court of Appeal in *Harmer v. Armstrong*, [1934] 1 Ch. 65 (Eng. C.A.). Bastarache J. stated that the *Harmer* decision merely provides a procedural method for the beneficiaries of a trust to effectively force the trustee to enforce its rights under agreements under seal for their benefit: at para. 29. The equitable right is based on the law of trusts, not the law of contract, and therefore it does not constitute an exception to the sealed contract rule. Bastarache J. also explained that the equitable rule does not have the effect of creating a legal relationship between the beneficiary and the contracting third party. Therefore, the third party may not use the rule to sue the beneficiary, and, importantly for this case, when the beneficiary sues to enforce the contract, it is to enforce the agreement 'according to its tenor' (emphasis added), meaning the beneficiary is asserting the trustee's rights and not his or her own: at paras. 28, 30."

This case is an interesting example of when relief in equity may potentially override what would otherwise be a harsh result created by the common law. Under s. 96(2) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, equitable rules prevail where they conflict with those created by the common law.

For practical purposes, a beneficiary may essentially enforce any right that a trustee could assert by effectively stepping into the trustee's shoes to do so, but only if the trustee is unable or unwilling to act. Although circumstances in which this equitable principle may be applicable may be relatively infrequent, this nevertheless represents a potentially powerful remedy in the hands of a beneficiary to a trust or estate.

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