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STATE OF WASHINGTON

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

Washington Court of Appeals Division Three

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.

PETITION FOR REVIEW

LAWRENCE R. SMALL, WSBA #2993
ERIN A. JACOBSON, WSBA #31717
PAINE, HAMBLIN, COFFIN,
BROOKE & MILLER LLP
717 W. Sprague Avenue, Suite 1200
Spokane, WA 99201-3505
(509) 455-6000

JOHN D. MUNDING, WSBA #21734
CRUMB & MUNDING, PS
601 W. Riverside Avenue, Suite 1950
Spokane, WA 99201-0628
(509) 624-6464

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I. IDENTITY OF PETITIONER

Kenneth B. Cook (“Cook”) petitions this Court for review of the Court of Appeals’ decision terminating review designated in Section II below.

II. COURT OF APPEALS DECISION

Cook seeks review of the decision filed by Division III of the Court of Appeals on November 22, 2005, reversing the trial court’s dismissal of Clark E. and Barbara E. Kinney’s (“Kinney”) suit against Cook. This published decision is attached. (App. 1-5).

III. ISSUES PRESENTED FOR REVIEW

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

IV. STATEMENT OF THE CASE

A. Factual background.

In December of 1993, Kinney and Cook agreed to form Spokane Freightliner, Inc. (the “Company”). (CP 4). The Company’s name now is Freedom Truck Centers, Inc. They agreed that each person would invest \$225,000 in the Company (a total of \$450,000) as equity in exchange for

fifty-percent of the shares of common stock issued by the Company. (CP 4).

Kinney borrowed his funds from Cook, as evidenced by a promissory note (the “1993 Note” or “Note”) issued by Kinney to Cook on December 31, 1993. (CP 4). In accordance with their agreement, Kinney used the money borrowed from Cook to purchase 50,000 shares of common stock of the Company. (CP 4). Kinney also signed a Pledge Agreement, pursuant to which Kinney pledged those shares of common stock to Cook as collateral to secure payment of the Note. (CP 92, 304). Cook purchased 50,000 shares and Kinney and Cook became equal shareholders of the Company.

Kinney and Cook remained equal shareholders of the Company until February 26, 1997. On that date, they entered into a Memorandum of Understanding that, among other things, provided for Cook’s purchase of Kinney’s shares and cancellation of the Note and Pledge Agreement. (CP 5). On September 15, 1998, however, Kinney brought a lawsuit against Cook and the Company in Spokane County Superior Court, alleging that the purchase of the shares from him by Cook violated the Washington State Securities Act (“WSSA”). (CP 5).

That lawsuit resulted in a jury verdict for Kinney on March 29, 2000. The Judgment on Verdict (the “Judgment”), prepared by counsel

for Kinney and entered by the Court on July 11, 2000, rescinded Cook's purchase of Kinney's shares, reinstated the 1993 Note, reinstated the 1993 Pledge Agreement, and reinstated Kinney as personal guarantor of the Company's debts. (CP 5, 41).

The Judgment entered by Judge Austin specifically stated:

1. For defendants' violation of Section 21.20.010 of the Securities Act of Washington, plaintiffs shall be entitled to the remedies provided for in RCW 21.20.430(2) as follows:

a. Defendants Kenneth B. Cook and Spokane Freightliner, Inc. shall return to Clark E. Kinney and Barbara E. Kinney 50,000 shares of Spokane Freightliner, Inc. common stock who shall deliver possession to the secured party (Kenneth Cook) under the Pledge Agreement dated December 31, 1993. In exchange for the return of the 50,000 shares of Spokane Freightliner, Inc. common stock, plaintiffs shall return to Spokane Freightliner, Inc. all consideration paid to them for the 50,000 shares of common stock. Said consideration consists of the following: (1) return to Kenneth B. Cook of the promissory note dated December 31, 1993 made by plaintiffs in favor of defendant Kenneth B. Cook, attached hereto as Exhibit "A" which is hereby reinstated, provided that no interest shall be payable on the promissory note during the period of the violation of the Washington Securities Act, from February 26, 1997 to the date of Judgment; (2) reinstatement of the Pledge Agreement dated December 31, 1993; (3) reinstatement

of officer receivables in the amount of \$48,654.77 as of February 26, 1997; (4) reinstatement of additional officer withdrawals in the amount of \$9,500.00 as of February 26, 1997; and (5) reinstatement of Clark E. Kinney and Barbara E. Kinney as guarantors of the debts of Spokane Freightliner, Inc.

(CP 41-42, emphasis added).

Kinney was represented by Maris Baltins in that litigation, as he is in this litigation. Kinney and his counsel have admitted repeatedly that the Judgment—and not some action by Cook—reinstated Kinney as a fifty-percent shareholder in the Company on July 11, 2000. (CP 92, 105, 151, 304). The Court of Appeals seems to have overlooked this important, undisputed fact. (App. 5).

On July 12, 2000, Cook delivered to Kinney a Notice of Default on the Note and demanded payment in full; this demand was made in accordance with the terms of the reinstated Note and Pledge Agreement. (CP 6, 304-05). In response to the Notice of Default, Kinney paid \$266,534.06 to Cook on July 26, 2000, in satisfaction of the 1993 Note. (CP 6). The debt incurred by Kinney finally was paid in full and the stock certificate held by Cook as a secured party was delivered to Kinney on or about July 28, 2000. (CP 6).

Kinney became a shareholder of the Company again when the Judgment was entered by the Court, not through any action taken by Cook. Kinney paid the debt he incurred in 1993, not to purchase the shares but to keep the shares. Cook had the right, under the Washington Uniform Commercial Code and the terms of the Pledge Agreement, to foreclose on Kinney's shares of common stock in the Company if Kinney failed to pay the 1993 Note upon maturity. See RCW 62A.9A-601. If the value of those shares as determined in the foreclosure process was less than the debt, Kinney would have been liable for the deficiency. Apparently, Kinney chose to pay the 1993 Note rather than risk becoming liable for a deficiency. The only action taken by Cook during this entire sequence of events was to demand payment of the Note. All other steps were taken by Kinney or by the Court in entering the Judgment.

B. Procedural background.

On April 30, 2003, Kinney brought the current action against Cook alleging a single cause of action for violation of the WSSA, specifically RCW 21.20.010. (CP 8). Kinney claimed that Cook violated the statute "in connection with the sale of the Company's common stock to Kinneys on July 26, 2000." (CP 8). Kinney's Complaint seems to specify the shares as the "security" involved in this transaction, as would be required for a transaction to be subject to the WSSA.

Cook brought a Motion to Dismiss for Failure to State a Claim under Civil Rule 12(b)(6); the trial court granted the motion, concluding that none of the facts alleged in Kinney's Complaint, nor in response to Cook's Motion to Dismiss for Failure to State a Claim, stated a claim under the WSSA. (CP 418-420).

Kinney appealed to Division III of the Court of Appeals, which reversed the trial court's dismissal in a published decision filed November 22, 2005. Cook now seeks review of that decision.

C. Civil Rule 12(b)(6) standard.

The appellate standard of review for an order on a Civil Rule 12(b)(6) motion is *de novo*. Port of Seattle v. Lexington Ins. Co., 111 Wn.App. 901, 906, 48 P.3d 334 (2002). Civil Rule 12(b)(6) provides that a complaint should be dismissed if it fails to state a claim upon which relief may be granted. CR 12(b)(6).

The question under this type of motion is primarily a legal question, with the "facts" considered as a conceptual backdrop for the legal determination. If none of the facts alleged in the complaint justify the recovery requested by the plaintiff, then the complaint should be dismissed for failure to state a claim. Reid v. Pierce County, 136 Wn.2d 195, 201, 961 P.2d 333 (1998). Furthermore, if the plaintiff cannot present a set of facts, consistent with the complaint, which would entitle

him to relief, the complaint should be dismissed. See Halvorson v. Dahl, 89 Wn.2d 673, 674, 574 P.2d 1190 (1978).

The Court of Appeals' decision relies only upon the undisputed facts alleged in the Complaint. Although a court may consider hypothetical facts in considering a Civil Rule 12(b)(6) motion, neither the trial court nor the Court of Appeals did so in this case.

Based on this standard, the trial court correctly concluded that none of the facts alleged in Kinney's Complaint, nor in response to Cook's Motion to Dismiss for Failure to State a Claim, stated a claim for violation of WSSA. (CP 418-420). The Court of Appeals erred in reversing the dismissal.

V. ARGUMENT IN SUPPORT OF REVIEW

The Court of Appeals' decision should be reviewed for two reasons. First, the decision conflicts with other Court of Appeals decisions. RAP 13.4(b)(2). Second, the decision involves an issue of substantial public interest that should be determined by the Supreme Court. RAP 13.4(b)(4).

A. The Court of Appeals' decision is in conflict with other Court of Appeals decisions.

Kinney's Complaint alleges a single cause of action for violation of the WSSA, specifically RCW 21.20.010. (CP 8). To state a claim

under this statute, Kinney has to allege facts showing that Cook made a misrepresentation or omission of material fact in connection with a sale of security. RCW 21.20.010. Kinney attempted to do so by alleging that Cook violated the statute “in connection with the sale of the Company’s common stock to Kinneys on July 26, 2000.” (CP 8).

This allegation fails to support Kinney’s claim for violation of the WSSA for three reasons: (1) The 1993 Note was not a security, and the 50,000 shares of common stock were not purchased by Kinney from Cook on July 26, 2000; (2) Cook was not a seller of securities on July 26, 2000, and (3) No sale occurred on July 26, 2000. Because there was no sale of a security, there could not have been a violation of the statute.

The trial court recognized these failures in Kinney’s Complaint, but the Court of Appeals reversed the trial court’s dismissal of the Complaint. In so doing, the Court of Appeals published a decision that is in conflict with other Court of Appeals decisions, all of which support dismissal of Kinney’s Complaint, as discussed below.

- (1) The Note was not a security, and the shares were not sold by Cook.

Although the broad definition of a “security” in RCW 21.20.005 includes the word “note”, the 1993 Note at issue here was not a security. Notes issued in a commercial context are not securities. By deciding that

Kinney's Complaint states a valid cause of action, the Court of Appeals necessarily determined that a security was present in the transaction described in the Complaint. The question, however, still is: What is the "security" that has to be present for WSSA to apply? The Court of Appeals agrees that a securities transaction "must involve one of the statutory definitions." (App. 4). The Court of Appeals quotes the WSSA definition of a security, but it does not answer the question! The Court of Appeals even makes the casual comment "when determining whether a transaction constitutes a security", form is disregarded for substance. A transaction is not a security.

Since the shares of common stock were transferred to Kinney by the Judgment, the Note is the only part of the transaction that could be a security. This is the position taken finally by Kinney in response to the Motion to Dismiss for Failure to State a Claim.

The family resemblance test, as applied in Douglass v. Stanger, 101 Wn.App. 243, 2 P.3d 998 (2000), is the proper test to determine whether the Note was a security under the WSSA definition. The family resemblance test is used to guide a court in deciding whether a note is a security in the hands of an investor and includes four considerations:

First, why did the seller and buyer enter into the transaction? Specifically, is the purpose of the transaction to raise money for a

business enterprise? Or is it, instead, for consumer goods or some other noncommercial reason? Second, is the note commonly traded for speculation or investment? Third, we look at the reasonable expectations of the investing public. What are the economic realities? Fourth, and finally, we look at whether another regulatory scheme significantly reduces the risk associated with the note and investment agreement and thereby renders application of the securities act regulation unnecessary.

Id. at 252-53. Legally, the test applied in Douglass is applicable.

Under the legal test, the 1993 Note does not resemble a security. The 1993 Note was issued in a commercial transaction in 1993 to evidence a loan from Cook to Kinney. (CP 4). Kinney immediately used the money borrowed from Cook to purchase half of the outstanding shares of common stock from the Company. (CP 4). The purpose of the transaction evidenced by the 1993 Note, however, was a simple loan of money. Furthermore, this 1993 Note is not the type that is traded in a securities market.

The parties in Douglass were in opposite positions from those here. Douglass was the party who loaned money in return for a note and an ownership interest in a business to be created by Stanger. Id. at 253-54. Douglass was the holder of the note; it was determined to be a security because it was issued as part of the transaction in which Douglass invested

money and expected to be a participant in the new business enterprise with Stanger. Id.

In the case of a promissory note, the investor is the note's holder—not its issuer. See, SEC v. Wallenbrock, 313 F.3d 532 (9th Cir. 2002). Douglass was the investor because he was the holder of the note.

In this case, Cook—not Kinney—is in the same position as Douglass. Cook, like Douglass, is the one who loaned money and held the 1993 Note. Cook is the investor whom the securities laws were meant to protect. Therefore, even if the 1993 Note is deemed to be a security under the family resemblance test, it is Cook who would be entitled to the protection of the securities laws.

Finding that Kinney is owed the protections of the WSSA because the Note is a security, as the Court of Appeals apparently held by allowing Kinney's suit to proceed, effectively turns the WSSA upside down. In adopting WSSA, the Washington legislature, as interpreted by the Court of Appeals in Douglass, intended the securities laws to protect those, like Cook, who permit others to use their money.

(2) Cook was not a seller of securities.

By holding that Kinney's Complaint states a valid cause of action, the Court of Appeals necessarily determined that Cook was a seller of

securities. That determination is an inappropriate application of Washington law to the facts of this case.

Under the WSSA, only those who offer or sell securities may be found liable for misrepresentation or omission of material facts. RCW 21.20.430(1); Shinn v. Thrust IV, Inc., 56 Wn.App. 827, 851, 786 P.2d 285 (1990), review denied 114 Wn.2d 1023, 792 P.2d 535 (1990). More specifically, liability is limited to actions or omissions by individuals from whom title to the securities directly passes. Brin v. Stutzman, 89 Wn.App. 809, 830, 951 P.2d 291 (1998), review denied 136 Wn.2d 1004, 966 P.2d 901 (1998).

Cook does not fit this definition of “seller” because he did not transfer shares of common stock to Kinney—in 1993 or in 2000. In 1993, Cook’s role in Kinney’s purchase of shares was limited to financially enabling Kinney to make the purchase of shares issued by the Company. The Company was the seller and issuer of the shares for securities laws purposes. Cook loaned Kinney money; he did not sell him a security.

The Judgment entered on July 11, 2000, returned Kinney to his former position as a shareholder. The trial court and jury were the acting parties. Kinney paid money to Cook in 2000 to satisfy a debt, not to buy securities. The shares were returned to Kinney when he was reinstated by the Judgment; he became a shareholder before he paid the Note. (CP 5,

41). The Pledge Agreement would have been worthless if Kinney had not been the owner of the shares. As stated by counsel for Kinney in the Response to Defendant's Motion to Dismiss (CP 304):

As the secured party under the Pledge Agreement, Cook retained possession of the stock certificate evidencing the Kinneys' interest in the Corporation.

Cook could not have been a seller of securities on July 26, 2000. He held the stock certificate as the secured party, not as the owner of the shares, and was the holder of the Note, not the payee. The Court of Appeals, by inference only, concludes that Cook was a Seller. (App. 5).

(3) No sale occurred on July 26, 2000.

By concluding that Kinney's Complaint states a valid cause of action, the Court of Appeals necessarily determined that a sale occurred on July 26, 2000. That determination is again an inappropriate application of Washington law to the facts of this case.

The Note was issued in 1993, and Kinney purchased his shares in the Company in 1993. (CP 4). Kinney sold his shares to Cook in 1997, but Kinney successfully fought for rescission of that sale in his first lawsuit against Cook on these issues. (CP 5). The Judgment in that case, entered on July 11, 2000, returned Kinney's shares and reinstated the

original Note. (CP 5, 41). Therefore, as of July 11, 2000, Kinney owned the shares that he claims to have “purchased” on July 26, 2000.

There is no authority to support Kinney’s theory that the payment of a note upon maturity is itself a new purchase of a security. Even if the 1993 Note was a security and Cook was a seller, the only transaction involving a security with any possible application of the WSSA occurred in 1993. A transaction is not a security. RCW 21.20.005(12)(a) does not include “transaction” in its definition of “security.” The applicable statute of limitations bars Kinney from suing on the 1993 transaction, and that is the only transaction that could arguably be considered a sale of securities. RCW 21.20.430(4)(b).

B. The Court of Appeals’ decision involves an issue of substantial public interest that should be determined by the Supreme Court.

To determine whether Kinney’s Complaint states a cause of action, the Court of Appeals had to determine under what circumstances a promissory note is a security. This determination has public policy ramifications, as discussed below, yet the issue has not been considered by the Supreme Court to date. Particularly considering the conflict with Douglass noted above, the Supreme Court should take this opportunity to clarify the test in Washington.

In Douglass, the Court of Appeals recognized that the test to determine whether a note is a security includes a public policy component, because the primary purpose of the WSSA is to protect investors in Washington. Douglass, 101 Wn.App. at 254. In Shinn, the Court of Appeals also recognized that, unlike federal securities laws, the WSSA's intent is to protect investors. Shinn, 56 Wn.App. at 850.

Because of this public policy component to the WSSA, under what circumstances a promissory note is a security under that law is necessarily an issue of public concern. To protect investors in Washington, as is the intent of the WSSA, investors need to know when they are in fact investors. In other words, investors must know whether, by holding and/or issuing a promissory note, they are making an investment that is protected by the WSSA.

The Court of Appeals' decision runs counter to this important public policy by muddying the test, rather than clarifying it. The Court of Appeals chose to publish its decision, thereby admitting the important public interest addressed by the decision. RAP 12.3(d). The decision, however, provides no guidance to future issuers and investors.

The Court of Appeals' decision is essentially a primer on basic securities law, followed by a brief conclusion that Kinney's Complaint should not have been dismissed by the trial court. The missing component

is the legal analysis applying that securities law to the facts of this case. In fact, the Court of Appeals did not even cite any of the cases relied on by either party, with the most important and glaring absence from citation being the Douglass case.

As discussed in Section A above, the Court of Appeals' decision conflicts with Douglass. Yet the Court of Appeals failed to recognize the significance of the Douglass case and, therefore, did not attempt to resolve the conflict. It chose to publish a decision involving an important issue that has the following vague conclusion (App. 5):

After reviewing the WSSA statutory definitions and other authority, Mr. Cook concludes that because there was not a violation of the WSSA, dismissal is appropriate. However, Mr. Cook moved for dismissal under CR 12(b)(6). Therefore, we decide only whether the plaintiffs stated a valid cause of action. Given these broad definitions and our accommodating attitude toward securities fraud victims, we cannot say that the Kinneys have failed to state a claim upon which relief can be granted. Dismissal was appropriate.

Investors are consequently left with confusion between this decision and the Douglass decision regarding the interpretation of this important public policy issue under the WSSA. This confusion must be resolved.

VI. CONCLUSION

The Court of Appeals' decision has two important flaws. First, the decision conflicts with other Court of Appeals decisions. RAP 13.4(b)(2). Second, the decision involves an issue of substantial public interest that should be determined by the Supreme Court. RAP 13.4(b)(4).

The Securities and Exchange Commission and state securities divisions understand that they have a responsibility to provide guidance to investors and issuers who are attempting to comply with state and federal securities laws. These regulatory agencies use both the rule-making authority granted to them by Congress and state legislatures, and administrative hearings to clarify issues and announce positions to be taken by those agencies on significant securities law subjects. The Washington Supreme Court previously has recognized the contribution that these agencies have made to the development of the state and federal securities laws. See, Cellular Engineering, Ltd. v. O'Neill, 118 Wn.2d 16, 820 P.2d 941 (1991).

Although decisions made by courts regarding state and federal securities issues apply only to the parties involved in those decisions, courts generally recognize the precedent setting nature of decisions and the contribution that those decisions make from time-to-time to the development of critical state and federal securities issues. When a state

court has the opportunity to contribute to the interpretive base of state securities law, as did the Court of Appeals in this case, the state court should do so by clearly articulating its position.

In this case, the Court of Appeals has published a vague and confusing opinion. It did not fulfill its responsibility to provide guidance to investors and issuers on the critical, threshold issue of what is a “security” as defined by WSSA. The Court of Appeals had undisputed facts upon which it could make clear legal statements. Therefore, it is incumbent upon the Supreme Court to grant this Petition for Review and take advantage of the opportunity presented to it to more clearly define the circumstances under which a promissory note becomes a security as defined by WSSA.

DATED this 21st day of December, 2005.

PAINE, HAMBLIN, COFFIN
BROOKE & MILLER LLP

By: Lawrence R. Small
LAWRENCE R. SMALL, WSBA #2993
ERIN A. JACOBSON, WSBA #31717

CRUMB & MUNDING, PS

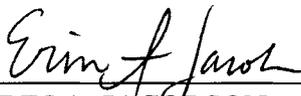
By: John D. Munding
Lawrence R. Small
JOHN D. MUNDING, WSBA #21734
per telephone approval 12-21-05
Attorneys for Petitioner

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 21st day of December, 2005, I caused to be served a true and correct copy of the foregoing PETITION FOR REVIEW as follows:

U.S. MAIL
 HAND DELIVERED
 OVERNIGHT MAIL
 TELECOPY

MARIS BALTINS
TAMARA W. MUROCK
WINSTON & CASHATT
601 W. Riverside, Suite 1900
Spokane, WA 99201-0695
(509) 838-6131



ERIN A. JACOBSON

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APPENDIX

(Publication page references are not available for this document.)

Court of Appeals of Washington,
Division 3,
Panel Two.

Clark E. KINNEY and Barbara E. Kinney,
individually and the marital community,
Appellants,

v.

Kenneth B. COOK, a single man, Respondent.
No. 22704-9-III.

Nov. 22, 2005.

Background: Corporate shareholders, who repurchased stock sold to other shareholder by paying other shareholder amount to satisfy promissory note on loan for original purchase, brought lawsuit under Washington State Securities Act (WSSA) against other shareholder. The Superior Court, Spokane County, Maryann C. Moreno, J., granted other shareholder's motion to dismiss. Plaintiffs appealed.

Holdings: The Court of Appeals, Schultheis, J., held that:

(1) plaintiffs stated cause of action under WSSA, and

(2) action was timely.
Reversed and remanded.

[1] Appeal and Error  893(1)

30k893(1) Most Cited Cases

A trial court's ruling on a motion to dismiss under court rule involves a question of law that is reviewed de novo. CR 12(b)(6).

[2] Pretrial Procedure  624

307Ak624 Most Cited Cases

Courts should dismiss action under court rule only when it appears beyond a reasonable doubt that no facts justifying recovery exist. CR 12(b)(6).

[3] Pretrial Procedure  624

307Ak624 Most Cited Cases

A complaint survives a motion to dismiss if any set of facts could exist that would justify recovery. CR 12(b)(6).

[4] Pretrial Procedure  681

307Ak681 Most Cited Cases

In ruling on a motion to dismiss, the court may use hypothetical facts not part of the record in arriving at

its determination whether any set of facts could exist that would justify recovery. CR 12(b)(6).

[5] Pretrial Procedure  622

307Ak622 Most Cited Cases

Motions to dismiss should be granted sparingly and with care and only in the unusual case in which a plaintiff includes allegations that show on the face of the complaint that there is some insuperable bar to relief. CR 12(b)(6).

[6] Pretrial Procedure  679

307Ak679 Most Cited Cases

Courts presume the truth of allegations in the complaint for the purpose of a motion to dismiss. CR 12(b)(6).

[7] Securities Regulation  246

349Bk246 Most Cited Cases

Courts recognize the remedial purpose of the Washington State Securities Act (WSSA) and liberally construe it to protect investors from the speculative or fraudulent schemes of promoters. West's RCWA 21.20.900.

[8] Securities Regulation  278

349Bk278 Most Cited Cases

Given broad definitions and accommodating attitude toward securities fraud victims embodied in Washington State Securities Act (WSSA), corporate shareholders, who repurchased stock sold to other shareholder by paying other shareholder amount to satisfy promissory note on loan for original purchase and complying with other shareholder's demand that they sign personal guaranties agreeing to act as co-guarantors on loans made to corporation, without being told that corporation had guaranteed debt of other shareholder's different business, stated valid WSSA cause of action against other shareholder. West's RCWA 21.20.005.

[9] Securities Regulation  248

349Bk248 Most Cited Cases

When courts define "security" under the Washington State Securities Act (WSSA), the approach 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 the money of others on the promise of profits. West's RCWA 21.20.005.

(Publication page references are not available for this document.)

[10] Securities Regulation 248

349Bk248 Most Cited Cases

When determining whether a transaction constitutes a security under the Washington State Securities Act (WSSA) form should be disregarded for substance and the emphasis should be on economic reality. West's RCWA 21.20.005.

[11] Securities Regulation 246

349Bk246 Most Cited Cases

For the Washington State Securities Act (WSSA), the terms "purchase" and "sale" are not limited to their common law meanings. West's RCWA 21.20.005.

[12] Securities Regulation 262.1

349Bk262.1 Most Cited Cases

In determining whether a transaction falls under the Washington State Securities Act (WSSA), the term "contract" is given a broad and liberal interpretation. West's RCWA 21.20.005.

[13] Limitation of Actions 95(18)

241k95(18) Most Cited Cases

Three-year period under Washington State Securities Act (WSSA) is tolled until the securities violation is discovered or should have been discovered. West's RCWA 21.20.430.

[14] Limitation of Actions 100(12)

241k100(12) Most Cited Cases

Cause of action under Washington State Securities Act (WSSA), by purchasers of stock who alleged seller concealed a \$4.5 million loan guaranty concerning corporation, accrued, for purpose of three-year statute of limitations, when purchasers learned of guaranty when seller filed his disclosure statement for plan of reorganization in bankruptcy. West's RCWA 21.20.430.

Maris Baltins, Tamara W.M. Urock, Baltins & Murock, P.S., Spokane, WA, for Appellants.

Lawrence R. Small, Erin A. Jacobson, Paine, Hamblen, Coffin, Brooks & Miller LLP, John D. Munding, Attorney at Law, Spokane, WA, for Respondent.

SCHULTHEIS, J.

¶ 1 A motion to dismiss under CR 12(b)(6) is granted only if there is no set of facts pleaded, known, or hypothetical that could justify recovery. Clark and Barbara Kinney appeal an order granting Kenneth Cook's CR 12(b)(6) motion to dismiss their suit under the Washington State Securities Act

(WSSA), chapter 21.20 RCW. We cannot conclude that Mr. Cook met his burden to sustain a CR 12(b)(6) motion. We also hold that the Kinneys filed their complaint within the statutory limitations period. Accordingly, we reverse and remand.

FACTS

¶ 2 In December 1993, the Kinneys decided to form Spokane Freightliner, Inc. (the corporation) with Mr. Cook to sell and service new and used heavy duty trucks, trailers, parts, and accessories. The Kinneys and Mr. Cook agreed to each contribute \$225,000 in exchange for 50 percent of the corporation's shares. The Kinneys borrowed money for their shares from Mr. Cook. They signed a promissory note on December 31, 1993, naming Mr. Cook as a payee. The note was secured by the Kinneys' signatures to a stock pledge agreement in which they pledged their shares to Mr. Cook as collateral. Upon receipt of the money, the Kinneys contributed it to the corporation in exchange for 50,000 shares of common stock in the corporation.

¶ 3 On February 26, 1997, the parties decided to end their relationship and entered into a memorandum of understanding in which Mr. Cook purchased the Kinneys' shares and the note and pledge agreement was cancelled.

¶ 4 On September 15, 1998, the Kinneys brought a lawsuit against Mr. Cook and the corporation, alleging that Mr. Cook's purchase of the shares violated the WSSA. They asserted that Mr. Cook acquired their shares in February 1997 by misrepresenting the financial condition of the corporation and the fair market value of the stock.

¶ 5 Meanwhile, in January 2000--when Mr. Cook was in sole control of the corporation during the pendency of the Kinneys' lawsuit--Mr. Cook entered into an agreement in which the corporation agreed to act as guarantor of a \$4.5 million loan made by Mercedes Benz Credit Corporation to Select Credit & Leasing, L.L.C., a limited liability company owned solely by Mr. Cook.

¶ 6 At trial, a jury found that Mr. Cook violated the WSSA. On July 11, 2000, a judgment was entered ordering, among other things, the rescission of Mr. Cook's purchase of the Kinneys' shares, reinstatement of the 1993 promissory note and pledge agreement, and reinstatement of the Kinneys as guarantors of the corporation's debts.

¶ 7 On July 12, one day after entry of the judgment,

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(Publication page references are not available for this document.)

Mr. Cook delivered a notice of default on the note to the Kinneys demanding full payment in accordance with the note and pledge agreement. The Kinneys paid the amount due, \$266,534.06, to Mr. Cook on July 26. The Kinneys received the stock two days later.

¶ 8 At the board of directors meeting on August 4, 2000, Mr. Cook demanded that the Kinneys sign personal guaranties agreeing to act as co-guarantors on loans made to the corporation. They complied. The Kinneys first learned that the corporation had guaranteed the \$4.5 million debt of Mr. Cook's other business on August 15, 2001, when they received bankruptcy papers that Mr. Cook had filed on behalf of the corporation.

¶ 9 In response, the Kinneys filed the present litigation on April 30, 2003, in which they asserted:

Without knowledge of the \$4,500,000 loan guarantee made by Cook, on July 26, 2000, plaintiffs repurchased their 50% interest in the Corporation by paying \$266,534.06 to defendant Cook in satisfaction of the Promissory Note.

... In return, on or about July 28, 2000, plaintiffs received a stock certificate for 50,000 shares in the Corporation.

Clerk's Papers at 6.

¶ 10 The Kinneys alleged that these acts violated the WSSA and asked for the return of the money they paid for their shares (\$266,534.06) together with rescission of their personal guaranties for the corporation's debts and attorney fees. Mr. Cook moved to dismiss under CR 12(b)(6). He essentially argued that because the note was a personal loan from him to the Kinneys it did not fall under the WSSA. The trial court granted Mr. Cook's CR 12(b)(6) motion, concluding that the payment of the promissory note did not constitute a sale of securities. The Kinneys appeal. Mr. Cook's motion on the merits to affirm was denied.

DISCUSSION

a. Motion to dismiss

[1][2][3][4][5][6] ¶ 11 A trial court's ruling on a motion to dismiss under CR 12(b)(6) involves a question of law that we review de novo. Cutler v. Phillips Petroleum Co., 124 Wash.2d 749, 755, 881 P.2d 216 (1994). Courts should dismiss under this rule only when it appears beyond a reasonable doubt that no facts justifying recovery exist. *Id.* Therefore, "a complaint survives a CR 12(b)(6) motion if any set of facts could exist that would justify recovery." Hoffer v. State, 110 Wash.2d 415, 420, 755 P.2d 781

(1988), *aff'd on reh'g*, 113 Wash.2d 148, 776 P.2d 963 (1989). A court may use hypothetical facts not part of the record in arriving at its determination. *Id.* "CR 12(b)(6) motions should be granted 'sparingly and with care' and 'only in the unusual case in which [a] plaintiff includes allegations that show on the face of the complaint that there is some insuperable bar to relief.'" Cutler, 124 Wash.2d at 755, 881 P.2d 216 (quoting Hoffer, 110 Wash.2d at 420, 755 P.2d 781). Courts presume the truth of allegations in the complaint for the purpose of the motion. *Id.*

¶ 12 Under the WSSA:

It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:

- (1) To employ any device, scheme, or artifice to defraud;
- (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
- (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

RCW 21.20.010.

¶ 13 The WSSA "is patterned after and restates in substantial part the language of the federal Securities Exchange Act of 1934." Guarino v. Interactive Objects, Inc., 122 Wash.App. 95, 110, 86 P.3d 1175 (2004) (quoting Clausing v. DeHart, 83 Wash.2d 70, 72, 515 P.2d 982 (1973)), *review denied*, 153 Wash.2d 1024, 110 P.3d 756 (2005). It is modeled after the Uniform Securities Act of 1956, which has been enacted in some form by the majority of states. Cellular Eng'g, Ltd. v. O'Neill, 118 Wash.2d 16, 23-24, 820 P.2d 941 (1991) (citing Haberman v. Wash. Pub. Power Supply Sys., 109 Wash.2d 107, 125, 744 P.2d 1032, 750 P.2d 254 (1987); Unif. Securities Act, 7B U.L.A. 509 (1985)).

[7] ¶ 14 The legislature directs us to construe the WSSA "to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this chapter with the related federal regulation." RCW 21.20.900. However, the Washington Supreme Court has recognized that since the purpose of the federal statute is to protect investors and the integrity of the marketplace while the WSSA's purpose is limited to investor protection, the WSSA would be more broadly construed than the federal law. Hoffer v. State, 113 Wash.2d 148, 152, 776 P.2d 963 (1989)

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(Publication page references are not available for this document.)

(citing Haberman, 109 Wash.2d at 125-26, 744 P.2d 1032). Therefore, we now recognize the remedial purpose of the WSSA and liberally construe it to protect investors from the speculative or fraudulent schemes of promoters. Cellular Eng'g, 118 Wash.2d at 23, 820 P.2d 941; Stewart v. Estate of Steiner, 122 Wash.App. 258, 264, 93 P.3d 919 (2004), review denied, 153 Wash.2d 1022, 108 P.3d 1229 (2005).

[8] ¶ 15 Mr. Cook argues that because the transaction here did not involve a security, the WSSA was not implicated and the Kinneys' complaint should be dismissed. He correctly points out that in order for the transaction to involve a security, it must involve one of the statutory definitions. Under the current WSSA, a "security" is broadly defined to include:

[A]ny note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; investment of money or other consideration in the risk capital of a venture with the expectation of some valuable benefit to the investor where the investor does not receive the right to exercise practical and actual control over the managerial decisions of the venture; voting-trust certificate; certificate of deposit for a security; fractional undivided interest in an oil, gas, or mineral lease or in payments out of production under a lease, right, or royalty; charitable gift annuity; any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof; or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any security under this subsection. This subsection applies whether or not the security is evidenced by a written document.

RCW 21.20.005(12)(a).

[9][10] ¶ 16 When we define "security" under the statutory scheme, our approach "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 the money of others on the promise of profits." Cellular Eng'g, 118 Wash.2d at 24, 820 P.2d 941 (quoting

Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 299, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946)). Similarly, when determining whether a transaction constitutes a security, "form should be disregarded for substance and the emphasis should be on economic reality." Id. at 24-25, 820 P.2d 941 (quoting Tcherepnin v. Knight, 389 U.S. 332, 336, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967)). This is consistent with what lawmakers had in mind when the securities laws were enacted, which was "to regulate investments, in whatever form they are made and by whatever name they are called." Id. at 25, 820 P.2d 941 (emphasis omitted) (quoting Reves v. Ernst & Young, 494 U.S. 56, 61, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990)).

¶ 17 Mr. Cook also asserts that the motion to dismiss is appropriate because a sale did not occur. But the definition and interpretation of sale is expansive. The WSSA defines "sale" as

every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value. "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.

Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing is considered to constitute part of the subject of the purchase and to have been offered and sold for value. A purported gift of assessable stock is considered to involve an offer and sale. Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert into another security of the same or another issuer, is considered to include an offer of the other security.

RCW 21.20.005(10).

[11][12] ¶ 18 The federal courts view the sale requirement in the context of the circumstances of the case before it because "the anti-fraud goals of the Rule should not be frustrated by the presence of 'novel or atypical transactions.'" In re Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig., 49 F.3d 541, 544 (9th Cir.1995) (quoting Madison Consultants v. Fed. Deposit Ins. Corp., 710 F.2d 57, 61 (2d Cir.1983) (quoting Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 798 (2d Cir.1969), rev'd in part, 490 F.2d 332 (2d Cir.1973))). The terms "purchase" and "sale" are not limited to their common law meanings. Northland Capital Corp. v. Silver, 236 U.S.App. D.C. 390, 735 F.2d 1421, 1427

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(Publication page references are not available for this document.)

(1984). For instance, federal courts have found that a sale has occurred when the parties have committed to each other, Griggs v. Pace American Group, Inc., 170 F.3d 877 (9th Cir.1999), or when there has been a meeting of the minds, Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 891 (2d Cir.1972). As stated by one court:

A bedrock requirement for the formation of any contract or bargain between unrelated parties, including those constituting a purchase or sale, is that the putative purchaser and seller come to a meeting of the minds or, in the phrase of the Restatement (Second) of Contracts, mutual assent on the essential terms of the transaction.

Northland Capital Corp., 735 F.2d at 1427. Moreover, even the term "contract" is given a broad and liberal interpretation. Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339, 346 n. 12 (9th Cir.1972).

¶ 19 Finally, Mr. Cook argues that dismissal was proper because he was not a seller. "Any person, who offers or sells a security in violation of any provisions of RCW 21.20.010 ... is liable to the person buying the security from him or her" and is entitled to a civil remedy. RCW 21.20.430(1).

¶ 20 After reviewing the WSSA statutory definitions and other authority, Mr. Cook concludes that because there was not a violation of the WSSA, dismissal is appropriate. However, Mr. Cook moved for dismissal under CR 12(b)(6). Therefore, we decide only whether the plaintiffs stated a valid cause of action. Given these broad definitions and our accommodating attitude toward securities fraud victims, we cannot say that the Kinneys have failed to state a claim upon which relief can be granted. Dismissal was inappropriate.

b. Statute of limitations

[13] ¶ 21 RCW 21.20.430(4)(b) relevantly provides, "No person may sue under this section ... more than three years after a violation of the provisions of RCW 21.20.010, either was discovered by such person or would have been discovered by him or her in the exercise of reasonable care." Under the statute "the 3-year period is tolled until the securities violation is discovered or should have been discovered." First Md. Leasecorp v. Rothstein, 72 Wash.App. 278, 287, 864 P.2d 17 (1993).

[14] ¶ 22 The Kinneys allege that Mr. Cook concealed a \$4.5 million loan guaranty. The Kinneys did not learn of the guaranty until Mr. Cook filed his Disclosure Statement for Plan of Reorganization on August 15, 2001. The Kinneys filed their complaint

for damages for securities violations on April 30, 2003, well within the three-year limitation period. There is no basis for holding otherwise.

CONCLUSION

¶ 23 The Kinneys' WSSA claim was improperly dismissed on a CR 12(b)(6) motion. Accordingly, Mr. Cook is not entitled to attorney fees for a frivolous suit as he requested. We reverse the order of dismissal and remand.

WE CONCUR: KATO, C.J., and BROWN, J.

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END OF DOCUMENT

West's RCWA 21.20.005

C

West's Revised Code of Washington Annotated Currentness

Title 21. Securities and Investments (Refs & Annos)

▣ Chapter 21.20. Securities Act of Washington (Refs & Annos)

▣ Definitions

→ **21.20.005. Definitions**

The definitions set forth in this section shall apply throughout this chapter, unless the context otherwise requires:

- (1) "Director" means the director of financial institutions of this state.
 - (2) "Salesperson" means any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect sales of securities. "Salesperson" does not include an individual who represents an issuer in (a) effecting a transaction in a security exempted by RCW 21.20.310 (1), (2), (3), (4), (9), (10), (11), (12), or (13), (b) effecting transactions exempted by RCW 21.20.320 unless otherwise expressly required by the terms of the exemption, or (c) effecting transactions with existing employees, partners, or directors of the issuer if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state.
 - (3) "Broker-dealer" means any person engaged in the business of effecting transactions in securities for the account of others or for that person's own account. "Broker-dealer" does not include (a) a salesperson, issuer, bank, savings institution, or trust company, (b) a person who has no place of business in this state if the person effects transactions in this state exclusively with or through the issuers of the securities involved in the transactions, other broker-dealers, or banks, savings institutions, trust companies, insurance companies, investment companies as defined in the investment company act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (c) a person who has no place of business in this state if during any period of twelve consecutive months that person does not direct more than fifteen offers to sell or to buy into or make more than five sales in this state in any manner to persons other than those specified in (b) of this subsection.
 - (4) "Guaranteed" means guaranteed as to payment of principal, interest, or dividends.
 - (5) "Full business day" means all calendar days, excluding therefrom Saturdays, Sundays, and all legal holidays, as defined by statute.
 - (6) "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities. "Investment adviser" also includes financial planners and other persons who, as an integral component of other financially related services, (a) provide the foregoing investment advisory services to others for compensation as part of a business or (b) hold themselves out as providing the foregoing investment advisory services to others for compensation. Investment adviser shall also include any person who holds himself out as a financial planner.
- "Investment adviser" does not include (a) a bank, savings institution, or trust company, (b) a lawyer, accountant, certified public accountant licensed under chapter 18.04 RCW, engineer, or teacher whose performance of these services is solely incidental to the practice of his or her profession, (c) a broker-dealer or its salesperson whose performance of these services is solely incidental to the conduct of its business as a broker-dealer and who receives no special compensation for them, (d) a publisher of any bona fide newspaper, news magazine, news column, newsletter, or business or financial publication or service, whether communicated in hard copy form, by electronic

West's RCWA 21.20.005

means, or otherwise, that does not consist of the rendering of advice on the basis of the specific investment situation of each client, (e) a radio or television station, (f) a person whose advice, analyses, or reports relate only to securities exempted by RCW 21.20.310(1), (g) an investment adviser representative, or (h) such other persons not within the intent of this paragraph as the director may by rule or order designate.

(7) "Issuer" means any person who issues or proposes to issue any security, except that with respect to certificates of deposit, voting trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions) or of the fixed, restricted management, or unit type; the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which the security is issued.

(8) "Nonissuer" means not directly or indirectly for the benefit of the issuer.

(9) "Person" means an individual, a corporation, a partnership, a limited liability company, a limited liability partnership, an association, a joint-stock company, a trust where the interest of the beneficiaries are evidenced by a security, an unincorporated organization, a government, or a political subdivision of a government.

(10) "Sale" or "sell" includes every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value. "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.

Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing is considered to constitute part of the subject of the purchase and to have been offered and sold for value. A purported gift of assessable stock is considered to involve an offer and sale. Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert into another security of the same or another issuer, is considered to include an offer of the other security.

(11) "Securities Act of 1933," "Securities Exchange Act of 1934," "Public Utility Holding Company Act of 1935," "Investment Company Act of 1940," and "Investment Advisers Act of 1940" means the federal statutes of those names as amended before or after June 10, 1959.

(12)(a) "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; investment of money or other consideration in the risk capital of a venture with the expectation of some valuable benefit to the investor where the investor does not receive the right to exercise practical and actual control over the managerial decisions of the venture; voting-trust certificate; certificate of deposit for a security; fractional undivided interest in an oil, gas, or mineral lease or in payments out of production under a lease, right, or royalty; charitable gift annuity; any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof; or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any security under this subsection. This subsection applies whether or not the security is evidenced by a written document.

(b) "Security" does not include: (i) Any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or some other specified period; or (ii) an interest in a contributory or noncontributory pension or welfare plan subject to the Employee Retirement Income Security Act of 1974.

(13) "State" means any state, territory, or possession of the United States, as well as the District of Columbia and Puerto Rico.

West's RCWA 21.20.005

(14) "Investment adviser representative" means any partner, officer, director, or a person occupying similar status or performing similar functions, or other individual, who is employed by or associated with an investment adviser, and who does any of the following:

- (a) Makes any recommendations or otherwise renders advice regarding securities;
- (b) Manages accounts or portfolios of clients;
- (c) Determines which recommendation or advice regarding securities should be given;
- (d) Solicits, offers, or negotiates for the sale of or sells investment advisory services; or
- (e) Supervises employees who perform any of the functions under (a) through (d) of this subsection.

(15) "Relatives," as used in RCW 21.20.310(11) includes:

- (a) A member's spouse;
- (b) Parents of the member or the member's spouse;
- (c) Grandparents of the member or the member's spouse;
- (d) Natural or adopted children of the member or the member's spouse;
- (e) Aunts and uncles of the member or the member's spouse; and
- (f) First cousins of the member or the member's spouse.

(16) "Customer" means a person other than a broker-dealer or investment adviser.

(17) "Federal covered security" means any security defined as a covered security in the Securities Act of 1933.

(18) "Federal covered adviser" means any person registered as an investment adviser under section 203 of the Investment Advisers Act of 1940.

CREDIT(S)

[2002 c 65 § 1; 1998 c 15 § 1; 1994 c 256 § 3. Prior: 1993 c 472 § 14; 1993 c 470 § 4; 1989 c 391 § 1; 1979 ex.s. c 68 § 1; 1979 c 130 § 3; 1977 ex.s. c 188 § 1; 1975 1st ex.s. c 84 § 1; 1967 c 199 § 1; 1961 c 37 § 1; 1959 c 282 § 60.]

HISTORICAL AND STATUTORY NOTES

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

Effective date--Implementation--1993 c 472: See RCW 43.320.900 and 43.320.901.

Severability--1979 c 130: See note following RCW 28B.10.485.

Laws 1989, ch. 391, § 1, in the definition of "investment adviser", in the first paragraph, added the second and third sentences; in the second paragraph, inserted "certified public accountant licensed under chapter 18.04 RCW" in cl. (b); inserted cl. (e); and redesignated the subsequent clauses accordingly.

Laws 1993, ch. 471, § 4, added the definition of "Customer".

West's RCWA 21.20.010

C

West's Revised Code of Washington Annotated Currentness

Title 21. Securities and Investments (Refs & Annos)

 Chapter 21.20. Securities Act of Washington (Refs & Annos)

 Fraudulent and Other Prohibited Practices

→ **21.20.010. Unlawful offers, sales, purchases**

It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:

- (1) To employ any device, scheme, or artifice to defraud;
- (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
- (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

CREDIT(S)

[1959 c 282 § 1.]

HISTORICAL AND STATUTORY NOTES

Uniform Law:

This section is similar to § 101 of the 1956 Uniform Securities Act. See Vol. 7C Uniform Laws Annotated, Master Edition, or ULA Database on Westlaw.

ADMINISTRATIVE CODE REFERENCES

Broker-dealer practices, see WAC 460-21B-008 et seq.

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C.J.S. Securities Regulation § § 208, 228, 237, 252, 253.

RESEARCH REFERENCES

Treatises and Practice Aids

Blue Sky Law § 9:26, Overview of Liability Under Section 410(A)(2)--Elements Plaintiff Does Not Have to Allege

West's RCWA 21.20.430

C

West's Revised Code of Washington Annotated Currentness

Title 21. Securities and Investments (Refs & Annos)

▣ Chapter 21.20. Securities Act of Washington (Refs & Annos)

▣ Civil Liabilities

→ **21.20.430. Civil liabilities--Survival, limitation of actions--Waiver of chapter void--Scienter**

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

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

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

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

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

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

West's RCWA 21.20.430

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

(7) Notwithstanding subsections (1) through (6) of this section, if an initial offer or sale of securities that are exempt from registration under RCW 21.20.310 is made by this state or its agencies, political subdivisions, municipal or quasi-municipal corporations, or other instrumentality of one or more of the foregoing and is in violation of RCW 21.20.010(2), and any such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such issuer acting on its behalf, or person in control of such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such person acting on its behalf, materially aids in the offer or sale, such person is liable to the purchaser of the security only if the purchaser establishes scienter on the part of the defendant. The word "employee" or the word "agent," as such words are used in this subsection, do not include a bond counsel or an underwriter. Under no circumstances whatsoever shall this subsection be applied to require purchasers to establish scienter on the part of bond counsels or underwriters. The provisions of this subsection are retroactive and apply to any action commenced but not final before July 27, 1985. In addition, the provisions of this subsection apply to any action commenced on or after July 27, 1985.

CREDIT(S)

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

HISTORICAL AND STATUTORY NOTES

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

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

Laws 1998, ch. 15, § 20, in the first sentence of subsec. (1), substituted "RCW 21.20.010, 21.20.140 (1) or (2), or 21.20.180 through 21.20.230" for "RCW 21.20.010 or 21.20.140 through 21.20.230"; and, in the first sentence of subsec. (4)(b), substituted "RCW 21.20.140 (1) or (2) or 21.20.180 through 21.20.230" for "RCW 21.20.140 through 21.20.230".

Uniform Law:

This section is similar to § 410 of the 1956 Uniform Securities Act. See Vol. 7C Uniform Laws Annotated, Master Edition, or ULA Database on Westlaw.

LIBRARY REFERENCES

1999 Main Volume

Securities Regulation  241 to 312.
Westlaw Topic No. 349B.
C.J.S. Securities Regulation § § 188 to 251.

RESEARCH REFERENCES

Treatises and Practice Aids

Blue Sky Law § 1:21, Development of a True Definition of "Security" by Specification--Appropriate Fraud Coverage.

Blue Sky Law § 4:56, Generally--Clauses Are Void--Clauses Void Under Anti-Waiver Provision.

West's RCWA 62A.9A-601

C

West's Revised Code of Washington Annotated Currentness
Title 62A. Uniform Commercial Code (Refs & Annos)

▣ Article 9A. Secured Transactions; Sale of Accounts, Contract Rights and Chattel Paper (Refs & Annos)

▣ Part 6. Default

→ **62A.9A-601. Rights after default; judicial enforcement; consignor or buyer of accounts, chattel paper, payment intangibles, or promissory notes**

(a) **Rights of secured party after default.** After default, a secured party has the rights provided in this part and, except as otherwise provided in RCW 62A.9A-602, those provided by agreement of the parties. A secured party:

(1) May reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure; and

(2) If the collateral is documents, may proceed either as to the documents or as to the goods they cover.

(b) **Rights and duties of secured party in possession or control.** A secured party in possession of collateral or control of collateral under RCW 62A.9A-104, 62A.9A-105, 62A.9A-106, or 62A.9A-107 has the rights and duties provided in RCW 62A.9A-207.

(c) **Rights cumulative; simultaneous exercise.** The rights under subsections (a) and (b) of this section are cumulative and may be exercised simultaneously.

(d) **Rights of debtor and obligor.** Except as otherwise provided in subsection (g) of this section and RCW 62A.9A-605, after default, a debtor and an obligor have the rights provided in this part and by agreement of the parties.

(e) **Lien of levy after judgment.** If a secured party has reduced its claim to judgment, the lien of any levy that may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:

(1) The date of perfection of the security interest or agricultural lien in the collateral;

(2) The date of filing a financing statement covering the collateral; or

(3) Any date specified in a statute under which the agricultural lien was created.

(f) **Execution sale.** A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this Article.

(g) **Consignor or buyer of certain rights to payment.** Except as otherwise provided in RCW 62A.9A-607(c), this part imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles, or promissory notes.

(h) **Enforcement restrictions.** All rights and remedies provided in this part with respect to promissory notes or an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, are subject to RCW 62A.9A-408 to the extent applicable.



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Court of Appeals Division III
State of Washington

Opinion Information Sheet

Docket Number: 22704-9-III
Title of Case: Clark E. Kinney, et ux v. Kenneth B. Cook
File Date: 11/22/2005

SOURCE OF APPEAL

Appeal from Superior Court of Spokane County
Docket No: 03-2-02879-1
Judgment or order under review
Date filed: 01/05/2004
Judge signing: Hon. Maryann C Moreno

JUDGES

Authored by John A. Schultheis
Concurring: Kenneth H. Kato
Stephen M Brown

COUNSEL OF RECORD

Counsel for Appellant(s)
Maris Baltins
Baltins & Murock, P.S.
7 S Howard St Ste 220
Spokane, WA 99201-3816

Tamara Whalen Murock
Baltins & Murock, P.S.
7 S Howard St Ste 220
Spokane, WA 99201-3816

Counsel for Respondent(s)
Erin Angela Jacobson
Attorney at Law
717 W Sprague Ave Ste 1200
Spokane, WA 99201-3919

John Degnan Munding
Attorney at Law
601 W Riverside Ave Ste 1950
Spokane, WA 99201-0628

Lawrence Ralph Small
Paine Hamblen Coffin Brooke & Miller LLP
717 W Sprague Ave Ste 1200

Spokane, WA 99201-3505

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

CLARK E. KINNEY and BARBARA E.) No. 22704-9-III
KINNEY, individually and the)
marital community,)
)
Appellants,) Division Three
) Panel Two
v.)
)
KENNETH B. COOK, a single man,) PUBLISHED OPINION
)
Respondent.)

SCHULTHEIS, J. -- A motion to dismiss under CR 12(b)(6) is granted only if there is no set of facts pleaded, known, or hypothetical that could justify recovery. Clark and Barbara Kinney appeal an order granting Kenneth Cook's CR 12(b)(6) motion to dismiss their suit under the Washington State Securities Act (WSSA), chapter 21.20 RCW. We cannot conclude that Mr. Cook met his burden to sustain a CR 12(b)(6) motion. We also hold that the Kinneys filed their complaint within the statutory limitations period. Accordingly, we reverse and remand.

FACTS

In December 1993, the Kinneys decided to form Spokane Freightliner, Inc. (the corporation) with Mr. Cook to sell and service new and used heavy duty trucks, trailers, parts, and accessories. The Kinneys and Mr. Cook agreed to each contribute \$225,000 in exchange for 50 percent of the corporation's shares. The Kinneys borrowed money for their shares from Mr. Cook. They signed a promissory note on December 31, 1993, naming Mr. Cook as a payee. The note was secured by the Kinneys' signatures to a stock pledge agreement in which they pledged their shares to Mr. Cook as collateral. Upon receipt of the money, the Kinneys contributed it to the corporation in exchange for 50,000 shares of common stock in the corporation.

On February 26, 1997, the parties decided to end their relationship and entered into a memorandum of understanding in which Mr. Cook purchased the Kinneys' shares and the note and pledge agreement was cancelled.

On September 15, 1998, the Kinneys brought a lawsuit against Mr. Cook and the corporation, alleging that Mr. Cook's purchase of the shares violated the WSSA. They asserted that Mr. Cook acquired their shares in February 1997 by misrepresenting the financial condition of the corporation and the fair market value of the stock.

Meanwhile, in January 2000--when Mr. Cook was in sole control of the corporation during the pendency of the Kinneys' lawsuit--Mr. Cook entered into an agreement in which the corporation agreed to act as guarantor of a \$4.5 million loan made by Mercedes Benz Credit Corporation to Select Credit & Leasing, L.L.C., a limited liability company owned solely by Mr. Cook.

At trial, a jury found that Mr. Cook violated the WSSA. On July 11, 2000, a judgment was entered ordering, among other things, the rescission of Mr. Cook's purchase of the Kinneys' shares, reinstatement of the 1993 promissory note and pledge agreement, and reinstatement of the Kinneys as guarantors of the corporation's debts.

On July 12, one day after entry of the judgment, Mr. Cook delivered a notice of default on the note to the Kinneys demanding full payment in accordance with the note and pledge agreement. The Kinneys paid the amount due, \$266,534.06, to Mr. Cook on July 26. The Kinneys received the stock two days later.

At the board of directors meeting on August 4, 2000, Mr. Cook demanded that the Kinneys sign personal guaranties agreeing to act as co-guarantors on loans made to the corporation. They complied. The Kinneys first learned that the corporation had guaranteed the \$4.5 million debt of Mr. Cook's other business on August 15, 2001, when they received bankruptcy papers that Mr. Cook had filed on behalf of the corporation.

In response, the Kinneys filed the present litigation on April 30, 2003, in which they asserted:

Without knowledge of the \$4,500,000 loan guarantee made by Cook, on July 26, 2000, plaintiffs repurchased their 50% interest in the Corporation by paying \$266,534.06 to defendant Cook in satisfaction of the Promissory Note.

. . . In return, on or about July 28, 2000, plaintiffs received a stock certificate for 50,000 shares in the Corporation.

Clerk's Papers at 6.

The Kinneys alleged that these acts violated the WSSA and asked for the return of the money they paid for their shares (\$266,534.06) together with rescission of their personal guaranties for the corporation's debts and attorney fees. Mr. Cook moved to dismiss under CR 12(b)(6). He essentially argued that because the note was a personal loan from him to the Kinneys it did not fall under the WSSA. The trial court granted Mr. Cook's CR 12(b)(6) motion, concluding that the payment of the promissory note did not constitute a sale of securities. The Kinneys appeal. Mr. Cook's motion on the merits to affirm was denied.

DISCUSSION

a. Motion to dismiss

A trial court's ruling on a motion to dismiss under CR 12(b)(6) involves a question of law that we review de novo. *Cutler v. Phillips Petroleum Co.*, 124 Wn.2d 749, 755, 881 P.2d 216 (1994). Courts should dismiss under this rule only when it appears beyond a reasonable doubt that no facts justifying recovery exist. *Id.* Therefore, '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, 420, 755 P.2d 781 (1988), *aff'd* on reh'g, 113 Wn.2d 148, 776 P.2d 963 (1989). A court may use hypothetical facts not part of the record in arriving at its determination. *Id.* 'CR 12(b)(6) motions should be granted 'sparingly and with care' and 'only in the unusual case in which {a} plaintiff includes allegations that show on the face of the complaint that there is some insuperable bar to relief.'" *Cutler*, 124 Wn.2d at 755 (quoting *Hoffer*, 110 Wn.2d at 420). Courts presume the truth of allegations in the complaint for the purpose of the motion. *Id.*

Under the WSSA:

It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:

- (1) To employ any device, scheme, or artifice to defraud;
- (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
- (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

RCW 21.20.010.

The WSSA 'is patterned after and restates in substantial part the language of the federal Securities Exchange Act of 1934.'" *Guarino v. Interactive Objects, Inc.*, 122 Wn. App. 95, 110, 86 P.3d 1175 (2004) (quoting *Clausing v. DeHart*, 83 Wn.2d 70, 72, 515 P.2d 982 (1973)), review denied, 153 Wn.2d 1024 (2005). It is modeled after the Uniform Securities Act of 1956, which has been enacted in some form by the majority of states.

Cellular Eng'g, Ltd. v. O'Neill, 118 Wn.2d 16, 23-24, 820 P.2d 941 (1991) (citing Haberman v. Wash. Pub. Power Supply Sys., 109 Wn.2d 107, 125, 744 P.2d 1032, 750 P.2d 254 (1987); Unif. Securities Act, 7B U.L.A. 509 (1985)).

The legislature directs us to construe the WSSA 'to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this chapter with the related federal regulation.' RCW 21.20.900. However, the Washington Supreme Court has recognized that since the purpose of the federal statute is to protect investors and the integrity of the marketplace while the WSSA's purpose is limited to investor protection, the WSSA would be more broadly construed than the federal law. Hoffer v. State, 113 Wn.2d 148, 152, 776 P.2d 963 (1989) (citing Haberman, 109 Wn.2d at 125-26). Therefore, we now recognize the remedial purpose of the WSSA and liberally construe it to protect investors from the speculative or fraudulent schemes of promoters. Cellular Eng'g, 118 Wn.2d at 23; Stewart v. Estate of Steiner, 122 Wn. App. 258, 264, 93 P.3d 919 (2004), review denied, 153 Wn.2d 1022 (2005).

Mr. Cook argues that because the transaction here did not involve a security, the WSSA was not implicated and the Kinneys' complaint should be dismissed. He correctly points out that in order for the transaction to involve a security, it must involve one of the statutory definitions. Under the current WSSA, a 'security' is broadly defined to include: {A}ny note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; investment of money or other consideration in the risk capital of a venture with the expectation of some valuable benefit to the investor where the investor does not receive the right to exercise practical and actual control over the managerial decisions of the venture; voting-trust certificate; certificate of deposit for a security; fractional undivided interest in an oil, gas, or mineral lease or in payments out of production under a lease, right, or royalty; charitable gift annuity; any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof; or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any security under this subsection. This subsection applies whether or not the security is evidenced by a written document.

RCW 21.20.005(12)(a).

When we define 'security' under the statutory scheme, our approach SQembodies 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 the money of others on the promise of profits.' Cellular Eng'g, 118 Wn.2d at 24 (quoting Sec. & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 299, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946)). Similarly, when determining whether a transaction constitutes a security, 'form should be disregarded for substance and the emphasis should be on economic reality.' Id. at 24-25 (quoting Tcherepnin v. Knight, 389 U.S. 332, 336, 88 S. Ct. 548, 19 L. Ed. 2d 564 (1967)). This is consistent with what lawmakers had in mind when the securities laws were enacted, which was 'to regulate investments, in whatever form they are made and by whatever name they are called.' Id. at 25 (emphasis omitted) (quoting Reves v. Ernst & Young, 494 U.S. 56, 61, 110 S. Ct. 945, 108 L. Ed. 2d 47 (1990)).

Mr. Cook also asserts that the motion to dismiss is appropriate because a sale did not occur. But the definition and interpretation of sale is expansive. The WSSA defines 'sale' as every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value. '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.

Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing is considered to constitute part of the subject of the purchase and to have been offered and sold for value. A purported gift of assessable stock is considered to involve an offer and sale. Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert into another security of the same or another issuer, is considered to include an offer of the other security.

RCW 21.20.005(10).

The federal courts view the sale requirement in the context of the circumstances of the case before it because 'the anti-fraud goals of the Rule should not be frustrated by the presence of 'novel or atypical transactions.''' In re Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig., 49 F.3d 541, 544 (9th Cir. 1995) (quoting Madison Consultants v. Fed. Deposit Ins. Corp., 710 F.2d 57, 61 (2d Cir. 1983) (quoting Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 798 (2d Cir. 1969), rev'd in part, 490 F.2d 332 (2d Cir. 1973))). The terms 'purchase' and 'sale' are not limited to their common law meanings. Northland Capital Corp. v. Silver, 236 U.S. App. D.C. 390, 735 F.2d 1421, 1427 (1984). For instance, federal courts have found that a sale has occurred when the parties have committed to each other, Griggs v. Pace American Group, Inc., 170 F.3d 877 (9th Cir. 1999), or when there has been a meeting of the minds, Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 891 (2d Cir. 1972). As stated by one court:

A bedrock requirement for the formation of any contract or bargain between unrelated parties, including those constituting a purchase or sale, is that the putative purchaser and seller come to a meeting of the minds or, in the phrase of the Restatement (Second) of Contracts, mutual assent on the essential terms of the transaction.

Northland Capital Corp., 735 F.2d at 1427. Moreover, even the term 'contract' is given a broad and liberal interpretation. Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339, 346 n.12 (9th Cir. 1972).

Finally, Mr. Cook argues that dismissal was proper because he was not a seller. 'Any person, who offers or sells a security in violation of any provisions of RCW 21.20.010 . . . is liable to the person buying the security from him or her' and is entitled to a civil remedy. RCW 21.20.430(1).

After reviewing the WSSA statutory definitions and other authority, Mr. Cook concludes that because there was not a violation of the WSSA, dismissal is appropriate. However, Mr. Cook moved for dismissal under CR 12(b)(6). Therefore, we decide only whether the plaintiffs stated a valid cause of action. Given these broad definitions and our accommodating attitude toward securities fraud victims, we cannot say that the Kinneys have failed to state a claim upon which relief can be granted. Dismissal was inappropriate.

b. Statute of limitations

RCW 21.20.430(4)(b) relevantly provides, 'No person may sue under this section . . . more than three years after a violation of the provisions of RCW 21.20.010, either was discovered by such person or would have been discovered by him or her in the exercise of reasonable care.' Under the

statute 'the 3-year period is tolled until the securities violation is discovered or should have been discovered.' First Md. Leasecorp v. Rothstein, 72 Wn. App. 278, 287, 864 P.2d 17 (1993).

The Kinneys allege that Mr. Cook concealed a \$4.5 million loan guaranty. The Kinneys did not learn of the guaranty until Mr. Cook filed his Disclosure Statement for Plan of Reorganization on August 15, 2001. The Kinneys filed their complaint for damages for securities violations on April 30, 2003, well within the three-year limitation period. There is no basis for holding otherwise.

CONCLUSION

The Kinneys' WSSA claim was improperly dismissed on a CR 12(b)(6) motion. Accordingly, Mr. Cook is not entitled to attorney fees for a frivolous suit as he requested. We reverse the order of dismissal and remand.

Schultheis, J.

WE CONCUR:

Kato, C.J.

Brown, J.

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