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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SIX

FRANK E. McGINITY, Plaintiff and Respondent, v. EUGENE ST. JOHN, JR. et al., Objectors and Appellants; SALLY ST. JOHN, Beneficiary and Respondent.	2d Civil No. B276982 (Super. Ct. No. 1035233) (Santa Barbara County)

This appeal involves a trust. But trust among the parties is not present here. The trustor's widow receives the income for her life, and the trustor's children from a prior marriage receive the remainder. The children objected to the trustee's accounts and his petition to borrow money secured by the trust corpus. The trial court approved the trustee's accounts and petition. The court also found the children's objections were made without probable cause and in bad faith. The court awarded attorney fees and costs to the trustee and life beneficiary. We affirm.

FACTS

In February 1984, Eugene St. John created a living trust. The corpus for the trust was almost entirely composed of two apartment buildings. The Strathmore building in Westwood has 121 units. The Laguna Del Rey building has 124 units.

In 1997, St. John borrowed against the two apartment buildings to provide the trust with liquidity. The lender required that the buildings be held by an entity other than the trust. St. John placed each building in a separate limited liability company (LLC). The LLCs were transferred into the trust.

Originally St. John was the sole trustee. In 1998, he added Frank McGinity as cotrustee. When St. John became incapacitated in 2001, McGinity became sole trustee. He remains so today. McGinity is also the sole manager of the LLCs.

St. John's Death

St. John died in 2005, leaving a widow, Sally St. John, now 80 years old, and three adult children by a prior marriage, Cecile St. John Mesirov, Eugene M. St. John, Jr., and Tracy Ann St. John (collectively "the Children").[1]

The trust provides that on St. John's death a 20 percent interest in the LLCs is to be distributed to the Children free of the trust. Of the 80 percent in the trust, 100 percent of the income is to be distributed to Sally during her life with the remainder to the Children free of the trust upon her death. Currently Sally receives approximately $1.4 million annually

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[1] We hereafter refer to Sally St. John and the Children by their first names, not from disrespect, but to ease the reader's task.

from the trust. All of the income is sheltered from state and federal taxes by depreciation.

McGinity's Administration

While St. John lived, he deferred maintenance on the buildings. After his death, McGinity pursued an aggressive program to maintain and improve the properties. Rather than reduce income from the properties to create a reserve, McGinity borrowed money against the properties to carry out his program of capital improvements.

In 2007, McGinity was faced with borrowing a significant amount of money for capital improvements. He met with the beneficiaries to obtain an agreement on how the expenses should be allocated. The parties agreed that the first $900,000 would be divided equally between income and principal. Any amount above that would be allocated to principal. In other words, $450,000 would be taken from Sally's income; the rest would be charged against the Children's remainder. McGinity has continued to follow that agreement.

All the beneficiaries objected to McGinity's tenth accounting, covering the calendar year 2008. Among the numerous objections was that McGinity was borrowing to inflate his trustee's fees. The dispute resulted in a settlement agreement approved by the court in May 2011. The settlement agreement contains a formula for determining the total amount of McGinity's fees, currently approximately $500,000 per year. It further provides that McGinity will not borrow money against the properties without the consent of all beneficiaries or approval of the court.

In 2012, the Children proposed to purchase a 30 percent interest in the LLCs from Sally. The purpose of the proposal was to save on inheritance taxes when Sally dies. Sally declined the offer, fearing, among other adverse consequences, capital gains taxes.

Accountings and Petition

McGinity filed the fourteenth and fifteenth trust accountings for the years 2012 and 2013. He also filed a petition for instructions authorizing borrowing to refinance an existing loan, plus an additional $5 million to pay for capital expenditures and trust expenses allocated to principal.

The Children objected to the accountings and petition for instructions. The objections were that McGinity was misallocating depreciation; he was failing to maintain proper reserves; he failed to diversify investments; he made an improper request for more borrowing; and he used improper accounting methods for calculating trust income and allocating expenses between income and principal.

Sally did not object to the accountings. She objected to the petition for instructions only insofar as she claimed the interest on the loan should be allocated to principal, not income.

Hearing

(a) McGinity

McGinity testified that all the capital improvements he made were necessary either for safety or competitive purposes or both. He allocated the cost between principal and income according to the agreement of the parties. He believes the agreement is fair to both Sally and the Children.

McGinity said he did not sell one of the buildings to diversify the trust assets because they are uniquely valuable properties and any sale would generate capital gains taxes. He estimated the tax would be $10 million. A tax-free exchange would not be beneficial because one has a limited time in which to designate the substitute property and that usually results in paying more for the substitute property than what one receives on the sale of the original property.

McGinity testified he has no personal relationship with Sally. The last time he had an extensive conversation with her was in 2006.

(b) Expert Testimony

McGinity called Ronald Buss, a pricing analyst for real estate, as his expert. Buss is familiar with the buildings owned by the LLCs and has appraised them multiple times.

In 2005, Buss appraised the value of the Laguna property to be $27.750 million. In 2015, Buss appraised the value of the property to be $46.475 million. In 2005, the value of the Strathmore property was $25 million. In 2015, the value was $48.500 million. Buss testified that both properties have "outperformed the market" in both rents and appreciation.

John Rogers, an attorney specializing in estates and trusts, testified as an expert for the Children. Rogers testified McGinity did not properly exercise his discretion with regard to allocating between income and principal. But Rogers admitted that McGinity has not done anything outrageous or egregious or acted in bad faith. Rogers said McGinity should not be surcharged.

Rogers also admitted that McGinity has broad discretion in the way he operates the LLCs and allocates between principal and income. Rogers agreed that it is a common business practice for management to decide whether to retain a reserve out of earnings, and that management is authorized to make that decision.

When Rogers was asked whether he was simply substituting his judgment for that of McGinity, Rogers replied: "To an extent, you could say that. Although that's not how I would put it. Under these circumstances, I believe that the trustee would be better advised to have held a reserve." Rogers admitted that he doubted McGinity had actually breached the trust.

Rogers testified it was wrong to have combined accountings for the LLCs and the trust. It would provide clarity if the accounting for the LLCs were separate from that of the trust.

Eileen Sheridan, the accountant for the LLCs and trust, testified she allocated depreciation to the beneficiaries in accordance with their percentage of ownership. That is the only way allowed under the tax law. She said depreciation is unrelated to whether a reserve is created.

(c) Children

One of St. John's children, Cecile, testified in her deposition as follows:

"Q Just to clarify. You and your siblings wanted to buy an interest in Mrs. St. John's interest in the trust?

"A Correct.

"Q She said no.

"A Correct.

"Q That upsets you.

"A Right.

"Q And that's one of the reasons you filed this lawsuit.

"A That is one of the reasons.

"Q You're saying this is what happens if Sally doesn't sell you a percentage of her interest.

"A Yes. [¶] . . .

"Q And because Sally St. John won't sell you a percentage of her interest in the trust, you and your siblings filed this lawsuit?

"[A] All I can tell you is that this is all of the reason why. Okay?

"Q Why what?

"A Maybe she would pay attention, read, listen, and -- listen to us if this is what it takes. We're serious. We want to protect our assets."

Ruling

The trial court overruled the Children's objections to the accountings. The court also approved McGinity's petition for instructions to obtain the loan. The court found that borrowing has been an appropriate approach to balance Sally's interest in preserving income and the Children's interest in preserving the assets. The court ordered interest on the loan to be charged to the principal. The court also ordered McGinity to provide separate accountings for the trust and the LLCs.

Finally, the trial court ordered the Children to pay Sally's and McGinity's attorney fees and costs. The court found that the Children were motivated to object by a desire to take control of the trust and reduce the amount payable to Sally. The court pointed to Cecile's testimony and found the Children's efforts to distance themselves from their intention disingenuous.

DISCUSSION

I

The Children's opening brief fails to contain a separate statement of facts. (Cal. Rules of Court, rule 8.204(a)(2)(C).) The facts that are stated are scattered throughout portions of the opening brief labeled "Summary of Argument" and "Argument." The brief is confusing because the Summary of Argument is longer than the Argument and raises issues not raised in the Argument. To add to the confusion, it is not clear whether the Children are appealing the trial court's substantive rulings or only the cost and attorney fee award.

What evidence the Children cite is viewed in a light most favorable to themselves. But that is not how we view the evidence. In viewing the evidence, we look only to the evidence supporting the prevailing party. (*GHK Associates v. Mayer Group, Inc.* (1990) 224 Cal.App.3d 856, 872.) We discard evidence unfavorable to the prevailing party as not having sufficient verity to be accepted by the trier of fact. (*Ibid.*) Where the trial court or jury has drawn reasonable inferences from the evidence, we have no power to draw different inferences, even though different inferences may also be reasonable. (9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 376, pp. 434-435.) The trier of fact is not required to believe even uncontradicted testimony. (*Sprague v. Equifax, Inc.* (1985) 166 Cal.App.3d 1012, 1028.)

II

This case comes down to a simple proposition. The Children are objecting that McGinity is adhering to an agreement the Children themselves made. The Children agreed that McGinity would apportion $450,000 of the cost of capital improvements to income. The rest of the costs would be apportioned to principal. That is what McGinity did.

There are only two ways to apportion capital improvement costs to principal: sell at least one of the buildings or borrow against them. McGinity gave cogent reasons why a sale would not be advantageous, including incurring substantial tax liability. That leaves borrowing.

Even in the absence of such an agreement, there would be nothing unfair or illogical in allocating 100 percent of the capital improvement costs to principal. In fact, Probate Code section 16335, subdivision (a)(4) provides that a fiduciary shall charge a disbursement to principal to the extent that the trust or the will and the Probate Code do not provide a rule for allocating the receipt or disbursement to or between principal and income.[2] The Children cite no authority that can even remotely be construed as providing that charging costs for capital improvements to principal constitutes a breach of fiduciary duty. That is where such a charge logically belongs.

III

The Children contend that only the probate court has the power to control the manner in which the trustee exercises his discretion.

The Children cite *Schwartz v. Labow* (2008) 164 Cal.App.4th 417, 427, for the proposition that the probate court has the general power and duty to supervise the administration of trusts. No one disputes that. We cannot discern why the Children raised the contention under a separate heading. Here the trial court in the exercise of that power found no fault with McGinity's administration of the trust.

IV

The Children contend their objections were narrow, specific and material. They argue that each of their objections "consist[s] of subject upon which reasonable minds can differ widely and strongly . . . ."

But to say that reasonable minds can differ proves McGinity's point. The Children concede that McGinity has broad discretion in managing the trust and LLCs. An abuse of discretion occurs where the actions of the party having discretion exceeds all bounds of reason. (See *Estate of Walker* (1963) 221 Cal.App.2d 792, 796.) To argue that reasonable minds can differ

[2] All statutory references are to the Probate Code.

about the appropriateness of McGinity's actions is to admit he did not abuse his discretion.

V

The Children contend that an LLC manager cannot favor one member over another. The Children argue that by borrowing to pay for capital improvements instead of creating a reserve out of income, the trustee is favoring Sally over them.

The Children rely on *Jones v. H.F. Ahmanson & Co.* (1969) 1 Cal.3d 93. In *Jones*, the majority shareholders in a closely held savings and loan association formed a holding company from which the minority shareholders were excluded. The majority transferred their controlling shares in the association to the holding company. The majority then pledged the association's assets and earnings to secure the holding company's debt. This left the minority's association shares unmarketable. A minority shareholder sued for breach of fiduciary duty by the majority.

Our Supreme Court stated: "[M]ajority shareholders, either singly or acting in concert to accomplish a joint purpose, have a fiduciary responsibility to the minority and to the corporation to use their ability to control the corporation in a fair, just, and equitable manner. Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business." (*Jones v. H.F. Ahmanson & Co.*, *supra*, 1 Cal.3d at p. 108.)

Here the trial court found that McGinity's action in borrowing to pay for capital improvements has been an appropriate approach to balance Sally's interest in preserving income with the Children's interest in preserving the assets. The Children claim that *Jones* shows the trial court's finding was wrong. But the Children do not state in what way *Jones* shows the trial court's finding was wrong. The facts in *Jones* are not remotely similar to the facts here. *Jones* has nothing to do with this case. The trial court's finding is amply supported by Buss's testimony that under McGinity's stewardship the apartments have outperformed the market both in appreciation and rent.

VI

The Children contend that they properly challenged McGinity's claim that his capital program was reasonably beneficial to them.

The Children expend much effort in their Summary of Argument attempting to convince us that McGinity's capital expenditures did not benefit them. The Children argue that any increase in the value of the properties is due to such factors as the general appreciation in the market and rent-controlled units resetting to market rates. The argument is replete with mathematical calculations.

The argument has a number of flaws: The argument belongs, if anywhere, at the trial court. It is not an appropriate argument before an appellate court. The argument is made for the first time on appeal; it relies on a view of the evidence favorable to the Children; and it is based on assumptions not supported by the evidence, an example of which is that rent-controlled units would have reset to market rates without the capital improvements.

When the evidence is properly viewed in a light most favorable to the judgment, we must credit McGinity's testimony that all the capital improvements were necessary and Buss's testimony that under McGinity's stewardship the buildings outperformed the marketplace in both rents and appreciation. Thus, the credible evidence shows the children received a substantial benefit from McGinity's capital improvement program.

VII

The Children contend their objections were neither frivolous nor in bad faith. Thus, they claim the trial court erred in awarding costs and attorney fees against them.

Section 17211, subdivision (a) provides in part: "If a beneficiary contests the trustee's account and the court determines that the contest was without reasonable cause and in bad faith, the court may award against the contestant the compensation and costs of the trustee and other expenses and costs of litigation, including attorney's fees, incurred to defend the account. . . ."

The Children argue that section 17211 requires both lack of probable cause and bad faith. There is substantial evidence to support both findings.

Concerning lack of probable cause, the Children had agreed to the apportionment of capital costs they are challenging; even in the absence of an agreement, the Children provide no authority or even make a credible argument that charging principal with the cost of capital improvements is in any way wrongful; even the Children's own expert testified McGinity was not in breach of the trust; and the Children admit on appeal that reasonable minds could differ on the matters that are the subject of the Children's objections.

It is true the trial court ordered the trustee to account separately for the trust and the LLCs. But a separate accounting was far from the substance of the Children's objections. Such an insubstantial victory does not imbue the Children's objections with probable cause.

The Children cite *Soukup v. Law Offices of Herbert Hafif* (2006) 39 Cal.4th 260, 292, for the proposition that bad faith requires ill will or some other ulterior motive. There is ample evidence of bad faith. One of the children testified that one of the reasons they filed the lawsuit is because Sally would not sell them a 30 percent interest. Cecile said, "Maybe she would pay attention . . . listen to us if this is what it takes." This admission under oath appears to be the rationale for this lawsuit. McGinity had been apportioning capital improvements to principal for years, and the Children made no objection until Sally rejected their offer to buy a 30 percent interest. Finally the lack of probable cause is additional evidence that the objections were raised in bad faith.

The judgment (order) is affirmed. Costs on appeal are awarded to respondents.

NOT TO BE PUBLISHED.

GILBERT, P. J.

We concur:

YEGAN, J.

PERREN, J.

Colleen K. Sterne, Judge

Superior Court County of Santa Barbara

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