

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 REPLY BRIEF

HENSON & EFRON, P.A.
Bruce C. Recher (#89989)
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

TABLE OF CONTENTS

TABLE OF AUTHORITIES	ii
ARGUMENT	1
I. THE TRIAL COURT ERRED WHEN IT REFUSED TO AWARD ANY RELIEF FOR RESPONDENT MARGOLIS' VIOLATION OF MINN. STAT. §501B.14, SUBD. 1 (2), AND WHEN IT APPROVED RESPONDENT MARGOLIS' ACCOUNTING WHICH ALLOCATED EVERY DOLLAR OF NURSING HOME EXPENSE TO THE TRUST.....	1
A. The Trial Court's Denial of a Remedy for Respondent's Violation of Minn. Stat. §501B.14, Subd. 1(2) Renders the Statute Meaningless	1
B. Section 8.8 of the Trust Agreement Does Not Exculpate Jack Margolis From Liability to Restore to the Trust the \$206,384 in Nursing Home Expenses He Allocated to the Trust	5
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	7
CONCLUSION.....	10

TABLE OF AUTHORITIES

STATE CASES

<u>B & S Rigging & Erection, Inc. v. Wydella</u> , 353 N.W.2d 163 (Minn. Ct. App. 1984) ...	4
<u>Countiss v. Whiting</u> , 306 Ill. App. 548, 29 N.E.2d 277 (1940).....	6
<u>Godette v. Estate of Cox</u> , 592 A.2d 1028 (D.C. 1991).....	5, 6
<u>In re Anneke’s Trust</u> , 229 Minn. 60, 38 N.W.2d 177 (1949).....	6
<u>In re Henry Youth Hockey Ass’n</u> , 511 N.W.2d 452 (Minn. Ct. App. 1994)	8
<u>In re Lee’s Estate</u> , 214 Minn. 448, 9 N.W.2d 245 (1943).....	7
<u>In re Revocable Trust of Margolis</u> , 731 N.W.2d 539 (Minn. App. 2007)	4, 8
<u>Langford v. Shamburger</u> , 417 S.W.2d 438 (Tex. Civ. App. 1967).....	6
<u>Smith v. Tolversen</u> , 190 Minn. 410, 252 N.W. 423 (1934).....	7, 9

FEDERAL CASES

<u>Warden v. McLelland</u> , 288 F.3d 105 (3d Cir. 2002).....	6
<u>Weiss v. Weiss</u> , 984 F. Supp. 675 (S.D.N.Y. 1997)	2, 6

STATUTES

Minn. Stat. §501B.14	1-3, 6-9
----------------------------	----------

OTHER AUTHORITIES

Restatement (Second) of Trusts §170.....	2
Restatement (Second) of Trusts §222	6

ARGUMENT

I. THE TRIAL COURT ERRED WHEN IT REFUSED TO AWARD ANY RELIEF FOR RESPONDENT MARGOLIS' VIOLATION OF MINN. STAT. §501B.14, SUBD. 1 (2), AND WHEN IT APPROVED RESPONDENT MARGOLIS' ACCOUNTING WHICH ALLOCATED EVERY DOLLAR OF NURSING HOME EXPENSE TO THE TRUST.

A. The Trial Court's Denial of a Remedy for Respondent's Violation of Minn. Stat. §501B.14, Subd. 1(2) Renders the Statute Meaningless.

The trial court rejected any remedy for Respondent Margolis' violation of Minn. Stat. §501B.14, which unambiguously prohibits trustees from using their discretion as trustees to make distributions of trust assets to themselves either directly (as in the first subsection), or indirectly, when the effect is discharge any legal support or other obligation of the trustee to any person. This Court has already ruled that Respondent Margolis violated Minn. Stat. §501B.14, subd. 1(2).

While it is true that Minn. Stat. §501B.14 does not expressly provide for a particular remedy, neither does any other statutory directive in Chapter 501B governing trusts. While the trial court and Respondent refer to the notion of strict liability or personal liability on the trustee, the statute unambiguously prohibits the trustee from exercising his discretion to make such distributions. The statute plainly provides the trustee is disqualified from making such distributions. A remedy which provides that a trustee should return to the Trust the profit from his actions in violating an unambiguous statute which prohibits him from distributing trust assets which relieve the trustee of his personal legal and contract obligations is not only fair, especially given the backdrop of this case, but is completely consistent with common law prohibitions on a trustee's self-

dealing. See Restatement (Second) of Trusts §170 comment a (a trustee is under a duty not to profit from dealing with the trust); Weiss v. Weiss, 984 F.Supp. 675 (S.D.N.Y. 1997) (trustee liable for profits obtained through use of trust assets).

Respondent has not explained the fallacy underlying the trial court's rejection of a remedy for Respondent's violation of this statute. Minn. Stat. §501B.14, subd. 1(2) is premised on one thing -- the exercise of a trustee's discretion. If the trust agreement provides for mandatory action by the trustee, then the trustee's distribution of assets is outside the ambit of the statutory prohibition. But if the trust agreement empowers the trustee to act with discretion, and the trustee uses that discretion to indirectly benefit himself, then the trustee runs afoul of the statutory prohibition. Without a trust agreement which authorizes the trustee's action, the statute would never apply to a trustee's decision-making.

The trial court held and Respondent argues that the Trust Agreement authorized Jack Margolis to expend Trust assets for Naomi Margolis' health care, i.e., that the subject of the distribution was contemplated by the Trust Agreement. This is true, although he was not required to do so, and the power conferred extended to other beneficiaries. AA 105. While the trial court used this authorization to justify a denial of a remedy for the statutory violation, that authorization should not absolve a trustee who violates the statute from returning the benefit that he personally received in connection with the distribution. It is clearly the intent of the legislature for the statutory prohibition to extend to exactly the situation we have here -- an action of a trustee who is empowered with discretion and authorized by a trust to act. The trial court held that because the Trust

Agreement here authorized Respondent's actions in paying his spouse's nursing home expenses (even though he had a legal obligation to pay his spouse's medical expenses, and independently contracted to personally make the payments), there could be no remedy. The trial court's ruling completely undermines the prohibition in this statute; it might as well not exist. If the trial court's analysis is followed, there will never be a remedy for a violation of this statutory prohibition, because without a trust agreement empowering the trustee to act with discretion, the statute is not operative.

Here, Respondent Margolis had an obvious conflict of interest; he could honor his personal legal obligations to make these nursing home expenses himself, he could use the nearly \$1 million in joint assets he owned with his incapacitated spouse from a lengthy marriage as the source of payment, or he could use his discretion under Naomi Margolis' Trust to allocate some or all of these expenses to the Trust. Consistent with the motivation which led him to take the Trust assets and conceal his actions from the beneficiaries, he chose to allocate every single dollar of the nursing home expense to the Trust. There is no doubt his actions as trustee benefited him personally. Moreover, while there were means available (such as appointing a trustee who is not disqualified) to address Respondent's disqualification under the statute, Respondent ignored his responsibilities, as he did on a host of matters involving his obligations to the Trust and its beneficiaries. A remedy which requires the trustee to return the amount which he was personally responsible to pay but for which he used trust assets to discharge his liability, is a measured and appropriate restitutionary remedy for a violation of Minn. Stat. §501B.14.

Section 8.3 of the Trust Agreement prohibits a trustee other than the Grantor from distributing assets to himself. Section 8.3 never stopped Jack Margolis when he took the Trust assets in November of 2003 and had them transferred to his own trust, the Jack Margolis Revocable Trust, in complete violation of his duty of loyalty to the Trust beneficiaries. The trial court found this to be a breach of fiduciary duty, but did not comment on Respondent's blatant violation of Section 8.3, other than to characterize his conduct as "questionable", a bit of an understatement. This section prohibits any discretionary distribution, direct or indirect. When Respondent Margolis used trust assets to discharge his personal obligations to his spouse, or his contract obligations to the Sholom Home, the effect of this distribution was as if he paid himself directly out of the Trust. Minnesota has always recognized that fiduciaries cannot do indirectly what they are prohibited from doing directly. See B & S Rigging & Erection, Inc. v. Wydella, 353 N.W.2d 163 (Minn. Ct. App. 1984). The fact that section 8.3 does not explicitly say that a trustee is prohibited from distributing trust assets to discharge a support obligation to his spouse is not a reason to deny restitutionary damages in this case. Moreover, Respondent not only had a duty to support his spouse, he had a contractual obligation to the Sholom Home, which was independent of his duty of support. In re Revocable Trust of Margolis, 731 N.W.2d 539, 544 (Minn. Ct. App. 2007 ([b]y contract and by law, respondent was liable for Naomi's medical care"). When he discharged his contract obligation, he placed himself squarely in the ambit of the prohibition in Section 8.3 of the Trust Agreement.

Nor is it an answer to say that there is no breach of the duty of loyalty when the Trust Agreement authorizes the action. This has nothing to do with whether there should be a remedy for a statutory violation, particularly in a case like this where this trustee has engaged in a pattern of self-dealing, prompted by a motive to benefit his children to the exclusion of the Trust beneficiaries, and where the trustee violated Section 8.3 of the Trust Agreement. Here, the statute prohibits the action when a trustee uses Trust assets to discharge either his duty to pay the medical expenses of his spouse, or to pay an independent contract obligation of the trustee. There is a statutory breach, and a restitutionary remedy for this trustee self-dealing makes perfect sense.

B. Section 8.8 of the Trust Agreement Does Not Exculpate Jack Margolis From Liability to Restore to the Trust the \$206,384 in Nursing Home Expenses He Allocated to the Trust.

Neither the trial court or Respondent has addressed Petitioner's arguments that the exculpatory provisions in Section 8.8 of the Trust Agreement are unenforceable and against public policy. First of all, any enforcement of an exculpatory provision in a contract to curtail remedies from a statutory violation which does not authorize such action is against public policy. See, Godette v. Estate of Cox, 592 A.2d 1028 (D.C. App. 1991); see cases cited in Appellant's Brief at pp. 23-24. While exculpatory provisions can be valid, it is one thing to exculpate a party from a common law liability, it is another thing entirely to contract away a statutory violation. Parties to contracts do not have power to immunize themselves from statutory prohibitions, particularly where the statute does not allow for such action. Employers cannot insert exculpatory provisions in employment agreements with employees that they will not be liable for discriminatory

conduct in violation of statutory prohibitions. Merchants cannot place exculpatory provisions in their form contracts which exculpate them from usurious practices as defined by statute. The trial court and Respondent do not even address these arguments.

Moreover, this is a statute which expressly articulates a method by which parties can avoid its application, i.e., to mention the statute by name in the Trust Agreement and state it does not apply. Minn. Stat. §501B.14, subd. 3. The legislature expressed a method means by which the prohibition's application could be avoided - an ambiguous exculpatory provision is not one of those methods.

The exculpatory provision in Section 8.8 is also unenforceable because exculpatory provisions have never been interpreted to allow a trustee to profit from their own actions. See, Restatement (Second) of Trusts §222(2) (a provision in a trust agreement is not effective to relieve the trustee of a liability for any profit which the trustee has derived from a breach of trust); see also, Weiss v. Weiss, 984 F. Supp. 675 (S.D.N.Y. 1997); Warden v. McLelland, 288 F.3d 105, 110 (3d Cir. 2002); Godette v. Estate of Cox, supra; Countiss v. Whiting, 306 Ill. App. 548, 29 N.E.2d 277, 280 (1940); Langford v. Shamburger, 417 S.W.2d 438 (Tex. Civ. App. 1967). These cases all hold that exculpatory provisions are not a safe haven for trustees who profit from their dealings with the trust.

Respondent's brief discusses exculpatory provisions interpreted under Minnesota law in a variety of contexts; but Minnesota courts have not addressed whether a trustee who profits from the use of his discretion in distributing trust assets in violation of a statutory duty is immunized by an exculpatory provision. Minnesota law has long

prohibited self-dealing on the part of trustees. In re Anneke's Trust, 229 Minn. 60, 38 N.W.2d 177, 179 (1949); In re Lee's Estate, 214 Minn. 448, 9 N.W.2d 245, 250 (1943); Smith v. Tolversen, 190 Minn. 410, 252 N.W. 423 (1934).

Respondent's brief never challenges the unassailable central fact in this case -- when Jack Margolis used Trust funds that he commingled with his own assets, and used those assets to pay for his wife's expenses which he had a personal obligation to pay, and for which he had a separate independent contract obligation to pay, Respondent Margolis profited from his dealings with the Trust. There is no getting around this in the circumstances of this case. When Jack Margolis, burdened with a conflict of interest, expended Trust funds and then allocated in his accounting every dollar he could to the Trust, he personally benefited from that decision - he avoided having to pay from his personal funds, or from joint funds in which he had an interest, these same expenses. Respondent does not challenge this, and the trial court never acknowledged it. But it *is* undeniably true. Exculpatory provisions do not immunize trustees in circumstances where the trustee profits from his dealings with 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.

Minn. Stat. §501B.14 provides a process to follow when a trustee is disqualified from using his discretion to distribute assets to himself or to discharge his duty of support

or other obligations. As this Court recognized, “prudent parties may work around the statute.” In re Revocable Trust of Margolis, 731 N.W.2d at 545. As this Court also pointed out, the district court’s conclusion that it was immaterial that Respondent had excluded petitioner as successor trustee, as this conclusion:

ignored the conflict of interest respondent faced over whether to use resources from Naomi’s trust or their joint accounts to pay her expenses. It further assumes that appellant or an independent, additional trustee either would have concurred that Naomi’s trust should bear the primary expense of her care or would not have any persuasive perspective on the question.

Id. at 547. Section 501B.14 expressly provides for a process where an independent trustee can exercise the discretion to distribute trust assets where the other trustee is prohibited from acting under the statute. But Respondent made a deliberate choice -- he wanted to control the Trust, without another trustee. So he ignored the Trust Agreement’s direction to have petitioner appointed as successor trustee when Naomi Margolis became incapacitated. Then, he circumvented the process which the statute provides for to address the conflict of interest he had and potentially cure his violation. See In re Henry Youth Hockey Ass’n, 511 N.W.2d 452, 456 (Minn. Ct. App. 1994) (a disregard and indifference to the requirements of statutory requirements is “willful” misconduct). Now he argues there should be no remedy for an unambiguous statutory violation which he plainly ignored.

The trial court allowed no new evidence on this issue, and engaged in the same speculation the court employed after the first trial, and made the identical conclusion. The trial court’s albeit “valid speculation” was that Appellant and Respondent Margolis

would have been at an impasse as to whether Trust assets should be expended for nursing home care, and a court would then have approved payments from the Trust.

There were other options available to a successor trustee -- negotiations with Respondent Margolis, the possibility of a conservatorship for Naomi Margolis, which would have allowed the use of other assets, including nearly a million dollars of jointly-held assets. See, Petitioner's Exhibit 66, AA 129-135. Only a trustee who is not "disqualified" can exercise the discretion to distribute Trust assets. Thus, there are major questions regarding whether the "impasse" contemplated by the trial court would have materialized. And there are questions about what would have materialized had there been such an impasse. All of this involves some degree of speculation, but it is speculation brought on by Respondent's actions, who wanted to control the Trust assets, who excluded Lorberbaum from a successor trustee role, and who was oblivious to his duties as trustee, not only under the Trust Agreement, but Minn. Stat. §501B.14.

Instead of making yet another excuse for a trustee who violated Minnesota law and failed to follow the Trust Agreement, the trial court should have resolved any doubts caused by Respondent against a breaching trustee. This has long been Minnesota law. See, Smith v. Tolversen, 190 Minn. 410, 252 N.W. 423 (1934). Respondent has not addressed this point. This presumption solves the uncertainties created by a trustee who did not act as a "prudent" party, and who failed to follow the Trust Agreement. The application of this long standing principle that uncertainties should be resolved against the trustee who created them would have required the district court to reach a different conclusion, and actually impose a remedy.

CONCLUSION

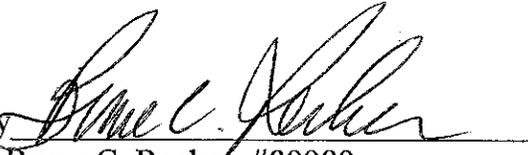
The trustee here possessed a conflict of interest on what assets should be used to pay for his incapacitated spouse's nursing home expenses. There was a legal obligation imposed under Minnesota law for the trustee to pay for this expense, and the trustee had a contractual obligation which he also assumed to personally pay these expenses. The trustee was also empowered under a trust to pay the expenses out of the Trust, but a Minnesota statute disqualified the trustee from using this discretionary power to indirectly benefit himself. Rather than follow the statute and have a successor or independent trustee put in place to resolve the conflicting legal duties and his disqualification, the trustee ignored his obligations under the statute. This same trustee violated the Trust Agreement when he failed to secure an independent trustee for his incapacitated spouse, and when he used and allocated in his accounting Trust assets to discharge both his contract obligation and his duty of support. This same trustee, prompted by a motivation to benefit his own children and not the Trust beneficiaries, took the Trust assets, misled the Trust beneficiaries and concealed his wrongdoing. This same trustee's actions in booking every single dollar of nursing home expense to the Trust instead of using his own funds, or ample jointly owned assets in which his spouse had an ownership interest, has the same effect as if he distributed the Trust assets to himself directly. This case is about how to resolve this trustee's conflict of interest and the various legal obligations imposed on this trustee. The trial court's ruling lets this trustee profit from his decision-making as trustee of a trust in violation of a statutory prohibition. This ruling is premised on a series of dubious conclusions and unsupportable

excuses, but most importantly, it lowers the bar on the obligations of trustees under Minnesota law.

Based on the foregoing, and Appellant's other arguments set forth in Appellant's Brief, this Court should reverse the District Court's judgment, order judgment in favor of Appellant in the amount of \$206,384, reverse the District Court's Order allowing Respondent attorneys' fees from the Trust, and either award or remand the matter to address Appellant's request for an award of attorneys' fees from Respondent.

HENSON & EFRON, P.A.

Dated: November 3, 2008.

By 
Bruce C. Recher, #89989

Suite #1800
220 South Sixth Street
Minneapolis, Minnesota 55402-4503
Telephone: 612-339-2500
Facsimile: 612-339-6364
Attorneys for Appellant

354744.DOC