

NO. A06-1018

State of Minnesota
In Court of Appeals

In Re: The Naomi Margolis Revocable Trust

Barry Lorberbaum,

Appellant,

vs.

Jack Margolis,

Respondent.

APPELLANT'S REPLY BRIEF

HENSON & EFRON, P.A.
Bruce C. Recher (#89989)
Richelle Wahi Reiff (#0330486)
Suite 1800
220 South Sixth Street
Minneapolis, Minnesota 55402-4503
(612) 339-2500

Attorneys for Appellant

DAVID M. JACOBS, P.A.
Grant R. J. Lindquist (#230224)
Barristers Trust Building
247 Third Avenue South
Minneapolis, Minnesota 55415
(612) 341-2525

Attorneys for Respondent

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ARGUMENT

The Trial Court clearly erred by allowing Trustee Margolis' accounting and in approving his request that the Naomi Margolis Revocable Trust (the "Trust") bear the sole burden to pay the nursing home and medical expenses for Naomi Margolis. In doing so, the Trial Court adopted Trustee Margolis' after-the-fact characterizations of his use of Trust assets, yet failed to make any findings on the pattern of wrongful conduct by Trustee Margolis, conduct which was clearly contrary to the express terms of the Trust Agreement, prohibited by statute, prompted by an improper motivation, and which involved a breach of nearly every fiduciary duty a trustee owes to a trust beneficiary. This is a case where the outcome is clearly the consequence of the Trial Court ignoring relevant facts before it in an effort to reach an ultimate result; a position the Respondent now urges this Court to approve. Allowing a trustee to engage in such wrongful and impermissible conduct on which Respondent's accounting is based is clearly erroneous, contrary to law and requires reversal.

The Trial Court simply ignored Minn. Stat. §501B.14, subd. 1(2) and failed to make any findings with respect to this provision, even though this case falls squarely within the ambit of the statute. Pursuant to the statute, Jack Margolis was disqualified as trustee from exercising his discretion under Section 2.2 of the Trust Agreement in using Trust funds which had the effect of retiring or minimizing his own contractual obligations and his duty of support which extended to his spouse.

Upon a review of this evidence this Court cannot be left with anything but a "firm and definite conviction" that a mistake was made.

I. MINN. STAT. §501B.14 IS APPLICABLE TO THIS CASE.

Respondent mischaracterizes and misconstrues Minn. Stat. §501B.14's application to this case. Respondent erroneously contends that the "statute was enacted *solely* for tax purposes." Brief of Respondent at 30; (emphasis added). While part of Minn. Stat. §501B.14 does address undesirable gift and estate tax consequences stemming from the existence of trustee power, the clear and unambiguous language of the statute explicitly prohibits exercises of discretionary power by the trustee where the trustee indirectly benefits from its use. "When the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit." Minn. Stat. §645.16. In the end, tax consequences follow compliance or the absence of compliance. But the prohibition in Minn. Stat. §501B.14 is operative unless the trust agreement exempts the trust, and those prohibitions are operative here, and have consequences beyond tax reporting.

The statute provides (in part) in plain language:

"Subdivision 1. Prohibition. No trustee may exercise or participate in the exercise of any of the following powers:

(2) any power to make discretionary distributions of either principal or income to discharge any legal support or other obligations of the trustee to any person."

Minn. Stat. §501B.14. Accordingly, under the clear language a trustee may not make discretionary distributions of either principal or income to discharge any legal support or other obligation of the trustee to any person. While the statute may also be used to avoid certain undesirable tax consequences if it is followed, the language prohibiting

discretionary distributions to discharge a duty of support is explicit, clear and unambiguous and, therefore, must be strictly construed. The statute provides that a trustee with such powers is disqualified from acting on such subjects with such discretion. There is nothing ambiguous about this language.

Furthermore, this prohibition on trustee use of discretionary power is consistent with the common law duty of loyalty which prevents a trustee from receiving an indirect benefit from the trust. While no Minnesota case is directly on point, secondary sources have reported that:

This newly created section details the prohibitions against a trustee's exercise of powers. A trustee may not exercise powers to make a discretionary distribution of principal or income to or for the benefit of the trustee as beneficiary, unless the terms of the trust document limit such distributions. Also, a trustee has no power to make a discretionary distribution to discharge any legal support or other obligation of the trustee to any person.

Significant Probate and Trust Legislation, 30 Real Prop. Prob.&Tr. J. 43 (Spring 2005).

Respondent contends that such a prohibition on power would essentially deem all marital living trusts void. This "parade of horrors" argument is simply not real. Pursuant to Minn. Stat. §501B.14, subd. 3(a) Naomi Margolis could have exempted her trust from the ambit of the statute by expressly doing so in the Trust Agreement. In fact, any person creating a marital living trust may exempt the trust from the application of the statute. Naomi Margolis chose not to do this. In addition, Naomi Margolis could have included in her Trust a provision requiring payment of all her medical expenses and in doing so, could have prevented the use of any discretion by the trustee. Again, Naomi

Margolis chose not to do this. This is just not a real concern - the "horribles" raised by Respondent can all be avoided in the drafting process.

II. MINN. STAT. §501B.14, SUBD. 1(2) DISQUALIFIED TRUSTEE MARGOLIS FROM MAKING DISTRIBUTIONS OF TRUST ASSETS FOR NURSING HOME EXPENSES WHEN DOING SO DISCHARGED HIS LEGAL DUTY TO SUPPORT HIS SPOUSE AND RELIEVED HIS PERSONAL CONTRACTUAL OBLIGATION TO PAY SUCH EXPENSES.

Jack Margolis' request to allocate the Trust income or other assets to pay Naomi Margolis' nursing home and medical expenses before any other assets in which she had an ownership interest were used cannot be reconciled with the provisions of Minn. Stat. §501B.14, subd. 1(2). Under that provision, Jack Margolis was disqualified as trustee from exercising his discretion under Section 2.2 of the Trust Agreement in using Trust funds which had the effect of retiring or minimizing his own legal duty of support as well as his contractual obligations.

The language of Section 2.2 of the Trust Agreement clearly reflects the intent of the Grantor to establish a discretionary power to expend those Trust assets that the trustees, in their discretion, deem necessary or advisable. The power is clearly discretionary, not mandatory. Section 2.2 of the Trust Agreement provides:

"At any time while the Grantor * * * is incapacitated through illness or any other cause, the Trustees shall pay to or expend for the benefit of the Grantor, such sum or sums from * * * the Trust Estate as the Trustees, in the Trustees' discretion, may deem necessary or advisable to provide for the proper support, maintenance, and health of the Grantor, and the Grantor's issue."

A.A. 60; Exh. 9 (emphasis added). Thus, Section 2.2 is squarely within the realm of Minn. Stat. §501B.14, subd. 1(2).

Under Minn. Stat. §519.05, there is no question Jack Margolis owed a duty of legal support and was personally liable for his wife's medical care expenses. Plain v. Plain, 307 Minn. 399, 403, 240 N.W.2d 330, 332-33 (1976); Meagher v. Hennepin Cty. Welfare Bd., 300 Minn. 446, 454, 221 N.W.2d 140, 144 (1974) (a husband is legally responsible for the support of his wife while they are married).

Not only did he have a duty of legal support with respect to medical and nursing home expenses to be paid on behalf of his wife, but he also had a contractual undertaking to the Sholom Home. Respondent admits that in signing the admission contract for his incapacitated wife, Respondent was acting as a spouse, not as trustee. Brief of Respondent at 34. The Trial Court erroneously concluded (as does Respondent) that in signing the admission contract he was not obligating himself personally to make payment, rather he was only contractually obligating himself in the event Naomi Margolis was unable to pay. This is still another result oriented determination with no basis in fact or law. Naomi Margolis never even signed the Agreement. Exh. 27. In signing the Sholom contract, Respondent personally obligated himself to make the payments on her behalf, as Naomi Margolis' husband. Exh. 27.

Both Matter of Eberhart, 171 Misc.2d 939, 656 N.Y.S.2d 159 (1997) and Sutliff v. Sutliff, 515 Pa. 393, 528 A.2d 1318 (1987), are particularly instructive, and both expressly prohibit a trustee's use of discretionary power to invade a trust to satisfy his obligation to support the beneficiary of the trust. Minn. Stat. §501B.14 is effectively a codification of the liability principles considered in these cases.

In Eberhart, the court held that a trustee under New York law may not exercise a discretionary power in his own favor, and concluded that a distribution of trust assets in a manner which reduced the trustee's own financial obligations were tantamount to a direct distribution to himself. 171 Misc.2d at 942, 656 N.Y.S.2d at 161. In holding that such a power could not be used, the court concluded that to hold otherwise would allow for a breach of fiduciary duty, and would allow the trust to recover from the trustee individually. Id. Similarly, in Sutliff, the Pennsylvania Supreme Court held that the father and business associate who acted as custodians under a Uniform Gift to Minors Act ("UGMA") set of accounts, who used the children's UGMA property to fulfill some part of the father's support obligation, breached their fiduciary duties and violated their duty of loyalty. 515 Pa. at 408, 528 A.2d 1330. The Sutliff Court went on to say that:

Where the parent is also a custodian, his dual obligation comes into conflict. In such case, he may not credit his custodial distribution against his support obligation. In the event of a dispute over the extent of his parental obligation, the parent custodian is removable at Common Pleas' discretion on petition by or on behalf of the children.

515 Pa. at 397, 528 A.2d 1320.

Like Eberhart and Sutliff, when Jack Margolis made the decision on what funds to use to pay the Shalom Home, he was under a significant conflict of interest, and he chose to benefit himself and burden the Trust with these expenses. Respondent attempts to distinguish these cases stating that these cases involved a "direct support obligation of the trustee and hence his principal obligation." Brief of Respondent at 27. Under Minn. Stat. §519.05, there is no question that Jack Margolis owed a "direct support obligation" for his wife's medical care expenses. Further, the contractual undertaking at the Shalom

Home was his own personal undertaking; in Respondent's words, still another "direct support obligation".

Trustee Margolis, in his accounting, after improperly transferring Trust assets to his personal trust and after commingling trust assets with marital assets, requested that he effectively be reimbursed with Trust assets for payment of Naomi Margolis' medical and nursing home expenses. In allowing such reimbursement, the Trial Court essentially failed to directly consider, analyze or even mention the impact of Minn. Stat. §501B.14, subd. 1(2).

III. TRUSTEE MARGOLIS ABUSED HIS DISCRETION AS TRUSTEE BY FAILING TO FOLLOW THE PROVISIONS OF THE TRUST AGREEMENT, BREACHING HIS FIDUCIARY DUTY OF LOYALTY TO THE TRUST BENEFICIARIES, ACTING WITH AN IMPROPER PURPOSE, AND ACTING WITH UNCLEAN HANDS.

A court should substitute its discretion for that of a trustee where it is necessary to remedy an abuse of discretion. In re Trusts of A & B Divine, 672 N.W.2d 912, 919 (Minn. App. 2004). Trustee Margolis' actions in this case cannot be characterized as anything less than an abuse of discretion.

A. TRUSTEE MARGOLIS' ACTIONS CANNOT BE CLASSIFIED AS ANYTHING SHORT OF WILLFUL MISCONDUCT.

Respondent asserts that liability does not attach pursuant to Paragraph 8.8 of the Trust Agreement. The explicit terms of paragraph 8.8 imposes liability upon a trustee where there is willful misconduct. The Trial Court made no such findings on willful misconduct.

Respondent's reliance on Section 8.8 of the Trust Agreement to exonerate him from liability for "a mistake of law and/or fact, for an error of judgment . . . except as a result of actual fraud or willful misconduct on the part of the trustee" is misplaced. Exculpatory provisions in trust agreements are not favored, and are to be strictly construed. In re Trusteeship of Williams, 591 N.W.2d 743, 747-48 (Minn. App. 1999). Such clauses will not be enforced if they are ambiguous or attempt to release a party from liability for intentional, willful, or wanton acts. Id. In Williams, a trustee was held liable for its negligence in connection with its management of a trust, despite a clause which purported to relieve the trustee of liability for mistakes or mere errors of judgment. In re Trusteeship of Trust of Williams, 631 N.W.2d 398 (Minn. App. 2001). Here, the acts underlying Trustee Margolis' actions were not only negligent, but intentional, and undertaken in bad faith. Moreover, exculpatory clauses in trust agreements cannot operate to insulate trustees from their duty to account for trust assets which came into their possession as trustee. Restatement (Second) of Trusts §222 (trustee may not be relieved of liability for "any profit which the trustee has derived from a breach of trust").

Trustee Margolis' actions in failing to adhere to provisions of the Trust Agreement set forth herein, retaining post death partnership distributions which were assets of the Trust without adequate justification, transferring assets of the Trust to a trust with favored beneficiaries with an improper motivation, using Trust funds to obtain a personal benefit, and misrepresenting the existence and extent of Trust assets in an attempt to conceal his potential liabilities as Trustee, were actions undertaken in a willful disregard of the rights

of the beneficiaries of the Trust, were without a good faith basis, violated his duty as Trustee to act in good faith, and amounted to gross and inexcusable misconduct.

B. TRUSTEE MARGOLIS FAILED TO FOLLOW THE MATERIAL PROVISIONS AND PURPOSES OF THE TRUST AGREEMENT.

Trustees are required to follow trust agreements; such an obligation is a fundamental part of being a trustee. A trustee who breaches his duty by not following the conditions of a trust instrument is breaching his or her duty, and any decision which flows from that breach cannot be upheld. See, Conway v. Emeny, 139 Conn. 612, 620, 96 A.2d 221, 225 (1953). This is an important principle, based on the notion that trustees have an overarching duty to carry out the intentions of the settlor as they have been communicated in the governing instrument. See, Rounds, Loring A Trustee's Handbook §6.1.2, at 234 (2005).

Respondent asserts that a Trustee may not follow certain provisions of a trust agreement as long as his choice to ignore certain provisions of the Trust Agreement do not interfere with the material purpose of the Trust. Respondent cites no authority for such assertion. This position produces a ludicrous result -- it allows every trustee in Minnesota to disregard certain trust provisions where the trustee might believe (or later try to justify) the provision to be unimportant to the desired result of the trustee.

Respondent continually asserts that the purpose of the trust was to provide for the Grantor's care. However, the explicit terms reflect that the overall purpose of the trust at the time in which Naomi Margolis became incapacitated was not only to provide for the care of the Grantor, but also included the "Grantor's issue". A.A. 60; Exh. 9. Further,

Section 2.2 required the Trustee to use his discretion, which puts him squarely within the ambit of Minn. Stat. §501B.14 and disqualifies Trustee Margolis from using such discretion to discharge his duty of support. The discretion empowered the Trustee to make a distribution or no distribution at all from the Trust. It is precisely this discretion that determines the extent to which Trust assets could be used, as opposed to jointly-held marital assets (which Naomi Margolis would have been entitled to use) in order to satisfy his direct obligation of support.

Respondent admits that “every technical facet of the trust agreement may not have been followed...”. Brief of Respondent at 25. All of these so called “technical facets” had a direct impact on how the Trust assets were to be used in the event Naomi Margolis was unable to serve as trustee because of health reasons, and, therefore, were material provisions. Trustee Margolis failed to follow the process required under the Trust Agreement to select an independent medical advisor, he failed to obtain the opinion of a competent medical advisor on whether Naomi Margolis was incapacitated within the meaning of the Trust Agreement, and he failed to implement the process in obtaining a successor trustee for Naomi Margolis under the Trust. The successor trustee provision operated to guard against the very conflict of interest his request placed front and center before the Trial Court, as did the other provisions. The Trust Agreement envisioned the participation of the Trust beneficiaries other than Naomi Margolis in the Trust administration, rather than to allow Jack Margolis, as sole trustee, to make all the decisions regarding Trust assets. Respondent ignored all this.

The Trial Court made no findings on Respondent's failure to follow the Trust Agreement. Rather, in its memorandum, the Trial Court pontificates, as does Respondent, that whether a successor trustee was appointed pursuant to the Trust Agreement is irrelevant because ultimately the trust assets could be used for Naomi Margolis' care. There is nothing in the Trust Agreement which requires the Trustee to spend all the Trust assets first, before other joint assets of Naomi Margolis were used. The Trial Court's indulgence in utter speculation to excuse in hindsight an undeserving disqualified trustee on the basis that certain Trust provisions he ignored are unimportant is clearly erroneous, contrary to law and requires reversal.

C. TRUSTEE MARGOLIS BREACHED FIDUCIARY DUTIES AND HIS UNCLEAN HANDS BAR EQUITABLE RELIEF.

Appellant's arguments on this issue are set forth in Appellant's Brief and are not repeated here.

CONCLUSION

Courts have traditionally enforced standards of trustee behavior in an uncompromising fashion:

“In its wish to guard the highly valuable fiduciary relationships against improper administration, equity deems it better to forbid disloyalty and strike down all disloyal acts, rather than to attempt to separate the harmless and the harmful by permitting the trustee to justify his representation of two interests.”

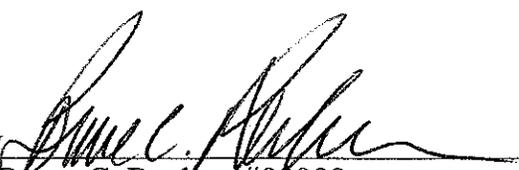
Bogert, Trusts and Trustees, §543, p. 228 (1993). In this case, the Trial Court lost track of these overriding principles so important to safeguarding the trustee/beneficiary relationship.

To uphold the Trial Court's findings requires this Court to look the other way -- to ignore that the Trustee lied to the beneficiaries, took Trust assets, kept Trust assets he pledged to return, failed to follow important administrative provisions in the Trust Agreement, and to ignore that the Trustee acted with a motive to injure his spouse's children, who were Trust beneficiaries. This Court should not diminish the standards governing trustee conduct to such a low level.

Appellant respectfully requests this Court to reverse the Trial Court's Findings of Fact and Conclusions of Law and remand the matter to the Trial Court with instructions to require Respondent to make appropriate restitution to the Trust as outlined in Appellant's principal brief.

HENSON & EFRON, P.A.

Dated: September 1, 2006.

By 
Bruce C. Recher, #89989
Richelle M. Wahi Reiff, #0330486
220 South Sixth Street - Suite #1800
Minneapolis, Minnesota 55402 4503
Telephone: 612-339-2500
Facsimile: 612-339-6364
Attorneys for Appellant

289374.DOC

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**APPELLANT'S CERTIFICATION
OF REPLY BRIEF LENGTH**

Jack Margolis,

Respondent.

I hereby certify that this brief conforms to the length requirements of Minn. R. Civ. App. P. 132.01, subs. 1 & 3, for a brief produced with a proportional font. The length of this brief is 3,180 words. This brief was prepared using Microsoft® Word 2002.

HENSON & EFRON, P.A.

Dated: September 1, 2006.

By



Bruce C. Recher, #89989

Richelle Wahi Reiff, #0330486

Suite #1800

220 South Sixth Street

Minneapolis, Minnesota 55402-4503

Telephone: 612-339-2500

Facsimile: 612-339-6364

Attorneys for Appellant