Creditor Access to the Assets of a Purpose Trust

A Report prepared for the British Columbia Law Institute by its Committee on the Modernization of the *Trustee Act*

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The British Columbia Law Institute was created in 1997 by incorporation under the Provincial *Society Act*. Its mission is to:

(a) promote the clarification and simplification of the law and its adaptation to modern social needs,
(b) promote improvement of the administration of justice and respect for the rule of law, and
(c) promote and carry out scholarly legal research.

The Institute is the effective successor to the Law Reform Commission of British Columbia which ceased operations in 1997.

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Introductory Note

The British Columbia Law Institute has the honour to present:

Report on Creditor Access to the Assets of a Purpose Trust

This Report is the sixth of a series of reports that form part of a larger project on the *Trustee Act* and related laws that is aimed at introducing reforms that will allow the law to meet the present-day requirements of trusteeship. Many provisions of on the *Trustee Act* are out of keeping with present-day conditions and practices and some provisions are so seriously outdated as to be significant obstacles to efficient trust administration.

This project is being carried forward on behalf of the Institute by a our *Trustee Act* Modernization Committee whose members were appointed by the Board of the Institute to reflect the wills and trusts Bar, the professional fiduciary sector, and academic specialists in trust law.

During the course of the Committee's work a decision with significant implications emerged that has generated a large measure of concern among Canadian charities. In *Re: Christian Brothers of Ireland in Canada* the Ontario Court of Appeal ruled that assets held as a special purpose charitable trust by a charity were available to satisfy the claims of creditors even where those claims arose out of circumstances wholly unrelated to the special purpose trust.

In the Committee's view this decision constitutes a serious distortion of the law of trusts. Since the circumstances of the case are such that no further appeal is likely, the Committee is concerned that this holding may be more widely adopted unless steps are taken. The Committee has, therefore, recommended that remedial legislation, in the form of a restatement, be enacted (with an appropriate saving for the rights of the parties in the *Christian Brothers* case itself).

The recommendation of the *Trustee Act* Modernization Committee set out in this Report has the full support and endorsement of the Institute and its Board and we commend it for implementation.

Gregory K. Steele, Q.C.
Chair, British Columbia Law Institute

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Introduction

A recent decision of the Ontario Court of Appeal, *Re: Christian Brothers of Ireland in Canada*[27] has generated a large measure of concern among Canadian charities, trust lawyers and academics. Briefly stated, the Court ruled that assets held as a special purpose charitable trust by a charity were available to satisfy the claims of creditors even where those claims arose out of circumstances wholly unrelated to the special purpose trust.

It has been suggested that the decision:[28]

> is likely to create serious problems for charities across Canada concerning the protection of their charitable trust property from tort creditors.

and that

> [t]his decision may also have a serious impact upon the ability of charities to raise monies from donors, particularly monies for endowment funds and situations where donors expect that their gifts will be protected from creditors of the charity.

I. The Case

The decision involved claims arising out of the horrific pattern of abuse that occurred at the Mount Cashel Orphanage in Newfoundland which had been operated by a religious community, the Christian Brothers of Ireland. The assets of the community were owned by the *Christian Brothers of Ireland in Canada* (CBIC). Victims of the abuse had obtained judgments for over $36 million while CBIC had general corporate assets of approximately $4 million available to satisfy them. CBIC was, therefore, being wound up[29] and an issue arose to the status of two schools in British Columbia operated by the same religious community and whether they were available to satisfy the victims' claims. The liquidator sought to take and sell the land, buildings and other property of the schools as part of CBIC's assets.

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1. (2000) 47 OR (3d) 674 (available on line at www.ontariocourts.on.ca/decisions/2000/april/christian.htm.)

2. Terence Carter, "Case comment: Christian Brother's decision exposes charitable trust assets to tort creditors," (2001), 16 The Philanthropist 28.

3. *Winding Up and Restructuring Act*, R.S.C. 1985, c. w-11.

At the trial level the liquidator's claim was resisted on two bases. First, it was argued that there was some sort of general notion of "charitable immunity" for the assets of a charity that insulated them from execution proceedings. The second basis was that even if there is no general charitable immunity, the schools were held on special purpose charitable trusts and, as such, did not form part of the assets that were available to creditors. The trial judge dismissed the suggestion that there was a general charitable immunity but did hold that assets held on a particular charitable purpose trust would not be available to compensate tort creditors whose claims did not arise from a wrong perpetrated within the framework of carrying out that particular purpose. The question of the ownership of the two British Columbia schools and the terms on which they were owned (i.e. whether they were held in trust, and if so, the nature of the trust) was referred to the British Columbia Courts for determination. The liquidator appealed.

In the Ontario Court of Appeal, Feldman J.A., who wrote the majority judgment, held that there was no general charitable immunity that could be invoked to protect these assets and asserted that this disposed of the matter – that it was essentially irrelevant whether the two schools were held on special purpose charitable trusts since those assets were exigible to pay the claims in any event. It was held that all of CBIC's assets, whether they were general corporate assets or held on special purpose trusts, were available to compensate the victims.

II. Implications of the Decision

In his comment on the decision Carter observes that:[30]

> [T]he Court of Appeal decision may have a negative impact on the operations of charities across Canada in at least four crucial areas:
>
> - First, tort victims will now be encouraged to pursue claims against charities, particularly larger charities, knowing that there may be "deep pockets" that had been previously untouchable but can now be readily accessed.
>
> - Second, property and/or funds held as special purpose charitable trusts, particularly endowment funds, that many charities depend upon for their continued existence, will now be susceptible to claims by tort victims. This in turn may prejudice the ability of some charities to continue operating and could result in either the bankruptcy or dissolution of some charities that are particularly vulnerable, such as religious denominations, local churches and educational institutions.

4. *Supra* n. 2 at 30.

- Third, the ability of donors to create enforceable special purpose trusts will be thwarted where claims by tort creditors cause those special purpose charitable trusts to be applied in ways totally different from what was originally contemplated by the donors. Such a result ignores the overriding jurisdiction and mandate of the court to apply special purpose charitable trusts *cy-prés* where the original charitable purpose has become either impossible or impracticable.

- Fourth, donors will be reluctant to give large gifts directly to charities, such as endowment funds that otherwise had been thought to be protected as special purpose charitable trusts when no assurance can be given to donors that such special purpose charitable trusts will be immune from present or future creditors of the charity.

> The combined overall "chill effect" that will likely result from the negative impact of the Court of Appeal decision may very well prejudice the financial stability of a large segment of the charitable sector in Canada and could even affect its long-term viability. This in turn may require that various levels of government fill the void that may result from the loss of social services currently being provided by charities affected by the decision.

Is Carter's view overly alarmist? He seems to be describing a "worst case scenario" but even if events do not unfold with all of the consequences he suggests there is clearly some cause for concern.

A more muted note has been sounded by Mr. Justice Cullity who, writing in The Philanthropist, has described the challenge these developments present to the Courts:[31]

> [T]he extent, if any, that the principles applicable to charitable trusts now diverge from those that govern private trusts as well as other issues may have to be considered in the future. These include the question of whether distinctions are to be drawn between trusts administered by a defendant charitable corporation and those administered by trust companies or others for the benefit of one or more of a corporation's objects; between trusts administered by such a corporation and those where other trustees have discretionary powers to apply income or capital to specific purposes within the objects of the defendant corporation; and between trusts creating endowments and other trusts.
>
> Related … issues will be to identify the principles that will determine when a plaintiff may have recourse to the assets of one or more charitable trusts of which a defendant tortfeasor, who is an individual or a trust company, happens to be a trustee and, perhaps, to determine whether the traditional use of protective trusts to insulate property from a beneficiary's creditors would be effective in the case of charitable trusts.
>
> There remains the fundamental issue of the criteria to be applied in determining whether property held by a charitable corporation is owned beneficially or in trust. Recent

5. The Honourable Mr. Justice Maurice Cullity, "The Charitable Corporation: A 'Bastard' Legal Form Revisited", (2002) 17 The Philanthropist 17 at 26. The case cited is *Bowman* v. *Secular Society Ltd.*, [1917] A.C. 406 (H.L.). *See also* Wolfe D. Goodman, Q.C., *Goodman on Estate Planning* 877.

> developments recognize that these are alternative methods of holding property for charitable purposes and, although it appears that the consequences will be similar, they will not necessarily be identical in all respects. Rejection of the review that trusteeship must be inferred from the charitable objects of a corporation, and acceptance of the principle in *Bowman*, suggests that a gift to such a corporation simpliciter, or even expressly for its general purposes, will not be sufficient to create a trust. Nor should indications - express or implied - that the donor's intention is to support the work of the body be enough. On the other hand, any special restrictions imposed by a donor on the management or application of the property that is the subject matter of the gift or, perhaps, evidence that sufficiently indicates the existence of an intention that the property is not to be dealt with in all respects as part of the general assets of the body in accordance with its corporate powers, may be sufficient to give rise to a trust.

Other concerns have also been raised in relation to the decision such as whether it heralds the advance of the "alter ego doctrine" into the law of trusts?[32] How far can a charity effectively divide its operating arm from its financial arm? It also raises troubling questions from an accounting standpoint where an ostensibly separate fund may find that it is tainted with a contingent liability arising out of activities relating to a different fund.

While the implications and potential consequences of the decision may be undesirable it does not necessarily follow that the Ontario Court of Appeal reached a wrong decision in law on the matter before them. It is to that issue we now turn.

III. Did the Ontario Court of Appeal Get it Right?

There is a substantial body of trust law which holds that personal creditors of a trustee have no claim against trust assets and that trust assets do not form part of the trustee's estate on the trustee's insolvency or bankruptcy. The introduction of charitable status in relation to the trustee and the assets has the potential to complicate the analysis.

A charitable organization that receives a gift of property to further its general purposes will not usually be a trustee of the property but will own the property beneficially. But additional factors may cause the gift to be characterized as creating a trust. The decision of the Ontario Court of Appeal might have been understandable had it been based on a view that the

6. The alter ego doctrine is a company law concept associated with piercing the corporate veil so as to identify an incorporated entity with its principals or with another corporation for. It may be invoked, for example, where a corporation and its principals are so closely identified that it is appropriate to assimilate their legal position. It may also arise where two corporations are under the management and control of the same persons (i.e. share a common board). It is the latter circumstance that raises the concern in relation to charities. Can a charitable entity create a foundation and move its assets into the foundation with a view to insulating them from liabilities incurred by its operating entity? Would the alter ego doctrine render such a step futile?

circumstances under which the two schools were given to the Christian Brothers did not constitute a trust. However, their status as trust assets was essentially irrelevant to the decision.

The issues relating to the ownership and trust status of the two British Columbia schools were referred by the Ontario trial judge to the British Columbia courts. They were considered first at the trial level and ultimately by the Court of Appeal for British Columbia.[33] The reasons of both the majority of the Court and the dissenting Justice focussed primarily on the "ownership" issues but in his dissent Braidwood J.A. went on to consider the correctness of the Ontario Court of Appeal judgment. It is instructive to note his views on this issue:[34]

> [179] I am of the opinion, with the greatest of respect, that the Court of Appeal judgment erroneously applied the concept that there is no charitable immunity. The Court of Appeal overlooked that there were two separate corpuses in the case at bar.
>
> [180] I put forth the following circumstances in order to highlight the issue. Let us assume that John Smith, a successful dealer in real estate, is asked by his relative, Mary Jones, if he would act as trustee and hold an apartment block that she owns in trust for the charitable purpose of assisting a certain Protestant school in perpetuity with John Smith being given power to appoint a successor of trustees with the power to pass on the trust. Let us also assume that somewhat later Michael Jones, seeing the success of the administration by John Smith, likewise conveys a building to him in trust but this time to aid a Jewish orphanage.
>
> [181] Clearly, the building conveyed by Mary would be available to any claims associated directly with that charitable trust. However, that does not for a moment mean that the building conveyed by Michael would also be available to satisfy negligence in the administration of the trust originally conveyed by Mary. I can see no valid distinction if Michael Jones had incorporated a corporation for these purposes.
>
> [182] Again, I am of the opinion that the law of British Columbia is that as set forth by Blair J. [the trial judge] in the Ontario case. Blair J. acknowledged that as a general rule trust assets are not exigible for claims against the trustees but nevertheless recognised an exception where the wrong is embedded in the further instance of the charitable purpose. Blair J.'s judgment simultaneously rejects the concept of absolute charitable immunity and leaves space for scenarios such as the one with which we are currently occupied, where there are two distinct corpuses. In this, Blair J. struck an appropriate policy balance between the need to respect the terms of the trust and the appropriateness of compensating victims whose injuries have arisen out of the further instance of the objects of the trust.
>
> [183] With deference to the contrary view expressed in the Ontario Court of Appeal, I am of the opinion that the doctrine rejecting charitable immunity does not warrant the conclusion reached. That doctrine rests on two propositions. The first is that a property owned

7. *Rowland* v. *Vancouver College Ltd*, (2001) 94 BCLR (3rd) 249 at 303.

8. The majority in the Court of Appeal for British Columbia did not find it necessary to address the correctness of the Ontario decision.

> beneficially by a charitable corporation is not immune from judgments against the corporation: *see Nyberg* v. *Provost Public Municipal Board*, [1927] S.C.R. 226. The second is that a property held in trust for a charitable purpose may be exigible to compensate tort claims in cases where trustees have wronged third parties in the course of administering the charitable trust: *see, for example, Mersey Docks and Harbour Board of Trustees* v. *Gibb*, [1861-73] All E.R. 397 per Westbury LJ.. Neither of these propositions, however, addresses the existence of discrete charitable purpose trusts or affects the viability of such trusts.
>
> [184] In my view, it is incorrect to postulate that merely because the trustee has chosen to administer two trusts the assets of each trust are available to compensate wronged third parties that relate only to one of the trusts.

We agree with this analysis.

It is our view, given its doubtful correctness and the undesirable results that potentially flow from it, that legislative intervention is necessary to ensure that the decision of the Ontario Court of Appeal in the *Christian Brothers* case does not form part of the law of British Columbia.

IV. The Parameters of Reform

We believe that reform legislation should take the form of a legislative restatement that sets out the legal position to be achieved. What should the scope and content of such a restatement be? Carter noted that the Ontario Court of Appeal:[35]

> ... in an attempt to limit the impact of the decision, was careful to note that the decision was limited to a very specific situation, i.e., only where:
>
> - there are claims by tort victims against a charity;
> - the general assets of the charity are insufficient to satisfy the resulting judgments;
> - the charity is no longer operating; and
> - the charity is being wound up pursuant to a winding-up order under the *Winding-up and Restructuring Act.*

It would be possible to develop a restatement that is sharply focussed on these circumstances. We do, however, question the wisdom of doing so. As Carter went on to observe:[36]

> These limitations, though, are generally arbitrary and provide little comfort to charities and

9. Supra note 2 at 30.

10. *Ibid*.

their legal counsel who may be concerned that the decision could become the "thin edge of the wedge" that may lead to future court decisions exposing special purpose trust property, such as endowment funds, to claims by tort victims in a broader context instead of only in the limited fact situation of the CBIC decision.

We believe that a restatement must address the problems raised by the decision in slightly broader terms. For example, a restatement need not be confined to claims by tort victims. To restate the legal position with reference to tort claims only would leave at large the status of claims resting on other bases. Suppose, for example, the claims in issue had been those of trade creditors of the Mount Cashel institution. There is no obvious reason why their access to trust assets should be any different from those of the tort creditors. Similarly, a restatement need not be confined to circumstances where the charity is no longer operating and is being wound up.[37]

V. Legislative Distribution

Where in the statute book should a restatement be placed? There are a number of possibilities.

- It might be included as a new section of the *Trustee Act*.[38] While the logic of locating a provision in the *Trustee Act* is undeniable, there is a danger that it could well be lost there. The *Trustee Act* is a legal antique of diminishing relevance to day-to-day trust administration.[39]
- It might be included as a new provision in the *Court Order Enforcement Act*[40] which, at least in part, is concerned with identifying what assets can be taken in execution and what can not.
- It might be included as a provision to the *Law and Equity Act*.[41] This act has been used in the past as a vehicle for specific reforms in relation to charitable trusts.[42]

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11. We recognize that a restatement might also address other issues that arise in relation to purpose trusts but this would transcend the narrower concerns that arise out of the *Christian Brothers* decision and call for consideration in a larger context.

12. R.S.B.C. 1996, c. 464.

13. This will change as the work of the Institute's Project Committee on Modernizing the *Trustee Act* matures.

14. R.S.B.C. 1996, c. 78.

15. R.S.B.C. 1996, c. 253.

16. *Ibid* s. 47.

- It might be implemented in the form of a stand-alone Act.

We have no firm views on this question. Ideally the restatement should form part of a new and modernized *Trustee Act* but we do not believe that implementation should await the creation and enactment of a new *Trustee Act*. Any one of the implementation vehicles identified above would probably be acceptable so long as the interim character of its placement is not lost sight of. For present purposes we have cast our recommended restatement in the form of a stand-alone act.

VI. Recommendation

It is our recommendation that the legislative restatement concerning the exigibility of particular purpose trust assets be implemented through the enactment of legislation comparable to the following:

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TRUST LAW DECLARATORY AND CLARIFICATION ACT, 2003

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of British Columbia, enacts as follows:

Trust property not to be seized

1. (1) Property held on trust by a charitable corporation or a trustee for one or more specific purposes, as opposed to property held generally for the purposes of the corporation or trust, may not be seized or attached under any process at law or in equity with the object of satisfying a judgment against that corporation or trustee except to the extent that the judgment is based on a liability incurred by the corporation or the trustee in carrying out or otherwise furthering that purpose or those purposes.

(2) This section declares what has always been the law of the province and accordingly it is retroactive to the extent necessary to give it effect according to its intent including its application to all judgments.

(3) Nothing in this section affects the rights of a party arising under or out of a decision of any court in connection with the matter concerning the liquidation of The Christian Brothers of Ireland in Canada or any agreement consequent on such a decision.

2. This Act comes into force on Royal Assent.