No. 94918-2

SUPREME COURT
OF THE STATE OF WASHINGTON

In re the Marriage of:

STEPHANIE F. FERGUSON (f/k/a VANDAL),

Respondent,

v.

JOSEPH H. VANDAL,

Petitioner.

ANSWER TO PETITION FOR REVIEW

SMITH GOODFRIEND, P.S.

By: Valerie Villacin
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A. Relief Requested by Respondent.

Stephanie Ferguson (f/k/a Vandal), respondent in the Court of Appeals, asks this Court to deny Joseph Vandal's petition for review of Division One's June 19, 2017 unpublished decision. The Court of Appeals decision affirming the trial court's characterization of the business owned by the husband when the parties married does not conflict with any decisions of this Court or the lower appellate courts. RAP 13.4(b)(1),(2). Nor does the Court's decision raise any issues of substantial public interest warranting review. RAP 13.4(b)(4). Petitioner's claim that review is warranted under any of the bases in RAP 13.4(b) is premised on a strained view of the current state of the law and a loose grasp of the facts of the case.

This Court should deny review, and as the Court of Appeals did, award respondent her fees incurred in answering the petition. RAP 18.1(j)

B. Restatement of the Case.

The parties were married on August 4, 2000. (RP 19) The husband owned and worked for Joseph H. Vandal, CPA, P.S. ("the business"), which he had begun as a sole proprietorship in 1989 and incorporated in 1991. (RP 854) According to the child support order entered in the dissolution of the husband's previous marriage in

April 2000, four months before the parties married, the husband had annual income from the business of $60,000. (Ex. 211) By the time the parties separated in August 2014,[1] the husband was earning an average of $318,017 annually from the business, which purported to pay him an annual salary of $70,000. (RP 877-78, 880)

The trial court valued the business at $446,000, based on its goodwill of $407,356 and net tangible assets of $38,363. (Finding of Fact (FF) 2.8.2.9, CP 394 *unchallenged*; CP 84) The trial court found the "value of the business is almost entirely based on the goodwill generated by the Respondent. Both valuation experts, Steven J. Kessler for the Petitioner and Douglas S. McDaniel for the Respondent, as well as the Respondent himself, testified that the clientele of the business and thus its goodwill required constant renewal which was accomplished by the community labor of the Respondent." (FF 2.8.2.5, CP 394) The trial court found "the husband's salary of approximately $70,000 per year, as he historically paid himself, was recognized by both experts and by the Respondent himself as inadequate to compensate the community for his labor." (FF 2.8.2.6, CP 394)

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[1] The parties separated after the husband was arrested for domestic violence against the wife, who required surgery for the injuries she sustained as a result of the husband's assault. (RP 81-88)

The net tangible assets, which comprised only a small portion of the value of the business, included bank accounts that were historically used for both business expenses and personal expenses. (CP 85, 228) The trial court expressed concern with the husband's use of the funds in these accounts in the months following separation, even after financial restraints were entered.[2] The trial court found, "it appears that the husband withdrew approximately $130,000 from various accounts post-separation and in violation of the financial restraints. The most efficient way to account for this is to award the husband all of these accounts [ ] at their value at the date of separation." (CP 240-41)

The trial court found while the business had been a separate asset when the parties first married, "over the 14 years of marriage, the business lost its characterization as the Respondent's separate property. It is not possible to trace what separate portion, if any, can

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[2] Among other expenditures, the husband used the funds in the business checking account to pay bail for his domestic violence arrest, his divorce attorney's fees, and designer clothes for himself and a woman he had met a few months before the parties separated. (RP 958-63; Ex. 26 at 84, 86, 87, 91, 94, 99) Even after financial restraints were entered, the husband used the business funds to buy gifts for a woman he was dating, including a $9,275 "move-in" ring from Tiffany's. (CP 518-27; RP 966-67, 973; Ex. 26 at 100, 111) He also spent money on on-line horse racing, paid his criminal attorney for his domestic violence assault, and pre-paid rent for the house he was sharing with his girlfriend. (RP 966-71, 973; Ex. 26 at 99, 100, 104, 105, 111, 122)

be segregated from the overwhelming community ownership. Therefore, the Court concludes that this is wholly community property." (FF 2.8.2.7, CP 394)

In support of its determination, the trial court found "subsequent to and during the marriage, there was not a clear separation of the monies paid into or paid from the business. Community monies from lines of credit were paid into the business, although the amounts cannot be determined." (FF 2.8.2.3, CP 393) The trial court noted, "many of the community and family expenses were paid through the business during the marriage, including both the business and personal lease payments and expenses for use of vehicles for both spouses. The Respondent characterized these monies as loans and stated that the accounts were reconciled at the end of the year, but no financial records or other concrete evidence was offered to support this assertion and the Court does not find his testimony to be credible." (FF 2.8.2.4, CP 393-94)

The trial court found that the marital estate, worth approximately $1 million, was entirely community property, including the business. (*See* FF 2.8, CP 392-96, *challenged in part*) The trial court divided the community property equally and awarded the wife spousal maintenance for six years.

The husband appealed. Division One of the Court of Appeals affirmed the trial court's decision in an unpublished decision on June 19, 2017. Division One rejected the husband's challenge to the characterization of the business as community property because "the trial court's findings regarding commingling, goodwill, and compensation to the community are supported by substantial evidence. The majority of the business's value was derived from goodwill. This goodwill was created by Joseph's labor and was a community asset. Joseph did not adequately compensate the community for his toil. And, he did not produce records at trial to show that community and business funds were treated separately. Therefore, we conclude that there was clear, cogent, and convincing evidence to overcome the presumption of separate property. The trial court did not err in characterizing the business as community property." (Opinion 9-10)

Division One also rejected the husband's argument that the trial court's decision awarding him the business accounts based on their value on the date of separation and as part of the business was "double counting." The Court noted the husband "never provided records that could identify the exact funds he claims were counted

twice, [therefore], we conclude that the trial court did not abuse its discretion." (Opinion 11)

Division One awarded the wife attorney fees under RCW 26.09.140, concluding that she has the financial need and the husband has the ability to pay. (Opinion 15-16) The Court denied the husband's request to publish its decision on July 31, 2017.

C. Grounds for Denial of Review.

1. Review is not warranted under RAP 13.4(b)(4). The burden of proof to establish a change in character of property is well-established and the Court of Appeals applied the correct burden.

Review is not warranted to answer a "currently unanswered question" following this Court's decision in *in Estate of Borghi,* 167 Wn.2d 480, 219 P.3d 392 (2009) – "what proof is required to change the characterization of property in the marital estate once that characterization is established as separate?" (Petition 9) There was nothing left "unresolved" by this Court's decision in *Borghi,* which is not "ambiguous" and did not create "uncertainty." (Petition 9-14) The husband's argument otherwise is premised on a deliberately flawed reading of the *Borghi* decision.

In *Borghi,* this Court held that "when it is once made to appear that property was once of a separate character, it will be presumed

that it maintains that character until some direct and positive evidence to the contrary is made to appear." 167 Wn.2d at 484, ¶ 8. This was not a new principle, as this Court relied on its decision from nearly 100 years earlier, *Guye v. Guye,* 63 Wash. 340, 115 P. 731 (1911). The Court of Appeals decision affirming the characterization of the business as community property in the unpublished decision here is wholly consistent with both *Borghi* and *Guye,* expressly concluding "that there was clear, cogent, and convincing evidence to overcome the presumption of separate property." (Opinion 10)

To the extent there was any "uncertainty" about the difference between "direct and positive evidence" and "clear, cogent, and convincing evidence," this Court resolved that uncertainty by expressly stating in *Borghi* that the "phrase 'direct and positive

evidence' [ ] should be understood as reflecting a 'clear and convincing evidence' standard." 167 Wn.2d at 484-85, n. 4.[3]

The husband nevertheless attempts to concoct an "ambiguity" that this Court should address on the grounds the lead opinion in *Borghi* was signed by only four justices, and "Justice Madsen did not agree, filing a separate concurrence in the 'lead opinion.'" (Petition 13) The husband falsely claims that Justice Madsen concurred with the "four-justice plurality in result and on who bears the burden of rebutting the presumption but specifically declaring that the

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[3] This Court apparently felt it necessary to address this question because 19 Weber, Washington Practice: Family and Community Property Law (1997), noted that the use of both phrases in different cases created uncertainty. *See Borghi,* 167 Wn.2d at 484-85, n. 4. Petitioner claims that this uncertainty still persists because the 2015 revision of Washington Practice "again notes" the same uncertainty. (Petitioner 14) But with the exception of footnotes, the 2015 edition made almost no changes to the sections of the prior edition that raised this uncertainty, and did not address this Court's decision in *Borghi. Compare,* 19 Weber, Washington Practice: Family and Community Property Law (1997), §§ 10.5, 10.6 at 138-40, *with,* 19 Horenstein, Washington Practice: Family and Community Property Law (2015), §§ 10.5, 10.6 at 194-97. This is more likely an editorial oversight, rather than evidence of "continuing uncertainty." That no uncertainty persists is evident by any number of intermediate appellate court decisions, published and unpublished, acknowledging that "direct and positive evidence" is the same as "clear and convincing evidence," all citing *Borghi. See e.g. Morgan v. Briney,* ___ Wn. App. ___, ___ P.3d ___ (Sept. 18, 2017)("Lindemann phrases the burden of proof as 'direct and positive' evidence, but the Supreme Court has indicated that we should conclude that burden is equal to the more general 'clear and convincing' standard."); *Marriage of Shapiro,* 175 Wn. App. 1007 (2013) (unpublished) ("The term 'direct and positive evidence' equates to a 'clear and convincing evidence' standard."); *Marriage of Triggs,* 163 Wn. App. 1016 (2011) (unpublished) ("'Direct and positive evidence' corresponds to the 'clear and convincing' standard applied to presumptions in modern community property cases.").

quantum of proof issue need not be reached, referencing the earlier 'direct and positive evidence' test in a way that showed she did not yet conclude it was the same as the clear and convincing test." (Petition 11, fn. 7)

But, contrary to the husband's claim, Justice Madsen did not "specifically declare" that the quantum of proof issue need not be reached. Instead, Justice Madsen wrote separately because she did "not believe this case requires us to decide what *type of evidence* is sufficient to overcome the separate property presumption." *Borghi,* 167 Wn.2d at 492, ¶ 20 (concurrence) (emphasis added). Specifically, Justice Madsen "declared" it was not necessary for the lead opinion to say "that only a writing may serve as evidence in determining whether Ms. Borghi intended to transform her separate property into a community asset." *Borghi,* 167 Wn.2d at 492, ¶ 20 (concurrence).

Contrary to the premise of the petition, Justice Madsen's concurrence clearly reached the "quantum of proof issue," stating "once established, separate property retains its separate character unless there is direct and positive evidence of a change in character," and "agree[ing] with the lead opinion that joinder of Bobby Borghi on a fulfillment deed issued during marriage does not, by itself,

demonstrate a sufficiently clear intent by Jeanette Borghi to transform her separate property into community property." *Borghi,* 167 Wn.2d at 492, ¶ 19 (concurrence).

Further, it is not true that Justice Madsen's reference to the "direct and positive evidence" test was somehow a sign that Justice Madsen "did not yet conclude it was the same as the clear and convincing test," as did the lead opinion. (Petition 11, fn. 7) In fact, Justice Madsen cited *Marriage of Skarbek,* 100 Wn. App. 444, 997 P.2d 447 (2000), for the "direct and positive evidence" test, which holds, "once established, separate property retains its separate character unless changed by deed, agreement of the parties, operation of law, or some other *direct and positive evidence* to the contrary. [ ] The burden is on the spouse asserting that separate property has transferred to the community to prove the transfer by *clear and convincing evidence,* usually a writing evidencing mutual intent." 100 Wn. App. at 447-48 (citations omitted) (emphasis added).

As the "proof required to change the characterization of property in the marital estate once that characterization is established as separate" is well-established, and the Court of Appeals decision is consistent with that precedent, there is no need for this Court to grant review to "resolve this issue." (Petition 14)

2. Review is not warranted under RAP 13.4(b)(1), (2). The Court of Appeals decision is wholly consistent with cases addressing when a separate property business may be transmuted to community property.

Review is not warranted because the Court of Appeals decision does not conflict with any cases addressing the circumstances where a separate property business will be transmuted to community property. (Petition 12, 15-17) Husband's argument otherwise is based on a distorted reading of the Court of Appeals' unpublished decision and the facts on which it relied.

Contrary to the husband's claim, the Court of Appeals did not conclude that the husband's separate property business lost its separate character due solely to inadequate compensation to the community. (Petition 15) Instead, it was due to the "clear, cogent, and convincing evidence" at trial that the majority of the value of the business – its goodwill – was entirely attributable to the community, and because the husband failed to meet his burden of tracing the commingled business accounts to a separate source. (*See* Opinion 10)

The Court of Appeals decision does not conflict with this Court's decision in *Marriage of Elam,* 97 Wn.2d 811, 650 P.2d 213 (1982), which holds that any "increase in the value of separate property is presumed to be separate property. This presumption

may be rebutted by direct and positive evidence the increase is attributable to community funds or labors." (Petition 10, quoting *Elam,* 97 Wn.2d at 816). In fact, the Court's decision is wholly consistent with *Elam.*

The Court of Appeals noted that "goodwill is often defined as an expectation of continued patronage." (Opinion 6, *citing Marriage of Hall,* 103 Wn.2d 236, 239, 692 P.2d 175 (1984)) Consistent with *Elam,* the wife presented direct and positive evidence that the business' goodwill was entirely attributable to the community. The Court pointed to the husband's testimony that "his clients do not have much loyalty to him;" "every year the business has to go out for bid;" and "he gets new clients [by] just going out there, shaking hands." (Opinion 8) Accordingly, "Joseph's client base had constant turnover, requiring him to constantly go out and form new relationships with new clients. Joseph's toil was community labor." (Opinion 8) Based on this evidence and the fact the husband "presented no evidence of the value of the business' goodwill prior to the marriage. He could have produced records to establish that the company's goodwill was not the result of his own labor. But, he did not do so" (Opinion 8), the Court of Appeals properly concluded

"there was clear, cogent, and convincing evidence to overcome the presumption of separate property." (Opinion 10)

The remaining value of the business was its net tangible assets, consisting of commingled bank accounts. The husband misrepresents the Court of Appeals decision by claiming that it "allows a different analysis for addressing community contributions to a separate business and a more relaxed standard for converting separate property to community property [ ] when it holds that 'the extensive commingling of funds suggests that the business lost its nature as separate property.'" (Petition 11) As this Court has long held, commingled funds are presumed to be community property, and the burden is on the spouse to clearly and convincingly trace them to a separate source. *Estate of Smith,* 73 Wn.2d 629, 631, 440 P.2d 179 (1968); *Mumm v. Mumm*, 63 Wn.2d 349, 352, 387 P.2d 547 (1963); *Estate of Allen*, 54 Wn.2d 616, 622, 343 P.2d 867 (1959); *Estate of Binge*, 5 Wn.2d 446, 466, 105 P.2d 689 (1940).

Consistent with these decisions, once the wife presented evidence that community funds, in the form of unpaid community income and draws from a community line of credit, were commingled with business funds, the burden shifted to the husband to "clearly and convincingly trace them to a separate source." The

Court of Appeals properly noted the husband failed to meet this burden because any records proving segregation "would have been in Joseph's control, yet he – a CPA – did not produce them. We conclude that the extensive commingling of funds suggests that the business lost its nature as separate property." (Opinion 6)

The husband claims that his failure to prove that the value of the business was attributable to something other than community efforts and his failure to trace the net tangible assets to a separate source must be overlooked because the community was compensated by the business paying the community's expenses. (Petition 15- 17) But "the rule is well settled that, where the separate property in question is an unincorporated business with which personal services ostensibly belonging to the community have been combined, all of the income or increase will be considered as community property in the absence of a contemporaneous segregation of the income between the community and the separate estates." *Smith*, 73 Wn.2d at 630-31; *Estate of Witte,* 21 Wn.2d 112, 128, 150 P.2d 595 (1944); *Salisbury v. Meeker,* 152 Wash. 146, 147-48, 277 P. 376 (1929); *Estate of Buchanan,* 89 Wash. 172, 180, 154 P. 129 (1916).

Petitioner's claim that the community was adequately compensated because it drew funds from the business to pay

community expenses is irrelevant absent contemporaneous segregation - which indisputably was not done. For instance, in *Pollock v. Pollock*, 7 Wn. App. 394, 499 P.2d 231 (1972), the Court of Appeals held that the husband failed to meet his burden proving that his separate property business properties had not been converted to community property when he failed "to allocate to the community of what in effect would be a reasonable salary for his services." 7 Wn. App. at 401. It was irrelevant in *Pollock* that the husband drew from the business to pay "business and personal expenditures, including household expenses." 7 Wn. App. at 402. The Court held that in the "absence of a contemporaneous segregation of the income between the community and the separate estates [ ], the acquisition of assets after marriage, even if from the proceeds of his unsegregated business or control account, must be deemed made from community income." *Pollock,* 7 Wn. App. at 402; *See also Lindemann v. Lindemann,* 92 Wn. App. 64, 74, 76, 960 P.2d 966 (1998) (the full value of male cohabitant's separate property business was community property even though he produced "evidence of draws and checks he wrote from his business account to pay for family expenses" because he made "no discernible effort to segregate the income attributable to his community labor from any rents, issues,

and profits inherently arising from his incorporated business"), *rev. denied*, 137 Wn.2d 1016 (1999).

The husband nevertheless claims that the Court of Appeals decision conflicts with cases from this Court he claims hold that "additions to the separate property of the spouse may be compensated for by withdrawals for living expenses." (Petition 16) But those cases are inapt because, unlike here, in each this Court concluded that the community was compensated *and* the assets could be traced to a separate source. *State ex rel. Van Moss v. Sailors*, 180 Wash. 269, 276, 39 P.2d 397 (1934) (Petition 15) (assets of the business were "the same kind and character today" as those originally contributed to it and "capable of identification and division as was the property that went into it")[4]; *Toivonen v. Toivonen*, 196 Wash. 636, 643, 84 P.2d 128 (1938) (Petition 16) (funds in account

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[4] In *Van Moss*, the husband claimed that stock that was originally his separate property was community property due to his efforts in the business in order to avoid garnishment by a creditor for his separate debt. This Court concluded that the stock did not lose its character as separate because the community was compensated for the husband's efforts by the business paying the community's expenses. In making its decision, this Court acknowledged that it was "confining ourselves to the facts in this case," and that each case must "be taken into consideration the sources from which the property came, the intention of the parties, the acts expressive of their intention, the extent, effect, and result of the commingling, and the ease or difficulty of tracing, identifying, and segregating the property, and, no doubt, other elements under peculiar circumstances." *Van Moss*, 180 Wash. at 277.

used to pay community living expenses was separate property of husband because only deposits to account were net proceeds of his separate property rental); *Estate of Binge,* 5 Wn.2d 446, 498-99, 105 P.2d 689 (1940) (Petition 16) (real property was husband's separate property as it was paid for from an account in which the only deposits were his separate property proceeds); *see also Marriage of Pearson-Maines,* 70 Wn. App. 860, 867, 855 P.2d 1210 (1993) (Petition 16) (separate property insurance proceeds did not become community property because it was deposited in an account with community funds when "the sources of the deposits can be traced and apportioned, and the use of withdrawals for separate or community purposes can be identified, the funds are not so commingled that the account itself becomes community property").

Finally, there is no need to "clarify the rule to the benefit of thousands of persons engaged in their separate, creative, innovative, or professional enterprises." (Petition 17) If a spouse who owns a separate property business wishes to ensure that the business retains its character, "the rule" was set out in *Pollock,* and has been followed ever since:

> The rule is that if plaintiff seeks to retain the separate character of income derived from a combination of his separate business and his post-marital personal services with respect thereto, he is required to make a

> contemporaneous segregation of the income so derived as between the community and his separate estate. This can be accomplished by the allocation to the community of what in effect would be a reasonable salary for his services. The allocation in the nature of a salary is then considered community income, and the balance of his income remains his separate property.

7 Wn. App. at 401. The Court of Appeals' unpublished decision is wholly consistent with cases addressing when a separate property business may be transmuted to community property and review therefore is not warranted.

3. Review is not warranted to review the Court of Appeals decision on issues that husband failed to adequately brief in the Court of Appeals.

This Court should deny review to address fanciful issues that the husband failed to adequately address in the trial court and in the Court of Appeals. (Petition 18-20) For instance, the husband complains that the trial court "double counted" by crediting him with the value of the business accounts on August 2, 2014, the date of separation, and including the accounts in valuing the business, based on the accounts' values as of December 31, 2014. (Petition 18) There was no evidence any of the funds in the accounts on December 31, included any of the funds that were in the accounts on the date of separation over which the husband had sole control. (*See* Exs. 24, 25, 26) Despite the trial court inviting the husband to prove his

"double counting" claim, the husband never sought to prove that any of the "cash" in the business valuation included funds awarded to him in the accounts as of the date of separation. (*See* RP 1172, 1186-88) In rejecting the husband's "double counting" argument on appeal, the Court of Appeals noted that the husband did not "attempt to identify and trace the allegedly double counted funds" in the trial court and he "still has not identified and traced these funds on appeal." (Opinion 10) Therefore, the Court concluded, "because Joseph never provided records that could identify the exact funds he claims were counted twice, we conclude that the trial court did not abuse its discretion." (Opinion 11)

Finally, this Court should reject the husband's argument that this Court adopt a "golden goose rule of reasonableness" – and "address the reasonableness of interim orders placing 'financial controls' on a separately owned and operated business and its bank accounts." (Petition 19-20) The husband never challenged any of the temporary financial restraining orders entered by the trial court. Nor could he, since he freely violated those orders - not to "operate and maintain [the business]' financial health" (Petition 20) – but to fund his lifestyle and buy presents for his girlfriend. Even were the "golden goose" argument viable and preserved, this would be a

particularly bad case in which to address the concept given the husband's blatant misconduct.

4. This Court should award the wife attorney fees for having to respond to this petition.

The Court of Appeals awarded the wife attorney fees based on her need and the husband's ability to pay under RCW 26.09.140. (Opinion 15-16) This Court should also award her attorney fees for having to respond to the husband's petition in this Court. RAP 18.1(j).

D. Conclusion.

This Court should deny review and award attorney fees to the respondent.

Dated this 29 day of September, 2017.

SMITH GOODFRIEND, P.S.

By: _____
Valerie Villacin
WSBA No. 34515

Attorneys for Respondent

DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on September 29, 2017, I arranged for service of the foregoing Answer to Petition for Review, to the court and to the parties to this action as follows:

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DATED at Seattle, Washington this 29th day of September, 2017.

Peyush Soni

SMITH GOODFRIEND, PS

September 29, 2017 - 1:15 PM

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