

TRUSTEE SURCHARGE

By Peter Askew and Gregory Sidlofsky

Introduction

It is well settled that when a trustee fails to carry out his or her obligations under the terms of a trust, the rules of equity, or a statute, the trustee may be held liable to the beneficiaries for losses they incur. Failure in this context may take the form of doing something contrary to the trustee's obligations, or of neglecting to do something which he or she ought to have done.¹ If found liable for a proven loss, and provided the court has declined to relieve the trustee of that liability,² the trustee will then be required to compensate the beneficiaries for the loss.

Questions about a trustee's failures and liability for same often arise on, and are addressed in passing of accounts proceedings. When a trustee applies to pass accounts, the beneficiaries have the right to raise objections. Those objections often focus on the trustees' failures in exercising their obligations. On the passing of accounts, the court has broad powers to award relief and hold the trustee liable for shortcomings in his or her administration of the trust. This paper discusses the now seldom referred to, but powerful ability to "surcharge" the accounts of the trustee and thereby hold the trustee directly liable for specific losses associated with the accounts.

¹ "Breach of Trust: Remedy of the Beneficiary Against the Trustee Personally", eds Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith, s. 25.1

² There are three basic defences available to trustees seeking to be excused for a breach of their duties: (i) the beneficiary was a party to the breach by either instigating it or acquiescing to it; (ii) the limitation period in which the beneficiary was required to bring his claim has expired; and (iii) the court should provide the trustee with relief pursuant to its statutory power, if it is satisfied that the conduct was honest, reasonable, and should be excused. For a discussion of this topic, see Justin de Vries, "Trustee Liability: When Will a Trustee be Excused?" (2007).

Traditional Equitable Principles Underpinning the Liability of Trustees

The Duty to Account

Traditionally, the law of equity has dictated that taking an account of the trust is the primary mechanism used to ensure its proper administration. It is the means by which the trustee is required to show what he or she has done with the trust property and justify his or her stewardship of the property.³ The duty to account also provides the beneficiary the right to object to any entry in the accounts and require the trustee to prove that the entry was justified.⁴

A trustee has always had an obligation to account to a beneficiary of the trust concerning the trust assets regardless of whether the trustee is compelled to formally pass accounts and regardless of whether there was any allegation of wrongdoing or breach of trust. However, a formal passing of accounts proceeding is the traditional means through which the beneficiary's remedies against the trustee are implemented.⁵

Surcharge and Falsification

Dating back to at least the late eighteenth century, if any discrepancies were revealed in a trustee's accounts, the primary means for the beneficiaries to address

³ Matthew Conaglen, "Equitable Compensation for breach of trust: Off *Target*", Melbourne University Law Review (2016) Vol 40:126 at 129; Paul S. Davies, "Compensatory Remedies for Breach of Trust" 2016 CanLIIDocs 44 (2016) 2(1) CJCL at 68.

⁴ See, for example, *Re Fish; Bennett v Bennett* [1893] 2 Ch 413, wherein the beneficiaries were not able to persuade the court that the trustee had breached his duties, but the court nonetheless held that they were "absolutely entitled" to see the trustee's accounts and to object to any items which they considered out of place. See commentary in Matthew Conaglen, "Equitable Compensation for breach of trust: Off *Target*", Melbourne University Law Review (2016) Vol 40:126 at 129.

⁵ "Breach of Trust: Remedy of the Beneficiary Against the Trustee Personally", eds Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith, s. 25.I at 4.

them was to request “surcharge” or “falsification” of the accounts.⁶ On a basic level, a surcharge alleges an omission where there ought to be a credit to the account, while a falsification alleges that an item on the debit side of the account is either wholly false or in some part erroneous.⁷

Surcharge and falsification were, in effect, claims to enforce the trustee’s obligations pursuant to his or her duty to account as opposed to claims for losses caused by a breach of duty. The claim for surcharge or falsification was tied directly to the specific entries in the accounts, and therefore related to specific, fixed amounts or items, unlike a damages claim for fraud or otherwise.⁸

In the normal course, surcharge and falsification limited the trustee’s liability to what he or she actually received or paid out of the trust funds, rather than what ought to have been received by the trust. In other words, the beneficiary was constrained to the arguments that either (i) more had been received than was disclosed in the account (surcharge), or (ii) that less had been disbursed than what was accounted for (falsification).⁹ If, for example, the beneficiary was able to show that the trustee received income from a rental property held by the trust, and that income was not recorded in the

⁶ See *Pit v. Cholmondeley* (1754) 2 Ves Sen 565, 566; 28 ER 360, 360, where Lord Harwicke LC stated: “if any of the parties can shew an omission, for which credit ought to be, that is a surcharge: or if any thing is inserted, that is a wrong charge, he is at liberty to shew it, and that is falsification ...”.

⁷ Macdonell, Sheard and Hull on *Probate Practice 4th ed.*, Hull and Hull (Carswell: 1996), p. 350.

⁸ “Breach of Trust: Remedy of the Beneficiary Against the Trustee Personally”, eds Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith, s. 25.I at 5.

⁹ Matthew Conaglen, “Equitable Compensation for breach of trust: Off *Target*”, *Melbourne University Law Review* (2016) Vol 40:126 at 132.

trust accounts, the accounts would be surcharged to reflect that income and the trustee would then be required to personally pay into the trust the amount received.¹⁰ Where it was found that the trustee had made, for example, an unauthorized investment, the disbursement could be falsified and the trustee would be ordered to re-pay into the trust fund the sum that was wrongfully disbursed.¹¹ The beneficiary also had the option of adopting the transaction to take the benefit of it if it happened to be successful.¹²

The remedy of surcharge could also extend to impose liability on the trustee for not only fixed items that were deemed to be missing from the accounts, but also for any monies that should have been received by the trust had the trustee fulfilled his or her duties. Such a claim must be founded on an allegation of breach of trust, rather than on the allowance, disallowance, or addition of particular, quantified items to the trustee's account. The argument is that "but for your breach, you would hold more property in trust".¹³ In the traditional language of equity, a beneficiary brought such a claim by demanding an account "on the basis of wilful default".¹⁴

¹⁰ Matthew Conaglen, "Equitable Compensation for breach of trust: Off *Target*", *Melbourne University Law Review* (2016) Vol 40:126 at 131.

¹¹ *Ibid.*

¹² "Breach of Trust: Remedy of the Beneficiary Against the Trustee Personally", eds Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith, s. 25.I at 5.

¹³ For an example, see *Siemens v. Bawolin*, 2002 CarswellSask 448, 46 E.T.R. (2d) 254 (Sask. C.A.). See also: *Re Proniuk Estate*, [1986] A.J. No. 686 (Alta. Surr. Ct.), where the court found that the trustees had improperly failed to invest funds held in the estate trust fund, resulting in a loss in interest the estate otherwise would have received. The court ordered the trustees to pay to the estate the interest it would have received had the funds all been properly invested.

¹⁴ "Breach of Trust: Remedy of the Beneficiary Against the Trustee Personally", eds Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith, s. 25.I, citing R. Chambers, "Liability" in *Birks and Pretto*, 1 at 16-20.

Surcharge, Falsification and Expansion of the Courts' Powers on Passing of Accounts

The remedies of surcharge and falsification were routinely awarded by the Surrogate Courts of Ontario, which were generally the courts responsible for handling the estates of deceased persons and in particular passings of accounts, during the eighteenth, nineteenth, and early twentieth centuries. The Surrogate Courts were born out of the Ecclesiastical Courts, which in turn were descended from the Roman Law Courts. As a result, the Surrogate Courts had administrative functions reflective of Roman Law Courts, as well as the purely litigious function of Common Law Courts. This hybrid character sometimes led to an overlapping of jurisdictions with other courts. For example, the Master's jurisdiction was in many ways analogous to that of the Surrogate Court.¹⁵

The scope of authority of the Surrogate Court in respect of passings of accounts was initially somewhat limited and was subsequently expanded over time. To illustrate, in *Re Russell*, it was held that the Surrogate Court did not have jurisdiction to determine whether a sum of money claimed as a gift by one of the executors should properly be considered an asset of the estate for which the executor should be held liable. Instead, the court could only approve the remaining accounts and report that a claim for surcharge had been made, leaving the issue to be dealt with by the High Court.¹⁶

¹⁵ Marni M.K. Whitaker, "Powers and Jurisdiction of Courts on Passing Accounts", *Widdifield on Executors and Trustees*, 6th ed. At 14.8.

¹⁶ *Re Russell* (1904), 8 O.L.R. 481, 24 C.L.T. 368 as described in *Turk v. Turk*, [1957] O.R. 482 at paras. 38-40.

The *Re Russell* decision prompted legislative change to empower the Surrogate Courts to properly deal with a greater scope of issues on passings of accounts. An *Act to Amend The Surrogate Courts Act*,¹⁷ (the “1905 Amendment”), was passed, adding a subsection to the *Surrogate Courts Act* which provided:

The judge, on passing the accounts of an executor, administrator or such a trustee, shall have jurisdiction to enter into and make full inquiry and accounting of and concerning the whole property which the deceased was possessed of or entitled to, and the administration and disbursement thereof in as full and ample a manner as may be done in the Master's office under an administration order, and, for such purpose, may take evidence and decide all disputed matters arising in such accounting subject to appeal.¹⁸

The 1905 Amendment directly strengthened the court's power to hold trustees and executors liable for amounts owing to the trust or estate. As stated by Meredith C.J. of Ontario Divisional Court, the object of the amending section was to “enlarge the powers of the judge” and to:

enable him to enter into any question which was necessary for him to deal with in order to determine how much the personal representative had received, or ought to have received, and to be charged with, and to credit him with what he properly had paid, so as to ascertain the balance with which he was chargeable.¹⁹

The expanded powers of the Surrogate Court to hold trustees liable on passings of accounts were affirmed in subsequent jurisprudence. In *Reid, Re*,²⁰ the issue initially before the court was whether sums of money deposited to the joint account of the deceased and his father was the property of the estate or the father and executor, who

¹⁷ 5 Ed. VII, c. 14 (assented to 25th May 1905).

¹⁸ Section 72(3).

¹⁹ *Re McIntyre* (1906), 11 O.L.R. 136 at p. 139.

²⁰ *Reid, Re* (1921), 50 O.L.R. 595 (Ont. C.A.).

asserted that the son had provided the monies to him as inter vivos gifts. The court held that the monies formed part of the estate and were chargeable against the father and other executor. Latchford J., of the High Court, reversed the Surrogate Court's decision and found that on the facts of the case, the gifts were not chargeable against the executors, which was affirmed by the majority of the Court of Appeal. However, regarding the jurisdiction of the Surrogate Court to make such an order, Hodgkins J.A. of the Court of Appeal affirmed that the Surrogate Court judge had jurisdiction to inquire into and charge the executors with assets said by them not to belong to the estate.

Expanding the Limits of Surcharge and Falsification

In the early twentieth century, appellate courts continued to affirm the courts' powers to surcharge and falsify a trustee's accounts by denying or granting specific items in trustees' accounts, but were somewhat conflicted as to whether they were entitled to go a step further and award greater amounts than what the trustee had actually received or paid out of the trust fund.

In 1932, there was some disagreement in the Court of Appeal as to whether trustees should be liable for the interest on sums found to be property of the estate or trust on a passing of accounts, following a decision by the Judicial Committee of the Privy Council (the "JCPC") in *Campbell v. Hogg* two years prior. In *Campbell*, the JCPC held that upon a passing of accounts, the person passing his or her accounts as trustee,

"may not be charged with interest on uninvested balances or with any sum in the nature of damages."²¹

Following the *Campbell* decision there arose some uncertainty as to the scope of the Surrogate Court's powers on a passing of accounts. In *Toronto General Trusts Co. v. Hogg*, Masten J.A., in dissent, distinguished *Campbell* and found "that the settled practice of the Surrogate Courts of Ontario of permitting surcharge and falsification of accounts and of awarding interest against defaulting trustees or executors is well founded in the provisions of the *Surrogate Courts Act* and the *Rules of Court* applicable thereto".²² Conversely, the Court of Appeal found less than a month later in *Re Johnson*, that the statement of the JPC in *Campbell* was *ratio decidendi* rather than *obiter* and consequently that the Surrogate Judge had no jurisdiction to make an order against the trustee for any amount more than the principal amount owing by the trustee to the estate as displayed in the receipts presented to the Surrogate Court judge.²³

The uncertainty brought about by the Court of Appeal's interpretation of *Campbell* in *Re Johnson* resulted in another legislative amendment to the *Surrogate Courts Act* in S.O. 1933, c. 63, s. 3. (the "1933 Amendment"), which expanded the power of the Surrogate Courts on a passing of accounts by expressly allowing the court to award damages against trustees. This amendment, which now appears as s. 49(3) of the Ontario *Estates Act*, permitted the judge on a passing of accounts to inquire into any

²¹ [1930] 3 D.L.R.673, at p. 683.

²² *Toronto General Trusts Co. v. Hogg*, [1932] O.R. 641 at p. 11.

²³ *Re Johnson*, [1932] O.R. 385, at p. 3.

complaint or claim against the trustee and order the trustee to pay any sum by way of damages or otherwise that the judge considered proper.²⁴

Following the 1933 Amendment, the courts exercised their expanded powers on applications to pass accounts and were able to order more flexible relief. In *Elliott v. Citrelli*,²⁵ a beneficiary objected to the accounts of the executor, claiming that he had failed to account for a sum alleged to have been lent to him by the testator, but which the executor claimed had been a gift. The Surrogate Court held that it had jurisdiction pursuant to the 1933 Amendment to hear oral evidence and completely determine the matter in issue.

The court in *Elliott* ultimately found the sum to fall within the estate and, relying on the law of equity, held the executor liable to the estate for the amount of the loan, plus interest at three percent starting one year from the date of the grant of probate. The court's reasoning was that given that the funds properly belonged to the estate, the executor was personally liable for the amount of the loan, with interest, as it should

²⁴ Macdonell, Sheard and Hull on *Probate Practice 4th ed.*, Hull and Hull (Carswell: 1996), p. 350; Marni M.K. Whitaker, "Powers and Jurisdiction of Courts on Passing Accounts", *Widdifield on Executors and Trustees*, 6th ed. At 14.8.

See also *Estates Act*, R.S.O. 1990, c. E. 21, s. 49(3):

The judge, on passing any 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 fund, but any order made under this subsection is subject to appeal.

²⁵ [1960] O.J. No. 602.

properly have been included in the accounts. The court however, declined to award costs against the executor personally or deny him executor's compensation on the basis that the decision rested on the burden of proof rather than the credibility of the witnesses before the Surrogate Court judge.²⁶

These decisions illustrate the evolution of the courts' conception and usage of surcharge and falsification into more versatile instruments following legislative changes that allowed the courts to order a greater range of relief on passings of accounts.

The Surcharge Remedy Today

Following the merger of the Surrogate Court with the High Court in 1989,²⁷ the Superior Court of Justice inherited the Surrogate Court's broad powers on passings of accounts, which are now set out in the *Estates Act*. Accordingly, the Superior Court has jurisdiction to hold trustees personally liable on passings of accounts, but will most commonly opt to decrease trustees' compensation before awarding damages.²⁸ The remedy of surcharge is still occasionally used, although evidence of breach of trust on the part of the trustee appears to be a necessary precondition for the remedy. The issues of surcharge and falsification are now properly raised by way of a notice of

²⁶ *Ibid.*, at para. 58.

²⁷ In 1989 the Surrogate Court was merged with the High Court with the passage of the *Courts of Justice Amendment Act, 1989*, creating one large large superior trial court, the Ontario Court (General Division). In 1999, the name of the Ontario Court (General Division) was changed to the Superior Court of Justice. See: <http://www.ontariocourts.ca/scj/about/history/>.

²⁸ Justin de Vries, "Trustee Liability: When Will a Trustee be Excused?" (2007), at 2.

objection to accounts under Rule 74.18(7) and particulars of such surcharge or falsification should be set out therein.²⁹

In *Rumford Estate*,³⁰ the court held that an executrix was required to surcharge her accounts to compensate the estate for the diminished value of goods which she had not sold in a timely manner. The executrix was found to have administered the estate in a grossly negligent manner as she had failed to distribute a large part of the estate to the beneficiaries over a decade after the death of the deceased, and the balance of the assets had diminished in value due to her delay.³¹ In particular, the executrix failed to purchase insurance for a valuable jewellery set from which items were lost by the jewellery dealer retained by her.

The *Rumford Estate* decision is an instance where the court used its ability to surcharge the accounts of the executrix in a flexible manner based on the circumstances of the case and what the judge considered to be reasonable. The court found the executrix liable for the jewellery set, albeit at a discount from the appraised value,³² with interest at 5 percent commencing on the date it should reasonably have been sold, as well as for any shortfall on the sale of household items that she was required to sell in a timely fashion. Costs were awarded against the executrix personally and she was denied any compensation, but she was held to be entitled to her

²⁹ Macdonell, Sheard and Hull on *Probate Practice 4th ed.*, Hull and Hull (Carswell: 1996), p. 350.

³⁰ 1996 CarswellOnt 3709 (Gen. Div.).

³¹ *Ibid.*, at para. 31.

³² The diminution in value of the jewellery was approximately \$14,000 but the court surcharged the accounts for \$10,000, taking into account that the initial valuation might have been too high.

disbursements. The court therefore surcharged the accounts only for an amount it felt was fair, rather than for the full decrease in value of the items that should have arguably been recovered by the estate had she fulfilled her duties.

In *Tigert Estate*,³³ on a passing of accounts, the court found that the estate trustee failed to properly distribute the deceased's estate in accordance with the rules of intestacy or to keep proper accounts. Over \$40,000 was distributed to persons who were not entitled to receive any distribution. The court noted that under ordinary principles, the estate trustee would be surcharged for the entire amount that was wrongly distributed,³⁴ but ordered that the estate trustee provide a proper reconciliation and *viva voce* evidence on the return of the application so that the proper amount of the surcharge could be ascertained.³⁵ It should be noted that the court's use of the term 'surcharge', meaning disallowing the improper distributions and holding the estate trustee liable for repayment, would properly be described as falsification rather than surcharge according to the authorities discussed above.

In *Picov Estate, Re*,³⁶ the Superior Court used its authority to surcharge the accounts of the estate trustee of the deceased's estate on his application to pass accounts. The court found breaches of trust and fraud on the part of the estate trustee, including failure to abide by court orders, lack of cooperation with the opposing

³³ [2002] O.J. No. 3853.

³⁴ *Ibid.*, at para. 12.

³⁵ *Ibid.*, at para. 13.

³⁶ 2000 CarswellOnt 632 (Ont. S.C.J.).

beneficiaries, and inaccurate and dishonest accounting. The estate trustee had continued to operate the deceased's bank account and charge his VISA account as if the deceased was still alive, and had forged several cheques in the deceased's name for his own benefit.

Greer J. found that she had the authority to apply surcharge and falsification to the administration of the estate pursuant to s. 49(2) of the *Estates Act*, and proceeded to surcharge and hold the estate trustee liable for all assets found to be undervalued, not valued, or missing from the accounts altogether. Her Honour also ordered that the estate trustee reimburse the estate for all falsified disbursements, including the cheques forged in the deceased's name and payments from the deceased's VISA account for the estate trustee's benefit. In total, the court ordered the estate trustee to pay \$31,397.40 to the estate in respect of the surcharged and falsified accounts, with interest. Further, Her Honour ordered that the estate trustee was not entitled to any compensation, and awarded costs against him personally on a solicitor-client scale.

In *Zimmerman v. McMichael Estate*,³⁷ the court again exercised its authority to surcharge the accounts of the former trustee and attorney for property of the deceased on his application to pass accounts. This was another case of egregious conduct on the part of the trustee/attorney, as the court found that the trustee/attorney had failed to perform his basic duty to account and was "grossly indifferent" to this obligation, failed

³⁷ 2010 ONSC 2947.

to comply with court orders, made improper and unauthorized payments and loans to himself out of the trusts, mingled trust property with his own, pre-took almost \$450,000 in compensation, and used assets of the trust for his own personal benefit.

In his reasons for decision, Justice Strathy (as he then was) stated the following in respect of surcharge and falsification:

It is a basic principle of trust law that a trustee is not entitled to use the trust property for his or her own personal benefit. If a trustee cannot account for or explain disbursements or expenses charged against a trust he/she is personally liable to the trust for those disbursements and expenses. This is known as a "surcharge": See, for example, *Jacobs v. Hershorn*, [2006] O.J. No. 1333, [2006] O.T.C. 331 (Ont. S.C.J.) at paras. 18-21.

Falsification of accounts occurs when there is a disbursement shown on the accounts which the objectors allege is wholly false or in some part erroneous: *Picov Estate, Re*, above, at para. 25; MacDonnell, Sheard, Hull, *Probate Practice*, (4thed.) at p. 350.³⁸

This statement of the law in respect of surcharge and falsification is not entirely consistent with the principles set out in the previous authorities outlined above, as it blurs the distinction between the two remedies. The way in which Strathy J. describes surcharge effectively equates to falsification, in the sense that a trustee is held liable for improper disbursements or expenses, which is distinct from instances where there are omissions that ought to have been credits to the account that are then held payable by the trustee by way of surcharge.³⁹

³⁸ *Ibid*, at paras. 44-45.

³⁹ Indeed, in *Jacobs v. Hershorn*, cited by Justice Strathy in respect of surcharge, the court ordered the former attorney for property of the deceased to reimburse the estate for various transactions entered into using the bank account and credit card of the deceased. This would constitute falsification rather than surcharge as defined in previous authorities. In any event, the reasons for decision of Marchand J. in *Jacobs v. Hershorn* make no mention of either surcharge or falsification and do not specify the specific

Without further differentiating between surcharge and falsification, Justice Strathy ultimately ordered that the attorney/trustee pay back the estate for almost \$400,000 in disbursements relating to unexplained cash withdrawals and personal expenses of the attorney/trustee,⁴⁰ as well as \$2,000 for an item not accounted for (this was a surcharge but not specifically identified as such), approximately \$35,000 for accounting services for preparation of the accounts, and almost \$450,000 in pre-taken compensation.⁴¹ The trustee/attorney was also ordered to personally pay almost \$300,000 in costs to the estate and trust.⁴²

Conclusion

The modern day decisions outlined above reveal that while the traditionally distinct concepts of surcharge and falsification may not be fully appreciated by judges today, the underlying remedies are still occasionally employed as the courts see fit. Given the broad powers afforded under section 49 of the *Estates Act* to make a full inquiry and accounting and award damages or otherwise at the discretion of the judge, courts now have many tools at their disposal to address wrongdoing pertaining to the conduct of trustees. In particular, the ability to award damages for breach of trust or other causes of action on passings of accounts has lessened the need to employ

legal basis for liability in respect of the identified transactions. This was an action for damages rather than a passing of accounts.

⁴⁰ See additional reasons in *Zimmerman v. Fenwick*, 2010 ONSC 5452.

⁴¹ *Zimmerman v. MicMichael Estate*, 2010 ONSC 2947 at paras. 115-117.

⁴² *Zimmerman v. MicMichael Estate*, 2010 ONSC 3855.

concepts like surcharge and falsification, except in cases where it is convenient or appropriate for the court to do so.

The foregoing has illustrated that while surcharge and falsification are no longer the primary instruments by which trustees are held liable, they remain a tool in the courts' arsenal that is still used in conjunction with other mechanisms such as denying the trustee's compensation, ordering that the trustee is personally liable for costs, or awarding damages. Where misconduct is established, the courts remain willing to employ surcharge (and falsification) to hold trustees to account as appropriate.