

Cross-App. Reply

NO.: 35504-3-II

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION II

JAMES JOHANNES, JANE DOE JOHANNES, and the marital
community composed thereof, Appellant

v.

ESTATE OF EVELYN C. JOHANNES, GERALD JOHANNES, Personal
Representative, Respondents,

and

SHERRY K. FERRANTE; KATHLEEN D. YORMARK; JEFFREY W.
JOHANNES; MATTHEW S. JOHANNES; and TIM F. JOHANNES,
Cross Appellants,

and

ESTATE OF EVELYN C. JOHANNES, GERALD JOHANNES, Personal
Representative, Cross Respondents.

REPLY BRIEF OF CROSS-APPELLANTS

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1. **Reply to counter statement of the case.**

Gerald Johannes claims there never was a complaint filed by the cross-appellants Sherri K. Farrante, Kathleen D. Yormack, Jeffrey W. Johannes, Matthew S. Johannes and Tim F. Johannes (Johannes grandchildren), when in fact a third party complaint was filed in this action by the Johannes grandchildren against Gerald Johannes (CP 11-13).

References to the last will and testament of Evelyn Johannes that all the income from the testamentary trust was to be paid to James Johannes during his lifetime, and that the trustee had the right pursuant to an ascertainable standard to invade the principal of the testamentary trust for James' benefit, while technically correct, ignores that in the seventeen years since the estate was opened, the trust was never funded and obviously there have been no trust distributions of income or principal to James Johannes. The argument by Gerald Johannes income and principal could have been distributed to James Johannes is meaningless and speculative, since it never happened.

I. ARGUMENT

1. Estate should have been closed by no later than 1993.

Gerald Johannes raises new factual contentions as to why the estate could not have been closed by 1993. In support he cites exhibit 62 and the claim there was a bond transfer error made by the estate's broker, and closing the estate at the end of 1994 would have resulted in a \$20,000 loss to the estate. This is a new theory submitted by Gerald Johannes. There was no testimony from Gerald Johannes he was waiting to resolve these bond issues before closing the estate. There was no testimony from Gerald Johannes the estate needed to be left open to resolve these bond issues. There was no testimony from Gerald Johannes that by closing the estate the trust would have lost the right to recover this alleged \$20,000 discrepancy. It makes no sense an alleged minimal \$20,000 bond issue stopped the closing of the estate, which according to the 706 estate tax return had a gross value in excess of \$1,000,000.

Gerald Johannes also now claims that the estate was not fully liquid until the end of 1994. However, that is directly contrary to the testimony of Gerald Johannes at trial where he admitted the estate was liquid by the end of 1993 (RP 452). Gerald Johannes also wrote a letter on March 31, 1992 to

the attorney for the estate recommending his way to close the estate (Exhibit 22). The estate was not closed at that time because the trustee of the trust established by the will, Puget Sound National Bank, was unwilling to deviate from the terms of the will as Gerald Johannes was proposing. (Exhibit 20). The only expert at trial who testified on the issue of when the estate should have been closed and the trust funded, was Robin Balsam. She believed that the estate could and should have been closed by the summer of 1990 (RP 201). The Johannes grandchildren believe at minimum the estate should have been closed in 1993, since the last non-liquid asset in the estate, the four-plex, was sold in April of 1993.

2. **No income or principal was ever distributed to James Johannes.**

The primary argument of Gerald Johannes is that since James Johannes was the income beneficiary of the trust, and the trustee will have certain rights to distribute principal of the trust to James Johannes under an ascertainable standard once the trust is funded, that somehow relieves Gerald Johannes from the damages caused by his breach of fiduciary duty on his failure to close the estate, fund the trust called for in the last will and testament of the decedent, as well as the lack of return on account of the substandard investment practices of Gerald Johannes. The testimony of Rick

Wyman, the financial expert who testified as to the proper investment for a long term income producing trust, was that an appropriate investment standard was 60% stock and 40% bonds (RP 259-262). This was not rebutted by any expert of Gerald Johannes. In fact Owen Dahl, the expert retained by Gerald Johannes, agreed that a 60% stock and 40% bond ratio was an appropriate investment strategy for a long term trust like this. (RP 618).

The facts before the trial court were that the trust was never funded and there was no income from the trust ever distributed to James Johannes, the income beneficiary of the trust. Arguments that the principal would or could have been distributed to James Johannes is meaningless since it never happened.

The only testimony at trial regarding the analysis a trustee goes through before authorizing principal distributions under an ascertainable standard as was in the will before the court, was by expert Robin Balsam. She testified someone like James Johannes would have to show a specific need for distribution of principal and make full financial disclosure. She also indicated because of the fiduciary duty the trustee has to residuary beneficiaries, the likelihood of significant principal of a trust being exhausted

for the benefit of an income beneficiary is extremely unlikely (RP 207-209, 227-229, 247).

Upon the trust being funded properly there may be issues the Johannes grandchildren, James Johannes and the trustee have to resolve as to any rights of James Johannes to accrued income in the trust. The first step though is the trust needs to be properly funded and placed in the position it would have been in but for the substantial breaches of fiduciary duties by Gerald Johannes. Regardless, the issues of the rights of the various beneficiaries of the trust amongst one another were not before the court.

3. **The Johannes grandchildren have standing.**

Gerald Johannes cites a couple of out-of-state cases addressing the issue of standing of remainder beneficiaries, but these cases are of no value because in Washington remainder beneficiaries do have standing. In *Nelsen v. Griffiths*, 21 Wn.App. 489, 585 P.2d 840, the trustee argued the standing issue, and that since survival is a condition precedent before a residuary beneficiary inherits his or her interest, a residuary beneficiary does not have standing to make the trustee do an accounting. Holding that the residuary beneficiaries had standing the court stated at page 493:

It is not necessary to determine whether Jacqueline is a vested remainderman or is a contingent

remainderman. The fact remains that Jacqueline and her children have a present interest in the remainder of the trust, *one-half of what may be left after Mrs. Polson's death*. Any uncertainty relates only to the amount they may receive, not to their right to receive.

Gerald Johannes claims that the Johannes grandchildren have no damages because their interest is not vested. That misses the point which is the Johannes grandchildren are asking for damages to be awarded to the estate of Evelyn Johannes, in order that the trust can be properly funded and be placed in a position that the trust would have been in but for the breaches of fiduciary duties by Gerald Johannes. The Johannes grandchildren fully recognize future events such as the productivity of the trust, future distributions to James Johannes, as well as whether each of the Johannes grandchildren survive their father, all impact what they may eventually receive. Literally what Gerald Johannes is arguing is if he in his capacity as personal representative fails to fund the trust or funds it with a nominal amount, there is no cause of action by the Johannes grandchildren because their interest in the trust is not fully vested and/or the amount of their interest is not fully known. That is directly contrary to *Nelson v. Griffiths*, which holds that the interest of remainder beneficiary is a present interest and that there is standing.

4. **The estate needs to be placed in the position it would have been in but for the breaches by Gerald Johannes.**

Gerald Johannes cites the case of *Estate of Jones*, 116. Wn.App. 353, 67 P.3d 1113 (2003), reversed on other grounds by, *Estate of Jones*, 152 Wn.2d 1, 93 P.3d 147 (2004) for the proposition that a non-intervention executor is not subject to the same requirements as the trustee of a trust. Once again, this misses the point. The case might be relevant if the trial court had found that it was proper for the estate to be open for seventeen plus years. Conclusion of law number 4 though found that Gerald Johannes breached his fiduciary duty by not closing the estate. The issue is the damages that arose from this failure to close the estate. The error of the trial court is once it found Gerald breached his fiduciary duty by failing to close the estate in a timely fashion, it failed to award the damages on account of that breach.

The Johannes grandchildren have no issue with the citations by Gerald Johannes to Restatement of Trusts (Third), section 227, comment (i) and Restatement of Trusts (Third) section 232, both which generally stand for the proposition when there is an income beneficiary and residuary beneficiary, the trustee needs to consider the interests of both. That is also codified in RCW 11.100.045, which states that a fiduciary needs to take into account the differing interests of the beneficiaries. Despite the claims of

Gerald Johannes that the duties of a trustee versus an executor need to be distinguished, RCW 11.68.090 is to the contrary since it holds that a personal representative with non-intervention powers is bound by the same duties as a trustee under the provisions of RCW 11.100, et seq.

This is important because the record is absent of any evidence that Gerald Johannes throughout his administration of the estate ever considered the interests of the Johannes grandchildren. He never informed the Johannes grandchildren of any events that happened in the estate. His testimony was that he assumed James Johannes was keeping the Johannes grandchildren informed (RP 297-298). This is completely improper since Gerald Johannes as personal representative had a duty to keep the Johannes grandchildren informed, especially since there is an inherent conflict of interest between an income beneficiary like James Johannes and residuary beneficiaries like the Johannes grandchildren.

References by Gerald Johannes to out-of-state cases which dealt with an attack by residuary beneficiaries as to the investment program of a trustee, have no applicability. At least in those cases the trustees were able to show a methodology and balancing between the interests of the income beneficiary and residuary beneficiaries. There was no balancing shown in the present case

by Gerald Johannes, nor was there any investment plan ever adopted by Gerald Johannes.

Reliance by Gerald Johannes on *Estate of Cooper*, 81 Wn.App. 79, 913 P.2d 393 (1996) actually supports the position of the Johannes grandchildren. In *Cooper* the trustee/personal representative was also an income beneficiary, with the trust corpus to go to the children of decedent after the death of trustee. The Cooper case involved a probate that remained open for several years after the death of the decedent during which time the trust was not funded until shortly before the lawsuit was filed. The court in that case specifically found against the trustee/personal representative on the losses the estate suffered as a result of his investment strategy when he was personal representative. The Cooper case supports the total return argument argued by the Johannes grandchildren, and that the trust ultimately should be placed in the position it would have been in, but for the breaches by Gerald Johannes. In Cooper the court found the trustee violated the prudent investor rule by almost exclusively investing the trust assets in bonds and not properly diversifying the assets. The court found that the trustee did not weigh the rights of the income beneficiary versus those of the residuary beneficiaries.

The remainder of the argument by Gerald Johannes again raises facts not in evidence and speculation that even if the trust had been properly funded and invested, these nonexistent income and principal distributions to James Johannes would have wasted the trust assets. It also disregards by law the duty of the court is to restore the estate to where it should have been but for the breaches of fiduciary duty by Gerald Johannes. Once the estate is restored to where it should have been, then the trust can be funded with 40% of the estate.

Finally, despite the attempts of Gerald Johannes to claim his actions benefitted the estate, the purported 59% increase in the total principal value when allocated over seventeen years is negligible. This is less than a 2% compounded return per year. Additionally, the actual liquid assets that presently remain in the estate are substantially less than the \$1,051,463.30 claimed by Gerald Johannes. The \$188,000 loan to James Johannes, plus accrued interest, is now a \$315,000 asset of the estate. It is interesting that Gerald Johannes throughout his brief argues James Johannes is broke and the trustee would have invaded the principal for the benefit of James Johannes, yet Gerald Johannes went ahead and made an unsecured loan in 1998 of \$188,000 to James Johannes. Regardless, if the \$188,000 loan and interest of

James Johannes is backed out of the estate assets, any actual increase to the estate is negligible.

5. **The 1998 loan from the estate to James Johannes was self-dealing.**

Arguments by Gerald Johannes the interests of the Johannes grandchildren were not prejudiced by the 1998 loan arrangement are ludicrous. Nine years after the loan was made it remains unpaid. The argument that Gerald could have taken his 60% of the estate outright at any time and that the \$188,000 loan to James Johannes did not benefit him is untrue. In making the loan Gerald Johannes not only got indirect benefits from the loan, but he also stood to still receive his 60% of the total estate, which included the \$188,000 loan plus interest. In fact he stood to substantially benefit since he would still receive 60% of the total estate, plus whatever benefit he received from the \$188,000 loan that was made to James Johannes.

The analysis of the corporate accountant Tom Pagano is that from the \$188,000 loan made by the estate to James Johannes, Gerald Johannes received a benefit of \$89,298, since substantial portions of the loan were paid to a company Gerald controlled. (Exhibit 120 and RP 104-105). Despite the claims of Gerald Johannes that he received no benefit from the loan, that is

directly controverted by the testimony of Tom Pagano and exhibit 120. Gerald Johannes did substantially benefit from the \$188,000 loan and it was a prohibited self-dealing as stated in RCW 11.100.090.

6. **Damages suffered by the estate.**

Gerald Johannes makes the unfounded claim that the trial court did not believe the testimony of accountant Frank Ault, who was retained by the Johannes grandchildren. The finding of the court specifically was Gerald Johannes did not keep adequate records of the transactions he managed for the estate and that any ability to produce an accounting was hampered by the insufficient records produced by Gerald Johannes. (conclusion of law 50). Gerald Johannes is saying that if a personal representative keeps insufficient records or fails to produce accounting records so that it is impossible to prove the amount that should be in an estate, that the personal representative cannot be sued for breach by the beneficiaries because they cannot prove damages. This also is what the trial court ended up ruling, which was error. In *Wilkins v. Lasater*, 46 Wn.App. 766, 778, 733 P.2d 221 (1987) the court stated:

In an accounting, the burden of proving the propriety of challenged transactions rests with the trustee. G. Bogert, *Trusts and Trustees* § 970, at 401 (2d rev. ed. 1983). Obscurities and doubts in the accounting will be resolved against the trustee.

The trial court's ruling that accountant, Frank Ault, an expert retained by the Johannes grandchildren, did not testify that any funds were taken by Gerald Johannes misses the legal requirement that the burden of proof actually rests with personal representative. Once accountant Frank Ault showed that funds were unaccounted for, that was an obscurity and doubt to be resolved against Gerald Johannes. The mistake of the trial court was in imposing an additional duty on James Johannes and the Johannes grandchildren in ruling they had to prove Gerald Johannes stole the missing assets. The actual burden of proof was that Gerald Johannes needed to explain in a satisfactory manner and show the evidence in the form of written records as to what happened to the missing \$29,857 total in 1990 and 1993 that Frank Ault found.

In reference to the issue of prejudgment interest, Gerald Johannes once again misses the point. The Johannes grandchildren are not asking that any prejudgment interest be paid to the Johannes grandchildren as Gerald Johannes attempts to claim. The argument is the damages caused by Gerald Johannes are liquidated items and prejudgment interest is appropriate in order that the estate be properly funded and put back into the position it should have been, and thereafter the trust funded with 40% of the total of the estate.

The argument of Gerald Johannes that the Johannes grandchildren cannot be “made-whole” since their beneficiary interest does not exist or is incapable of being determined now, is not the law.

What Gerald Johannes is really arguing is he has no liability to residuary beneficiaries. That is directly contrary to *Estate of Cooper*, supra, where the residuary beneficiaries did have a cause of action against the trustee to restore the trust to where it should have been. The residuary beneficiaries in *Estate of Cooper* were in the same position as the Johannes grandchildren in that the exact amount of their residuary amount would not be known until it came into fruition.

7. **The accountings of the estate were improperly admitted.**

Gerald Johannes makes contrary arguments in reference to the 2001 and 2004 Frank Johnson statements that the court adopted as the accounting for the estate. Gerald Johannes admits the 2001 Frank Johnson statement was not submitted to prove an accounting. The argument on the 2004 accounting seems to be that since Gerald Johannes filed it in the Estate of Evelyn Johannes (a cause of action separate and apart from this litigation) that somehow makes it valid. Disregarded is there is no evidence that the 2004 accounting was ever provided to the Johannes grandchildren, nor were they

ever informed that it was filed in a separate probate action. It is impossible to object to an accounting filed in a wholly separate action that you have not been provided notice of.

Arguments that it is admissible as a business record under RCW 5.45.020 also fail. RCW 5.45.010 defines the term “business”, and an estate would not qualify as a business, profession or occupation. RCW 5.45.020 requires that a custodian or other qualified witness testify as to the identity and mode of its preparation; that it was made in the regular course of business; at or near the time of the act; and that the sources of information, method and time of preparation are such to justify its admission.

There was no custodian or other qualified witness that testified to the 2004 Frank Johnson statement and its mode of preparation. There was no witness that testified it was made in the regular course of business. It attempts to describe events that occurred over a fifteen year period. It does not document events that happened near the time of the preparation of the record as required by the statute.

Without claiming it as a summary, Gerald Johannes seems to be maintaining it is on page 23 of his brief stating that testimony was introduced about how author Frank Johnson compiled these records into the accounting,

and the claim that the records used by Mr. Johnson would otherwise be admissible. However, Mr. Johnson did not testify so there is no evidence how Mr. Johnson compiled the records that comprise the 2004 statement that he prepared, nor was there any testimony as to the records used by Mr. Johnson. Even a summary under the evidence rules requires a party offering the summary to produce the records relied on. There simply was no basis for the trial court to adopt the 2004 Johnson statement as an accounting.

8. **Attorneys' fees.**

The position of the grandchildren is that they are entitled to reimbursement of their fees and costs incurred in the underlying litigation. The trial court awarded them judgment of \$27,076.80 from Gerald Johannes and a like sum from James Johannes.

James Johannes has now appealed the award of \$27,076.80 in fees and costs of the Johannes grandchildren awarded against him. The position of the Johannes grandchildren is they need to be made whole if in the event the award of fees and costs to them from James Johannes is overturned by the Court of Appeals. In that event the Johannes grandchildren are entitled to recover all their fees and costs from Gerald Johannes.

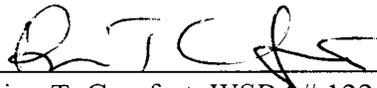
9. **Conclusion.**

The court should find that Gerald Johannes breached substantial fiduciary duties including failing to close the estate by 1993, and award damages against him of \$249,313.07 to the trust as per the total return approach testified to by expert Rick Wyman. It should also enter judgment against Gerald Johannes on behalf of the estate in the amount of \$28,000 for the missing certificate of deposit, the missing funds of \$29,857 from 1990 and 1993 as testified to by Frank Ault, the payments to Puget Sound Bank for the non-existent loan totaling \$44,403, the \$2,093 from the United Bank account that was not accounted for in the estate, the unaccounted for 1989 gift of \$20,000, and the \$100,000 uncompleted gift on the Phoenix bonds. The trust then would receive forty percent (40%) of the estate.

Alternatively, on account of the various breaches of fiduciary duties by Gerald Johannes, remand this for trial on the issue of accounting and damages identifying that the estate should have been closed by 1993, and any inferences and obscurities in the accounting should be held against Gerald Johannes. Finally, that the Johannes grandchildren be awarded all their attorney's fees and costs on appeal.

Respectfully submitted this 5th day of July, 2007.

COMFORT, DAVIES & SMITH, P.S.

By: 
Brian T. Comfort, WSBA# 12245
of attorneys for cross-appellant

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**DECLARATION OF DELIVERY OF REPLY BRIEF OF CROSS-
APPELLANTS**

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Kathy R. Goulet, certifies and states as follows:

I am a citizen of the United States of America, a resident of Pierce County, Washington, over the age of twenty-one (21) years and competent to be a witness in the above-entitled cause.

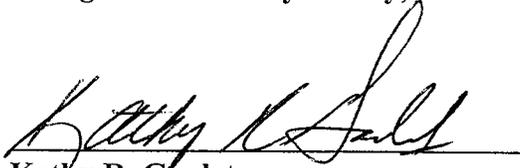
That on the 5th day of July, 2007, she forwarded a true and correct copy of the *reply brief of cross-appellants* in connection with the above-captioned matter, by ABC-Legal Messengers, Inc., and by facsimile to the following address:

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I declare under the penalty of perjury of the laws of the state of Washington that the foregoing statement is true and correct.

Dated at Tacoma, Washington this 5th day of July, 2007.


Kathy R. Goulet