

Income Funds

February 13, 2006

Are Income Fund Trustees Subject to Different Standards than Directors?

As the market for income funds has matured, an increasing number of situations are emerging in which the actions of trustees are likely to be subject to review in and by the courts. A question that inevitably will arise in this context is whether trustees should be assessed against the strict standards applied to fiduciaries under trust law or be afforded the greater deference enjoyed by corporate directors, including the benefit of the “business judgment rule”.

While there has been much debate of the question there has been little by way of judicial guidance to date.

Trustees may, however, take some comfort from observations that Mr. Justice Farley provided (notwithstanding that he did not find it necessary to deal with the question specifically) in his 2001 decision in *Rio Tinto Canadian Investments Ltd. v. Labrador Iron Ore Royalty Income Fund (Trustee of)*.

The question before Mr. Justice Farley was whether the trustees of the income fund could amend the fund’s declaration of trust to facilitate the implementation and operation of a unit holder rights plan. Without that amendment, the additional units that would be required

to make the right plan effective (through dilution of the holdings of an unfriendly acquiror) could not be issued. As a matter of contractual interpretation, Mr. Justice Farley determined that the declaration of trust should not be interpreted so as to permit the issuance of those units.

Mr. Justice Farley reached this conclusion notwithstanding that he found the trustees of the income fund may have had the best interests of unitholders at heart in their desire to interpret the declaration of trust so as to facilitate the rights plan.

In two unnecessary but interesting concluding paragraphs, Mr. Justice Farley noted that:

The Fund Trust is a commercial one which is modeled upon a corporate enterprise including providing for the duties and obligations of the Trustees to be equivalent to those of the directors of a (public issuer) corporation incorporated under the *Canada Business Corporations Act*. Thus the subject trust and the Declaration of Trust should be viewed according to quasi-corporate principles ...

In assessing the actions of the trustees in a quasi-corporate situation such as this, trust obligations and duties of trustees should be appropriately modified to take into account the “corporate aspect.” This corporate aspect would include the business judgment rule ...

Trustees with similarly drafted declarations of trust may take some comfort from these observations. Trustees whose declaration stray from a corporate model may not be as sanguine.

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Goodmans^{LLP} Update

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