IN THE SUPREME COURT
STATE OF WASHINGTON

Supreme Court No. 91371-4

(Court of Appeals No. 69625-4-1-I)

JACK M. GARRISON; the GARRISON FAMILY LLC, a Washington limited liability company; LESA B. NEUGENT, individually and as Trustee of the JACK M. GARRISON AND CHARLOTTE L. GARRISON REVOCABLE TRUST, the JACK M. GARRISON SURVIVOR'S TRUST, the CHARLOTTE L. GARRISON MARITAL TRUST, the CHARLOTTE L. GARRISON EXEMPT MARITAL TRUST, the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO MARK GARRISON and the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO LESA NEUGENT,

Plaintiffs/Respondents,

v.

MARK M. GARRISON and MICHELLE GARRISON, his wife, and their marital community, and SAGEPOINT FINANCIAL, INC., a Delaware corporation licensed to do business in Washington, f/k/a/ AIG FINANCIAL ADVISORS, INC.,

Defendants/Petitioner.

PETITION FOR REVIEW OF SAGEPOINT FINANCIAL, INC.

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PETITION FOR REVIEW

Petitioner SagePoint Financial, Inc. (formerly known as AIG Financial Advisors, Inc. or "AIG") seeks review of the Court of Appeals' January 20, 2015 revised opinion reversing the grant of summary judgment to AIG on claims for negligent supervision and violations of the Washington State Securities Act (WSSA).

The Court of Appeals published its original decision on July 14, 2014. On August 4, 2014, AIG moved the Court of Appeals to reconsider that decision. On January 20, 2015, the Court of Appeals granted AIG's motion, withdrew its July 14 opinion, and issued a revised opinion, but the outcome remained the same.

INTRODUCTION

In one of the most famous lines from a judicial opinion, Justice Cardozo once explained that "proof of 'negligence in the air' . . . will not do." *Palsgraf v. Long Island R.R. Co.*, 162 N.E. 99, 99, 248 N.Y. 339, 341 (N.Y. 1928). That has long been the law in Washington and nearly every other State.

With the Court of Appeals' decision below, however, negligence claims against broker-dealers may now fill the Washington air. The Court of Appeals' decision imposes on broker-dealers a new duty to monitor the suitability of transactions in a non-customer's brokerage account held at another brokerage firm—even if (as was the case here) the broker-dealer had no practical ability to so monitor those transactions. Compounding

that error, the Court of Appeals ignored this Court's precedent to hold that a broker-dealer may also face control-person liability under the WSSA even if the broker-dealer had no control over the challenged transactions.

The plaintiffs in this case (the "Garrison Plaintiffs") sued Mark Garrison—their family member, a named beneficiary of the Garrison Family Trusts, and the Trusts' former manager and trustee—alleging that Mark's risky and speculative investments in 2008 caused the Trusts considerable losses. All of the Trusts' investments were held in brokerage accounts maintained at Wells Fargo Investments, LLC. No one disputes that, as manager and trustee, Mark had authority to direct the Trusts' investments in those accounts.

In addition to serving as the Trusts' manager and trustee, Mark was a registered investment adviser who co-owned Acumen Financial Group, Inc., an independent investment advisory firm. At the time of the allegedly risky investments, Mark was also an independent contractor/ registered representative for AIG, a FINRA registered broker-dealer. Mark was not AIG's employee. And the Trusts held no accounts at AIG and received no investment advice from AIG.

The Garrison Plaintiffs tried to pin liability on Wells Fargo in arbitration, but they lost. They also sued AIG, alleging that AIG was negligent in supervising Mark's trading activities in the Trusts' Wells Fargo accounts. The trial court granted summary judgment to AIG.

But the Court of Appeals reversed on the negligent-supervision and WSSA claims. In its view, once Mark and Acumen began taking

investment advisory fees from the Garrison Wells Fargo accounts, National Association of Securities Dealers, Inc. (NASD) Rule 3040 (which governs, with certain exceptions, the private securities transactions of persons associated with broker-dealers) imposed on AIG a duty to monitor the suitability of Mark's investments in those accounts—even though Wells Fargo (the broker-dealer that held the accounts) had no corresponding duty.[1]

If that sounds like a perverse result, it's because it is. The Court of Appeals reached that strange (and inequitable) result by misapplying NASD Rule 3040 and this Court's precedents.

The Court of Appeals added error to error by holding that AIG must also face control-person liability under the WSSA for purportedly failing to monitor Mark's trades in the Wells Fargo accounts. AIG could not possibly have been a control person under the Act (a prerequisite to liability) because AIG had no control—*none*—over Mark's trades in the Wells Fargo accounts. In ruling otherwise, the Court of Appeals misapprehended the statute's reach and this Court's decision in *Hines v. Data Line Systems, Inc.*, 114 Wash. 2d 127, 787 P.2d 8 (1990), which together limit control-person liability to those who in fact had control.

The Court of Appeals' opinion would be bad enough if it were "a restricted railroad ticket, good for this day and train only." *Smith v. Allwright*, 321 U.S. 649, 669, 64 S. Ct. 757, 88 L.Ed. 987 (1944) (Roberts, J., dissenting). Unfortunately, it's not. If left to stand, the decision will

[1] The NASD is now known as the Financial Industry Regulatory Authority (FINRA).

reverberate in the State's courts, encouraging strike suits against broker-dealers any time a broker-dealer purportedly ignores "red flags" in a non-customer's account held at another broker-dealer. That has never been the law in Washington or anywhere else.

ISSUES PRESENTED FOR REVIEW

(1) Did Washington law impose on AIG a duty to monitor the suitability of Mark's investment activities in non-customers' accounts held at another broker-dealer?

(2) Can a broker-dealer face control-person liability under the WSSA if the broker-dealer had no control over a trustee/manager's authorized investment decisions in non-customers' accounts held at another broker-dealer, just because the trustee/manager was also the broker-dealer's independent contractor?

STATEMENT OF THE CASE

1. Mark Garrison was a registered investment adviser who co-owned Acumen, an investment firm in Bloomington, Minnesota. *See* Court of Appeals' Jan. 20, 2015 Op. 3.

In 1999, Mark became a registered representative for AIG, a registered broker-dealer. A written independent-contractor agreement governed the parties' relationship. Op. 3. That agreement remained in force from September 1999 until April 2009, at which point AIG terminated it. *Id.* at 2.

Mark was never AIG's employee.

2. In early 2006, Mark's grandparents Jack and Charlotte Garrison established the Garrison Family Trusts and placed the Trusts' assets in brokerage accounts at Wells Fargo Investments LLC, another registered broker-dealer. Op. 2. The Trusts named Mark as a beneficiary. *Id.*

In September 2006, Jack Garrison appointed Mark trustee and manager of the Garrison Trusts, giving Mark discretionary authority over the Trusts. Op. 2. In accordance with NASD Rule 3050, Wells Fargo provided AIG with duplicate copies of the confirmation slips and monthly statements for the Trusts' accounts. SagePoint's August 4, 2014 Motion to Reconsider (MTR) at 3; Op. 7-8.

On November 14, 2006, AIG sent Mark a letter acknowledging his appointment as trustee and manager of the Garrison Trusts. Op. 6. AIG also explained that, given Mark's status as an independent contractor/registered representative for AIG, he could not serve as the registered representative for the Trusts' Wells Fargo accounts. *Id.* at 6-7.

3. Mark's contract with AIG required him to submit an Outside Business Activities Questionnaire (OBAQ) each year disclosing his outside business activities. Op. 6. On December 6, 2006, Mark submitted his OBAQ for 2005-06. In it, he disclosed that he was a registered investment advisor who co-owned Acumen, "an independent registered investment adviser, separate from [AIG]"; that he was "Trustee/Owner/Manager" of the Garrison Trusts; and that he was not an

"AIG investor provider representative." *Id.* at 9.

On March 14, 2007, Mark sent an email to the Garrison Trusts' stockbrokers at Wells Fargo and to the accountant for one of the Trusts explaining that he planned to hire Acumen to advise the Trusts. Mark also explained that Wells Fargo would continue to execute all trades for the Trusts. Op. 9. Two days later, Mark wrote a $65,524 check from the Garrison Family LLC account to Acumen for "investment advisory services" rendered in the fourth quarter of 2006. *Id.* at 10.

In October 2007, Mark submitted his 2006-07 OBAQ. He again disclosed his ownership interest in Acumen. Op. 10. Mark also reported that he was "actively engaged" as "Trustee/Owner/Manager on accounts held at Wells Fargo investments in Seattle, WA, for my grandfather—Jack Garrison" (*id.*), and he suggested obliquely that his activities with the Garrison Trusts were linked to "investment related activity" by Acumen, a "Registered Investment Advisor." *Id.* (emphasis in original).

In December 2007, Mark wrote AIG informing the company of his plans to open personal brokerage accounts at TD Ameritrade. Op. 11. AIG approved the request and asked Mark to send it duplicate copies of confirmation slips and account statements for those personal accounts. *Id.*

Mark controlled the trading activity in the Wells Fargo accounts. AIG made no investment recommendations for those accounts. MTR 6. It simply asked (in keeping with NASD Rule 3050 and internal policy) that Wells Fargo send it duplicate copies of account statements and trade confirmation slips so that it could ensure that Mark's activities posed no

threat to AIG or its customers. It made the same request of TD Ameritrade. But Rule 3050 imposed on AIG no duty to monitor the suitability of Mark's trades in the Wells Fargo or TD Ameritrade accounts.

4. The Garrison Plaintiffs allege that, in 2008, Mark transferred nearly $10 million from the Garrison Trusts to his personal brokerage accounts at TD Ameritrade, paid Acumen excessive investment advisory fees totaling more than $550,000, paid himself excessive trustee fees exceeding $370,000, and caused the Trusts more than $20 million in losses by making risky investments in 2008. *See* April 22, 2011 Compl., ¶¶ 77-79, 86-88, 106-10, 114-29, 143, 205. The Garrison Plaintiffs first sued Wells Fargo in arbitration to recover those losses. In April 2012, a FINRA arbitration panel ruled in Wells Fargo's favor and dismissed the Garrison Plaintiffs' claims. MTR 17.

Meanwhile, in April 2011, the Garrison Plaintiffs sued Mark alleging "Securities Law Violations, Breach of Fiduciary Duty, Negligence, and Other Claims." Op. 2. The Garrison Plaintiffs also named AIG as a defendant, alleging claims for negligent supervision, violation of the WSSA, and *respondeat superior*. *See id.* ¶¶ 172-208.

AIG denied liability, contending that it had no duty to monitor Mark's trading activities in the Garrison Wells Fargo accounts and that, in any event, it was not negligent. AIG's June 28, 2011 Answer ¶¶ 186-92, 194-97. The parties filed cross-motions for summary judgment.

5. The trial court granted summary judgment to AIG on all claims. AIG dismissed its cross-claim against Mark, and the parties stipulated to a

final judgment under CR 54(b). The Garrison Plaintiffs appealed.

The Court of Appeals reversed the grant of summary judgment to AIG on the negligent-supervision and WSSA claims. AIG moved the Court to reconsider its decision. It did, issuing a revised opinion, but the Court stood by its decision to reinstate the negligent-supervision and WSSA claims against AIG.

On the negligent-supervision claim, the Court agreed with AIG that NASD Rule 3050 governed Mark's transactions in the Wells Fargo accounts—both before and after Mark and Acumen started taking investment-advisory fees from the accounts. Op. 22, 31-32. The Court also agreed that AIG had complied with Rule 3050. *Id.* at 31-32.

But then the Court of Appeals lost its way. It held that once Mark and Acumen began taking investment fees from the Garrison Wells Fargo accounts, NASD Rule 3040 kicked in and imposed on AIG a duty to supervise Mark's transactions in the accounts. Op. 27-32. The Court reached that conclusion even though Rule 3040 excludes from its coverage "transactions subject to the notification requirements of Rule 3050." NASD Rule 3040(e)(1). The Court of Appeals also held that even if Rule 3040 did not apply, there are material issues of fact about whether "suspicious circumstances" in the Wells Fargo accounts raised "red flags" that AIG should have investigated and about "whether the information Mark submitted in the October 2007 OBAQ required [AIG] to investigate potential[ly] unapproved outside business activity as an investment advisor for the Garrison Trusts and the Garrison Family LLC." *Id.* at 32.

The Court of Appeals also reversed the grant of summary judgment to AIG on the WSSA claim, holding that AIG might qualify as a "control person" under the Act because it somehow could have controlled Mark's trading activities in the Trusts' Wells Fargo accounts. Op. 33-34.

This petition follows.

ARGUMENT

In reviving the negligent-supervision and WSSA claims against AIG, the Court of Appeals turned FINRA Rule 3040 and Washington law on its head. Never before has a court imposed on a broker-dealer a general duty to supervise an independent contractor's trading activities in a non-customer's account held at another broker-dealer. Yet that is now the law in Washington. *See Am. Disc. Corp. v. Shepherd*, 129 Wash. App. 345, 355, 120 P.3d 96 (2005) *aff'd*, 160 Wash. 2d 93, 156 P.3d 858 (2007) ("Where the Supreme Court has not addressed an issue, an existing Court of Appeals decision is the law.").

No one disputes that when Mark became trustee and manager of the Garrison Family Trusts, AIG had no duty to supervise the Trusts' Wells Fargo accounts. Nor does anyone dispute that the Garrison Trusts were never AIG's customers. And yet despite all that, the Court of Appeals held that AIG may face liability for purportedly failing to monitor Mark's trading activities in the Garrison Wells Fargo accounts even though Wells Fargo itself had no similar duty—all because Mark (permissibly) took advisory fees from the Wells Fargo accounts.

That twisted result cannot stand. This Court should correct it now to bring Washington law back into the judicial mainstream.

I. THE COURT OF APPEALS ERRED IN IMPOSING A DUTY ON AIG TO MONITOR NON-CUSTOMERS' ACCOUNTS HELD AT ANOTHER BROKER-DEALER.

The Court of Appeals resurrected the negligent-supervision claim against AIG based on its twin conclusions that (1) NASD Rule 3040 imposed on AIG a duty to supervise Mark's transactions in the Garrison Wells Fargo accounts once he and Acumen began taking investment advisory fees from the accounts, and (2) even if Rule 3040 did not apply, "suspicious activity" in the accounts and in Mark's OBAQ submissions raised "red flags" sufficient to trigger a duty on AIG's part to investigate his trading activities in the Trusts' Wells Fargo accounts. Op. 32. The Court erred on both counts, and those errors threaten to transform Washington into a breeding ground for opportunistic (but meritless) broker-dealer litigation.

A. The Court of Appeals' holding that NASD Rules 3040 and 3050 can apply to the same transaction flouts the Rules' plain language and turns the law of negligent supervision on its head.

The Court of Appeals correctly held (and the Garrison Plaintiffs concede) that NASD Rule 3050 applied to Mark's transactions in the Wells Fargo accounts. The Court of Appeals also held—again, correctly—that AIG fulfilled its limited obligations under Rule 3050 and that, in any

event, Rule 3050 imposed on AIG no duty to protect the Garrison Trusts. Op. 21-22, 32-32.

But in the very next breath, the Court of Appeals ruled that once Mark and Acumen began taking investment advisory fees from the Wells Fargo accounts, NASD Rule 3040 imposed on AIG a duty to monitor Mark's transactions in those accounts. That holding flies in the face of Rule 3040's language, which makes clear that the Rule does not apply to Rule 3050 transactions or accounts.

Rule 3040 applies only to "private securities transactions," which the Rule defines as follows:

> **(e) Definitions**
>
> For purposes of this Rule, the following terms shall have the stated meanings:
>
> (1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, *provided however that transactions subject to the notification requirements of Rule 3050*, transactions among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, *shall be excluded.*

NASD Rule 3040(e)(1) (emphasis added).

By its terms, Rule 3040 does not apply to "transactions subject to the notification requirements of Rule 3050." That should have been the end of the matter: Everyone agrees that Mark's transactions in the

Garrison Wells Fargo accounts were "subject to the notification requirements of Rule 3050," so Rule 3040 did not apply. Period.

The Court of Appeals reached the opposite conclusion based on an unnatural—and as NASD commentary reveals, conclusively wrong—reading of the Rule. According to the Court, Rule 3040 does not exclude from its coverage *all* Rule 3050 transactions; it excludes only Rule 3050 transactions "for which no associated person receives any selling compensation." Op. 24.

The Court of Appeals acknowledged that under the canon of construction known as the last-antecedent rule, the qualifying phrase "for which no associated person receives selling compensation" normally would modify only the last antecedent ("transactions among immediate family members (as defined in Rule 2790)"), but the Court concluded that the placement of a comma before the qualifying phrase "means that the phrase applies to both preceding antecedents: 'transactions subject to the notification requirements of Rule 3050' and 'transactions among immediate family members . . . for which no associated person receives selling compensation.'" Op. 24.

The Court of Appeals' application of the so-called "comma exception" to the last-antecedent rule was wooden. *See State ex rel. Wilson v. King County*, 7 Wash. 2d 104, 108, 109 P.2d 291 (1941) ("[C]anons of interpretation are . . . at the most aids to construction, and after all it becomes the duty of the court to determine, if possible, what the real intention of the lawmakers was."). The Court applied the exception as

a first resort (not a last) and did so mechanically, affording talismanic power to a single comma. That was a mistake: "Punctuation is a most fallible standard by which to interpret a writing." *Ewing's Lessee v. Burnet*, 36 U.S. 41, 54, 9 L.Ed. 624 (1837). In pressing its eye against a single comma, the Court of Appeals blocked its vision of other indicia of meaning—grammar, syntax, official NASD commentary, other rules of construction. Those other cues confirm that Rule 3040 excludes from its coverage all Rule 3050 transactions, even those for which an associated person receives selling compensation.

First, Rule 3040's grammatical structure leaves no doubt that the qualifying phrase modifies only "transactions among immediate family members (as defined in Rule 2790)," not "transactions subject to the notification requirements of Rule 3050." The clause "transaction among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation" is the second in a series of three types of transactions excluded from Rule 3040's coverage. If the SEC had wanted the qualifying phrase "for which no associated person received selling compensation" to apply both to Rule 3050 transactions and to transactions among immediately family members, it would not have placed that phrase behind the second of three items in a series. At the very least, it would not have done so without also joining the first two items in the series with a conjunction.

The most natural reading of Rule 3040 is that it excludes three different types of transactions from its coverage: (1) Rule 3050

transactions; (2) transactions among immediate family members for which no associated person receives any selling compensation; and (3) personal transactions in investment company and variable annuity securities. The Court of Appeals looked past the Rule's plain meaning.

Second, even if Rule 3040's language left some doubt about its coverage, NASD commentary would erase it. In its official commentary on Rule 3040, the NASD explained that the phrase "for which no associated person receives selling compensation" modifies only "transactions among immediate family members":

> Transactions subject to Article III, Section 28 of the NASD Rules of Fair Practice, and personal transactions in investment company and variable annuity securities are excluded [from Rule 3040's coverage], as are transactions among immediate family members (as defined in the Interpretation of the Board of Governors on Free-Riding and Withholding) for which no associated person receives any selling compensation.[2]

NASD Notice to Members 85-84 (Nov. 12, 1985); *see also* FINRA Notice to Members 91-27 n.1 (1991) ("The transactions subject to Section 28 [Rule 3050] are not considered to be private securities transactions [under] Article III, Section 40 of the Rules of Fair Practice [another name for Rule 3040]."). That commentary—to which courts owe great deference (*see, e.g., In re Sehome Park Care Ctr., Inc.*, 127 Wash. 2d 774, 780 903 P.2d 443 (1995) (en banc); *Dawson v. N.Y. Life Ins. Co.*, 135 F.3d 1158, 1168

[2] "Article III, Section 28 of the NASD Rules of Fair Practice" is another name for Rule 3050.

(7th Cir. 1998))—confirms that Rule 3040 does not apply to any Rule 3050 transaction. The Court of Appeals erred in holding otherwise.

Third, this Court has held that in interpreting statutes or rules, "unlikely, absurd, or strained results must be carefully avoided." *Berrocal v. Fernandez*, 155 Wash. 2d 585, 590, 121 P.3d 82, 84 (2005) (en banc). Threatening AIG with liability for authorized transactions in non-customers' accounts held at another broker-dealer is by any view absurd.

B. There were no "red flags" in the monthly statements and trading confirmations that Mark sent AIG.

Compounding its error, the Court of Appeals also held that even if Rule 3040 did not apply, "red flags," namely a change in the nature of the investments and certain transactions in the Wells Fargo accounts and Mark's engagement of Acumen as the Trusts' investment adviser, triggered a duty on AIG's part to investigate Mark's activities in the Wells Fargo accounts. Op. 30-32.

The investments and transactions in the Wells Fargo accounts could not have been a "red flag" to AIG because AIG knew that Mark was authorized to direct those investments and transactions, and AIG had no right or ability to question the "riskiness" of investments made by non-customers in accounts held with another broker-dealer.

The slight, almost imperceptible change in Mark's October 2007 OBAQ indirectly linking his previously disclosed work for Acumen with his previously disclosed service as trustee of the Garrison Trusts likewise was not a "red flag." Op. 32. It was barely a blip on the radar. Mark had

authority to hire an investment adviser for the Garrison Trusts, so Mark's disclosure that he hired Acumen did not suggest suspicious activity in the least. At any rate, Mark's hiring Acumen to serve as the Trusts' investment adviser did not change the essential character of the Wells Fargo accounts: They remained accounts maintained at another broker-dealer "which [Mark] had a financial interest in, or discretionary authority over." NASD Rule 3050. Hiring Acumen to advise those accounts would not have raised eyebrows at AIG or at any other broker-dealer.

In concluding otherwise, the Court of Appeals relied heavily on *McGraw v. Wachovia Securities, L.L.C.*, 756 F. Supp. 2d 1053 (N.D. Iowa 2010), but *McGraw* doesn't support the Court of Appeals' decision.

For starters, *McGraw* involved Rule 3040 transactions, not Rule 3050 transactions. The Court of Appeals cited no case or FINRA ruling imposing on a broker-dealer a duty to supervise Rule 3050 accounts for suspicious activity simply because an independent contractor took fees from the accounts. For good reason: There is no such case or ruling. The Court of Appeals created a new duty out of thin air.

Regardless, *McGraw* does not support the result below. There, the plaintiff-investors presented evidence that arguably placed the broker-dealer on notice that its registered representative was "engaged in improper conduct": The investors met frequently with the registered representative at the broker-dealer's office and sent checks for their investments to that office. 756 F. Supp. 2d at 1075. Indeed, the investors' contact with the broker-dealer was so substantial that some of them

thought that they were investing *with* the broker-dealer. *Id.* at 1058. In the *McGraw* court's view, those "troublesome 'red flags'" should have alerted the broker-dealer that its registered representative was violating firm policy and "engag[ing] in improper activities." *Id.* at 1075-76.

There are no *McGraw*-type facts here. AIG was not entangled with the Garrison Plaintiffs. It had no relationship with them. Mark controlled the Wells Fargo accounts as the Trusts' manager and trustee; AIG was a complete stranger to those accounts. The supposed "red flags"—trades in the accounts coupled with Mark's accurate disclosures about Acumen's work for the Trusts—were innocent through and through. They did not suggest that Mark was violating NASD rules or AIG policy.[3]

The bottom line is that AIG was not negligent. In suggesting the contrary, the Court of Appeals rewrote Washington law.

* * *

The implications of the Court of Appeals' decision cannot be overstated. Before the Court of Appeals' decision (and questions of duty aside), it was well-settled in Washington that a plaintiff asserting negligent supervision must prove that (among other things) the defendant knew or

[3] The Court of Appeals also seized on a directive in AIG's sales manual requiring its registered representatives to "on an annual basis . . . disclose to the Firm, via the OBAQ, any outside business activities prior to engaging in such activity." Op. at 30 (quoting AIG's Financial Advisors Sales Practice Manual). In the Court's view, that directive coupled with Mark's disclosure in October 2007 that Acumen was advising the Garrison Trusts should have raised AIG's suspicion. Yet even if Mark did not follow the sales manual to the letter, his small delay in disclosing certain outside business activity would not have been apparent on the face of the OBAQs and in all events would not have triggered a general duty on AIG's part to study Mark's investments in the Wells Fargo accounts for customer suitability.

should have known that the supervised person posed a risk of harm to others *and* that the plaintiff was a foreseeable victim of the defendant's negligence. *See Niece v. Elmview Grp. Home*, 131 Wash. 2d 39, 51-52, 929 P.2d 420 (1997); *Smith v. Sacred Heart Med. Ctr.*, 144 Wash. App. 537, 544, 184 P.3d 646 (2008). After the decision, a plaintiff arguably doesn't need to make *either* showing to pin liability on a broker-dealer.

AIG had no duty to monitor Mark's trades in the Wells Fargo accounts for customer suitability and had no reason to think that Mark posed a threat to the Garrison Trusts or to himself. That should have been enough to dispose of the negligent-supervision claim; it *was* enough at the trial court. The Court of Appeals' contrary ruling works a sea change in the law of negligent supervision in the State. It creates a universe in which Wells Fargo—the broker-dealer that held the Garrison accounts and that indisputably had some limited responsibilities to those accounts—is insulated from liability but AIG, a stranger to the accounts, is not.[4]

That begs many questions: Why should AIG face liability when Wells Fargo doesn't? Why is AIG potentially on the hook for Mark's authorized, independent investment decisions in non-customers' accounts held at another broker-dealer? Why reward the alleged wrongdoer at an

[4] Mark had authority to and did direct the trades in the Garrison Wells Fargo accounts, so under the applicable rules, Wells Fargo had no duty to monitor the Garrison Wells Fargo accounts for suitability even though it was required to collect and maintain customer information for the Garrison Trusts (the Trusts' purposes, stated risk tolerances and investment objectives, and so on). *See* NASD Rule 2310; FINRA Rule 2111; RCW 21.20.702. In fact, it was *because* Wells Fargo had no duty to monitor the Garrison Wells Fargo accounts for suitability that Wells Fargo prevailed in its separate arbitration with the Garrison Trusts. *See* MTR 17.

innocent bystander's expense? This Court should correct the Court of Appeals' decision before it takes on a life of its own in the lower courts.

II. AIG CANNOT FACE "CONTROL-PERSON" LIABILITY FOR TRANSACTIONS THAT IT DID NOT AND COULD NOT CONTROL.

The Court of Appeals' decision to reinstate the negligence claim against AIG is enough by itself to warrant immediate review. But the Court also erred in resuscitating the claim under the WSSA. That error could produce a cascade of meritless securities claims in the State.

A. AIG had no control over Mark's trades in the Garrison Wells Fargo Accounts.

In *Hines v. Data Line Systems, Inc.*, this Court held that control-person liability under the WSSA requires a defendant to have "actually participated in (*i.e.*, exercised control over) the operations of the corporation in general" and to have held the "*power to control* the specific transaction or activity upon which the primary violation is predicated." 114 Wash. 2d 127, 136 (1990) (en banc) (emphasis in original); *see also* RCW 21.20.430. That ruling makes sense: By definition, control-person liability requires control.

The Court of Appeals paid lip service to *Hines* but ignored its teaching. AIG had no control over Mark's trading activities in the Trusts' Wells Fargo accounts. Mark was not AIG's employee. He was an independent contractor. As trustee and manager, Mark controlled the trading activities in the Garrison Wells Fargo accounts. AIG was a

stranger to those accounts and had no control over them. That forecloses control-person liability against AIG.

The Court of Appeals purported to find support for its contrary view in *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990), but one look at that decision confirms that it lends no support to the Court of Appeals' adventurous take on control-person liability. The *Hollinger* court explained that broker-dealers like AIG *do not* face control-person liability when the plaintiffs "plac[ed] the[ir] money with [the registered representative] for purposes *other than* investment in markets to which [the registered representative] had access *only by reason of his relationship with [the] broker-dealer.*" *Id.* at 1575 n.26 (emphasis added). Here, Mark's independent-contractor arrangement with AIG played no part in his investment decisions for the Garrison Wells Fargo accounts. And at any rate, AIG could not have stopped those transactions. No control, no control-person liability. *Hines*, 114 Wash. 2d at 136.

CONCLUSION

The Court of Appeals misapplied the facts and the law to revive negligent-supervision and WSSA claims against AIG that the trial court rightly dismissed. The Court of Appeals strayed from well-established Washington precedent and set the State's jurisprudence on a course away from the judicial mainstream.

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Respectfully submitted this 19th day of February, 2015.

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CERTIFICATE OF SERVICE

I certify that on February 19, 2015, I served a copy of this brief on the following parties by personal service:

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Appendix A

Court of Appeals Decision

No. 69625-4-1-I

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

JACK M. GARRISON; the GARRISON FAMILY LLC, a Washington limited liability company; LESA B. NEUGENT, individually and as Trustee of the JACK M. GARRISON AND CHARLOTTE L. GARRISON REVOCABLE TRUST, the JACK M. GARRISON SURVIVOR'S TRUST, the CHARLOTTE L. GARRISON MARITAL TRUST, the CHARLOTTE L. GARRISON EXEMPT MARITAL TRUST; the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO MARK GARRISON, and the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO LESA NEUGENT, Appellants, v. SAGEPOINT FINANCIAL, INC., a Delaware corporation licensed to business in Washington, f/k/a AIG FINANCIAL ADVISORS, INC., Respondent, MARK M. GARRISON and MICHELLE GARRISON, his wife, and their marital community, Defendants.	No. 69625-4-1-I DIVISION ONE PUBLISHED OPINION FILED: January 20, 2015

SCHINDLER, J. — Mark M. Garrison was a licensed investment advisor and co-

owner of a financial advice firm, Acumen Financial Group Inc. In 1999, Mark[1] entered into an independent contractor agreement with AIG Financial Advisors Inc. to act as a registered securities representative (stockbroker). In 2002, Mark's grandparents Jack and Charlotte Garrison established the Garrison Family LLC. In 2006, Jack and Charlotte transferred all of the assets of the LLC to the Jack M. Garrison and Charlotte L. Garrison Revocable Trust (Revocable Trust). The Revocable Trust designates Jack and Charlotte as the cotrustees and income beneficiaries, and names Mark and his sister Lesa B. Neugent as the remainder beneficiaries. The Garrison Family LLC and the Revocable Trust held approximately $26 million in two brokerage accounts at Wells Fargo Investments LLC. After Charlotte died in August 2006, Jack appointed Mark as the sole manager and trustee of the Garrison Family LLC and the Revocable Trust.

In April 2011, Jack Garrison, Lesa Neugent, the Revocable Trust, and the trusts created after Charlotte's death (collectively Garrison Trusts) filed a lawsuit against Mark and SagePoint Financial, formerly known as AIG Financial Advisors Inc., alleging joint and several liability for the loss of more than $20 million and claims of breach of fiduciary duty; negligent supervision; violation of the "Washington State Securities Act" (WSSA), chapter 21.20 RCW; and respondeat superior. AIG filed a motion for summary judgment dismissal arguing that under National Association of Securities Dealers (NASD) Rule 3050, Transactions for or by Associated Persons (amended effective Oct. 15, 2002), AIG had no duty to supervise the transactions in the Wells Fargo accounts. The Garrison Trusts filed a cross motion for summary judgment, arguing AIG owed a duty to supervise under NASD Rule 3040, Private Securities Transactions of an

[1] We refer to members of the Garrison family by their first names for purposes of clarity.

Associated Person (amended effective March 23, 2004). In the alternative, the Garrison Trusts argued AIG had a duty to investigate and monitor the suspicious activity in the Wells Fargo brokerage accounts. The court granted AIG's motion for summary judgment and dismissed the claims against AIG. We affirm dismissal of the respondeat superior claim against AIG. Because there are material issues of fact as to whether AIG knew or should have known by October 2007 that Mark was acting as an investment advisor for compensation triggering a duty under the NASD Rules to either supervise the securities transactions in the Wells Fargo brokerage accounts or to investigate and monitor the securities transactions in the Wells Fargo accounts, we reverse summary judgment dismissal on the claims against AIG for negligent supervision and violation of the WSSA.

FACTS

Mark M. Garrison was a licensed investment advisor registered with the United States Securities and Exchange Commission (SEC). Beginning in 1995, Mark was co-owner of a financial investment advice firm in Bloomington, Minnesota, Acumen Financial Group Inc.

In 1999, Mark entered into an "Independent Contractor Agreement for Registered Representative" with AIG Financial Advisors Inc.[2] AIG is a securities broker-dealer registered with the SEC and a member of the National Association of Securities Dealers (NASD).[3] As a licensed registered securities representative or stockbroker, Mark also registered with the SEC.

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[2] AIG is now known as SagePoint Financial Inc.

[3] In 2007, the two self-regulatory organizations, NASD and the regulatory arm of the New York Stock Exchange (NYSE), merged and are now jointly known as the Financial Industry Regulatory Authority (FINRA).

As part of the Independent Contractor Agreement with AIG, Mark agreed to comply with "the statutes, rules, regulations and statements of policy of the [SEC], the Conduct Rules of the NASD and any state securities and insurance laws and regulations," and AIG policies and procedures. Mark agreed to notify AIG "in writing of any outside business activity prior to engaging in such activity."[4] The Independent Contractor Agreement states, in pertinent part:

> I will notify the Company in writing of any outside business activity prior to engaging in such activity. I will not engage in any conduct which conflicts with the business of the Company, nor will I engage in any conduct which is not the business of the Company at the location where I conduct the business of the Company without advising the Company of such business activity in writing. I will not accept or retain employment or compensation from any person or business or as a self-employed person as a result of business activity outside the scope of my affiliation with the Company without advising the Company in writing of such employment or compensation. I agree to make books and records with respect to my outside business activities available to the Company upon request.[5]

Mark's grandparents Jack M. Garrison and Charlotte L. Garrison owned a shipping company. In 2002, Jack and Charlotte established the Garrison Family LLC, transferring approximately $11 million to the LLC. Jack and Charlotte were the sole shareholders and Jack was named the manager of the LLC. The Garrison Family LLC assets were held in brokerage accounts at the Seattle branch of Wells Fargo Investments. Jack worked with Wells Fargo registered securities representatives Jean Adams and Rebbie Thomas.

In 2006, Jack and Charlotte established the Jack M. Garrison and Charlotte L. Garrison Revocable Trust. Jack and Charlotte transferred their Garrison Family LLC shares plus approximately $16 million into the Revocable Trust. The "Revocable Living

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[4] Emphasis added.

[5] Emphasis added.

Trust Agreement" designates Jack and Charlotte as the cotrustees and lifetime beneficiaries of the trust, and names their grandchildren Mark M. Garrison and Lesa B. Neugent as the remainder beneficiaries, with a 62 percent interest allocated to Mark and a 38 percent interest to Neugent. The Revocable Trust directs the creation of several other trusts upon the death of either Jack or Charlotte—an exempt marital trust, a marital trust, a survivor trust, an exempt family trust for the benefit of Neugent, and an exempt family trust for the benefit of Mark.[6]

Charlotte died on August 8, 2006. Shortly after her death, Jack was diagnosed with dementia. On September 11, 2006, Jack resigned and appointed Mark as the manager of the Garrison Family LLC and the trustee of the Revocable Trust.

Over the years, Jack had invested conservatively in the Wells Fargo brokerage accounts. In September 2006, the assets in the Wells Fargo accounts for the Garrison Family LLC and the Revocable Trust totaled approximately $26.5 million, consisting of approximately $21.8 million in the LLC brokerage account, $4.6 million in the Revocable Trust brokerage account, and $120,000 in the LLC checking account.

In compliance with NASD Rule 3050, on October 6, 2006, Wells Fargo sent a letter requesting approval of Mark's appointment as "trustee, owner and manager on accounts held with our firm." The letter states, in pertinent part:

> This letter is to inform you that Mark M[.] Garrison, an employee of your firm, has requested to be appointed trustee, owner and manager on

[6] Upon the death of either Jack or Charlotte, the Revocable Living Trust Agreement also designates "Specific Cash Gifts" in the amount of $200,000 each to "accountant and friend" Hal Carrothers, Wells Fargo "financial advisor and friend" Jean Adams, and Wells Fargo "financial advisor and friend" Rebbie Thomas.

> accounts held with our firm. In order to execute his request, we must have approval in writing from your Compliance Officer (Rule 407 letter).[7]

On October 16, 2006, Mark's assistant faxed the Wells Fargo letter to the AIG Compliance Department. The cover sheet states, in pertinent part:

> [P]lease find a letter from the Seattle, WA office of Wells Fargo requesting approval from your department for Mark Garrison to act as the trustee, owner and manager on accounts held in a trust for Mark's grandparents. Please forward your approval to the address shown on the Wells Fargo letterhead.

On November 14, 2006, the AIG Compliance Department sent Mark a "Letter of Understanding for Acting as Trustee/Owner/Manager on the Garrison Wells Fargo Accounts." The letter states that AIG does not object to Mark acting as the "trustee/owner/manager" on the conditions that Mark does not act as a registered representative/stockbroker and that he complies with the requirements to disclose annually his outside business activity on the AIG "Outside Business Activities Questionnaire" (OBAQ). The November 14 letter states, in pertinent part:

> **Re: Letter of Understanding for Acting as Trustee/Owner/Manager on the Garrison Wells Fargo Accounts (#s W35823867, 745-1146604, & W29758675)**
>
> Dear Mr. Garrison:
>
> This letter will serve as your record that AIG Financial Advisors, Inc. ("AIGFA") is aware that you are trustee/owner/manager on the above-referenced Garrison accounts held at Wells Fargo. AIGFA does not object to your participation in this activity as long as the following are met:
>
> 1. You sign and return the attached Indemnification Form;
>
> 2. You may not act as the representative of record for these or any

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[7] NYSE Rule 407, Transactions—Employees of Members, Member Organizations and the Exchange (amended effective Dec. 15, 2008), is equivalent to NASD Rule 3050. See FINRA Regulatory Notice 09-22, FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Personal Securities Transactions for or by Associated Persons (discussing consolidation of NYSE Rule 407 and NASD Rule 3050).

other accounts of Garrison (held at Wells Fargo or elsewhere);

3. You are limited to acting solely as the trustee/owner/manager for the above referenced accounts; you are otherwise prohibited from acting in any capacity as the trustee/owner/manager for anyone and/or any accounts outside of your immediate family;

4. Copies of statements for Garrison accounts should be maintained in a centralized file in your OSJ [(Office of Supervisory Jurisdiction)] Branch Office. It is not necessary for the Home Office to receive duplicate statements;

5. You must maintain a copy of this letter as well as the amended Indemnification Form (attached hereto and alluded to in item #1 above) in your office at all times; and

6. This activity must be disclosed on your Outside Business Activity Questionnaire on an annual basis.[8]

On November 22, the AIG director of branch supervision, Leslie Ayers, sent a letter to Mark approving maintaining the brokerage accounts at Wells Fargo as the trustee, owner, and manager subject to his compliance with NASD regulations and AIG policies, receipt of duplicate "confirms and statements" from Wells Fargo for the accounts, and monitoring by the "First Line Supervisor." The November 22 letter states, in pertinent part:

> Re: Outside Account for W35823867, 745-1146604 & W29758675
>
> Dear Mark Garrison,
>
> . . . .
>
> The Compliance and Regional Management departments at AIG Financial Advisors, Inc. do not object to Mark Garrison maintaining an account at Wells Fargo. Please note that this letter addresses only the account number provided above. Any additional accounts must be acknowledged in writing by the Home Office prior to opening.
>
> In order to comply with federal and NASD regulations, it is necessary for the First Line Supervisor to monitor all Registered Representative-related

[8] Emphasis in original.

accounts. In order to demonstrate and document compliance with these rules, all parties must agree to abide by the following:

Mark Garrison agrees that:

- He will not participate in purchasing any securities in an Initial Public Offering (IPO) as it is against AIG Financial Advisors' policy.
- He will comply with AIG Financial Advisors' policies regarding personal brokerage accounts and all other policies, including but not limited to Anti-Money Laundering Policies which are located in the Firm's Sales Practice Manual and Compliance Journals.
- He must enter orders on the same side of the market for clients ahead of orders placed for RR [(registered representative)] in an identical security.

Please note: the firm will ensure that duplicate confirms and statements are being received by the FLS [(First Line Supervisor)] for supervision purposes.[9]

Attached to the letter is an addendum describing the "First Line Supervisor Responsibilities for Outside Personal Brokerage Accounts." The addendum lists a number of "[p]rohibited activities," including insider trading, prearranged trading, adjusted trading, "Wash or Cross Transactions," "Front running," and "Freeriding." The addendum also states, "If the RR has a large number of trades every month, the FLS should perform a quarterly profit and loss analysis to determine whether the RR's account has large losses (increasing incentive to churn their clients' accounts)." From April 2006 through April 2009, Director of Branch Supervision Ayers was responsible for "supervising the [AIG] personnel who monitored the transactions in personal brokerage accounts in the name or for the benefit of [AIG] registered representatives, including Mark M. Garrison, held at other broker-dealers." Michelle Nielsen reported to Ayers and was the First Line Supervisor for the Wells Fargo brokerage accounts.

[9] Emphasis in original.

In December 2006, Mark submitted his annual OBAQ to AIG for 2005 to 2006. Mark states he is not an AIG "investment provider representative" but reports that he is a registered investment adviser and owns Acumen, "an independent registered investment adviser, separate from [AIG]." Mark states he is registered as an investment advisor in approximately 20 states and receives compensation from commissions, hourly estate planning fees, and asset-based fees. Mark also states he understands "that with respect to investment advisory activities," he "must make clear to clients that such investment advisory activities are separate from the broker-dealer [AIG] and are not offered by the broker-dealer [AIG]." In the OBAQ, Mark states that the percentage of time he spends as an investment advisor with Acumen is 26 to 50 percent and that he receives compensation over $50,000.

Under the 2005 to 2006 OBAQ section "Other Activities," Mark states that "I have been named the Trustee/Owner/Manager on accounts held at Wells Fargo Investments in Seattle, WA, for my grandfather - Jack Garrison." Mark reports spending "0-25%" of his time "conducting this activity" and receiving "[u]nder $10,000" annually.

On March 14, 2007, Mark sent an e-mail to Wells Fargo stockbrokers Jean Adams and Rebbie Thomas and the accountant for the Revocable Trust, Hal Carrothers, stating that he planned to hire Acumen to provide investment advice to the Garrison Family LLC and the Garrison trusts but that Wells Fargo would continue to execute trades. The e-mail states, in pertinent part:

> In addition to the TRUSTEE'S FEE of .80% annually (.20% quarterly) which we have already established, I have decided to hire Acumen Financial Group, Inc. [(AFG)] to provide INVESTMENT ADVISORY SERVICES to the LLC and various trusts. Since Jack has a strong relationship with Jean Adams and Rebbie Thomas at Wells Fargo, I will leave the money/investments there for now to handle the execution on

> trading within the accounts, and simply hire Acumen Financial Group, Inc. for the investment advice. As you know, I am one of the owners of AFG. AFG will charge 1.2% annually for Investment Advisory Services, or .30% quarterly. . . .
>
> . . . .
>
> SECOND, JEAN & REBBIE - To take advantage of current market weakness, please invest an extra $100,000 into each of the existing MUTUAL FUNDS in the LLC AND [REVOCABLE] TRUST. Do not add anything more to [the other trusts] at this time. I may call in a trade today or tomorrow . . . but that will be separate from the $100,000 per existing Mutual fund order. Sell enough bonds to cover these costs, PLUS enough to cover all the checks above, any liquidity Hal might need, AND whatever amount you expect to transfer over to the [Revocable] Trust from the LLC as part of your regular quarterly program.
>
> Do NOT show Jack any Excel Spreadsheets until further notice. I will give you the "all clear" once the markets rebound, which I expect to be in 2-3 months.

On March 16, 2007, Mark wrote a check to Acumen in the amount of $65,524 from the Garrison Family LLC account for "Investment Advisory Services" in the fourth quarter of 2006. Mark also wrote a check to Acumen in the amount of $13,905 from the Revocable Trust account.

Mark submitted his 2007 annual OBAQ to AIG on October 30, 2007. Mark reports his outside business activity and compensation as an independent registered investment advisor and co-owner of his independent investment business Acumen. In a separate section under "Other: Outside Business Activities," Mark reports that he is "actively engaged" as the "named . . . Trustee/Owner/Manager on accounts held at Wells Fargo Investments in Seattle, WA, for my grandfather - Jack Garrison." Mark also reports it is an "[i]nvestment related activity"[10] conducted by Acumen, a "Registered Investment Advisor." Mark states that he spends 16 hours per month and receives

[10] Emphasis in original.

annual compensation of "$25,000 to $50,000."

In late 2007, Mark submitted a written request to AIG seeking approval to open personal brokerage accounts at TD Ameritrade. In December 2007, AIG approved the request in writing for the "personal brokerage accounts held at TD Ameritrade in the name of Mark Garrison including Account No. 789-930283, and . . . an account in the name of Michelle Garrison, Account No. 789-654167." AIG instructed Mark to provide duplicate copies of "confirmation slips and account statements" for the TD Ameritrade accounts.

On April 22, 2011, Jack M. Garrison, the Garrison Family LLC, and Mark's sister Lesa B. Neugent, individually and as trustee of the Jack M. Garrison and Charlotte L. Garrison Revocable Trust, the Jack M. Garrison Survivor's Trust, the Charlotte L. Garrison Marital Trust, the Charlotte L. Garrison Exempt Marital Trust, the Charlotte L. Garrison Exempt Family Trust for the benefit of Mark Garrison, and the Charlotte L. Garrison Exempt Family Trust for the benefit of Lesa Neugent (collectively the Garrison Trusts), filed a lawsuit against Mark and Michelle Garrison and AIG for "Securities Law violations, Breach of Fiduciary Duty, Negligence and Other Claims, and for Declaratory Judgment."

The Garrison Trusts allege that Mark transferred $9.6 million from the Garrison Family LLC and the Revocable Trust brokerage accounts at Wells Fargo to personal accounts at TD Ameritrade, that during 2008 and 2009 Mark paid Acumen over $550,000 in investment advisory fees and paid himself more than $370,000 in trustee fees, and that Mark's speculative and high-risk investments during 2008 resulted in a loss of over $20 million, leaving the "combined net value of all of the Plaintiffs' accounts,

including the Garrison Family LLC, . . . to just under $200,000."[11] The complaint asserts AIG is jointly and severally liable for the loss of over $20 million and alleges claims against AIG for negligent supervision; violation of the Washington State Securities Act (WSSA), RCW 21.20.010; and liability under a respondeat superior theory. The complaint also asserts Wells Fargo is jointly and severally liable but states the contractual duty to arbitrate precludes "nam[ing] Wells Fargo as a defendant in this action."[12]

AIG filed an answer denying liability and a cross claim for indemnification against Mark. AIG denied that it owed any duty to the Garrison Trusts and asserted it had no notice that Mark acted as an investment advisor for the Garrison Trusts or participated in private securities transactions in the Wells Fargo brokerage accounts.

AIG filed a motion for summary judgment dismissal of all claims. In support, AIG submitted the declaration of expert witness David E. Paulukaitis, a managing director of Mainstay Capital Markets Consultants Inc. Paulukaitis states, in pertinent part:

> . . . [A]ll transactions subject to the notification requirements of [NASD] Rule 3050 are excluded from the ambit of NASD Conduct Rule 3040, whether or not the associated person receives selling compensation in connection with those transactions.
>
> . . . .
>
> . . . The transactions effected by Mark in the Wells Fargo Accounts and the Ameritrade Personal Accounts were outside the scope of his association with [AIG] but were not "private securities transactions" as

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[11] Emphasis in original.

[12] The complaint states, in pertinent part:

> **Wells Fargo Investments, LLC** ("Wells Fargo") is a securities broker-dealer, registered with the SEC and FINRA to sell securities and conduct a securities brokerage business. The investment accounts at issue in this case were all held at Wells Fargo's Seattle, Washington branch. Plaintiff contends that Wells Fargo is jointly and severally liable for many of the losses of which Plaintiffs complain, but because the Plaintiffs all are bound by contract to arbitrate their claims against Wells Fargo in an arbitration forum administered by FINRA, Plaintiffs cannot name Wells Fargo as a defendant in this action.

(Emphasis in original.) The Garrison Trusts also state that Acumen is "judgment-proof."

> defined under NASD Conduct Rule 3040. . . .
> . . . Securities industry rules and regulations place no duty on [AIG] to supervise the activity in the Wells Fargo Accounts or the Ameritrade Personal Accounts. [AIG]'s duty with respect to those accounts was limited to monitoring the transactions in those accounts to ensure that they did not conflict with the interests to [AIG] or [AIG]'s customers.

The Garrison Trusts filed a motion for partial summary judgment on the grounds that AIG owed a duty to supervise the securities transactions in the Wells Fargo brokerage accounts. The Garrison Trusts submitted the declaration of expert witness John H. Chung, a chief compliance officer at three NASD member firms. Chung disagreed with AIG expert Paulukaitis. Chung states that when Mark acted as an investment advisor for compensation, AIG had a duty to supervise under NASD Rule 3040. Chung also states that AIG had a duty under NASD Rule 3050 to exercise "appropriate supervision." In his declaration, Chung states, in pertinent part:

> When a registered representative is acting as an RIA [(registered investment advisor)] for compensation and executes transactions at another broker-dealer, his actions are private securities transactions within the meaning of NASD Rule 3040. The rule cited by Mr. Paulukaitis, NASD Rule 3050 (Transactions for or by Associated Persons), does not stand for the proposition that such activity need not be supervised by the employer/broker-dealer. Instead, the rule requires that registered representatives maintaining personal or discretionary accounts at another broker-dealer to notify their employer, and permits employers so notified to elect to receive duplicate confirmations and account statements for purposes of exercising appropriate supervision over such activity.

The court denied the Garrison Trusts motion for partial summary judgment and granted the motion for summary judgment dismissal of the claims against AIG. AIG agreed to dismiss the cross claim against Mark, and the parties stipulated to entry of a final judgment under CR 54(b).

ANALYSIS

The Garrison Trusts contend the trial court erred by granting summary judgment dismissal of the claims against AIG for negligent supervision, violation of the WSSA, and respondeat superior.

We review summary judgment de novo and consider all the facts and reasonable inferences in the light most favorable to the nonmoving party. Hearst Commc'ns, Inc. v. Seattle Times Co., 154 Wn.2d 493, 501, 115 P.3d 262 (2005); Michael v. Mosquera-Lacy, 165 Wn.2d 595, 601, 200 P.3d 695 (2009). Summary judgment is appropriate if the pleadings, depositions, and affidavits show there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. CR 56(c). A material fact precluding summary judgment is a fact that affects the outcome of the litigation. Elcon Constr., Inc. v. E. Wash. Univ., 174 Wn.2d 157, 164-65, 273 P.3d 965 (2012). Where there are competing inferences that may be drawn from the evidence, the issue must be resolved by the trier of fact. Johnson v. UBAR, LLC, 150 Wn. App. 533, 537, 210 P.3d 1021 (2009).

Negligent Supervision

The Garrison Trusts contend that under NASD Rule 3040, AIG had a duty to supervise Mark's activities as an investment advisor for the Garrison Trusts. In the alternative, the Garrison Trusts assert that the monthly statements and trading confirmations received by AIG in accord with NASD Rule 3050 triggered the duty to investigate and monitor the activity of the Wells Fargo accounts.[13]

[13] The Garrison Trusts concede "breach, causation, and damages" are not at issue on appeal.

"The theory of negligent supervision creates a limited duty to control an employee for the protection of third parties, even where the employee is acting outside the scope of employment." Niece v. Elmview Grp. Home, 131 Wn.2d 39, 51, 929 P.2d 420 (1997). To establish a claim for negligent supervision, the Garrison Trusts must show (1) Mark acted outside the scope of his employment with AIG; (2) he presented a risk of harm; (3) AIG knew, or should have known in the exercise of reasonable care, that Mark posed a risk to others; and (4) AIG's failure to supervise was a proximate cause of the loss. LaPlant v. Snohomish County, 162 Wn. App. 476, 479 n.7, 271 P.3d 254 (2011). An employer is not liable for negligently supervising an employee whose conduct was outside the scope of the employment unless the employer knew, or in the exercise of reasonable care should have known, the employee presented a risk of danger to others. Thompson v. Everett Clinic, 71 Wn. App. 548, 555, 860 P.2d 1054 (1993) (citing Peck v. Siau, 65 Wn. App. 285, 294, 827 P.2d 1108 (1992)). The existence of a duty is usually a question of law that we review de novo. Aba Sheikh v. Choe, 156 Wn.2d 441, 448, 128 P.3d 574 (2006). However, "where duty depends on proof of facts that are disputed . . . summary judgment is inappropriate." Hymas v. UAP Distribution, Inc., 167 Wn. App. 136, 150, 272 P.3d 889 (2012).

The Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. sections 78a-78mm, and its amendments create a detailed, comprehensive system of federal regulation of the securities industry. Swirsky v. Nat'l Ass'n of Sec. Dealers, 124 F.3d 59, 61 (1st Cir. 1997). The Exchange Act authorizes self-regulatory organizations to promulgate their own governing rules and regulations subject to extensive oversight and control by the SEC. Mayo v. Dean Witter Reynolds, Inc., 258 F. Supp. 2d 1097, 1101

(N.D. Cal. 2003). Congress granted the SEC broad supervisory responsibilities over a system of supervised self-regulation in the securities industry. See S. REP. No. 73-792 (1934). "[T]he congressional aim in supervised self-regulation is to insure fair dealing and to protect investors from harmful or unfair trading practices." Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117, 130, 94 S. Ct. 383, 38 L. Ed. 2d 348 (1973).

NASD is a self-regulatory organization registered with the SEC. The Exchange Act authorizes the NASD "to develop and enforce rules of professional conduct for its member firms, subject to oversight by the SEC." Gurfel v. Sec. & Exch. Comm'n, 340 U.S. App. D.C. 292, 205 F.3d 400, 400 (2000) (citing 15 U.S.C. § 78o-3); see also 4 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION 87, 89 (5th ed. 2005). With some limited exceptions, all NASD rules, policies, practices, and interpretations must be approved by the SEC. See 15 U.S.C. § 78s(b)(1); Swirsky, 124 F.3d at 62; Fiero v. Fin. Indus. Regulatory Auth., Inc., 660 F.3d 569, 572 (2d Cir. 2011). The SEC requires NASD rules and regulations conform to the Exchange Act. See 15 U.S.C. §§ 78f(b), 78o-3(b). Under the Maloney Act of 1938, 15 U.S.C. § 78o-3 et seq., NASD is also responsible for investigations of and commencing compliance with federal securities laws and regulations, and for discipline proceedings against member firms and their associated member representatives. Fiero, 660 F.3d at 571-72.

"[A] person cannot lawfully engage in the securities business unless he or she is either registered with the NASD as a broker-dealer or as a person associated with a broker-dealer." Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1573 (9th Cir. 1990). As a condition of the right to engage in the securities business, broker-dealers and

registered representatives must abide by NASD rules and regulations. As You Sow v. AIG Fin. Advisors, Inc., 584 F. Supp. 2d 1034, 1048 (M.D. Tenn. 2008); Sec. & Exch. Comm'n v. Waco Fin., Inc., 751 F.2d 831, 832 (6th Cir. 1985) (broker-dealers "who belong to the NASD are required to abide by NASD Rules of Fair Practice and to meet other NASD requirements").

While NASD Rules do not create a private cause of action, courts have looked to the Rules to define the scope of a common law duty such as negligent supervision. Craighead v. E.F. Hutton & Co., 899 F.2d 485, 493 (6th Cir. 1990) ("We agree with the district court that NYSE [(New York Stock Exchange)] Rule 405 does not imply a private right of action cognizable in federal court."); As You Sow, 584 F. Supp. 2d at 1048-49 ("violations of NASD rules alone do not give rise to actionable claims," but NASD Rule 3040 and other NASD rules "assist Tennessee and other courts in defining the extent of a legal duty at common law"); McGraw v. Wachovia Sec., LLC, 756 F. Supp. 2d 1053, 1075 (N.D. Iowa 2010) (recognizing duty based on NASD rules); Colbert & Winstead, PC 401(K) Plan v. AIG Fin. Advisors, Inc., No. 3:07-1117, 2008 WL 2704367, at *10 (M.D. Tenn. July 8, 2008) (court order) ("the NASD may define the scope of a duty of a broker dealer"); Cf. Miley v. Oppenheimer & Co., 637 F.2d 318, 333 (5th Cir. 1981) (NYSE and NASD Rules are "excellent tools" to assess reasonableness of broker's conduct); Piper, Jaffray & Hopwood Inc. v. Ladin, 399 F. Supp. 292, 299 (S.D. Iowa 1975) (concluding NASD and NYSE rules are "admissible as evidence of negligence"); Mihara v. Dean Witter & Co., 619 F.2d 814, 824 (9th Cir. 1980) (NASD and NYSE rules "reflect the standard to which all brokers are held").

The crux of the dispute in this case is the scope of AIG's duty to supervise Mark's outside business activity as an investment advisor directing transactions in the Wells Fargo brokerage accounts. The Garrison Trusts argue the supervisory requirements of NASD Rule 3040 apply. AIG contends only the supervisory requirements of NASD Rule 3050 apply and under the plain language of NASD Rule 3040, NASD Rule 3050 transactions are excluded.

As a general overarching rule, NASD Rule 3010, Supervision (amended effective Dec. 19, 2007), requires a brokerage firm to establish, implement, and maintain a system that includes written procedures to supervise the activities of each registered representative and other associated persons reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD Rules.[14]

Former NASD Rule 3030, Outside Business Activities of an Associated Person (effective Oct. 13, 1988), prohibits a registered representative from participating in outside business activity unless the employer member receives "prompt written notice." Former NASD Rule 3030 states:

> No person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity, other than a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member. Such notice shall be in the

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[14] NASD Rule 3012, Supervisory Control System (amended effective Feb. 14, 2006), also states, in pertinent part:

> **(a) General Requirements**
>
> (1) Each member shall designate and specifically identify to NASD one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures that (A) test and verify that the member's supervisory procedures are reasonably designed with respect to the activities of the member and its registered representatives and associated persons, to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules.

Emphasis in original.

> form required by the member. Activities subject to the requirements of Rule 3040 shall be exempted from this requirement.

NASD Rule 3040, "Private Securities Transactions of an Associated Person," addresses private securities transactions of a registered securities representative for compensation. "Selling compensation" is broadly defined to include "any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security." NASD R. 3040(e)(2). NASD Rule 3040(a) states that "[n]o person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this Rule." NASD Rule 3040(b) requires the registered securities representative to provide written notice to the employer member prior to engaging in any private security transactions. NASD Rule 3040 states, in pertinent part:

> **(b) Written Notice**
> Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction.[15]

After receiving notice of a private securities transaction, the employer member must approve or disapprove the proposed participation in private securities transactions in writing. NASD R. 3040(c)(1). NASD Rule 3040(c) states, in pertinent part:

> (2) If the member approves a person's participation in a transaction pursuant to paragraph (c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.
> (3) If the member disapproves a person's participation pursuant to paragraph (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

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[15] Emphasis in original.

NASD Rule 3050, "Transactions for or by Associated Persons," also addresses outside business activities and expressly applies to "an account or order in which an associated person has a financial interest or with respect to which such person has discretionary authority." NASD R. 3050(e). Under NASD Rule 3050(c) and (d), prior to engaging in any transactions, a registered representative who opens an account or places an order for a securities transaction at another financial institution must notify the employer member in writing of the intent to open the account or place an order.

The other financial institution or executing member has an obligation to notify the employer member. NASD R. 3050(b). If the employer member approves engaging in transactions under NASD Rule 3050, upon written request from the employer member, the executing member must provide copies of confirmations, account statements, and other information regarding the account. NASD R. 3050(b)(2). NASD Rule 3050 states, in pertinent part:

> (c) Obligations of Associated Persons Concerning an Account with a Member
>
> A person associated with a member, prior to opening an account or placing an initial order for the purchase or sale of securities with another member, shall notify both the employer member and the executing member, in writing, of his or her association with the other member; provided, however, that if the account was established prior to the association of the person with the employer member, the associated person shall notify both members in writing promptly after becoming so associated.
>
> (d) Obligations of Associated Persons Concerning an Account with a Notice-Registered Broker/Dealer, Investment Adviser, Bank, or Other Financial Institution
>
> A person associated with a member who opens a securities account or places an order for the purchase or sale of securities with a broker/dealer that is registered pursuant to Section [78o(b)(11)] of the [Exchange] Act ("notice-registered broker/dealer"), a domestic or foreign

investment adviser, bank, or other financial institution, except a member, shall:

> (1) notify his or her employer member in writing, prior to the execution of any initial transactions, of the intention to open the account or place the order; and
>
> (2) upon written request by the employer member, request in writing and assure that the notice-registered broker/dealer, investment adviser, bank, or other financial institution provides the employer member with duplicate copies of confirmations, statements, or other information concerning the account or order;
>
> provided, however, that if an account subject to this paragraph (d) was established prior to a person's association with a member, the person shall comply with this paragraph promptly after becoming so associated.

The purpose of NASD Rule 3050 is to prevent "potential and actual conflicts of interest raised through registered representatives' personal trading activities." Dep't of Enforcement v. Ng, No. 2009019369302, at 10 (Fin. Indus. Regulatory Auth. Nat'l Adjudicatory Council Apr. 24, 2013).[16] NASD Rule 3050 states, in pertinent part:

> (a) Determine Adverse Interest
>
> A member ("executing member") who knowingly executes a transaction for the purchase or sale of a security for the account of a person associated with another member ("employer member"), or for any account over which such associated person has discretionary authority, shall use reasonable diligence to determine that the execution of such transaction will not adversely affect the interests of the employer member.
>
> (b) Obligations of Executing Member
>
> Where an executing member knows that a person associated with an employer member has or will have a financial interest in, or discretionary authority over, any existing or proposed account carried by the executing member, the executing member shall:
>
> (1) notify the employer member in writing, prior to the execution of a transaction for such account, of the executing member's intention to open or maintain such an account;

[16] Available at http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/nacdecisions/p249257.pdf.

> (2) upon written request by the employer member, transmit duplicate copies of confirmations, statements, or other information with respect to such account; and
>
> (3) notify the person associated with the employer member of the executing member's intention to provide the notice and information required by subparagraphs (1) and (2).

The Garrison Trusts concede that from 2006 to 2007, AIG complied with NASD Rule 3050. The concession is well taken. In compliance with NASD Rule 3050, Wells Fargo, as the executing member, expressly requested written approval from AIG to allow Mark to act as the "trustee, owner and manager" of the Garrison trusts and Garrison Family LLC for the brokerage accounts at Wells Fargo. In the November 14, 2006 letter of understanding from the AIG Compliance Department to Mark concerning the request, AIG does not object to Mark acting "solely as the trustee/owner/manager" on the condition that he is prohibited from acting in any other capacity and that he annually disclose the Wells Fargo activity in the AIG OBAQ. In a letter dated November 22, AIG also requested monthly account statements and trading confirmations from Wells Fargo for the brokerage accounts and specifically stated that the NASD regulations require the First Line Supervisor to monitor the Wells Fargo accounts.

The Garrison Trusts claim that when Mark hired Acumen in March 2007 to provide investment advice for a fee, AIG had a duty to supervise under NASD Rule 3040. The Garrison Trusts argue that only transactions "for which no associated person receives any selling compensation"[17] are excluded from the requirements of NASD Rule 3040. AIG asserts that because the plain language of NASD Rule 3040 excludes all transactions subject to NASD Rule 3050, the requirements of NASD Rule 3040 do not

[17] NASD R. 3040(e)(1).

apply.

Interpretation of statutes and regulations is a question of law this court reviews de novo. Skinner v. Civil Serv. Comm'n, 168 Wn.2d 845, 849, 232 P.3d 558 (2010). NASD Rule 3040 applies only to "private securities transactions." Rule 3040 defines "private securities transaction" as transactions outside "the regular course or scope of an associated person's employment" and excludes three discrete categories of transactions from the definition. "Private securities transaction" is defined as follows:

> "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in Rule 2790), for which no associated person receives selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

NASD R. 3040(e)(1).[18]

The definition of "private securities transaction" clearly excludes three distinct categories of transactions: (1) transactions subject to the requirements of NASD Rule 3050, (2) transactions among immediate family members under Rule 2790, and (3) personal transactions in investment company and variable annuity securities. NASD R. 3040(e)(1). The question is whether the phrase "for which no associated person receives any selling compensation" applies only to the immediately preceding phrase "transactions among immediate family members" or to both the preceding phrase that

[18] Former NASD Rule 2790(i)(5), Restrictions on the Purchase and Sale of Initial Equity Public Offerings (amended effective Sept. 5, 2007), defines "immediate family member" as "a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material support." The definition of "immediate family member" does not include grandparents. The parties do not contend this exclusion applies.

excludes NASD Rule 3050 transactions and the phrase that excludes immediate family member transactions. See NASD R. 3040(e)(1).

Under the "last antecedent rule" of statutory construction, a qualifying phrase refers to the last antecedent unless there is " 'a comma before the qualifying phrase.' " Berrocal v. Fernandez, 155 Wn.2d 585, 593, 121 P.3d 82 (2005) (quoting In re Sehome Park Care Ctr., Inc., 127 Wn.2d 774, 781, 903 P.2d 443 (1995)). A comma before the qualifying phrase indicates that the phrase " 'is intended to apply to all antecedents instead of only the immediately preceding one.' " Berrocal, 155 Wn.2d at 593[19] (quoting Sehome Park, 127 Wn.2d at 782). Here, use of the comma before the qualifying phrase "for which no associated person receives any selling compensation" means the qualifying phrase applies to both preceding antecedents: "transactions subject to the notification requirements of Rule 3050" and "transactions among immediate family members . . . for which no associated person receives selling compensation."[20]

The Garrison Trusts also cite NASD Notice to Members (NTM) 94-44, Board Approves Clarification on Applicability of Article III, Section 40 of Rules of Fair Practice to Investment Advisory Activities of Registered Representatives, and NASD NTM 96-33, NASD Clarifies Rules Governing RR/IAs [(Registered Representative/Investment Advisors)], in support of the argument that AIG had a duty to supervise Mark's activities as an investment advisor receiving selling compensation and directing securities transactions in the Wells Fargo brokerage accounts.

A number of NTMs address the application of NASD Rule 3040 where an associated registered representative is also acting as a registered investment adviser.

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[19] Emphasis in original.

[20] NASD R. 3040(e)(1).

Courts may give substantial deference to NASD's interpretation of its own rules. Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1168 (7th Cir. 1998); Ronay Family Ltd. P'ship v. Tweed, 216 Cal. App. 4th 830, 842, 157 Cal. Rptr. 3d 680 (2013); Siegel v. Sec. & Exch. Comm'n, 389 U.S. App. D.C. 94, 592 F.3d 147, 155 (2010); see also York Research Corp. v. Landgarten, 927 F.2d 119, 123 (2d Cir. 1991).

In NASD NTM 91-32, Request for Comments on Compensation Arrangements for Activities of Registered Representatives Who Are Also Registered with the Securities and Exchange Commission as Investment Advisers, NASD states that NASD Rule 3040 "should apply to all investment advisory activities conducted by registered representatives other than their activities on behalf of the member that result in the purchase or sale of securities by the associated person's advisory clients." According to NASD NTM 91-32, "to conclude otherwise would permit registered persons to participate in securities transactions outside the scope of the oversight and supervision of the employer member and of a self-regulatory organization to the potential detriment of customers."

NASD NTM 94-44 states that "[i]n clarifying its previous position in Notice to Members 91-32, the Board [of Governors] focused primarily upon the RR/RIA's [(registered representative/registered investment advisor's)] participation in the execution of the transaction—meaning participation that goes beyond a mere recommendation." NASD NTM 94-44 describes an example of where the transaction of a registered representative acting as a registered investment advisor would trigger the requirements of NASD Rule 3040:

> An example of a RR/RIA clearly participating in the execution of trades is where he or she enters an order on behalf of the customer for particular

> securities transactions either with a brokerage firm other than the member they are registered with, directly with a mutual fund, or with any other entity, including another adviser, and receives any compensation for the overall advisory services.

NASD NTM 96-33 specifically reiterates that a dually licensed registered representative and investment advisor must provide prior written notice to the member before engaging in any investment advisory activity for a fee. NASD NTM 96-33 states, in pertinent part, "A member must receive prior written notice from an RR/IA requesting approval to conduct investment advisory activities for an asset-based or performance-based fee on behalf of each of his or her advisory clients." NASD NTM 96-33 states the prior written notice "must include details such as:"

- a declaration that the individual is involved in investment advisory activities;
- the identity of each customer to whom the notice would apply;
- the types of securities activities that may be executed away from the firm;
- a detailed description of the role of the RR/IA in the investment advisory activities and services to be conducted on behalf of each identified customer;
- information regarding the RR/IA's discretionary trading authority, if any;
- compensation arrangements;
- the identity of broker/dealers through which trades away will be executed; and
- customer financial information.

NASD NTM 96-33 specifically directs a registered securities representative/investment advisor such as Mark to provide the employer member with "a subsequent written notice that details" the change in his role. NASD NTM 96-33

states, in pertinent part:

> Only after written approval from the NASD member may the RR/IA engage in the disclosed activities. If there is a change in the RR/IA's proposed role or activities for any customer from what the member initially approved, the RR/IA must provide the member with a subsequent written notice that details the changes and requests the member's further approval to conduct advisory activities on behalf of the customer. The employer member must thereafter record subsequent transactions on its books and records and supervise activity in the affected accounts as if it were its own.

Here, the undisputed record shows that Mark did not comply with the requirement to obtain prior written approval before hiring Acumen in March 2007 to provide investment advice for the Wells Fargo brokerage accounts. Nor did Mark comply with the requirement to provide AIG with written notice that his role had changed from trustee and manager of the Garrison trusts and the Garrison Family LLC to investment advisor. The undisputed record also shows that Mark acted as an investment advisor receiving selling compensation and directed private securities transactions in the Wells Fargo brokerage accounts. The dispositive question is whether AIG knew or should have known that Mark's role had changed from trustee and manager of the Garrison trusts and Garrison Family LLC under NASD Rule 3050 to acting as an investment advisor directing transactions for a fee in the Wells Fargo brokerage accounts, thereby triggering compliance with NASD Rule 3040.

The Garrison Trusts rely on the two annual OBAQs Mark submitted to AIG for 2005 to 2006 and 2007 to show AIG had notice triggering the duty to supervise under NASD Rule 3040. The Garrison Trusts contend the difference between the two OBAQs provided notice to AIG that Mark was acting as an investment advisor and receiving selling compensation.

In the 2005 to 2006 OBAQ, Mark reported he was "Trustee/Owner/Manager" for the Wells Fargo accounts and stated he received "[u]nder $10,000" for this activity. The 2005 to 2006 OBAQ states, in pertinent part:

> **VI. Other Activities**
> **1. Are you involved in any other Outside Business Activities?**
> Yes.
>
> **1.1. What is your full title?**
> - Trustee/Owner/Manager
>
> **1.2. Please disclose, in detail, all of your duties and responsibilities in this position:**
> - I have been named the Trustee/Owner/Manager on accounts held at Wells Fargo Investments in Seattle, WA, for my grandfather - Jack Garrison.
>
> . . . .
>
> **1.4. Please indicate the percentage of time you spend conducting this activity:**
> 0-25%
>
> **1.5. Please indicate the average annual dollar amount of compensation that you receive:**
> Under $10,000.[21]

By contrast, in the 2007 OBAQ dated October 30, 2007, Mark reports not only that he is the "Trustee/Owner/Manager" on the accounts held at Wells Fargo but also that it is "an Investment related activity" conducted under his independent financial advice business Acumen.[22] The October 30, 2007 OBAQ submitted by Mark states, in pertinent part:

> **1. Please select the category for this activity: (If you are currently not participating in any of these below activities, please select "No Activity")**
> Other

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[21] Emphasis in original.

[22] Emphasis in original.

. . . .

1.2. Is this an Investment related activity?
Yes

1.3. What is the name of the business this activity is conducted under?
- Acumen Financial Group, Inc.

1.4. What is the nature or structure of the business? Please select from the following:
- Registered Investment Adviser

. . . .

1.6. What is your position/title for this activity? Please select from the following:
Owner

1.7. Please enter the date you started this activity:
- 10-16-1995

1.8. Please enter the approximate number of hours/month you spend on this activity:
- 16

1.9. Please enter the approximate number of hours you spend on this activity during securities trading hours:
- 16

1.10. Please provide a description of your duties:
- I have been named the Trustee/Owner/Manager on accounts held at Wells Fargo Investments in Seattle, WA, for my grandfather - Jack Garrison.

. . . .

1.12. Please indicate the average annual dollar amount of compensation that you receive:
$25,000 to $50,000.[23]

Because the OBAQ submitted in October 2007 does not comply with the written notice requirements set forth in NASD Rule 3040(b) and NASD NTM 96-33, the 2007

[23] Emphasis in original.

OBAQ standing alone may not have provided AIG with notice that Mark's role had changed in March 2007 and that he was acting as the investment advisor for compensation rather than solely as the trustee and manager of the Garrison trusts and Garrison Family LLC brokerage accounts at Wells Fargo. However, when coupled with the directive from AIG and the "AIG Financial Advisors Sales Practice Manual," there is a genuine issue of material fact as to whether AIG knew or should have known that by October 2007, Mark was acting as an investment advisor for the Wells Fargo brokerage accounts and receiving selling compensation. The AIG manual states that "[o]n an annual basis, RRs are required to disclose to the Firm, via the OBAQ, any outside business activities prior to engaging in such activity."

The Garrison Trusts also assert that even if AIG did not have notice triggering the supervisory requirements of NASD Rule 3040, the monthly statements and trading confirmations AIG received under NASD Rule 3050 revealed suspicious circumstances or "red flags" triggering the duty to investigate or monitor the transactions in the Wells Fargo brokerage accounts. Under NASD Rule 3050, both Wells Fargo as the executing member and AIG as the employer member had an obligation to review the monthly account statements and securities transaction confirmation slips for the Wells Fargo brokerage accounts, not only for insider trading and conflicts of interest but also for unapproved outside business activities and suspicious circumstances.

In McGraw, the plaintiffs alleged the employer member Wachovia owed them a duty to supervise the outside activities of an associated stockbroker. McGraw, 756 F. Supp. 2d at 1058-59. The court cites the general rule that absent notice, " 'a broker-dealer owes no duty to a non-customer who has invested money through an

independent investment advisor' " but notes " 'this general proposition of non-liability is far from a per se rule.' " McGraw, 756 F. Supp. 2d at 1072[24] (quoting Bear Stearns & Co. v. Buehler, 23 App'x 773, 775 (9th Cir. 2001)). The court describes the well-defined exception to the general rule as follows:

> "Where there is additional involvement by the broker-dealer, a duty may be found. In Software Design[& Appl. v. Hoefer & Arnett, Inc.], the court noted that 'sufficiently suspicious' circumstances may place a broker-dealer on notice that her customer is perpetrating fraud on non-customer investors. 49 Cal. App. 4th [472,]483, 56 Cal. Rptr. 2d 756[(1996)]. Once aware of troublesome 'red flags,' the broker-dealer may have a duty which runs to non-customers to monitor and investigate any unusual account activity. [Software Design, 49 Cal. App. 4th at 483]; see also City of Atascadero v. Merrill Lynch[, Pierce, Fenner & Smith, Inc.], 68 Cal. App. 4th 445, 483-84, 80 Cal. Rptr. 2d 329 (1998) (finding trustee-investors, who had no direct contact with Merrill Lynch, could nonetheless state a claim for breach of fiduciary duty if Merrill Lynch actively participated in broker's fraud)."

McGraw, 756 F. Supp. 2d at 1072[25] (quoting Bear Stearns, 23 App'x at 776). Accordingly, the court held:

> Although brokerage firms generally are not responsible for supervising any outside business activities or private securities transactions engaged in by their representatives, unless they have received notice of or have approved those activities, they do have a duty to monitor and investigate activities for which they have had no proper notice, if there is evidence of "red flags" that would alert the brokerage firm to the possibility of undisclosed outside activities.

McGraw, 756 F. Supp. 2d at 1075.

Here, it is undisputed that AIG complied with the requirements of NASD Rule 3050 when it approved Mark acting as the trustee and manager of the Garrison trusts and Garrison Family LLC for the Wells Fargo brokerage accounts. Beginning in 2006, AIG received monthly account statements and confirmation slips from Wells Fargo for

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[24] Emphasis in original.

[25] Most alterations in original.

trading transactions in the brokerage accounts for the Garrison trusts and the Garrison Family LLC. In December 2007, AIG also approved personal brokerage accounts at TD Ameritrade for Mark and Michelle Garrison. From early 2008 to April 2009, AIG received confirmation slips and account statements for the personal brokerage accounts at TD Ameritrade.

An excerpt from the AIG Financial Advisors Sales Practice Manual describes the First Line Supervisor's responsibility for monitoring outside business activities and the annual OBAQ report. The manual appears to require the First Line Supervisor not only to review the OBAQ "for any potential conflict with the Firm's business" but also to "[q]uestion RR regarding potential unapproved outside business activities referenced in OBAQ/ACQ [(outside business activities questionnaire/annual compliance questionnaire)] or other red flags or indications of misunderstanding of Firm or Regulatory policies."[26]

Viewing the evidence in the light most favorable to the Garrison Trusts, there are material issues of fact as to whether suspicious activity or red flags required AIG to investigate and monitor Mark's activity in the Wells Fargo accounts. For example, there are material issues of fact as to whether the information Mark submitted in the October 2007 OBAQ required the AIG First Line Supervisor to investigate potential unapproved outside business activity as an investment advisor for the Garrison trusts and the Garrison Family LLC. The Garrison Trusts also presented evidence that Mark changed the nature of the investments between January 2007 and November 2008, and that by November 2008, Mark had transferred more than $9.6 million from the Wells Fargo

[26] AIG's internal manual is evidence of the standard of care. Joyce v. Dep't of Corr., 155 Wn.2d 306, 324, 119 P.3d 825 (2005) ("Internal directives, department policies, and the like may provide evidence of the standard of care and therefore be evidence of negligence.").

accounts to his personal brokerage TD Ameritrade accounts.

WSSA

The Garrison Trusts contend that as a matter of law, AIG is a "control person" under the WSSA, RCW 21.20.430(3). In the alternative, the Garrison Trusts contend material issues of fact preclude dismissal of the "control person" claim.

Under the WSSA, it is unlawful to engage in fraud or deceit in connection with the offer, sale, or purchase of any security. RCW 21.20.010. RCW 21.20.430(3) states that certain persons may be secondarily liable for a violation of the act:

> Every person who directly or indirectly controls a seller or buyer liable under subsection (1) or (2) above, every partner, officer, director or person who occupies a similar status or performs a similar function of such seller or buyer, every employee of such a seller or buyer who materially aids in the transaction, and every broker-dealer, salesperson, or person exempt under the provisions of RCW 21.20.040 who materially aids in the transaction is also liable jointly and severally with and to the same extent as the seller or buyer, unless such person sustains the burden of proof that he or she did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

In Hines v. Data Line Systems, Inc., 114 Wn.2d 127, 787 P.2d 8 (1990), our state Supreme Court established a two-prong test to establish whether a defendant is a "control person":

> "[F]irst, that the defendant . . . actually participated in (i.e., exercised control over) the operations of the corporation in general; then he must prove that the defendant possessed the power to control the specific transaction or activity upon which the primary violation is predicated, but he need not prove that this later power was exercised."

Hines, 114 Wn.2d at 136[27] (quoting Metge v. Baehler, 762 F.2d 621, 630-31 (8th Cir. 1985)). The plaintiff does not need to show that the defendant " 'culpably participated' " to establish control person liability. Hines, 114 Wn.2d at 137. Because there are

[27] Emphasis in original, alteration in original, internal quotation marks omitted.

material issues of fact as to whether AIG knew or should have known Mark was acting as an investment advisor rather than as only the trustee and manager, we conclude there are also genuine issues of material fact as to the extent to which AIG could exercise control over the transactions in the Wells Fargo accounts. See also Hollinger, 914 F.2d at 1574 ("The broker-dealer's ability to deny the representative access to the markets gives the broker-dealer effective control over the representative at the most basic level.").[28]

Respondeat Superior

The Garrison Trusts also contend the court erred by dismissing its claim that AIG was liable based on respondeat superior. We disagree.

Respondeat superior, or vicarious liability, imposes liability on an employer for the torts of an employee who is acting on the employer's behalf within the scope of employment. Niece, 131 Wn.2d at 48. Respondeat superior is analytically distinct and separate from a cause of action for negligent hiring, retention, and supervision. Niece, 131 Wn.2d at 48.

Here, it is undisputed that Mark's actions as a registered investment advisor were outside the scope of his employment with AIG. Nonetheless, the Garrison Trusts contend AIG is liable under a respondeat superior theory because as an AIG branch office manager, Mark was responsible for supervising his own outside business activities. But the undisputed record establishes an AIG First Line Supervisor was responsible for supervising and reviewing Mark's outside business activities as the

[28] The Garrison Trusts also cite Hollinger, 914 F.2d at 1564, to argue that a broker-dealer is always a control person of a registered representative under the WSSA. We disagree with that argument. The two-prong test in Hines determines whether AIG was a "control person." See Hines, 114 Wn.2d at 136.

trustee and manager of the Garrison trusts and the Garrison Family LLC, as well as the TD Ameritrade personal accounts. We conclude the court did not err by dismissing the respondeat superior claim.

In sum, we affirm summary judgment dismissal of the respondeat superior claim but reverse summary judgment dismissal of the claims against AIG for negligent supervision and violation of the WSSA, and remand for trial.[29]

WE CONCUR:

Spearman, C.J.

Cox, J.

[29] Because we reverse, we need not address the argument that the court erred in denying the motion for reconsideration.

Appendix B

Court of Appeals Order Granting Motion for Reconsideration

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

JACK M. GARRISON; the GARRISON FAMILY LLC, a Washington limited liability company; LESA B. NEUGENT, individually and as Trustee of the JACK M. GARRISON AND CHARLOTTE L. GARRISON REVOCABLE TRUST, the JACK M. GARRISON SURVIVOR'S TRUST, the CHARLOTTE L. GARRISON MARITAL TRUST, the CHARLOTTE L. GARRISON EXEMPT MARITAL TRUST; the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO MARK GARRISON, and the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO LESA NEUGENT, Appellants, v. SAGEPOINT FINANCIAL, INC., a Delaware corporation licensed to business in Washington, f/k/a AIG FINANCIAL ADVISORS, INC., Respondent, MARK M. GARRISON and MICHELLE GARRISON, his wife, and their marital community, Defendants.	No. 69625-4-1-I DIVISION ONE ORDER GRANTING MOTION FOR RECONSIDERATION IN PART AND WITHDRAWING AND SUBSTITUTING OPINION

Respondent AIG Financial Advisors Inc. filed a motion to reconsider the opinion filed on July 14, 2014, and the Garrison Trusts filed an opposition to the

motion. The panel has determined that reconsideration of the analysis of the last antecedent rule should be granted but in all other respects the motion to reconsider denied, and the opinion filed on July 14, 2014 should be withdrawn and a substitute opinion filed. Now, therefore, it is hereby

ORDERED that respondent's motion for reconsideration is granted in part but in all other respects the motion to reconsider is denied, and the opinion filed on July 14, 2014 shall be withdrawn and a substitute opinion shall be filed.

DATED this 30th day of January, 2015.

Schindler, J.

Cox, J.

Spearman, C.J.

Appendix C

Copies of statutes and rules relevant to the issues presented for review

RCW 21.20.430
Civil liabilities — Survival, limitation of actions — Waiver of chapter void — Scienter.

(1) Any person, who offers or sells a security in violation of any provisions of RCW 21.20.010, 21.20.140 (1) or (2), or 21.20.180 through 21.20.230, is liable to the person buying the security from him or her, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at eight percent per annum from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he or she no longer owns the security. Damages are the amount that would be recoverable upon a tender less (a) the value of the security when the buyer disposed of it and (b) interest at eight percent per annum from the date of disposition.

(2) Any person who buys a security in violation of the provisions of RCW 21.20.010 is liable to the person selling the security to him or her, who may sue either at law or in equity to recover the security, together with any income received on the security, upon tender of the consideration received, costs, and reasonable attorneys' fees, or if the security cannot be recovered, for damages. Damages are the value of the security when the buyer disposed of it, and any income received on the security, less the consideration received for the security, plus interest at eight percent per annum from the date of disposition, costs, and reasonable attorneys' fees.

(3) Every person who directly or indirectly controls a seller or buyer liable under subsection (1) or (2) above, every partner, officer, director or person who occupies a similar status or performs a similar function of such seller or buyer, every employee of such a seller or buyer who materially aids in the transaction, and every broker-dealer, salesperson, or person exempt under the provisions of RCW 21.20.040 who materially aids in the transaction is also liable jointly and severally with and to the same extent as the seller or buyer, unless such person sustains the burden of proof that he or she did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

(4)(a) Every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant.

(b) No person may sue under this section more than three years after the contract of sale for any violation of the provisions of RCW 21.20.140 (1) or (2) or 21.20.180 through 21.20.230, or more than three years after a violation of the provisions of RCW 21.20.010, either was discovered by such person or would have been discovered by him or her in the exercise of reasonable care. No person may sue under this section if the buyer or seller receives a written rescission offer, which has been passed upon by the director before suit and at a time when he or she owned the security, to refund the consideration paid together with interest at eight percent per annum from the date of payment, less the amount of any income received on the security in the case of a buyer, or plus the amount of income received on the security in the case of a seller.

(5) No person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract. Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void.

(6) Any tender specified in this section may be made at any time before entry of judgment.

(7) Notwithstanding subsections (1) through (6) of this section, if an initial offer or sale of securities that are exempt from registration under RCW 21.20.310 is made by this state or its agencies, political subdivisions, municipal or quasi-municipal corporations, or other instrumentality of one or more of the foregoing and is in violation of RCW 21.20.010(2), and any such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such issuer acting on its behalf, or person

in control of such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such person acting on its behalf, materially aids in the offer or sale, such person is liable to the purchaser of the security only if the purchaser establishes scienter on the part of the defendant. The word "employee" or the word "agent," as such words are used in this subsection, do not include a bond counsel or an underwriter. Under no circumstances whatsoever shall this subsection be applied to require purchasers to establish scienter on the part of bond counsels or underwriters. The provisions of this subsection are retroactive and apply to any action commenced but not final before July 27, 1985. In addition, the provisions of this subsection apply to any action commenced on or after July 27, 1985.

[1998 c 15 § 20; 1986 c 304 § 1; 1985 c 171 § 1; 1981 c 272 § 9; 1979 ex.s. c 68 § 30; 1977 ex.s. c 172 § 4; 1975 1st ex.s. c 84 § 24; 1974 ex.s. c 77 § 11; 1967 c 199 § 2; 1959 c 282 § 43.]

Notes:

Severability -- 1986 c 304: "If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected." [1986 c 304 § 2.]

Effective date -- 1974 ex.s. c 77: See note following RCW 21.20.040.

RCW 21.20.702
Suitability of recommendation — Reasonable grounds required.

(1) In recommending to a customer the purchase, sale, or exchange of a security, a broker-dealer, salesperson, investment adviser, or investment adviser representative must have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to his or her other security holdings and as to his or her financial situation and needs.

(2) Before the execution of a transaction recommended to a noninstitutional customer, other than transactions with customers where investments are limited to money market mutual funds, a broker-dealer, salesperson, investment adviser, or investment adviser representative shall make reasonable efforts to obtain information concerning:

(a) The customer's financial status;

(b) The customer's tax status;

(c) The customer's investment objectives; and

(d) Such other information used or considered to be reasonable by the broker-dealer, salesperson, investment adviser, or investment adviser representative in making recommendations to the customer.

[1994 c 256 § 26; 1993 c 470 § 2.]

Notes:

Findings -- Construction -- 1994 c 256: See RCW 43.320.007.

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2111. Suitability

(a) A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

(b) A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in Rule 4512(c), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decisionmaking authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent.

• • • Supplementary Material: ----------

.01 General Principles. Implicit in all member and associated person relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of FINRA rules, with particular emphasis on the requirement to deal fairly with the public. The suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct.

.02 Disclaimers. A member or associated person cannot disclaim any responsibilities under the suitability rule.

.03 Recommended Strategies. The phrase "investment strategy involving a security or securities" used in this Rule is to be interpreted broadly and would include, among other things, an explicit recommendation to hold a security or securities. However, the following communications are excluded from the coverage of Rule 2111 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities:

(a) General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (e.g., equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, and (v) assessment of a customer's investment profile;

(b) Descriptive information about an employer-sponsored retirement or benefit plan, participation in the plan, the benefits of plan participation, and the investment options available under the plan;

(c) Asset allocation models that are (i) based on generally accepted investment theory, (ii) accompanied by disclosures of all material facts and assumptions that may affect a reasonable investor's assessment of the asset allocation model or any report generated by such model, and (iii) in compliance with Rule 2214 (Requirements for the Use of Investment Analysis Tools) if the asset allocation model is an "investment analysis tool" covered by Rule 2214; and

(d) Interactive investment materials that incorporate the above.

.04 Customer's Investment Profile. A member or associated person shall make a recommendation covered by this Rule only if, among other things, the member or associated person has sufficient information about the customer to have a reasonable basis to believe that the recommendation is suitable for that customer. The factors delineated in Rule 2111(a) regarding a customer's investment profile generally are relevant to a determination regarding whether a recommendation is suitable for a particular customer, although the level of importance of each factor may vary depending on the facts and circumstances of the particular case. A member or associated person shall use reasonable diligence to obtain and analyze all of the factors delineated in Rule 2111(a) unless the member or associated person has a reasonable basis to believe,

documented with specificity, that one or more of the factors are not relevant components of a customer's investment profile in light of the facts and circumstances of the particular case.

.05 Components of Suitability Obligations. Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) The reasonable-basis obligation requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least *some* investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the member's or associated person's familiarity with the security or investment strategy. A member's or associated person's reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.

(b) The customer-specific obligation requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a).

(c) Quantitative suitability requires a member or associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.

.06 Customer's Financial Ability. Rule 2111 prohibits a member or associated person from recommending a transaction or investment strategy involving a security or securities or the continuing purchase of a security or securities or use of an investment strategy involving a security or securities unless the member or associated person has a reasonable basis to believe that the customer has the financial ability to meet such a commitment.

.07 Institutional Investor Exemption. Rule 2111(b) provides an exemption to customer-specific suitability regarding institutional investors if the conditions delineated in that paragraph are satisfied. With respect to having to indicate affirmatively that it is exercising independent judgment in evaluating the member's or associated person's recommendations, an institutional customer may indicate that it is exercising independent judgment on a trade-by-trade basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions for its account.

Amended by SR-FINRA-2014-016 eff. May 1, 2014.
Amended by SR-FINRA-2013-001 eff. Feb. 4, 2013.
Adopted by SR-FINRA-2010-039 and amended by SR-FINRA-2011-016 and SR-FINRA-2012-027 eff. July 9, 2012.

Selected Notices: 11-02, 11-25, 12-25, 12-55.

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2310. Recommendations to Customers (Suitability)

This rule is no longer applicable. NASD Rule 2310 has been superseded by FINRA Rule 2111. Please consult the appropriate FINRA Rule.

(a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

(b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:

(1) the customer's financial status;

(2) the customer's tax status;

(3) the customer's investment objectives; and

(4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

(c) For purposes of this Rule, the term "non-institutional customer" shall mean a customer that does not qualify as an "institutional account" under Rule 3110(c)(4).

Amended by SR-NASD-95-39 eff. Aug. 20, 1996.
Amended by SR-NASD-90-09 and SR-NASD-90-39 May 2, 1990 eff. for accounts opened and recommendations made after Jan. 1, 1991.

Selected Notices: 90-12, 90-52, 96-60, 96-86, 01-23, 05-59.

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3040. Private Securities Transactions of an Associated Person

(a) Applicability

No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this Rule.

(b) Written Notice

Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

(c) Transactions for Compensation

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice pursuant to paragraph (b) shall advise the associated person in writing stating whether the member:

(A) approves the person's participation in the proposed transaction; or

(B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to paragraph (c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.

(3) If the member disapproves a person's participation pursuant to paragraph (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

(d) Transactions Not for Compensation

In the case of a transaction or a series of related transactions in which an associated person has not and will not receive any selling compensation, a member which has received notice pursuant to paragraph (b) shall provide the associated person prompt written acknowledgment of said notice and may, at its discretion, require the person to adhere to specified conditions in connection with his participation in the transaction.

(e) Definitions

For purposes of this Rule, the following terms shall have the stated meanings:

(1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

(2) "Selling compensation" shall mean any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's

fees; securities or rights to acquire securities; rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements.

Amended by SR-NASD-99-60 eff. March 23, 2004.
Adopted by SR-NASD-85-28 eff. Nov. 12, 1985.

Selected Notices: 75-34, 80-62, 82-39, 85-21, 85-54, 85-84, 91-32, 94-44, 96-33, 01-79, 03-79.

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3050. Transactions for or by Associated Persons

(a) Determine Adverse Interest

A member ("executing member") who knowingly executes a transaction for the purchase or sale of a security for the account of a person associated with another member ("employer member"), or for any account over which such associated person has discretionary authority, shall use reasonable diligence to determine that the execution of such transaction will not adversely affect the interests of the employer member.

(b) Obligations of Executing Member

Where an executing member knows that a person associated with an employer member has or will have a financial interest in, or discretionary authority over, any existing or proposed account carried by the executing member, the executing member shall:

(1) notify the employer member in writing, prior to the execution of a transaction for such account, of the executing member's intention to open or maintain such an account;

(2) upon written request by the employer member, transmit duplicate copies of confirmations, statements, or other information with respect to such account; and

(3) notify the person associated with the employer member of the executing member's intention to provide the notice and information required by subparagraphs (1) and (2).

(c) Obligations of Associated Persons Concerning an Account with a Member

A person associated with a member, prior to opening an account or placing an initial order for the purchase or sale of securities with another member, shall notify both the employer member and the executing member, in writing, of his or her association with the other member; provided, however, that if the account was established prior to the association of the person with the employer member, the associated person shall notify both members in writing promptly after becoming so associated.

(d) Obligations of Associated Persons Concerning an Account with a Notice-Registered Broker/Dealer, Investment Adviser, Bank, or Other Financial Institution

A person associated with a member who opens a securities account or places an order for the purchase or sale of securities with a broker/dealer that is registered pursuant to Section 15(b)(11) of the Act ("notice-registered broker/dealer"), a domestic or foreign investment adviser, bank, or other financial institution, except a member, shall:

(1) notify his or her employer member in writing, prior to the execution of any initial transactions, of the intention to open the account or place the order; and

(2) upon written request by the employer member, request in writing and assure that the notice-registered broker/dealer, investment adviser, bank, or other financial institution provides the employer member with duplicate copies of confirmations, statements, or other information concerning the account or order;

provided, however, that if an account subject to this paragraph (d) was established prior to a person's association with a member, the person shall comply with this paragraph promptly after becoming so associated.

(e) Paragraphs (c) and (d) shall apply only to an account or order in which an associated person has a financial interest or with respect to which such person has discretionary authority.

(f) Exemption for Transactions in Investment Company Shares and Unit Investment Trusts

The provisions of this Rule shall not be applicable to transactions in unit investment trusts and variable contracts or redeemable securities of companies registered under the Investment Company Act of 1940, as amended, or to accounts which are limited to transactions in such securities.

Amended by SR-NASD-2002-40 eff. Oct. 15, 2002.
Amended by SR-NASD-90-58 eff. June 1, 1991.
Amended by SR-NASD-86-29 eff. Dec. 15, 1986; Mar. 14, 1991.
Amended by SR-NASD-82-25 eff. Feb. 28, 1983.

Selected Notices: 82-21, 82-44, 83-17, 85-41, 87-2, 91-27, 97-25, 02-73.