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No. 36178-7-II

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

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

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

REPLY 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, income beneficiary of the Testamentary Trust Created for the Benefit of Donald M. Barovic, has appealed the Trial Court's Order Approving the Interim Accounting of the Donald Barovic Trust for the 2004 and 2005 accountings, the Trial Court's denial of Appellant Barovic's motion to continue the hearing on the 2004 and 2005 accountings, and for an order permitting discovery pursuant to RCW

11.96A.115.

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. REPLY ARGUMENT

A. The Trial Court erred by not finding that the Trustee breached 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.

The predominant argument posed by Respondent appears to focus on the belief that the provisions of the Trust Created for the Benefit of Donald M. Barovic are somehow in conflict with the Trustee's statutory obligations and duties posed by a wide variety of statutes; and therefore, the Trustee has not breached her fiduciary duties. However, the Respondent fails to demonstrate how the provisions of the Trust are in conflict with the statutory duties which Appellant argues were breached by the Trustee. In support of its argument, Respondent cites the Chapter 11.97 et.seq (Effect of Trust Instrument) which states:

The trustor of a trust may by the provisions of the trust relieve the trustee from any or all of the duties, restrictions,

and liabilities which would otherwise be imposed by chapters 11.95, 11.98, 11.100, and 11.104A RCW and RCW 11.106.020, or may alter or deny any or all of the privileges and powers conferred by those provisions; or may add duties, restrictions, liabilities, privileges, or powers to those imposed or granted by those provisions. *If any specific provision of those chapters is in conflict with the provisions of the trust, the provisions of the trust control* whether or not specific reference is made in the trust to any of these chapters, except as provided in RCW 11.98.200 through 11.98.240 and 11.95.100 through 11.95.150. In no event may the trustee be relieved of the duty to act in good faith and with honest judgment. *RCW 11.97.010 (emphasis added).*

To demonstrate this alleged conflict between the Trust provisions and the statutory duties and obligation of the Trustee, the Respondent repeatedly focuses on a subsection of Section Eighth of the Last Will and Testament of Andrea C. Barovic which grants the Trustee the authority to “purchase or otherwise acquire . . . any and all stocks, bonds, notes, or other securities, or any real or personal property, including stocks or interests in investment trusts and common trust funds . . ., whether or not such investments be of the character permissible for investments by fiduciaries. Investments need not be diversified and *may* be made or retained with a view to a possible increase in value.” (CP 105) (emphasis added).

The Respondent apparently believes that the foregoing subsection somehow modifies the primary purpose for the Trust, which clearly states

in section Fourth that the purpose of the Trust Created for the Benefit of Donald M. Barovic is to provide income for the income beneficiary. Therefore, the primary purpose of the Trustee in administering the assets of the Trust is to invest the principal assets in a manner as to provide an income for the income beneficiary.

FOURTH: A. My residuary estate shall be divided into three equal shares.
One share shall be distributed to PUGET SOUND NATIONAL BANK, as trustee, in the trust for the benefit of my son, DONALD M. BAROVIC. During the lifetime of my son, he shall receive, in at least annual payments, the net income of the trust estate. In addition, the trustee shall pay to him or to others on his behalf such of the principal as the Trus[tee] deems necessary or advisable to meet emergency needs of my son. (CP 88-89) (emphasis added).

Although the remaindermen (Donald Barovic's children) are entitled to the balance of the Trust upon Donald Barovic's death, the primary purpose of the Trust is to generate an income for the income beneficiary.

Section Fourth continues:

Upon the death of my son, the balance of the trust estate is to be distributed in equal shares, share and share alike, one share to his wife, PAMELA McCAIN BAROVIC, if she be then living and married to him at the time of his death, and one share to each of his then living children, or to the descendants of a deceased child of his, subject to the withholding provisions herein. (CP 89).

The Respondent next cites the basic fiduciary duties regarding the allocation of receipts and disbursement to or between principal and income found in RCW 11.104A.010 and the powers of the Trustee to adjust funds between principal and income found in RCW 11.104A.020 and states that these statutory duties “may be superseded by the specific language of the trust;” however, Respondent fails to cite any specific provision found in the Trust which conflicts with these statutory obligations. As there are no conflicts between the language of the Trust and the statutory fiduciary duties and obligations, the statutory obligations and powers to adjust are applicable to the Trustee’s actions. However, as previously argued in the Brief of Appellant, the Trustee failed to follow the statutory obligations, and therefore breached her fiduciary duty to the income beneficiary.

The Respondent argues that “the respondent trustee has always tried to maintain assets in the trust which not only generate a substantial income for the benefit of the income beneficiary, but also provide for some appreciation which would be for the ultimate benefit of the remaindermen.” *Brief of Respondent at 8*. Appellant believes that, considering the amount of assets contained in the Trust, the income generated by the Trustee was not reasonable, let alone “substantial.”

While the Appellant concedes that the Trustee owes a duty to the remaindermen as well as the income beneficiary, the underlying primary principal of trust management when there are multiple beneficiaries is to consider the interests of all the beneficiaries. As previously argued, Appellant believes that the actions taken by the Trustee clearly demonstrate a pattern of focusing on the interests of the remaindermen by investing the Trust assets in a manner which will provide significant principal appreciation while proportionally generating little income.

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 into account any differing interests of the beneficiaries. *RCW 11.100.045.*

As previously argued in detail in the hearing on the approval of the 2004 and 2005 accountings at the Trial Court level, and in the Brief of Appellant, the Trustee has breached her fiduciary duty by not acting impartially in managing the Trust assets and has acted in a manner which greatly favors increasing the principal of the Trust to the detriment of the income beneficiary.

The assets of the Trust include the Liberty Theater, which is leased by a tenant, the Canyon Creek Apartments, and the Nations Fund account

(presently the “Columbia Funds” account). The Respondent argues that the Nations Fund account generates income for the benefit of the income beneficiary through earned dividends. *Brief of Respondent at 4*. While it is correct that the Nations Fund did generate some income through dividends which were distributed as income (approximately 1%), the type of fund selected by the Trustee was greatly weighed toward principal appreciation. *Brief of Appellant at 7*. While the Fund was paying a 1% dividend, the Fund increased the principal amount by approximately 9%. *Id.*

With regard to the Canyon Creek Apartments, the Respondent states that “there is nothing in the record which would indicate that the income from the (Canyon Creek) property is unreasonably low.” *Brief of Respondent at 9*. However, as previously demonstrated by the Appellant, the record clearly demonstrates that the Canyon Creek Apartments generated little income for the income beneficiary while greatly appreciating in value. In the 2004 Interim Accounting filed by the Trustee, the Trustee states that the Canyon Creek Apartments generated an income of \$5,000.00 (CP 04). However, a closer inspection of the numbers provided by the Trustee in the 2004 Interim Accounting actually shows a \$8,064.00 loss. In 2005, the Canyon Creek Apartments apparently

generated an income of \$57,980.00. (CP 23). Therefore, during the 2004/2005 accounting period, the Canyon Creek Apartments averaged an income of approximately \$25,000, which represents an approximate 1% return based on the asset value of \$2,500,000.00. Clearly a 1% return on both the Nations Fund Accounts and the Canyon Creek Apartments, which make up the predominant income generating assets of the Trust, would be considered “unreasonably low.”

The Appellant has argued that the Trustee had a duty to make adjustments between the principal and income accounts. *Brief of Appellant at 11-12*. However, in the Brief of Respondent, the Respondent argues that RCW 11.104A.010 is “inapplicable to the case at bar” and does not, as argued by the Appellant, “grant the trustee the power to make adjustments between principal and interest based on what is fair and reasonable to all of the beneficiaries.” This argument is apparently supported by the conclusion that the language of the Trust only entitles Donald Barovic to “the net income of the trust estate,” and would prohibit such adjustments. *Brief of Respondent at 9*. This argument is without merit as the language of the Trust does not conflict in any way with the Trustee’s ability to make adjustments between principal and income as allowed by RCW 11.104A.

The Appellant has argued that the Trustee has a duty to administer the Trust impartially with respect to the income beneficiary and the remaindermen, and to ensure that the distributions between principal and income are equitably distributed between the multiple beneficiaries. *Brief of Appellant at 12*. Respondent argues that the Trust language regarding the distributions of the net income of the Trust estate to Donald Barovic “does [not] provide that the amount of income has to be reasonable.” *Id.* (*emphasis added*). However, in the next paragraph, inexplicably, the Respondent argues that “where the trust is creating reasonable income for the income beneficiary, there is no duty or legal requirement for the trustee to distribute more than the net income by granting the income beneficiary additional funds for some of the appreciation which may be occurring with regard to the principal assets.” *Brief of Respondent at 10* (*emphasis added*).

B. The Trial Court erred by finding that a court order permitting discovery is not required under RCW 11.96A.115 in a proceeding to approve an interim accounting filed under RCW 11.106.030 and for denying Appellant’s Motion to Continue the Hearings on the 2004/2005 Accountings.

The Appellant has argued that the Appellant was prohibited from conducting any discovery with regard to the 2004 and 2005 Interim

Accountings without a court order issued pursuant to RCW 11.96A.115. As the present matter did not involve a petition commenced under RCW 11.96A.100, but was an accounting filed pursuant to RCW 11.106.030, as the accounting was governed by the Trust and Estate Dispute Resolution Act (RCW 11.96A.020), discovery was only permitted upon a showing of good cause and the granting of a court order. Respondent replies that “the Appellant did not require court approval to conduct discovery,” but fails to mention, let alone provide any legal argument regarding RCW 11.96A.115. Respondent further argues that the motions were untimely; however, the Trial Court’s ruling was not based on timeliness. Judge Serko’s ruling on Appellant’s motion for a continuance of the hearing and an order permitting discovery was based on, in the Appellant’s view, a mistaken belief that an order permitting discovery under RCW 11.96A.115 was not required to allow the parties to conduct discovery. *Brief of Appellant at 16-17.* The Trial Court further based its decision on the belief that a continuance on the hearing to approve the 2004 and 2005 accountings was not necessary as the parties would be allowed to conduct discovery in the separate case of Barovic v. Pemberton. This ruling was error due to the fact that, as previously argued in the Brief of Appellant,

the newly added section of the Trust and Estate Dispute Resolution Act (“TEDRA” RCW 11.96A.115), clearly requires a court order in order for any discovery to be permitted. Additionally, the ability to conduct discovery regarding the Trustee’s breaches of fiduciary duties in the separate *Barovic v. Pemberton* matter as the approval of the 2004 and 2005 accountings, as previously decided by this Court, made those claims for breaches of any fiduciary duties during those accounting periods moot. *See Barovic v. Pemberton, 128 Wn. App. 196, 201, 114 P.3d 1230, 1233 (2005).*

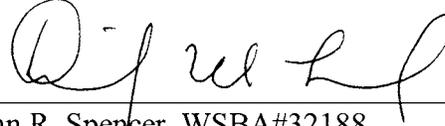
V. CONCLUSION

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 Trustee breached her fiduciary duties in her management of

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the Trust and surcharging the Trustee in an amount to be determined by the Trial Court.

Respectfully submitted,



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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.

SIGNED AND DATED this 21st day of November, 2007, at Tacoma, Washington.



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