NO. 95420-8

SUPREME COURT OF THE STATE OF WASHINGTON

FEDERAL HOME LOAN BANK OF SEATTLE,

Petitioner,

v.

CREDIT SUISSE SECURITIES (USA) LLC, f/k/a CREDIT SUISSE FIRST BOSTON LLC, CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORP., and CREDIT SUISSE MANAGEMENT LLC, f/k/a CREDIT SUISSE FIRST BOSTON MANAGEMENT LLC,

Respondents.

BRIEF OF AMICUS CURIAE WASHINGTON STATE DEPARTMENT OF FINANCIAL INSTITUTIONS IN SUPPORT OF PETITION FOR REVIEW

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I. IDENTITY AND INTEREST OF AMICUS CURIAE

The Department of Financial Institutions administers the Securities Act of Washington, Chapter 21.20 RCW, which regulates the offer and sale of investments to Washington residents. *See* RCW 21.20.450. The Department registers securities, broker-dealers, salespersons, investment advisers, and investment adviser representatives; promulgates rules for the industry; and, when necessary, takes enforcement actions for violations of the Act. The Department has a substantial interest in this matter because proper interpretation and application of the Securities Act is critical to the Department's overall administration and enforcement efforts. The Act's provision that was interpreted by the Court of Appeals, RCW 21.20.010, establishes unlawful conduct that is subject to administrative, civil, and criminal actions under RCW 21.20.110, RCW 21.20.280, RCW 21.20.390 and RCW 21.20.400. RCW 21.20.010 does not create a cause of action by itself. It serves as a predicate to other sections of the Securities Act that provide various remedies, including for private actions under RCW 21.20.430, as was involved in the case below. Because of limited government resources, these private actions serve as a "necessary supplement" to the enforcement efforts of government regulators. *See Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310, 105 S.Ct. 2622, 86 L.Ed.2d 215 (1985).

II. ARGUMENT

A. The Court of Appeals' Imputation of a Reliance Requirement in the Securities Act Affects a Substantial Public Interest and Diminishes Private Rights of Action Under the Securities Act

This matter affects a substantial public interest and requires evaluation and clarification by this Court. *See* RAP 13.4(b)(4). The Department respectfully submits that the Court of Appeals has erroneously inserted an element of "reliance" into the Act's civil remedy provision in RCW 21.20.430, based on its interpretation of the antifraud provision in RCW 21.20.010. This interpretation jeopardizes investor protections in Washington by significantly weakening the deterrent effect of the Act's antifraud provisions and imposing a requirement that will prevent defrauded Washington investors from obtaining relief.

RCW 21.20.430 establishes a civil cause of action for violations of the Securities Act of Washington, including fraudulent conduct prohibited by RCW 21.20.010. RCW 21.20.010(2) makes it unlawful to "make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading" in connection with the offer, sale, or purchase of a security. Neither RCW 21.20.010 nor 21.20.430 requires reliance.[1]

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[1] The requirement of materiality has sometimes been confused with reliance. *See* Joseph C. Long, *Pleading and Proving Liability for Material Misstatements and*

Injecting a reliance requirement into the provision of the Act that establishes fraudulent conduct not only creates an additional burden, but it also requires proof of something that even a prudent investor may not be able to produce.[2] The lower court's decision permits an issuer to make any number of material, untrue statements or omissions and yet escape liability. Such a result conflicts with the standard of conduct in a securities transaction that places the primary burden on the seller to be truthful when dealing with an investor. *See Aspelund v. Olerich,* 56 Wn. App. 477, 483, 784 P.2d 179 (1990). It also fundamentally conflicts with the primary purpose of the Act to protect investors and the instruction that it be liberally construed. *Cellular Engineering, Ltd. V. O'Neill*, 118 Wn.2d 16, 23, 820 P.2d 941 (1991). This Court should grant review to correct this mistaken interpretation of the Act.

B. Review Is Also Necessary to Resolve the Conflict Between the Court of Appeals' Decisions and This Court's Decisions

The Court of Appeals misreads this Court's opinion in *Hines v. Data Line Systems, Inc.*, 114 Wn.2d 127, 134, 787 P.2d 8 (1990), as having affirmatively considered and articulated that reliance is an element in a claim under the Securities Act. Other court of appeals' opinions have

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Omissions—"By Means Of"—;Reliance, 12A Blue Sky Law §9:41 at 4 (2017) (hereinafter, Long Art.)

[2] Requiring plaintiffs to prove reliance presents difficult challenges. *See* id at 1 (plaintiffs "can rarely identify the individual factors" that influenced their judgment).

also mistakenly added a reliance requirement. *See, e.g., Stewart v. Steiner,* 122 Wn. App. 258, 260, 93 P.3d 919 (2004) (citing *Hines*); *Guarino v. Interactive Objects, Inc.*, 122 Wn. App. 95, 118-19, 86 P.3d 1175 (2004) (citing *Hines*); *Shermer v. Baker*, 2 Wn. App. 845, 858, 472 P.2d 589 (1970)(mentioning reliance but citing no source for the element).

Reliance was not an issue before this Court in *Hines*. "Where the literal words of a court opinion appear to control an issue, but where the court did not in fact address or consider the issue, the ruling is not dispositive and may be reexamined without violating stare decisis in the same court or without violating an intermediate appellate court's duty to accept the rulings of the Supreme Court." *In re Stockwell*, 179 Wn.2d 588, 600, 316 P.3d 1007 (2014) (citations omitted). The statement about reliance in *Hines* is mere dicta, and this Court should take the opportunity to definitively reject the insertion of a reliance element into the statute.

The lower court based its interpretation on a statement in *Hines* that "investors need only show that the misrepresentations were material and that they relied on the misrepresentations in connection with the sale of the securities." *Hines*, 114 Wn.2d at 134. When viewed in context, however, this statement does not purport to articulate the elements of a claim. Rather, it is an explanation of why the Court dismissed the notion that a plaintiff in a state securities fraud civil suit must show "loss

causation." *Id.* at 134-35. In the very next paragraph, the Court provides a "plain reading" of RCW 21.20.010 that does not require reliance, namely that the statute "makes it unlawful for a seller to make a material misrepresentation or omission in connection with the sale of a security." *Id.* Further, the Court continues, "The violation is in the representation itself[.]" *Id.* at 135.

Reading *Hines* as adding an additional element also contradicts other decisions of this Court in which the Court set forth the elements of a violation under RCW 21.20.010. For example, in *Go2Net, Inc. v. Freeyellow.com, Inc.*, though the Court mentions reliance in its summation of the facts of that case,[3] in its analysis the Court stated that "the Act thus requires only proof of the seller's material, preclosing misrepresentation or omission" and that (citing *Hines*), the Act does not "require a showing that the misrepresentation or omission actually caused a purchaser to incur losses in a securities transaction" – "[s]imply put, a seller's violation [of the Act] is in the misrepresentation itself." 158 Wn.2d 247, 253, 143 P.3d 590 (2006) (internal quotes and citations omitted). Additionally, in *Kinney v. Cook*, 159 Wn.2d 837, 842, 154 P.3d 206 (2007) this Court reviewed the elements of a violation under RCW 21.20.010 in connection with a

[3] That sentence reads, "The jury further found that the misrepresentation or omission was material and that Go2Net had relied on the misrepresentation or omission in its decision to acquire FreeYellow." 158 Wn.2d at 251.

motion to dismiss and stated, "The statute has two essential elements: (1) a fraudulent or deceitful act committed (2) in "connection with the offer, sale or purchase of any security." Reliance was not mentioned. Thus, in two decisions rendered since *Hines*, this Court declined to state that a reliance element is also required to prove a private Securities Act violation under RCW 21.20.010(2).

Requiring investors to prove an extra-statutory element of reliance is inconsistent with the Act's purpose of protecting investors and deterring fraud. This Court has rejected previous attempts to interject common law elements into the Act that increase an investor's burden of proof, and should do so here. For example, this Court previously held that the scienter element of common law fraud is not applicable to Securities Act violations under RCW 21.20.430. *See Kittilson v. Ford*, 93 Wn.2d 223, 226-27, 608 P.2d 264 (1980). This Court has also determined that requiring an investor to prove loss and loss causation contravenes the purpose of the Act, and that the equitable defenses of waiver and estoppel are not available to defendants in cases like this. *Hines,* 114 Wn.2d at 134; *Go2net*, 158 Wn.2d at 254. As argued by Petitioner (Br. at 17), these cases are consistent with the legislature's intention "to hold violators strictly accountable." *See Go2Net,* 158 Wn.2d 247 at 254 (citations omitted). The Court should accept review to avoid further conflicts as to whether a

reliance requirement has been improperly added to the plain language of the Act.

C. The Draftsmen's Commentary From the Uniform Securities Act of 1956 Illustrates That Actions By Private Citizens for Violations of RCW 21.20.010(2) Do Not Require Reliance

In the case below, the Court of Appeals said that characterizing the language in *Hines* as dicta would not dissuade them from concluding "that the legislature intended reasonable reliance to be an essential element of a claim under RCW 21.20.010."[4] *Fed. Home Loan Bank of Seattle v. Credit Suisse Sec. (USA) LLC*, No. 75779-2-1, slip op. at 8 (Dec. 11, 2017). In coming to this conclusion, Division One focuses almost exclusively on RCW 21.20.010; however, it is RCW 21.20.430 that establishes a private right of action. *See Wades v. Skippers, Inc.*, 915 F.2d 1324, 1331 (1990). RCW 21.20.430 permits actions by private citizens for violations of RCW 21.20.010. The two statutes work in tandem, and as a result, the legislative histories of both must be considered.

When Washington adopted the Washington Securities Act in 1959, it modeled the provisions on the Uniform Securities Act of 1956.

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[4] The court also suggested that the legislature had acquiesced in the matter since it has not amended the Act. However, given the conflicting language between decisions which purport to state the elements of liability, and the fact that this Court has never squarely addressed the issue, it is not clear what the legislature could be said to have acquiesced to.

Haberman v. Washington Public Power Supply Sys., 109 Wn.2d 107, 125, 744 P.2d 1032 (1987). RCW 21.20.430 is based on Section 410 of the Uniform Securities Act of 1956, which is "almost identical with §12(2) of the Securities Act of 1933." *Uniform Securities Act with Official Comments and Draftsmen's Commentary*, § 410, reprinted in Louis Loss & Edward M. Cowett, *Blue Sky Law*, Appendix I at 390 (1958). The Draftsmen's Commentary notes that "[t]he resemblance of §12(2) of the Securities Act of 1933...will once more make for an interchangeability of federal and state judicial precedence in this very important area" and that it was "not intended as a requirement that the buyer prove *reliance* on the untrue statement or the omission." *Id.* (emphasis in original). Section 12(2) has long been recognized as a strict liability statute. Long Art. at 1.

Division One based much of its discussion on federal courts' interpretations of SEC Rule 10b-5, and the similarity between Rule 10b-5 and RCW 21.20.010. *See* Slip Op. at 5-6. However, this analysis overlooks that courts have determined that actions under Rule 10b-5—the antifraud provision of the Securities Exchange Act of 1934—require reliance only because there is no express claim for relief under Rule 10b-5. Thus courts have had to use tort law concepts to define the contours of the implied action. *See* Long Art. at 4. In contrast, both Section 12(a)(2) of the Securities Act of 1933 and RCW 21.20.430 contain an express cause

of action within the text of the statute. Consequently, "the language of the statutes, not a comparable common law tort should provide the elements necessary for recovery" and "reading the statutes as written, there should not be a reliance requirement." *See* Long Art. at 4-5. Washington's private cause of action under the Securities Act is modelled on the Uniform Securities Act and the omission of a reliance element has remained a mainstay of the Uniform Securities Act for more than sixty years.[5] It should also be omitted from Washington's Securities Act.

D. Division One's Interpretation of the Act Could Be Extended To Prevent the Department From Protecting Investors From Fraud

Violations of RCW 21.20.010 may separately result in administrative action by the Department under RCWs 21.20.110, .280, and .390. A judicial interpretation that proof of "reasonable reliance" is required to establish a violation of RCW 21.20.010(2) could seriously undermine the Department's ability to bring administrative action in cases of fraud. As a practical matter, courts may extend Division One's interpretation to conclude that the Department is unable to enforce RCW 21.20.010 in situations in which fraudulent offers had been made, but no investor had yet been duped. As a result, a person could continue to make

[5] The promulgation of the Uniform Securities Act in 2002 similarly does not require reliance. Joel Seligman, *The New Uniform Securities Act,* 81 WAULQ 243, 288 (2003).

even blatant misstatements to potential investors and induce countless more investors to purchase the fraudulent investment. This result conflicts with the Department's role in administering the Securities Act, the primary purpose of which is to "protect investors from speculative or fraudulent schemes of promoters." *Cellular Eng'g, Ltd.*, 118 Wn.2d at 23. The petition presents an issue of substantial public importance warranting this Court's review.

III. CONCLUSION

This case presents issues of substantial public interest, as the lower court's decision could have devastating consequences on investors seeking relief from untruthful securities sellers and the Department's ability to enforce the Act. In addition, reviewing the decision below provides this Court with an opportunity to clarify the elements of a securities fraud violation in light of the confusion created by Division One's interpretation of *Hines.* For these reasons, this Court should grant review.

RESPECTFULLY SUBMITTED this 9th day of March, 2018.

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I, Jeanette Fagerness, make the following declaration:

1. I am over the age of 18, a resident of Lewis County, and not a party to the above action.

2. On March 9, 2018, I caused to be served a true and correct courtesy copy of the Amicus Curiae Brief and this Certificate of Service via U.S. Mail to:

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RESPECTFULLY SUBMITTED this 9th day of March, 2018.

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