100013-8

No. 80619-0-I

IN THE COURT OF APPEALS OF THE
STATE OF WASHINGTON

DIVISION ONE

YING CHAN,

Respondent,

v.

WHATCOM OPPORTUNITIES REGIONAL CENTER, INC.,

Appellant.

RESPONSE TO PETITION FOR REVIEW

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I. INTRODUCTION

The Court of Appeals got it exactly right when they identified this case as a claim by Ying Chan ("Chan") to enforce an illegal contract. In accordance with long established precedent the court determined that it should leave the parties as it found them. Enforcing the contract in this case would have forced Whatcom Opportunities Regional Center, Inc, ("WORC") to violate the Securities and Exchange Act of 1934 (the "Exchange Act").

Chan continues to present this case as something it is not. The only claim in this case is Chan's claim for breach of contract. CP 802-12. At the Court of Appeals, Chan attempted to turn it into a case under a provision of the Securities Act that provides for a cause of action to rescind a contract made in violation of the Act, 15 U.S.C. § 78cc(b). Brief of Respondent at 22-23. This is not a Securities Act case, but rather a contract dispute regarding unpaid commissions. The Securities Act is relevant only as to the question whether the contract was illegal.

Chan also tries to assert an entirely new argument under the Supremacy Clause in Article IV of the United States Constitution. That argument is incomplete and incoherent. Whether the Supremacy Clause displaces or prohibits a state law depends on whether Congress intended to preempt state legislation and requires "rigorous analysis of the preemption issue." *Hue v. Farmboy Spray Co., Inc.*, 127 Wn.2d 67, 77, 896 P.2d 682 (1995). Chan never even mentions preemption.

This petition is ill-conceived and a waste of the Court's time. The Court should deny the petition and award WORC attorney fees for a frivolous petition under RAP 18.9.

II. IDENTITY OF RESPONDENT

Respondent and appellant/defendant below Whatcom Opportunities Regional Center, Inc. ("WORC") requests the relief set forth herein.

III. STATEMENT OF THE CASE

This case was tried to a jury that returned a special verdict answering nine questions. CP 682-84. The trial Court entered judgment on the findings CP 669-71. The facts found by the Jury in its Special Jury Verdict and by the court in its Judgment are the established facts of this case, but Chan does not cite any of them in his Petition. Instead, Chan cites his own trial testimony 15 times as fact. Petition at 2-4. The only other substantive evidence cited by Chan is 1 excerpt from the trial testimony of WORC's president and the parties' contracts. In its opinion, the Court of Appeals set forth all of the jury's Special Interrogatory answers and properly decided the case on the basis of those facts. Opinion at 8-9.

The trial court instructed the jury that if it found for Chan on his breach of contract claim, it must consider WORC's illegality claim. CP 822-23; CP 683 at Question 4. It then instructed the Jury that "If you find that Whatcom Opportunities Regional Center, Inc. has proven its affirmative defense of illegality, you must next consider the issue of estoppel." CP 824. The trial court further instructed the jury that if it found the elements of estoppel, it must render a verdict for Chan, which it did. CP 824, 682-84. The trial court entered judgment for Chan on the verdict. CP 669-71.

On appeal, the court began by pointing out that Washington has developed an extensive body of case law clearly holding that our courts will not enforce an illegal contract, but may leave the parties to such a contract where it found them." Opinion at 10. The Court then noted that "it has long

been true that estoppel may not be utilized to enforce a contract found to be illegal." *Id.* at 7. Reversal was mandated by overwhelming law.

V. ARGUMENT

Whether review should be granted is decided by reference to the considerations set forth in RAP 13.4. Chan asserts that he seeks review under RAP 13.4(b)(1) and 13.4(b)(2) on the grounds that the Court of Appeals decision in in conflict with decisions of this Court and reported decisions of the Court of Appeals, and under RAP 13.4(b)(3) because a significant question of law under the Constitution of the United States is involved. Petition at 5.

A. The Court of Appeals Decision Is Consistent With Washington Precedent.

Chan's argument appears to be that the Court of Appeals' reliance on Washington state law to decide whether Chan may assert his estoppel argument conflicts with cases holding that "Federal precedent controls our application of federal law." Petition at 8 (quoting *Mission Springs, Inc. v. City of Spokane*, 134 Wn.2d 947, 968, 954 P.2d 250 (1998)). However, Chan fails to explain why the case required the court to apply federal law at all.

Chan cites precisely two cases in support of his contention that the court must apply federal law in this case. In *Mission Springs* was "an action against the City of Spokane and local officials pursuant to RCW 64.40 and 42 U.S.C. sec.1983 for alleged wrongful refusal to process a grading permit." *Id.* at 951. *Schuster v. Prestige Senior Mgmt., LLC*, 193 Wn. App. 616, 627-28, 376 P.3d 412 (2016) concerned a claim that arbitration was required under the Federal Arbitration Act, 9 U.S.C. §§ 1 –14. Chan also

cites *Snohomish County Public Utility District No. 1 v. Broadview TV Co.*, 91 Wn.2d 3, 586 P.2d 851 (1978), in which the defendant asserted a defense to a contract claim under federal antitrust law.

It is neither remarkable nor subject to dispute that when deciding a claim or defense asserting a right under a federal statute that courts look to federal precedent. No Washington precedent does or could exist interpreting federal statutory law. However, no one asserted any claim or defense under federal law in this case.

1. 15 U.S.C. § 78cc(b) Has No Bearing on This Case.

Chan opens his argument by asserting that "federal law allows estoppel to be asserted in response to a defense that a contract is illegal under federal securities law." Petition at 6. Although that statement is largely accurate, comments about unrelated federal claims is not helpful in this case.

Section 29(b) of the Securities Act (15 U.S.C. § 78cc(b)) establishes "a private, equitable cause of action for rescission or similar relief" for contracts made in violation of the Exchange Act. *Transamerica Mortgage Advisors, Inc TAMA v. Lewis*, 444 U.S. 11, 17 (1979)). That provision is narrow in scope and consists of a single improbably long sentence.

> Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to

> paragraph (3) of subsection (c) of section 78o of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) or (2) of subsection (c) of section 78o of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.

15 U.S.C. § 78cc(b).

The relief available under 15 U.S.C. § 78cc(b) is in the nature of rescission. *Berckeley Inv. Group, Ltd. v. Colkitt*, 455 F.3d 195, 205 (3rd Cir. 2006) ("Section 29(b) itself does not define a substantive violation of the securities laws; rather, it is the vehicle through which private parties may rescind contracts that were made or performed in violation of other substantive provisions."); *Boguslavsky v. Kaplan*, 159 F.3d 715, 722 (2nd Cir. 1998) ("Section 29(b) provides for the rescission of a contract if the contract violates any provision of the Act or its regulations. See 15 U.S.C. § 78cc(b) (1994).").

No one in this case brought an action under 15 U.S.C. § 78cc(b) or sought rescission of a contract. Moreover, the Exchange Act was enacted to protect investors, and the Court of Appeals aptly noted:

> Critical to our review of the case before us is the fact that neither party was an investor in these securities, nor was fraud alleged. This is not a Securities Act case, but rather a contract dispute regarding unpaid compensation which WORC alleges was due to the illegality of the contract. There is no indication in the record that any investor was defrauded or did not receive what they were owed. This background is informative in that it bolsters why this court must rely on our state's general approach to illegal contracts.

Opinion at 11-12.

2. Federal Precedent Permits Equitable Defenses to a Claim Under 15 U.S.C. § 78cc(b) Because Such Claims Are Themselves Equitable.

Chan then asserts that "federal law allows the assertion of estoppel to defeat a claim that federal securities laws were violated." Petition at 6. That statement is half true at best. Chan broadly asserts that estoppel may be asserted against any claim that securities laws were violated, but the cases he cites state only the equitable defenses may be asserted in response to a claim brought under Section 29(b) of the Exchange Act.

Chan primarily relies on *Regional Properties Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 562 (5th Cir. 1982), but he never mentions why *Regional Properties* reached its decision. The court began its analysis by quoting the Supreme Court's statement in *Transamerica Mortgage Advisors, Inc TAMA* that Section 29(b) "does provide a private, equitable cause of action for rescission or similar relief." *Regional Properties*, 678 F.2d at 558 (quoting *Transamerica Mortgage Advisors, Inc TAMA*, 444 U.S. at 17. *Regional Properties* concerned a claim that was asserted under Section 29(b).

Regional Properties held that parties can assert equitable defenses to Section 29(b) claims because claims under Section 29(b) are themselves equitable in nature.

> The starting points for our discussion are the propositions, too elementary to require citation, that, historically, a suit to void a contract sounded in equity, and that, in suits in equity, equitable defenses, such as laches, estoppel, etc., may be raised. While actions to void a securities broker's contract obviously stem from statute rather than a traditional equitable right, they are equitable in nature.

Regional Properties, 678 F.2d at 572. If WORC had asserted a claim under Section 29(b) then Chan might have a point. However, WORC asserted no

such claim. The claims in the lawsuit are Chan's claim for breach of contract and WORC's defense of illegality.

Chan also misunderstands the consequence of the decision in *Regional Properties*. The court held that equitable defenses could be raised, but it also said that those equitable defenses must be decided under state law.

> On remand, the district court shall determine: (1) whether Weinstein was representing Regional (though not necessarily only Regional) in his work on the Kingsley Creek project; (2) if so, whether Weinstein's knowledge should, **under Texas law**, be imputed to Regional; and (3) if so, whether Financial therefore succeeded, **under Texas law**, in establishing any of its claimed defenses to Regional's section 29(b) claims.

Id. at 563 (emphasis added). Washington's estoppel law includes the rule that "Validity cannot be given to an illegal contract through any principle of estoppel." *Vedder v. Spellman*, 78 Wn.2d 834, 837, 480 P.2d 207 (1971); *Finch v. Matthews*, 74 Wn.2d 161, 169, 443 P.2d 833 (1968); *Sherwood & Roberts-Yakima, Inc. v. Leach*, 67 Wn.2d 630, 639, 409 P.2d 160 (1965); *Cooper v. Baer*, 370 P.2d 871, 59 Wn.2d 763 (1962); *State v. Northwest Magnesite Co.*, 28 Wn.2d 1, 182 P.2d 643 (1947); *Reed v. Johnson*, 27 Wash. 42, 56, 67 P. 381 (1901).

Lastly, Chan boldly asserts that "No case has used substantive state law to determine the application of a defense based on a federal law." Petition at 11. Without belaboring the point, respondent points out that in *Hara v. Kunath, Karren, Rinne, & Atkin LLC*, No. 71767-7-1, 2015 Wash. App. LEXIS 1319 (June 22, 2015) (unpublished), Division One of the Court of Appeals affirmed a trial verdict in a similar case that a contract with an investment adviser representative was illegal under federal law. The first part of the decision was entitled: "A. Illegality of Payments Under Federal

Law." *Id.* The decision was based entirely on Washington State illegality law.

B. <u>The Supremacy Clause Never Was and Is Not an Issue</u>.

It is truly astonishing that Chan makes an argument under the Supremacy Clause of the United States Constitution without even mentioning preemption. Chan blithely assumes that federal laws invalidate and prohibit any state laws regarding the same subjects. It would not take much legal research to learn that the Supremacy Clause is neither absolute nor automatic.

If one undertook that research, one would quickly discover that Washington courts "adhere to a rigorous analysis of the preemption issue because of this Court's continuing desire to uphold state sovereignty to the maximum extent, tempered only by the mandate of the Supremacy Clause of the United States Constitution." *Hue v. Farmboy Spray Co., Inc*., 127 Wn.2d 67, 77, 896 P.2d 682 (1995). One also would quickly discover the "strong presumption against preemption" *NW. Wholesale, Inc. v. Pac Organic Fruit, LLC*, 184 Wash.2d 176, 182, 357 P.3d 650 (2015); *Stevedoring Services of America, Inc. v. Eggert*, 129 Wn.2d 17, 24, 914 P.2d 737 (1996); *Campbell v. Department of Social and Health Services*, 83 P.3d 999, 150 Wash.2d 881 (2004).

Chan effectively argues that Washington state's law concerning illegal contract is preempted for contracts subject to the Exchange Act. Washington's law regarding illegal contracts is a matter of public policy and has existed since before Washington was a state. *Bach v. Smith*, 2 Wash.Terr. 145. 3 P. 831 (1882).

C. The Court Should Award RAP 18.9 Terms.

This Court may deny a petition for review and order the petitioner to pay fees for a frivolous petition pursuant to RAP 18.9. *E.g. Namiki v. ICT Law & Tech. Grp., PLLC*, 190 Wash.2d 1032, 421 P.3d 460 (Table) No. 95746-1 (2018). An award of sanctions is an extraordinary action and should not be done lightly. However, in this case, sanctions are warranted. Chan has asserted entirely spurious arguments and made new arguments in his Petition. WORC should not bear the expense of his tactics.

VI. CONCLUSION

The case should have been dismissed years ago. The contract between the parties was illegal on its face, and the trial court's judgment compelled the parties to violate the law again. The petition should be denied, and WORC should be awarded its fees and costs as sanctions for a frivolous appeal.

Dated this 20th day of August, 2021.

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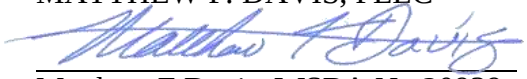

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