

No. 74611-1-I

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**IN THE COURT OF APPEALS  
OF THE STATE OF WASHINGTON  
DIVISION I**

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FUTURESELECT PORTFOLIO MANAGEMENT, INC.,  
FUTURESELECT PRIME ADVISOR II LLC, THE MERRIWELL  
FUND, L.P., and TELESIS IIW, LLC,

*Plaintiffs/Appellants,*

v.

KPMG LLP,

*Defendant/Respondent.*

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**APPELLANTS' OPENING BRIEF**

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Appellants FutureSelect Portfolio Management, Inc., FutureSelect Prime Advisor II, LLC, The Merriwell Fund, L.P., and Telesis IIW, LLC (collectively “FutureSelect” or “Plaintiffs”) appeal the trial court’s June 3, 2011 grant of Respondent KPMG LLP’s (“KPMG” or “Defendant”) Motion to Compel Arbitration (“Arbitration Motion”).

## I. INTRODUCTION

This Court unanimously reversed the June 3, 2011 orders of the King County Superior Court dismissing Plaintiffs’ complaint. *FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 175 Wn. App. 840, 894-95, 309 P.3d 555 (2013) (*FutureSelect I*). The Supreme Court unanimously affirmed. *FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 180 Wn.2d 954, 972-74, 331 P.3d 29 (2014) (*FutureSelect II*). The only June 3, 2011 ruling *not* reversed was not appealable at the time—the Superior Court’s grant of defendant accounting firm KPMG’s motion to compel arbitration. However, given a second chance, the Superior Court *did* recognize that FutureSelect was *not* subject to mandatory arbitration on account of an arbitration agreement among an auditor and its non-party audit client.

Upon remand, defendant accounting firm Ernst & Young LLP (“EY”) made the same motion to compel arbitration as accounting firm KPMG on the same grounds based on the substantially same arbitration

clause. This time, the Superior Court denied the motion to arbitrate, rejecting the same arguments KPMG had previously made. In its December 3, 2014 Order Denying EY's Motion to Compel Arbitration the Superior Court concluded that FutureSelect was "not bound by the arbitration clause in EY's audit engagement agreements because the Plaintiff's did not sign EY's agreements and their claims are direct claims against EY . . . ." CP 692.

The Superior Court was right the second time. KPMG actually admitted as much, stating that FutureSelect "cannot plead that there was any relationship resembling privity between KPMG and any individual limited partner of the Rye Funds." CP 366. If KPMG claims it owed no contractual duty to Plaintiffs—even admitting that Plaintiffs were *not even* third-party beneficiaries under the contract between KPMG and Tremont—then the arbitration agreement in that contract cannot apply to FutureSelect.

The extraordinary, inconsistent and unexplained denial of Washington citizens' access to court on a crippling loss on investments solicited in Washington, through misrepresentations made in Washington, and under laws designed to protect Washington investors, was incorrect. FutureSelect respectfully requests reversal so that its case against KPMG

may proceed to trial just like FutureSelect's case against EY did. The jury found against EY and in favor of FutureSelect.

## **II. ASSIGNMENT OF ERROR**

The trial court erred in granting KPMG's Arbitration Motion and compelling arbitration of FutureSelect's claims.

## **III. STATEMENT OF THE CASE**

FutureSelect, Washington-based investors, lost nearly \$200 million as a result of their investments in certain Tremont Rye Funds. CP 2.

KPMG negligently issued audit opinions on the financial statements of the Rye Funds for years ended 2004 through 2007, certifying as real billions of dollars in fake assets. KPMG stated that the Rye Fund financial statements were "fairly stated" containing "no material misstatement," when in fact virtually all of the assets *did not exist*. CP 8, 25.

FutureSelect lost its entire investment in reliance on KPMG. CP 15.

When FutureSelect brought claims against KPMG for negligent misrepresentation and violations of the Washington State Securities Act ("WSSA"), the Superior Court granted KPMG's Arbitration Motion without explanation. CP 400. None exists. FutureSelect was not a party to KPMG's engagement letter to audit the Rye Funds, nor *any* other arbitration agreement, and was not a third-party beneficiary, party-in-interest or a participant in *any* agreement to arbitrate. Because arbitration

is exclusively a species of *agreement*, *Satomi Owners Ass'n v. Satomi, LLC*, 167 Wn.2d 781, 810-811 (2009) (“[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.”) (citations omitted), and FutureSelect has *never* agreed to arbitrate, the Superior Court’s ruling was in error.

**A. FutureSelect**

FutureSelect, which includes FutureSelect Portfolio, Prime Advisor, Merriwell, and Telesis, are registered Washington companies operating out of Washington and acting on behalf of investors holding mostly Washington assets. CP 5-6. FutureSelect invested money with Bernard Madoff through the Rye Funds.<sup>1</sup> CP 9. The Rye Funds are a series of funds that were sold and managed by Tremont Group Holdings, Inc. and Tremont Partners, Inc. (collectively, “Tremont”) and invested exclusively or nearly exclusively with Bernard Madoff and his companies. CP 9-10.

**B. The Auditors: KPMG and EY**

Tremont knew that the Rye Funds would be much more attractive investments if the funds’ financial statements were audited by reputable,

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<sup>1</sup> The “Rye Funds” include Rye Select Broad Market Fund, L.P., Rye Select Broad Market Prime Fund, L.P., and Rye Select Broad Market XL Fund, L.P.

well-known auditors. Accordingly, Tremont first hired accounting firm EY as its auditor from 2000-2003. CP 8. When Tremont was acquired by Oppenheimer, it switched auditors to KPMG. CP 20. KPMG audited Tremont from 2004-2007. CP 20, 24-25. EY and KPMG utilized similar auditing methods. CP 27-30.

**1. The Arbitration Agreements Are Between the Auditors and Tremont, *Not FutureSelect***

EY and KPMG used substantially the same arbitration clauses in their engagement letters with Tremont. CP 428, 295. The engagement letters were executed by Tremont and either EY or KPMG alone. CP 426, 291, 328. *FutureSelect was not a signatory to the engagement letters and did not participate in any way in the negotiation, drafting or execution of the engagement letters. Id.*

Each engagement letter contained an agreement to arbitrate among Tremont and EY or KPMG. KPMG's arbitration clause provided:

Any dispute or claim arising out of or relating to the engagement letter between the parties, the services provided thereunder, or any other services provided by or on behalf of KPMG or any of its subcontractors or agents to Tremont or at its request (including any dispute or claim involving any person or entity for whose benefit the services in question are or were provided) shall be resolved in accordance with the dispute resolution procedures set forth in Appendix II, which constitute the sole methodologies for the resolution of all such disputes. By operation of this provision, the parties agree to forego

litigation over such disputes in any court of competent jurisdiction.

CP 295 (Engagement Letter between KPMG and Tremont Capital Management Inc. Nov. 23, 2004).

Arbitration shall be used to settle the following disputes: (1) any dispute not resolved by mediation 90 days after the issuance by one of the parties of a written Request for Mediation (or, if the parties have agreed to enter or extend the mediation, for such long period as the parties may agree) or (2) any dispute in which a party declares, more than 30 days after receipt of a written Request for Mediation, mediation to be inappropriate to resolve that dispute and initiates a Request for Arbitration . . .

CP 299.

## **2. EY and KPMG Certified Billions of Fake Assets**

As auditors, EY and KPMG's job was to verify that the billions of dollars the Rye Funds claimed to have under the management of Madoff were real and properly valued. CP 4. As auditors, EY and KPMG were to act as the "public watchdog," with "ultimate allegiance" to investors like FutureSelect.

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility *transcending* any employment relationship with the client. The independent public accountant performing this special function *owes ultimate allegiance to the corporation's creditors and stockholders, as well as to investing public.*

*United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18, 104 S. Ct. 1495, 79 L. Ed. 2d 826 (1984); *In re Metro. Sec. Litig.*, 532 F. Supp. 2d 1260, 1301 (E.D. Wash. 2007) (citing *Haberman v. WPPSS*, 109 Wn. 2d 107, 125-26, 744 P.2d 1032 (1987)). EY and KPMG breached their public responsibility to act as the public watchdog for FutureSelect. Year after year, EY and KPMG claimed to have done their job, misrepresenting that they had conducted their audits in conformity with Generally Accepted Auditing Standards (“GAAS”), and falsely stating that the Rye Funds’ financial statements were “free of material misstatement” and were in accordance with Generally Accepted Accounting Principles (“GAAP”). CP 4, 21, 22-26.

In fact, EY and KPMG missed the largest misstatement in history. EY and KPMG could not perform the tests required under GAAS at Tremont because Tremont’s entire investment was in Madoff, and Madoff prepared and controlled all of the information regarding the investments. CP 27. Because Madoff had control over these assets, the auditors could comply with GAAS by either obtaining assurance that they could rely on Madoff’s information or auditing Madoff’s operations themselves—they did neither. CP 27-29.

EY and KPMG did not perform the testing that was required under GAAS. CP 707, 27. Because the auditors failed to do so and because they

had no basis to rely on the information supplied by Madoff, EY and KPMG had insufficient audit evidence to conduct the audits and issue their unqualified opinions on the Rye Funds' financial statements. CP 28. In fact, if KPMG had performed the required procedures, it would have discovered the Madoff fraud. CP 29-30.

A jury already has determined that EY performed negligent audit work and negligently misrepresented that Tremont's financial statements were free of material misstatement, when in fact Tremont's financial statements were misstated by hundreds of millions of dollars. CP 707.

**C. FutureSelect's Claims Against KPMG**

FutureSelect filed its Complaint where it resides, where it was solicited, where it received and relied on KPMG's misrepresentations, and where it was injured—in Washington, and in the Superior Court. CP 8. FutureSelect's Complaint alleges a violation of the WSSA against KPMG, and seeks to hold KPMG liable under the WSSA. CP 38-39. The Complaint also alleges claims for negligent misrepresentation against KPMG. CP 46-47.

**D. KPMG's Arbitration Motion**

**1. KPMG's Arguments for Arbitration**

On December 8, 2010, KPMG moved to dismiss the claims against KPMG or in the alternative compel arbitration of FutureSelect's claims

based on the arbitration provision contained in the engagement agreement between KPMG and Tremont. CP 55. All other defendants also moved to dismiss. *FutureSelect I*, 175 Wn. App. at 856. Co-defendant and Tremont’s auditor prior to KPMG, Ernst & Young, had a similar arbitration clause in its own engagement letter with Tremont, but did not even move to compel arbitration. As to its argument for arbitration, KPMG claimed (i) that FutureSelect’s claim was derivative of Tremont; (ii) that FutureSelect was a third-party beneficiary to the agreement between KPMG and Tremont, or (iii) that FutureSelect is collaterally estopped from avoiding the arbitration agreement by a decision in the Southern District of New York compelling arbitration between John Dennis (“Dennis”), an investor in FutureSelect Prime Advisor, and KPMG. CP 74, 76-77.

**2. KPMG Admits the Contract Is Not Binding on FutureSelect**

In its Motion to dismiss or in the alternative for arbitration, KPMG admitted that the engagement letters between KPMG and Tremont—the ones containing the arbitration clause—were not binding on FutureSelect. Specifically, KPMG first conceded that not only was FutureSelect not a party to the engagement letters (CP 76), but that “there was no relationship resembling privity between KPMG and individual limited partners of the

Rye Funds, such as Plaintiffs. CP 82. But KPMG went even further: KPMG argued that FutureSelect was not even a third-party beneficiary under the engagement letters containing the arbitration clauses. “KPMG does not concede that Plaintiffs are third-party beneficiaries of the Engagement Agreement. *In fact, they were not.*” CP 76 n.9 (emphasis added). KPMG went still further, admitting that KPMG owed no contractual duty (or any duty) to FutureSelect: “KPMG owed no duty to Plaintiffs.” CP 76 n.9. Under KPMG’s own admissions, Plaintiffs cannot be compelled to arbitrate with KPMG.

### **3. The Court’s Check-the-Box Order**

KPMG submitted a proposed order to the King County Superior Court that literally had two check boxes—the first box to order arbitration and the second to dismiss. On June 3, 2011, the trial court checked the first box for arbitration, signed the proposed order, and crossed out the word “proposed” with a pen. CP 400-01.

### **E. All Other Rulings by the Trial Court Are Reversed**

FutureSelect filed a notice of appeal of the grant of KPMG’s motion to compel arbitration as well as all the orders granting KPMG’s co-defendants’ motions to dismiss. By Motion, this Court dismissed the appeal of the KPMG Order. On August 12, 2013, this Court unanimously reversed the trial court’s dismissal of all the remaining defendants.

*FutureSelect I*, 175 Wn. App. at 894-95. Rejecting the primary argument of the Defendants below, the Court found that Washington law applied based on the pleadings. *Id.* at 861-62. In July 17, 2014, the Washington Supreme Court unanimously affirmed. *FutureSelect II*, 180 Wn.2d at 972-74. Upon remand, the Superior Court also held that Washington law applied to the claims against accounting firm EY—the same claims asserted against accounting firm KPMG. Order Den. Def. Ernst & Young LLP’s Mot. For Summ. J., *FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, No. 10-2-30732-0 SEA (Wash. Super. Ct. Aug. 5, 2015), 2015 WL 8486478.

**F. EY’s Arbitration Motion Is Denied**

Upon its return to the trial court on September 3, 2014, accounting firm EY moved to compel arbitration based upon substantially identical arbitration clauses that accounting firm KPMG successfully relied upon. CP 402. EY, like KPMG, argued that FutureSelect should be bound to the arbitration agreements because it’s claims against EY were derivative claims on behalf of the Rye Funds and because FutureSelect was a third party beneficiary of the engagement agreements between EY and Tremont. CP 414, 417.

This time, the Superior Court of Washington for King County correctly denied the motion reversing itself on the same arguments. “The

court concludes that the Plaintiffs are not bound by the arbitration clause in EY's audit engagement agreements *because the Plaintiffs did not sign EY's agreements and their claims are direct claims against EY, not derivative claims.*" CP 678. The Court noted:

The Court of Appeals held that "FutureSelect's complaint adequately alleges WSSA claims against [EY]. Moreover, the complaint adequately alleges negligent misrepresentation claims against Tremont and Ernst & Young." 175 Wn. App. at 851 . . . On July 17, 2014, the Supreme Court affirmed the Court of Appeals' opinion. *FutureSelect Portfolio Management, Inc. v. Tremont Group, Inc., et al., v Tremont Group Holdings, Inc., et al.*, 180 Wn.2d 954, 331 P.3d 29 (2014).

CP 680-681. The Court went on to hold "In the case of non-signatories, '[t]raditional principles of state law determine whether a contract [may] be enforced by or against nonparties to the contract through . . . third-party beneficiary theories . . . and estoppel." CP 682.

The Court held that "inducement and misrepresentation claims are fundamentally direct" (CP 684), citing to the Washington Supreme Court's holding in this case that "[The complaint] alleged Ernst & Young made *direct misrepresentations* that FutureSelect relied on in maintaining and adding to its investment in the Rye Funds." CP 684.

The Court unequivocally stated that, "applying the *Tooley* test, the court concludes that [the allegations in the Complaint] sufficiently establish that: (1) EY had a direct and independent duty to the Plaintiffs

that is not merely derivative of EY's fiduciary duties as the Rye Funds' auditor, but rather arises from EY's alleged misstatements and professional incompetence; (2) the Plaintiffs' injuries are independent of any alleged injury to the Rye Funds; and (3) the Plaintiffs can prevail without showing an injury to the Rye Funds" and concluded "Plaintiffs' WSSA claims and their negligent misrepresentation claims are direct claims, and thus that the claims are not subject to the arbitration provisions in the EY-Tremont engagement letters." CP 686 (citing *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004).

The Court also held that Plaintiffs were not third-party beneficiaries to the engagement agreements, stating "the court sees no evidence that the signatories to the EY-Tremont engagement agreements intended that the Plaintiffs were to have any rights or obligations under the agreements . . . The court concludes Plaintiffs' WSSA claims and their negligent misrepresentation claims are not subject to the arbitration provisions in the EY-Tremont engagement letters based upon a third-party-beneficiary theory or based upon equitable estoppel." CP 687.

#### **IV. STANDARD OF REVIEW**

The Court reviews a trial court's decision to grant a motion to compel or deny arbitration de novo. *Adler v. Fred Lind Manor*, 153 Wn.

2d 331, 342, 103 P.3d 773 (2004). “Whether a particular litigant’s claim is subject to arbitration is a question of law.” CP 681.

## V. ARGUMENT

### A. FutureSelect Cannot Be Compelled to Arbitrate by KPMG

As the Superior Court most recently concluded in this action against accounting firm EY, FutureSelect’s claims against KPMG are not subject to arbitration because it has never agreed to arbitrate a dispute with KPMG. CP 678.

It is undisputed that FutureSelect was not a signatory to the engagement agreements on which KPMG relies, which were executed between KPMG and Tremont. Because “nonsignatories are not bound by arbitration clauses,” *Townsend v. Quadrant Corp.*, 173 Wn.2d 451, 460, 268 P.3d 917 (2012), FutureSelect cannot be compelled to arbitrate based on KPMG’s and Tremont’s agreement. *See also Satomi*, 167 Wn.2d at 810-811 (“[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.”) (citation omitted).

Moreover, the “strong policy favoring arbitration does not overcome the policy that one who is not a party to an agreement to arbitrate cannot generally be required to arbitrate.” *Woodall v. Avalon*

*Care Center-Federal Way, LLC*, 155 Wn. App. 919, 935, 231 P.3d 1252 (2010).

To avoid this bedrock law, KPMG has argued that Plaintiffs are nonetheless subject to *Tremont's* agreement to arbitrate with KPMG based on two limited exceptions to the general requirement that arbitration may only be compelled against a party that has agreed to it: (1) that FutureSelect's claims are derivative of Tremont, the entity that *did* agree to arbitrate claims; or (2) FutureSelect are third-party beneficiaries to KPMG's agreements with Tremont. In fact, neither exception applies.

**1. KPMG's Admissions Preclude Arbitration**

KPMG's own admissions preclude its arguments. KPMG admitted: (i) Plaintiffs were not signatories to the agreement to arbitrate; (ii) Plaintiffs were not in privity in any way with KPMG as a result of the Tremont/KPMG engagement letters; (iii) Plaintiffs were not third-party beneficiaries of the Tremont/KPMG engagement letters and (iv) KPMG did not owe any contractual or other duty to Plaintiffs. CP 76, 82, 366. These admissions preclude FutureSelect from being bound by the arbitration clauses in the engagement letters.

First, KPMG's third-party beneficiary argument obviously fails. KPMG cannot admit that FutureSelect is *not* a third-party beneficiary to the contract and then force a non-signatory to arbitration on the grounds

that FutureSelect is a third-party beneficiary. FutureSelect asserts non-contractual claims (negligent misrepresentation and the WSSA) and does not rely on the contract or assert it is a third-party beneficiary. CP 38, 46.

Second, KPMG cannot argue that FutureSelect is bound by the engagement letter's arbitration clause but then admit that KPMG owes no contractual duty to FutureSelect and that FutureSelect is not in privity with KPMG. Put another way, KPMG admits that FutureSelect received no benefits of any provision of the agreement and that KPMG owes no duty to FutureSelect, but that somehow FutureSelect is bound by one provision of the agreement: the arbitration clause. EY tried the same tactic and the Superior Court, given a second chance, rejected it. CP 687. KPMG argues that FutureSelect asserts a derivative claim—meaning FutureSelect stands in the shoes of KPMG audit client Tremont's Rye Funds—but admits this is impossible because KPMG concedes that FutureSelect is *not* Tremont under the contracts themselves that contain the arbitration clause. CP 76.

## **2. FutureSelect's Claims Are *Direct*, Not Derivative**

KPMG's admissions are correct because FutureSelect's claims are direct, not derivative, as a matter of law. Whether a claim is direct or derivative is a question of Delaware law. *Stevanov v. O'Connor*, No. 3820-VCP, 2009 WL 1059640, at \*6 (Del. Ch. Apr. 21, 2009) (“the

question of whether a claim is direct or derivative presents a question of law”); *Gentil v. Rossette*, 906 A.2d 91, 93 (Del. 2006) (“The issue presented on this appeal is one purely of law: can [plaintiff] bring a direct claim against [defendant], or is such a claim exclusively derivative?”).<sup>2</sup>

**a. Misrepresentation Claims Are Direct**

FutureSelect’s claims against KPMG are based on misrepresentations by KPMG inducing FutureSelect to invest in the Rye Funds. Courts have repeatedly held that inducement (like the WSSA claim) and misrepresentation claims, such as those at issue here, are fundamentally direct claims. *See, e.g.*, CP 684 (“inducement and misrepresentation claims are fundamentally direct”); *In re Adelphia Commc’ns Corp. Sec. & Deriv. Litig.*, No. 03 MDL 1529(JMF), 2013 WL 6838899, at \*4 (S.D.N.Y. Dec. 27, 2013) (“easily reject[ing]” Deloitte’s claim because “Plaintiffs are not seeking to recover for harms done to Adelphia; instead, they are seeking to recover for breaches of duties allegedly owed to them and that allegedly existed independent of their status as Adelphia shareholders”); *Albert v. Alex. Brown Mgmt. Servs., Inc.*, No. Civ.A. 762-N, Civ.A. 763-N, 2005 WL 2130607, at \*12-13 (Del. Ch. Aug. 26, 2005) (claims are direct where partners “lost their

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<sup>2</sup> The parties agree that Delaware law applies in determining whether a claim is direct or derivative.

opportunity to request a withdrawal from the Funds”); *AHW Inv. P'ship, MFS v. Citigroup Inc.*, 980 F. Supp. 2d 510, 516-518 (S.D.N.Y. 2013) (“[P]laintiffs’ injuries are not dependent on [the company’s] injury merely because the same misconduct might have harmed [the company]. . . . Indeed plaintiffs ‘can prevail without showing an injury to’ [the company] because the nature of the allegation is that the misstatements and omissions concealed damage to [the company’s] assets that had already been done.”) (citations omitted); *Poptech, L.P. v. Stewardship Inv. Advisors, LLC*, 849 F. Supp. 2d 249, 263-264 (D. Conn. 2012) (“Fraudulent inducement claims ‘are direct to the extent (and only to the extent) that they allege (1) violation of a duty owed to potential investors at large and (2) that such violations induced plaintiff to invest in [the corporation].’”)<sup>3</sup> (citations omitted).

More specifically, courts have refused to compel investors to arbitrate misrepresentation claims under KPMG’s arbitration agreements. In *KPMG LLP v. Cocchi*, 88 So. 3d 327 (Fla. Dist. Ct. App. 2012), the court held that claims based on misrepresentation and inducement claims were not subject to arbitration under KPMG’s engagement letters because

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<sup>3</sup> See also *Isakov v. Ernst & Young, Ltd.*, No. 3:10cv1517 (MRK), 2012 WL 951897, at \*11 (D. Conn. 2012); *Newman v. Family Mgmt. Corp.*, 748 F. Supp. 2d 299, 316 (S.D.N.Y. 2010); *Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC*, 922 A.2d 1169, 1181 n.54 (Del. Ch. 2006).

they were direct, not derivative. *Id.* at 330 (“Because the claims of negligent misrepresentation and violation of FDUTPA allege individual harm to the plaintiffs and involve torts directed at the individual limited partners, we conclude that the limited partners suffered individual harm.”) (citations omitted).

Moreover, courts addressing the specific misrepresentation claims at issue here—whether, under Delaware law, Madoff-related claims against auditors for inducement and misrepresentation are direct or derivative—have repeatedly confirmed that those claims are direct. *Askenazy v. KPMG LLP*, 988 N.E.2d 463, 466-469, 83 Mass. App. Ct. 649 (2013); *Cocchi*, 88 So. 3d at 330; *Saltz v. First Frontier, LP*, 782 F. Supp. 2d 61, 79-80 (S.D.N.Y. 2010); *Stephenson v. Citgo Grp., Ltd.*, 700 F. Supp. 2d 599, 611-612 (S.D.N.Y. 2010); *Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 372, 401 n.9 (S.D.N.Y. 2010).

**b. WSSA Claims Are Necessarily Direct**

Only buyers of securities can assert WSSA claims for false statements by a seller. RCW 21.20.430(1) (“Any person, who offers or sells a security . . . is liable *to the person buying* the security from him or her, who may sue . . .”). Tremont and the Rye Funds are only sellers of the securities at issue. KPMG impossibly argues that FutureSelect is asserting Tremont or the Rye Funds’ “derivative” WSSA claim against

KPMG—that FutureSelect stands in the shoes of Tremont or the Rye Funds. This is impossible. Tremont and the Rye Funds have no “buyer” WSSA claims to assert because they were never “buyers” and there is no such allegation in the Complaint or anything in the record otherwise.

Moreover, this Court and the Supreme Court already have held that virtually identical allegations in the complaint, against fellow auditor of the Rye Funds EY, state a WSSA “buyer” claim. *FutureSelect I*, 175 Wn. App at 870-871; *FutureSelect II*, 180 Wn.2d at 972. Still further, a sufficient factual record was developed at trial against EY to send FutureSelect’s WSSA “buyer” claim to the jury, which concluded that EY itself was a “seller” but found for EY on other grounds. CP 705.

Because FutureSelect’s WSSA claim cannot be a derivative claim of a seller under the statute itself, there is no basis to arbitrate the WSSA claim.

**2. FutureSelect’s Claims Are Not Derivative Claims of Tremont’s Rye Funds Under *Tooley***

In *this* case, under substantially identical circumstances (involving EY instead of KPMG), the trial court applied the *Tooley* test and held that Plaintiffs’ WSSA claims and negligent misrepresentation claims against EY were direct because the allegations “sufficiently establish that: (1) EY had a direct and independent duty to the Plaintiffs that is not merely

derivative of EY's fiduciary duties as the Rye Funds' auditor, but rather arises from EY's alleged misstatements and professional incompetence; (2) the Plaintiffs' injuries are independent of any alleged injury to the Rye Funds; and (3) the Plaintiffs can prevail without showing an injury to the Rye Funds." CP 686.

The reasons that the Superior Court in evaluating EY's substantially similar arbitration agreement, other courts evaluating KPMG's same arbitration agreement, and still more courts hearing Bernard Madoff feeder funds investor claims have so uniformly declined to compel arbitration—and the reason why arbitration cannot be compelled here—is simple. The cases all involve direct inducement and misrepresentation because (1) KPMG owed FutureSelect an independent duty; (2) the harm was suffered by FutureSelect; and (3) the recovery will be awarded directly to FutureSelect. *Tooley*, 845 A.2d at 1035. Each of these *Tooley* factors compel the conclusion, as a matter of law, that FutureSelect's claims are direct.

**a. KPMG Owed FutureSelect an Independent Duty**

FutureSelect alleged and will prove that KPMG owed a duty *to FutureSelect*, KPMG made misrepresentations *to FutureSelect* in breach of that duty, *FutureSelect* relied on those misrepresentations in making *FutureSelect's* investment decisions, and as a result, *FutureSelect* was

damaged. Only FutureSelect suffered the damage alleged in the complaint and only FutureSelect would benefit from any recovery from these claims.

To satisfy the first prong of the *Tooley* test, Plaintiffs “must demonstrate that the duty breached was owed to [it] and that [it] can prevail without showing an injury to the corporation.” *Tooley*, 845 A.2d at 1039. The touchstone is whether KPMG owed an independent duty to FutureSelect. *Askenazy*, 988 N.E.2d at 467. Here, KPMG’s duties arise from the misrepresentations and omissions it made to FutureSelect, and these duties are owed directly to FutureSelect.

The Washington Supreme Court, in addressing EY’s motion to dismiss, found that the complaint “alleged Ernst & Young made **direct misrepresentations** that FutureSelect relied on in maintaining and adding to its investment in the Rye Funds.” *FutureSelect II*, 180 Wn.2d at 961-62. The relevant allegations in the complaint regarding KPMG’s misrepresentations are substantially identical to those relied on by the Washington Supreme Court regarding EY, including:

79. . . . The Auditors [including KPMG] misrepresented that they had conducted audits in conformity with GAAS . . . .

96. KPMG knew Plaintiffs were receiving and relying on its audits of the funds. Each audit was addressed to the “Partners” of the fund, which . . . KPMG knew included Plaintiffs. In fact, for each audit, KPMG sent Prime Advisor II, the Merriwell Fund and Telesis IIW

requests for confirmation of their investment as Partners of Broad Market, Broad Market Prime and Broad Market XL.

97. In each audit, KPMG stated that the funds' financial statements were "free of material misstatement" and were in accordance with generally accepted accounting principles. Those statements and the financial statements were false.

98. Each year KPMG certified that the Rye Funds' assets were real. However, none of those assets existed.

102. KPMG was grossly negligent when it certified that the Broad Market, Broad Market Prime and Broad Market XL funds had hundreds of millions of dollars . . . . The funds never had any of the assets KPMG certified as real year after year.

119. . . . KPMG knew that FutureSelect would rely on the audit opinions they sent to FutureSelect on the Rye Funds' financial statements—each auditor addressed every audit to the "Partners" of the fund, of which FutureSelect was one.

153. KPMG made untrue statements of material facts and engaged in acts of fraud and deceit upon FutureSelect regarding Madoff and the Rye Funds that were a substantial factor contributing to FutureSelect's investment in the Rye Funds such that KPMG was a seller of a security in violation of RCW 21.20.010

157. . . KPMG knew and intended that FutureSelect would rely on its misrepresentations when it invested in the Rye Funds.

158. FutureSelect reasonably and justifiably relied on KPMG's misrepresentations when it invested in the Rye Funds.

210. . . . KPMG owed FutureSelect the duty to use reasonable care, or the competence or skill of a professional

independent auditor, in . . . rendering audit opinions that were addressed and distributed to FutureSelect . . . KPMG knew that FutureSelect would rely upon its audit reports in purchasing and retaining ownership interests in the Rye Funds.

211. . . . KPMG supplied information for the guidance of others, including FutureSelect that was false . . . KPMG informed FutureSelect that it had conducted audits on the Rye Funds in accordance with GAAS . . . . KPMG also omitted material facts . . . .

212. KPMG knew and intended to supply such information for the benefit and guidance of FutureSelect in making its investment decisions regarding the Rye Funds.

213. KPMG knew and intended to supply such information to influence FutureSelect in making its investment decisions regarding the Rye Funds.

214. KPMG was negligent . . . in communicating such false information.

216. FutureSelect has been damaged by KPMG's dissemination of false information . . .

CP 21, 24-27, 30, 38-39, 46-48.

The independent duty of the auditor has been specifically recognized in other Madoff cases. *Askenazy*, 988 N.E.2d at 654 (auditors owe “duty to each plaintiff that is not merely derivative of KPMG’s fiduciary duties as the Rye Funds’ auditor, but rather arises from KPMG’s misstatements and professional incompetence.”); *AHW Inv.*, 980 F. Supp.2d at 517; *Adelphia*, 2013 WL 6838899, at \*4.

KPMG's duty to FutureSelect is independent of any contract with KPMG's audit client, Tremont. *See Askenazy; AHW Inv.; Adelpia, supra.* The United States Supreme Court, as cited by the Eastern District of Washington, holds that auditors like KPMG act as the "public watchdog" and owe "ultimate allegiance" to the public, including investors like FutureSelect. *United States v. Arthur Young*, 465 U.S. 805, 817-18 (1984) ("This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust."); *In re Metropolitan Sec. Litig.*, 532 F.Supp.2d 1260, 1301 (E.D. Wash. 2007) (holding that an "auditor . . . assum[es] a *public responsibility transcending any employment relationship with the client*").

KPMG owed a specific duty to FutureSelect that was independent of any contractual or other duty owed to Tremont or the Rye Funds. FutureSelect has not alleged, nor will it endeavor to prove, that KPMG owed any duty to Tremont, that KPMG made any misstatements to Tremont, or that Tremont relied on KPMG's misrepresentations to their detriment in any way.

**b. FutureSelect, and Not Tremont, Suffered the Harm**

Ordinarily, the determination of who suffered a harm concerns whether an investor (here, FutureSelect) can demonstrate that it can prevail without regard to any injury suffered by the company (here, Tremont). *See Tooley*, 845 A.2d at 1036 (“Looking at the body of the complaint and considering the nature of the wrong alleged and the relief requested, has the plaintiff demonstrated that he or she can prevail without showing an injury to the corporation?”). The evaluation here is simpler because *only* the Rye Funds investors were injured.

FutureSelect—and fellow investors—suffered harm as a result of KPMG’s misstatements. FutureSelect was induced to invest as a result of KPMG’s misrepresentations and omissions *to FutureSelect*. *See Albert*, 2005 WL 2130607, at \*12; *Askenazy*, 988 N.E.2d at 467 (negligent misrepresentation claims against auditor involved individualized harm independent of harm to the Rye Funds); *Stephenson*, 700 F. Supp.2d at 611-612; *Cocchi*, 88 So. 3d at 330; *Poptech*, 849 F. Supp. 2d at 263.

Moreover, FutureSelect’s injuries are not dependent on *any* injury suffered by Tremont. To whatever extent Tremont *was* harmed by KPMG’s misrepresentations to FutureSelect, the company’s injury is not the same as the investors’ injury “merely because the same misconduct

might have harmed [the company]. . . . Indeed, plaintiffs can prevail without showing an injury to [the company] because the nature of the allegation is that the misstatements and omissions concealed damage to [the company's] assets that had already been done.” *AHW*, 980 F. Supp. 2d at 517.

In fact, that is exactly what the Superior Court held in *this* case in evaluating the EY arbitration clause. Noting that FutureSelect's nearly identical allegations against EY stated claims for direct damages to FutureSelect, the Court held that “the Plaintiffs’ injuries are independent of any alleged injury to the Rye Funds.” CP 686. The same is true here.

**c. Recovery Will Be Awarded Directly to FutureSelect**

That FutureSelect will “receive the benefit of the recovery or other remedy,” *Tooley*, 845 A.2d at 1035-36, has already been proved: In a like action against fellow auditor EY, FutureSelect was awarded damages on its behalf for misrepresentations made by EY to FutureSelect, independent of any injury to Tremont. CP 701-711. The payment went to FutureSelect, not Tremont. CP 701-03.

This case is no different. Here, any recovery on FutureSelect's claims would be awarded directly to FutureSelect, *not to the partnership*, and thus, it alone will receive the benefit of any remedy. *Tooley*, 845 A.2d

at 1036; *Albert*, 2005 WL 2130607, at \*13 (“the [investors] would receive any recovery, not the Funds”); *Isakov*, 2012 WL 951897, at \*11 (“Necessarily, recovery on a claim based on such inducement would flow only to those individuals who were so induced.”); *Newman*, 748 F. Supp. 2d at 316 (recovery flows to those investors who were induced); *Stephenson*, 700 F. Supp. 2d at 611-12. That FutureSelect alone will receive any recovery from this action is fatal to KPMG’s argument that the action is derivative.

### **3. Plaintiffs Are Not Third-Party Beneficiaries to the Agreement**

KPMG’s second argument, that FutureSelect is a third-party beneficiary of KPMG’s engagement letter with Tremont is specious by KPMG’s own admission: “KPMG does not concede that Plaintiffs are third-party beneficiaries of the Engagement Agreement. **In fact, they were not.**” CP 76, n.9 (emphasis added). KPMG is correct: As a matter of law, FutureSelect is not a third-party beneficiary of the engagement letters and are not bound by their terms.<sup>4</sup>

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<sup>4</sup> To avoid reality, KPMG claims that FutureSelect *alleged* that it was a third-party beneficiary to the agreement. Even if those allegations could avoid reality, FutureSelect did not so allege. The mere fact that FutureSelect relied on the statements and omissions of KPMG and that KPMG knew that investors would do so does not, as a matter of law, make FutureSelect a third-party beneficiary of the agreement. *See* CP 14, 24-25 (FutureSelect invested in Rye Funds in reliance on KPMG’s audits; KPMG knew that FutureSelect would receive and rely on its audits), 20-21 (FutureSelect received and relied on the Rye Funds’ audited financial statements). FutureSelect never made any allegations that it was a third-party beneficiary, nor any allegations about its rights under

To prove that FutureSelect was a third-party beneficiary to the agreements, KPMG would have to prove that both KPMG and the Rye Funds intended to create a third-party beneficiary contract. *Postlewait Constr., Inc. v. Great Am. Ins. Cos.*, 106 Wn.2d 96, 99, 720 P.2d 805 (1986) (“[T]he creation of a third-party beneficiary contract requires that the parties intend that the promisor assume a direct obligation to the intended beneficiary at the time they enter into the contract.”); *Comer v. Micor, Inc.*, 436 F.3d 1098, 1102 (9th Cir. 2006) (no third-party beneficiary status where contract does not evidence an intention of the parties to the contract to benefit the third-party). Neither party has alleged any intentions of KPMG or the Rye Funds at the time they entered into the engagement agreements. Therefore, FutureSelect cannot be considered a third-party beneficiary to the engagement letters, and the arbitration agreement is not enforceable against it.

Moreover, even if FutureSelect was a “third-party” to and a “beneficiary” of the engagement agreements, it could not be bound to the arbitration clause. While a third-party beneficiary may have rights under a contract, he cannot be bound to that contract if he was not a party to it. *Comer*, 436 F.3d at 1102 (“A third party beneficiary might in certain

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the agreements between Tremont and KPMG because FutureSelect does not assert any claim under the engagement agreements.

circumstances have the power to sue under a contract; it certainly cannot be *bound* to a contract it did not sign or otherwise assent to.”) Only when a third party-beneficiary sues under the terms of the contract may he be bound to that contract. *Lagrone Const., LLC v. Landmark, LLC*, 40 F. Supp. 3d 769, 781 (N.D. Miss. 2014) (“Third party beneficiaries are not bound to an arbitration clause if they sue on legal theories that do not seek to enforce terms of the contract.”); *Fleetwood Enters., Inc. v. Gaskamp*, 280 F.3d 1069, 1075 (5th Cir. 2002) (“A nonsignatory can only be bound by the terms of an arbitration provision in an agreement if the nonsignatory is asserting claims that require reliance on the terms of the written agreement containing the arbitration provision.”); *R.J. Griffin & Co. v. Beach Club II Homeowners Ass’n*, 384 F.3d 157, 164 (4th Cir. 2004) (“[Plaintiff], in asserting its claims, is not seeking a direct benefit from the provisions of the general contract it did not sign, and the doctrine of equitable estoppel cannot be used to force [Plaintiff] to arbitrate.”); *Woods v. Christensen Shipyards, Ltd.*, No. 04-61432-CIV, 2005 WL 5654643, at \*5 (S.D. Fla. Sept. 23, 2005) (“While Elin Woods arguably is a third party beneficiary under the Contract . . . she is not invoking any benefits under the Contract and therefore cannot be held bound by any of the burdens of the Contract”).

Because FutureSelect's claims are based entirely on misrepresentations KPMG made to FutureSelect, and not on terms of KPMG's agreements with the Rye Funds, FutureSelect's claims are not subject to the terms of those agreements, including the arbitration clause.

**B. FutureSelect Is Not Collaterally Estopped**

KPMG's collateral estoppel argument fails on so many independent grounds it is not clear that KPMG will make the argument on appeal. If it does, the Court should quickly reject it. An investor in FutureSelect, John Dennis, purported to sue KPMG derivatively in New York federal court on behalf of FutureSelect Prime Advisors (one of three plaintiffs in this case) for breach of fiduciary duty and malpractice. *In re Tremont State Law Action*, No. 08-CV-11183 (S.D.N.Y., filed Apr. 20, 2009) (the "Dennis Case"). The Court sent the admittedly derivative claims that could only be asserted by the Tremont Rye Funds and not by FutureSelect to arbitration. This has no bearing on this case.

First, Dennis *admitted his claims were derivative*, unlike the misrepresentation and WSSA claims here. CP 484. Second, Dennis asserted different claims with a different direct/derivative analysis, which precludes the finding of collateral estoppel as a matter of law. Third, Dennis asserted claims *that FutureSelect could not assert in this action*. Because FutureSelect is not the audit client, it cannot assert a malpractice

claim. Instead, it must assert a negligent misrepresentation claim under Section 552 of the Restatement. *FutureSelect I*, 175 Wn. App. at 884-885. This again precludes collateral estoppel. Fourth, two of the plaintiffs here were not plaintiffs in that case. Fifth, Mr. Dennis' claims were held "subject to mandatory arbitration" in a single page order from the Southern District of New York ("Dennis Order") that did not even decide whether Dennis' different claims were derivative or any basis for compelling arbitration, precluding the legal comparison required for collateral estoppel under Washington law. CP 464.

For the Dennis Order to collaterally estop FutureSelect in this case, however, KPMG bears the burden of demonstrating that (1) the issue decided in the earlier proceeding is identical to the issue here; (2) the plaintiffs in this case (*i.e.*, FutureSelect) were a party to, or in privity with, a party to the earlier proceeding; and (3) applying collateral estoppel would not work an injustice against Plaintiffs. *State v. Williams*, 132 Wn.2d 248, 254, 937 P.2d 1052 (1997) ("The party asserting collateral estoppel bears the burden of proof") (citations omitted); *Christensen v. Grant Cty. Hosp.*, 152 Wn.2d 299, 307, 96 P.3d 957 (2004). KPMG cannot meet its burden of proving any of these.

**1. The Issues Decided in the Dennis Case Are Not “Identical” to the Issues in This Case**

KPMG must prove by “‘competent evidence’ that the issue presented in [this action] was identical in all respects to the issue decided in the prior proceeding, including the applicable legal rules.” *LeMond v. Dep’t of Licensing*, 143 Wn. App. 797, 806, 180 P.3d 829, 834 (2008) (citations omitted). They are not.

**a. Dennis Asserted Different Claims With a Different Derivative Analysis Than the Washington Claims in This Case**

In the Dennis Case, Dennis asserted claims for breach of fiduciary duty and malpractice “derivatively” on behalf of Tremont’s Rye Funds. As KPMG stated in the Dennis Case, “breach of fiduciary duty and professional negligence both depend on the existence of validity of the audit engagement agreement.” CP 650. Here, the opposite is true. FutureSelect’s claims under the WSSA and for negligent misrepresentation do *not depend* on the audit engagement letter. *FutureSelect I*, 175 Wn. App. at 884.

Moreover, because Dennis—unlike FutureSelect—admittedly brought a derivative claim, KPMG argued that “[a] plaintiff who brings a derivative lawsuit enjoys rights that are no greater than those of the entity on whose behalf the plaintiff sues and is bound by any agreements the entity has entered into, including arbitration agreements.” CP 650. Here,

KPMG argues *just the opposite*: That FutureSelect is *not in privity* with KPMG, that FutureSelect is *not a third-party beneficiary* and that KPMG owes *no contractual duty* to FutureSelect. CP 76, 82, 366.

Delaware law also reviews breach of fiduciary duty/negligence claims differently than misrepresentation claims for purposes of whether the claims are direct or derivative. While breach of fiduciary duty and negligence claims are often held derivative, the misrepresentation claims brought by FutureSelect are *not derivative*. *Askenazy*, 988 N.E.2d at 654; *AWH*, 980 F. Supp. 2d at 517; *Adelphia*, 2013 WL 6838899, at \*4.

Because Dennis asserted different claims with a different analysis, KPMG cannot prove that “the issue presented in [this action] was identical in all respects to the issue decided in the prior proceeding, including the applicable legal rules.” *LeMond*, 143 Wn. App. at 806.

**b. Arbitrability Analysis Is Different for the Different Claims**

The arbitrability analysis in the two actions is different because the causes of action are different. Dennis’s claims against KPMG were for breach of fiduciary duty and malpractice (CP 580, 589) where the claims FutureSelect now brings in Washington against KPMG are for negligent misrepresentation and violations of the WSSA. CP 210.

Because the causes of action at issue in the two actions are different, the arbitrability issues are necessarily different. The issue of arbitrability of each individual claim is determined separately.

*Campaniello Imports, Ltd. v. Saporiti Italia S.p.A.*, 117 F.3d 655, 666 (2d Cir. 1997) (“In reviewing the District Court’s determination concerning the arbitrability of appellants’ claims, the court . . . must determine whether the scope of the agreement encompasses the claims asserted.”) (citations omitted); *Rosen v. Mega Bloks Inc.*, 2007 WL 1958968, at \*8 (S.D.N.Y. July 6, 2007) (“Case law contemplates the examination of the arbitrability of each ‘particular claim’ separately.”); *KPMG LLP v. Cocchi*, 132 S. Ct. 23, 24, 181 L. Ed. 2d 323 (2011) (“[S]tate and federal courts must examine with care the complaints seeking to invoke their jurisdiction in order to separate arbitrable from nonarbitrable claims.”); *id.* at 26 (“The Court of Appeal listed all four claims, found that two were direct, and then refused to compel arbitration on the complaint as a whole because the arbitral agreement ‘would not apply to the direct claims.’ . . . [T]he Court of Appeal should examine the remaining two claims to determine whether either requires arbitration.”) (citations omitted).

**c. The Issues Are Not Identical Because the Dennis Court Never Decided the Issues in This Case**

As a matter of law, the Dennis Court never decided the issue of whether WSSA and negligent misrepresentations claims brought by FutureSelect are subject to mandatory arbitration, because FutureSelect's WSSA and negligent misrepresentation claims were not brought in the Dennis Case. Because arbitrability of FutureSelect's negligent misrepresentation and WSSA claims was never decided in the Dennis Case, KPMG cannot prove by competent evidence that the issues decided in the Dennis Case were identical to the issues presented here.

Finally, enforceability as to each claimant creates separate issues among the two actions. In determining whether an arbitration agreement is enforceable, courts must determine whether the parties agreed to arbitrate. *Genesco, Inc. v. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 844 (2d Cir. 1987) (“[A] court asked to stay proceedings pending arbitration . . . must determine whether the parties agreed to arbitrate . . . .”) (citations omitted). The Court did not, therefore, find all factors necessary to determine the issue of whether the arbitration agreement was enforceable as to FutureSelect.

The Dennis Court's one-page order is plainly insufficient to establish identity of issues for purposes of collateral estoppel. *LeMond*,

143 Wn. App. at 806-07 (court's order in prior action providing "no delineation of the court's basis for its determination" did not provide sufficient clarity to allow collateral estoppel analysis).

**2. FutureSelect Was Not a Party to or in Privity With a Party to the Dennis Case**

KMPG also cannot prove that FutureSelect was a party to the Dennis Case or "in privity" with Dennis. The burden is on Defendant to show that the parties are identical or in privity. *Christensen*, 152 Wn.2d at 307.

For starters, Mr. Dennis was an investor in Prime Advisor. There are no allegations (or facts for that matter) that demonstrate his privity with either of the other two plaintiffs here, Merriwell and Telesis. Accordingly, even if Mr. Dennis were in privity with Prime Advisor, that would not be sufficient to compel Merriwell and Telesis into arbitration.

Even as to Prime Advisor, KPMG's lone claim to "privity" is that Mr. Dennis's claims were derivative on behalf of Prime Advisor. Even if true, it is not collateral estoppel to this case. Nonetheless, KPMG cannot even meet its burden to show that the different claims Dennis did assert are derivative. Even further, FutureSelect did not litigate the issue.

KPMG claims that Mr. Dennis's claims are derivative because Dennis "purported to bring derivative claims on its behalf." CP 69.

However, Dennis purporting to bring a derivative claim does not make it a derivative claim. *Anglo Am. Sec. Fund, L.P. v. S.R. Global Int'l Fund, L.P.*, 829 A.2d 143, 150 (Del. Ch. 2003) (“In every case the court must determine from the complaint whether the claims are direct or derivative and may not rely on either party’s characterization.”) The burden is on Defendant to show that the claims were, in fact, derivative—they were not.

To start with, Dennis had no standing to bring a derivative claim on behalf of Prime Advisor. To bring a proper derivative claim in New York, Dennis would have had to comply with Delaware’s Court of Chancery Rules for bringing derivative actions. *Frankel v. Am. Film Technologies, Inc.*, 675 N.Y.S.2d 837, 839, 177 Misc. 2d 279 (N.Y. Sup. Ct. 1998) (“[B]ecause the Corporation is incorporated in the State of Delaware, the relevant substantive law to be applied in this shareholders derivative suit is the law of Delaware . . . The Delaware Chancery Court Rules set forth the requirement of a demand to a Board of Directors before a shareholders derivative action may be commenced.”).

“For example, if an action is derivative, the plaintiffs are then required to comply with the requirements of Court of Chancery Rule 23.1, that the stockholder: (a) retain ownership of the shares throughout the litigation; (b) make presuit demand on the board; and (c) obtain court

approval of any settlement.” *Tooley*, 845 A.2d at 1036. This rule prevents individual partners from improperly usurping the power of the partnership to litigate, as Defendant suggests happened here. *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d 726, 730 (Del. 1988) (“Because the shareholders’ ability to institute an action on behalf of the corporation inherently impinges upon the directors’ power to manage the affairs of the corporation the law imposes certain prerequisites on a stockholder’s right to sue derivatively.”) (citations omitted); *In re Ezc Corp Inc. Consulting Agreement Derivative Litig.*, No. 9962-VCL, 2016 WL 440800, at \*7 (Del. Ch. Jan. 15, 2016) (“Under these controlling Delaware precedents, until the derivative action passes the Rule 23.1 stage, the named plaintiff does not have authority to sue on behalf of the corporation or anyone else . . . The only plaintiff legitimately in the case at that point is the stockholder plaintiff.”).

KPMG has not alleged that Dennis took any of the requisite steps sufficient to give him standing to act on behalf of Prime Advisor. Moreover, to show that Mr. Dennis’s claims are derivative, KPMG must show that (i) Prime Advisor, not Dennis, suffered the harm alleged in Dennis’s complaint; and (ii) Prime Advisor, not Dennis, would receive the benefit of any recovery or other remedy. *Tooley*, 845 A.2d at 1035.

Defendant has failed to even speculate on either of these crucial elements in determining whether Dennis's claims against KPMG were derivative.<sup>5</sup>

**3. FutureSelect Did Not Have Full Opportunity to Litigate the Enforceability of the Arbitration Clause**

FutureSelect brought no claims against KPMG in the S.D.N.Y. Case. KPMG moved to compel arbitration between itself and the claimants against it. As FutureSelect had no claims against KPMG, it had no standing to oppose KPMG's Motion to Compel Arbitration of the claims against it. *Farrell v. Burke*, 449 F.3d 470, 494 (2d Cir. 2006) ("Federal courts as a general rule allow litigants to assert only their own legal rights and interests, and not the legal rights and interests of third parties.") "The doctrine of collateral estoppel may not be applied to preclude a party from litigating an issue in a subsequent proceeding if that party had no opportunity in the prior proceeding to fully litigate that issue." *Everett v. Abbey*, 108 Wn. App. 521, 532, 31 P.3d 721 (2001).

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<sup>5</sup> KPMG argues that Plaintiffs somehow agreed that Dennis could bring claims on its behalf. CP 69-70. The letter cited by KPMG, however, was dated before Dennis filed any claims. CP 285. Clearly, Plaintiffs could not have acquiesced to a lawsuit that had not yet been brought. The letter discussed class claims, not derivative claims. The letter also made clear that Plaintiffs were "exploring the possibility of bringing a lawsuit jointly with other large Tremont investors." CP 360. In no way does the letter relied on by KPMG demonstrate that Plaintiffs agreed to be a party to the S.D.N.Y. Case. In fact, Plaintiffs filed a motion to dismiss Mr. Dennis's claims because they did not consent to his acting on their behalf. CP 232.

**C. FutureSelect May Appeal the Arbitration Order Now**

KPMG has also moved to dismiss FutureSelect’s appeal on the ground that the appeal is premature and that the parties should first arbitrate their dispute before this Court determines validity of the Arbitration Order.<sup>6</sup> That argument is counter to logic and current law, and the motion should be denied.

In *Hill v. Garda CL Northwest, Inc.*, 179 Wn.2d 47, 54, 308 P.3d 635 (2013), *decided after FutureSelect was initially denied the right to appeal the KPMG Arbitration Order*, the Washington Supreme Court addressed a materially identical issue and found the obvious—that the interests of justice are served when appeal of an order compelling arbitration is heard *before* the parties go to the tremendous expense and effort of actually arbitrating:

When the trial court declines to compel arbitration, that decision is immediately appealable . . . . While we have never addressed whether the opposite is always true, similar considerations are at play. **If a court compels arbitration without deciding the validity of the arbitration clause, a party may be forced to proceed through a potentially costly arbitration before having the opportunity to appeal . . . .**

. . . **We find no support** in the rules of procedure or case law for the Court of Appeals’ decision to compel

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<sup>6</sup> FutureSelect will timely, and separately, submit an opposition to KPMG’s Motion to Dismiss the Appeal. This section references KPMG’s Motion to Dismiss and Declaration of George E. Greer in support of said Motion, filed in this court April 4, 2016.

arbitration without considering whether the arbitration clause is even valid.”

*Garda*, 179 Wn.2d at 54 (emphasis added).

The Supreme Court’s holding ran contrary to previous decisions of lower courts which had suggested that a party seeking to avoid arbitration did not have a right to appeal prior to final judgment, and in fact is contrary to this Court’s denial of discretionary review of the Arbitration Order. Consistent with Washington procedure, FutureSelect did once move for appellate review of the Arbitration Order. Greer Decl. Ex. B. KPMG moved to dismiss that motion, citing several cases arguing that parties opposing orders compelling arbitration were not entitled to appellate review of those orders as a matter of right,<sup>7</sup> (Greer Decl. Ex. C) and the Appellate Court denied the motion in its November 21, 2011 Order Denying Discretionary Review (“Denial of Review”). Greer Decl. Ex. D.

Since the Denial of Review, the Washington Supreme Court has clarified Washington law in *Hill* that a party opposing arbitration *has* a right to appellate review of the validity of an arbitration agreement, and articulated the logic behind that rule: that arbitrability is a threshold issue and there is no sense in making parties arbitrate if, as here, they ultimately

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<sup>7</sup> See KPMG Mot. to Dismiss at 4.

cannot be compelled as a matter of law to do so. There have been no Washington cases since the *Hill* decision which have declined review of an order compelling arbitration.

Moreover, to whatever extent appellate review was not available as a matter of right, the Appellate Court has the right to—and should—review its own previous decision and modify that decision in the interest of justice based on its current understanding of the law. RAP 2.5(c)(2) (“The appellate court may at the instance of a party review the propriety of an earlier decision of the appellate court in the same case and, where justice would be best served, decide the case on the basis of the appellate court’s opinion of the law at the time of the later review.”); *State v. Schwab*, 163 Wn.2d 664, 672-673, 185 P.3d 1151 (2008) (RAP 2.5(c)(2) “allows a prior appellate holding in the same case to be reconsidered where there has been an intervening change in the law.”) (citation omitted).

In light of *Hill*, which came after this Court’s Denial of Review, as well as the Superior Court’s own reversal of position in materially identical circumstances—*see* Order Denying EY’s Motion to Compel Arbitration (CP 678)—FutureSelect respectfully requests that its appeal of the Arbitration Order be heard as a matter of discretion and this Court’s inherent ability to revisit its prior rulings. *See, e.g., State v. Hathaway*,

161 Wn. App. 634, 651-52, 251 P.3d 253 (2011) (Where a “challenge is not properly before this court in this appeal as a matter of right . . . . RAP 1.2(c) permits us to waive or alter the rules of appellate procedure ‘in order to serve the ends of justice.’”).

Denying FutureSelect’s right to appeal the order compelling arbitration and forcing FutureSelect and KPMG into expensive and time consuming arbitration before having the opportunity to appeal would pose substantial undue burden on both parties. Forcing FutureSelect and its investor who lost millions to pay unnecessary arbitration fees and pay for arbitrators to have its case heard by this Court is exactly what the Supreme Court recognized makes no sense and is prejudicial. Moreover, requiring an arbitration would put further distance between the events causing this litigation—KPMG’s gross negligence—and the actual, legitimate trial that those events merit, prejudicing FutureSelect.

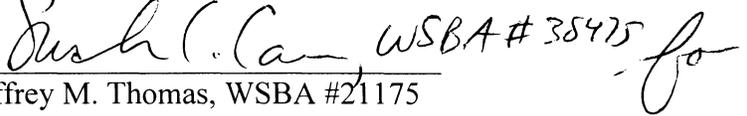
## **VI. CONCLUSION**

For the reasons above, FutureSelect respectfully requests that this Court reverse the trial court’s grant of KPMG’s motion to compel arbitration and remand to the trial court for further proceedings. Alternatively, FutureSelect respectfully requests that the Court reverse the trial court and grant FutureSelect leave to amend the Complaint to cure any defect.

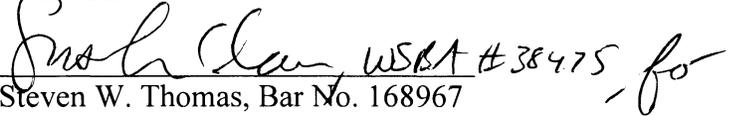
Dated: April 11, 2016

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**DECLARATION OF SERVICE**

The undersigned declares under penalty of perjury under the laws of the State of Washington that on the below date, I caused a true and correct copy of this document to be delivered via email and U.S. first class mail to:

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DATED this 11th day of April, 2016, at Seattle, Washington.

  
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