NO. 36178-7

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

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

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

BRIEF OF RESPONDENT

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I. COUNTER-STATEMENT OF THE CASE

The trust which is the subject matter of this action is a testamentary trust that was created under the Last Will and Testament (CP 102-111), and "Second Codicil to Last Will and Testament of Andrea C. Barovic" (CP 88-90) which were probated in Pierce County Cause No. 90-4-01128-6. The Last Will and Testament of Michael Barovic and the Second Codicil thereto were probated under Pierce County Cause No. 94-4-00800-8, and are identical to the will and second codicil of Andrea Barovic, so they have not been included in the Clerk's Papers.

The testamentary documents establishing the trust directed the trustee to distribute the "net" income of the trust, at least annually, to Donald Barovic, the sole income beneficiary, and upon his demise, to distribute the principal of the trust to his children (CP 89).

The bank which was named as the original trustee declined to act and the income beneficiary was appointed as the trustee. After he proposed to sell himself certain assets of the trust on terms which were favorable to himself, he was removed as trustee, and the Respondent was appointed to act as trustee in 1996. The trust administration case, which was separate from the two probate cases, was assigned to the Honorable Thomas Swayze, who maintained jurisdiction of it as a judge pro tem after his retirement from the Pierce County Superior Court Bench.

The trustee chose to file intermediate annual accountings as allowed under RCW 11.106.030. The trustee filed an intermediate account for calendar year 2004, along with a petition for approval of the accounting and authorization for certain distributions on June 28, 2005 (CP 1-20). A copy of said 2004 accounting and petition and notice of hearing were sent to the income beneficiary and all of the remaindermen at that time. Because of health complications, Judge Swayze could not hear the petition for approval of the accounting at the scheduled time, and the matter was postponed. Judge Swayze eventually died, and the court had difficulty assigning the trust administration case to another department because of several recusals. Eventually, the case was assigned to Judge Serko.

The trustee then filed her intermediate accounting for calendar year 2005, along with a petition for approval, on December 6, 2006, and provided a copy of that intermediate accounting and petition to all of the beneficiaries, along with a notice of hearing setting the matter for March 16, 2007 (CP 21-38). On March 14, 2007, the Appellant income beneficiary filed his objection to the intermediate accountings for 2004 and 2005, the hearing for which was scheduled March 16, 2007 (CP 39-56). The objection was stated to contain a "Cross Petition for Continuance and Order to Compel Discovery." On March 15, the trustee filed her response to the objection and cross-petition which had been filed by Appellant (CP 73-85).

After a full hearing on March 16, 2007, the court denied the motion to continue and the motion for discovery, and entered separate orders approving the 2004 and 2005 accountings (CP 60-61 and 62-63).

The primary assets of the trust consist of:

a. The Canyon Creek Town Homes, which are professionally managed for the benefit of the trust;

b. The Liberty Theater, which is leased to a tenant; and

c. The liquid principal investment fund, which is known as "Nations Fund," and currently referred to as Columbia Funds, a subsidiary of Bank of America. (CP 7, 27)

II. STATEMENT OF PROCEEDINGS

By previous order, these two testamentary trusts were consolidated into the present case.

On March 16, 2007, the Court entered two separate orders, one approving the trustee's annual accounting for the calendar year 2004 (CP 60-61), and one approving the accounting for the calendar year 2005 (CP 62-63). A third order, approving the trustee's plan to sell the Canyon Creek Town Homes subject to further court approval of the actual sale, was entered at the same time.

Appellant filed a timely appeal of the two orders approving the accountings (CP 64-69), but did not appeal the order regarding the sale.

III. ARGUMENT

The court did not err in approving the 2004 and 2005 intermediate accountings.

A. There is no credible evidence that the trustee has favored the interests of the remaindermen over those of the income beneficiary.

B. There is no credible evidence of breach of fiduciary duty or negligence.

C. The court did not abuse its discretion in denying Appellant's last minute motion for continuance.

Of the three principal assets of the trust, two are real estate: the Canyon Creek Town Homes, and the Liberty Theater (CP 7, 27). Presumably, those assets, being real property, tend to appreciate, because most land appreciates, although the value of the improvements (buildings) may tend to depreciate over time. In any event, that appreciation in value cannot be realized until an asset is sold. RCW 11.104A.130(2) makes it clear that any money or proceeds received from the sale, exchange or liquidation or change in form of a principal asset, including realized profit, is to be allocated to principal, not to income. The same is definitely true regarding appreciation in real estate values which are not even realized until time of sale or exchange. Meanwhile, all rental income has been allocated to the income account (CP 3-5, 23-25).

The Columbia Funds account represents an investment of cash which the trust received from the estate of Andrea Barovic at the time of the commencement of the trust, and from later cash distributions from the estate of Mike Barovic to the trust (CP 22).

The Columbia Funds account generates income through earned dividends. All of that income has been allocated to the income account of the trust, for the benefit of the income beneficiary, as a part of the net income of the trust (CP 4, 24).

The actions of a trustee are controlled by both the provisions of the trust and, where applicable, by statute. RCW 11.97.010, entitled "Power of Trustor-

Trust provisions control" makes it clear that the language of the trust document supersedes statutory restrictions:

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

In this case, the trustors (Andrea and Michael Barovic) granted the trustee certain powers found in Article Eighth of their wills (CP 104-107). Under Section (A) of said Article, the trustee in this case can acquire or retain assets which the trustee deems advisable:

> "...whether or not such investments be of the character permissible for investments by fiduciaries. Investments need not be diversified and may be made or retained with a view to a possible increase in value." (CP 105)

Subsection (I) provides that the trustee is:

> "To determine in accordance with generally recognized and accepted trust accounting practices under the laws of the state of Washington all questions as to what constitutes income or principal; provided that all dividends which represent capital gains realized from the sale of securities owned by regulated investment companies shall be treated as principal." (CP 107)

Notwithstanding the language in Article Eleventh of the Last Will and Testament of Andrea C. Barovic (CP 108-109), which would relieve the trustee from "any and all duties as to accountings which are or may be imposed upon the trustee by the Uniform Trustees Accounting Act or any similar act of the state of Washington...," the trustee has elected to file annual accountings with a petition for approval and notice of hearing given to all beneficiaries of the trust. The trustee has also elected to give notice of all actions constituting a significant non-routine transaction, such as the sale or purchase of trust assets.

The statutory duties of the trustee (which may be superseded by the specific language of the trust) are found in RCW 11.104A.010, which provides the following general principles:

"Fiduciary duties — General principles.

(a) In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of this chapter, a fiduciary:
   (1) Shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this chapter;
   (2) May administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by this chapter;
   (3) Shall administer a trust or estate in accordance with this chapter if the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration; and
   (4) Shall add a receipt or charge a disbursement to principal to the extent that the terms of the trust and this chapter do not provide a rule for allocating the receipt or disbursement to or between principal and income.

(b) In exercising the power to adjust under RCW 11.104A.020 (a) or (e) or another discretionary power of administration regarding a matter within the scope of this chapter, whether granted by the terms of a trust, a will, or this chapter, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may

> favor one or more of the beneficiaries. A determination in accordance with this chapter is presumed to be fair and reasonable to all of the beneficiaries."

B. Appellant income beneficiary argues that: "The asset management approach taken by the appellee greatly favored capital appreciation of the Trust assets and as discussed further below, failed to provided the Income Beneficiary with an equitable share of the appreciation of the Trust assets."

Appellant income beneficiary cites no authority for the concept that the income beneficiary is entitled to a portion of the appreciation of the value of the assets of the trust. Not only is there no legal requirement that the income beneficiary receive a portion of said appreciation, the language of the trust itself would allow the trustee to "retain, whether originally part of the trust or subsequently acquired, any and all stocks, bonds, notes, or other securities, or any variety of real or personal property, including stocks or interest in investment trusts and common trust funds, as they may deem advisable." See Article Eighth, Subsection (A) of the Last Will and Testament of Andrea C. Barovic (CP 105). That subsection went on to say:

> "Investments need not be diversified and may be made or retained with a view to a possible increase in value."

At the time of the appointment of the current respondent trustee, the trust contained an undeveloped parcel of real estate, which was generating little if any income. The trustee sought and obtained court approval for the sale of said undeveloped property, and the use of the proceeds thereof to acquire the Canyon

Creek Town Homes, which provide a substantial portion of the income which is paid to the beneficiary.

Under the terms of the trust as set out in the Last Will and Testament of Andrea Barovic, the trustee could have retained that undeveloped property in its original condition (CP 105). Doing so would have been a substantial detriment to the income beneficiary. The respondent trustee has always tried to maintain assets in the trust which not only generate a substantial income for the benefit of the income beneficiary, but also provide for some appreciation which would be for the ultimate benefit of the remaindermen.

Respondent respectfully submits that there is nothing in the trust instruments, nor in any applicable state law, that requires the trustee to make sure that there is an equal benefit received by both the income beneficiary and the remaindermen. The trustee is required to maintain the proper distinction between cash funds which come in to the trust for the benefit of the income account as opposed to funds which come into the trust for the benefit of the principal account. The trustee has always done that.

Appellant argues that the trustee has not managed the trust in a manner that provides him sufficient income. This argument is apparently based on the contention that the Canyon Creek Town Homes have an actual market value of $3,200,000, and therefore should be producing greater income. However, on September 6, 2007, the trial court, after a contested hearing, approved the trustee's proposal to sell the Canyon Creek Apartments for $2,500,000, which order of the court has not been appealed. There is nothing in the record which would indicate that the income from that property is unreasonably low.

Appellant also argues that RCW 11.104A.010 grants the trustee the power to make adjustments between principal and interest based on what is fair and reasonable to all of the beneficiaries.

Respondent respectfully submits that RCW 11.104A.010 has no application to the case at bar. Subsection (a)(i) requires that the trustee "shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this Chapter." The testamentary terms of the trust, as found in the second codicil to the last will and testament of the decedent (CP 89) clearly states:

> "During the lifetime of my son, he shall receive, in at least annual payments, the net income of the trust estate."

It doesn't give the trustee discretion as to the amount to be distributed, nor does it provide that the amount of income has to be "reasonable" or has to meet any specific amount. If the trustee were to exercise a power to make adjustments between income and principal, it would be contrary to the terms of the will and codicil, and there is no statutory authority for the trustee to ignore the specific terms of the trust.

The trustee has not made any such adjustments, because none were allowed by law, or required by circumstance. The trust has been generating significant income for the income beneficiary. That income, during the 2004 and 2005 accounting periods, averaged $113,900 per year actually paid to the income beneficiary (CP 5, 25). The trustee respectfully submits that where the trust is generating reasonable income for the income beneficiary, there is no duty or legal requirement for the trustee to distribute more than the net income by granting the income beneficiary additional funds for some of the appreciation which may be occurring with regard to the principal assets. Not only is there no requirement for the trustee to do so, there is really no statutory authority allowing the trustee to do so because the terms of the testamentary document creating the trust are quite clear as to what the income beneficiary is to receive.

Appellant makes conclusory allegations that the trustee has "abused her discretion" or "acted negligently," but there are no specifics set forth which would support either one of those conclusory allegations. The appellant also alleges that the trustee has breached her fiduciary responsibility by "grossly favoring the remaindermen in her choice of investments, without making any adjustments between income and principal to insure an equitable distribution of the trust assets between the parties."

In reply to that, it is important to note that there is absolutely no evidence of any favoring of the remaindermen in the choice of investments. In fact, choosing to sell a piece of undeveloped real estate which she had the right to retain, in order to buy a piece of income-producing property (the Canyon Creek Town Homes), shows a favoring of the income beneficiary. Secondly, there is no evidence to support the contention that the net income being received by the income beneficiary is not an "equitable distribution of the trust assets between the parties." The terms of the trust did not require the trustee to make sure that there was equity between the income beneficiary and the remaindermen, it only required the trustee to pay the net income to the income beneficiary.

C. The court did not abuse its discretion in denying the respondent's last minute motion for a continuance.

Just prior to the March 16, 2007 hearing on the petitions for approval of the 2004 and 2005 accountings, the income beneficiary, on March 14, 2007, filed a motion for continuance and for an order compelling discovery (CP 39-56).

The 2004 accounting had been served on the income beneficiary on June 28, 2005, and the 2005 accounting and petition for approval had been served on the income beneficiary on December 6, 2006. At no time prior to March 14, 2007, did the income beneficiary ever make a request for production, send a written interrogatory, or note a deposition with regard to those accountings. The income beneficiary had the ability to exercise any of those discovery devices, but did none of them, and then, at the last minute, 2 days before the hearing, suddenly decided that he needed to do those things before the hearing. The court in such matters has discretion as to whether or not there should be a continuance, and there is no evidence that the court abused that discretion. Appellant did not require court approval to conduct discovery, and even if he did, he certainly didn't seek it in a timely manner.

IV. ATTORNEYS' FEES

Appellant requests an award of the reasonable attorneys' fees and costs of making this appeal. RCW 11.96A.150 grants the court the authority to award reasonable attorneys' fees and costs in regard to matters such as this. In this case, the court should require the appellant to pay respondent's reasonable attorneys' fees and costs, as the appeal was not well taken.

V. CONCLUSION

Appellant income beneficiary had more than sufficient time, prior to the scheduled hearing on the petitions for approval of the 2004 and 2005 accountings, within which to conduct discovery and present any evidence that he might consider relevant. No credible evidence was presented at the hearing that would support a claim that the trustee had breached her fiduciary duty or been guilty of negligence. The court properly denied the income beneficiary's request for a continuance and properly approved the annual accountings.

The orders of the trial court should be affirmed, and the Appellant should be required to pay the Respondent's reasonable attorneys' fees and costs in regard to the appeal.

Respectfully submitted this 22Nd day of October, 2007.

KRILICH, LA PORTE, WEST &
LOCKNER, P.S.

By ______________________
THOMAS G. KRILICH, WSBA 2973
Attorney for Appellant

CERTIFICATE OF DELIVERY

On this day, I hand delivered a true and accurate copy of the foregoing to John R. Spencer and David N. Land of Spencer & Loescher, PLLC, 1326 Tacoma Avenue South, Suite 100, Tacoma, WA 98402, and Eileen S. Peterson, Gordon Thomas, Honeywel, et al, 1201 Pacific Avenue, Suite 2100, Tacoma

WA 98402 . I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 22nd day of October, 2007, at Tacoma, WA.

THOMAS G. KRILICH, WSBA 2973
Attorney for Appellants