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IN THE SUPREME COURT  
OF THE STATE OF WASHINGTON

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JOHN BEHNKE and CARL BEHNKE as Trustees and on behalf of the  
G.W. SKINNER CHILDREN'S TRUST and the G.W. SKINNER TRUST  
NO. 2,

Petitioners,

v.

EDWARD AHRENS and TERI AHRENS, et al.,

Respondents.

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**BRIEF OF RESPONDENTS**

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## I. INTRODUCTION

With full knowledge of all the risks, Appellants Carl and John Behnke implemented a tax shelter to avoid paying \$20 million in capital gains tax. When the very risks they were told about happened, they blamed everyone but themselves for their decisions, including the promoter, other law firms, and eventually Edward Ahrens.

The Behnkes are sophisticated co-trustees of family trusts who, with the help of a team of professional advisors, manage family assets worth over \$300 million. In October 2001, they decided to diversify their trust holdings. Mr. Ahrens was recommended and they sought his advice on tax shelters. But, the Behnkes were told from the outset they would need to hire another law firm to advise them on the shelter's merits. They selected Lewis Rice Fingersh ("Lewis Rice") to evaluate the shelter, help them implement it, and write a formal opinion letter sanctioning it. In Carl Behnke's words: "I concluded that Lewis Rice was the only law firm that could timely assist us in giving advice regarding the advisability of the strategies and proper implementation." RP 470.

Against the advice of several of their advisors, the Behnkes chose a shelter from The Heritage Organization ("Heritage"), an entity they believed was small enough to avoid IRS scrutiny. Indeed, in addition to Lewis Rice, the Behnkes also relied on Heritage for legal and financial advice. After learning the IRS was investigating their transaction, and after consulting yet another law firm, Preston Gates & Ellis ("PG&E"), they

decided to implement it anyway. Then, after the IRS declared this type of shelter illegal—a risk the Behnkes were warned of before proceeding—the Behnkes looked to assign blame to cover their bet after the fact. Initially they blamed Heritage—Carl Behnke stated that “Heritage ... committed professional malpractice,” Trial Exhibit (“TX”) 317 ¶ 6 (Appendix “App.” 2)—then Lewis Rice, later PG&E, and finally Mr. Ahrens.

The jury rejected much of their damage claim. Only then did the Behnkes decide to label the verdict as advisory. The jury was not an advisory jury and the trial court properly refused to reject the jury’s decision. Mr. Ahrens respectfully asks this Court to do the same.

## **II. RESTATEMENT OF ASSIGNMENTS OF ERROR AND ASSOCIATED ISSUES**

1. Did the court err in dismissing Consumer Protection Act (“CPA”) claims where the dispute was a private one with an attorney, when the conduct did not: (a) affect a *substantial portion* of the public; (b) affect the public interest; or (c) involve entrepreneurial conduct?

2. Where plaintiffs failed to cite any evidence establishing a genuine issue of material fact regarding key elements of their claim, did the trial court commit reversible error in dismissing CPA claims?

3. Where all their damages evidence was admitted into evidence and the jury used a verdict form and relied on jury instructions submitted by the plaintiffs, were the plaintiffs deprived of a fact-finder to consider their damages for breach of fiduciary duty?

4. When well-settled law mandates that the Rules of Professional

Conduct (“RPC”) are not to be used as a basis for civil liability and when the jury assessed the same conduct using the same legal standard and concluded the plaintiffs’ claimed damages were not proximately caused by the conduct that violated the RPC, were the plaintiffs entitled to have the trial court award anything but disgorgement over and above the jury’s verdict?

5. Did the trial court properly decline to reject a jury’s verdict—reached after weeks of testimony and many days of careful deliberation—as tainted by passion and prejudice, when the plaintiffs have presented no evidence (let alone “unmistakable” evidence) that the jury’s decision was the result of passion and prejudice?

6. Did the trial court properly decline to order additur where neither of the prerequisites for such relief are met?

7. Did the trial court properly hold that the conflict here was waivable (even while holding that it was not, in fact, waived)? And would any error nonetheless be harmless where both the trial court (for purposes of determining the RPC violation) and the jury (for purposes of determining the breach of fiduciary duty claim based on the conflict of interest) concluded that plaintiffs did not waive the conflict and awarded both proximately caused civil damages and disgorgement based on the conflict?

8. Where plaintiffs are judicially estopped from pursuing their claims because their sworn statements to a court in Texas are inconsistent with their current claims do alternate grounds exist for affirmance?

9. Where plaintiffs cannot show proximate cause because they

“opted to file an amended tax return and pay the resulting additional taxes . . . rather than attempting to vindicate their original reporting position,” do alternate grounds exist for affirmance under *Carroll v. LeBoeuf, Lamp, Greene & MacRae, LLP*, 623 F. Supp. 2d 504, 513 (S.D.N.Y. 2009)?

### III. RESTATEMENT OF THE CASE

#### A. Procedural Background

In September 2006, the Behnkes filed suit against Mr. Ahrens, his law firm, and several of his partners (the “Ahrens defendants”). The Behnkes alleged negligence, breach of contract, breach of fiduciary duties, negligent misrepresentation, and violation of the CPA. CP 1–22. Defendants answered and, among other things, alleged fault of others as an affirmative defense. CP 23–33. The Behnkes later filed an amended complaint alleging the same causes of action and adding the Lewis Rice law firm and one of its lawyers as co-defendants. CP 34–56.

The Ahrens defendants demanded a jury. Supp. CP 7367–68. In December 2008, they moved for partial summary judgment dismissing some claims, CP 848–75; and some legally untenable damages, CP 828–44. *See* CP 99–827. While those motions were pending, the Behnkes sought and obtained leave to file another amended complaint. Supp. CP 7433–44. The second amended complaint asserted claims only against Mr. Ahrens, his partner Darin DeAngeli, and their wives.<sup>1</sup> CP 1754–71. For the first time plaintiffs asserted fraud claims and sought disgorgement,

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<sup>1</sup> The Behnkes had settled their claims against Lewis Rice, and evidently decided they had no legal basis for their claims against Mr. Ahrens’ law firm and most of its attorneys. *See* Supp. CP 7369–7432.

in addition to millions of dollars of damages. CP 1769–71.

The trial court partially granted defendants’ motions, dismissing certain of the Behnkes’ damages claims, CP 3076–78; and their CPA claim, CP 3080–82. Trial was continued for several months, during which time the Behnkes abandoned claims against the DeAngeli defendants and their negligent misrepresentation and breach of contract claims. *See* CP 4793–4814 (Trial Brief); CP 4815–55 (Proposed Jury Instructions); CP 4853–55 (Proposed Special Verdict Form); CP 4858 (Dismissal Order).

The Behnkes also sought a summary determination “of liability on breach of fiduciary duty claim.” CP 1929–62. The trial court denied this motion because there were disputed issues of fact relating to the extent of the disclosures the Behnkes received. CP 3072–74. The Behnkes’ claims for intentional misrepresentation, intentional concealment, negligence, and breach of fiduciary duty were tried in October and November 2009.

**B. The Behnkes’ Brief Leaves Out Critical Facts**

RAP 10.3(a)(5) requires that the opening brief include a discussion of the “facts and procedure relevant to the issues presented for review.” Despite this rule, the Behnkes’ brief leaves out facts that are not only relevant but critical. Indeed, although they appeal from a month long trial, their brief contains only a handful of citations to the trial transcript.

**1. The Behnkes fail to mention that their relationship with Mr. Ahrens contemplated that the Behnkes would obtain advice from a separate law firm**

Nowhere in the Behnkes’ brief is there even a mention, let alone any discussion, of Lewis Rice. Lewis Rice is the separate law firm the

Behnkes hired to advise them regarding the Strategy. This omission is significant because the core of the Behnkes' theory was that they did not get independent legal advice due to Mr. Ahrens' claimed conflict of interest as a result of his relationship with Heritage.

The Behnkes, however, admit they paid Lewis Rice \$175,000 for implementing the Strategy, preparing all of the Strategy documents, forming all of the entities, and preparing the opinion letters advising them on the merits of the Strategy. RP 353; TX 12. (In contrast, Mr. Ahrens billed about \$12,000 for work on various issues over four years. TX 39.) The Behnkes also admit Mr. Ahrens told them from the outset another firm would have to provide them with an opinion of the Strategy's merits. RP 239 (Carl Behnke admitting Ahrens told him "[w]e needed, the plan that we went forward and did, needed to be examined by another law firm and they had to opine on if it was a good plan and if it was more likely than not to be—to pass muster with IRS. They looked at all of the elements of it"). Indeed, Mr. Ahrens' engagement letter presumes the existence of other counsel evaluating the Strategy and preparing a legal opinion.<sup>2</sup>

**2. Despite claiming the jury's decision resulted from passion and prejudice, the Behnkes fail to mention their lack of credibility on key causation testimony**

One of the most hotly-contested issues during the month long trial was proximate cause: whether Mr. Ahrens' conduct actually caused the Behnkes to incur the expenses they had paid in connection with the Strat-

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<sup>2</sup> TX 5 ("We will represent you in regard to the planning project that you are intending to do with The Heritage Organization and the law firm of Lewis, Rice & Fingersh, L.C. Our work will include review of the documents, planning designs and legal opinions in order to implement this planning.").

egy. Said differently, although there was no dispute the Behnkes paid various expenses and fees, the real dispute regarding these “damages” was whether the Behnkes could show proximate cause.

The Behnkes’ causation case theory boiled down to the idea that, before meeting Mr. Ahrens, they were not aware of Heritage and had Mr. Ahrens told them his true views on the Strategy or details about the extent of his relationship with Heritage, they never would have proceeded. Mr. Ahrens argued, on the other hand, that the evidence showed quite the contrary. Indeed, it was clear from the contemporaneous evidence and the Behnkes’ own admissions that they made a decision, knowing all the risks, to proceed with the Strategy despite warnings from their advisors. TX 6, 9 (App. 4–5). Further, even after they were aware that the IRS was targeting their transaction (and with the advice of yet another independent law firm, PG&E), they still decided to proceed. *See, e.g.*, TX 17 at 1–2 (App. 8); RP 2144–46. In other words, although it was true that the Behnkes were not familiar with Heritage before meeting Mr. Ahrens, it would have made no difference had they known more about his relationship with Heritage: they had a chance to save \$20 million and took that chance and the IRS shut down all firms using this type of shelter, not just Heritage.<sup>3</sup>

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<sup>3</sup> The trial court’s finding at CP 6376 reflects only the first part of the causation picture (Ahrens introduced the Behnkes to Heritage, RP 491), but does not address the disputed issues the jury decided as to what the Behnkes would have done if Mr. Ahrens provided them with more information. The jury had to decide whether, in Judge Learned Hand’s words, “the performance of the defendant’s duties would have avoided loss, and what loss it would have avoided.” *Barnes v. Andrews*, 298 F. 614, 616 (S.C.N.Y. 1924). Here, the jury concluded if Mr. Ahrens told the Behnkes more it would not have made much of a difference. To the extent the trial court’s finding is interpreted as inconsistent with the jury’s conclusion, it would be error if the court’s conclusion is relevant at all.

The Behnkes' proximate cause case rested heavily on their testimony. On direct examination, Carl Behnke portrayed Mr. Ahrens as their primary lawyer on the merits of the Strategy. Carl Behnke testified that: he "relied on Mr. Ahrens as his professional adviser," Mr. Ahrens "was the lawyer that gave [him] advice concerning the adviseability of the strategies," Mr. Ahrens was the one who "told [him] that the Heritage plan was legal," and Mr. Ahrens did not tell him about the risks of the Strategy, including the economic substance issues or the cases that were not favorable to the taxpayers. RP 360, RP 255–56. He tried to sell the jury on the idea that the responsibility for his decision to proceed should be laid at Mr. Ahrens' feet. The Behnkes' position was Mr. Ahrens recommended and directed them to hire Lewis Rice. CP 954; CP 4795 (trial brief).

But Carl Behnke was confronted on cross-examination with his own sworn statements to a Texas court that severely undermined his credibility on this key causation testimony. A copy of the relevant declaration is at CP 4863–70 (App. 1) and was marked for identification as TX 435. Carl Behnke was forced to admit that: TX 435 was his own declaration from a case involving the Behnkes and Heritage in Texas, he signed it under penalty of perjury, he understood the judge in Texas would be relying on what he said, and he was careful when he read it and understood it was an important document. RP 469. Mr. Behnke admitted he told the Texas court: "We relied on *Heritage* as our professional advisor and as an expert in the field of capital gains strategy," it was *Heritage's* recommendation that he followed in selecting Lewis Rice, "[t]he *Heritage* represen-

tative assured us that it was legal and the strategies were legal,” and it was *Heritage’s* advice that caused the Behnkes to suffer damage when they implemented the Strategy. RP 471–72 (emphasis added). In fact, Carl Behnke admitted he never mentioned Mr. Ahrens at all. RP 472.

As if that was not damaging enough, Carl Behnke was confronted with a second declaration, TX 317 (App. 2), he submitted in Texas. RP 473. He conceded he told the Texas court *Heritage* should pay the fees the Behnkes incurred to Heritage and other parties and these were the same damages he now claimed were Mr. Ahrens’ fault. RP 476, 474. In Texas, rather than blaming Mr. Ahrens, he blamed only Heritage and claimed Heritage’s professional misconduct caused the damages. RP 475; *see also* RP 1143–44 (Behnkes’ expert Durney admitting the Behnkes, through Linda Eads, told the Texas court Heritage was acting as their lawyer along with Lewis Rice and made no mention of Mr. Ahrens).

Carl Behnke’s declarations were not the only sworn statements fundamentally inconsistent with the Behnkes’ causation story. Carl Behnke also had to admit the Behnkes told the IRS under oath who they relied on for the Strategy and listed only Lewis Rice and Heritage. RP 493–94, 480–83; TX 326 at 57; TX 444 at 3 (App. 3); TX 437 at 6; TX 16 at 3; TX 383 at 7, 10, 16, 19, 106. The language of one of the IRS forms involved, Form 8886, was extremely broad: it required a listing of “each person to whom you paid a fee with regard to the transaction if that person promoted, solicited, or recommended your participation in the transaction, or provided tax advice related to the transaction.” App. 3 at 3. Carl

Behnke likewise admitted that the Behnkes told the IRS as part of their settlement that Heritage was their financial advisor and Lewis Rice was their legal advisor and did not name Mr. Ahrens. RP 487. Sally Behnke admitted they initiated the Strategy on *Heritage's* advice and paid Lewis Rice for a legal opinion on *Heritage's* recommendation. RP 165, 183.

The Behnkes' efforts to explain away these admissions were even more damaging. TX 444 was an email from John Behnke's assistant to their accountant, Les Curtis, sending Form 8886. John Behnke testified he must not have seen the form listed only Heritage and Lewis Rice and not Mr. Ahrens because he put his hand over it. RP 2141. Carl Behnke, for his part, tried to blame Mr. Curtis: "Mr. Curtis prepared [Form 8886]. He made a mistake. At th[at] time, Mr. Curtis was at the end of his career .... He probably wasn't as sharp as he once was." RP 649. Of course, this blame-laying was hollow in that he had earlier admitted Mr. Curtis was a "good accountant" that they used "for many years." RP 478–79.

Also as part of their attempt to blame Mr. Ahrens, the Behnkes tried to convince the jury that they believed (and were told by Mr. Ahrens) that the Strategy had a 99 percent chance of success, something Mr. Ahrens denies saying. RP 238, 511–12, 2090–91, 1478. Carl Behnke testified this was the reason he went forward with the Strategy. RP 522. Of course, this testimony was belied by exhibits showing the Behnkes were informed the Strategy was "more likely than not" to succeed; in other words, only greater than 50 percent. *E.g.*, TX 12 at 10. When forced to explain, Carl Behnke claimed that, contrary to its plain meaning, he was

“told [by both Mr. Ahrens and Lewis Rice] that the more likely than not standard meant 90 percent.” RP 511–12. Incredibly, Carl Behnke testified he believed “more likely than not” actually meant “virtually certain.”

The Behnkes’ testimony that Mr. Ahrens told them the Strategy was a virtual slam dunk were also belied by their own admissions they were informed of and understood the Strategy’s risks. For example, although Carl Behnke tried to deny he was shown the extensive risk disclosures contained in TX 13 during his meetings with Heritage, RP 266, 496, he admitted his own declaration from Texas described the risk portion of TX 13. RP 496–97. In other words, after telling the jury that he was never shown the critical risk section of one of the most significant trial exhibits, Carl Behnke had to admit that he really did see it after all because he described it to the Texas court when it suited his purposes there.

Carl Behnke also testified nobody told him the Strategy was aggressive. RP 284. This testimony was belied by that of others in the same meetings, including his mother. RP 162 (Sally Behnke admitting she understood it was an “aggressive tax strategy”); RP 170, 713 (Mr. Adamonis, a co-trustee of the family trusts, admitting it was an “aggressive tax strategy”); 716 (Adamonis admitting Ahrens “made it clear that the transaction was an aggressive tax strategy”). Indeed, the Behnkes admitted they understood all of the risks of the Strategy, including the very risks that actually came to pass, and decided to proceed anyway.<sup>4</sup>

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<sup>4</sup> RP 152–54, 155–57, 501 (Carl Behnke admitting he understood the IRS could change the law retroactively and Heritage and Mr. Ahrens informed him of that risk); RP 505 (Carl Behnke admitting he was told the Strategy was subject to

Other testimony confirmed the Behnkes received extensive disclosures on the risks before deciding to proceed. RP 2067–68, 2071–80 (Heritage representative Ralph Canada describing disclosure process); TX 13. Further, Mr. Adamonis—the co-trustee of the trusts along with the Behnkes, a professional trustee from Union Bank of California—told John Behnke the bank was not happy with the transaction, and demanded and received an indemnification letter from them. RP 2115, TX 6 (App. 4).

After telling the jury Mr. Ahrens did not tell him about the economic substance issues or the cases unfavorable to taxpayers, RP 255–56—testimony already belied by the Texas declarations—Carl Behnke made a further critical admission. One of the key adverse case law developments according to the Behnkes’ trial theory was *Salina Partnership LP v. Commissioner*, T.C. Memo. 2000-352 (Nov. 14, 2000). After denying Mr. Ahrens told him about *Salina*, Carl Behnke was impeached with his own deposition admitting Mr. Ahrens discussed it with him. RP 506.

A huge hurdle for the Behnkes’ causation case against Mr. Ahrens was the fact that they hired not one but two other law firms to advise them on the Strategy: Lewis Rice and, later, PG&E. Even more significantly, they hired PG&E in 2003 *after* learning the IRS was targeting their transaction and before they had taken a position on the Strategy on their tax

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challenge under § 752); RP 506 (Carl Behnke admitting he was told of the potential for a penalty); RP 555–56 (Carl Behnke admitting he understood Notice 2000-44 could be expanded to include the Heritage plan and the expansion could be retroactive); RP 601–02 (Carl Behnke admitting he understood there was a risk they would have to litigate against the IRS over whether the plan was legal); RP 2104–05; 2111–12 (John Behnke admitting he understood risks); RP 2112 (John Behnke admitting he knew the IRS might be focusing on the strategy).

return. Thus, they still had the option to just pay their taxes, in John Behnke's words, "like everybody else." TX 18.

To overcome these hurdles, the Behnkes suggested that, even after they hired PG&E to advise them regarding whether to take advantage of the Strategy, *see* TX 17 (App. 8), nonetheless Mr. Ahrens was the lawyer they looked to for advice. Again, the Behnkes' credibility on this causation point was undermined by their own admissions and other evidence. For example, their PG&E lawyer, Lance Behnke (no relation), testified they never mentioned Mr. Ahrens' name. RP 2023.

In 2003, after the Behnkes learned the IRS was targeting the Strategy, Lance Behnke prepared a memorandum (TX 17) discussing the risks and benefits of different tax alternatives, ranging from claiming the full advantage of the Strategy to abandoning it and paying the full amount due. In an effort to convince the jury the damages resulting from their choice of how to proceed were still Mr. Ahrens' fault (even though the Behnkes had independent advice from another law firm regarding their options and by this time they knew the IRS was targeting their transaction, TX 17 at 1 (App. 8)), John Behnke testified he discussed TX 17 with Mr. Ahrens in an October 3 call.<sup>5</sup> Mr. Behnke, however, had a difficult time explaining how that could be true because TX 17 *did not exist on October 3* and was not prepared and circulated until November 6, 2003. RP 2152, 2154–57.

Another fact relevant to causation and other issues (such as

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<sup>5</sup> That meeting was so short that Mr. Ahrens did not bill for it. TX 39. But the Behnkes had no other conversation between Mr. Ahrens and the Behnkes during this time frame that would have supported their causation theory. *Id.*

whether any conflict was waivable) was the Behnkes' sophistication. On this point, Carl Behnke tried to convince the jury he was not sophisticated with money. RP 230. This testimony too was incredible: he went to Princeton and then Harvard Business School; he served as Vice President then President of ALPAC, the family bottling company, which he ran for about ten years; under his tenure, it became the second largest Pepsi bottling company in the country; and he bought Sur La Table and grew it from one store to 75 around with \$200 million in sales. RP 216–17, 219–21, 225, 227. And, of course, he served as trustee for his family trusts, handling hundreds of millions of dollars. His testimony was even contradicted by his brother, John Behnke, who admitted he was a “sophisticated investor,” who gained familiarity with tax shelters before meeting Mr. Ahrens and was introduced to them in the mid-1990s. RP 2092, 2099.

In light of this testimony, it is not surprising that the trial court discredited Carl Behnke's testimony. The Court found that the Behnkes were indeed just as sophisticated as they appeared. CP 6378 ¶ 4.

The Behnkes also tried to convince the jury that, if Mr. Ahrens had disclosed the amount of payments he (through FWP) received from Heritage over the years, they would never have proceeded. Carl Behnke testified he would have wanted to know about those payments because it would mean there was cross-loyalty. RP 251–52. There were three problems with this. First, the jury just did not believe him given his lack of credibility. Second, the Behnkes were told Heritage was a past and current client and never claimed they did not know Mr. Ahrens was being

paid. TX 5 at 3. They also knew the type of work he did for Heritage—providing legal advice and tax strategies. *Id.*; RP 2123–24.

Third, other evidence the Behnkes' brief fails to mention undermined Carl Behnke's claim he would not have proceeded if Mr. Ahrens told him the amount Heritage had paid through the years. For instance, one of Carl Behnke's investment advisers warned him that he should ask whether any finder's fees were involved in the Heritage case. TX 9 (App. 5). Nonetheless, the Behnkes never asked whether anyone would receive a finder's fee on their transaction. RP 2084.<sup>6</sup> Instead, there was clear evidence that when the Behnkes approached Mr. Ahrens, they had already committed themselves to pursuing a tax shelter. RP 2070–71.

In sum, the facts showing the cross-loyalty Carl Behnke claimed to be so concerned about were disclosed and they proceeded anyway. Thus, the jury had ample evidence to conclude the Behnkes were intent on proceeding with the Strategy and would have proceeded even if Mr. Ahrens had disclosed more about his relationship with Heritage.

**3. The Behnkes' brief likewise fails to mention important evidence about the Behnkes' core case theory**

A core case theory for the Behnkes was that Mr. Ahrens did not tell them his true views about the Strategy. The Behnkes relied heavily on TX 196, a February 2000 memorandum in which Mr. Ahrens expresses

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<sup>6</sup> In this regard, the Behnkes also fail to mention that Carl Behnke admitted that he had *no evidence* Mr. Ahrens received any money from Heritage relating to the Behnkes' transaction. RP 557; *see also* RP 1365–68 (Mr. Ahrens' testimony that he did not believe any of the payments related to the Behnkes); TX 207, 230 (showing the payments to FWP from Heritage do not align in timing or amount with the payments the Behnkes made to Heritage).

concerns about the Strategy to Heritage. Notably, the Behnkes' brief does not mention this theory. At trial, this theory was severely undermined because the Behnkes failed to provide their own experts with a critical memorandum, TX 375, showing Mr. Ahrens' views had changed.

The plaintiffs' intentional dishonesty case theory was highlighted in their opening statement. RP 34 (stating that Mr. Ahrens "deliberately didn't tell [Mr. Behnke] his true and honest views about the transaction. He thought it had enormous problems. Yet he was steering him into it, and recommending it and said that it was a good solid program. That broke the duty of honesty. Those simple things are why we are in this courtroom. As a result, the family trusts lost millions of dollars."); *see also* CP 4794, 4797 (stating if the Behnkes had known Ahrens' true opinion, they would not have proceeded). Carl Behnke's testimony also emphasized the theme. RP 243-44 (stating Ahrens never told him about extreme concerns with the Strategy's viability). Likewise, the Behnkes' experts emphasized TX 196, treating it as a smoking gun, and opined Mr. Ahrens had a duty to tell the Behnkes of his views expressed in TX 196.<sup>7</sup>

It became clear, however, the Behnkes had not shared with their own experts a critical memorandum showing Mr. Ahrens' views had changed because of several significant taxpayer victories in court and a favorable settlement. TX 375. In fact, Peter Jarvis, the Behnkes' ethics

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<sup>7</sup> RP 763 (Jarvis opining Ahrens had a duty to inform the Behnkes about his views in TX 196); RP 940-41 (Jarvis admitting a "significant portion" of his testimony related to TX 196); RP 864 (Jarvis referring to TX 196 as the "famous or infamous Exhibit 196"); RP 1097 (Michael Durney admitting TX 196 was his "starting point for whether or not Mr. Ahrens was honest and loyal").

expert, admitted his opinion was predicated on the idea there was no evidence that either the legal environment for the Strategy had changed between TX 196 and Mr. Ahrens' meeting the Behnkes or that Mr. Ahrens had changed his opinion as set out in TX 196. RP 941–42. He agreed that a lawyer must give his honest view of the law at the time to the client. RP 942. He admitted that the plaintiffs never showed him TX 375 or a related memorandum, TX 164 (App. 9), RP 957–58, which showed Mr. Ahrens' views had changed and the legal environment had improved.

**4. The Behnkes' brief omits significant information about even the jury verdict from which they appeal**

The Behnkes likewise fail to mention significant facts regarding the jury's verdict. First, the jury was instructed using very broad breach of fiduciary duty instructions the Behnkes submitted. *Compare* CP 4838–39 *with* CP 7088–89. The jury used a verdict form the Behnkes submitted (over Mr. Ahrens' objection) that included specific line items for each item of damage the Behnkes claimed was caused by Mr. Ahrens' breach of fiduciary duty. *Compare* CP 4853–55, 5323–27 *with* CP 5413–16. The Behnkes made no exceptions to the jury instructions. RP 2876–77.

The Behnkes fail to mention as well that the jury rejected all of the claims they made based on intentional conduct: both those based on misrepresentation and those based on concealment. CP 5413–16. The jury found in the Behnkes favor on the non-intentional torts (breach of fiduciary duty and negligence) and concluded Mr. Ahrens breached his fiduciary duty but that his breach only caused \$6,162.25 in damages. *Id.*

**5. Although the Behnkes attack the jury's verdict as non-**

**sensical, they fail to inform the Court of the evidence that supports the jury's conclusion**

Pointing to the verdict form, the Behnkes attack the jury's verdict as difficult to understand, suggesting it is not grounded on the evidence. But they failed to mention key facts that support the jury's conclusion.

As to the breach of fiduciary duty claim, the jury awarded the Behnkes 50 percent of the fees Mr. Ahrens billed to them during his engagement as proximately caused by Mr. Ahrens' breach of fiduciary duties in failing to properly disclose and obtain a waiver for the conflict: \$6,125.25. CP 5413-16. The jury had evidence that the Behnkes arranged directly with Heritage for Heritage to pay the other 50 percent. TX 5 at 3. A separate section of the jury form asked the jury to assign comparative negligence percentages to Mr. Ahrens and the Behnkes, and the jury assigned 53 percent of the fault to Mr. Ahrens and 47 percent to the Behnkes. CP 5413-16. But this section does not apply to the breach of fiduciary duty claim, only the negligence claim.

**C. The Behnkes Got What they Paid For But Chose to Abandon the Strategy Despite Advice They Could Prevail**

In the end, with full information about the risks (and ample potential rewards) of the Strategy, the Behnkes decided to take a shot at saving \$20 million in taxes. Despite their initial efforts to deny it, they understood that the Strategy was risky and was not guaranteed.

But then, instead of fully implementing the Strategy, the Behnkes ultimately decided not to take the risk of litigation with the IRS and settled. RP 602. They did this even though PG&E advised them that it was

not “clear the IRS will be successful” in any such litigation. *Id.* No evidence was presented at trial that undermined Lewis Rice’s opinion letter, which (after lengthy analysis) concluded that the Strategy was more likely than not to succeed if defended in litigation with the IRS. TX 12.

#### IV. ARGUMENT

##### A. **The Trial Court Properly Dismissed the Behnkes’ CPA Claim on Summary Judgment**

###### 1. **The Behnkes failed to provide evidence of the essential elements of their CPA claim**

The Ahrens defendants moved for summary dismissal of the CPA claim. CP 848–75; *see* CP 99–827. They did so because under *Short v. Demopolis*, 103 Wn.2d 52, 61, 691 P.2d 163 (1984), the CPA claim did not involve the entrepreneurial or commercial aspects of law; and because federal court decisions involving similar facts and applying settled Washington law, established that the Behnkes could not meet the unfair or deceptive act and/or public interest elements of a CPA claim. CP 873–74 (citing *Malone v. Clark Nuber, P.S.*, 2008 WL 2545069 (W.D. Wash. June 23, 2008); *Swartz v. KMPG, LLC*, 401 F. Supp. 2d 1146, 1153–54 (W.D. Wash. 2004), *aff’d in relevant part*, 476 F.3d 756, 761 (9th Cir. 2007)). The trial court agreed, dismissing the CPA claim. CP 3080–82.

The Behnkes ask this Court to reverse that summary judgment ruling, but do so without mentioning the evidence on summary judgment. This failure is procedurally dispositive. It also underscores the dearth of evidence supporting the Behnkes’ CPA claim. The undisputed summary judgment evidence established that the Behnkes are highly educated professionals with years of experience running corporations and trusts. CP

122–23, 147–48, 622, 628, 953. Aided by a team of CPAs, lawyers, and investment advisors, the Behnkes manage family assets worth over \$300 million. CP 123–25, 128–32, 953, 1692. Upon the recommendation of one of their advisors, the Behnkes sought out Mr. Ahrens for advice on how to shelter some \$100 million from capital gains taxes. CP 155–56, 266, 953. Ahrens suggested multiple tax strategy entities and tax strategies; the Behnkes selected Heritage’s § 752 shelter. CP 142, 157–60, 185–88, 212. They did so knowing the risks and against the advice of their advisors. CP 172–74, 331–479, 639, 641, 721–23.

The Behnkes premised their CPA claim on Ed Ahrens’ allegedly inadequate disclosures. John Behnke admitted Ahrens orally disclosed that he had created some tax strategies for Heritage; and the Ahrens defendants disclosed in writing that they provided legal services to Heritage. CP 170–71, 522. What allegedly was not disclosed was that Heritage paid Ed Ahrens (through FWP) royalties when it used his tax strategies. Br. at 1, 21. But whether or not Mr. Ahrens made that disclosure, it was undisputed he did not believe he would receive Heritage royalties if the Behnkes selected Heritage’s Strategy; and when he did believe he would receive royalties, he disclosed that to his clients. CP 200–01, 1259–60, 1274–75, 1729–30; *see* CP 2864–81. (Indeed, at trial, Carl Behnke admitted that he had *no evidence* Mr. Ahrens received any money from Heritage relating to the Behnkes’ transaction. *See supra* note 6.) The only reasonable inference to draw from those undisputed facts was that the alleged failure to disclose was not influenced by entrepreneurial motives.

These undisputed facts were dispositive of the CPA claim. They established (1) no one else had been or would be injured by a failure to disclose royalty information; (2) there was no likelihood additional plaintiffs had been or would be injured in exactly the same fashion; (3) the Behnkes were not representative of bargainers subject to exploitation and unable to protect themselves; and (4) Ahrens' alleged nondisclosure did not relate to the entrepreneurial or commercial aspects of his law practice.

The purpose of the CPA is "to protect the public from acts or practices which are injurious to [Washington] consumers and not to provide an additional remedy for private wrongs which do not affect the public generally." *Lightfoot v. MacDonald*, 86 Wn.2d 331, 333, 544 P.2d 88 (1976) (citing RCW 19.86.920); see RCW 19.86.010(2) (defining trade and commerce as sales and services "affecting the people of the State of Washington"). To prevail on a CPA claim, a plaintiff must prove five elements: (1) an unfair or deceptive act or practice; (2) occurring in trade or commerce; (3) affecting the public interest; (4) that injures the plaintiff in his business or property; and (5) a causal link between the unfair or deceptive act and the injury suffered. *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.*, 105 Wn.2d 778, 785-93, 719 P.2d 531 (1986). As explained more fully below, the evidence before the trial court on summary judgment did not establish any of the first three elements.

**2. The Behnkes failed to establish the unfair or deceptive act or practice element of their CPA claim**

*Hangman Ridge* held that to show an unfair or deceptive act or practice, plaintiff must show "the alleged act had the *capacity* to deceive a

**substantial portion** of the public.” 105 Wn.2d at 785 (bold added); *accord Travis v. Wash. Horse Breeders Ass'n*, 111 Wn.2d 396, 406, 759 P.2d 418 (1988); *Burns v. McClinton*, 135 Wn. App. 285, 302–03, 143 P.3d 630 (2006), *rev. denied*, 133 Wn.2d 1005 (2007); *Goodyear Tire & Rubber Co. v. Whitman Tire, Inc.*, 86 Wn. App. 732, 744, 935 P.2d 628 (1997). In *Travis*, plaintiff showed that defendant horse sellers, using media designed to reach new buyers, routinely represented horses as being top quality without verifying the horses’ physical condition, and that these practices led to the sale of other unsound horses. 111 Wn.2d at 406. In *Burns*, on the other hand, this element was not satisfied because plaintiff failed to show with evidence (not speculation) that any other clients were deceived in the same way. 135 Wn. App. at 303–06.

This case is like *Burns*. The Behnkes provided no evidence of any other Ahrens’ client (let alone a Washington client) having been deceived by a failure to disclose royalties. Nor did such evidence exist, as Ahrens made such disclosures when (unlike here) he believed royalty payments would be forthcoming. CP 200–01, 1259–60, 1274–75, 1729–30; *see* CP 2864–81. Under the cases cited above that is dispositive. If plaintiff cannot show that the complained of conduct could deceive anyone else, plaintiff has not established the deceptive act or conduct element of the CPA. *Hangman Ridge*, 105 Wn.2d at 785–86; *Burns*, 135 Wn. App. at 303–06.

On appeal the Behnkes try to avoid this rule, claiming the court ruled the CPA does not protect the wealthy. No case so holds and neither did the court. What *Malone*, *Schwartz*, and the trial court held is that if the

evidence provides no basis for inferring the alleged conduct could affect more than a small group of people, there is no CPA claim. *Malone*, 2008 WL 2545069 at \*10; *Schwartz*, 401 F. Supp. 2d at 1153–54. The district court in *Schwartz*—a case also involving a failed tax shelter—thus held:

The number of consumers who could conceivably find themselves in plaintiff’s circumstances – looking for a tax savings on millions of dollars of capital gains – is extremely small and unable to qualify as “a substantial portion of the public” under any reasonable definition .... *As a matter of law, conduct directed toward a small group cannot support a CPA claim.*

401 F. Supp. 2d at 1153–54 (emphasis added; citing *Micro Enhancement Int’l, Inc. v. Coopers & Lybrand, LLP*, 110 Wn. App. 412, 438–39, 40 P.3d 1206 (2002); and *Henery v. Robinson*, 67 Wn. App. 227, 289–91, 834 P.2d 1091 (1992)); accord *Malone*, 2008 WL 2545069 at \*10.

The Behnkes also try to distract the Court from their “substantial portion of the public” failure of proof by arguing that Ahrens’ purported conduct had the capacity to deceive a “substantial portion” of the “purchasing public” who would seek his tax shelter advice. But the Behnkes cite no case supporting the idea that a subset of an already small subset (the tax shelter “purchasing public”) of the general public can bring a CPA claim. Nor do they explain why CPA law should adopt that approach, which is contrary to the very purpose of the CPA: to protect the general public, “not to provide an additional remedy for private wrongs which do not affect the public generally.” *Lightfoot*, 86 Wn.2d at 333.

Under settled Washington law, whether one looks at “the public” or the “purchasing public,” plaintiff must show the acts in issue have the capacity to deceive a substantial portion of the public. *E.g., Hangman*

*Ridge*, 105 Wn.2d at 785. The Behnkes cite no case to the contrary and indeed, their “purchasing public” cases largely involve consumer disputes, not private disputes such as this one.<sup>8</sup> The case from which they quote, for example, involved sales of a consumer product (re-refined automotive oil labeled “new”) marketed to the general public. *Kerran v. Fed. Trade Comm’n*, 265 F.2d 246, 247–48 (10th Cir. 1959). It is inapposite.

In sum, the Behnkes gave the trial court no evidence anyone else was deceived by Ahrens’ failure to disclose Heritage royalty payments. The trial court did have undisputed evidence that when Ahrens believed royalty payments would be forthcoming, he disclosed that information. *See supra* at 20. Given this undisputed evidence, the trial court could not have found the Behnkes showed “the alleged act had the *capacity* to deceive a **substantial portion** of the public,” *Hangman Ridge*, 105 Wn.2d at 785 (bold added). That failure of proof—regardless of wealth—required

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<sup>8</sup> To the extent they relate at all, these “purchasing public” cases involve products purchased by or acts potentially affecting significant numbers of consumers. *Haner v. Quincy Farm Chems., Inc.*, 97 Wn.2d 753, 649 P.2d 828 (1982) (defective wheat seed); *Burbo v. Harley C. Douglass, Inc.*, 125 Wn. App. 684, 106 P.3d 258 (2005) (home builder who advertised to general public); *Magnay v. Lincoln Mut. Sav. Bank*, 34 Wn. App. 45, 659 P.2d 537 (1983) (due on sale clause in deed of trust); *Testo v. Russ Dunmire Oldsmobile, Inc.*, 16 Wn. App. 39, 554 P.2d 349 (1976) (used car sales). The *Hangman Ridge* court described *Haner* and *Testo* as consumer transactions. 105 Wn.2d at 789–90.

No more supportive are cases the Behnkes cite for their “CPA protects the wealthy” arguments. While that principle is not disputed, it is telling that they still misstate the cases’ holdings. For example, the Behnkes say one held that excess insurers can pursue CPA claims against primary insurers, but in fact it involved claims an insurer brought on behalf of its insured through subrogation. *First State Ins. Co. v. Kemper Nat’l Ins. Co.*, 94 Wn. App. 602, 610–11, 971 P.2d 953 (1999). They say another allowed an insurer to bring CPA claims against a drug company, but in fact the Court affirmed the trial court’s rejection of that claim. *Wash. State Physicians Ins. Exch. & Ass’n Corp. v. Fisons Corp.*, 122 Wn.2d 299, 323–24, 858 P.2d 1054 (1993). The Behnkes also cite *Travis*, but, unlike here, as explained above, it involved deceptive conduct repeatedly directed at a significant number of potential purchasers. 111 Wn.2d at 406.

dismissal of their CPA claim. *See Micro Enhancement*, 110 Wn. App. at 438–39 (proper to summarily dismiss CPA claim where plaintiff “failed to present evidence from which a reasonable trier of fact could conclude [defendant’s acts] could deceive a substantial portion of the public.”).

**3. The Behnkes failed to establish the public interest element**

The trial court properly dismissed the Behnkes’ CPA claim for an independently dispositive reason—their failure to establish their dispute with the Ahrens defendants affects the public interest. Disputes involving professional services are private disputes. *E.g., Hangman Ridge*, 105 Wn.2d at 790 (citing cases). Whether the public has an interest in a private dispute turns on whether: (1) the acts were committed in the course of defendant’s business; (2) defendant advertised to the public in general; (3) defendant actively solicited this particular plaintiff, indicating potential solicitation of others; and (4) plaintiff and defendant occupied unequal bargaining positions. *Id.* at 790–91. There is no unequal bargaining position when plaintiff is an experienced businessperson and/or is receiving professional advice. *Id.* at 794. Disputes involving such plaintiffs do not affect the public interest because such plaintiffs “are not representative of bargainers subject to exploitation and unable to protect themselves.” *Id.*; accord *Goodyear*, 86 Wn. App. at 744–45; *Pac. Nw. Life Ins. Co. v. Turnbull*, 51 Wn. App. 692, 702–03, 754 P.2d 1262 (1988); see *Segal Co. v. Amazon.com*, 280 F. Supp. 2d 1229, 1234 n.5 (W.D. Wash. 2003). Put differently, experienced and professionally advised businesspersons are not the kinds of persons the CPA was enacted to protect.

Here, the Behnkes presented no evidence showing the Ahrens defendants advertised their tax shelter work to the public, they admit they sought out Ed Ahrens, and it was uncontested at summary judgment not only that a host of CPAs, attorneys, and financial advisors were advising the Behnkes, but that they advised the Behnkes not to proceed. Under *Hangman Ridge*, this case does not involve an unequal bargaining position. Nor does it involve the public interest. 105 Wn.2d at 794. When, as here, the record shows no widespread advertising, no solicitation of plaintiff, and plaintiffs had substantial business experience and retained other professional advisors, their CPA claims fail for lack of public interest. *E.g., id.* at 794–95; *Goodyear*, 86 Wn. App. at 744–45.

The trial court here reached the same conclusion under *Schwartz* and *Malone*—cases that applied settled Washington law to CPA claims involving tax shelters. *See supra* at 22–23. Consistent with *Hangman Ridge* and its progeny, the *Schwartz* and *Malone* courts noted that multimillionaires seeking tax shelters “are not the focus of the legislative intent behind the CPA” and “the extremely wealthy are neither unsophisticated nor easily subject to chicanery.” *Schwartz*, 401 F. Supp. 2d at 1153–54 (citing *Goodyear*, 86 Wn. App. at 745); *Malone*, 2008 WL 2545069 at \*10.

On appeal, the Behnkes argue this was error because CPA claims survived in *Eriks v. Denver*, 118 Wn.2d 451, 824 P.2d 1207 (1992), and *Cotton v. Kronenberg*, 111 Wn. App. 258, 44 P.3d 878 (2002), *rev. denied*, 148 Wn.2d 1011 (2003), two cases involving attorneys accused of

fiduciary breaches. They are mistaken. Although the Behnkes say “*Eriks is fundamentally on all fours*,” Br. at 28; *Eriks* was a class action brought by at least 240 investor-clients who all suffered the same injury. 118 Wn.2d at 454–55; see *Lightfoot*, 86 Wn.2d at 338 (distinguishing for CPA purposes between class action against an attorney and claims by a single client). Moreover, the *Eriks* plaintiffs did not prevail on their CPA claim. The trial court refused to declare as a matter of law that defendant’s acts violated the CPA and refused to award CPA treble damages or fees and costs. This Court affirmed. 118 Wn.2d at 456, 463–65.

*Cotton* is no more supportive of the Behnkes. It involved CPA claims premised on an attorney’s fee agreement. The trial court entered summary judgment for the client on his CPA claim, but the appellate court reversed, questioning the sufficiency of evidence that three other of defendant’s clients had filed bar complaints regarding his fee agreements and collection practices. 111 Wn. App. at 263–64, 273–75. Here, of course, the Behnkes did not submit even that minimal amount of evidence; in fact, there is no evidence of any other client complaining Mr. Ahrens failed to make the type of disclosures that are the basis of their CPA claim here.

**4. The Behnkes failed to establish the trade or commerce element**

In *Short*, the Court held that claims attacking the performance of an attorney’s legal advice and services are not actionable under the CPA. 103 Wn.2d at 61–66. But claims that “primarily challenge the entrepreneurial aspects of legal practice – how the price of legal services is determined, billed, and collected and the way a law firm obtains, retains, and

dismisses clients” are “trade or commerce” under RCW 19.86.010(2) and 19.86.020 and subject to the CPA. 103 Wn.2d at 61, 65. The Behnkes do not explain how their non-disclosure/breach of fiduciary duty claims primarily challenge the entrepreneurial aspects of the Ahrens defendants’ law practice. Nor do they cite any case finding such claims within the CPA’s purview. *Eriks* is not such a case: the trial court found no CPA violation. 118 Wn.2d at 463–65. In any event, the *Eriks* court made clear that a conflicted attorney “only violated the CPA if he failed to disclose the conflict for the purpose of obtaining clients or increasing profits.” *Id.* at 465. No evidence before the trial court permitted an inference of that motive here.

To survive summary judgment, the Behnkes had to show Mr. Ahrens’ alleged nondisclosure was influenced by entrepreneurial motives. *Id.*; see also *Michael v. Mosquera-Lacy*, 165 Wn.2d 595, 603–04, 200 P.3d 695 (2009). They did not. The Behnkes sought out Ed Ahrens. It was undisputed that Mr. Ahrens did not believe he would receive a royalty from Heritage even if the Behnkes used a strategy he developed. It was undisputed that when Mr. Ahrens did believe a royalty would be paid, he disclosed that fact. *See supra* at 20. From this undisputed evidence reasonable persons could reach just one conclusion: Mr. Ahrens’ alleged nondisclosure did not result from some entrepreneurial impulse—it was at most a negligent omission.<sup>9</sup> The Behnkes failed to establish the “trade or commerce” element of their CPA claim and for that reason, too, the trial

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<sup>9</sup> The jury effectively agreed when it rejected the “intentional misrepresentations or material concealments” claims, and found for Behnkes only on their non-scienter legal malpractice and breach of fiduciary duty claims. CP 5413–14.

court committed no error in dismissing the Behnkes' CPA claim.

**B. The Behnkes' Major Premise—that “No One Ever Considered” Their “Undisputed” Damages—is False**

The centerpiece of the Behnkes' arguments on appeal is that, in their words, “no one ever considered” the damages they claim are “undisputed.” *See, e.g.*, Br. at 43. This premise is simply false.

**1. The jury considered and rejected the damages the Behnkes now seek**

The jury fully considered the Behnkes' claim that Mr. Ahrens' conduct caused them millions of dollars in damages. All of their damages evidence was admitted for the jury's consideration. The Behnkes just do not like the jury's conclusion. But the Behnkes likewise recognize that determining damages is “within the jury's province” and that “courts are generally reluctant to interfere with a jury's damages award.” Br. at 39. Because of such case law, and because the jury's conclusion was amply supported by the evidence, the Behnkes know they could not prevail in a head-on challenge to the verdict, so they have come up with a number of theories to get around the jury's decision, all of which lack merit.

The trial in this case spanned a month. RP 1–2908. One of the key disputed issues the jury was asked to resolve was proximate causation. Thus, although the Behnkes label their “damages” as “undisputed consequential damages,” *e.g.*, Br. at 2, they were anything but. Mr. Ahrens never disputed that the Behnkes incurred the costs they claimed as damages, but a significant part of the four week trial addressed whether the Behnkes incurred those costs because of anything Mr. Ahrens did. In fact,

the Behnkes' own expert, Evin Morris, confirmed that point:

Q. [T]o what extent, if any, do you render an opinion that the conduct of Mr. Ahrens caused those damages?

A. I am not rendering an opinion as to causality. That issue as I understand it is for the jury to decide.

What I have done is an analysis of the costs that have been incurred, assuming that the jury finds that Mr. Ahrens breached his duties as a lawyer, and that as a result of that breach, that the Trusts incurred these costs.

I understand that Mr. Behnke has testified that absent the improper conduct of Mr. Ahrens, that these costs would not have been incurred.

My calculations assume that the jury find[s] that that is correct; that, therefore, these costs constitute damages.

RP 1188–89.<sup>10</sup> It is somewhat disingenuous to call these damages “undisputed consequential damages” under the circumstances here.

The Behnkes supported their causation case by testifying that, if Mr. Ahrens told them his “true views” about the Strategy or more about his relationship with Heritage, they never would have proceeded. *Supra* III.B.2. They also testified it was Mr. Ahrens who advised them to proceed, to hire Lewis Rice, and advised them regarding the merits of the Strategy. *Id.* Carl Behnke claimed he was never told about the Strategy’s risks and Mr. Ahrens did not discuss unfavorable cases. *Id.* In labeling the damages as “undisputed,” the Behnkes’ argument presumes that the jury had no choice but to believe the Behnkes’ testimony in this regard.

But the Behnkes’ credibility on these issues was extremely suspect. *See id.* They were confronted with statement after statement under oath blaming others for the same damages and never mentioning Mr. Ahrens at

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<sup>10</sup> *See also* RP 1245–46 (Behnkes’ counsel stating Morris “made no assumptions about the causation, it is for the jury to decide whether or not, but for Mr. Ahrens’s conduct these damages would be incurred”).

all and admitting they understood all the risks. *Id.*

The jury was instructed using a broad breach of fiduciary duty instruction the Behnkes submitted. *Compare* CP 4838–39 *with* CP 7088–89. The jury used the Behnkes’ verdict form with line items for the damages the Behnkes now claim “no one ever considered.” Br. at 43; CP 5413–16, 5323–27; RP 2891–94.<sup>11</sup>

The jury found in the Behnkes’ favor and concluded Mr. Ahrens breached his fiduciary duty but his breach only caused \$6,162.25 in damages. The Behnkes’ own verdict form made it perfectly clear the jury was permitted to and did consider every aspect of the Behnkes’ claimed damages on the breach of fiduciary duty claim. CP 5413–16. That form invited the jury to award the damages that are the subject of this appeal if it concluded Mr. Ahrens’ breach of fiduciary duties proximately caused harm. CP 5414–15. The jury did not. *Id.*; *see also* RP 2900.

**2. For similar reasons, the jury did not “omit” any damages, as the Behnkes now claim**

The Behnkes’ arguments that the jury omitted a category of damages rest on the presumption that the only disputed issue before the jury was liability. Br. at 41–42. Not so. Proximate cause was hotly contested. *Supra* Section IV.B.1. The jury did not omit any damages. Instead, using the Behnkes’ own jury instructions and verdict form, the jury made clear its conclusion that Mr. Ahrens did not proximately cause most of the dam-

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<sup>11</sup> The trial court even pointed out that the Behnkes’ jury form included separate line items for each of the claimed damages for each of the Behnkes’ claims, including breach of fiduciary duty. RP 2866 (“[W]ith regard to the verdict form, I have used with some modification the plaintiffs’ supplemental proposed special interrogatories. It breaks out the damages as to each claim.”).

ages the Behnkes claimed. CP 5413–16; CP 7088–89, 7098–99. The jury did not credit Carl Behnke’s testimony that, had they known more about Mr. Ahrens’ relationship with Heritage, they never would have proceeded. (The jury’s conclusion in this regard is, in fact, consistent with the Behnkes’ own testimony in the Texas court and the Behnkes’ statements to the IRS. *See supra* at 3–10.) The trial court, thus, properly rejected this argument when the Behnkes raised it below. CP 6694–95, 6522–24.

### **3. The Behnkes were not deprived of a factfinder**

The Behnkes’ apparent argument is that the jury never had the ability to “consider” their damages because the trial court did not instruct the jury that Mr. Ahrens’ conduct violated the RPC conflict rules, so the jury deliberated without knowing the court’s eventual conclusion that Mr. Ahrens’ conduct violated the RPC. (Of course, this was consistent with well-settled law. *Infra* Section IV.C.) Thus, the Behnkes urge they were deprived of a factfinder. But their own admissions gut this argument.

The Behnkes admit the jury’s conclusion that Mr. Ahrens breached fiduciary duties rested on the determination that Mr. Ahrens had a conflict that was either unwaivable or not properly waived. Br. at 29. They further admit the expert testimony on the standard of care on the breach of fiduciary duty claim the jury considered was *exactly the same* as the RPC standard the trial court later considered. Br. at 37. In other words, the experts fully articulated the standard applicable to the jury, but they were not permitted (in front of the jury) to put an RPC *label* on the standard. Armed with these standards, the Behnkes’ breach of fiduciary duty claim

based on Mr. Ahrens' conflict of interest was submitted to the jury.

Thus, based on the same evidence and using the same legal standard (just without the RPC label), the jury concluded Mr. Ahrens' conduct violated his fiduciary obligations (the same RPC obligations the court considered). CP 5414. And the jury also then considered what damages were proximately caused by the breach and concluded it was \$6,125.25.<sup>12</sup> CP 5414–15. These admissions defeat the Behnkes' core argument that “no one ever considered” the damages they claim were caused by Mr. Ahrens' breach of his fiduciary obligations and they were deprived of a factfinder to “properly determine[]” their damages.” Br. at 43, 32.

Moreover, the Behnkes' admissions make clear that even if there was error here—which there was not—it is harmless. Arguing now that the trial court should have instructed the jury the conflict was not waivable or was not waived would have made no difference because, as the Behnkes admit, the jury concluded Mr. Ahrens had a conflict of interest that breached fiduciary duties (whether because it was not properly waived or not waivable) and already awarded the Behnkes “all of the damages proximately caused by Ahrens' breach.” Br. at 31; CP 5414. In other words, the Behnkes had a month long jury trial on their breach of fiduciary duty claim and were given an extra benefit: the court gave them disgorgement above and beyond the damages the jury awarded for the same conduct. Thus, at the end of the day, the Behnkes were given more money

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<sup>12</sup> The jury awarded half of the fees because of the Behnkes had negotiated directly with Heritage for Heritage to pay the other half. TX 5 at 3.

as a result of this procedure than the jury concluded they were entitled to as damages because, as discussed further below, disgorgement does not require causation. Any error here was certainly harmless.

**4. The Behnkes' appeal to equity is misplaced**

The Behnkes grasp at “principles of equity” to appeal the jury’s decision. Br. at 34. The Behnkes vacillate wildly between portraying their breach of fiduciary duty claim as some kind of equitable claim reserved to the court and acknowledging that it is a tort claim that was submitted to the jury. *Compare* Br. at 34 *with* Br. at 35.

But even if this Court were to conclude—contrary to all the evidence as well as the trial court’s findings and conclusions, CP 6373—that the breach of fiduciary duty claim was not submitted to the jury, principles of equity would not save the Behnkes. It is, indeed, somewhat bizarre for the Behnkes to suggest a fundamental change to well-established law to “do substantial justice to the parties,” Br. at 34, under these circumstances:

- Before trial, the Behnkes distinguished between tort damages for fiduciary breach and disgorgement remedies. CP 4803–04.
- The Behnkes fully presented their breach of fiduciary duty claim before the jury. All their damage evidence was admitted. Indeed, the trial lasted nearly a month.
- The jury was given instructions on breach of fiduciary duty that had been proposed by the Behnkes. CP 7088–90, 7098.
- The jury was given a jury verdict form, also prepared by the Behnkes, with separate line items for each of the items of damage the Behnkes claim were caused by Mr. Ahrens. CP 5413–16.
- The jury was instructed to consider liability, causation, and damages on the fiduciary duty claim. CP 7088–90, 7098–99.
- In fact, it deliberated for days. RP 2897.
- The jury was careful, and in fact sent out questions to the Court regarding damages. CP 5424–27.

- After lengthy consideration, the jury concluded Mr. Ahrens' conduct violated his fiduciary duty to the Behnkes, and the only damages caused were approximately \$6,000. CP 5413–16.

In light of all this, it is somewhat ironic for the Behnkes to claim “justice” requires the trial court or this Court to disregard the jury’s verdict and award them millions in damages. Indeed, if anything, principles of equity should prevent the Behnkes from fully presenting their claim to the jury, waiting to see what the jury concludes, and then—when they do not like the result—grabbing a second bite at the apple using the RPC as a basis for civil liability as they attempt in this case below and on appeal.<sup>13</sup>

#### **5. The Behnkes’ claim that the jury was advisory is false**

In a final attempt to support their argument that “no one considered” their alleged breach of fiduciary duty damages, the Behnkes resort to one last play. They now claim the jury was only advisory as to their breach of fiduciary claim. Br. at 1. This is, to put it bluntly, false.<sup>14</sup>

The Behnkes sought a jury determination of their breach of fiduci-

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<sup>13</sup> The Behnkes rely on a series of cases they claim stand for the proposition that the trial court has wide discretion in fashioning remedies. But none address circumstances like this case, in which after receiving a full jury trial and receiving a damage award, a plaintiff claims the right to a do-over before the trial court and additional damages rejected by the jury for an RPC violation. *Allen v. Am. Land Research*, 95 Wn.2d 841, 844–45, 852, 631 P.2d 930 (1981) (bench trial of CPA claim on fraudulent land sales in California; Court holds trial court had authority to use restitution as a measure for CPA damages); *Hough v. Stockbridge*, 150 Wn.2d 234, 76 P.3d 216 (2003) (court sitting in equity has authority to issue restraining orders to feuding neighbors); *Esmieu v. Hsieh*, 92 Wn.2d 530, 535, 598 P.2d 1369 (1979) (court in quiet title action could order party to buy out a lease); *Carpenter v. Folkerts*, 29 Wn. App. 73, 78, 627 P.2d 559 (1981) (court in quiet title action could order party to convey clear title and permit distribution of the purchase price to opposing party if clear title is not conveyed). *Senn v. Northwest Underwriters, Inc.*, 74 Wn. App. 408, 875 P.2d 637 (1994), does not even seem to address the proposition the Behnkes claim it does.

<sup>14</sup> And even on its merits, the Behnkes cannot keep their “advisory jury” argument straight: they treat the jury as advisory when they like its decision (liability on breach of fiduciary duty), but wish to disregard it when they do not (proximate causation of damages on breach of fiduciary duty).

ary duty claim and submitted jury instructions—which were given—on the issue. *Compare* CP 4838–39 *with* CP 7088–89. Indeed, the trial court’s findings and conclusions acknowledge the claim was tried to the jury. CP 6373 (“Plaintiffs’ claims of intentional misrepresentation and omission, common law fiduciary breach and legal negligence were tried to a jury.”). The trial court stated many times the claim was submitted to the jury. RP 2921 (“we submitted [the claim] to the jury”); RP 2943 (“[W]e submitted the common law breach of fiduciary duty issue to the jury, and they decided it, and I do not want anything I do here to be construed as challenging or speculating or undoing the jury’s decision.”).

**C. The Court Properly Determined it was the Jury’s Role to Decide Liability for Fiduciary Breach and Award Damages and the Court was Limited to Disgorgement for any RPC Violation**

The trial court’s role post-trial was limited: after the Behnkes’ claims were submitted to the jury and the jury rendered its verdict, the trial court’s role was to determine whether it should order disgorgement if it concluded that the *same conduct* that the jury evaluated based on the *same standards* the jury used constituted a violation of the RPC. After trial, the Behnkes asked the trial court to award for violation of the RPC all damages the jury rejected for lack of proximate cause. The Court properly recognized that, in examining what additional remedies were available just because the conflict the jury found happened to breach fiduciary duties contained in the RPC, the Court was limited to its disgorgement authority.

**1. The trial court properly recognized it lacked authority to award more than disgorgement an RPC violation**

a. ***Hizey and the RPC support the trial court***

As the trial court recognized, *no Washington court has ever permitted civil damages for violation of the RPC*. See CP 6378–79. The trial court lacked authority to do what the Behnkes asked because it is well-established that civil liability cannot be premised on a violation of the RPC. *Hizey v. Carpenter*, 119 Wn.2d 251, 261, 830 P.2d 646 (1992).

In *Hizey*, the Court drew a bright line between public, *disciplinary* remedies on the one hand, and private, *civil* remedies on the other. The Court held that “breach of an ethics rule provides only a public, e.g., disciplinary, remedy and not a private remedy.” *Id.* at 259. In fact, the Behnkes admit *Hizey* “holds ... that ethics rules do not give rise to an independent cause of action.” CP 5517 at n.1. In so holding, *Hizey* expressly observed that the ethics rules “*were never intended as a basis for civil liability.*” 119 Wn.2d at 261 (emphasis added). The RPC recognize:

Violation of a Rule should not itself give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached. .... The Rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. ***They are not designed to be a basis for civil liability.*** ... Furthermore, the purpose of the Rules can be subverted when they are invoked by opposing parties as procedural weapons. The fact that a Rule is a just basis for a lawyer’s self-assessment, or for sanctioning a lawyer under the administration of a disciplinary authority, ***does not imply that an antagonist in a collateral proceeding or transaction has standing to seek enforcement of the Rule.***

RPC Preamble & Scope, cmt. 20 (emphasis added). Indeed, the *only case* the drafters saw fit to cite is *Hizey*. *Id.* at cmt. 22.

Under *Hizey*, the remedy for such a violation lies with disciplinary action by the bar association. See 119 Wn.2d at 259 (citing *State v. Lord*,

117 Wn.2d 829, 887, 822 P.2d 177 (1991), with approval for the proposition that “remedy for claimed violation of the RPC is request for discipline by the bar association”); *id.* (citing *Terry Cove N., Inc. v. Marr & Friedlander, P.C.*, 251 So.2d 22 (Ala. 1988), with approval for the proposition that “infractions of Code provide basis for attorney discipline, not private cause of action”); *see also* *Restatement of the Law Governing Lawyers* § 125 cmt. a (2000) (if lawyer’s conflicting interests harm client, client’s remedy is a professional malpractice claim). Thus, as *Hizey* stated, the RPC should operate in the “*separate* sphere[]” the bar association administers with authorization of the Supreme Court. 119 Wn.2d at 262 (emphasis added).<sup>15</sup> Thus, explicit language in both *Hizey* and the RPC unambiguously preclude their use as a basis for civil liability.

**b. Neither *Eriks* nor *Cotton* support the Behnkes**

The Behnkes rely on *Eriks v. Denver* and *Cotton v. Kronenberg*. Br. at 32. The Behnkes’ reliance is misplaced.

As an initial matter, *Eriks* came down before *Hizey* and *Cotton* is a Court of Appeals decision. Neither case could decimate *Hizey*’s holding that the RPC are not to be used as a basis for civil liability. In fact, as discussed below, *Eriks* was decided under the old CPR, not the RPC.

But more significantly, *Eriks* and *Cotton* do not undermine *Hizey*;

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<sup>15</sup> Moreover, the *Hizey* Court found it significant that a plaintiff suing his lawyer “already [has] available adequate and recognized common law theories under which to” proceed. *Id.* at 263. This principle has been brought into stark relief here. As the Behnkes admit, the common law breach of fiduciary duty claim they argued to the jury is duplicitous of their RPC violation arguments—a situation that the *Hizey* Court disapproved. Indeed, *Hizey* stated: “The [Code of Professional Responsibility (“CPR”)] and RPC *do not enlarge* upon an attorney’s common law duties.” *Id.* at 264 (emphasis added).

they respect the fundamental division between civil and disciplinary remedies. (*Hizey* acknowledged *Eriks* and concluded that it need not overrule *Eriks* because *Eriks* held only that “violation of CPR is a question of law, not fact.” 119 Wn.2d at 264; *see also Eriks*, 118 Wn.2d at 457–58.)

In *Eriks*, the trial court concluded the lawyer’s joint representation of the promoter and investors in the same tax proceeding without disclosure of the conflict to the investors violated the CPR. *Id.* at 460–61. The trial court ordered the attorney to disgorge all fees paid by the investor clients. *Id.* at 462. In upholding the disgorgement order, the Court followed the general principle that “a breach of ethical duties may result in denial or disgorgement of fees.” *Id.* Significantly, a disgorgement order does not require a finding of either causation or damages. *Id.* The Court’s decision upholding disgorgement instead rested on the principle that “[a] fiduciary who represents [multiple parties] ... may not perfect his claim to compensation by insisting that, although he had conflicting interests, he served his several masters equally well.” *Id.* (internal quotation marks omitted). The Court then expressly held that disgorgement of fees “is a reasonable way to ‘discipline specific breaches of professional responsibility, and to deter future misconduct.’” *Id.* at 463. Thus, the CPR violation in *Eriks* dealt specifically with a **disciplinary** remedy—*i.e.*, disgorgement. *See id.*

**c. The trial court recognized that it lacked authority to remedy alleged violations of the RPC except through disgorgement**

*Hizey*, *Eriks*, and *Cotton* are consistent with the rule that original jurisdiction over RPC violations “lies exclusively with the Supreme

Court.” *Danzig v. Danzig*, 79 Wn. App. 612, 620, 904 P.2d 312 (1995). Indeed, there are only two exceptions. First, a court can regulate the ethical conduct of the attorneys appearing before it. *Id.* Second, the court may order disgorgement of an attorney’s fee or refuse to enforce a fee agreement for a breach of ethical duties. *Id.* Otherwise, a superior court lacks jurisdiction to administer lawyer discipline. *Id.*

Of course, the first exception does not apply to this case: Ahrens did not appear before the trial court. And the second exception, which the trial court relied upon to order disgorgement for the RPC violation it found, represented the full scope of the trial court’s authority here.<sup>16</sup>

**d. The procedure used does not deprive litigants of a remedy**

Litigants, like the Behnkes, are not deprived of their right to obtain damages found by a finder of fact for breach of fiduciary duty when the conduct that violates the RPC also violates common law fiduciary duty standards. Instead, just as the parties did here, that litigant presents the jury with the standards for breach of fiduciary duty—which often, as they Behnkes admit they did here (Br. at 37), track the RPC standards—and the jury determines liability, causation, and damages. What the Behnkes ac-

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<sup>16</sup> The Behnkes rely on a trio of cases from other jurisdictions for the general proposition that a fiduciary is not permitted to profit from his wrong. Br. at 34. As described below, these cases do not assist the Behnkes and the trial court properly rejected the same arguments when the Behnkes argued that the disgorgement authority permitted the court to order Mr. Ahrens to pay over to the Behnkes the royalty payments he received from Heritage. CP 6093–99; CP 6110–16; CP 6379 (“The scope of the remedy of disgorgement does not include those fees paid by Heritage to Defendant Ahrens.”). Indeed, the Behnkes have not even correctly described the holding in *Wormhoudt Lumber Co. of Ottumwa v. Cloy*, 219 N.W.2d 543 (1974), which actually determined that the agent involved had ciphoned off profits that should have been turned over to his employer and thus was liable to the employer for the gains he had stolen. *Id.* at 546.

tually want is a way to avoid the jury's finding. But disgorgement is fundamentally different from damages: One of the reasons courts are permitted to order disgorgement for an RPC violation is that disgorgement does not hinge on causation or damages. *Eriks*, 118 Wn.2d at 462.

**2. Even if the trial court's conclusions were error, they were certainly harmless here**

Moreover, all of this debate is about something that, if it were error at all (which it is not), would be harmless twice over. First, as described above, the jury found the same conduct breached fiduciary duties and awarded all proximately caused damages. Second, there is no indication the trial court would award other damages if it had the authority to do so.

The jury evaluated the same conduct based on the same standards (just without the RPC label), found a breach of fiduciary duty, and awarded the Behnkes their damages. CP 5414–15. It is difficult to imagine how it could be anything but harmless that the Behnkes could not say the words “RPC” to the jury when the jury found in their favor.<sup>17</sup>

In an effort to suggest they have been harmed, the Behnkes claim the court “[r]eject[ed]” the jury's verdict. Br. at 40. Not so. The jury concluded only approximately \$6,000 of Mr. Ahrens' fees constituted damages caused to the Behnkes by anything Mr. Ahrens did. CP 5414–15. The court's task was different when evaluating disgorgement: it had discretion to order Mr. Ahrens to disgorge all fees even in the absence of causation and it chose to exercise that discretion. CP 6378–79. The court

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<sup>17</sup> The analysis might be different in a case in which the jury had not found liability, but those are not the facts presented in this case.

properly concluded it “cannot reach the issue of other damages, because I do not find that they are available.” RP 2947.<sup>18</sup> And it also specifically stated it did not intend to do anything that would be inconsistent with the jury’s verdict. RP 2943 (“[W]e submitted the common law breach of fiduciary duty issue to the jury, and they decided it, and I do not want anything I do here to be construed as challenging or speculating or undoing the jury’s decision.”). Of course, an award of additional civil damages for the RPC violation that is based on the same conduct and the same standards as the breach of fiduciary duty claim the jury evaluated (and largely rejected) would certainly be inconsistent with the jury’s determination.

The court properly rejected the Behnkes’ additur motion. CP 6515–30, 6694–96. The court would have granted the motion if it was convinced that the Behnkes were entitled to additional damages for breach of fiduciary duty. That it did not also shows any error would be harmless.

**D. The Behnkes’ Argument that the Jury was Inflamed by Passion and Prejudice Makes No Sense and was Properly Rejected**

The Behnkes’ claim the jury was inflamed with passion and prejudice is meritless. Br. at 38–43. They do this because they recognize that, constitutionally, one of the only ways to undo a jury’s verdict on damages “within the range of the credible evidence” is to prove it was “manifestly ... the result of passion or prejudice.” *Green v. McAllister*, 103 Wn. App. 452, 461–62, 14 P.3d 795 (2000) (internal quotation marks omitted); Const. art. I, § 21. They claim there was a theme throughout this case that

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<sup>18</sup> Significantly, in the portion of the Behnkes’ brief recounting the trial court’s findings, the portion of that section that relates to the so-called “undisputed out-of-pocket damages” is not a finding of the trial court. Br. at 20.

the “wealthy are less deserving of protection.” Br. at 38. Notably absent is any reference to any part of the trial transcript giving any indication Mr. Ahrens pursued this “theme” or the jury accepted it. *Brundridge v. Fluor Fed. Servs., Inc.*, 164 Wn.2d 432, 454, 191 P.3d 879 (2008) (stating that the “record” must show that the “award is contrary to the evidence”).

Instead, Mr. Ahrens took the position that it was perfectly legal for the Behnkes to attempt to reduce or eliminate their capital gains taxes on a \$100 million transaction. *E.g.*, RP 69. Mr. Ahrens was hardly inflaming the jury to punish the wealthy, as the Behnkes suggest.

Moreover, if the jury was really inflamed by passion and prejudice, it would not have returned a verdict in favor of the Behnkes. CP 5413–16. It would not have taken days to deliberate. RP 2897. It would not have asked questions regarding damages. CP 5424–26. This jury deliberated over days, asking questions along the way, carefully considered the claims, accepted some and rejected others, and awarded the damages caused by Mr. Ahrens. CP 5413–16, 5424–27; RP 2897; .

The jury’s verdict was well-grounded in the evidence; it certainly was not “so inadequate as to unmistakably indicate that they were the result of passion or prejudice.” Br. at 39; *Brundridge*, 164 Wn.2d at 454. This case is not akin to those cited by the Behnkes (Br. at 40–42).

The Behnkes’ effort to manufacture inconsistencies in the verdict also fails.<sup>19</sup> The damage award is not difficult to explain. Br. at 40. As

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<sup>19</sup> Moreover, to the extent there could be error resulting from the verdict form, the Behnkes invited it by submitting the form and failing to except to the instructions. CP 7095; RP 2876–77. Further, any such error is likewise harmless

the trial court made clear, the jury instructions only permitted contributory negligence for the legal malpractice claim, not the breach of fiduciary duty claim. RP 2871 (“I don’t think that contributory negligence is ... available as a defense to the breach of fiduciary duty issue. ... It seems to me that that is an issue of causation, there: once there is a fiduciary duty, then if it is breached, the issue is proximate cause.”). Thus, contributory negligence is not relevant to breach of fiduciary duty here.

The evidence likewise supports the jury’s decision to award 50 percent of Mr. Ahrens’ fees. The jury had evidence the Behnkes had negotiated directly with Heritage to pay half of Mr. Ahrens’ fees. TX 5 at 3; RP 1375–76. Thus, the jury could have found the Behnkes were only ultimately responsible for 50 percent of the fees. Even their own expert, Mr. Jarvis testified that half of the approximately \$12,000 Mr. Ahrens charged over four years “may have come from Heritage.” RP 932–33.

**E. The Behnkes Do Not Meet Either Requirement for Additur**

Additur is unavailable here because the Behnkes do not meet the requirements even they acknowledge must be met. First, Mr. Ahrens has not consented to increase the jury’s verdict. Br. at 39. Second, as described above, there is no evidence the jury’s verdict was the result of passion or prejudice. *Id.* Both of these are required. *Id.* The trial court properly rejected the additur request. CP 6515–30; CP 6694–96.

**F. The Trial Court Properly Concluded the Conflict was Waivable, but Even if There Was Error, it is Certainly Harmless**

The Behnkes claim the court erred in concluding the conflict was

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as the trial court awarded all of Mr. Ahrens’ fees as disgorgement. CP 6379.

waivable (although the court also concluded it was not properly waived). Br. at 29. The trial court's conclusion is correct: very few circumstances justify the drastic conclusion that a conflict is nonwaivable. But even if there was error, it was harmless here.

Nonwaivable conflicts are properly limited to very narrow circumstances, such as a lawyer in litigation representing both sides of the same dispute. Or, as in one of the cases cited by the Behnkes, when the lawyer will be required to cross examine another client in an attempt to show he or she participated in a fraud. *See In re Celcyte Genetic Corp. Sec. Litig.*, No. C08-47RSL, 2008 WL 5000156, at \*3 (W.D. Wash. Nov. 20, 2008). The reason this doctrine is particularly narrow is that nonwaivable conflicts undermine a client's decision to hire the lawyer of his or her own choosing. *Id.* at \*5 (concluding that a finding of a nonwaivable conflict is "drastic" and stating that the "Court is loathe to interfere with a party's choice of counsel or with the attorney-client relationship"). As the trial court recognized in determining the conflict here was waivable, the sophistication of the client is an important factor. CP 6378. Here, in a transactional setting where both sides wish to proceed and when the clients (the Behnkes) are extremely sophisticated, the trial court properly concluded the conflict could be waived with proper disclosures. *Id.*

Moreover, as the Behnkes recognize, Br. at 30, the appropriate response to a nonwaivable conflict is to send the client to another lawyer. The Behnkes, of course, fail to mention this is what happened. Indeed, the Behnkes brief never mentions Lewis Rice, the lawyers who implemented

the Strategy and advised the Behnkes regarding its merits, including preparing the opinion letter and creating the required entities. *Supra* Section III.B.1. The Behnkes in fact relied on Lewis Rice and Heritage, not Mr. Ahrens. *E.g.*, TX 444 at 3 (App. 3); RP 470. In fact, before filing their tax return (the point at which they had to decide whether to use the Strategy), but after they knew the IRS was targeting the Strategy, the Behnkes hired PG&E to recommend a tax position. TX 15, 17 (App. 7–8).

Because both the court and the jury concluded there was a non-waived conflict, it hardly matters whether it was non-waivable or simply not properly waived. The Behnkes' own expert agreed a conflicted lawyer can give proper advice. RP 940. And the Behnkes did not challenge the adequacy of the Lewis Rice opinion letter. Even if the conflict was non-waivable, the jury was still entitled to determine causation and damages and it did. CP 7088–89, 7098–99, 5413–16.

The Behnkes wrongly claim the court should have summarily ruled the conflict was nonwaivable. Even if the court should have granted summary judgment when material facts were in dispute, CP 3072–75, there is no appealable error when the claim was later heard by the jury, as the Behnkes' breach of fiduciary duty claim was. *Adcox v. Children's Orthopedic Hosp. & Med. Ctr.*, 123 Wn.2d 15, 35 n.9, 864 P.2d 921 (1993) (“When a trial court denies summary judgment due to factual disputes, as here, and a trial is subsequently held on the issue, the losing party must appeal from the sufficiency of the evidence presented at trial, not from the denial of summary judgment.”).

The Behnkes claim that “[t]he trial court should have instructed the jury to award all of the damages proximately caused by Ahrens’ breach.” Br. at 31. Of course, they fail to mention the trial court gave the jury their breach of fiduciary duty and causation instructions. *Compare* CP 7088–90, 7098–99 *with* CP 4838–40, 4849. Indeed, the Behnkes did not except to the court’s instructions. RP 2876–77. The jury *was* instructed to award all damages proximately caused by any breach of fiduciary duty. CP 7098–99. And, it did. CP 5414–15.

**G. Alternate Grounds Exist to Reject the Behnkes’ Claims**

Mr. Ahrens has not appealed the judgment below. That said, if alternate grounds exist to reject the Behnkes’ appeal, they can be raised as long as Mr. Ahrens does not seek affirmative relief, as can “acts which, if repeated on remand, would constitute error prejudicial to respondent.” RAP 2.4(a). Here, several independent reasons exist to reject the Behnkes’ attempt to obtain additional damages the jury rejected.

**1. Judicial estoppel bars the Behnkes’ claims**

In connection with claims asserted in litigation with Heritage, the Behnkes submitted declarations to the Texas court stating they relied solely on Heritage’s advice, on Heritage’s representations about the legality of the Strategy, and on Heritage’s false assurances that the IRS was not investigating Heritage and had not questioned the Strategy’s legitimacy. *See supra* Section III.B.2. They did so to support their defenses to Heritage’s claim against them for fees they owed upon implementing the Strategy, and in support of their counterclaims for fraud, breach of fiduciary

duty, undue influence, etc. The Texas court resolved these issues in their favor, allowing them to walk away from the promissory notes they signed.

“Judicial estoppel is an equitable doctrine that precludes a party from asserting one position in a court proceeding and later seeking an advantage by taking a clearly inconsistent position.” *Arkison v. Ethan Allen, Inc.*, 160 Wn.2d 535, 538, 160 P.3d 13 (2007) (internal quote marks omitted). The core factors are whether (1) the later position is clearly inconsistent with the earlier, (2) judicial acceptance of the second position would create a perception either the first or second court was misled, and (3) the party asserting the inconsistent position would obtain an unfair advantage or impose an unfair detriment if not estopped. *Id.* at 538–39.

All of these factors are present. In the Texas case, the Behnkes pointed the finger at Heritage, making no mention of Mr. Ahrens. *See supra* Section III.B.2. At trial, the Behnkes told a different story, blaming Mr. Ahrens for the same things they earlier claimed were Heritage’s fault. *Id.* Certainly, it would be unseemly to permit them to tell a different story in the Washington courts after benefiting from their opposite position in Texas (walking away from their obligations to Heritage). Likewise, it would be unfair to permit the Behnkes to proceed against him in Washington after gaining from their position that it was Heritage’s fault in Texas. As Mr. Ahrens moved in the trial court, the Behnkes are judicially estopped from pursuing their claims. CP 868–70, 4936–38, 5473–74.

## **2. The claims should be dismissed under *Carroll***

After consulting with new counsel at PG&E, the Behnkes aban-

done the Strategy, filed an amended tax return, and paid the resulting additional taxes and interest. *See supra* Section III.C. They did so instead of attempting to vindicate their original reporting position and retain tax benefits of the Strategy. This necessitates dismissal for lack of causation.

In circumstances nearly identical to those here, the District Court for the Southern District of New York held as a matter of law that plaintiff taxpayers could not show they suffered an injury caused by alleged tax shelter promoters. There, as here, “[p]laintiffs opted to file an amended tax return and pay the resulting additional taxes and interest rather than attempting to vindicate their original reporting position[.]” *Carroll*, 623 F. Supp. 2d at 513. Having done so: “[p]laintiffs ... cannot demonstrate that they suffered an injury caused by defendants when they voluntarily decided to take a less risky approach on their tax return.” *Id.*

Indeed, when Mr. Ahrens moved for judgment, CP 4953–59, the trial court stated the *Carroll* case presents “a close question for the Court” regarding whether to grant the motion and dismiss the Behnkes’ case entirely, RP 1661–62. The rule makes sense here: the Behnkes are suing Mr. Ahrens relating to a tax shelter they admit may have worked if they had seen it through. In this regard, the Behnkes made a strategic decision not to challenge the Lewis Rice opinion letter because they wanted to prevent Mr. Ahrens from allocating fault to Lewis Rice, the primary law firm handling the transaction for the Behnkes. *See infra* note 20. This Court should adopt the *Carroll* rule, which precludes the Behnkes’ claims.<sup>20</sup>

---

<sup>20</sup> In the event the Court determines that a remand is appropriate here, the

## V. CONCLUSION

Mr. Ahrens respectfully requests that this Court affirm the trial court and reject the Behnkes' appeal.

DATED this 5<sup>th</sup> day of May, 2011.

McNAUL EBEL NAWROT &  
HELGREN PLLC

By: Malaika M. Eaton

Robert M. Sulkin, WSBA No. 15425

Malaika M. Eaton, WSBA No. 32837

Barbara H. Schuknecht, WSBA No. 14106

Attorneys for Respondents

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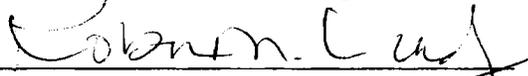
Court should likewise rule that the Behnkes are barred from recovering attorneys fees as damages under the ABC rule. *See* CP 4958 (citing *Jain v. J.P. Morgan Secs., Inc.*, 142 Wn. App. 574, 587, 177 P.3d 117 (2008)). Here, the Behnkes' own conduct played a substantial role in their becoming involved in litigation with Heritage and in needing legal assistance to negotiate a settlement with the IRS. Likewise, the Court should also rule that Mr. Ahrens should be permitted to argue that fault should be allocated to Lewis Rice and Heritage in light of: (1) the Behnkes' statements blaming those entities for their damages, (2) the Behnkes' statements that Heritage lied to them and, but for the lie, they would not have proceeded with the Strategy, and (3) with respect to Lewis Rice, expert testimony that its conduct fell below the standard of care (if what the Behnkes' claimed was true). RP 2647-49 (summary of evidence supporting fault allocation arguments); RP 2884-85 (excepting to jury instructions that do not include fault allocation).

**DECLARATION OF SERVICE**

The undersigned declares under penalty of perjury under the laws of the State of Washington that on May 5, 2011, that I arranged for service of the foregoing Brief of Respondents on the following in the manner described:

Christopher Pence Law Office of Christopher Pence PLLC 9911 N.E. Knight Road Bainbridge Island, WA 98110 chris@pencelaw.com	_____ Messenger <u>XXX</u> U.S. Mail <u>XXX</u> Electronic mail
Kenneth W. Masters Masters Law Group, P.L.L.C. 241 Madison Avenue North Bainbridge Island, WA 98110 ken@appeal-law.com	_____ Messenger <u>XXX</u> U.S. Mail <u>XXX</u> Electronic mail
Darrell D. Hallett Chicoine & Hallett, P.S. 719 Second , Suite 425 Seattle, Washington 98104 dhallet@c-hlaw.com ctang@c-hlaw.com	_____ Messenger <u>XXX</u> U.S. Mail <u>XXX</u> Electronic mail

DATED this 5<sup>th</sup> day of May, 2011, at Seattle, Washington.

By:   
 Robin M. Lindsey, LEGAL ASSISTANT

**APPENDIX**

- Declaration of Carl Behnke, dated January 21, 2006,  
In re The Heritage Organization, L.L.C.,  
U.S. Bankr. Ct., No. Dist. Tex, Dallas Div.,  
No. 04-35574-BJH-11[CP 4863-4870]..... Appendix 1
- Affidavit of Carl G. Behnke in Support of Response  
of the G. W. Skinner Trust No. 2 and the G.W.  
Skinner Children’s Trust FBO Sally Behnke to  
Debtor’s Objection to Claim Nos. 42-43, dated  
May 26, 2004, U.S. Bankr. Ct., No. Dist. Tex.,  
Dallas Div., No. 04-35574-SAF-11 [TEX 317] ..... Appendix 2
- Email, dated October 3, 2003, from Erin Buehler  
to Les Curtis, re Boulder-Trust, with attached  
IRS Form 8886 [TEX 444]..... Appendix 3
- Letter, dated March 1, 2002, from R.E.B. Enterprises  
(Sally Behnke, Carl Behnke, John Behnke) to  
Robert Adamonis/Union Bank of CA [TEX 6] ..... Appendix 4
- Email, dated December 4, 2001, from Robert Trenner  
to Carl and John Behnke [TEX 9] ..... Appendix 5
- Letter, dated November 30, 2001, from Michael  
Mulligan/Lewis, Rice & Fingersh to John and  
Carl Behnke re terms of engagement [TEX 309] ..... Appendix 6
- Letter, dated October 31, 2003, from Lance Behnke  
(Preston Gates Ellis) to John Behnke re terms  
of engagement [TEX 15] ..... Appendix 7
- Memorandum, dated November 6, 2003, from Lance  
Behnke to John Behnke re Procedural Issues re  
2002 Tax Return and Listed Transaction  
Investment [TEX 17]..... Appendix 8
- Memorandum, dated October 8, 2001, from Ed  
Ahrens to The Files re Salina Partnership L.P.  
Tax Court Settlement [TEX 164] ..... Appendix 9

# **APPENDIX 1**

Richard D. Anigian, TSB #01264700  
Marty L. Brimmage, Jr., TSB #00793386  
Scott Everett, TSB #00796522  
HAYNES AND BOONE LLP  
901 Main Street, Suite 3100  
Dallas, Texas 75202-3789  
Telephone: 214.651.5053  
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Michael J. Gearin  
PRESTON GATES & ELLIS LLP  
925 4<sup>th</sup> Avenue, Suite 2900  
Seattle, WA 98104  
Telephone: 206.623.7580  
Facsimile: 206.623.7022

ATTORNEYS FOR: G.W. Skinner Children's Trust FBO Sally Behnke and  
The G.W. Skinner Trust No. 2

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF TEXAS  
DALLAS DIVISION

In Re:

THE HERITAGE ORGANIZATION,  
L.L.C.,  
Debtor.

No. 04-35574-BJH-11

DECLARATION OF CARL BEHNKE

I, CARL BEHNKE, declare as follows:

1. I am a trustee of the G. W. Skinner Children's Trust FBO Sally Behnke ("Children's Trust") and the G. W. Skinner Trust No. 2 ("Trust No. 2") (collectively the "Trusts") and have personal knowledge of and am competent to testify to the matters stated below.

2. In Fall 2001, The Heritage Organization, LLC ("Heritage") met with representatives of the Trusts in Seattle, Washington and offered to provide capital gains tax

DECLARATION OF  
CARL BEHNKE - 1

1016-01

planning services. Heritage representatives met with Trust representatives on at least two separate occasions. I attended both of those meetings.

3. In the first meeting, Heritage representatives, Ralph Canada and Vernon Lee, traveled to Seattle to introduce Heritage's services to Trust representatives. I attended this meeting as did my brother John Behnke and our mother Sally Behnke.

4. During the initial meeting, Messrs. Canada and Lee described Heritage's proposed tax saving strategies in general concepts. They stressed that we could not share these ideas or strategies with anyone else and that severe monetary penalties would apply for any unauthorized disclosure.

5. On or about November 16, 2001, Heritage representatives returned to Seattle for a second meeting with representatives for the Trusts. I attended this meeting as well. The Heritage representatives repeated the same concerns for secrecy regarding the tax strategies. They told us that if we communicated the strategies with anyone without Heritage's prior approval, Heritage would demand payment in full of its entire multi-million dollar fee and would impose a \$2 million penalty for each disclosure. This prohibition on disclosure included our attorneys, accountants, and financial planners. At the November 16, 2001 meeting, Heritage presented a written agreement to us on a "take it or leave it" basis. In order to learn the specifics of Heritages proposed tax savings strategies, we were required to execute the agreements of behalf of the Trusts.

6. During our meetings, the Heritage representatives provided PowerPoint presentations that described the tax saving concepts. The Heritage presentations included a section described as "Summary of IRS Positions and Court Decisions." The Heritage

DECLARATION OF  
CARL BEHNKE - 2

representatives described various legal cases, including a factual description of the cases, the position of the Internal Revenue Service ("IRS"), and the court's ruling. They provided handouts that highlighted important portions of these cases through the use of underlining, bold type, and enlarged font. The Heritage representatives also provided legal articles describing various tax strategies. I have reviewed some of the documents that the Chapter 11 Trustee, Dennis Faulkner, produced (TEESKIN0558-794) and they appear to be some portion of those Heritage presentations.

7. During our meetings, we repeatedly asked the Heritage representatives whether IRS had ever questioned any of Heritage's tax strategies. The Heritage representatives assured us "it was legal" and "the strategies were legal." The Heritage representatives denied that the IRS had questioned the strategies and gave no indication that the IRS was in anyway skeptical or interested in the legitimacy of Heritage's strategies. The Heritage representatives never told us that the IRS had notified Heritage that Heritage was required to divulge the names of any customers who implemented the Heritage strategies.

8. I individually relied upon the representations made by the Heritage representatives regarding the legality of the tax strategies in making the decision to execute the agreements with Heritage. Moreover, as a group, my mother Sally Behnke, my brother John Behnke, and myself relied on Heritage's assurances that the IRS had never questioned the legitimacy of the strategies in making the decision to enter into the agreements with Heritage. Whether or not the IRS questioned these strategies was very important to us in deciding to contract with Heritage. Because Heritage restricted our contact with outside people, we placed considerable weight on what Heritage told us about the legitimacy of its

DECLARATION OF  
CARL BEHNKE - 3

approach. It was very important to us the IRS had not questioned the Heritage approach. We would not have entered into the agreements with Heritage if we had known that the IRS was questioning the legitimacy of the tax saving strategies.

9. We relied on Heritage's assertions that if we implemented the strategies in the manner Heritage prescribed (e.g., creating a partnership structure designed to avoid the taxation of gain on highly appreciated stock), then the tax savings to the Trusts would be legal. We considered this legal advice. We relied on Heritage as our professional advisor and as an expert in the field of capital gains tax strategies.

10. The Heritage representatives repeatedly stressed the need to take immediate action in learning about and implementing the proposed tax strategies. They asserted that there was considerable risk that the tax code provisions allowing the strategies might be subject to revision effective January 1, 2002 and that the Trusts should implement before year end 2001 in order to eliminate that risk. The Heritage representatives conveyed this concern so convincingly that we believed there was a likely chance that the changes would occur and prevent us from implementing the strategies. We felt we had to act immediately, despite initial reluctance, given Heritage's concerns regarding the changes to the tax code. We would not have executed the agreements with Heritage in 2001 absent Heritage's claims regarding the tax code changes.

11. The Heritage representatives directed us to the law firm of Lewis, Rice & Fingersh ("Lewis Rice") for a legal opinion regarding the validity of the tax strategies and assistance in implementing the strategies. According to the Heritage representatives, Lewis Rice was familiar with the strategies and could develop an opinion very quickly. Based upon

DECLARATION OF  
CARL BEHNKE - 4

4

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the Heritage's recommendation, I concluded that Lewis Rice was the only law firm that could timely assist us in giving advice regarding the advisability of the strategies and proper implementation. The Heritage representatives failed to disclose to us that Heritage was a significant client of Lewis Rice. Lewis Rice also failed to disclose to us that it represented Heritage.

12. Lewis Rice provided us a written legal opinion regarding the Heritage tax strategies in April 2002 ("Lewis Rice Legal Opinion"). A true and accurate copy of the Lewis Rice Legal Opinion is attached hereto as "Exhibit A."

13. In late December 2001 through February 2002, we were actively implementing the Heritage tax planning strategies with the assistance and direction of Heritage. During this time, Heritage never disclosed the IRS' concerns to me, despite our inquiries regarding the IRS's position regarding the Heritage tax saving strategies. During the period February 2002 through May 2003, Heritage continued to bill us for the tax savings strategies. Heritage never informed us that the tax savings strategies had been called into question by the IRS and never informed us that Heritage was under investigation by the IRS for promoting those strategies.

14. In general, the Heritage transaction was a partnership structure designed to avoid the taxation of gain on highly appreciated Pepsico and Tricon stock (the "Stock") held by the Trusts. The partnership structure proposed by Heritage was the same as that being sold by a number of other tax shelter promoters. The structure generally required the Trusts to incur debt, which debt was assumed by a partnership, and the Trusts to contribute the Stock to such partnership. This structure created positive basis in the Trusts' partnership

DECLARATION OF  
CARL BEHNKE - 5

interest and following a deemed liquidation of the partnership allowed for the Trusts to subsequently recognize less gain upon the sale of the Stock.

15. We did not know that Heritage recorded its telephone conversations with us. Heritage never disclosed to us that it recorded our telephone conversations. We also did not know that Heritage made it a practice to surreptitiously record meetings.

16. In 2002, Trust No. 2 paid \$123,468.30 to Heritage under the terms of the Agreement, but received no benefit from the transaction. In 2003, Trust No. 2 paid \$259,986.76 to Heritage under the terms of the Agreement, but received no benefit from the transaction.

17. In 2002, the Children's Trust paid \$111,809.81 to Heritage under the terms of the Agreement, but received no benefit from the transaction. In 2003, the Children's Trust paid \$255,140.83 to Heritage under the terms of the Agreement, but received no benefit from the transaction.

18. In 2002, 2003, and 2004, in addition to amounts paid directly to Heritage under the Agreement, the Trusts paid additional amounts to legal and financial advisors in reliance upon the advice afforded them by Heritage. In 2002, on the recommendation of Heritage, Trust No. 2 paid \$43,750.00 to Lewis, Rice & Fingersh, L.L.C., for a legal opinion regarding the tax and estate planning strategy sold to it by Heritage, for which the Trusts received no tax benefit.

19. In 2002, on the recommendation of Heritage, the Children's Trust paid \$43,750.00 to Lewis, Rice & Fingersh, L.L.C., for a legal opinion regarding the tax and estate planning strategy sold to it by Heritage, for which the Trusts received no tax benefit.

DECLARATION OF  
CARL BEHNKE - 6

20. In 2003, the Trusts finally learned that the Heritage tax strategies had been listed by the IRS as illegitimate. The Trusts sought independent legal advice about the taxes and returns that had been based upon the Heritage Organization's advice. In October 2003, the Trusts filed 2002 federal income tax returns. In November 2003, the Trusts filed amended returns and reversed the strategies. The Trusts participated in the Son of Boss Settlement Initiative pursuant to IRS Announcement 2004-46. As a consequence of following Heritage's advice, the Trusts paid substantial professional fees and penalties after unwinding the Heritage transactions.

21. In 2002 and 2003, Trust No. 2 paid \$5,571.75 to Ahrens & DeAngeli, PLLC, a law firm, in relation to the tax planning strategy sold to it by Heritage.

22. In 2002 and 2003, the Children's Trust paid \$5,571.75 to Ahrens & DeAngeli, PLLC, a law firm, in relation to the tax planning strategy sold to it by Heritage.

23. In 2002 and 2004, Trust No. 2 paid \$4,404.00 to Whitley Penn, an accounting firm, in relation to the tax planning strategy sold to it by Heritage.

24. In 2002 and 2004 the Children's Trust paid \$4,404.00 to Whitley Penn, an accounting firm, in relation to the tax planning strategy sold to it by Heritage.

25. In 2003 and 2004, Trust No. 2 paid \$8,556.00 to Preston Gates & Ellis LLP in relation to the tax planning strategy sold to it by Heritage, in order to mitigate damages caused by inadequate advice provided by Heritage.

26. In 2003 and 2004, the Children's Trust paid \$8,556.00 to Preston Gates & Ellis LLP in relation to the tax planning strategy sold to it by Heritage, in order to mitigate damages caused by inadequate advice provided by Heritage.

DECLARATION OF  
CARL BEHNKE - 7

7

I016-07

27. In 2005, in accordance with the terms of the Son of Boss Settlement Initiative, which terms were set forth in Announcement 2002-2, 2002-2 C.B. 304 (the "SOBA Settlement Initiative"), the IRS imposed a penalty of approximately \$286,784 on Trust No. 2 as a result of its implementation of the Heritage tax strategy. Also in accordance with the terms of the SOBA Settlement Initiative, Trust No. 2 had an increased tax liability of approximately \$2,833,490, which would have been paid but for the implementation of the Heritage strategy.

28. In 2005, in accordance with the terms of the SOBA Settlement Initiative, the IRS imposed a penalty of approximately \$295,405 on the Children's Trust as a result of its implementation of the Heritage tax strategy. Also in accordance with the terms of the SOBA Settlement Initiative, the Children's Trust had an increased tax liability of approximately \$2,922,027, which would have been paid but for the implementation of the Heritage strategy.

I certify and declare under penalty of perjury that the above is true and correct.

DATED this 21<sup>st</sup> day of January, 2006, at Seattle, Washington.

/s/ Carl Behnke  
CARL BEHNKE

DECLARATION OF  
CARL BEHNKE - 8



## **APPENDIX 2**

COPY

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF TEXAS  
DALLAS DIVISION

In re: )  
HERITAGE ORGANIZATION, L.L.C. ) Case No. 04-35574-SAF-11  
Debtor. )

**AFFIDAVIT OF CARL G. BEHNKE IN SUPPORT OF  
RESPONSE OF THE G.W. SKINNER TRUST NO. 2 AND THE G.W. SKINNER  
CHILDREN'S TRUST FBO SALLY BEHNKE TO DEBTOR'S OBJECTION TO CLAIM  
NOS. 42-43**

STATE OF WASHINGTON )  
COUNTY OF KING ) ss

CARL G. BEHNKE, having been first duly sworn upon oath, deposes and says:

1. I am a trustee of the G.W. Skinner Trust No. 2 ("Trust No. 2") and the G.W. Skinner Children's Trust FBO Sally Behnke ("Children's Trust") (collectively the "Trusts") and have personal knowledge of and am competent to testify to the matters stated below.

2. In 2001, the Heritage Organization, LLC ("Heritage") approached representatives of the Trusts in Washington and offered to provide them with tax and estate planning services. Over the course of several months, representatives of the Trusts concluded that they would be willing to engage Heritage to advise on these matters.

3. On November 16, 2001, Heritage presented a power point presentation in Washington offering various tax and estate planning strategies to the Trusts.

4. On November 16, 2001, trustees for each of the Trusts and Heritage executed two nearly identical contracts entitled "Agreement" (collectively the "Agreement").

AFFIDAVIT OF CARL G. BEHNKE - 1

Exhibit 18  
Witness C. Behnke  
Date 7/11/07  
Buell Realtime Reporting  
(206) 297-9080

PGE07895

5. Under the terms of the Agreement, the Trusts were allegedly obligated to pay Heritage for its tax and estate planning services a fee equal to "twenty-five percent (25%) of all present and future Taxes That Would Have Been Incurred As Projected For The Principals that would have been incurred by any Principal without a Utilization relating in any way to a Sale or relating in any way to any Strategy that has one of its objectives or byproducts the effect of reducing Taxes That Would Have Been Incurred As Projected For The Principals relating in any way to (i) all Property used to Implement one or more of the Strategies related to each Result, and (ii) all Property otherwise used in any way with any Strategy to attempt to obtain each Result ... " Agreement, ¶ 4.1.

6. The Trusts believe that they are entitled to remuneration from Heritage for the fees paid to Heritage under the terms of the Agreement and for certain related fees paid to third parties because (i) the Trusts received no benefit from the tax and estate planning strategies sold to them by Heritage, (ii) the fees charged by Heritage were inherently unreasonable, and (iii) Heritage, when it sold such strategies, committed professional malpractice.

7. In 2002, Trust No. 2 paid \$123,468.30 to Heritage under the terms of the Agreement, but received no benefit from the transaction. In 2003, Trust No. 2 paid \$259,986.76 to Heritage under the terms of the Agreement, but received no benefit from the transaction.

8. In 2002, the Children's Trust paid \$111,809.81 to Heritage under the terms of the Agreement, but received no benefit from the transaction. In 2003, the Children's Trust paid \$255,140.83 to Heritage under the terms of the Agreement, but received no benefit from the transaction.

AFFIDAVIT OF CARL G. BEHNKE - 2

PGE07896

9. In 2002, 2003, and 2004, in addition to amounts paid directly to Heritage under the Agreement, the Trusts paid additional amounts to legal and financial advisors in reliance upon the advice afforded them by Heritage.

10. In 2002, on the recommendation of Heritage, Trust No. 2 paid \$43,750.00 to Lewis, Rice & Fingersh, L.L.C., for a legal opinion regarding the tax and estate planning strategy sold to it by Heritage, for which the Trusts received no tax benefit.

11. In 2002, on the recommendation of Heritage, the Children's Trust paid \$43,750.00 to Lewis, Rice & Fingersh, L.L.C., for a legal opinion regarding the tax and estate planning strategy sold to it by Heritage, for which the Trusts received no tax benefit.

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13. In 2002 and 2003 the Children's Trust paid \$5,571.75 to Ahrens & DeAngeli, PLLC, an accounting firm, in relation to the tax and estate planning strategy sold to it by Heritage, for which the Trusts received no tax benefit.

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15. In 2002 and 2004 the Children's Trust paid \$4,404.00 to Whitley Penn, an accounting firm, in relation to the tax and estate planning strategy sold to it by Heritage, for which the Trusts received no tax benefit.

AFFIDAVIT OF CARL G. BEHNKE - 3

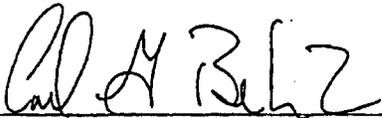
PGE07897

16. In 2003 and 2004, Trust No. 2 paid \$8,556.00 to Preston Gates & Ellis LLP in relation to the tax and estate planning strategy sold to it by Heritage, in order to mitigate damages caused by inadequate advice provided by Heritage.

17. In 2003 and 2004, the Children's Trust paid \$8,556.00 to Preston Gates & Ellis LLP in relation to the tax and estate planning strategy sold to it by Heritage, in order to mitigate damages caused by inadequate advice provided by Heritage.

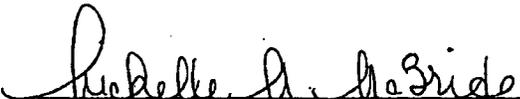
18. Heritage placed into its Agreement a very comprehensive copyright statement and confidentiality provision on each of its pages. While neither of the Trusts nor I agree that this provision is enforceable with respect to these or other Court or arbitration proceedings, and expressly do not waive any right to contest its application, we are prepared to await this Court's direction before providing a copy of the Agreement to the Court. That is why the Agreement is not attached to my affidavit.

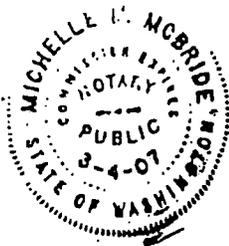
DATED this 26 day of May, 2004, at Seattle, Washington.

  
\_\_\_\_\_  
Carl G. Behnke

SIGNED AND SWORN TO this 26 day of MAY, 2005, by

CARL G. Behnke

  
\_\_\_\_\_  
NOTARY PUBLIC  
MICHELLE M. McBride  
[Printed Name]  
My appointment expires: 3-4-07



AFFIDAVIT OF CARL G. BEHNKE - 4

PGE07898

## **APPENDIX 3**

Les and Sue Curtis

---

From: "Michelle McBride" <michellemcbride@seanet.com>  
To: "Les Curtis" <iscurtis@verizon.net>  
Sent: Friday, October 03, 2003 11:58 AM  
Attach: Boulder-Trust.tif

Les,

These documents are from John. He said, Just in case you need them.

Erin Buehler

CURTIS 004241

10/4/2003

-----

Internal Revenue Service  
IM: PIRE: OTSA  
Large & Mid Size Business Division  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

CURTIS 004242

10/05/2003 09:09 2662286138

REB ENTERPRISES

PAGE 04/04

Form **8886**  
(March 2003)  
Department of the Treasury  
Internal Revenue Service

**Reportable Transaction Disclosure Statement**

▶ Attach to your tax return.  
▶ See separate instructions.

OMB No. 1545-0047

Attachment  
Sequence No. 137

Name(s) shown on return

Identifying number

**WARM SPRINGS INVESTORS L.P.**  
Number, street, and room or suite no.  
**601 UNION STREET, SUITE 3016**

City or town, state, and ZIP code  
**SEATTLE, WA 98101**

1a Name of reportable transaction

1b Tax shelter registration number (11-digits) (if any)

**SILVER CREEK**

**NONE**

2 Identify the type of reportable transaction. Check the box(es) that apply. (see instructions)

- a  Listed transaction
- b  Confidential transaction
- c  Transaction with contractual protection
- d  Loss transaction
- e  Transaction with significant book-tax difference
- f  Transaction with brief asset holding period

3 If the transaction is a "listed transaction" or substantially similar to a listed transaction, identify the listed transaction (see instructions) ▶ **SHORT SALE OF US TREASURY SECURITIES; NOTICE 2000-44**

4 Enter the number of transactions reported on this form ..... ▶ **1.**

5 If you invested in the transaction through another entity, such as a partnership, an S corporation, or a foreign corporation, identify the name and employer identification number (EIN) of that entity ..... ▶

**N/A**

6 Enter in columns (a) and (b) below, the name and address of each person to whom you paid a fee with regard to the transaction if that person promoted, notified, or recommended your participation in the transaction, or provided tax advice related to the transaction.

(a) Name	(b) Address
<b>THE HERITAGE ORGANIZATION, LLC</b>	<b>5001 SPRING VALLEY ROAD, EAST TOWER DALLAS, TX 75244</b>
<b>LEWIS, RICE &amp; FINGERSH, L.C.</b>	<b>500 N. BROADWAY, STE 2000 ST. LOUIS, MO 63102</b>

Form 8886 (3-2003)

JWA  
80873  
02-18-03

REDACTED

CURTIS 004243

WARM SPRINGS INVESTORS L.P.

Form 8886 (3-2002)

Page 2

7 Facts. Describe the facts of the transaction that relate to the expected tax benefits, including your participation in the transaction.

SEE STATEMENT 16

8 Expected tax benefits. Describe the expected tax benefits, including deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, etc. See instructions for more details.

UPON THE DEEMED TERMINATION OF THE LLC THE TAXPAYER RECEIVED A BASIS IN THE ASSETS HELD BY THE LLC EQUAL TO THE TAXPAYERS ADJUSTED BASIS IN ITS LLC MEMBER INTEREST. BECAUSE THE TAXPAYER'S BASIS IN THE LLC WAS GREATER THAN THE BASIS THE LLC HAD IN ITS ASSETS, THE DEEMED TERMINATION DECREASED GAINS ON SUBSEQUENT DISPOSITIONS OF SUCH ASSETS SOLD IN 2002.

9 Estimated tax benefits. Provide a separate estimate of the amount of each of the expected tax benefits described above for each affected tax year (including prior and future years).

2001 - NO BENEFITS RESULTED

2002 - ESTIMATED REDUCTION IN FEDERAL INCOME TAX LIABILITY APPROXIMATELY \$6.5 MILLION

FUTURE ESTIMATED REDUCTION IN FEDERAL INCOME TAX LIABILITY APPROXIMATELY \$10 MILLION

JWA

Form 8886 (3-2002)

REDACTED

2-0012  
08-19-03

CURTIS 004244

# **APPENDIX 4**

R.E.B. Enterprises  
520 Pike  
Seattle, Washington  
(206) 623-6140

March 1, 2002

Robert Adamonis, V.P.  
Union Bank of California, N.A.  
P.O. Box 3123  
Seattle, WA 98114-3123

Dear Bob:

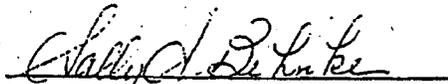
Re: Warm Springs Investors, LP  
Silver Creek Partners, LLC  
G.W. Skinner Trust #2  
G.W. Skinner Children's Trust fbo Sally Behnke

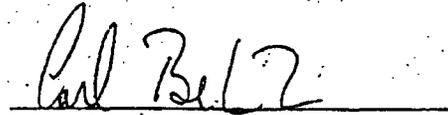
The undersigned comprise all of the income and remainder beneficiaries of the two trusts referenced above. This letter serves to restate the intent and agreement of our meeting last November, 2001.

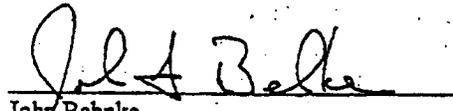
Acting on advice we solicited from Heritage Organization, LLC, we decided to initiate some sophisticated tax planning. This planning required the creation of the limited partnership and limited liability company referenced above.

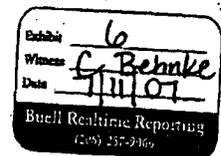
We understand that, if were you the sole trustee of these trusts, UBOC would not have engaged in this process. Further, we understand that had we taken a vote of co-trustees on this issue, UBOC's conservative policy of risk management would have mandated a vote against.

The bank is our agent for the Children's Trust, Warm Springs and Silver Creek, and one of three co-trustees for the Trust #2. We hereby exculpate and hold UBOC harmless for any consequences resulting from these transactions.

  
Sally Behnke

  
Carl Behnke

  
John Behnke



UBOC 000403

# **APPENDIX 5**

**Les and Sue Curtis**

**From:** <Bob@CSTONE-ADV.COM>  
**To:** <REBent@AOL.com>  
**CC:** <arbutus@aol.com>, <scurtis@verizon.net>  
**Sent:** Tuesday, December 04, 2001 12:49 PM  
**Subject:** Thank you

I appreciate you taking the time to having breakfast with me. Over the past six years, we have worked hard to earn the respect of you and your family. While we may not appear to be as experienced or sophisticated as some others you meet, I am confident that we are their intellectual equals. More importantly I believe, is our wisdom, which is evidenced by the way we have structured our company. I am proud to say that our advice to you is not biased by self-serving economic motive.

To that end, I counsel you to carefully re-consider both the ethical issues and risk/rewards associated with the proposed capital gains elimination strategy. At the very least, you might consider several different long-term deferral opportunities that are much less risky. In addition, I recommend that you comparison shop the offerings available. I also recommend that you query who receives compensation if the family adopts a particular strategy. (Recently, we were offered very significant finders fees if we successfully referred clients to a particular professional services firm that offers such products. It goes without saying that we would never accept such a fee).

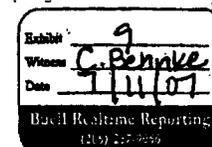
Finally, we believe that our in-house and outside manager evaluation services are the equal or exceed the expertise of Canterbury. As of 4/30/01, Canterbury reports on their Form ADV that they oversee \$8 billion of assets. Cornerstone and CTC combine for 18 billion dollars. The Canterbury ADV also describes themselves as a broker dealer, creating a potential conflict of interest.

I hope that we will be given the opportunity to present our ideas for the diversification and management of the trust assets.

Again, thank you for having breakfast with me this morning.

Robert F. Trenner  
 President  
 Cornerstone Advisors, Inc.  
 777 108th Ave. NE, Suite 2000  
 Bellevue, WA 98004-5118  
 (425) 455-8181

PS: Please provide name for head hunter that you like...



12/4/01

CURTIS 000126

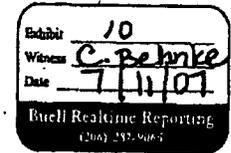
## **APPENDIX 6**

LEWIS, RICE & FINGERSH, L.C.

ATTORNEYS AT LAW

500 N. BROADWAY, SUITE 2000  
ST. LOUIS, MISSOURI 63102-2147  
WWW.LRF.COM  
MMULLIGAN@LEWISRICE.COM

MICHAEL D. MULLIGAN  
DIRECT (314) 444-7757



TEL (314) 444-7600  
FAX (314) 612-7157

November 30, 2001

VIA FEDERAL EXPRESS

PERSONAL AND CONFIDENTIAL

John S. Behnke, Carl G. Behnke and  
Union Bank of California, N.A., Trustees of  
G.W. Skinner Trust No. 2  
c/o R E B Enterprises  
520 Pike Street, Suite 2620  
Seattle, Washington 98101-4001

Dear Trustees:

I am writing you to set forth our proposal regarding the legal services which this firm is to provide you. This letter identifies those services and the terms of our engagement by you.

Services to be Rendered. We are to furnish legal services in connection with steps you propose to take in the year 2001 to establish and implement specific business strategies and to protect the value of certain of your investments. Our services will include preparing documents forming various entities to implement your planning decisions, and rendering advice concerning the tax and legal consequences of the transactions in which you engage. We shall also furnish you a written legal opinion as to the tax consequences of those transactions.

Fees and Expenses. We propose to perform the above services for a total sum of \$87,500, including expenses, of which \$21,875 is to be paid as a non-refundable retainer upon your acceptance of this engagement letter. An additional amount of \$21,875 is to be paid upon the completion of the formation of various entities, but no later than December 28, 2001. The remaining \$43,750 will be due within ten days after we have furnished our opinion letter.

Confidentiality. All matters which you discuss with us are personal and confidential. Those matters will not be shared with any individuals outside the firm without your consent.

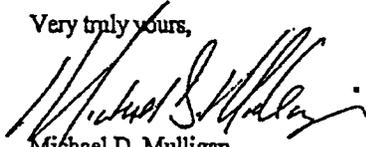
I am sending you two signed originals of this letter. If the foregoing is acceptable to you as the terms of your engagement of this firm, please sign and date one of those originals and return it to me, together with your retainer in the amount of \$21,875.

LEWIS, RICE & FINGERSH, L.C.

John S. Behnke, Carl G. Behnke and  
Union Bank of California, N.A., Trustees  
November 30, 2001  
Page 2

If you have any questions regarding the above, please feel free to get in touch with me.

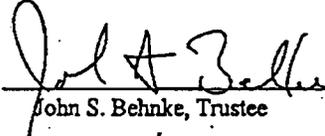
Very truly yours,



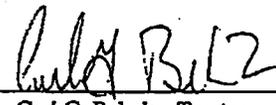
Michael D. Mulligan

MDM:wp  
909376.1

AGREED: G.W. SKINNER TRUST NO. 2

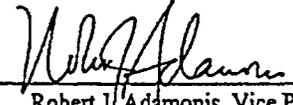
By:   
John S. Behnke, Trustee

Date: 12/3/01

By:   
Carl G. Behnke, Trustee

Date: 12/3/01

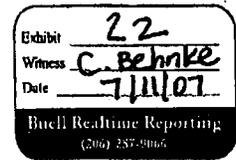
UNION BANK OF CALIFORNIA, N.A., Trustee

By:   
Robert J. Adamonis, Vice President

Date: \_\_\_\_\_

LR-GWS 00859

# **APPENDIX 7**



October 31, 2003

**PERSONAL AND CONFIDENTIAL**

Mr. John S. Behnke  
REB Enterprises  
Two Union Square  
601 Union Street, Suite 3016  
Seattle, WA 98101-2341

Re: Engagement Letter

Dear John:

Preston Gates & Ellis LLP welcomes the opportunity to serve you. We appreciate your confidence in our firm and look forward to working with you.

Accompanying this letter is Preston Gates' Privacy Principles, and our Statement of Legal Services and Charges. This letter and the statements (as supplemented or amended by this letter), are Preston's engagement agreement with you and will continue in effect unless we both make other written arrangements.

The Scope of the Representation

Our engagement is limited to advising you regarding federal income tax reporting procedure issues generated by transactions that occurred in 2002 relating to an investment that became a "listed transaction" (i.e., a transaction identified by the U.S. Treasury and the IRS as "tax avoidance transactions") after you initially make such investment. Our advice regarding the procedural reporting issues regarding the 2002 transactions is focused on (i) complying with applicable reporting requirements with a view to avoiding imposition of interest or penalty charges related to underpayment of taxes and (ii) putting you in a position to participate in any future national settlement the IRS may offer regarding the underlying investment. You have not asked us to review the substance of the underlying transaction or to advise you with respect to the merits of any particular tax characterization of the investment. Moreover, you will not provide to us any of the documents relating to such investment for our review. We have not been engaged to address any possible claims you may have against third-parties regarding your decision to engage in the investment. In addition, you have asked us to review the federal income tax aspects of liquidating Silver Creek Partners, L.L.C. (a limited liability company formed under the Missouri Limited Liability Company Act on December 14, 2001).

Check for Conflicts of Interest

We have made a check for conflicts of interest, based upon the information that you have provided. We have located no present conflicts of interest.

A LAW FIRM | A LIMITED LIABILITY PARTNERSHIP INCLUDING OTHER LIMITED LIABILITY ENTITIES

925 FOURTH AVENUE, SUITE 2900 SEATTLE, WA 98104-1158 TEL: (206) 623-7580 FAX: (206) 623-7022 www.prestongates.com  
Anchorage Coeur d'Alene Hong Kong Orange County Portland San Francisco Seattle Spokane Washington, DC

PGE00053

Mr. John S. Behnke  
October 31, 2003  
Page 2

We do not want to represent clients in connection with specific matters in which other client's interests are adverse to yours. It is possible, however, that in the future, existing or new clients may seek our services in connection with matters which are not substantially related to our work for you but in which the interests of those clients may be adverse to yours. Please understand that our firm cannot undertake to represent you without assurance that you will not seek, on the basis of that representation, to disqualify us from representing other clients in any matter that is not substantially related to our work for you. We agree, however, that your prospective consent to this conflicting representation would not apply in an instance where, as the result of representing you, we obtained sensitive, proprietary or otherwise confidential information that, if known to any other client, could be used by them to your material disadvantage. As a client of the firm, you would, of course, receive the same consideration as our present clients in terms of conflicts posed by future clients.

Because circumstances change, both we and you must be continually alert to the development of any conflicts. Please call us immediately if you become aware of a conflict or potential conflict.

#### Work Assignments

I will be your principal contact. You should contact me with any questions that you may have about our work or any other aspect of our representation. You can reach me directly at (206) 370-8380. Please feel free to call my secretary, Jeanine Wiese, directly for any reason as well. She can be reached at (206) 370-6631. If it is more convenient or you would prefer to talk with other attorneys working on this representation, please also feel free to call one of those attorneys.

As appropriate, we may assign work to other partners, associates, legal assistants or other staff members. If you have questions about the staffing of your matter or other issues, please let me know right away.

We will also work with other representatives on your behalf. If you prefer that we only take directions from or report to particular people, please advise us in writing. Absent that, we will assume that the representative with whom we are working is authorized to provide direction to us and that he or she will disseminate our advice to you.

#### Fees

The attached statement explains how we generally establish our fees. While hourly rates are not the only component of our fees, I want you to know my present hourly rate is \$460. As noted in the statement, we bill monthly. If you ever have a question about a bill or disagree with an entry, please call me immediately. Our hourly rates are typically adjusted annually and changes in the rates go into effect immediately. Those changes will thus be reflected in the next month's billing statement.

PGE00054

Mr. John S. Behnke  
October 31, 2003  
Page 3

Other Practices and Procedures

The statement sets forth in more detail certain of our firm's practices and procedures, such as scope of representation, conflicts of interest, work assignments, fees, ancillary charges, monthly billing statements, retainers or advance fee deposits (if applicable), delinquent accounts and termination of services and related matters. Please review the statement and contact me if you have any questions about it. If there are any changes that you would like to see, we will need to agree to them in writing.

Questions

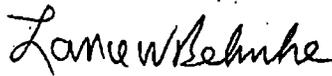
We recognize that we are in a service business. We appreciate your choice of Preston Gates & Ellis LLP to serve your legal needs and we will strive to provide legal services in a manner that meets your expectations. Please call me at any time regarding questions you may have about our services or billing practices.

If the foregoing meets with your approval, please sign the enclosed copy of this letter, and return it to me in the return envelope provided within ten (10) days of the date of this letter. If you have any questions, please feel free to call me.

On behalf of all of us at Preston Gates, we look forward to working with you.

Very truly yours,

PRESTON GATES & ELLIS LLP

By   
Lance W. Behnke

LWB:jw  
Enclosure

K11M0600262LWB\LWB\_A20VP

APPROVED AND AGREED:

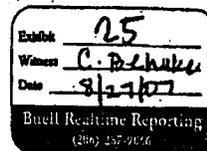
JOHN S. BEHNKE

By \_\_\_\_\_

Date \_\_\_\_\_

PGE00055

## **APPENDIX 8**



PRIVILEGED AND CONFIDENTIAL  
ATTORNEY-CLIENT PRIVILEGE

MEMORANDUM

TO: John S. Behnke  
FROM: Lance W. Behnke  
DATE: November 6, 2003  
SUBJECT: Procedural Issues re 2002 Tax Return and Listed Transaction Investment

Introduction

This memorandum records our October 2, 2003, discussion of procedural matters regarding the federal income tax reporting of the 2002 transactions associated with a 2001 investment (the "Investment") that is a "listed transaction" (i.e., a transaction identified by the U.S. Treasury and the Internal Revenue Service (the "IRS") as a "tax avoidance transaction").

Facts

In our conversation you explained that in 2001 certain family trusts formed a limited partnership ("LP") which in turn entered into a series of transactions (the "Investment"), including the acquisition of an interest in a limited liability company (the "Company"), all to achieve certain economic goals and also to yield significant federal income tax benefits (the "anticipated tax benefits"). During 2002, the Company entered into transactions in which LP realized a portion of the anticipated tax benefits. Also, during 2002 you became aware that the IRS identified the investment as a tax avoidance transaction.<sup>1</sup>

<sup>1</sup> Subsequent to our conversation, I received by fax copies of the Form 8886 Reportable Transaction Disclosure Statement describing the Investment as similar to transactions described in Notice 2000-44. The description indicates that LP (Warm Springs Investors, LP, a limited partnership owned by the two family trusts) received capital contributions in late 2001 of cash, corporate securities, and proceeds from an open short investment in U.S. Treasury Notes. LP contributed these assets to the Company in exchange for less than 100% of the membership interests in the Company (and it appears that the Company assumed certain inchoate obligations associated with the proceeds from the open short investment that were not treated as assumed liabilities for purposes of IRC 752). In 2001, the Company closed out the U.S. Treasury Notes transaction, and LP became the sole owner of the Company, causing a liquidation of the Company for federal income tax purposes. As a result of the liquidation of the Company, LP's tax bases in the Company's remaining assets were increased to equal LP's basis in its Company interest. This higher basis reduced gain on the sale of these assets.

A LAW FIRM | A LIMITED LIABILITY PARTNERSHIP INCLUDING OTHER LIMITED LIABILITY ENTITIES

825 FOURTH AVENUE SUITE 2900 SEATTLE, WA 98104-1158 TEL: (206) 623-7500 FAX: (206) 623-7022 WWW.PRESTONGATES.COM  
Anchorage Coeur d'Alene Hong Kong Orange County Portland San Francisco Seattle Spokane Washington, DC

PGE00309

We understand that LP and the partners received a significant amount of information from third party advisors and from the promoter of the Investment prior to entering into the Investment. This information addressed the potential for an economic profit. We also understand that LP and the partners received a tax opinion from a reputable law firm or accounting firm regarding the anticipated tax consequences of the Investment and the risks associated with reporting the Investment in certain ways. You indicated that the tax opinion held that there was substantial authority for the tax reporting position proposed by the promoter and that, more likely than not, such position would be upheld. Based on this opinion you reasonably believed and currently believe that the proposed reporting position more likely than not will be upheld.

After LP made the Investment, and prior to the time LP or its partners filed their 2002 federal income tax returns (extended to October 2003), you became aware that the IRS had included the Investment as a listed transaction. We further understand that each 2002 return will properly disclose the Investment per IRS Form 8886. We did not discuss whether the parties should have reported the Investment on Form 8886 in a prior year.

#### Review and Evaluation of Alternative Procedural Approaches

In our conversation, we discussed three alternative approaches (each is described in detail below) that LP and its partners could take with respect to the 2002 transactions related to the Investment. We examined these alternatives with a focus on (i) avoiding interest and penalties on underpayment of taxes, and (ii) maximizing the possibility that LP and its partners could participate in any possible future national settlement the IRS may offer regarding the Investment. We considered the benefits and risks of each alternative (as set out below).

Following our discussion of the alternative reporting procedures, you determined that Alternative Two (i.e., file returns claiming the anticipated tax benefits of the Investment, and file an amended return shortly after the due date for the extended return (October 15) that reverses such tax benefits, paying the additional taxes) presented the most attractive approach, after weighing the benefits and the risks associated with each alternatives. Alternative Two has the advantage of stopping the running of interest on underpayment of tax (with the filing of the amended return and payment of taxes as if the Investment had not occurred). Also, with respect to any future national settlement offered by the IRS regarding the Investment, it allows the partners to be in a substantially similar position as taxpayers who claimed the anticipated tax benefits of the Investment but did not file amended returns.

We discussed two risks associated with Alternative Two: (i) the possibility of an accuracy related penalty under IRC 6662 (forty percent of any underpayment of tax in the case of overstatement of basis) and (ii) the possibility that the IRS's future national settlement offer might distinguish between taxpayers who file amended returns after claiming the benefit of an Investment-type transaction and those that do not file amended returns. In the case of the accuracy related penalty, we pointed out that the timely filed return (and not the amended return) is the operative return for purposes of determining the penalty. We also noted that there can be

no guarantee that the IRS will not seek to impose these penalties and that, in the case of certain prior national settlements, the IRS had directed each local district to determine whether to assert the penalty on a taxpayer-by-taxpayer basis. If this approach is taken in the case of the Investment, we believe that the IRS should take into account the fact that taxpayers' decision to report the anticipated benefits of the Investment on its timely return and then to immediately file an amended return to eliminate such benefits and pay additional taxes, was undertaken to enable the taxpayer to participate in any future national settlement. We pointed out that the underpayment penalty would not apply if (i) there is substantial authority for the reporting position, and (ii) the taxpayer reasonably believed that the tax treatment was more likely than not proper. See IRC 6662(d)(2)(C). Moreover, a penalty should not be imposed if the taxpayer has reasonable cause for the underpayment and acted in good faith. See IRC 6664(b)(1) and Treas. Reg. 1.6664-4. Reasonable cause exists where a taxpayer reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities that unambiguously concludes that there is a greater than fifty percent likelihood that the tax treatment will be upheld if challenged by the IRS. We understand that you have received such opinions. We discussed the impact of the IRS's characterization of Investment-like transactions as "listed transactions" on your reasonable belief as to the likelihood that the anticipated tax benefits of the Investment will be upheld. Also, we discussed the fact that you should report the transaction on Form 8886.

The risk that the IRS might not make the national settlement available to taxpayers who file amended returns after initially claiming the anticipated benefits of an Investment-like transaction is a possibility. However, the rationale for distinctions of this distinction is not clear and would seem to be inconsistent with the policy to "cleaning up" all these types of investments in a single approach. It would also seem to penalize taxpayers who elected to remit the disputed taxes prior to the announcement of the settlement.

**Alternative One – Disregard Anticipated Tax Benefit of Investment, File Tax Refund Claim.**

Steps

- *Step One.* LP and each partner file their 2002 federal income tax return by disregarding the anticipated federal income tax benefits from the Investment. Because these anticipated benefits are not reported, the partners would each owe the full amount of federal income tax on any income otherwise intended to be sheltered by the Investment.
- *Step Two-A.* Subsequent to the filing of the 2002 return and at the earlier of (i) the running of the applicable statute of limitations for refunds, or (ii) the IRS's announcement of a national settlement with respect to the Investment, the parties would file a refund claim, reporting the anticipated tax benefit from the Investment.
- *Step Two-B.* If the partners have to file a refund claim to avoid application of the statute of limitations, and if the IRS rejects the refund claim, the partners would have to file a refund suit (in District Court), to preserve their claim.

- *Step Three.* On the IRS's announcement of the national settlement position with respect to the transaction, partners apply to participate in the settlement.

#### Risks

- *Participation in National Settlement.* It is possible that the IRS may seek to limit the national settlement to those taxpayers whose initial returns included the anticipated tax benefits of the Investment-like transaction, and exclude those individuals who claim the anticipated tax benefit through a refund claim. This possible distinction is logically inconsistent, and it is not clear why the IRS might take this view.
- *Interest Risk on Underpayment.* Because the partners will pay taxes without taking into account the anticipated tax benefits of the Investment, there should be no underpayment of tax with respect to the Investment, and therefore, no interest should accrue on unpaid taxes. (If the refund claim is permitted prior to the time of the national settlement, and the partners actually receive a refund at such time, they may own interest to the extent the refund constitutes an overpayment.) To the extent it is determined that the partners have overpaid their taxes (i.e., the national settlement permits some tax benefit from the investment), they should receive interest on the overpayment of tax.
- *Accuracy Related Penalty (IRC § 6662).* The accuracy related penalty of IRC § 6662 should not apply because the partners have not reported the anticipated benefit of the Investment in their federal income tax returns.
- *Estimated Tax Penalty (IRC § 6654).* Assuming that the partners computed their estimated taxes taking into account the anticipated tax benefit of the Investment, filing the tax returns without such tax benefits could result in an underpayment the estimated tax.

#### Alternative Two – File Consistently with Anticipated Tax Benefit, File Amended Return, and Wait for Refund Claim

#### Steps

- *Step One.* LP and each partner file their 2002 federal income tax return taking into account the anticipated federal income tax benefits from the Investment. Each partner's tax liability will be less because of the anticipated tax benefits of the Investment.
- *Step Two.* Very shortly after filing the 2002 federal income tax return, LP and each partner file amended federal income tax returns, reversing the anticipated tax benefits from the Investment. At the time each partner files its amended return, it will remit additional taxes resulting from the elimination of the tax benefits of the Investment. The

additional payment would include interest on the additional taxes from the due date (April 15, 2002) through the date of the payment.

- *Step Three--A.* Subsequent to the filing of the amended 2002 return and at the earlier of (i) the running of the applicable statute of limitations for refunds, or (ii) the IRS's announcement of a nationwide settlement with respect to the Investment, the partners would file a refund claim, reporting the anticipated tax benefit from the Investment.
- *Step Three--B.* If the partners have to file a refund claim to avoid application of the statute of limitations, and if the IRS rejects the refund claim, the partners would have to file a refund suit (in District Court), to preserve their claim.
- *Step Four.* On the IRS's announcement of the national settlement position with respect to the transaction, the partners should participate in the settlement (subject to the risk described below) and should be entitled to a refund and interest on any portion of the anticipated tax benefit from the Investment allowed in such settlement.

#### Risks

- *Participation in National Settlement.* This structure should permit the partners the opportunity to participate in any national settlement because such settlement should be offered to taxpayers whose returns included the anticipated tax benefits of the Investment. The fact that the partners subsequently filed an amended return should not adversely affect the partners' opportunity to participate in the settlement, but there can be no guarantee that the IRS will take this approach.
- *Interest Risk on Underpayment.* Because the partners' tax return will reflect the anticipated tax benefits of the Investment, there will be an underpayment of tax for the period following the filing of the return and prior to filing the amended return. Interest will accrue on this underpayment prior to the time the partners file their amended returns. With the filing of the amended return and the payment of the additional tax (and accrued interest), the interest risk should be eliminated. To the extent it is determined that the partners have overpaid their taxes because of the position taken on the amended return (i.e., the national settlement permits some tax benefit from the investment), they should receive interest on the overpayment of tax.
- *Accuracy Related Penalty (IRC § 6662).* The 2002 returns filed within the extension period will reflect the anticipated tax benefit of the Investment, and therefore, it is likely that these returns will reflect an underpayment of tax. The accuracy related penalty of IRC 6662 (forty percent of the tax underpayment in the case of overstatement of basis) could possibly apply to this underpayment. To avoid this penalty under the rules applicable to tax shelters, each partner must have (i) substantial authority for its tax position, and (ii) must reasonably believe that the treatment claimed on the return was "more likely than not" property. See IRC § 6662(d)(2)(c). Also, the penalty can be

abated if the partner demonstrates that there was "reasonable cause" for the underpayment and the taxpayer acted in good faith. IRC § 6664. Reasonable cause exists where the taxpayer reasonably relied in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities that unambiguously concludes that there is a greater than fifty percent likelihood that the tax treatment will be upheld if challenged. See Treas. Regs. § 1.6664-4(c). We understand that the tax opinions obtained by the partners and LP in making the Investment concluded that there was a greater than fifty percent likelihood that the anticipated tax benefit would be upheld if challenged.

- *Estimated Tax Penalty (IRC § 6654).* The estimated tax penalty is based on the tax shown on the return filed by the due date and not on the tax shown on the amended return. Because the return includes the anticipated tax benefit of the Investment, there return, the return should not result in application of estimated tax penalty of IRC § 6654. See Rev. Rul. 83-36, 1983-1CB 358.

**Alternative Three – File Consistent with Anticipated Tax Benefit of Investment, Make Non-Interest Bearing Deposit with IRS**

Steps

- *Step One.* The Company and each partner file their 2002 federal income tax return taking into account the anticipated federal income tax benefits from the Investment. The partners' tax liability will be reduced because they take into account the anticipated tax benefits of the Investment.
- *Step Two.* Pay into the U.S. Treasury a "deposit" generally equal to the amount of the tax benefit of the Investment. This deposit will stop the running of interest on any underpayment of tax associated with claiming the anticipated federal income tax benefit from the Investment. As explained below, the deposit will offset interest on underpayment of tax, but the IRS will not pay interest on the portion of the deposit that exceeds the actual tax liability.
- *Step Three.* On the IRS's announcement of the national settlement position with respect to the transaction, the partners will participate in the settlement. At such time, the partners would agree to permit the IRS to convert the deposit into a tax payment, and would be entitled to a return of that portion of the deposit (but with no interest) that exceeded the tax liability determined under the national settlement arrangement.

Risks

- *Participation in National Settlement.* This structure should permit the partners the opportunity to participate in any national settlement because their returns reflect the anticipated tax benefit.

MEMORANDUM  
November 6, 2003  
Page 7

- *Interest Risk on Underpayment.* Because the partners will not pay any portion of the taxes sheltered by the Investment, there will be an underpayment of tax due at the time of the settlement. Interest will accrue with respect to the underpayment. (Interest is suspended for *individuals* after eighteen months, if the IRS does not provide a notice to the taxpayer regarding the unpaid tax liability. However, it is our understanding that the partners are trusts.) This interest will be suspended by the filing of the deposit. However, the IRS will not pay any interest on the portion of the deposit that exceeds the amount of tax ultimately determined with respect to the Investment (taking into account the national settlement).
- *Accuracy Related Penalty (IRC § 6662).* The accuracy related penalty of IRC § 6662 should not apply because the partners have not reported the anticipated benefit of the investment in their federal income tax returns.
- *Estimated Tax Penalty (IRC § 6654).* Assuming that the partners of the Company computed their estimated taxes taking into account the anticipated tax benefit of the Investment, filing the tax returns without such tax benefits could result in an underpayment the estimated tax.

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## **APPENDIX 9**

# MEMORANDUM

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To: The Files  
From: Ed Ahrens  
Date: October 8, 2001  
Re: Salina Partnership L.P. - Tax Court Settlement

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Last Friday I talked with Martin Nissenbaum, Director of Retirement Planning and Personal Income Tax Planning for Ernst & Young, LLP ("E&Y"). In essence, he is their top personal income tax planning person. I asked Martin if he could confirm information that I had received from other parties that the settlement of Salina Partnership was very favorable to the taxpayer. He responded that it was very favorable, but that I should talk directly with Robert T. Carney in their Washington D.C. office who was counsel for the taxpayer (FPL Group, Inc./Florida Power & Light).

When the case commenced, Mr. Carney was with Fulbright & Jaworski. He continued as counsel after moving to E&Y. Mr. Carney likewise confirmed that they achieved a very favorable settlement. He referenced two other docket numbers (6653-00 and 10811-00) set forth on page 2 of the decision that were settled at the same time. I asked if I could ascertain the economics of the settlement by reviewing those two additional dockets. He said that I would not be 100% accurate if I did so. Mr. Carney offered to ask the taxpayers' vice president of tax for permission to provide me with the details of the settlement. That person is out of his office for the remainder of this week. There is no agreement with the IRS to not disclose the settlement terms and, therefore, Mr. Carney thought his client might like it to be known that they settled very favorably.

I will wait to hear back from Robert Carney next week.

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