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**STATE OF MINNESOTA
IN COURT OF APPEALS
A13-0248**

In re Harry Inge Baker and Jeanne C. Baker Trust
Dated August 9, 1988

Janet Baker Evans
as Successor Trustee of the Harry Inge Baker and Jeanne C. Baker Trust
Dated August 9, 1988,
Appellant,

vs.

Marla B. Smith, individually,
and as Personal Representative of the Estate of Jeanne C. Baker, et al.,
Respondents.

**Filed August 5, 2013
Affirmed in part, reversed in part, and remanded
Chutich, Judge**

Dakota County District Court
File Nos. 19HA-CV-10-1531
19HA-CV-08-4109

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P.L.L.P., St. Paul, Minnesota (for appellant)

J. Kevin McVay, Richfield, Minnesota (for respondents)

Considered and decided by Smith, Presiding Judge; Peterson, Judge; and Chutich,
Judge.

UNPUBLISHED OPINION

CHUTICH, Judge

Appellant Janet Baker Evans, as Successor Trustee of the Harry Inge Baker and Jeanne C. Baker Trust dated August 9, 1988, challenges the district court's decision following a court trial arising from a dispute over the administration of a trust established by her late father and stepmother. Evans argues that the district court erred by: (1) determining that missing records precluded recovery of more than \$250,000 of her claim; (2) applying the doctrine of laches against her as an alternative basis to deny that portion of her claim; (3) awarding attorney fees to respondents; and (4) applying a low lost-investment interest rate to the allowed portion of her claim.

We affirm the district court's ruling on the applicable lost-investment interest rate. But because the district court erroneously concluded that Evans could not recover undisputedly missing trust assets, abused its discretion in applying the doctrine of laches, and inappropriately awarded attorney fees to respondents, we reverse and remand to the district court for entry of an amended judgment and reconsideration of Evans's attorney-fee award.

FACTS

Harry Baker and Jeanne Baker ("Baker") were married in 1987 and entered into a Declaration of Trust on August 9, 1988. The trust was funded with about \$1.2 million of Harry Baker's assets. Harry Baker's remaining children, and the trust beneficiaries, are Evans and her sister, Linda Pickett.

Harry Baker died in 1990. The trust declaration provided for the creation of three distinct trusts upon his death. The first was the “Survivor’s Trust,” which was to be funded by Baker’s separate assets and her share of the couple’s community property. Both principal and income from the Survivor’s Trust could be used to pay for Baker’s “health, maintenance and reasonable comfort, and best interests.” Baker did not keep any of her money in this trust after Harry Baker’s death, and the couple had no community property, so the Survivor’s Trust was unfunded.

The second trust created after Harry Baker’s death was the “Decedent’s Trust,” consisting of about half of the trust assets, from which the trustee was authorized to pay income to Baker, Evans, and Pickett in equal shares during Baker’s lifetime. The third trust, the “Marital Election Trust,” contained the balance of the trust assets and authorized the trustee to pay income from those assets to Baker during her lifetime. Upon Baker’s death, the principal from both the Decedent’s and Marital Election Trusts would be distributed to Evans and Pickett in equal shares. By its terms, the trust is governed by Arizona law. Because all of the assets from the original trust went into the Decedent’s and Marital Election Trusts and both of those trusts prohibit distribution of principal, and because a determination of which particular assets were held in each trust is not relevant to the case, we will refer to the original trust, and the resulting Decedent’s and Marital Election Trusts, collectively as “the trust.”

Baker served as trustee from Harry Baker’s death in 1990 until early 2005. During that time, she deposited the income from the trust assets into one bank account and distributed the income quarterly to herself, Evans, and Pickett in the proportions

specified in the trust. The trust document named Evans as successor trustee of the Decedent's and Marital Election Trusts, and provided that Evans would serve as trustee if Baker resigned, died, or was unable to manage her affairs. Besides occasional cards and emails, Evans had little contact with Baker after Harry Baker died.

Baker delivered the quarterly income checks and a K-1 tax form each year to Evans and Pickett, but they never requested or received an annual reconciliation of the assets in the trust. After receiving her income check, K-1 form, and Baker's work papers in September 2004, Evans became concerned that assets were missing from the trust. She spoke to Baker, who told Evans that she simply forgot to list about \$270,000 worth of assets on the work papers. Evans was satisfied with Baker's response and did not investigate further.

At some point before May 2005, Baker began to develop dementia. In May 2005, Baker's daughter, respondent Marla Smith, became Baker's agent for trust matters by virtue of a clause in the trust document that allowed a settlor to delegate or relinquish her powers under the trust to another person.¹ Baker also executed a Minnesota Power of

¹ The parties and the district court applied the delegation clause to mean that Baker, as trustee, could delegate her trustee powers and duties to another person. Our review of the clause suggests that this interpretation is incorrect. The clause appears in the section of the trust addressing the powers of a living settlor, which include the power to approve or disapprove the trustee's investment or disposal of trust assets. The delegation clause provides that "[a] settlor may . . . delegate to the other settlor, to any other person or to the trustee or relinquish any or all powers reserved to him or her hereunder." (Emphasis added.) The clause therefore does not appear to allow a trustee to delegate his or her powers and duties *as a trustee* to another. Because the district court and the parties read this clause to allow Smith to act as Baker's agent for her actions as trustee, however, and because Smith was also Baker's agent under a Power of Attorney, we will assume that an agency relationship existed for trustee matters.

Attorney form designating Smith as her attorney-in-fact. From the time Smith became Baker's agent until Baker died in 2009, Smith spent principal from the trust for Baker's care.

Evans did not learn of Smith's delegation as Baker's agent until late 2007 when Evans and Pickett noticed that their quarterly income checks had become smaller and that Smith had been sending the checks instead of Baker. Evans spoke to Smith in late 2007 and learned of the delegation and of Baker's dementia, though Smith did not inform her of its severity. Evans asked Smith about the smaller distributions, and Smith told her that they were due to fluctuations in the market. Smith told Evans that she had not read the trust document and later admitted that she did not even have a copy of it.

It soon became apparent to Evans that Smith believed she could spend not only income but also principal from the trust for Baker's care. Evans told Smith that she believed Smith and her attorney were reading the trust document incorrectly, and requested that she become successor trustee. Smith told Evans that she intended to continue paying for Baker's care with principal, as she had apparently been told by Baker, Baker's attorney, and her own attorney, Sandra Sather, that withdrawing principal from the trust was proper. During this time, Smith also told Evans that nothing had changed with Harry Baker's trust money, a statement she knew to be false because she had been spending principal. Smith admitted to spending \$203,200 of principal from the trust from the time she began acting as Baker's agent in 2005 until Evans took over as successor trustee in 2008.

In September 2008, Smith filed a petition with the district court requesting that the court construe the trust, ratify and confirm all of her previous distributions of principal and income, and appoint a successor trustee. Evans objected to Smith's petition because she believed that trust assets were missing. With Smith's agreement, Evans became successor trustee in October 2008.

Jeanne Baker died in 2009. In February 2010, after unsuccessfully attempting to receive an accurate accounting of trust assets from Smith for more than a year, Evans brought suit against Smith individually and as personal representative of Baker's estate. Evans sought a surcharge against Baker's estate to recover the wrongfully spent or transferred trust principal, and she later added the Jeanne C. Baker Revocable Living Trust as a defendant.² The district court consolidated the two actions filed by Smith and Evans and held a court trial in May 2012.

Attorney Sandra Sather began representing Smith and the trust in January 2008 and advised Smith, as Baker's agent, that it was permissible to spend principal from the Marital Election and Decedent's trusts. Once the district court proceedings began, Sather represented Smith, individually and as personal representative of Baker's estate, and the Jeanne C. Baker Revocable Living Trust, while Evans, as successor trustee, engaged separate counsel for the trust. Sather never sought or received consent from Evans to

² The Jeanne C. Baker Revocable Living Trust, in which Smith is a beneficiary and has a 40% interest, apparently holds Baker's separate assets that were meant to be included in the Survivor's Trust. In 2008, Baker's trust contained about \$220,000. When she died, Baker's probate and non-probate assets totaled about \$480,000.

represent respondents after she no longer represented the trust, and she continued to represent respondents up until trial, withdrawing only when she was called as a witness.

Evans testified both in a personal capacity and based on her professional expertise as a forensic accountant. During her investigation into the missing assets, she attempted to get trust records from various financial institutions, but records created before 2006 were unavailable. In addition, because checkbooks or bank records were missing, Evans was unable to specifically trace assets missing from the trust. Evans also reviewed Baker's work papers, concluding from the documents that cash was taken out of the trust and not returned or reinvested.

Many trust-related documents from Baker's time as trustee were missing. Smith gave three different explanations for the missing records: (1) Baker threw away records due to her confusion from dementia; (2) Baker discarded old paperwork when she moved out of her home into an assisted-living facility; and (3) a flood at Baker's assisted-living facility destroyed records.³ The district court found that the documents were not discarded in bad faith and that Smith and Baker "substantially fulfilled their duty to maintain records of the Trust."

As the district court found, "[e]ven with Evans'[s] best efforts to obtain records, she did not have all of the records from the beginning of the Trust, particularly the missing bank account records, that would tell her where the missing cash went." Based

³ The facility's maintenance director testified at trial that a broken water pipe flooded the facility's storage room in 2006. He had no knowledge, however, of whether any trust records were in the storage room or whether any trust records were destroyed by the flood.

on her forensic examination of the available documents, Evans concluded as follows: (1) \$253,053.74 in assets went missing from the trust between 1994 and April 19, 2004; (2) \$203,200 went missing from the trust between May 2006 and August 2008, which Smith admitted spending for Baker's care; and (3) the lost-investment interest rate on the missing principal through the date of trial should be calculated at 6%.

Other experts also testified at trial. Accountant Larry Greely reviewed the same documents as Evans and calculated a tentative figure for assets that might be missing from the trust. Greely was unable to render an ultimate opinion about the missing assets, however, because he determined that the records were insufficient to find with any reasonable professional certainty that any specific amounts were missing from the trust or to trace any missing assets.

Lynda Mohs, the accountant who had prepared Baker's tax returns since 1997, also testified and admitted that assets were missing from the trust. Mohs had limited information about the trust and "made a number of guesses or assumptions about missing assets," but admitted that the missing records made it difficult to determine where the assets went.

The district court also considered testimony and evidence about attorney fees and other fees incurred during the litigation. Smith requested attorney fees and costs from the trust totaling \$218,509.02. Of this amount, Smith had already paid \$94,077.98 to her attorneys from Baker's assets. Along with forensic-accounting fees, Evans sought attorney fees in the amount of \$360,398.31.

The district court issued its decision in August 2012. After making detailed factual findings and reciting the relevant principles of Arizona trust law, the district court ruled first that the trust document unambiguously precludes distributions of principal from the Decedent's and Marital Election Trusts, and any such distributions by Baker or Smith were improper.

The district court concluded that Smith, Baker's estate, and the Jeanne C. Baker Revocable Living Trust are jointly and severally liable for the \$203,200 of principal that Smith admitted spending for Baker's care between 2006 and 2008. The district court found that Smith breached her fiduciary duties of care and loyalty to the trust and its beneficiaries and acted in bad faith in spending the principal. The district court also found that Baker breached her duty to the trust by failing to exercise reasonable care in selecting Smith as her agent and failing to establish the scope and terms of the delegation.

Concerning assets missing before April 2004, the district court found that "[d]uring the period of time that Jeanne Baker served as trustee, approximately \$253,053.74 of principal was unaccounted for, and the tracing of such amount is dependent upon bank account records which are missing." Because it found that the evidence in the record was "insufficient to show that anyone took any specific amount of principal from the trust prior to 4/19/04 and spent it in any specific manner," the district court declined to impose liability for any assets missing before that date. The district court further concluded that the doctrine of laches precluded Evans from recovering the pre-2004 assets.

The district court found that Smith was entitled to attorney fees paid from the trust “to the extent that they relate to a good faith defense or prosecution of this action.” Because Smith acted in “bad faith” in spending \$203,200 in principal from 2006 through 2008, she was not entitled to fees attributable to that portion of her defense. The district court included in this “bad faith” category the \$94,077.98 that Smith had already paid to her attorneys from Baker’s separate assets, and thus did not order the trust to reimburse her for that amount. The district court also concluded that Sather’s conflict of interest did not require Smith’s attorneys to disgorge any fees.

The district court found that Smith was entitled to attorney fees for the “good faith” portion of her defense, which consisted of defending Evans’s unsuccessful claims about the pre-2004 missing assets. The district court thus awarded Smith the balance of her requested attorney fees, \$124,431.04, “incurred in a good faith defense of her administration of the trust.”

Concerning Evans’s fees, the district court found that her request of \$360,398.31 was too high in relation to “the amount involved and the results obtained.” The district court thus reduced her requested fees and awarded her \$282,457.49, an amount equal to the trust’s total judgment.

In total, the district court awarded judgment in favor of Evans in the amount of \$572,914.98. This amount included \$203,200 in known assets missing from the trust; \$31,101.87 in lost-investment interest (calculated at 3.77%); \$48,155.62 in statutory pre-judgment interest (10%); \$8,000 in forensic-accounting fees; and \$282,457.49 in attorney fees. The judgment was entered jointly and severally against Smith, individually and as

personal representative of Baker’s estate, and the Jeanne C. Baker Revocable Living Trust.

The district court denied the parties’ motions for amended judgment, and Evans appealed.

D E C I S I O N

I. Pre-2004 Missing Assets

Evans first argues that the district court erred in not allowing her to recover the value of assets missing from the trust before 2004 when Baker was trustee and the trust assets were under her control. Because the district court erred in concluding that missing records and documentation precluded recovery of undisputedly missing assets, we agree with Evans.

In considering the district court’s ruling after a court trial, we review findings of fact for clear error and legal conclusions de novo. *Slattengren & Sons Props., LLC v. RTS River Bluff, LLC*, 805 N.W.2d 279, 281 (Minn. App. 2011); Minn. R. Civ. P. 52.01. “If the district court’s ruling is free of legal or factual errors, we will not overturn the decision unless the court’s discretion is exercised in an arbitrary or capricious manner.” *City of N. Oaks v. Sarpal*, 797 N.W.2d 18, 24 (Minn. 2011) (quotation omitted).⁴

The district court accepted Evans’s professional opinion after her forensic analysis, finding that “[d]uring the period of time that Jeanne Baker served as trustee,

⁴ Because the trust is governed by Arizona law, we apply Arizona law to substantive issues and Minnesota rules and law to procedural matters. *See Davis v. Furlong*, 328 N.W.2d 150, 153 (Minn. 1983) (stating that the law of the forum governs matters of procedure).

approximately \$253,053.74 of principal was unaccounted for.” The district court did not allow Evans to recover that amount, however, because it found that the evidence in the record was “insufficient to show that anyone took any specific amount of principal from the trust . . . and spent it in any specific manner.”

Arizona has a comprehensive statutory chapter on trusts. Ariz. Rev. Stat. tit. 14, ch. 11 (2009). In the absence of a statute or other common-law interpretation, however, Arizona trust law is governed by the Restatement (Second) of Trusts. Ariz. Rev. Stat. § 14-10106 (2009); *see also In re Naarden Trust*, 990 P.2d 1085, 1087 (Ariz. Ct. App. 1999). Under Arizona law, a trustee has the fiduciary duty to “administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries.” Ariz. Rev. Stat. § 14-10801 (2009); *see also Minn. Title Co. v. Congress Indus., Inc.*, 570 P.2d 491, 493 (Ariz. 1977) (“Arizona law requires the trustee to follow the instructions of the trust instrument.”).

If a trustee violates a duty she owes to a beneficiary, a court may, among other remedies, “[c]ompel the trustee to redress a breach of trust by paying money, restoring property or other means” or “impose . . . a constructive trust on trust property or trace trust property wrongfully disposed of and recover the property or its proceeds.” Ariz. Rev. Stat. § 14-11001 (2009). The measure of damages for a breach of trust is “[t]he amount required to restore the value of the trust property and trust distributions to what they would have been had the breach not occurred.” Ariz. Rev. Stat. § 14-11002 (2009).

While the district court’s findings as to the value of the missing assets are not clearly erroneous, its legal conclusion that missing records preclude recovery of the

undisputedly missing assets is incorrect. The district court applied certain relevant principles of Arizona trust law, but implicitly placed the burden on Evans to prove not only that Baker had breached her duties as trustee, but also to show where the missing assets went during the time that Evans had no control over trust records.

Before analyzing Evans's claims using the proper burdens of proof, we address Smith's individual liability for the pre-2004 portion of Evans's claim. The district court found, and neither party disputes, that Baker alone acted as trustee before Smith took over as her agent in May 2005. Smith was therefore not responsible for any missing principal before that time or for Baker's failure to maintain proper trust records. Smith therefore should not incur any *individual* liability for the pre-2004 missing assets.

Under Arizona law, a party seeking to surcharge a trustee "has the burden of proving that the trustee breached the applicable fiduciary duty." *Shriners Hosps. for Crippled Children v. Gardiner*, 733 P.2d 1102, 1105–06 (Ariz. Ct. App. 1986), *vacated on other grounds*, 733 P.2d 1110 (Ariz. 1987). "Once the party petitioning for surcharge establishes a *prima facie* breach of trust, the burden of persuasion shifts to the trustee to either produce rebuttal evidence or to present a good defense." *Id.* at 1106.

Evans's forensic analysis of the available records showed, and the district court found, that principal went missing from the trust before 2004. The terms of the trust unambiguously prohibited distributions of principal from the Marital Election or Decedent's trusts, and Baker therefore breached her duties as trustee to administer the trust in accordance with its terms. *See* Ariz. Rev. Stat. § 14-10801. The district court's

findings support the conclusion that Evans, as the petitioner for surcharge, met her burden of proving a *prima facie* breach of trust.

Because Evans made a *prima facie* showing, the burden of persuasion then shifts to Smith, as Baker's agent and as personal representative of Baker's estate, to show that no breach of trust occurred "or to present a good defense." *Shriners*, 733 P.2d at 1106. Because principal was wrongfully missing from the trust, Smith cannot show that no breach of trust occurred.

Moreover, Smith has not presented a good defense for the breach of trust. She does not dispute that principal went missing from the trust before 2004, but contends that missing documentation precludes liability for that breach of trust. We find no merit to this contention. Evans asserted, and the district court found, that approximately \$253,053.74 of trust principal vanished in the period before 2004; a determination of where exactly the money went would be helpful, but is ultimately irrelevant. Smith has not met her burden of persuasion that the breach of trust should be excused.

Further, the reason that the missing principal is untraceable is because Baker lost, discarded, or destroyed trust records. While we recognize that these actions may not have been taken in bad faith, Baker, as trustee, had the fiduciary duty to "keep and render clear and accurate accounts with respect to the administration of the trust." Restatement (Second) of Trusts § 172 (1959); *see also John E. Shaffer Enters. v. City of Yuma*, 904 P.2d 1252, 1255–56 (Ariz. Ct. App. 1995) (discussing Restatement (Second) of Trusts § 172), *review denied* (Ariz. Oct. 24, 1995). A trustee who fails to keep proper records is "liable for any loss or expense resulting from that failure" and "[a] trustee's failure to

maintain necessary books and records may also cause a court in reviewing a judicial accounting to resolve doubts against the trustee.” Restatement (Third) of Trusts § 83 cmt. a(1) (2007).⁵

Under these circumstances, the district court’s finding that Smith and Baker “substantially fulfilled their duty to maintain records of the Trust” is clearly erroneous. The trust and its beneficiaries should not be penalized for missing trust records that were entirely under Baker’s control. Rather, we believe that the loss should be borne by those responsible for losing or discarding the records.

We therefore conclude that the district court erred in failing to place any burden on Smith to show that a good defense existed for the breach of trust. The record is clear that assets went missing from the trust before 2004 and Evans conducted a thorough forensic investigation with the limited records available. The district court accepted Evans’s opinion that \$253,053.74 was missing from the trust before 2004, and we conclude that the lack of records should not preclude Evans from recovering this amount. We therefore reverse the district court’s denial of this portion of Evans’s claim.

II. Laches

Evans also challenges the district court’s determination that she was not entitled to recover trust principal missing before 2004 under the equitable doctrine of laches.

⁵ We note that Arizona’s statutory chapter on trusts directs courts to apply the Restatement (Second) of Trusts in the absence of a statute or other common-law interpretation. Ariz. Rev. Stat. § 14-10106. Section 83 of the Restatement (Third) of Trusts, however, is substantially similar and not inconsistent with section 172 of the Restatement (Second) of Trusts § 172. Moreover, section 83 of the third Restatement has recently been cited with approval by the Arizona Court of Appeals. *In re Estate of Peters*, No. 1 CA-CV 07-0869, 2009 WL 2411439 (Ariz. Ct. App. Aug. 6, 2009).

Appellate courts in both Minnesota and Arizona review a district court's laches determination for abuse of discretion. *In re Marriage of Opp*, 516 N.W.2d 193, 196 (Minn. App. 1994), *review denied* (Minn. Aug. 24, 1994); *McLaughlin v. Bennett*, 238 P.3d 619, 621 (Ariz. 2010). "Absent erroneous interpretation of the law or clearly erroneous factual underpinnings, the trial court's [laches] determination can be overturned only if its decision represents an unreasonable judgment in weighing relevant factors." *McComb v. Superior Court*, 943 P.2d 878, 885 (Ariz. Ct. App. 1997) (quotation omitted).

"Laches will generally bar a claim when a delay is unreasonable and results in prejudice to the opposing party." *Sotomayor v. Burns*, 13 P.3d 1198, 1200 (Ariz. 2000). To determine whether a delay was unreasonable, Arizona courts "examine the justification for the delay, including the extent of plaintiff's advance knowledge of the basis for the challenge." *League of Ariz. Cities & Towns v. Martin*, 201 P.3d 517, 519 (Ariz. 2009) (quotation omitted). "The delay must also result in prejudice, either to the opposing party or to the administration of justice, which may be demonstrated by showing injury or a change in position as a result of the delay." *Id.* (citation omitted). To determine whether laches should apply to bar a trust beneficiary's claim, courts consider "whether the beneficiary knew or had reason to know of the breach of trust." Restatement (Second) of Trusts § 219 cmt. a (1959).

The district court found that laches precluded Evans's claim for pre-2004 missing principal because she was first aware that the trust assets had diminished when she received work papers from Baker in September 2004. According to the district court,

“Evans had ample opportunity to request . . . records when they still existed and/or when Jeanne Baker was still able to provide explanation, but did not do so.” The delay prejudiced the administration of justice, said the district court, “in that it has hampered the parties’ efforts to prove or disprove the validity of the pre-2004 claim.”

Evans asserts that it was reasonable for her to rely on Baker’s explanation for the missing assets and that she had no reason to know that she had a cause of action for missing principal when she received the 2004 work papers. Evans also points out that Smith, after taking over trustee duties from Baker, assured her that no assets were missing.

While we respect the discretion afforded to the district court in making a laches determination, the district court’s conclusion here “represents an unreasonable judgment.” *McComb*, 943 P.2d at 885. Despite Evans’s professional experience as a forensic accountant, she was not the trustee and had no control over the trust assets or records until she became successor trustee in 2008. Evans and her sister received their distribution checks for 15 years presumably without incident, and when Evans questioned Baker about the 2004 work papers it was reasonable for her to rely on Baker’s explanation that she forgot to list two assets. Further, Evans had limited contact with Baker over the years and had no reason to know of the existence or extent of her dementia until Smith began acting as Baker’s agent. Evans had no duty to maintain trust

records and the doctrine of laches should not preclude her from recovering pre-2004 missing principal where the records were solely in the control of Baker and/or Smith.⁶

Thus, the district court abused its discretion in determining that laches barred Evans's claim for principal missing before 2004.

III. Attorney Fees

Evans next challenges the district court's award of attorney fees to both parties. We review an award of attorney fees and costs for an abuse of discretion. *Green v. BMW of N. Am., LLC*, 826 N.W.2d 530, 534 (Minn. 2013).

Arizona law allows a trustee to recover attorney fees only when specifically authorized by statute or agreement of the parties. *In re Balke's Estate*, 206 P.2d 732, 736 (Ariz. 1949). Concerning trusts, Arizona law provides that

A. A trustee or a person who is nominated as trustee is entitled to reimbursement from the trust for that person's reasonable fees, expenses and disbursement, including attorney fees and costs, that arise out of and that relate to the good faith defense or prosecution of a judicial . . . proceeding involving the administration of the trust, regardless of whether the defense or prosecution is successful.

B. A court . . . may order that a party's reasonable fees, expenses and disbursements pursuant to subsection A be paid by any other party or the trust that is the subject of the judicial proceeding.

Ariz. Rev. Stat. § 14-11004 (2009). A determination of "good faith" requires an objective review based on all of the circumstances. *In re Guardianship of Sleeth*, 244

⁶ We also note that applying laches to bar the pre-2004 claim would work an injustice on the other trust beneficiary, Pickett. The record does not reflect that Pickett had any notice of missing records or any accounting experience that would have alerted her to discrepancies in Baker's records.

P.3d 1169, 1176 (Ariz. Ct. App. 2010). “[E]vidence of a benefit to the [trust] may indicate good faith and is a factor to be considered, just as the lack of benefit may reflect the absence of good faith.” *Id.*

Smith’s Attorney-Fee Award

Evans contends that the district court erred in determining that \$124,431.04 of Smith’s attorney fees was incurred in “good faith” defense of Evans’s claims and must be paid from the trust. The district court found that, because Smith’s position concerning the pre-2004 missing principal “not only had arguable merit but actual merit,” her defense as it related to that claim was in good faith and she was entitled to attorney fees from the trust for that portion of the defense. We conclude that the district court abused its discretion in awarding Smith attorney fees for two reasons.

First, looking at the district court proceedings as a whole, Smith was not participating in the action in her capacity as trustee or trustee’s agent. The Arizona attorney-fee statute only allows “[a] trustee or a person who is nominated as trustee” to recover attorney fees “that arise out of and that relate to the good faith defense or prosecution of a judicial . . . proceeding involving the administration of the trust.” Ariz. Rev. Stat. § 14-11004. In defending Evans’s claims that she and Baker wrongly spent trust principal, Smith was not acting as a trustee.

Instead, Smith was acting in the interest of Baker’s estate and in her own self-interest as a beneficiary of the Jeanne C. Baker Revocable Living Trust. Smith was not defending Evans’s claims for the benefit of the trust, but rather to benefit Baker’s estate, which would be liable for any surcharge. Our reading of section 14-11004, therefore,

shows that Smith is not entitled to attorney fees under that section. Because no agreement exists between the parties concerning attorney fees, and because no other statute allows Smith to recover such fees, we conclude that Smith is not entitled to recover attorney fees in this matter. *See Balke's Estate*, 206 P.2d at 736.

Second, even if Smith were entitled to recover attorney fees under section 14-11004, an objective view of the circumstances shows that recovery would be improper because her fees were not incurred in “good faith.” Smith repeatedly took the incorrect position that she was allowed to spend principal from the trust for Baker’s care. While she claims that Baker and her attorneys told her she could spend principal, Smith failed to read or even obtain a copy of the trust document after she became Baker’s agent. Further, Smith was successful in defending against Evans’s pre-2004 claim not because the evidence showed no principal missing before 2004, but only because insufficient records existed to trace the missing funds.

Moreover, Smith’s defense of the action was not in good faith because it resulted in no benefit to the trust—if anything, it was detrimental to the trust because the unaccounted-for assets were not recovered. *See Sleeth*, 244 P.3d at 1176 (stating that lack of benefit to the trust may show the absence of good faith). Throughout the litigation, Smith was acting in the interests of herself and Baker’s estate, instead of in the interests of the trust. The district court therefore abused its discretion in awarding \$124,431.04 in attorney fees to Smith and the other respondents, and we reverse that award.

Disgorgement

Evans next contends that the district court erred in declining to order Smith's attorneys to disgorge \$94,077.98 in fees already paid by Smith. Evans argues that disgorgement is warranted because Sather's representation of Smith, Baker's estate, and the Jeanne C. Baker Revocable Living Trust after she had previously represented the trust amounted to a conflict of interest. The district court found that Sather had a conflict of interest, but that all parties knew of Sather's "switching of sides," and concluded that "[w]hile Sather certainly has/had a conflict of interest in representing one side of the case and then the other, said conflict does not compel disgorgement where Sather was open and obvious in doing so and was loyal to each client at the time that she represented them."

The ethical rules governing attorney conduct in Minnesota prohibit an attorney "who has formerly represented a client in a matter . . . [from] thereafter represent[ing] another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing." Minn. R. Prof. Conduct 1.9(a).⁷ If a conflict of interest exists and the former client has not given informed consent to the new representation, the attorney forfeits her right to compensation. *Rice v. Perl*, 320

⁷ Although the trust is governed by Arizona law, because this matter came before a Minnesota court we apply Minnesota law to attorney-conduct issues. See Minn. R. Prof. Conduct 8.5(b)(1) (stating that "for conduct in connection with a matter pending before a tribunal" we apply "the rules of the jurisdiction in which the tribunal sits").

N.W.2d 407, 411 (Minn. 1982) (“This court has repeatedly stated that an attorney (or any fiduciary) who breaches his duty to his client forfeits his right to compensation.”).

While Sather’s conflict of interest was known to all parties, the district court’s conclusion that Sather did not breach any fiduciary duties is incorrect. The district court found that Sather did not breach her duty of loyalty *while* representing the trust. Although this finding may be accurate, Sather’s actions in representing Smith and the other respondents *after* she had represented the trust, without obtaining Evans’s consent, show a clear conflict of interest and breach of the duty of loyalty that would require disgorgement of any fees paid by the trust. The record does not show, however, and Evans does not allege, that any of Sather’s fees were paid out of trust monies or that the trust owes Sather any money.

To the contrary, the record shows that Smith paid for Sather’s services. Any cause of action for disgorgement because of Sather’s breach of fiduciary duty to Smith, Baker’s estate, and the Jeanne C. Baker Revocable Living Trust belongs therefore not to Evans, but to the respondents. *See* Minn. R. Prof. Conduct 1.7(a) (stating that an attorney has a conflict of interest if the representation will be “directly adverse to another client” or “there is a significant risk that the representation . . . will be materially limited by the lawyer’s responsibilities to . . . a former client”).

Smith has not sought disgorgement, however, and does not challenge the district court’s conclusion that disgorgement is unwarranted. We therefore decline to consider disgorgement to Smith based on this conflict of interest. *See City of Ramsey v. Holmberg*, 548 N.W.2d 302, 305 (Minn. App. 1996) (stating that issues decided

adversely to a respondent are not properly before this court if no notice of related appeal has been filed), *review denied* (Minn. Aug. 6, 1996).

The district court's finding that McVay did not have a conflict of interest and need not disgorge any fees is not erroneous. Unlike Sather, McVay did not represent the trust before he began representing Smith and the other respondents in late 2008. Thus, the district court did not abuse its discretion in denying Evans's request to disgorge McVay's fees.

In sum, although the district court abused its discretion in finding that Sather did not have a conflict of interest requiring disgorgement or forfeiture of fees, this error is harmless because Sather has not been paid from the trust and because Smith has not challenged the order. We affirm the determination that Sather and McVay need not disgorge any fees.

Evans's Attorney-Fee Award

Finally, Evans contends that the district court abused its discretion in reducing her claimed attorney fees in light of "the amount involved and the results obtained." Evans acted in good faith in pursuing this action against respondents on behalf of the trust in her capacity as successor trustee, and she is therefore entitled to recover fees under section 14-11004. Because we conclude that the district court erred in not allowing Evans to recover the pre-2004 missing principal, we remand for reconsideration of Evans's attorney-fee award in light of our amended judgment.

IV. Lost-Investment Interest

Finally, Evans argues that the district court erred in applying a lost-investment interest rate of 3.77%, rather than a 6% rate. We review the district court's award of damages for an abuse of discretion. *VanLandschoot v. Walsh*, 660 N.W.2d 152, 156 (Minn. App. 2003); *see also Hughes v. Sinclair Mktg., Inc.*, 389 N.W.2d 194, 199 (Minn. 1986) (stating that a reviewing court will not disturb a damage award "unless its failure to do so would be shocking or would result in plain injustice").

Evans urged the 6% rate to the district court "based on a theoretical investment in a Franklin Fund." Certain trust assets are held in a Franklin Fund, but our review of account statements shows that it most recently has returned only about 4.4% interest. Further, as the district court noted, the trust principal was held in several different funds and accounts, and "it is merely speculative that the principal would have been otherwise invested at all, much less in the Franklin Fund, and that it would have actually earned 6% given current market realities." The district court instead imposed a 3.77% interest rate, based on the average rate from an account where principal was being held. Because the award of interest at 3.77% is not "manifestly and palpably contrary to the evidence," *VanLandschoot*, 660 N.W.2d at 156 (quotation omitted), we affirm the district court's application of a lost-investment interest rate of 3.77%.

V. Conclusion

We reverse the district court's award of \$124,431.04 in attorney fees to respondents. We also reverse the district court's determination that Evans is not entitled to recover pre-2004 missing assets and direct entry of an amended judgment for Evans

that includes an additional \$253,053.74, along with applicable statutory pre-judgment interest and lost-investment interest calculated at 3.77%. Smith shall have no individual liability for this additional judgment, but Baker's estate and the Jeanne C. Baker Revocable Living Trust shall share joint and several liability. On remand, the district court shall reconsider Evans's attorney-fee award in light of the amended judgment. The district court's decision is affirmed in all other respects.

Affirmed in part, reversed in part, and remanded.