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THE UNIVERSITY OF BRITISH COLUMBIA FACULTY OF LAW

FINAL EXAMINATION – DECEMBER 2019

**LAW 451- Trusts
Section 2**

Professor John Smith

TOTAL MARKS: 100

**TIME ALLOWED: 3 HOURS TOTAL
(including reading time)**

- NOTE:**
- 1. This is an open book examination. A candidate may bring into the examination room any written materials they wish.**
 - 2. ANSWER ALL THREE QUESTIONS. You may answer them in any order.**
 - 3. PLEASE budget your time.**

THIS EXAMINATION CONSISTS OF 3 QUESTIONS.

MARKS

- 35 1. This problem concerns trust arrangements left by A who died in 2016. Over several decades A had built a good business in a company ("Sportco") selling sporting goods, with a number of retail outlets in the lower mainland. He had an excellent eye for merchandising, product selection and store layout, and had strong relationships with the store managers in each of the outlets. His brother B has been equally successful in separate business ventures. On his death, A left surviving his widow C and his children D, E and F. D was significantly involved in the business of Sportco. He was the store manager of Sportco's flagship store, was a director of Sportco with A, and was involved in company-wide management decisions, all subject to A having the final say. While A was alive neither E nor F had any role in Sportco.

The shares of Sportco are held in a trust that was established before A's death, which holds the single class of voting equity shares of Sportco. During A's life he was the sole income beneficiary of the trust. Since A's death the Trust Deed requires the trustees to distribute the annual income of the trust among C (for as long as she is alive), D, E and F (and the children of any deceased child) in such proportions as the trustees in their discretion determine. Following C's death the trustees will have the discretion to distribute capital from the trust, and in the event that Sportco is sold will be required to distribute the capital, in each case as to 40% to D and 30% each to E and F (with in any case the share of any deceased child going to their issue).

The Trust Deed provides the trustees with the power to sell the Sportco shares but also the power to retain the Sportco shares so long as it is prudent to do so, and specifically provides that there is no duty to diversify the investments of the trust so long as Sportco is the principal asset of the trust.

While A was alive, he was the sole trustee of the trust, and A and D were the directors of Sportco. Following A's death B and D validly became trustees of the trust, with D continuing as the sole director of Sportco. B had agreed with A that he would serve as trustee, with A telling B that A expected D to run Sportco, and A just wanted B to keep an eye on D. That was acceptable to B, particularly since he still has his own successful businesses to run. B and D had a lengthy meeting following A's death. B agreed that Sportco's business was sound, but needed to adapt to online shopping and other technological changes. D advised B that he had been keen to start down that path, but A had resisted. B stated that he would leave it to D to undertake those changes.

Shortly after A's death, D received an offer to buy Sportco for \$30 million. He consulted a friend who was an investment banker and asked him to do a high-level valuation of Sportco. The investment banker said that he thought that the value would be between \$35 and \$45 million, and was sure that the offer was just an opening position, and that D would be able to negotiate a sale price within the value range. D told his friend that he would not sell for less than \$50 million and simply declined the offer, without telling B or any of the other family members about it.

Sportco has struggled since A's death. D has retained the loyalty of store managers and other employees, but has not proven to have his father's eye for merchandising, so sales have suffered. More significantly, Sportco's development of an online sales platform has not gone well, both from the perspective of technology (receiving and processing of orders and payments) and logistics (delivery of product). (The project was financed with a loan from "Holdco", as discussed below.) D hired his brother E who had previously been the CFO of a tech business to handle the tech side, but E did not have the necessary operating experience and the people whom he hired to implement were not up to the task. D himself took on the logistics side, but again lacked experience and proved not to be up to the task.

While A was alive he had paid himself an annual salary of \$200,000 and typically declared annual dividends of roughly that amount to the trust, which were paid to A. Since A's death D has paid himself a salary of \$400,000 per annum from Sportco and has declared no dividends payable to the trust. Sportco has paid E a salary of \$150,000 per annum.

B, D and E are the trustees of the residue of A's Estate, with a provision for majority rule. The principal asset is a holding company ("Holdco") which, after all the obligations of A's Estate were satisfied, held a portfolio of marketable securities worth approximately \$20 million. D and E have been the directors of Holdco since A's death, and B has had no involvement, but remains a trustee of the Estate. The shares of Holdco are held in trust to pay the income to C for her life, with power to encroach on the capital during C's lifetime for her benefit. The capital is to be distributed equally among D, E and F following C's death, with the issue of any deceased child taking the share of that child. C has few assets other than the family home, a vehicle and personal possessions, and is dependent on distributions from the Estate (and hence from Holdco) to permit her to live in the style to which A and C were accustomed.

Prior to embarking on Sportco's attempt to establish an online sales platform, D and E discussed funding for that. They agreed that Holdco would lend \$10 million to Sportco with interest (calculated at 4%) and principal payable only when D determines that Sportco is able to afford such payment. This reduced the income of Holdco available for dividends, so Holdco has made some distributions out of the capital of Holdco's portfolio which the Estate has paid to C. As a result of the foregoing Holdco's portfolio has been reduced to \$9 million.

B was recently approached by Sportco's bank and by a competitor of Sportco, both of whom have told B that Sportco is struggling and should be sold, and in the case of the competitor making an offer to purchase Sportco for \$25 million. This caused B to insist on getting a full financial picture of Sportco and Holdco from D, and B then met with D and E to discuss the situation. B was shocked to learn how poorly Sportco is doing, and about the loan from Holdco to Sportco. Without making a thorough analysis of the situation, B's opinion is that Sportco is not salvageable by D (and E) so it should be sold for whatever they can get. (A purchaser would use its own online platform, so that the \$10 million spent on developing Sportco's platform (from the loan provided by Holdco) would essentially be written off.) D maintains forcefully (and E less so) that Sportco is worth more than \$25 million at present and will soon turn a corner and be worth much more. Over the protests of D and E, B has made C and F aware of the situation, who were understandably distressed.

B seeks your advice as to what can be done about the past actions and the current situation, including who if anyone may be liable and for what, and what actions might be pursued and by whom. Please advise B.

MARKS

- 35 2. G had a life with many challenges that she worked hard to overcome, successfully. Her husband was killed in a workplace accident over 20 years ago leaving her to raise their two young daughters H and J alone, which she did commendably, but by the time she was 50 she had little to show in terms of assets. That was in 2013 when her daughters were aged 27 and 23. Then came a stroke of good fortune. Her wealthy aunt who had been close to G and her daughters left them \$1 million in her will, to be divided 50% to G and 25% to each of H and J. By this time, H had with G's financial help graduated from university and embarked on a career in healthcare. On graduating high school J had immediately got a clerical job, since G said she could not afford to help J go to university. Up to 2013 all three lived together in rented accommodation as they always had,

with all contributing to the rent and household expenses once the daughters started work.

From an early age J had harboured a dream to own a farm growing specialized organic produce for sale. G had come to like the idea as well. The inheritance gave them the chance to consider this. They found a suitable acreage ("Property") with a somewhat rundown house on it, which was available for \$1,250,000. J estimated (correctly) that it would cost up to \$250,000 to get the farm business going, so \$1.5 million was needed in aggregate. The most that could be borrowed was \$500,000, so G and J asked H if she would contribute her \$250,000 inheritance. H did not want to be part of the farm venture and did not want to be responsible for any borrowing. She was grateful to G who had helped her get through university and start on her career, and H wanted to support J's plan, so H agreed. There was no documentation respecting H's contribution and no discussion of what H might get for it or whether it would be repaid. The entire \$1,000,000 plus \$250,000 from a \$500,000 loan secured by a mortgage was used to purchase the Property. Title was taken in the name of G and J as tenants in common, as to two-thirds for G and one-third for J, and they both signed the mortgage.

G and J moved into the Property with H finding her own rental accommodation close to her work. G kept working at her job to bring in income to maintain herself and J (including making all the mortgage payments) while J devoted herself to developing the farm business, financed by the remaining \$250,000 available on the mortgage. Thanks primarily to J's efforts, with G putting in some additional work at busy times, the business got off the ground and has done well, allowing payment of a salary to J from 2016 onwards (from which J contributed half the mortgage payments from that point on). J has become well known and well regarded in the "farm to table" community. She does all of the contracting for the business (the purchase of supplies and equipment, hiring of contractors and seasonal part time employees, and sales) in her own name.

During the less busy months, J has also worked to improve the house on the Property, spending approximately \$40,000 on materials and essential contractor assistance, which came from the cash flow of the business, and providing significant unpaid labour, which would have cost \$60,000 had paid contractors been retained. Thanks to these efforts and a rise in real estate values, the Property is worth \$2.2 million. The business on its own is likely worth \$500,000 with the potential to grow further.

G died suddenly a year ago leaving a will (made prior to 2013) that appointed her friend I as sole executor and divided G's Estate between H

and J equally. I probated the will and the time for either H or J to seek a variation of the will has passed. For probate purposes, based on information supplied by J, I did not declare that G had any interest in either the Property or the farm business. Both H and J were grief stricken and put their energies into supporting each other and their work. Recently however, H asked J what she had in mind about ownership of the Property and the business. J takes the position that she alone owned the business at all times, and that she alone owns the Property now. J says that she views H's \$250,000 inheritance as having been a loan to J, which J will repay over time.

J produced a letter written by G a year before her death addressed to J in which G, after saying that she had never expected to be as happy as she was at the farm and that she considered the Property to be as much J's as G's, stated that J deserved everything she could get out of the business, and was forever grateful that the aunt's inheritance had made it all possible. Picking up on the last point, H observed that G and H deserved at least some share of the Property.

In these circumstances, what claims may each of H and J advance in relation to the Property and the business, and what remedies may be available in respect of such claims?

MARKS

- 30 3. K who died three years ago was a "Champagne Socialist" who made a lot of money from real estate but supported a great many causes, some of them unpopular, and could fairly be described as a social activist. As part of his will, K established a specific trust fund (the "Fund") in the amount of \$2 million to be held upon the following terms:

"The Trustees shall use the Fund to make distributions to support acts of civil disobedience which further causes of which I would approve. The Trustees shall in their discretion select the individuals to receive amounts so distributed. I expect that the Fund will primarily be applied in making payments to help people pay fines incurred for engaging in such acts of civil disobedience."

The will left the residue of K's estate to various trusts for his family.

The will appointed two Trustees of the Fund. One is L, who is a law professor (but not a member of any law society) who has been a prominent advocate of civil liberties and an activist herself, participating in protests and being arrested at them on a couple of occasions. M, the

other Trustee, is an avowed anarchist and is considered by many civil libertarians to be little more than a hoodlum, having been in prison four times for various offences, including a serious assault on his former partner. K's will also provides that O has the power to change Trustees of the Fund and/or add Trustees. O was a close friend of K and is a (generally law-abiding) leader within the environmental movement.

The executors of K's will, who are people other than L and M and are the trustees of the residue of K's estate, duly proved the will, and distributed \$2 million to L and M. From the start L and M have had difficulties getting along as Trustees. In the period prior to the legalization of marijuana, L wished to pay the fines of anyone who was arrested during 4-20 "protests", whereas M felt that such people were just out for a good time, and that the Fund should be reserved for those who were taking positive action against government initiatives, such as pipelines. L wanted to use \$200,000 from the Fund for research projects that would underpin the arguments of those seeking to change various government initiatives and programs. L and M reached a somewhat uneasy compromise, under which L received a one-time distribution of \$150,000 to fund her research projects and it was agreed that each year M could determine the recipients of \$100,000 from the Fund and L could do the same with \$50,000 annually. They both acknowledged that this would deplete the Fund, likely within 15 years, but agreed that K would not have wanted money to sit around indefinitely. The current value of the Fund (which is and has been properly invested) is \$1.7 million.

The \$150,000 was paid to L, and at the start of each year \$100,000 has been put under the separate control of M and \$50,000 under L's control. L used the \$150,000 to hire students to assist in her research (making the students aware of where the money came from by showing them the provision in K's will), and has used the \$50,000 each year to fund fines of people engaged in campaigns in which K himself had been personally active. M has used some of "his" \$100,000 per annum for similar purposes, but has paid almost \$100,000 to his close friend P, who has used the money to pay legal fees in defending himself on theft and robbery charges, which M justifies on the basis that P was thereby generating funds to oppose government initiatives. M and P had discussed the terms governing the Fund and how it could be used. A number of people have complained to O about the handling of the Fund. She has investigated the matter and learned the facts above, about which she is concerned. She has discussed the matter with the executors of K's will who are also concerned.

Please address:

- the legal consequences of the provision of K's will that set up the Fund;
- whether any actions of the Trustees have been improper;
- potential remedies and legal and other actions available, and against whom; and
- who may seek or take such remedies and actions.

END OF EXAMINATION