

NO. A08-1407

State of Minnesota
In Court of Appeals

In Re: The Naomi Margolis Revocable Trust

Barry Lorberbaum,

Appellant,

vs.

Sherry Huff, as Special Administrator
for the Estate of Jack Margolis,

Respondent.

APPELLANT'S BRIEF AND APPENDIX

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF THE LEGAL ISSUES

1. Did the trial court err when it failed to award to Appellant the sum of \$206,384 for Respondent's violation of Minn. Stat. §501B.14 subd.1(2) because: (a) the Trust Agreement authorized the Trustee's use of discretion; (b) the Trust Agreement's exculpatory provision barred a remedy when (i) as a matter of law, the exculpatory provision is unenforceable as against public policy, and (ii) was ambiguous in scope; and (c) because Respondent engaged in willful misconduct?

Trial Court Ruling:

The trial court approved Respondent's accounting, and failed to order any remedy for Respondent's violation of Minn. Stat. §501B.14 subd.1 (2).

Apposite Cases and Statutory Provisions:

B & S Rigging & Erection, Inc. v. Wydella, 353 N.W.2d 163, 168 (Minn. Ct. App. 1984).
Godette v. Estate of Cox, 592 A.2d 1028, 1034 (D.C. 1991).
In re Trusteeship of Williams, 591 N.W.2d 743 (Minn. Ct. App. 1999) ("Williams I").
Restatement (Second) of Trusts §222(2).

2. Did the trial court err when it concluded that Respondent's exclusion of Appellant as successor trustee was immaterial after being directed by this Court to reconsider this issue, when any uncertainty as to the source of funds to use for nursing home expense was caused by a trustee who breached his duties to follow the Trust Agreement?

Trial Court Ruling:

The trial court approved Respondent's accounting, and failed to order any remedy for Respondent's violation of Minn. Stat. §501B.14 subd.1 (2).

Apposite Cases and Statutory Provisions:

Smith v. Tolversen, 190 Minn. 410, 414, 252 N.W. 423, 425 (1934).
In re Anneke's Trust, 229 Minn. 60, 38 N.W.2d 177 (1949).

3. Did the trial court err when it failed to enter an award of reasonable attorneys fees and expenses to be paid by Respondent to the Trust?

Trial Court Ruling:

The trial court denied Appellant's request for an award of attorneys fees and costs against Respondent as redress for Respondent's breaches of fiduciary duty.

Apposite Cases and Statutory Provisions:

In re Trusteeship of Williams, 591 N.W.2d 743 (Minn. Ct. App. 1999) ("Williams I")
Dardovitch v. Haltzman, 190 F.3d 125 (3d Cir. 1999)

4. Did the trial court abuse its discretion when it awarded Respondent attorneys fees and expenses to be paid by the Trust when Respondent breached fiduciary duties, violated Minn. Stat. §501B.14 subd.1 (2) as a matter of law, engaged in conduct which favored his own children in opposition to the Trust beneficiaries, and when the request was untimely and never made until after a remand from the Court of Appeals?

Trial Court Ruling:

The trial court awarded Respondent's request for an award of attorneys fees and costs against the Trust in its entirety.

Apposite Cases and Statutory Provisions:

In re Trusteeship of Williams, 591 N.W.2d 743 (Minn. Ct. App. 1999) ("Williams I").
In re Trusteeship of Trust of Williams, 631 N.W.2d 398 (Minn. Ct. App. 2001) ("Williams II").

STATEMENT OF THE CASE

This is an appeal from two orders of the Ramsey County District Court, the Honorable Margaret Marrinan presiding. This action was commenced in 2005 under Minn. Stat. §501B.16 to compel an accounting by Respondent Jack Margolis in his capacity as trustee of the Naomi Margolis Revocable Trust, to remove him as trustee, to compel a Court-ordered accounting, and for redress for Respondent Margolis' breaches of fiduciary duty and violation of Minn. Stat. §501B.14, subd. 1. The trial court ordered Respondent to provide an accounting by Order dated September 13, 2005, at which time

Respondent ceased acting as trustee. Appellant filed objections to Respondent's accounting. The case was tried on January 6, 2006, and in addition, the parties entered into a Stipulation of Facts. Appellant had sought restitution from Respondent in excess of \$300,000. The trial court's Findings of Fact, Conclusions of Law and Order for Judgment dated March 29, 2006 granted limited relief to Appellant, and allowed the Accounting filed by Respondent on the condition that he pay to the Naomi Margolis Revocable Trust the sum of \$1,518.80. The trial court's Findings of Fact and Conclusions of Law denied Appellant's claims that Respondent breached fiduciary duties as trustee, but did not specifically address these claims. Nor did the trial court's findings address Appellant's principal argument that Respondent Margolis violated Minn. Stat. §501B.14 when he used discretion as trustee to distribute trust assets to pay Naomi's nursing home expenses, as opposed to his personal assets, or assets which were jointly held with Naomi, when the use of the trust assets in this manner discharged his duty of support as a spouse and his personal liability under a contract with the nursing home.

Appellant appealed the trial court's order in May of 2006. In an opinion issued on May 22, 2007, the Court of Appeals affirmed in part and reversed in part. The Court of Appeals affirmed the trial court's finding that Appellant failed to prove that a Norwest CD listed in Naomi Margolis notes as a trust asset was ever titled in the name of the trust to shift the burden to Respondent to explain it. The Court of Appeals reversed and remanded on other issues. The Court of Appeals held that Respondent Margolis had violated Minn. Stat. §501B.14, subd. 1(2) as a matter of law, and remanded to determine the appropriate remedy, if any, for Respondent's violation. The Court of Appeals also

remanded the matter with instructions to the trial court to determine Petitioner's breach of fiduciary duty claims, and expressly directed the trial court to reconsider the impact of Respondent's failure to follow the trust agreement by excluding Appellant as a successor trustee to Naomi Margolis when she became incapacitated and unable to serve as trustee.

On remand, the trial court ordered the parties to make several submissions, and scheduled a hearing in October 2007. Appellant presented an offer of proof of testimony from Appellant on the successor trustee issue, but the trial court excluded the evidence. Appellant also argued that the Trust Agreement's exculpatory provision was unenforceable for a variety of reasons, but the trial court failed to address these arguments. Instead, the trial court held that the exculpatory provision barred a remedy for Respondent Margolis' violation of Minn. Stat. §501B.14, subd. 1, or alternatively, that no remedy was available for any violation of the statute. On another subject of the remand, the trial court found that Jack Margolis breached fiduciary duties in transferring trust assets from the Naomi Margolis Revocable Trust to his own trust, concealing the transfer and other information from the trust beneficiaries, and in commingling Trust funds with his personal funds, but held that there were no remedies for these several breaches. The trial court found Jack Margolis conduct (including his taking the Trust assets and transferring them to his trust with different beneficiaries) was "questionable", but characterized his breaches to be of no consequence.

Appellant presented evidence of attorneys' fees and expenses incurred related to Respondent Margolis' breaches of fiduciary duty, but the trial court rejected Appellant's request for an award of attorneys fees against Respondent. The trial court entered an

order awarding Appellant the sum of \$1,518.80, and reaffirmed the trial court's earlier Order from March of 2006.

When the case was tried in January of 2006, Respondent did not make a request for attorneys' fees to be paid from the Naomi Margolis Revocable Trust. Nor was Respondent's request for attorneys' fees an issue before the Court of Appeals; nor was it an issue identified by the Court of Appeals as a subject for remand. Respondent made a motion for attorneys' fees for the first time after the remand from the Court of Appeals. At the time it issued its Order of January 16, 2008, the trial court deferred ruling on Respondent's Motion for Attorneys' Fees. On June 24, 2008, the trial court allowed Petitioner's accounts, but also awarded attorneys' fees to be paid by the Naomi Margolis Revocable Trust to Respondent in the entire amount requested.

STATEMENT OF FACTS

Background Facts

Jack Margolis was married to Naomi Margolis in 1979, a marriage that lasted over 24 years. (Joint Stipulation; Margolis Dep., pp. 7-10). This was the second marriage for both of them, and each had children by a prior marriage. *Id.*, p. 10. Naomi Margolis died in February of 2004. (Joint Stipulation). Jack Margolis died in March of 2006.

The Joint Estate Planning of Jack and Naomi Margolis

The Naomi Margolis Revocable Trust (the "Trust") was established in 1994. (Joint Stipulation; Ex. 9). Under the Naomi Margolis Revocable Trust Agreement (hereinafter "Trust Agreement"), Naomi Margolis was the Grantor, and Naomi and Jack Margolis were named as Trustees. *Id.* The Trust Agreement provided that the Trust assets remaining

after Naomi's death would pass to her children, Barry Lorberbaum ("Petitioner" or "Appellant") and Marlee Jo Ortego, now Marlee Jo Burns. (Joint Stipulation; Ex. 9, Sections 1.1, 4.1). Section 8.3 of the Trust Agreement provided that no individual trustee, except for the Grantor, could exercise any discretion to distribute income or principal to himself, to discharge a legal support obligation with respect to his or her issue, or engage in certain other conduct. (Margolis Dep., Ex. 9, Section 8.3, p. 20).

The Jack Margolis Revocable Trust was also established on June 28, 1994. (Ex. 51). The Jack Margolis Revocable Trust Agreement, at least until 2002, left the bulk of his estate to Naomi Margolis if she survived him. Jack Margolis made certain amendments to the Jack Margolis Revocable Trust in June of 2002. The beneficiaries under that trust remained Jack Margolis' children, and Naomi Margolis, if she survived him. (Ex. 11). The 2002 amendments to the Jack Margolis Revocable Trust included a \$300,000 bequest to Naomi Margolis from his trust if she survived him. (Exs. 10, 11).

Assets Held by the Naomi Margolis Revocable Trust

Jack Margolis was a partner in the Margolis Brothers Nursery, and had been an investor for many years. (Joint Stipulation). He accumulated significant wealth in the course of his marriage to Naomi. Id. During his marriage, he transferred certain assets to Naomi Margolis, which were then transferred to the Trust. Id., pp. 20-30, Exs. 2-8. These included three minority interests in three partnerships that owned shopping or retail centers, Knollwood (12.619%), Ridgehill (8.33%), and Rosewood (7.5%). (Joint Stipulation). From 1994 through October 2003, these partnerships periodically made distributions to the Trust. Id. Assets were also transferred into an account in the name of

the Trust at Piper Jaffray. Id., Exs. 13 and 14. Certificates of Deposit at North Star Bank were also held in the name of the Trust. (Joint Stipulation, Ex. 12).

Naomi Margolis' Admission to the Sholom Home

Jack Margolis was in charge of financial and investment decisions after his wife's admission to a nursing home in 2001. (Margolis Dep., pp. 42, 51). As he put it, "[i]t was my money". Id., pp. 51, 81. On May 18, 2001, Naomi Margolis was admitted to the Sholom Home, a nursing home facility. (Joint Stipulation). In connection with that admission, Jack Margolis signed an Admission Agreement. When Jack Margolis entered into the Admission Agreement with the Sholom Home, he assumed a personal contractual obligation to pay the nursing home expenses of Naomi Margolis to the Sholom Home.

Payments to the Sholom Home for Naomi Margolis' nursing home care were made out of the joint checking account of the Margolis' at Wells Fargo. (Joint Stipulation). Trust funds were commingled with other personal assets. Jack Margolis testified that he used Trust income and distributions to pay the Sholom Home. (Joint Stipulation; Margolis Dep., pp. 54, 55, 58, 68, 113, 140, 141, and 142). There are no documents reflecting that the payments to the nursing home were in the name of the Trust. The sum of \$206,384 was paid to the Sholom Home and for medical expenses for Naomi Margolis from 2001 until her death. (Joint Stipulation).

Jack Margolis Failed to Follow the Trust Agreement in Involving a Successor Trustee for Naomi Margolis, Even Though He Had Her Removed as Trustee of His Own Trust

Naomi remained a trustee of her Trust until her death. (Joint Stipulation). No action was taken after the admission of Naomi Margolis to the Sholom Home in 2001 to

remove Naomi as trustee of her own Trust, or to have a successor trustee appointed, even though it was clear to Jack Margolis that she was not capable of exercising trustee functions. (Margolis Dep., pp. 42-44). In June, 2002, Jack Margolis removed Naomi Margolis as a trustee of the Jack Margolis Revocable Trust, because she was unable to serve as trustee. (Ex. 11, p. 1).

The Trust Agreement, in Section 8.1 (Ex. 9, p. 18), specifically includes a provision for the appointment of a successor trustee if Naomi Margolis was unable to serve. There is no evidence that Naomi Margolis designated a successor trustee other than Barry Lorberbaum. (Joint Stipulation). Despite having numerous opportunities to do so on Petitioner's visits to Minnesota, Respondent's removal of Naomi Margolis as a trustee of his trust, and notwithstanding Naomi's incapacitated state, Jack Margolis never contacted Barry Lorberbaum and asked him to act as successor trustee pursuant to the Trust Agreement. *Id.*; Margolis Dep., p. 47; Lorberbaum Tr., p. 47.

Jack Margolis' decision to exclude Barry Lorberbaum was an intentional one; he testified he did not see any need in replacing Naomi as a trustee if he was handling the Trust. (Margolis Dep., p. 47). Had Barry Lorberbaum been advised of the opportunity during Naomi's lifetime, he would have accepted the successor trustee position. (Lorberbaum Tr., p. 47). The Trust Agreement provided that there would be two trustees if Naomi Margolis was unable to serve -- if Naomi Margolis was unable to serve, her son, Barry Lorberbaum, would act as successor trustee. If he was appointed as co-trustee, it is obvious that Barry Lorberbaum would have been in a position to work out some alternative arrangement with Respondent with respect to the payment of nursing home

expenses for Naomi Margolis. The trial court refused to allow Appellant to testify on this issue; his offer of proof is contained in Exhibit 66. AA 129-135.

Respondent's failure to act on the Trust Agreement's provisions providing for the appointment of Petitioner as successor trustee deprived Petitioner of the opportunity to address Jack Margolis' violations of Minn. Stat. §501B.14, subd. 1(2), and to work out any agreement or compromise which would have reduced the use of Trust assets to pay for Naomi Margolis' nursing home and medical expenses that Jack Margolis was legally obligated to pay personally.

Respondent's exclusion of Barry Lorberbaum as successor trustee was willful misconduct -- intentional action which amounted to a careless and reckless disregard for the provisions of the Trust, which was motivated by Jack Margolis' self-interest. The exclusion of Barry Lorberbaum as successor trustee also prevented Petitioner from addressing Respondent's breaches of duty that occurred after Naomi Margolis' admission to the nursing home; if Respondent had involved Mr. Lorberbaum as successor trustee, most if not all of the events which led to this litigation would have been avoided, including the attorneys' fees incurred by Petitioner.

The November 2003 Assignments of Trust Assets to the Jack Margolis' Trust Breached His Duty of Loyalty to the Trust Beneficiaries

During his testimony, Jack Margolis agreed that he understood that he had obligations to honor the terms of the Trust Agreement and to act in the best interests of the beneficiaries. (Joint Stipulation; Margolis Dep., p. 38). Shortly after receiving a check for \$50,474 paid to the Trust (Ex. 26), in November of 2003, Jack Margolis testified he

discussed with his attorney, Kathleen Doar, moving the real estate partnership interests owned by the Trust to the Jack Margolis Revocable Trust. Id.; Margolis Dep., p. 101. In this time frame, Naomi's death was regarded as imminent. Id., p. 138. One of the attorneys at Ms. Doar's firm had drafted the Trust in 1994. Id., p. 31.

In November of 2003, Jack Margolis authorized his daughter, Sherry Huff, to work on his behalf with Kathleen Doar, his lawyer, on these asset transfers. Acting on his authority, Sherry Huff corresponded with Kathleen Doar about these matters, and kept Jack Margolis informed by giving him copies of Ms. Doar's e-mails and her letters, or by reading Ms. Doar's responses to her father. Huff Tr., p. 14, Ex. 52.

Jack Margolis' motivation in these asset transfers was to benefit his own children, beneficiaries under the Jack Margolis Revocable Trust, to the disadvantage of the Trust beneficiaries. Among other things, this is corroborated by Sherry Huff's communication to Ms. Doar dated November 14, 2003, where she quoted Jack Margolis as stating: "I worked hard my whole life and I have nothing for her kids". (Ex. 52).

In November 2003, he told Ms. Huff, who told Ms. Doar, that he wanted Naomi's share of the Knollwood, Ridgehill and Rosewood limited partnership interests "transferred to him under the trust". Id. In response to Ms. Huff's questions and Jack Margolis' requests, Ms. Doar, sent an e-mail on November 19, 2003, and warned Ms. Huff and Mr. Margolis of the risks:

"He can use his power as Trustee of Naomi's Revocable Trust, acting alone pursuant to the delegation, to transfer assets from her Revocable Trust to his Trust. He runs a risk moving assets from her trust to his that her children will argue that he 'took' her assets."

(Ex. 55 (emphasis added)).

On November 19, 2003, Ms. Doar sent a document which purported to transfer assets from the Naomi Margolis revocable Trust to the Jack Margolis Revocable Trust. (Margolis Dep., Ex. 21). Exhibit A to the Action by Trustee identified the Ridgehill, Knollwood, and Rosewood partnership interests owned by the Trust, as well as real estate and some Wells Fargo accounts which were not held by the Trust. (Joint Stipulation). Jack Margolis signed Exhibit 21, with the attached Exhibit A. Id.

Jack Margolis testified that he was advised to do this by his lawyers, and then he put the assets back [in 2004] on their advice, because it was “wrong”. (Margolis Dep., pp. 91-92, 103). The request to transfer these assets, however, came directly from Jack Margolis to the lawyers, by his request that he wanted Naomi’s share of the Knollwood, Ridgehill and Rosewood limited partnership interests “transferred to him under the trust”. His taking the Trust assets was prompted by an overriding motive to benefit his favored set of beneficiaries to the detriment of the Trust beneficiaries. (Exs. 54 and 52). Jack Margolis agreed that the transfer of the remaining assets of the Trust to the Jack Margolis Revocable Trust did not benefit the beneficiaries of the Trust. Id. at pp. 129-30.

The actions of Jack Margolis in orchestrating the transfers of assets out of the Trust to the Jack Margolis Revocable Trust were motivated by his bias against one of the beneficiaries. On one occasion, apparently disappointed over Marlee not visiting her mother in the nursing home, Jack Margolis told Barry Lorberbaum that hell would freeze over before Marlee would receive anything from Naomi’s estate. (Lorberbaum Tr., p. 51). On another occasion, Jack Margolis told Barry Lorberbaum that Marlee Burns would not

obtain Naomi's wardrobe after her death. Id. Mr. Lorberbaum testified that Jack Margolis gave away Naomi's wardrobe and clothes after her death, and when some of the personal property was provided to him many months after her death, there were no clothes. Id. Jack Margolis acted as personal representative under Naomi's Will. (Ex. 50). His own testimony confirmed he was "very unhappy" with Marlee Burns, one of the beneficiaries, and that this contributed to his taking Trust assets. (Margolis Dep., pp. 127-29).

It is obvious that Respondent's motives were personal in nature - he acted to advantage his own children at the expense of the Trust beneficiaries, i.e., Naomi's children. Jack Margolis did not act in good faith with respect to these transfers, and his conduct amounted to both fraud and willful misconduct within the meaning of Section 8.8 of the Trust Agreement.

Jack Margolis' Misleading Representations as to Matters Involving the Trust and Breaches of His Duty of Disclosure as Trustee

After Naomi Margolis' death in 2004, Barry Lorberbaum asked and wrote Jack Margolis about matters involving her estate, including the Trust Agreement that he had seen nearly a decade before. (Ex. 19). Jack Margolis admitted that he ignored these requests. (Margolis Dep., pp. 90-91).

In September of 2004, attorneys for Mr. Lorberbaum inquired of Kathleen Doar regarding the status of Naomi Margolis' estate. In response to these inquiries, Kathleen Doar wrote a letter dated September 7, 2004, where she indicated "I do not believe that Naomi's Revocable Trust was funded" (See, Margolis Dep., Ex. 18). Jack Margolis was copied on this letter, but did not correct his attorney's representation that the Trust had

not been funded. (Margolis Dep., p. 87-89). Mr. Margolis knew of the three partnership interests that were formerly held in the name of the Trust, as well as other accounts that had been held in the name of the Trust. He had previously been advised by his lawyer in 2003 that he might be accused of theft of Trust assets if he had them transferred to him. (Ex. 55).

As of September of 2004, the partnership interests owned by the Trust had been transferred to Jack's trust, on forms prepared by the Parsinen firm and signed by Jack Margolis, approximately one year earlier. (See Ex. 21). Jack Margolis received a copy of Exhibit 18, read it at the time, but took no action to correct the misstatement that the Trust had not been funded. (Margolis Dep., p. 86-88). The failure to respond to simple requests about the Trust, the representations in Exhibit 18 that the Trust had not been funded, and the omission of any reference to the November 2003 assignments, were misleading, and a breach of Jack Margolis' duty of full disclosure as Trustee.

In 2004, after Naomi Margolis' death, after Mr. Lorberbaum's efforts to find out about the Trust had been rebuffed by Jack Margolis, and after Respondent's attorney had informed Petitioner's counsel that the Naomi Margolis Revocable Trust had not been funded, Petitioner's attorney met with Ms. Doar and provided her documentation from the public records which reflected assets held in the name of the Naomi Margolis Revocable Trust, and that the Trust had in fact been funded. (Recher testimony, 10/23/07). After Petitioner's counsel provided this information, Ms. Doar wrote a letter dated October 28, 2004, where she indicated that she had "now verified" that the Trust owned a 12.619% interest in Knollwood West Partners, an 8.33% interest in Ridgehill Partners, and a 7.5%

interest in Rosewood Center Partners. (Joint Stipulation; Ex. 25). Ms. Doar characterized the November 2003 assignments as “legally ineffective” and indicated that the partnerships had been notified to restore the ownership of the partnership interests assigned in November 2003 back to the Trust. Id.

During the course of this proceeding, in response to inquiries by the beneficiaries of the Trust and the successor trustee (Petitioner) as to the other assets that were held in the name of the Trust, Jack Margolis provided an Affidavit, through attorneys at the Parsinen firm. (Ex. 15). This Affidavit states:

“Aside from the partnership interests in Rosewood Center Partners, Knollwood West Partners and Ridgehill Partners, there were no other assets held in the name of the Naomi Margolis Revocable Trust, dated June 28, 1994.”

Jack Margolis was a Trustee of the Naomi Margolis Revocable Trust at the time he provided this Affidavit under oath. The unqualified statement in the Affidavit regarding the assets of the Trust failed to mention the North Star Bank CDs in the name of the Trust, and the Piper Jaffray account held in the name of the Trust, and was false, misleading and incomplete, and inconsistent with his duty of full disclosure as Trustee.

Respondent Breached His Duty To Provide An Accounting As Trustee

In November of 2004, Barry Lorberbaum signed documents indicating his acceptance of a trusteeship for the Trust, and communicated that to Respondent’s attorneys. (Lorberbaum Tr., p. 64). Petitioner then requested that Jack Margolis provide a detailed accounting of all financial matters relating to the Trust, including a listing of the assets, the expenses, and the income of the Trust during his trusteeship. Respondent,

through his attorneys, refused to provide an accounting, and requested both a release and indemnification in favor of Jack Margolis. (Ex. 25). Respondent's refusal to provide an accounting took place after he took Trust assets and transferred them to himself, ignored the requests of the beneficiaries for basic information about the Trust, knowingly misrepresented that the Trust had not been funded when it had substantial assets, and concealed his taking of Trust assets.

In May of 2005, Appellant commenced an action under §501B.16 to confirm his appointment as trustee, to remove Jack Margolis as trustee, to require Jack Margolis to provide an accounting as trustee, and to redress Respondent's breaches of trust. (See Petition dated May 4, 2005). Respondent objected to being required to provide an accounting of the Trust's financial matters and made such objections in Court. On September 13, 2005, this Court entered an Order requiring Respondent to file an accounting with the Court of the financial condition of the Trust during his trusteeship.

When Jack Margolis Used Trust Income and Assets to Pay Naomi Margolis' Nursing Home Expenses, He Used His Discretion under the Trust Agreement to Indirectly Benefit Himself and Discharge His Duty of Support and His Personal Obligations

Distributions and other income generated by the Trust assets were never deposited in separate accounts by Jack Margolis. (Joint Stipulation). Rather, cash distributions from the partnerships to the Trust were generally deposited into a Wells Fargo savings/checking account held in the names of Jack or Naomi Margolis. Id. This was a joint account. Id. This commingling of Trust assets was the regular practice of Jack Margolis, and it did not change after Naomi was admitted to the nursing home. (Margolis Dep. pp. 52-54; Ex. 28).

When Jack Margolis made the decision to pay the Sholom Home, he had three basic options: he could use his own personal funds, he could use Trust funds, or he could use his and Naomi's jointly-owned assets. Not only did Jack Margolis have a personal contractual obligation to pay the Sholom Home, he owed a legal duty of support to personally pay the medical expenses of his spouse. In re Revocable Trust of Margolis, 731 N.W.2d 539, 544-45 (Minn. App. 2007). When Respondent made the decision to use Trust assets, which he had deposited into a joint account which held other assets, the only way he could so was to exercise his discretion as Trustee under Section 2.2 of the Trust Agreement.

Jack Margolis had a conflict of interest in connection with his decision making with respect to what funds or assets to use to pay the bills of the Sholom Home from 2001 to Naomi Margolis' death. In re Revocable Trust of Margolis, 731 N.W.2d at 547. If he used Trust funds to pay the nursing home and medical expenses, he depleted Trust assets but avoided using his personal funds to pay for Naomi's care, even though he was contractually obligated to the Sholom Home to make the payments, and was under a legal duty of support to pay for his spouse's medical care. If he used joint assets or his own personal assets, he would preserve the Trust assets, but deplete personal assets.

Jack and Naomi Margolis had ample assets to cover the nursing home and medical expenses paid to the Sholom Home. At the end of 2000, just prior to Naomi Margolis' admission to the nursing home, the joint checking and savings accounts held in the names of Jack and Naomi Margolis at Norwest, exceeded \$900,000. (Margolis Dep., Ex. 28, 29, 30, 31, 32, 33 and 34). Respondent testified that with the exception of the Knollwood,

Rosewood and Ridgehill properties, “[e]verything was joint with the exception of those three pieces.” (Margolis Dep., p. 81-82). Jack Margolis was also trustee of the Jack Margolis Revocable Trust; shortly before any nursing home expenses began to be incurred, his trust held assets of nearly \$2 million. (Exs. 35, 36, 37).

When Jack Margolis used Trust assets to pay Naomi Margolis’ nursing home expenses, he benefited himself, increased and preserved his personal net worth, and profited by using his status as trustee to use Trust income as the sole source of funds to pay for Naomi Margolis medical and nursing home expenses. In doing so, he violated the prohibitions on trustee self-dealing in Minn. Stat. §501B.14, subd. 1(2). In re Revocable Trust of Margolis, 731 N.W.2d at 545.

ARGUMENT

I. JACK MARGOLIS, AS TRUSTEE, DID NOT HAVE THE POWER TO MAKE PAYMENTS FROM THE TRUST TO THE NURSING HOME UNDER MINN. STAT. §501B.14, SUBD. 1(2), AND HIS CONDUCT VIOLATED THE STATUTE’S PROHIBITION ON TRUSTEE’S INDIRECTLY BENEFITTING FROM THE USE OF TRUST FUNDS. THE TRIAL COURT SHOULD HAVE REQUIRED RESPONDENT TO PAY TO THE TRUST THE SUM OF \$206,384 FOR TRUSTEE MARGOLIS’ VIOLATION, AS THE STATUTE PROHIBITS SUCH EXPENDITURES AND THE EXCULPATORY PROVISION SHOULD NOT BE ENFORCED.

A. INTRODUCTION

Minn. Stat. §501B.14, subd. 1(2) provides, in part, as follows:

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, subd. 1(2). Section 2.2 of the Trust Agreement provides the trustee with discretion to make payments to the Grantor and the Grantor's issue in the event the Grantor is incapacitated through illness or any other cause. This grant of discretion gave Jack Margolis the contractual power to expend Trust funds for Naomi's medical expenses, but Minn. Stat. §501B.14, subd. 1(2) removed his power to exercise discretion to expend trust funds in a way that indirectly benefited himself, by discharging his contractual and support obligations. This is not a novel concept, it is a prohibition on self-dealing by trustees. As the Court of Appeals concluded, Jack Margolis violated this statutory prohibition as a matter of law.

The trial court rejected Appellant's arguments that the amount expended for the nursing home expenses should either be paid to the Trust or that such an expenditure should be disallowed in Respondent's accounting because of Respondent Margolis' violation of Minn. Stat. §501B.14, subd. 1(2). First, the trial court held that because the Trust agreement authorized the use of funds in this manner, there could be no remedy for a violation of Minn. Stat. §501B.14. AA, p. 5. This is circular reasoning at best, if not an outright rejection of the Court of Appeals' holding that a violation of the statute existed as a matter of law. The statute plainly does not become operative unless a trustee uses his discretion to expend trust funds in a manner which discharge his duty of support or other obligation. It does not matter that the Trust Agreement authorizes the expenditure of Trust assets in a certain way. What matters is whether the effect of exercise of discretion

by an interested trustee indirectly benefits the trustee by discharging the interested trustee's support or contractual obligations. If the Agreement authorizes the trustee's action, but the action runs afoul of the statute's prohibition, the statute trumps the authorization, and the action is void if an interested trustee exercises discretion in a prohibited way. The trial court's order on remand undermines this Court's decision.

Second, the trial court concluded that Section 8.8 of the Trust Agreement, an exculpatory provision, operated to immunize Jack Margolis from any liability for his violation of Minn. Stat. §501B.14, subd.1. The trial court referenced the "novelty of the statute", and expressly found that the actions of the trustee were a "mistake of law and/or fact" under Section 8.8 of the Trust. AA. 7. The court made this conclusion about a "mistake" on the basis of a record which was completely barren of any evidence that the trustee operated under some mistaken interpretation of Section 501B.14. There was no evidence on this point, and the trial court made a whole series of assumptions to justify the conclusions about a mistake. The trial court also at least implicitly rejected the notion that Jack Margolis was motivated to favor another set of beneficiaries, and held that his actions (taking Trust assets, breaching his duty of disclosure) had no impact on whether willful misconduct was present. Consistent with what has occurred in the past on several of the arguments raised by Appellant, the trial court failed to address or even comment on Appellant's arguments that the exculpatory provision was unenforceable for reasons of ambiguity or public policy.

Most importantly, the trial court seemingly refused to recognize the undeniable reality in this case -- that when a trustee with a conflict of interest uses trust funds in a

manner which benefits the trustee, the trustee profits every bit as much as if he directly paid himself. This is trustee self dealing, although accomplished in an indirect manner, and here, accomplished against a backdrop of blatant overreaching by a trustee who converted Trust assets and attempted to conceal his self dealing. Indirect self dealing by trustees is an obvious concern of Section 501B.14, subd.1. Minnesota law has long recognized that fiduciaries cannot do indirectly what they are prohibited from doing directly. B & S Rigging & Erection, Inc. v. Wydella, 353 N.W.2d 163, 168 (Minn. Ct. App. 1984) (corporate directors of insolvent corporation obtained an unlawful preference when they arranged for the corporation to pay down a debt for which they were also personally liable). The trial court's focus on the Trust Agreement's authorization for Jack Margolis to act under section 2.2 obscures other realities -- Naomi Margolis had ample other assets in which she had an interest from her 20 plus year marriage, but because of her dementia, she could not make the decision as to what source of funds to use to pay her nursing home expenses, and whether to sacrifice her bequests. Instead, Jack Margolis made that decision for her. When he did so, his personal assets and the assets of the Jack Margolis Revocable Trust increased, his personal obligations to Naomi and the Sholom Home were extinguished, and he profited as a result of his decision making as trustee. This conclusion is inescapable -- by using and allocating Trust assets to pay his personal liabilities, his other assets have increased dollar for dollar, and as a trustee he has impermissibly profited from his decision-making.

B. SECTION 8.8 OF THE TRUST AGREEMENT DOES NOT EXCULPATE JACK MARGOLIS FROM LIABILITY FOR THE \$206,384 OF MEDICAL EXPENSES WHICH WERE HIS PERSONAL RESPONSIBILITY TO PAY,

BUT FOR WHICH HE USED TRUST ASSETS OR ATTEMPTED TO ALLOCATE TO THE TRUST IN HIS ACCOUNTING.

1. Any Enforcement Of An Exculpatory Provision To Curtail Remedies From A Statutory Violation Would Be Against Public Policy.

Minn. Stat. §501B.14, subd. 1 sets forth the policy of the State of Minnesota, which prohibits trustees from exercising their discretion to distribute trust assets to themselves or in a way which discharges their personal liabilities or duties of support. The statute makes it clear that the trust agreement can exempt the operation of the statute -- but only if the trust agreement expressly mentions Minn. Stat. §501B.14, and states that the prohibitions do not apply. Minn. Stat. §501B.14, subd. 3 (“[T]his section applies to any exercise of any powers of the trustee after May 14, 1993, under any trust created before, on, or after May 14, 1993, unless the terms of the trust refer specifically to this section and provide that this section does not apply.”). The Trust Agreement contains no such provision.

Unlike other statutory provisions, Section 501B.14 does not allow a trust agreement to modify the operation of the statute unless it is exempted in the manner specified in Minn. Stat. §501B.14, subd. 3, which was not done here. In contrast, the Minnesota legislature enacted Minn. Stat. §501B.151, subd. 1 (the prudent investor rule), but provided that it is a default rule; such a rule “may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust.” Id. The legislature took an entirely different approach and sanctioned flexibility with respect to a trust agreement’s modification of the prudent investor rule, but it did not authorize the same flexibility with respect to Section 501B.14’s prohibition on self-dealing.

In Minnesota, the object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the legislature. Minn. Stat. §645.16. Section 501B.14 is a flat out prohibition on self-dealing by trustees unless the trust agreement specifically exempts its application in the manner set forth in the statute -- it hardly can be the intent of the legislature to allow a trustee to retain the proceeds of improperly distributed trust funds in violation of this section on the basis that the trustee did not act improperly when he engaged in the very conduct prohibited by the statute.

Parties to contracts do not have the power to override a statutory policy by ascribing some state of mind to the conduct which is prohibited by the statute. An illustrative case is Godette v. Estate of Cox, 592 A.2d 1028 (D.C. App. 1991). In Godette, the District of Columbia Court of Appeals affirmed the trial court's ruling that appellant, a personal representative, had mismanaged an estate. The personal representative violated several probate statutes, including statutory directives to keep receipts, obtain court approval prior to paying himself, and to prudently manage the financial affairs of the estate. The personal representative relied on an exculpatory provision which provided that the executor was not liable except "in case of willful default or bad faith". Id. at 1033. The Godette court began its analysis by stating the obvious:

The courts generally enforce an exculpatory or immunity clause that relieves a personal representative from personal liability for losses resulting from failure to meet a required standard of care, unless the clause is contrary to the statute or public policy.

* * *

An exculpatory clause that excuses self-dealing or attempts to limit liability for breaches of duty committed in bad faith, intentionally, or with reckless

indifference to the interests of the beneficiary, is generally considered to be against public policy.

Id. at 1033-34 (citing Restatement (Second) of Trusts §222(2)). These violations were statutory, and the court concluded that they were “at the heart of orderly and accountable estate administration” and were unaffected by the exculpatory provision. Id. at 1035. In summary, the court concluded:

We are unwilling to conclude that a provision of a will can lawfully qualify the specific provisions of a statute outlining the duties of a personal representative to provide an accounting and to obtain court approval of compensation before withdrawing the requested fee from estate funds.

Id. at 1036. The Godette case confirms that an exculpatory provision cannot override a policy expressed in a statute when the statute itself does not allow for such modification.

Minnesota courts have held that it is against public policy for a railway to contract around liability for negligence imposed by statute. Starr v. Great N. Ry. Co., 67 Minn. 18, 22, 69 N.W. 632, 634 (1896) (“contracts entered into, releasing the company from any liability for negligence upon its part in operating its road, were in conflict with the public policy enunciated by the statutory provisions referred to, and are void.”) Numerous other courts have held exculpatory provisions which would immunize a party from liability for conduct which is in violation of a statute are ineffective to relieve the actor from liability because such provisions are against public policy. See, e.g., Strawbridge v. Sugar Mountain Resort, Inc., 320 F. Supp.2d 425, 432 (W.D.N.C. 2004); Aetna Cas. & Sur. Co. v. Leo A. Daly Co., 870 F. Supp. 925, 935 (S.D. Iowa 1994) (applying Iowa law, holding that exculpatory clauses are void if they are “against public policy owing to some statutory prohibition”); Muhammad v. County Bank of Rehoboth

Beach, 912 A.2d 88, 99 (N.J. 2006) (“In New Jersey, exculpatory waivers that seek a release from a statutorily imposed duty are void as against public policy”); Vallone v. Donna, 729 N.E.2d 648, 649 (Mass. Ct. App. 2000) (a contractual “release may not shield a defendant from responsibility for violation of a statutory duty”); Murphy v. N. Am. River Runners, Inc., 412 S.E.2d 504, 509 (W. Va. 1991) (provision contrary to statutory provision is unenforceable); Stevens v. Thompson, 525 N.E.2d 353, 355 (Ind. Ct. App. 1988) (holding that a private agreement or contract cannot release party from a statutorily imposed obligation); see also Restatement (Second) of Contracts §195 cmt. a (if a statute imposes a standard of conduct, a court may decide that a term exempting a party from a failure to conform to such standard is unenforceable if the plaintiff is a member of the class of persons who is harmed by the conduct).

Enforcement of an exculpatory provision for a statutory violation when the statute does not provide that its prohibition can be altered in such a manner is against the public policy of the State of Minnesota. For this reason alone, Section 8.8 cannot be enforced to exculpate or immunize trustee Margolis from liability for his violations of Minn. Stat. §501B.14, subd. 1(2). As a matter of law, the exculpatory provision is unenforceable in this setting, or to bar relief under Minn. Stat. §501B.14, subd. 1(2). The trial court’s ruling should be reversed, and this Court should enter an order directing the trial court to enter judgment in favor of Appellant in the amount of \$206,384.

2. **The Enforcement of Section 8.8 to Exculpate a Trustee Who Profits From His Decision-Making In Violation Of Minn. Stat. §501B.14, Subd. 1(2) Would Be Against The Public Policy of the State of Minnesota.**

The Restatement (Second) of Trusts provides, in part, as follows:

Exculpatory Provisions

- (1) Except as stated in Subsections (2) and (3), the trustee, by provisions in the terms of the trust, can be relieved of liability for breach of trust.
- (2) A provision in the trust agreement is not effective to relieve the trustee of liability for breach of trust committed in bad faith or intentionally, or with reckless indifference to the interests of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust.

Id. §222 (emphasis added). The comment on Subsection (2) provides that no provision in the terms of a trust is effective to relieve the trustee who derives a profit from a breach of trust from liability to the extent of the profit. See id. §222, cmt. b (“Such provisions as these are invalid on the ground that it would be contrary to public policy to give effect to them.”). The Restatement provision essentially makes a distinction between liability for the restitution of assets which a trustee does not have the right to possess (where a trustee profits as a result of his conduct), and a consequential loss caused by the trustee (similar to the prudent investor/diversification claims in Williams I).

There are numerous cases which hold, consistent with the Restatement (Second) of Trusts §222(2), that exculpatory provisions will not be enforced if a trustee gains or generates a profit from his trusteeship. In Weiss v. Weiss, 984 F. Supp. 675 (S.D.N.Y. 1997), a federal district court found a provision excluding liability for acts undertaken in good faith was inapplicable when a trustee engaged in self-dealing and profited from his actions in terminating a trust, even though he acted in good faith. Id. at 677-78; see also Warden v. McLelland, 288 F.3d 105, 110 (3d Cir. 2002) (provision that stated that any

trustee's interest in a business was not a conflict of interest "cannot fairly be read to permit trustees to engage in self-dealing"); Godette v. Estate of Cox, 592 A.2d 1028, 1034 (D.C. 1991) (exculpatory provisions that excuse self-dealing by a trustee are generally considered to be against public policy); Countiss v. Whiting, 306 Ill. App. 548, 29 N.E.2d 277, 280 (1940) (a "trustee who pays to himself funds due to other beneficiaries" cannot avoid liability under an exculpatory provision); Langford v. Shamburger, 417 S.W.2d 438 (Tex. Civ. App. 1967) (exculpatory provision cannot be used to excuse a trustee from the misapplication of trust funds for personal benefit).

Respondent's violation of Minn. Stat. §501B.14 is also a violation of the Trust's prohibition on trustee self-dealing -- when trust funds are expended which relieve the trustee's personal obligations or liabilities, the trustee profits from his decision making; such actions have the same effect as if the trustee paid himself directly. B & S Rigging & Erection, Inc. v. Wydella, 353 N.W.2d 163, 168 (Minn. Ct. App. 1984); Matter of Eberhart, 171 Misc. 2d 939, 656 N.Y.S.2d 159 (1997). Minnesota has long had a policy which prohibits self-dealing on the part of trustees. In re Lee's Estate, 214 Minn. 448, 9 N.W.2d 245, 250 (1943) ("A trustee cannot make any private profit out of its trust"). A trustee's "primary duty [is] not to allow his interest as an individual even the opportunity of conflict with his interest as trustee." Smith v. Tolversen, 190 Minn. 410, 413, 252 N.W. 423, 425 (1934); see also In re Anneke's Trust, 229 Minn. 60, 38 N.W.2d 177,179 (1949).

Any application of a provision to exculpate a trustee from liability for self-dealing which results in a profit to the trustee through a violation of statute runs afoul of

Minnesota public policy and cannot be enforced. As a matter of law, Respondent Huff is liable to restore the profit made as a result of trustee Margolis' decision making.

3. An Exculpatory Provision In A Trust Agreement Which Is Ambiguous In Its Scope Cannot Be Applied To Limit A Trustee's Liability For Self-Dealing, and the Scope of Section 8.8 is Ambiguous and Unenforceable.

In In re Trusteeship of Williams, 591 N.W.2d 743 (Minn. Ct. App. 1999) ("Williams I"), the Court of Appeals reversed a district court's dismissal of a surcharge action against trustee Norwest Bank. The trial court dismissed the petition on the basis that the exculpatory provision barred any liability on the part of Norwest for its negligence in connection with its failure as trustee to diversify trust investments. The Court of Appeals reversed on the basis that the exculpatory provision was ambiguous and did not bar negligent conduct. The Williams I Court stated:

Generally, exculpatory clauses are not favored by the law and are strictly construed against the benefited party. Schlobohm, 326 N.W.2d at 923. If an exculpatory clause is either ambiguous in scope or attempts to release the benefited party from liability for intentional, willful, or wanton acts, the clause will not be enforced.

Williams I, 591 N.W.2d at 747 (emphasis added). Williams I dealt with a trustee's negligence in the investment management of trust assets; it in no way dealt with a trustee's self-dealing, a whole different species of conduct.

Section 8.8 of the Trust Agreement provides, in part, as follows:

Liability of Trustees. No person or corporation acting as a trustee hereunder shall at any time be held liable for a mistake of law and/or fact, for an error of judgment, nor for any loss or injury coming to any trust estate or to any beneficiary thereof (or to any beneficiary under this Trust Agreement, or to any other person), except as a result of actual fraud or willful misconduct on the part of the trustee to be charged.

(Ex. 9, p. 21).

The coverage of an exculpatory provision needs to be examined in light of other prohibitions in the Trust Agreement. Walton v. Fujita Tourist Enterprises Co., Ltd., 380 N.W.2d 198 (Minn. Ct. App. 1986) (exculpatory provision ambiguous because of internal inconsistency in agreement). Section 8.3 of the Trust Agreement makes it clear that, with the exception of the Grantor, trustee self-dealing is not permitted -- a trustee other than the Grantor is not permitted to distribute trust assets to himself or herself, and cannot engage in conduct which would directly or indirectly benefit the trustee.

Important omissions in the coverage of Section 8.8 render it ambiguous and unenforceable in the context of Respondent's violation of Minn. Stat. §501B.14's prohibition on trustee self-dealing. The focus on the type of conduct to be exculpated addresses only errors of judgment or mistakes, not trustee self-dealing. Section 8.8 does not specifically address or immunize conduct which results in a trustee profiting from his actions. Nor does it specifically address strict liability scenarios, or conflicts of interest on the part of the trustee. Nor does it attempt to address statutory violations, as opposed to conduct which may be otherwise actionable at common law. Nor does Section 8.8 attempt to clarify how violations of provisions which prohibit trustee self-dealing found elsewhere in the Trust Agreement should be resolved. All of these omissions render Section 8.8 "ambiguous in scope". Williams I, at 747.

As an illustration of the glaring omissions missing from Section 8.8 of the Trust Agreement, one need look no further than the exculpatory provision in the Second

Amendment and Restatement of the Jack Margolis Revocable Trust dated June 13, 2002, Exhibit 11, Section 8.2, which provides in part:

8.2. Exculpation from Strict Liability for Conflicts of Interest.

The Grantor acknowledges that in the exercise of the powers granted to the Trustees by this Trust Agreement, the Trustees may be placed in a position where a court could find the Trustees to have conflicting interests as the Trustees of a trust under this Trust Agreement and under other trust agreements which have been established by the Grantor or the Grantor's spouse, as the Personal Representative of the Grantor's Probate Estate or the Probate Estate of the Grantor's spouse As a result, the Trustees could be held liable for self-dealing or perceived conflicts of interest without further inquiry for the Trustees' acts in such a situation regardless of any fault or wrongdoing on the Trustees' part. Therefore, the Grantor directs that any rule of law which may impose strict liability on the Trustees on such a basis shall not be applied to the Trustees and any such law is specifically waived so that the Trustees are exculpated from any and all strict liability relating to perceived self-dealing or conflicts of interest.

* * *

The liability of the Trustees shall be limited solely to any action or omission made in bad faith, or which constitutes gross negligence, willful misconduct, intentional wrongdoing, or fraud against any beneficiary.

(Exhibit 11, p. 23-24, (emphasis added)). This Section explicitly addresses self-dealing and conflicts of interest regarding any "rule of law" which may impact liability; Section 8.8 has no such language.

Courts have historically insisted that exculpatory language specifically address the issue of a trustee's conduct which may violate the duty of loyalty, involve conflicts of interests, or personal profit from dealing with trust assets. In Renz v. Beeman, 589 F.2d 735 (2d Cir. 1978), cert. denied, 444 U.S. 834 (1979), the United States Court of Appeals for the Second Circuit concluded the trust agreement did not grant the trustee the right to prefer his own interests to those of the trust, and explained:

We do not agree, however, that the exculpatory clauses . . . justified a lowering of the standard of the trustee's obligation. Only the most explicit language can protect a fiduciary from liability in a conflict of interest with his Cestuis.

* * *

Courts may not read exculpatory language broadly, lest they unwillingly permit erosion of the fiduciary duty itself.

Id. at 745 (citations omitted). In finding that an exculpatory clause (similar to the one here), which stated that the trustee shall not be liable for mistakes in judgment "nor for any other loss, unless the same shall happen through its own willful default," did not cover trustee self-dealing, a New York court expressed similar concerns:

With this established premise we consider the so-called exculpatory clauses. They must be read in light of the principle that an instrument will not be construed to authorize a trustee to occupy a position of divided loyalty or to deal on his own behalf with the trust property unless the instrument clearly expresses the purpose to give such power. The grant of such broad and unusual authority, hostile to the elementary and fundamental duty of every trustee, that of fidelity to his trust alone, will not be inferred from general or equivocal language.

In re Schlusel's Trust, 203 Misc. 749, 759-60, 117 N.Y.S.2d 48, 58-59 (1952) (reversed on other grounds). See also Restatement (Second) of Trusts §222, cmt. a. (exculpatory provisions are to be strictly construed and "the trustee is to be relieved of liability only to the extent to which it is clearly provided he shall be excused").

The language of Section 8.8 is at best "general", and it does not clearly and unmistakably exonerate a trustee for self-dealing, statutory prohibitions, or from retaining profits at the expense of the Trust. See In re Anneke's Trust, 229 Minn. 60, 38 N.W.2d 177 (1949) (if the settlor intends to waive or limit the effects of self-dealing by trustees, he "must say so in clear and unmistakable language"). As Section 8.8 is ambiguous in

its scope, and there is no clear and unmistakable language exonerating the trustee for transactions which benefit him, as a matter of law, Section 8.8 does not bar a remedy for trustee Margolis' statutory violations.

4. Alternatively, The Trial Court's Findings Were Clearly Erroneous When It Failed To Find That Respondent Engaged In Fraud Or Willful Misconduct Within The Meaning Of Section 8.8 Of The Trust Agreement In Connection With His Decision To Use, Or To Allocate As The Sole Source Of Payment, Trust Assets For Naomi Margolis' Medical And Nursing Home Expenses, Among Other Breaches of Fiduciary Duty As Trustee.

As the Court of Appeals recognized, the record here supports findings of numerous breaches of fiduciary duty by trustee Margolis. Margolis, 731 N.W.2d at 545-46. Jack Margolis intentionally took Trust assets and transferred them to his own trust in order to favor one set of beneficiaries over others he owed a duty of loyalty to, he ignored requests for basic information about the Trust, he misrepresented assets of the Trust, and he failed to correct his lawyer's representation that the Trust had never been funded when, in fact, he knew it had significant assets which had been transferred to his Trust. (See Exs. 15, 18, 19, 21; Margolis Dep., p. 75-76; 80-81; 86-91; 103; 129-30). Trustee Margolis commingled trust assets with his own funds, he failed to keep records, and refused to provide an accounting while trustee after he took Trust assets and tried to cover up the fact that he did so. (Margolis Dep., p. 52-54; 107-109; Ex. 25; Recher testimony). There is a pattern of conduct on the part of this trustee which is inescapable - he acted to benefit himself and his favored set of beneficiaries, i.e., his own children, by enhancing his personal assets and the assets of the Jack Margolis Revocable Trust, which

had the effect of depleting the assets of the Trust, which harmed those to whom he owed a duty of utmost loyalty.

In Johanns v. Minnesota Mobile Storage, Inc., 720 N.W.2d 5 (Minn. Ct. App. 2006), the Court of Appeals remanded the matter to determine whether the Lessor's conduct in selling the plaintiff's property after a default was willful, and stated:

Willful conduct includes "a disregard for governing statutes and an indifference to their requirements, or a careless disregard of statutory requirements."

Id. at 12, citing In re Henry Youth Hockey Ass'n, 511 N.W.2d 452, 456 (Minn. Ct. App. 1994), modified, in part, on other grounds, 559 N.W.2d 410 (Minn. 1994) (Association engaged in willful conduct when it ignored internal controls and disregarded legal requirements imposed by statute).

Like his approach to his trusteeship, Jack Margolis acted with an indifference to and careless disregard for Section 501B.14's requirements. He never sought permission from the Court for the Trust to pay expenses which relieved him of his personal liability and duty of support. See In re Anneke's Trust, 229 Minn. 60, 38 N.W.2d 177, 183 (1949) (trustee could have applied to the court but failed to do so). He never involved an independent trustee, and he excluded Barry Lorberbaum as successor trustee because he wanted to control the Trust assets. As the Court of Appeals noted, "prudent parties may work around the statute." Jack Margolis disregarded any of the options in the statute to have a different trustee make discretionary distributions or to seek instruction from the Court. Margolis, 731 N.W.2d at 545. After he commingled Trust assets with the parties' joint assets and paid medical expenses from a joint account, Respondent allocated every

dollar he could to the Trust to pay nursing home expenses, but these expenses were his personal responsibility and obligation. His accounting was filed after he had breached a host of trustee duties. It is obvious that the same motivation which compelled him to allocate every dollar of medical expense to the Trust also motivated him to take the Trust assets and transfer them to the Jack Margolis Trust -- he and his children would benefit, his assets would be preserved, all at the expense of Naomi's children and her desire to pass the remaining Trust assets to her kids.

Willful misconduct does not require fraud -- it requires a careless disregard for statutory requirements and an indifference to statutory requirements. Respondent is seeking the protection of the exculpatory provision. Trustees who are in conflict of interest positions have the burden to show their actions were fair. In re Lee's Estate, 214 Minn. 448, 458, 9 N.W.2d 245, 250 (1943). The burden of proving that his actions conformed to the standard of his duty falls upon the trustee and not upon the beneficiaries. Malcolmson v. Goodhue Cty. Nat'l Bank of Red Wing, 198 Minn. 562, 567, 272 N.W. 157, 160 (1937). Exculpatory provisions are to be strictly construed against the one who seeks its protection. Williams I, 591 N.W.2d 743 (Minn. Ct. App. 1999). Respondent had a conflict of interest with respect to what source of funds to use to pay nursing home medical expenses. It is therefore the burden of Respondent to prove that the terms of the exculpatory provision exonerate him from violations of the self-dealing prohibitions of Minn. Stat. §501B.14.

There is no evidence in the record that Jack Margolis was unaware of Section 501B.14's prohibitions, or that he acted under some kind of mistake regarding the

statute's application. There is no documentation, no testimony, and nothing in his deposition that proves any mistake or any error of judgment on his part. Even during this litigation, in providing an accounting, Respondent ignored the prohibitions of the statute.

The evidence is overwhelming that Jack Margolis generally acted with a careless indifference to his duties as trustee and with a motivation to favor his own children. His use of Trust funds as the sole source of payment for Naomi's medical expenses, all of which relieved him of his personal liability and support duties, was willful misconduct. The trial court's findings are one sided and an abuse of discretion; there is not a shred of evidence to support the notion of a mistaken interpretation of this statute by this Trustee, who consistently failed in his duties as a trustee. Even if the exculpatory provision is enforceable in this setting, Section 8.8 does not absolve Jack Margolis from liability for the \$206,384 expended for nursing home and medical expenses, which was his personal responsibility to pay, given his willful misconduct. Respondent should restore this sum to the Trust.

II. THE TRIAL COURT ABUSED ITS DISCRETION WHEN THE COURT EXCLUDED APPELLANT'S EVIDENCE ON THE SUCCESSOR TRUSTEE ISSUE, AND ITS' FINDINGS ON THE SUCCESSOR TRUSTEE ISSUES ARE CLEARLY ERRONEOUS. THE TRIAL COURT IMPROPERLY PLACED THE BURDEN OF PROOF ON THE APPELLANT TO PROVE SOME OTHER RESOLUTION WOULD HAVE MATERIALIZED IF APPELLANT HAD BEEN TIMELY APPOINTED AS A SUCCESSOR TRUSTEE, INSTEAD OF RESOLVING UNCERTAINTIES AGAINST A BREACHING TRUSTEE.

In 2006, the district court concluded that trustee Margolis' exclusion of Appellant as successor trustee was of no consequence, as any court would have approved the expenditures for nursing home expenses out of the Trust to the exclusion of any other

sources of payment. The Court of Appeals pointed out that this reasoning failed to recognize the conflict of interest Respondent faced, that it assumed Appellant or an independent additional trustee would have concurred that the Trust should bear the primary expense for her care, and instructed the district court to “reconsider the adverse effect, if any, of Respondent’s failure to obtain a successor trustee”. In Re Revocable Trust of Margolis, 731 N.W.2d at 547.

On remand, the trial court came to the same conclusion it made originally, that it was “immaterial whether Barry Lorberbaum was notified to act as a successor trustee by Respondent”. AA, pp. 14-17. The trial court concluded that the successor trustee issue involved speculation. It then proceeded to what it characterized as “albeit valid speculation” - that Appellant and Respondent would have been at an impasse on whether Trust assets (as opposed to other assets) should be expended for nursing home care, and that a court would have then approved the expenditure from the Trust. This alleged “valid speculation” seems to overlook the statute’s direction that only a trustee who is not “disqualified” can exercise the power under subdivision 1; thus, only a successor trustee who is not disqualified had the power to make the decision to expend Trust assets, to the exclusion of the interested trustee. Minn. Stat. §501B.14, subd. 2 (“Any power described in subdivision 1 that is conferred upon two or more trustees may be exercised by the trustee or trustees who are not disqualified”). Thus, Jack Margolis may not have had the ability to effectively cause the “impasse” if Appellant was the successor trustee and decided not to use Trust assets to pay the nursing home expenses.

After the remand from the Court of Appeals, the trial court ordered the parties to submit disclosures with respect to any additional testimony that they might have. Appellant submitted Exhibit 66 (AA 129-135), which detailed what Appellant intended to testify to at a further hearing, which included explanations on the successor trustee issue. The trial court excluded this evidence and would not allow Appellant to testify; Exhibit 66 is Appellant's offer of proof. There was no further evidence presented on the successor trustee issue that the district court was directed to reconsider.

Respondent's intentional exclusion of Appellant from the successor trustee position, has placed the parties and the Court in a position to grapple with a series of "what if" issues, which are to a certain degree speculation. It was not Appellant that put the parties in this position; it was Jack Margolis, who consistently ignored his duties as a trustee, who removed Naomi as a trustee of his trust, but left himself in the sole position to make financial decisions involving her Trust.

Trustees have a duty to act pursuant to the terms of the Trust. In Re Revocable Trust of Margolis, 731 N.W.2d at 546. It is black letter law on fiduciaries that a trustee bears the burden to prove that his actions conform to the standard of duty imposed on him. Malcolmson, 272 N.W. at 160; see also In Re Anneke's Trust, 38 N.W.2d at 183 (trustee had a "difficult burden of proof").

What occurred in the trusteeship of Jack Margolis, and events which led to this litigation, were all avoidable if a successor trustee was in a position of control over Trust matters. The fundamental problem with the trial court's approach is that the court has speculated that an outcome favorable to this trustee would have materialized, when the

trustee offered no evidence on the subject, when the statute provides the disinterested trustee had the power to make the decision and when uncertainties should be resolved against a trustee in violation of his duties.

“[A] trustee may not hide behind obscurity that he himself has created.” Cobell v. Kempthorne, --- F. Supp. 2d ----, 2008 WL 3155157, at *2 (D.D.C. Aug. 7, 2008), citing Rainbolt v. Johnson, 669 F.2d 767, 769 (D.C. Cir. 1981). Minnesota law has always resolved doubts against a breaching trustee. Smith v. Tolversen, 190 Minn. 410, 414, 252 N.W. 423, 425 (1934) (if a trustee fails to keep clear and accurate records, “leaving many transactions in the fog which must come of absence or ambiguity or records . . . the consequent obscurity or doubt cannot operate to [the trustee’s] advantage, but must be resolved against him”). Because a trustee cannot hide behind his own breach of duties, he or she carries the burden of proof to show that a prohibited transaction did not damage the trust. See, Leigh v. Engle, 727 F.2d 113, 138-39 (7th Cir. 1984) (doubts regarding damages caused by an ERISA plan trustee’s actions must be resolved against the trustee). That the burden should rest with the wrongdoing trustee comports with “[t]he most elementary conceptions of justice and public policy . . . that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created.” Bigelow v. RKO Radio Pictures, 327 U.S. 251, 265, 66 S. Ct. 574, 580 (1946). Any uncertainty should be resolved against Respondent when his breaches caused the uncertainty. The trial court’s reconsideration of this issue does not take these principles into account; instead, the trial court relied on speculation favorable to the breaching trustee.

III. THE TRIAL COURT HAD THE EQUITABLE POWER TO “REDRESS A BREACH OF TRUST” UNDER MINN. STAT. §501B.16(19) AND AWARD PETITIONER REASONABLE ATTORNEYS’ FEES TO REMEDY RESPONDENT’S INTENTIONAL BREACHES OF FIDUCIARY DUTY.

The trial court denied Appellant’s request for an award of attorneys fees against Respondent on the authority of In re Trusteeship of Trust of Williams, 631 N.W.2d 398 (Minn. Ct. App. 2001) (“Williams II”). This Court declined to order an award of attorneys’ fees against the trustee in Williams II; the Williams litigation involved a failure to act prudently in diversifying trust assets, not intentional breaches to benefit oneself as trustee. The Williams II court noted that attorney fees awards had been made in scenarios involving “gross or inexcusable” misconduct by trustees, but found that negligent diversification claims made in the litigation did not involve this type of “unusual situation” or gross or inexcusable misconduct. In Williams II, the Court of Appeals affirmed a surcharge against trustee Norwest Bank, and required the trustee to disgorge the fees it was paid during the time of its negligent failure to diversify trust investments. Id. at 410.

While the Williams II Court questioned whether it had authority to assess attorneys’ fees against a trustee that has breached his duties, a district court does, in fact, have the power to award attorneys’ fees to “redress a breach of trust” under its equitable powers and the statutory authority vested by Minn. Stat. §501B.16(19). Surcharge actions are equitable actions. See In re Anneke’s Trust, 229 Minn. 60, 38 N.W.2d 177 (1949). Minn. Stat. §501B.16(19) empowers the court to redress a breach of trust by a trustee. In settings like Williams, where the trustee failed to comply with its duty of care

to act reasonably as a trustee and prudently invest trust assets, attorneys' fees should not be awarded against a trustee for what is essentially negligence. But this is a different case, a case where the trustee, burdened with a major conflict of interest, engaged in improper self-dealing, took Trust assets, profited from his dealings as trustee, failed to follow the Trust Agreement, and breached his duty of disclosure.

Minn. Stat. §501B.16(19) vests trial courts with equitable powers to redress a breach of fiduciary duty. Minnesota courts have long had such equitable power. See In re Anneke's Estate, 229 Minn. 60, 38 N.W.2d 177 (1949); In re Lee's Estate, 214 Minn. 448, 458, 9 N.W.2d 245, 250 (Minn. 1943) ("Equity will scrutinize dealings between the fiduciary and his cestui que trust."). In other scenarios involving equitable jurisdiction, courts have the power to award attorneys' fees in litigation. One example of this is shareholder derivative litigation. See Bosch v. Meeker Cooperative Light & Power Ass'n, 257 Minn. 362, 101 N.W.2d 423 (Minn. 1960). A court with equitable powers has the authority to enter orders to fully redress the harm caused by the wrongdoer, including awards of attorneys' fees. Bogert & Bogert, The Law of Trusts and Trustees, §IV(A), §871 (1993 ed.).

Courts from other jurisdictions have consistently held that awards of attorneys' fees can be imposed against a trustee who engages in breaches of fiduciary duty and obtains a profit as a result of his self-dealing. Dardovitch v. Haltzman, 190 F.3d 125 (3d Cir. 1999); Dunkley v. Peoples Bank & Trust Co., 728 F.Supp. 547 (W.D. Ark. 1989); Heller v. First Nat'l Bank of Denver, N.A., 657 P.2d 992 (Colo. Ct. App. 1982); Donahue v. Watson, 413 N.E.2d 974 (Ind. Ct. App. 1980); Estate of Bonin, 457 A.2d 1123 (Me.

1983); Feinberg v. Adolph A. Feinberg Hotel Trust, 922 S.W.2d 21 (Mo. Ct. App. 1996); In re Niles, 176 N.J. 282, 823 A.2d 1 (2003); Parker v. Rogerson, 49 A.D.2d 689, 370 N.Y.S.2d 753 (1975); Matter of Wills of Jacobs, 91 N.C. App. 138, 370 S.E.2d 860 (1988); Allard v. Pacific Nat'l Bank, 99 Wash. 2d 394, 663 P.2d 104 (1983). These courts all generally apply the American rule that litigants pay their own attorneys' fees. However, in a surcharge action involving trustee self-dealing, these courts recognize that a court of equity may fashion its order "to fit the nature and gravity of the breach and the consequences to the beneficiaries and trustee." Bogert, supra §IV(A), §543(v). To the extent Williams II implies that trial courts cannot award attorneys fees against trustees who engage in intentional misconduct, such a holding is out of step with virtually all other courts, and inconsistent with the equitable powers of trial courts in surcharge actions against a trustee.

The rationale for these awards are several. As recognized by the New Jersey Supreme Court in In re Niles, 823 A.2d at 9, but for the trustee's breach of duty, the trust's and beneficiaries' interests would not have been damaged, and to "hold otherwise would mean that [the self-dealing trustee] has shifted a substantial portion of the economic burden of his misdeeds to the victims -- the beneficiaries of the trusts". Fee awards in such circumstances are a form of the "equitable balancing of benefits", which functions as an exception to the American rule. Feinberg, 922 S.W.2d at 27. Some courts recognize that a co-trustee has a duty to take reasonable action to redress the breach and that this is another factor in justifying a fee award. Parker, 37 N.Y.S.2d at 755. Another factor considered is whether litigation or other actions result in a benefit to

the trust as a whole. See Dardovitch, 190 F.3d at 144-48. This Court has the power to render a fee award in a situation where a trustee breaches fiduciary duties and engages in self-dealing to obtain a benefit. All the factors which normally justify a fee award against an errant fiduciary are present here.

In Dardovitch v. Haltzman, 190 F.3d 125 (3d Cir. 1999), the United States Court of Appeals for the Third Circuit approved the award of attorneys' fees against a trustee in favor of a beneficiary. Id. at 130. A dispute arose between the creditor beneficiary and the lawyer trustee, when the lawyer trustee refused to provide information, conveyed inaccurate and incomplete information about the trust, and refused the creditor beneficiary's request for an accounting. Id. at 133. The trial court granted summary judgment in favor of the creditor on whether he was a beneficiary, and ordered the lawyer trustee to provide an accounting. After the accounting was filed, further litigation ensued, and the creditor established that the lawyer trustee had engaged in self-dealing by the lawyer trustee's receipt of inappropriate payments from the trust. Id. at 144. The trial court divided the matter into segments for purposes of considering the plaintiff's requests for attorneys' fees from the trustee -- fees incurred in connection with obtaining a court ordered accounting, and fees incurred in the litigation which resulted in the lawyer trustee being ordered to restore to the trust the improperly received payments from the trust. The trial court awarded attorneys' fees in favor of the creditor beneficiary to be paid by the attorney trustee for the "pre-Accounting litigation", on the basis that the only possible explanation for the trustee's refusal to provide the information was bad faith, and where the litigation was made necessary by the actions of the trustee. Id. at 146-47. The trial

court also ordered the trustee to pay a portion of the creditor beneficiary's attorneys' fees for the post accounting litigation, given that the trust benefitted from an order requiring the trustee to restore improperly received payments to the trust. Dardovitch, 190 F.3d at 147.

This case has similarities to Dardovitch, and Appellant presented a bifurcated approach to issues involving attorneys fees. Like Dardovitch, the conduct of the trustee here precipitated this litigation -- Jack Margolis violated his duties of disclosure after engaging in self-dealing and refused to account or provide basic information about the Trust. Dardovitch supports the justification for a "pre-accounting" award of attorneys' fees. See Ex. 64; Recher Testimony (10/23/07). The efforts of Appellant's attorneys in achieving a restoration of the partnership interests to the Trust was undoubtedly a benefit to the Trust. The services related to obtaining an accounting also benefited the Trust -- some certainty was provided as to the extent of the assets in a very uncertain setting, where the information provided by Respondent and his lawyers before September of 2005 was consistently wrong, inaccurate, and misleading. (Id.; Lorberbaum Tr., p. 65-67; Exs. 15, 18, 19). As a result of such efforts, Jack Margolis resigned as trustee, which was in the best interests of the Trust under the circumstances. This Court should direct the trial court to award Petitioner \$40,013 in attorneys' fees incurred for the "pre-accounting" stage of this litigation.

If this matter is reversed on the issues involving the payment of nursing home expenses and Respondent's violation of Minn. Stat. §501B.14, subd. 1(2), then Appellant

should also be entitled to an award of attorneys fees and expenses for the post-accounting litigation. See Dardovitch, 190 F.3d at 147; Ex. 65.

IV. THE TRIAL COURT'S AWARD OF ATTORNEYS FEES TO RESPONDENT WAS AN ABUSE OF DISCRETION.

The trial court, in its order of June 24, 2008, awarded Respondent attorneys' fees and litigation expenses from the Trust in the entire amount of what was requested. This award was an abuse of discretion.

Respondent's request was not made until after the Court of Appeals remanded the matter in 2007. The trial court excluded Appellant's testimony on the successor trustee issue, purportedly because it had not been offered at the prior trial, even though the Court had been directed to reconsider the issue. Even though Respondent had not made a motion or request for attorneys' fees previously, the trial court not only considered this untimely request, but granted it in its entirety. This is neither fair nor consistent.

While appellate decisions sometimes finalize a particular case, "[i]f complete finality cannot be accomplished, if something remains to be done by the court below, the appellate court will ordinarily so indicate, usually by a remand with directions or a mandate which the trial court must follow." Mattson v. Underwriters at Lloyds of London, 414 N.W.2d 717, 720 (Minn. 1987). The Court of Appeals gave this Court specific instructions on remand, which focused on claims which the trial court had not resolved and what remedies should be ordered. Given such instructions, the Court must stay within the "parameters of the remand," and, therefore, should not have considered

Respondent's motion for attorneys' fees, presented for the first time on remand. See, e.g., Serino v. Serino, 2003 WL 108829, at *2 (Minn. Ct. App. Jan. 14, 2003).

Not only was this request untimely, this award of attorneys fees from the Trust in favor of Respondent was made to a trustee who breached his duty of loyalty to the Trust beneficiaries, breached his duty of duty of disclosure by concealing matters involving the Trust and his taking Trust assets, who refused to provide an accounting, breached his duty to keep records and not commingle Trust funds, and who this Court held violated the prohibitions under Minn. Stat. §501B.14, subd. 1(2). The trial court has ruled against Appellant on virtually every issue since the remand; this ruling, with the backdrop of this case, is perhaps the most difficult to fathom.

Minnesota law provides that a court should consider certain factors in connection with requests for attorneys' fees against a Trust. In Williams I, the trial court initially dismissed the co-trustee's surcharge action, on the basis that an exculpatory provision barred the action against another co-trustee, Norwest. In doing so, the trial court denied Norwest's request to charge the trust with its attorneys fees in defense of the surcharge action. At this point, Norwest had prevailed in the action, yet the trial court still denied their request for attorneys fees. The Court of Appeals reversed the trial court's findings with respect to the exculpatory provision on the basis that it was ambiguous and therefore did not protect Norwest, remanded the action for trial on the co-trustee's surcharge action, but affirmed the trial court's denial of the trustee's request to have the trust pay Norwest's attorneys fees incurred in defense of the action. The Court of Appeals held that an award of attorneys fees in favor of the respondent trustee is in the discretion of the

trial court, and commented that if the trustee had acted in bad faith or been guilty of fraud or inexcusable neglect, the trustee may be denied attorneys fees. Id., 591 N.W.2d at 748-49. But this is not the linchpin for an award of attorneys fees - the Williams court noted that the trial court could consider, among other things, the underlying allegations against the trustee in exercising its discretion on whether to award or deny a request for attorneys fees by a trustee, and issues raised late in the litigation. The trial court denied Norwest's requests for fees, which were made before any appeal ensued.

On remand, the trial court held that Norwest should be surcharged because of its failure to diversify investments in the trust, and denied trustee fees (i.e., compensation to Norwest) during the period of Norwest's negligence. On appeal, the Court of Appeals affirmed the trial court's findings, and remanded the denial of all the trustee fees charged by Norwest to determine if a blanket denial should be imposed, which was to be determined by whether Norwest's failed to render services properly during the time frames in question. Williams, 631 N.W.2d at 408-09. In doing so, the Court stated it was within the trial court's discretion to deny a trustee compensation, especially if there are findings of fraud, bad faith, inexcusable neglect or a breach of duty.

On the basis of delay, bad faith, inexcusable neglect and breach of duty, the decisions in Williams require a denial of Respondent's request for attorneys fees from the Trust. Jack Margolis engaged in an intentional pattern of conduct in breach of his obligations as trustee to disadvantage the Trust beneficiaries in favor of his children, the beneficiaries of a separate trust. The trial court, who failed to address the fiduciary duty issues at the first trial, begrudgingly found that trustee Margolis breached several duties,

characterized his conduct in taking trust assets and concealing information as “questionable”, yet denied Appellant a remedy for trustee Margolis’ violations of Minnesota law. This is also a case where as a matter of law the trustee has been found to have violated Minnesota law. It is also a case where the trustee has indirectly profited and enhanced the value of another trust by allocating all the nursing home expense to the Trust, instead of fulfilling his personal obligations from his own funds. The trial court’s decisions in this case have consistently been wrong, they have lowered the bar for fiduciary conduct, and the award of attorneys fees to Respondent from the Trust is plainly an injustice.

CONCLUSION

This case should be reversed, with instructions to the district court to: 1) enter judgment in favor of Appellant and against Respondent in the amount of \$206,384; 2) vacate the trial court’s order granting Respondent attorneys’ fees against the Trust; and 3) enter an Order awarding Appellant expenses and attorneys’ fees for services relating to pre- accounting and post- accounting matters.

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