

No. 74058-0-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

JOHN NORTON; KRISTINE NORTON;
and NORTHLAND CAPITAL LLC,

Appellants,

v.

U.S. BANK NATIONAL ASSOCIATION,

Respondents,

JOSE NINO DE GUZMAN, and NDG INVESTMENT GROUP, LLC,

Defendants.

APPEAL FROM THE SUPERIOR COURT
FOR KING COUNTY
THE HONORABLE BETH ANDRUS

APPELANTS' REPLY BRIEF

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I. INTRODUCTION

Purporting to rely on “undisputed” evidence in the record, U.S. Bank ignores both the governing standard of review of the trial court’s summary judgment of dismissal, as well as the substantial evidence that the Bank gave preferential treatment to Nino de Guzman that crossed the “routine banking services” line it repeatedly espouses in its Respondent’s Brief. The Bank’s reliance on the absence of a banking relationship with the Nortons misses the mark because the Nortons were foreseeable victims when the Bank allowed its employees to lend its assistance to de Guzman’s fraudulent scheme.

De Guzman’s substantial and frequent wire transfers exhibited a pattern of fraud that the Bank’s own employees enabled and that was allowed to continue due to the Bank’s failure to supervise violation of its own policies. If the Nortons’ circumstantial evidence of the Bank’s knowing and substantial assistance to de Guzman’s fraud fell short, it was solely due to a protective order that was the result of the Court of Appeals’ overly broad interpretation of the narrow privilege granted by the Bank Secrecy Act.

This Court should reverse the trial court’s summary judgment, and, under RAP 2.5I, hold that the Bank Secrecy Act privilege does

not preclude discovery of a bank's policies for monitoring and investigating suspicious activity or the steps it took to monitor and supervise its employees in the course of standard risk management in the absence of the Bank Secrecy Act.

II. REPLY ARGUMENT

III. **On appeal from final judgment, this Court should correct the Court of Appeals' previous erroneous expansive reading of the Bank Secrecy Act Privilege pursuant to RAP 2.5I(2).**

The Bank's reliance on the law of the case doctrine ignores that RAP 2.5I(2) expressly allows this Court to "review the propriety of an earlier decision of the appellate court in the same case." This appeal from a final judgment gives the Court the factual context to recognize the harm caused by its prior decision, which held that the Bank Secrecy Act privilege, codified in 12 C.F.R. § 21.11(k)(1), barred discovery of the Bank's risk management policies, procedures, and any investigations that exist independent of the Bank's reporting obligations under federal law.

The Bank concedes that RAP 2.5I(2) authorizes this Court to reconsider its initial decision where "the prior decision is clearly erroneous, and the decision would work a manifest injustice to the party." (Resp. Br. 44) *See Roberson v. Perez*, 156 Wn.2d 33, 42, ¶¶23-24, 123 P.3d 844 (2005). This exception is applicable here,

both because the Court of Appeals' previous decision was clearly erroneous and because that decision allowed the Bank to withhold evidence that would have allowed the Nortons to establish directly the Bank's knowledge of de Guzman's scheme.

The Bank Secrecy Act precludes disclosure of the existence of Suspicious Activity Reports ("SAR") but authorizes disclosure of the "underlying facts, transactions, and documents upon which a SAR is based." 12 C.F.R. § 21.11(k)(1)(ii)(A)(2). This Court's review of the statutory language is de novo.

The Court's prior decision was clearly erroneous because it failed to give effect to the plain language of the statute and regulation. The statute itself, 31 U.S.C. § 5318(g)(2)(A), provides only that banks may not notify persons involved in the suspicious transaction that it has reported to the federal government. And the Controller's regulation plainly limits the privilege to "[a] SAR, and any information that would reveal the existence of a SAR" 12 C.F.R. § 21.11(k). Although the Court need not go beyond the plain language of these provisions, the previous decision is also erroneous because it broadly, not narrowly construed the privilege, in derogation of established rules of statutory construction. (App. Br. 28-29) Under this extremely broad interpretation of the privilege,

only account statements could qualify as discoverable “underlying facts, transactions, and documents upon which a SAR is based.” A bank’s investigations and procedures that exist regardless of a bank’s reporting obligations to the federal government do not fall within the narrow discovery privilege created by the Bank Secrecy Act.

Further, the injustice of allowing the Bank to plead ignorance while withholding any direct evidence of its knowledge of de Guzman’s scheme is particularly manifest now that the Court has a complete summary judgment record that allowed the Bank to characterize de Guzman’s relationship with the Bank as “routine” and to highlight the absence of direct evidence of the Bank’s knowledge of de Guzman’s fraudulent scheme.

The Bank does not dispute that its employees violated the Bank’s conflict of interest rules in receiving referral fees from de Guzman while he transferred millions of dollars of investor funds from Peru to the various LLC accounts established at U.S. Bank and then transferred millions more into de Guzman’s personal account. The Bank may portray itself as ignorant of the criminal nature of de Guzman’s investment scheme and the roles of its employees in assisting de Guzman only because the Court’s expansive view of the Bank Secrecy Act’s limited discovery privilege deprived the Nortons

of the very evidence that would have shown what the Bank knew and when it knew it.

A financial institution can only act through its employees and agents, whose knowledge is imputed to the Bank. *See Deep Water Brewing LLC v. Fairway Resources Ltd*, 152 Wn. App. 229, 269-70, ¶¶94-96, 215 P.3d 990 (2009), *rev. denied*, 168 Wn.2d 1024 (2010); *Collings v. City First Mort. Services, LLC*, 177 Wn. App. 908, 925-27, ¶¶37-41, 317 P.3d 1047 (2013), *rev. denied*, 179 Wn.2d 1028 (2014). The trial court apparently relied on the employees' protestations of ignorance concerning de Guzman's scheme. The protective order deprived the Nortons of potentially powerful impeachment evidence that would have rebutted these employees' claims that they were ignorant of de Guzman's fraud.

As the Bank recognizes, the Nortons have not argued that there "has been intervening, controlling BSA precedent" that mandates reconsideration of this Court's earlier decision under the alternative exception to the law of the case doctrine under RAP 2.5I(2). (Resp. Br. 45) *See Roberson*, 156 Wn.2d at 42, ¶24 (application of law of the case doctrine may "be avoided where there has been an intervening change in controlling precedent"). But the Court can and should consider that the previous opinion is contrary

to the weight of more recent federal decisions construing this federal privilege. *See In re JPMorgan Chase Bank, N.A.*, 799 F.3d 36, 44 (1st Cir. 2015) (rejecting privilege after in camera review; “none of the documents at issue constitute a draft SAR, and none of the documents reflect the decision-making process as to whether a SAR should be filed, the process of preparing a SAR, or an attempt to explain the content of a SAR post-filing”), on remand, *Mansor v. JPMorgan Chase Bank, N.A.*, CV 12-10544-JGD, 2016 WL 1676482 (D. Mass. Apr. 26, 2016), in addition to the cases cited in App. Br. 30-33.

The Bank is correct that these decisions are not “controlling.” *See State v. Barefield*, 110 Wn.2d 728, 732 n.2, 756 P.2d 731 (1988) (“this court is not bound by the interpretations placed on federal law by inferior federal courts.”), citing *Amalgamated Clothing Workers of Am. V. Richman Bros.*, 348 U.S. 511, 75 S.Ct. 452, 99 L.Ed. 600 (1955). After relying upon those “inferior federal court” decisions that favored its position and ignoring the same authority that confirmed the limited nature of the discovery privilege to secure its protective order, the Bank cites the absence of controlling precedent as a reason not to review the Court of Appeals prior holding. But our Supreme Court’s failure to address the scope of the Bank Secrecy Act

privilege instead counsels in favor of a de novo review of this legal issue, which is of substantial concern to Washington fraud victims.

This Court should hold that the Bank Secrecy Act precludes disclosure of the existence of Suspicious Activity Reports but authorizes disclosure of the “underlying facts, transactions, and documents upon which a SAR is based,” as the regulation states. 12 C.F.R. § 21.11(k)(1)(ii)(A)(2). The law of the case doctrine does not bar this Court from holding, with the benefit of subsequent authority that confirms the limited nature of the Bank Secrecy Act’s discovery privilege, that the prior decision was an erroneous interpretation of federal law.

B. The trial court ignored the circumstantial evidence that would allow a jury to find that U.S. Bank knowingly lent substantial assistance to de Guzman’s scheme, and that its failure to supervise its employees contributed to the Nortons’ losses.

1. The Court must view the evidence, and all inferences from that evidence, in the light most favorable to the Nortons.

The Bank ignores that the trial court dismissed the Nortons’ aiding and abetting, and negligent supervision claims on summary judgment. This Court must therefore consider not just the facts, but all inferences from those facts in the light most favorable to the Nortons, the non-moving party. CR 56I; *August v. U.S. Bancorp*, 146

Wn. App. 328, 339, ¶27, 190 P.3d 86 (2008), *rev. denied*, 165 Wn.2d 1034 (2009). The Bank does not mention, let alone employ, this governing standard of review.

2. A jury could find that U.S. Bank knowingly facilitated de Guzman’s fraud, lending substantial assistance to de Guzman’s egregious breach of duty to the Nortons.

The Bank gets no special dispensation as a financial institution, as it repeatedly argues. There is no unique “high threshold” to protect the Bank as a financial “service provider.” (Resp. Br. 21) Under Washington law, a defendant is liable to a third person for the tortious conduct of another if the defendant “knows that the other’s conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other.” Restatement (Second) Torts § 876 (1979); *Martin v. Abbott Laboratories*, 102 Wn.2d 581, 596, 689 P.2d 368 (1984). The Bank is liable for aiding and abetting de Guzman’s fraud, coercion and breach of fiduciary duty under the same standard as anyone else who knowingly provided substantial assistance to a fraud.

The Bank’s argument that its duty is limited to the Bank’s customers ignores the Nortons’ theory of liability. It is undisputed and now an adjudicated fact that de Guzman breached his fiduciary duties by defrauding the Nortons. (CP 16-18) The Bank can be liable

along with de Guzman if it knowingly assisted de Guzman “in the commission of a tort, or . . . in violating his fiduciary or trust obligation.” *LaHue v. Keystone Inv. Co.*, 6 Wn. App. 765, 783, 496 Pl2d 343, *rev. denied* 81 Wn.2d 1003 (1972). The fact that the Nortons were not Bank customers is completely irrelevant to the issue of the Bank’s liability for aiding and abetting de Guzman.

As the Bank recognizes, the Nortons are not alleging that U.S. Bank owed or breached a fiduciary duty the Bank owed to them. And while the Bank argues that its failure to follow its own policies and reasonable banking practices – breaches that are largely unaddressed in its brief – did not cause the Nortons’ losses, the Nortons have not argued that the Bank owes a duty of care to non-customers. Thus, *Zabka v. Bank of America Corp.*, 131 Wn. App. 167, 127 P.3d 722 (2005), *rev. denied*, 158 Wn.2d 1012 (2006), which held that non-customers whose funds were stolen by third parties after they wired the funds into a customer’s account had no claim of negligence against a bank, is inapposite.

Instead, the Nortons have cited the Bank’s breach of reasonable banking procedures as circumstantial evidence of its knowledge of de Guzman’s wrongdoing and its substantial assistance to de Guzman’s fraud. Because “[i]t is often difficult to supply direct

evidence of actual knowledge . . . circumstantial evidence may support a finding of actual knowledge.” *Waite v. Whatcom County*, 54 Wn. App. 682, 686-87, 775 P.2d 967 (1989).

U.S. Bank does not dispute that its employees Copstead and Marza actively promoted de Guzman’s Ponzi scheme to third parties in return for referral fees while in the Bank’s employment, in violation of the Bank’s own conflict of interest rules. (CP 1150-51, 1526, 1532, 1534, 1550-52, 1558, 1560-62, 1587-90) The Bank argues that its employees were themselves victims of de Guzman’s fraud. But unlike the Bank’s employees, the Nortons were not paid to help perpetrate de Guzman’s fraud and were not agents of the Bank who assisted in that fraud. More important, stating that Bank employees lost money in the fraud does not address that one of the purposes of U.S. Bank’s conflict of interest rules is to preclude the Bank and its employees from placing their own self-interest over the Bank’s obligation to avoid being used as an instrumentality for a Ponzi scheme. The fact that Bank employees lost money (far less money than investors who were **not** paid to perpetrate the fraud) is as irrelevant to this Court’s analysis of the Nortons’ aiding and abetting claim as is the Nortons’ status as non-customers. Both Bank arguments are classic red herrings.

Relying on Behn's self-serving testimony that he "had no knowledge of the fraud," the Bank contends that its manager did nothing more than provide "ordinary services," (Resp. Br. 15), and that he lowered the risk rating on the account opened by de Guzman for P.R.E. "because a subordinate inaccurately completed the form." (Resp. Br. 16) Behn's self-serving testimony ignores that the subordinate in fact **properly** recorded de Guzman's use of his Bank accounts for massive foreign transactions and stands in contrast to the substantial and frequent transfers in those accounts, some opened with zero balances, with money going in and out often on the same day. (CP 1177-86) A jury could reject his explanation and find, as Behn admitted, that he changed the form based on "[m]y knowledge of the bank account activity of Jose's accounts," (CP 1615-17), just as it could reject Behn's contention that he was unaware of wire transfer activity in the other "low risk" accounts he opened for de Guzman "based on what Jose told me at the time." (See CP 1624-25) Whether Behn, and thus the Bank, had actual knowledge of de Guzman's scheme, when Behn's testimony about de Guzman's "bank account activity" is completely contradicted by de Guzman's actual, voluminous, large foreign transfers and transfers to his own personal accounts, should be a question for trial.

U.S. Bank does not contest that its employees opened more than 30 accounts for de Guzman, an ex-U.S. Bank employee who used his connections with the Bank to implement his Ponzi scheme. (CP 1188, 1177-85) U.S. Bank allowed its former employee to parlay his relationships with Bank employees, some of whom he was paying, to receive favorable treatment from the Bank's management. De Guzman was allowed to engage in "high risk" transactions while Bank management changed account documentation to characterize that activity as "low risk."

The Bank's contention that it provided nothing more than "routine" banking services ignores that de Guzman's wire transfers frequently exceeded the \$50,000 threshold beyond which the Bank's Operating Procedures required review by its risk management division. (CP 1193) de Guzman's pattern of transferring funds between related accounts, frequently on the same day and aggregating transfers before transferring them to another account were all classic warning signs of fraud. (CP 1177-80) Yet U.S. Bank continued to designate his accounts "low risk," allowing de Guzman's scheme to continue without the careful scrutiny that a high risk account would garner. (CP 1186)

The involvement of the Bank's own employees with de Guzman renders these transactions far different from the federal district court cases cited by U.S. Bank in which the issue was simply whether a financial institution had knowledge of a customer's fraud. These were not "ordinary business transactions that a bank preforms for its customer." *El Camino Res. Ltd, v. Huntington Nat'l Bank*, 722 F. Supp. 2d 875, 911 (W.D. Mich 20110), *aff'd* 712 F.3d 917 (6th Cir. 2013), the primary case relied upon by the Bank. In *El Camino*, the defendant bank accepted a payoff on a loan from its borrower that was made from funds that the borrower had induced the plaintiff to pay by promoting a sale and lease of non-existent computers. 722 F. Supp. 2d at 896. There was no allegation that any bank employee profited from or participated in the fraud in any way. Instead, the Bank risk manager eventually assisted the FBI in uncovering the fraud.

Here, U.S. Bank allowed de Guzman to run his Ponzi scheme through its accounts without interruption. Why? A jury could find that de Guzman received preferential treatment because he was a former employee, because he had enlisted other Bank employees to solicit investors, and because its branch manager had an incentive to increase account balances at his branch and allow the millions of

dollars in wire transfers that were central to the Ponzi scheme to proceed unabated. U.S. Bank's participation in enabling de Guzman's fraud went well beyond "merely providing routine professional services," but constituted substantial assistance.

3. The scope of the Bank's duty to supervise its employees extends to foreseeable victims of its breach of that duty.

The Nortons were foreseeable victims of the Bank's breach of its duty to supervise its employees and enforce its conflict of interest rules and standards requiring review of high risk accounts involving significant foreign wire transfers. The duty of supervision is not enforceable by only business customers, as the Bank argues, again relying on *Zabka*. While *Zabka* addressed whether non-customers could enforce the Bank's duty "to follow standard procedures and monitor transactions according to its own internal standards," the Court did not address a claim that the Bank's failure to supervise its employees who themselves profited from a Ponzi scheme contributed to the victimization of a non-customer. 131 Wn. App. at 173.

The Bank concedes it has a legal duty to exercise reasonable care in supervising its employees, but argues that such a duty does not extend to non-customers or to prevent criminal actions by a

former employee, such as de Guzman. This Court should disavow the Bank's interpretation of *Zabka*, which would limit the class of plaintiffs who can claim a breach of a bank's duty to supervise its own employees to the Bank's own customers. The Bank's attempt to limit the scope of its duty is contrary to the principle that "all persons foreseeably put at risk by the defendant's negligent conduct" may assert the defendant's breach of the standard of care. *Schooley v. Pinch's Deli Market, Inc.*, 80 Wn. App. 862, 868-69, 912 P.2d 1044 (1996), *aff'd* 134 Wn.2d 468, 951 P.2d 749 (1998).

The notion that "the concept of foreseeability determines the scope of the duty owed," *Hansen v. Friend*, 118 Wn.2d 476, 483, 824 P.2d 483 (1992), is not limited to owners and occupiers of land, as the Bank argues. (Resp. Br. 35-36, discussing *McKown v. Simon Property Group, Inc.*, 182 Wn.2d 752, 344 P.3d 661 (2015). *See, e.g.*, *Colbert v. Moomba Sports, Inc.*, 132 Wn. App. 916, 926, ¶127, 135 P.3d 485 (2006), *aff'd* 163 Wn.2d 43, 176 P.3d 497 (2008). "The concept of duty turns on foreseeability and pertinent policy considerations." *Bailey v. Town of Forks*, 108 Wn.2d 262, 266, 737 P.2d 1257 (1987), amended, 753 P.2d 523 (1988) (Utter, J.).

The Bank has failed to establish as a matter of policy that the costs of requiring its employees to follow established industry

procedures to insure that the Bank is not used as a vehicle for criminal ventures outweigh the public benefits of preventing harm to non-customers, whose funds are at risk from a Ponzi scheme. The Bank knows that this is a false equation; the Bank must require compliance for the benefit of the public, not just its customers. Plaintiffs must still prove that they are foreseeable victims, as the Nortons have done here. This Court should hold that a Bank's duty of supervision extends to all foreseeable victims of a Ponzi scheme.

4. The Bank's actions proximately caused the Nortons' damages.

The Bank's causation argument – that its failure to follow its own practices did not hurt the Nortons – invokes both cause in fact and legal causation. Cause in fact exists where “a cause which in a direct sequence, unbroken by any superseding cause, produces the injury complained of and without which such injury would not have happened.” WPI 15.01. Because it is a factual “determination of what actually occurred,” cause in fact is “generally left to the jury.” *Schooley*, 134 Wn.2d at 478.

U.S. Bank was certainly a vehicle for de Guzman's fraud and a cause in fact of the Nortons' damages. It designated his accounts “low risk” despite the high number of foreign wire transfers, its employees encouraged other investors to give their money to de

Guzman, and allowed de Guzman to transfer large sums from Peru to LLC accounts and then into his personal accounts. By the time Norton was convinced to invest with de Guzman, de Guzman had been running his scheme through U.S. Bank for two years. The Bank had received the operating agreements of the LLCs that established de Guzman's duties to his investors yet permitted unfettered transfers between his personal and business accounts. The Bank not only lent its reputation to de Guzman's scheme (CP 1734-35), but its failure to enforce its own conflict of interest rules allowed de Guzman to continue his fraudulent scheme undetected.

The Bank claims that because it did not "vouch" for de Guzman and did not control his investments, de Guzman's relationship with U.S. Bank was not a factor in the Nortons' investment. (Resp. Br 41-42) But Mr. Norton was aware "of the banking relationship that NDG had with U.S. Bank." (CP 148) As Mr. Norton testified, de Guzman's relationship with a reputable national bank gave his enterprise an air of legitimacy that it otherwise would have lacked had U.S. Bank terminated its banking relationship with him due to unusually large and suspicious foreign wire transfers and its employees' conflicts of interest. (CP 1734-35) Whether de Guzman would have succeeded in defrauding Norton in

the absence of that established banking relationship is an issue of “but for” causation for the jury.

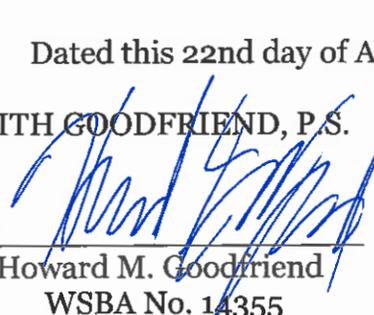
The Bank’s argument that causation is lacking because the Bank had “no duty to ‘refuse’ to provide banking services to Nino de Guzman” is a legal argument regarding the scope of the Bank’s duty to supervise its employees and enforce its policies regarding scrutiny of “high-risk” accounts. *See Schooley*, 134 Wn.2d at 478 (“legal cause is grounded in policy determinations as to how far the consequences of a defendant’s acts should extend”). This Court should hold that the Bank’s duty to ensure its employees do not receive incentive compensation to further a bank customer’s Ponzi scheme and to scrutinize high-risk accounts that are used to transfer millions of dollars from overseas, and then from various entities into personal accounts controlled by that customer, extends to foreseeable victims of the scheme. The Nortons presented more than adequate direct and circumstantial evidence to allow a jury to find that the Bank proximately caused the Nortons’ losses and to allow a jury to find U.S. Bank liable for aiding and abetting and negligent supervision

III. CONCLUSION

Even without discovery of “underlying facts, transactions, and documents upon which a SAR is based” as permitted by the Bank Secrecy Act, this Court should reverse the trial court’s summary judgment and remand for a jury to consider the direct and circumstantial evidence of U.S. Bank’s aiding and abetting of de Guzman’s fraud. The Court should also correct the Court of Appeals’ previous erroneous and prejudicial expansive reading of the Bank Secrecy Act privilege pursuant to RAP 2.5(c)(2), reverse the trial court’s summary judgment and remand for trial after allowing discovery of the Bank’s records concerning its review, conducted in the ordinary course of business, of its employees conduct and de Guzman’s accounts.

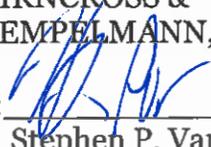
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DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on August 22, 2016, I arranged for service of the foregoing Appellants' Reply Brief, to the court and to the parties to this action as follows:

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