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No. 36178-7

Pierce County Superior Court No. 95-04-01492-8

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IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

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IN THE MATTER OF THE TESTAMENTARY TRUSTS  
CREATED FOR THE BENEFIT OF  
DONALD M. BAROVIC

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BRIEF OF APPELLANT

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## I. ASSIGNMENT OF ERROR

TRIAL COURT ERRED IN APPROVING 2004 AND 2005 INTERMEDIATE ACCOUNTINGS WHERE TRUSTEE BREACHED FIDUCIARY DUTIES. TRIAL COURT ERRED IN DENYING MOTION TO CONTINUE HEARING AND MOTION TO PERMIT DISCOVERY FOR INTERMEDIATE ACCOUNTING.

### A. Issues Pertaining to Assignment of Error.

1. Did the trustee breach a fiduciary duty by failing to act impartially in managing trust assets where the principal appreciation of the trust assets greatly outweighed trust income provided to an income beneficiary?
2. Is a court order under RCW 11.96A.115 to allow discovery in a proceeding to approve an interim accounting filed under RCW 11.106.030?

## II. STATEMENT OF THE CASE

Appellant Donald Barovic (“Appellant”) is the sole Income Beneficiary of the Testamentary Trust Created for the Benefit of Donald Barovic (the “Trust”) which was created from the Last Will and Testament of Donald Barovic’s parents, Mike and Andrea Barovic (CP-39). As the Appellant is the Income Beneficiary, the Trustee is to distribute all of the income of the trust assets to Mr. Barovic during his lifetime (CP-40).

Appellant Barovic's four children are remaindermen beneficiaries of the Trust ("Remaindermen") and will directly receive the principal assets of the Trust upon the death of Appellant Barovic. *Id.*

Appellee Tanya Pemberton ("Appellee") is the Trustee for Mr. Barovic's Trust. Appellee Pemberton was appointed on May 7, 1996, as the Trustee of the Barovic Trust (CP-39). In 1999, pursuant to the Trustee Accounting Act, Appellee Pemberton filed a petition requesting the court's approval of the intermediate accounting for the fiscal year 1998. The foregoing intermediate accountings for the five years between 1998 and 2003 were all approved by the court at each of the five annual hearings (CP-40). The matter which is the subject of this appeal relates to the March 15, 2007 trial court's orders approving the Intermediate Account for 2004 and Petition for Order Approving Intermediate Account, Payment of Fees and Allocation of Expenses and the Intermediate Account for 2005 and Petition for Order Approving Intermediate Account, Payment of Fees and Allocation of Expenses ("2004/2005 Accountings") (CP 1-38). These accountings cover the income and distributions of the Barovic Trust for the period of January 1, 2004 through December 31, 2005 which were filed by Appellee Pemberton pursuant to RCW 11.106.030. *Id.*

In response to the 2004/2005 Accountings, Appellant Barovic filed Beneficiary Don M. Barovic's Objection to Trustee Tanya Pemberton's Intermediate Account for 2004 and 2005 and Petition for Order of Approval and For Cross Petition for Continuance and Order to Compel Discovery pursuant to RCW 11.106.040 (CP 39-46). Appellant Barovic argued that the 2004/2005 Accountings should not be approved by the court as the Trustee breached her fiduciary duties by failing to invest the assets of a trust in a manner which took into account both the interests of the income beneficiary and the remaindermen as well as failing to reallocate assets between the income and principal accounts in order to correct for the fact that the assets demonstrated significant capital appreciation while providing little income for the income beneficiary (CP 42-44).

In addition to opposing the approval of the 2004/2005 Accountings, the Appellant moved the court for an order continuing the hearing on the accountings and moved the court for an order to permit discovery so that the Appellant's accountant would be able to obtain sufficient documentation to evaluate the accuracy of the accountings and the actions and/or omissions of the Appellee during the 2004/2005

accounting period (CP-44). In support of Appellant Barovic's Objection to the approval of the 2004/2005 Accountings, and cross motions for a continuance and to allow discovery, Appellant filed the Declaration of Michael L. Fullaway, Certified Public Accountant (CP 47-56). In his declaration, Mr. Fullaway stated that:

"I have requested additional account information from Dwyer, Pemberton, and Coulson, P.C.,<sup>1</sup> accountants for the Barovic Trust, through the Trustee; however, I do not have all of the financial records needed to do a full analysis. Without this additional requested information I do not have sufficient information to determine rates of return of each specific asset, values, and management fees; however, the data set out in Exhibits 1, 2, and 3 attached show a very low return for the value of the investment and a healthy increase in market value." (CP 47-53).

The trial court erred in its denial of Appellant's motions requesting a court order allowing discovery regarding the accounting and for a request to continue that March 15, 2007 hearing until said discovery could be conducted.

On March 14, 2007, prior to the hearing on the 2004/2005 Accountings, the Appellant filed a Petition to Remove Trustee Pemberton

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<sup>1</sup>Dwyer, Pemberton and Coulson is the accounting firm that handles the accounting for Appellee Pemberton; although Tanya Pemberton is not directly associated with this firm.

and a Complaint for Breach of Fiduciary Duties in her administration of the Trust (“Barovic v. Pemberton” matter) (CP-10).

Currently the Barovic Trust is primarily comprised of ownership of two pieces of real estate, the Canyon Creek Apartments and the Liberty Theater, both located in Puyallup, Washington as well as an account with Nations Fund (currently Columbia Management Fund) (CP 27). The assessed value of the Canyon Creek Apartments as of the time of the 2004/2005 Accountings was \$1,749,700.00 and the Liberty Theater assessed value was \$235,500.00 (CP-27). In the 2004/2005 Accountings the Nations Fund account contained investments totaling \$1,009,342.05 (CP-27).

Although the Barovic Trust contained significant assets, the asset management approach taken by the Appellee greatly favored capital appreciation of the Trust assets and as discussed further below, failed to provide the Income Beneficiary with an equitable share of the appreciation of the Trust assets. Although the Appellant’s accountant was able to provide the court with his analysis clearly demonstrating these inequities in the investments of the Trust assets, the trial court committed error by denying the Appellant’s motion to allow discovery relating to the

accounting matters. The trial court also committed error by approving the accounting and failing to surcharge the Trustee for her breaches of the fiduciary duties in her administration of the Trust.

### **III. STATEMENT OF PROCEEDINGS**

On April 10, 2007, the Appellant filed a Notice of Appeal of the above referenced Order approving the intermediate accounting for the years 2004 and 2005 entered by the Superior Court on March 15, 2007.

### **IV. ARGUMENT**

A. Court Erred in Approving 2004 and 2005 Interim Trust Accounting as Court Failed to Consider the Trustee's Failure to Take All Beneficiaries' Interests into Account.

In Appellee Pemberton's administration of the Trust, the evidence presented at the March 15, 2007, hearing clearly demonstrated a clear intent to favor the Remaindermen over the Income Beneficiary. The Appellant argued that alternatively Appellee Pemberton abused her discretion as Trustee by not making any allocations or adjustments between the Income Beneficiary and the Remaindermen to rectify this disparity.

At the March 15, 2007, hearing the Appellant provided evidence from Micheal Fullaway, CPA, who had determined that the

Remaindermen received an increase of not less than 12.6% or more, while the Income Beneficiary, Barovic received a mere 4% based on fair market value (FMV)<sup>2</sup>. When asked at the hearing what the rate of return on the Canyon Creek Apartments was, which would have been provided as income to the Appellant, the Appellee responded simply "I don't know." (VRP-38).

In reviewing the returns for the Nations Fund accounts for the 2004 time period, Michael Fullaway determined that the Remaindermens' assets gained approximately 9%, while at the same time the Fund only paid a dividend income to Appellant Barovic of \$8,262.65, or less than 1% (VRP-40). In the hearing, the Trustee stated that the dividend incomes was about 5.1%, which is inaccurate based on the accounting she produced showing a gain of only 1% (VRP-38). While the Appellee had the ability to choose a number of different types of accounts which would provide an equitable balance between paying a dividend and reinvesting any gains in the principal of the asset, the Appellee failed to do so or to take any measures to correct the deficiencies between the beneficiaries. If not

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<sup>2</sup>See notes from Accountant Fullaway, dated 7-15-05 attached (part of Declaration of Michael Fullaway Attachment A (CP-50)).

before, in 2004 the Trustee should have made adjustments to the investments, as any prudent investor would have, to cure the deficiencies between the principal and the income side of the Trust assets, but the Appellee failed to do so in breach of her fiduciary duties.

Although Appellant Pemberton has determined that the accounting value for the Canyon Creek Apartments was 1,749,700.00 (CP-27), the actual market value of the Canyon Creek Apartments was approximately \$3,200,000.00 (CP 54-55). Although the Canyon Creek Apartments represented a Trust asset with a fair market value of \$3,200,000.00 and a tax assessed value of \$1,749,400, in 2004 this asset only provided a net income to the Appellant of approximately \$5,000. (VRP 38). For years, the Canyon Creek Apartments showed little if any income which was provided to the Appellant; however, during the same period of time, the Remaindermen have realized a significant increase in the value of the Trust asset. Based upon a fair market value of 3.2 million, the Canyon Creek Apartments had a net income of less than 2% (CP 53); however, the actual principal value of the asset increased approximately 25% (CP 43). If the Appellee Pemberton attempted to administer the Trust in a manner that took both the Income Beneficiary and the Remaindermens' interests into

account and not simply those of the Remaindermen, the Trustee would have either attempted to reduce the operating expenses of the real estate holdings to increase the income derived from these assets or simply sold the assets and invested the proceeds in any investment account that could have provided an equitable distribution between the Income Beneficiary and the Remaindermen. The Appellee's failure to do so was a breach of her fiduciary duty.

A trustee owes beneficiaries "the highest degree of good faith, care, loyalty and integrity." *Allard v. Pacific National Bank*, 99 Wash.2d 394, 403, 663 P.2d 104, 110 (1983).

A fiduciary shall invest and manage the trust assets solely in the interests of the trust beneficiaries. If a trust has two or more beneficiaries, the fiduciary shall act impartially in investing and managing the trust assets taking in account any differing interests of the beneficiaries. RCW 11.100.045., See Also *Esmieu v. Schrag*, 88 Wn.2d 490, 563 P.2d 203 (1977) (*emphasis added*).

Beneficiaries of a trust include both current and future beneficiaries. *Matter of Polson*, 21 Wn.App. 489, 493, 585, P.2d 840, 843 (1978).

Subject to the provisions of RCW 11.100.060 and any express provisions in the trust instrument to the contrary, a fiduciary shall diversify the investments of the trust unless the fiduciary reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying. RCW 11.100.047.

Although a fiduciary is authorized to acquire and retain any kind of property as an investment for a trust, a fiduciary is expected to act prudently and take a total asset management approach. RCW 11.100.020. In determining the prudence of a particular investment the fiduciary “shall give due consideration to the role that the proposed investment or investment course of action plays within the overall portfolio of assets. In applying such total asset management approach, a fiduciary shall exercise the judgment and care under the circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs.” *Id.*

Under the prudent investor rule the following are among the factors that should be considered by a fiduciary in applying this total asset management approach:

- (a) The probable income as well as the probable safety of their capital;
- (b) Marketability of investments;
- (c) General economic conditions;
- (d) Length of the term of the investments;
- (e) Duration of the trust;
- (f) Liquidity needs;
- (g) Requirements of the beneficiary or beneficiaries;
- (h) Other assets of the beneficiary or beneficiaries, including earning capacity;
- (i) Effect of investments in increasing or diminishing liability for taxes. *Id. (emphasis added).*

Although the direct reversal of the situation presented in this matter, the Court has previously found that a fiduciary breached the prudent investor rule when a trustee who was also an income beneficiary weighed trust

assets in his favor by maintaining balance of assets that weighed heavily toward current income rather than capital appreciation. *Matter of Estate of Cooper*, 81 Wash.App. 79, 90, 913 P.2d 393, 399 (1996).

Appellee Pemberton failed to take a total asset management approach or to diversify the investments of the Trust in a manner which would take into account the differing interests of the Income Beneficiary and the Remaindermen. Although the Trust assets showed significant capital appreciation over the 2004/2005 Accounting periods, the investments had little liquidity and provided minimal income to the Income Beneficiary who relied solely on the Trust distributions for his personal income.

In addition to the Trustee's failure to administer the Trust in a manner which considered the interests of all of the Beneficiaries, the Trustee failed to make any adjustments between the principal and income accounts to ensure that all Beneficiaries of the Trust were treated fairly and reasonably. Under the 2002 Principal and Income Act, a trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee determines that after applying the rules in RCW 11.104A.010(a), the trustee is unable

to comply with RCW 11.104A.010(b). *RCW 11.104A.020(a)*. RCW 11.104A.010(b) requires that: “in exercising the power to adjust under RCW 11.104A.020 ... a fiduciary shall administer a trust, or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent the terms of the trust or the Will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries.” *RCW 11.104A.010. (emphasis added)*. The Appellee was aware of her power to make such adjustments; however, notwithstanding many requests, the Trustee did not make any adjustment between the Principal and Income Beneficiaries (VRP-52).

The powers to adjust allocation of receipts and expenses between income and principal which were granted to the Appellee under the Principal and Income Act ensure that in the administration of a trust, both the remaindermen and the income beneficiaries will receive a fair distribution of the assets of a trust and that, absent an expressed intent of the testator, neither party shall be favored by a trustee. In the present case, Appellee Pemberton has abused her discretion or acted negligently and breached her fiduciary responsibility by grossly favoring the Remaindermen in her choice of investments without making any adjustments between income and principal to ensure an equitable distribution of the Trust assets between the parties. As such, the trial court

committed error by approving the 2004/2005 Accountings and for failing to surcharge the Trustee for her breaches of fiduciary duties.

B. An Order of the Court Pursuant to RCW 11.96A.115 to Conduct Discovery Regarding an Interim Accounting Filed Pursuant to RCW 11.106.030.

Prior to the March 15, 2007, hearing on the 2004/2005 Accountings, the Appellant moved the court for an order to permit discovery and to continue the approval of the intermediate accountings to allow the Appellant an opportunity to obtain sufficient information to evaluate whether Appellee Pemberton abused her discretion or breached her fiduciary duty in administering the Trust during the 2004 and 2005 accounting periods. The Appellant's motion to continue the hearing and to allow discovery by the Appellant was denied by the trial court (VRP 54-55). As previously discussed, the Appellant's accountant was only provided the summary report of the intermediate accounting filed by the Appellee which contained none of the actual records of the management of the Trust or statements or reports of the Nations Fund Account (CP 47-48). Without discovery and an ability to request these records or to depose the Trustee or the principals of property management company or the Trust's accountants, the Appellant's accountant was unable to provide the Court with a complete analysis of the accountings or the actions and/or omissions of the Appellee. *Id.* Therefore it was imperative that the court

permit discovery to be conducted in this case; however, without a court order, the Appellant was unable to conduct any discovery.

Disputes relating to the determination of a trust accounting are governed by the Trust and Estate Dispute Resolution Act (“TEDRA”) RCW 11.96A et. seq. “(1) It is the intent of the legislature that the courts shall have full and ample power and authority under this title to administer and settle: (b) All trusts and trust matters.” *RCW 11.96A.020.*

Nothing in chapter 345, Laws of 2002 is intended to restrict the application of chapter 11.96A RCW to issues, questions, or disputes that arise under or that relate to chapter 345, Laws of 200. A. Any and all such issues, questions, or disputes shall be resolved judicially or nonjudicially under chapter 11.96A RCW. *RCW 11.104A.901.*

Under the Trust and Estate Dispute Resolution Act (“TEDRA”) discovery is limited to occur in two distinct circumstances.

In all matters governed by this title, discovery shall be permitted only in the following matters:  
(1) A judicial proceeding that places one or more specific issues in controversy that has been commenced under RCW 11.96A.100, in which the case discovery shall be conducted in accordance with the superior court civil rules and applicable local rules; or  
(2) a matter in which the court orders that discovery be permitted on a showing of good cause in which case discovery shall be conducted in accordance with the Superior Court Civil Rules and applicable local rules unless otherwise limited by the order of the court.” *RCW 11.96A.115 [2006 c 360§ 11, eff. June 7, 2006] (emphasis added).*

RCW 11.96A.115, which only became effective in June of 2006 is a new section to TEDRA. Therefore, with regard to this Court's interpretation of this statute, this matter appears to be a case of first impression. However, the language of the new section is clear and unambiguous on its face. The 2004/2005 Accountings were filed under RCW 11.106.030 and were not ordered by the Court as a result of a petition filed by a beneficiary under RCW 11.106.040. Therefore, the 2004/2005 Accountings are not part of an action commenced under RCW 11.96A.100. As such, the statute clearly states that discovery may be "permitted only" in a matter which "the court orders discovery be permitted on a showing of good cause." *RCW 11.96A.115.*

At the hearing on the 2004/2005 Accounting the Appellant argued that he was unable to determine the accuracy of the accounting or whether the actions and/or omissions of the Trustee during the 2004 and 2005 accounting periods complied with the Principal and Income Act (RCW 11.104A et. seq.), the Trustee's Accounting Act (RCW 11.106 et.seq.) and the Prudent Investor Act which was incorporated in the Principal and Income Act (RCW 11.100 et.seq.).

As previously discussed, although Appellant Barovic retained an accountant to review the Interim Accountings filed by the Appellee, the accountant was unable to provide a full analysis and the accounting did not

provide sufficient information to determine the rates of return of each specific asset, values, and costs of management fees.” (CP 47-48). Appellant argued that while the accountant was able to provide some analysis which demonstrated an inequality between the returns between the income and principal accounts, only being provided with the Appellee’s summary of the accounts as set forth in the intermediate accounting allowed the accountant to provide only an “opinion on someone else’s opinion.” (VRP 7). Therefore, an order to allow discovery under RCW 11.96A.115 was critical to provide the actual documentation for the court to be able to evaluate the Appellee’s actions and approve the 2004/2005 Accountings. This clearly establishes good cause required for the court to order discovery under RCW 11.96A.115.

In response, the Court denied the Appellant’s motion to allow discovery stating that “I don’t agree with your interpretation (that discovery in the case could not be conducted without a court order pursuant to RCW 11.96A.115) Mr. Spencer, on discovery. I think that you have the ability to request production of documents, subpoena records, take depositions, if you think that is appropriate prior to accounting.” (VRP 13).

In other words, I believe that request for production, subpoenas, deposition requests and so forth, interrogatories, ought to be issued. And if they are not answered, you can

certainly come back to the court and ask for an order to compel. Now I don't know whether that would be in the context of this proceeding or, perhaps, in the context of the other proceeding on which Judgment Nelson would be presiding.

MR. SPENCER: Okay. My particular interest is to that Provision 115 which we interpret different than you do, and I would like a ruling that, in fact, John, you're wrong. And the reason for that is –

THE COURT: I hate to tell yo, Mr. Spencer, that you're wrong, but I think I interpret the statute differently and our civil rules on discovery differently. And I think you do have the right, and I'm saying it out loud and on the record, to issue requests for production, interrogatories, take depositions, subpoena records, and if they are refused for some reason, if it's in the context of this litigation, please come back to this Court and I certainly would issue an order compelling if I thought it was discoverable which, of course, is very, very broad.

MR. SPENCER: Thank you. Your Honor, I take that as your ruling that we do not need to have Court's permission to take those kinds of discovery that you just enumerated.

THE COURT: That's my ruling. (*See* VRP 54-44).

The Court further reasoned that the Appellant would not be prejudiced in pursuing the *Barovic v. Pemberton* action which was filed on March 14, 2007, if it denied Appellant's motion to continue the hearing and to allow discovery as "it wouldn't foreclose in any way a continuing lawsuit under 11.96A or whatever has been filed." *Id.* Appellant further argued that under the 2005 *Barovic v. Pemberton* case the court's denial of Appellant's motion would terminate any claims against Appellant Pemberton for any acts or omissions which occurred during the 2004/2005

or any prior accountings of the Barovic Trust. *Barovic v. Pemberton*, 128 Wash.App. 196, 201, 114 P.3d 1230, 1233 (2005).

The Appellant believes that the trial court's interpretation of RCW 11.96A.115 that an order to permit discovery was not necessary in this case was an error. The Appellant further believes that the denial of the motion to permit discovery and to continue the hearing based on the Court's belief that such denial would not prejudice the Appellant or terminate any rights of the Appellant under the separate action which had been filed requesting removal of the Trustee and for damages resulting from breaches of fiduciary duties was error.

The approval of the 2004/2005 Accountings terminates the claims of the Appellant with regard to any actions or omissions of the Appellee during the 2004/2005 Accounting period. The 2004/2005 Accountings and all prior accountings filed by the Appellee were filed pursuant to RCW 11.106.030.

After a trustee has filed with the court an intermediate accounting, "upon or before the return date any beneficiary of the trust *may* file the beneficiary's written objections or exceptions to the account filed or to any action of the trustee or trustees set forth in the account." *RCW 11.106.060*.

Upon the return date...the court without the intervention of a jury and after hearing all evidence submitted shall determine the correctness of the account and the validity and propriety of all actions of the trustee or trustees set

forth in the account including the purchase, retention, and disposition of any of the property and funds of the trust, and shall render its decree either approving or disapproving the account or any part of it, and surcharging the trustee or trustees for all losses, if any caused by negligent or wilful breaches of trust. *RCW 11.106.070.* (emphasis added)

The decree rendered under RCW 11.106.070 shall be deemed final, conclusive, and binding upon all the parties interested including all incompetent, unborn, and unascertained beneficiaries of the trust subject only to the right of appeal under RCW 11.106.090. *RCW 11.106.080. See Also Barovic at 201.*

As the Decree approving the 2004/2005 Accountings effectively acted as a bar from the Respondent bringing future claims for any breaches of fiduciary duties of the Trustee and the Trustee has not provided sufficient evidence in the accounting for the Respondent or the Court to evaluate the validity of the accounting or the Trustee's actions, the Court committed error by failing to grant the Appellant's motions to continue the hearing on the 2004/2005 accounting and to allow discovery to be conducted.

C. **Attorneys Fees**

Appellant respectfully requests, pursuant to RAP 18.1, RCW 11.96A.150 or as otherwise allowed by law, that the Court award his reasonable attorneys fees and costs in making this appeal.

(1) Either the superior court or the court on appeal may, in its discretion, order costs, including reasonable attorneys' fees, to be awarded to any party; (a) from any party to the

proceedings; (b) from the assets of the estate or trust involved in the proceedings; or (c) from any nonprobate asset that is the subject of the proceedings. The court may order the costs to be paid in such amount and in such manner as the court determines to be equitable.

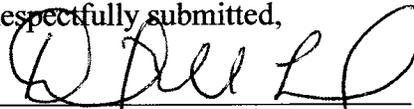
(2) This section applies to all proceedings governed by this title, including but not limited to proceedings involving trusts, decedents's estates and properties, and guardianship matters. *RCW 11.96A.150.*

The Appellant further requests that these fees be awarded and charged to Appellant/Trustee, Tanya Pemberton, personally or secondarily, from principal assets of the Trust.

#### V. CONCLUSION

The Appellant respectfully requests that this Court find that the trial court committed error in denying the Appellant's motion to continue the 2004/2005 Accounting hearing, and remand this matter instructing the trial court to issue an order that the parties be allowed the ability to conduct discovery pursuant to RCW 11.96A.115. The Appellant further requests that this Court find that the trial court committed error by failing to find that the Appellee breached her fiduciary duties in her management of the trust and surcharging the Trustee in an amount to be determined by the trial court.

Respectfully submitted,



John R. Spencer, WSBA#32188

David N. Iland, WSBA #32517

Attorneys for Appellant Donald M. Barovic

**CERTIFICATE OF SERVICE**

On this day, I faxed and delivered a true and accurate copy of the foregoing to Thomas G. Krilich at Krilich, LaPorte, West & Lockner, P.S., 524 Tacoma Avenue S. Tacoma, Washington 98402. I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 16<sup>th</sup> day of August, 2007.



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STATE OF WASHINGTON  
BY \_\_\_\_\_ DEPUTY