

FILED
JAN 19 2006

CLERK OF SUPREME COURT
STATE OF WASHINGTON
ajc

78128-1

RECEIVED
SUPREME COURT
STATE OF WASHINGTON

06 JAN 19 AM 9:36

SUPREME COURT NO. 78128-1 BY C. J. HERRITT

(COURT OF APPEALS, DIVISION III, NO. ~~22704-9-III~~)

CLERK

SUPREME COURT OF THE STATE OF WASHINGTON

KENNETH B. COOK,
a single man,

Petitioner,

v.

CLARK E. KINNEY, and BARBARA E. KINNEY,
individually and the marital community,

Respondents.

ANSWER TO PETITION FOR REVIEW

MARIS BALTINS, WSBA 9107
TAMARA W. MUROCK, 26324
BALTINS & MUROCK, P.S.
7 S. Howard Street, Suite 220
Spokane, WA 99201
Telephone: (509) 444-3336

TABLE OF CONTENTS

	Page
A. ISSUES PRESENTED FOR REVIEW	1
B. STATEMENT OF THE CASE	1
C. ARGUMENT	3
The decision of the Court of Appeals should not be reviewed as it does not conflict with another decision of the Court of Appeals and it does not involve an issue that should be determined by the Supreme Court.	3
1) The Court of Appeals applied the proper CR 12(b)(6) standards.	3
2) The Court of Appeals' decision is not in conflict with another decision of the Court.	4
a. The July 2000 transaction is a sale of a security within the meaning of the WSSA.	4
b. Cook is a seller of a security.	9
3) The Court of Appeals' decision does not involve an issue that should be determined by the Supreme Court.	13
D. CONCLUSION	14

TABLE OF AUTHORITIES

CASES

<u>Bravo v. Dolsen Companies,</u> 125 Wn.2d 745, 888 P.2d 147 (1995).	3
<u>Brin v. Stutzman,</u> 89 Wn.App. 809, 951 P.2d 291 (1998), <i>review den.</i> 136 Wn.2d 1004, 966 P.2d 901 (1998).	10, 11
<u>Cellular Engineering, Ltd. v. O’Neil,</u> 118 Wn.2d 16, 820 P.2d 941 (1991).	5, 6
<u>Douglas v. Stanger,</u> 101 Wn.App. 243, 2 P.3d 998 (2000).	5, 6, 7, 8, 14
<u>Fondren v. Klickitat County,</u> 79 Wn.App. 850, 905 P.2d 928 (1995).	3
<u>GO2NET, Inc. v. FREEYELLOW.COM, Inc.,</u> 126 Wn.App. 769, 109 P.3d 875 (2005).	8
<u>Haberman v. Washington Public Power Supply System,</u> 109 Wn.2d 107, 744 P.2d 1032, 750 P.2d 254 (1987).	10
<u>Helenius v. Chelius,</u> ___ Wn.App. ___, 120 P.3d 954 (2005).	6, 7
<u>Herrington v. Hawthorne, CPA, P.S.,</u> 111 Wn.App. 824, 47 P.3d 567, <i>amended on denial of recon.</i> 53 P.3d 1019 (2002).	9, 10
<u>Hines v. Data Line Systems,</u> 114 Wn.2d 127, 787 P.2d 8 (1990).	6, 10, 12
<u>Hoffer v. State,</u> 110 Wn.2d 415, 755 P.2d 781 (1988).	3

<u>Hoffer v. State,</u> 113 Wn.2d 148, 776 P.2d 963 (1989).	10
<u>ITO Corp. v. Prescott, Inc.,</u> 83 Wn.App. 282, 921 P.2d 566 (1996).	7
<u>Kittilson v. Ford,</u> 23 Wn.App. 402, 595 P.2d 944 (1979), <i>aff'd</i> 93 Wn.2d 223, 608 P.2d 264 (1980).	8
<u>McClellan v. Sundholm,</u> 89 Wn.2d 527, 574 P.2d 371 (1978).	6, 13
<u>Sauve v. K.C., Inc.,</u> 91 Wn.2d 698, 591 P.2d 1207 (1979).	7
<u>S.E.C. v. Glenn W. Turner Enters.,</u> 474 F.2d 476 (9 th Cir.), <i>cert. denied</i> , 414 U.S. 821 (1973).	5
<u>S.E.C. v. W. J. Howey Co.,</u> 328 U.W. 293 (1946).	6
<u>State v. Argo,</u> 81 Wn.App. 552, 915 P.2d 1103 (1996).	5, 6, 7, 13
<u>State v. Pederson,</u> 122 Wn.App. 759, 95 P.3d 385 (2004).	6
<u>State v. Philips,</u> 108 Wn.2d 627, 741 P.2d 24, <i>review granted</i> , 107 Wn.2d 1024, <i>aff'd</i> , 108 Wn.2d 627, 741 P.2d 24 (1987).	6
<u>Stewart v. Steiner,</u> 122 Wn.App. 258, 93 P.3d 919 (2004).	6
<u>Tcherepnin v. Knight,</u> 389 U.S. 332 (1967).	7

RULES AND STATUTES

CR 12(b)(6)	1, 3, 4
RAP 13.4(b)(4)	13
RCW 21.20.005(10)	5
RCW 20.20.005(12)(a)	4, 7
RCW 21.20.010	5
RCW 21.20.430(1)	11

A. ISSUES PRESENTED FOR REVIEW

Kenneth Cook (“Cook”) requests this Court review the following issues: whether the Complaint of Clark and Barbara Kinney (the “Kinneys”) states a claim for which relief may be granted and whether the Court of Appeals erred in reversing the trial court’s dismissal of the Kinneys’ suit under Civil Rule 12(b)(6).

B. STATEMENT OF THE CASE

This lawsuit arises from a July 2000 transaction in which the Kinneys’ paid Cook \$266,534.06 for their 50% interest in Freedom Truck Centers, Inc., formerly known as Spokane Freightliner, Inc. (hereinafter the “Company”). (CP 6) The facts and circumstances of the transaction are set forth in the Opening Brief of Clark E. Kinney and Barbara E. Kinney and the Reply to Brief of Respondent. The most pertinent facts can be briefly stated as follows:

* On January 6, 2000, while in sole control of the Company, Cook caused the Company to guarantee a \$4.5 million loan to his wholly owned limited liability company. (CP 8; CP 305)

* On July 11, 2000, a Judgment Upon Verdict was entered against Cook in the Spokane County Superior Court Cause No. 98-205964-2, for violations of the WSSA. Under the terms of the Judgment, the Kinneys

would recover shares in the Company upon tender of the consideration they received for the shares in 1997. The Promissory Note and Pledge Agreement were reinstated, and Cook was returned to the position of secured party and retained possession of the stock certificate evidencing the pledged shares. (CP 5; CP 40-47)

* On July 12, 2000, only one day after the Judgment, Cook demanded payment of \$266,534.06 from the Kinneys, without disclosing the existence of the \$4.5 million loan guarantee or that he was on the verge of forcing the Company into bankruptcy. (CP 6-7; CP 305)

* On July 26, 2000, after analyzing the Company's books and records, and thereby expecting to receive profits in return for their investment, the Kinneys paid Cook \$266,534.06 in exchange for their 50% interest in the Company. (CP 6)

* On August 4, 2000, Cook demanded the Kinneys sign personal guarantees on corporate loans and again failed to disclose the existence of the \$4.5 million loan guarantee. (CP 7)

* On February 6, 2001, Cook filed an Involuntary Chapter 11 Petition forcing the Company into bankruptcy. (CP 7-8)

* On August 15, 2001, Cook finally disclosed the existence of the \$4.5 million loan guarantee. It was at this time that the Kinneys learned

Cook withheld accurate corporate records and financial information that would have disclosed the guarantee. (CP 7-8)

C. ARGUMENT

The decision of the Court of Appeals should not be reviewed as it does not conflict with another decision of the Court of Appeals and it does not involve an issue that should be determined by the Supreme Court.

1) The Court of Appeals applied the proper CR 12(b)(6) standards.

To prevail on a CR 12(b)(6) motion, a defendant has the burden of establishing “beyond doubt that the plaintiff can prove no set of facts, consistent with the Complaint, which would entitle the plaintiff to relief.”

Fondren v. Klickitat County, 79 Wn.App. 850, 854, 905 P.2d 928 (1995);

Bravo v. Dolsen Companies, 125 Wn.2d 745, 750, 888 P.2d 147 (1995).

The plaintiff’s factual assertions are accepted as true. Bravo, 125 Wn.2d at 750.

Moreover, the motion should be granted sparingly and with caution in order to make certain that plaintiff is not improperly denied a right to have his claim adjudicated on the merits. Fondren, 79 Wn.App. at 854. A complaint survives a CR 12(b)(6) motion if *any* set of facts could exist that would justify recovery. Hoffer v. State, 110 Wn.2d 415, 421, 755 P.2d 781 (1988), *aff’d on reh’g*, 113 Wn.2d 148, 776 P.2d 963 (1989).

Cook acknowledges that the decision of the Court of Appeals relied upon the undisputed facts alleged in the Complaint. These undisputed facts set forth a claim upon which relief can be granted under the WSSA. The Court of Appeals did not err in holding Cook did not meet his burden to sustain a CR 12(b)(6) motion.

2. The Court of Appeals' decision is not in conflict with another decision of the Court of Appeals.

Cook asserts several arguments as to why he believes the Court of Appeals' decision conflicts with other Court of Appeals decisions. As the following discussion as well as the Kinneys' briefs filed with the Court of Appeals demonstrate, these arguments fall short of satisfying Cook's burden under CR 12(b)(6).

a. The July 2000 transaction is a sale of a security within the meaning of the WSSA.

The Court of Appeals correctly identified the security in this case to be the July 2000 transfer of the 50% interest in the Company in exchange for payment of \$266,534.06 to Cook. The promissory note was merely the medium of paying for that security.

Cook attempts to restrict the definition of a security to those items explicitly enumerated in RCW 21.20.005(12)(a), contrary to established case law. He argues that simply because the term "transaction" is not

among this list of what a security may include, the July 2000 transaction is not afforded the protections of the WSSA. This argument is contrary to clearly established and consistently applied Washington law.

The only requirement for a transaction to be afforded the protections of the WSSA is that it be “in connection with the offer, sale or purchase of any security, directly or indirectly.” *See* RCW 21.20.010.

The term “sale” or “sell” includes every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value. RCW 21.20.005(10). “Offer” or “offer to sell” includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.” *Id.*

Washington courts have repeatedly and consistently identified the primary policy of the WSSA is “to protect investors.” Douglass v. Stanger, 101 Wn.App. 243, 254, 2 P.3d 998 (2000). The securities acts are remedial in nature and are designed to protect investors from speculative or fraudulent schemes of promoters. Accordingly, both Washington and federal courts apply a broad definition to the term “security.” State v. Argo, 81 Wn.App. 552, 559, 915 P.2d 1103 (1996), *citing* S.E.C. v. Glenn W. Turner Enters., 474 F.2d 476, 480-81 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973); Cellular Engineering, Ltd. v. O’Neil,

118 Wn.2d 16, 23, 820 P.2d 941 (1991); State v. Philips, 108 Wn.2d 627, 631, 741 P.2d 24, *review granted* 107 Wn.2d 1024, *aff'd* 108 Wn.2d 627, 741 P.2d 24 (1987); *see also* McClellan v. Sundholm, 89 Wn.2d 527, 533, 574 P.2d 371 (1978); Douglass, 101 Wn.App. at 254; Helenius v. Chelius, ___ Wn.App. ___, 120 P.3d 954, 960 (2005). The courts construe the securities acts broadly in order to maximize protection for the investing public. *See* Hines v. Data Line Systems, 114 Wn.2d 127, 145, 787 P.2d 8 (1990). As explained by the Court in Stewart v. Steiner, 122 Wn.App. 258, 274, 93 P.3d 919 (2004), “We are mindful of the admonition that our state securities laws are to be interpreted liberally to achieve the desired effect of protecting investors.”

Washington appellate courts have consistently explained that the definition of a security “embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits.” Argo, 81 Wn.App. at 558-59, *citing* S.E.C. v. W. J. Howey Co., 328 U.S. 293, 299 (1946); *see also* State v. Pederson, 122 Wn.App. 759, 764, 95 P.3d 385 (2004). In determining whether an investment constitutes a security, “form should be disregarded for substance and the emphasis should be on economic reality.” Argo, 81

Wn.App. at 559, *citing Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *see also Sauve v. K.C., Inc.*, 91 Wn.2d 698, 701, 591 P.2d 1207 (1979); *ITO Corp. v. Prescott, Inc.*, 83 Wn.App. 282, 290, 921 P.2d 566 (1996); *Pederson*, 122 Wn.App. at 764.

The Legislature certainly cannot be expected to foresee the countless number of schemes that can be devised seeking the use of money of others on the promise of profits. RCW 21.20.005(12)(a) was therefore not intended to be an exhaustive list of what a security may include. Cook's argument to exclude the July 2000 transaction from the definition of a security merely because it is not specifically listed in RCW 21.20.005(12)(a) contradicts the very intent of the WSSA and is inconsistent with established and consistently applied Washington cases .

A court should avoid a strained or absurd result in interpreting a statute. *Helenius*, 120 P.3d at 962. In light of the clear dictate to interpret the definition of a security broadly and liberally, the July 2000 transaction is not excluded from the definition of a security.

Cook further argues that the decision of the Court of Appeals conflicts with *Douglass v. Stanger*, 101 Wn.App. 243, 2 P.3d 998 (2000). Cook would have this Court interpret *Douglass* as affording the protections of the WSSA only to holders of a promissory note. This

position not only misinterprets the Douglass holding, but also places form over substance and is contrary to the very essence of securities laws, i.e., to protect investors from speculative or fraudulent schemes of others.

In substance and effect, the July 2000 transaction was a disposition of a 50% interest in the Company in exchange for payment of valuable consideration. During the pendency of the first lawsuit, Cook secretly caused the Company to guarantee a \$4.5 million loan to his limited liability company. After losing the lawsuit, Cook concealed the Company's true financial condition and tricked the Kinneys into paying him \$266,534.06 for an interest in a company he had impossibly hobbled and knew was bankrupt. As the Court of Appeals correctly recognized, this is precisely the type of scheme the WSSA is designed to protect investors against.

The fact that the scheme, as devised by Cook, placed Cook in the position of note holder under which payment for the security was made, is irrelevant. The WSSA is a remedial statute that the courts will construe liberally "to suppress the evil and advance the remedy." GO2NET, Inc. v. FREEYELLOW.COM, Inc., 126 Wn.App. 769, 782-83, 109 P.3d 875 (2005), *citing* Kittilson v. Ford, 23 Wn.App. 402, 407, 595 P.2d 944 (1979), *aff'd* 93 Wn.2d 223, 608 P.2d 264 (1980).

Cook's application of the Douglass holding only to note holders is inconsistent with, and amounts to an inversion of, the policies underlying the securities laws. Such a limited application would protect the very individual the WSSA imposes liability upon, i.e., the individual who devised the scheme to use the money of others on the promise of receiving profits from a company. The Court of Appeals' decision is not in conflict with other Court of Appeals decisions.

b. Cook is a seller of a security.

Cook asserts that he cannot be held liable under the WSSA because title to the securities did not directly transfer from him to the Kinneys. He argues that the Company "was the seller and issuer of the shares for securities laws purposes." In effect, Cook requests this Court ignore the fact that he was in sole control of the Company and was the catalyst to the events giving rise to this lawsuit.

Washington courts will look beyond the façade and the manner in which title to the securities passes. As explained in Herrington v. Hawthorne, CPA, P.S., 111 Wn.App. 824, 47 P.3d 567, *amended on denial of recon.* 53 P.3d 1019 (2002):

Our Supreme Court rejected the "strict privity" approach that has since been adopted by the United States Supreme Court and other jurisdictions in favor of a "substantial factor-proximate cause" analysis. Thus, liability under the

WSSA is not limited to one who sells securities. Rather, one may be liable as a seller under the statute if one's acts were a "substantial contributive factor" in the transaction.

Id. at 830, *citing* Haberman v. Washington Public Power Supply System, 109 Wn.2d 107, 130-31, 744 P.2d 1032, 750 P.2d 254 (1987); *see also* Hoffer, 113 Wn.2d at 152.

A court must consider three factors in determining whether a defendant's conduct was a "substantial contributive factor" in the transaction:

- (1) the number of other factors which contribute to the sale and the extent of the effect which they have in producing it;
- (2) whether the defendant's conduct has created a force or series of forces which are in continuous and active operation up to the time of the sale, or has created a situation harmless unless acted upon by other forces for which the actor is not responsible; and
- (3) lapse of time.

Haberman, 109 Wn.2d at 131-32; *see also* Hines v. Data Line Systems, 114 Wn.2d 127, 148-49, 787 P.2d 8 (1990); Herrington, 111 Wn.App. at 831.

Cook's explanation that "liability is limited to actions or omissions by individuals from whom title to the securities directly passes" is a misstatement of Brin v. Stutzman, 89 Wn.App. 809, 830, 951 P.2d 291 (1998), *review den.* 136 Wn.2d 1004, 966 P.2d 901 (1998), the case he

references in his petition. In that case, Division I of the Washington State Court of Appeals stated:

[The] substantial contributing factor analysis simply expands the strict privity approach to sellers so as to include those parties who have attributes of a seller and thus who policy dictates should be subject to liability under RCW 21.20.430(1), but who would escape primary liability for want of privity.

Id. at 829. An individual is therefore a seller under the WSSA if he takes part in the sales process by acting as the “catalyst” between the seller and the buyer. *See Id.* at 830.

Cook is not the mere bystander he describes himself to be. He is not a minority shareholder at the mercy of a large company over which he exercises no control. He is not a defendant simply complying with the terms and conditions imposed upon him by the trial court and jury.

Before the jury’s verdict, Cook was in sole control of the Company and made the Company guarantee his \$4.5 million loan to his wholly-owned limited liability company. After the jury’s verdict, the Kinneys were reinstated as shareholders. (CP 5; CP 40-47) Not content with this result, Cook devised a plan to defraud the Kinneys. He concealed the \$4.5 million guarantee so that when the Kinneys had examined the Company’s books and records they would have no knowledge of the debt. Cook led the Kinneys to believe that the Company was financially viable and that

they could expect to share in its profits. (CP 6-7; CP 305) And he revealed the existence of the debt only after he tricked the Kinneys into paying him \$266,534.06, and after he forced the Corporation into bankruptcy. (CP 7-8)

Cook obviously did not want to share ownership in the Corporation with the Kinneys. However, if his actions were merely in reaction to the trial court and jury, he would have disclosed the \$4.5 million guarantee. The Kinneys would not have invested \$266,534.06 for a 50% interest in a bankrupt company.

Instead, Cook wanted to defraud the Kinneys. It was Cook, not the trial court or jury, who made the Company guarantee the \$4.5 million loan. It was Cook, not the trial court or jury, who concealed the guarantee. It was Cook, not the trial court or jury, who demanded the Kinneys pay him \$266,534.06 for a 50% interest in the Company he knew was bankrupt.

Cook was the "catalyst." It was his conduct that had the predominant effect of violating the WSSA. *See Hines*, 114 Wn.2d at 149. His claim that the Company was the seller of the securities and that the trial court and jury were the acting parties in the July 2000 transaction is wholly disingenuous. The fact that the Jury Verdict rescinded the previous sale of securities did not give Cook a license to violate the WSSA yet

again. Cook's potential liability as a seller of securities under the WSSA is consistent with other Court of Appeals' decisions.

- 3) The Court of Appeals' decision does not involve an issue that should be determined by the Supreme Court.

Cook argues this case should be reviewed by the Supreme Court because it involves a claim under the WSSA, which in turn, has a public policy of protecting Washington investors. Under this broad interpretation of RAP 13.4(b)(4), this Court would review all securities cases. This review is simply not necessary. As the above discussion clearly demonstrates, there is significant Washington statutory and case law to guide the courts and investors. The Court of Appeals' decision is consistent with that precedent.

Moreover, Washington courts look to federal law to determine the meaning of the term "security" under the Washington Act. Argo, 81 Wn.App. at 558; *see also* McClellan, 89 Wn.2d at 531. There is an abundance of federal statutory and case law to guide both courts and investors. The fact that this case involves an issue under the WSSA is not sufficient grounds for this Court's review.

Additionally, the Court of Appeals' decision creates no conflict or confusion. After carefully considering the oral arguments of counsel and their respective briefs, the Court of Appeals applied the WSSA in a

manner consistent with other Court of Appeals decisions. The only confusion Cook complains of is that caused by his strained and unreasonable interpretation of Douglass v. Stanger. As the numerous state and federal authorities demonstrate, Cook's interpretation of Douglass as promoting form over substance and, in effect, protecting the schemer and not his victims, is contrary to the underlying policy and purpose of the WSSA.

It is not necessary for this Court to clarify the WSSA or the effect of the decision of the Court of Appeals. As a result of the Court of Appeals' decision, individuals are put on notice that regardless of the countless schemes and designs they may contrive, they will be held accountable for their actions under the WSSA.

The facts of this case do not present an issue that should be determined by the Supreme Court. The law is clear and unambiguous, and there is significant authority to guide both courts and investors.

D. CONCLUSION

The Court of Appeals' decision does not conflict with other Court of Appeals decisions, and it does not involve an issue that should be determined by the Supreme Court. Petitioner's petition for appeal should be denied. Petitioner has failed to meet his burden under the limited

circumstances in which the Supreme Court will exercise its discretion to grant review.

DATED this 18~~th~~ day of January, 2006.

A handwritten signature in cursive script that reads "Tamara W. Murock". The signature is written in black ink and is positioned above a horizontal line.

MARIS BALTINS, WSBA #9107

TAMARA W. MUROCK, WSBA #26324

BALTINS & MUROCK, P.S.

Attorneys for Clark E. Kinney and

Barbara E. Kinney