No. 69625-4-I

COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

GARRISON FAMILY LLC, a Washington limited liability company; LESA B. NEUGENT, individually, as Guardian of the Estate of Jack M. Garrison and as Trustee of the JACK M. GARRISON AND CHARLOTTE SURVIVOR'S TRUST, the CHARLOTTE L. GARRISON MARITAL TRUST, the CHARLOTTE L. GARRISON EXEMPT MARITAL TRUST, the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO MARK GARRISON, and the CHARLOTTE L. GARRISON EXEMPT FAMILY TRUST FBO LESA NEUGENT,

Appellants,

vs.

SAGEPOINT FINANCIAL, INC., a Delaware corporation licensed to business in Washington, f/k/a AIG FINANCIAL ADVISORS,

Respondent.

BRIEF OF RESPONDENT SAGEPOINT FINANCIAL, INC.

Averil Rothrock, WSBA #24248
Troy Greenfield, WSBA #21578
SCHWABE, WILLIAMSON & WYATT, P.C.
U.S. Bank Centre
1420 5th Avenue, Suite 3400
Seattle, WA 98101-4010
Telephone: 206.622.1711
Fax: 206.292.0460
Attorneys for SagePoint Financial, Inc.

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I. INTRODUCTION

In this appeal, Plaintiffs-Appellants ("the Garrison Entities") attempt to fit a square peg into a round hole. Each legal theory they assert fails. The loss of their funds by the allegedly "wild" securities trading of family member Mark Garrison ("Mark") in accounts held at Wells Fargo Investments is not the fault or responsibility of AIG/SagePoint.[1] Wells Fargo Investments and AIG/SagePoint have no connection. The case is simple. AIG/SagePoint was not the broker-dealer for the transactions at issue. The Garrison Entities were not AIG/SagePoint's customers. AIG/SagePoint made no profit from the transactions. Mark was an independent contractor at AIG/SagePoint, and his involvement with the Garrison Entities' accounts occurred "outside" of his relationship with AIG/SagePoint. The Garrison Entities have no legal claim against AIG/SagePoint because AIG/SagePoint owed no legal duty to review the conduct or suitability of the "outside" transactions at issue or treat them as AIG/SagePoint transactions. The trial court properly granted summary judgment and this Court should affirm that decision.

Throughout their brief, the Garrison Entities conflate standard of care with duty. Whether a duty exists is a question of law for the court. As a matter of law, AIG/SagePoint had no duty to non-customers the Garrison Entities. Mark's activities as an investment advisor of Acumen Financial

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[1] In 2009, AIG Financial Advisors changed its name to SagePoint Financial, Inc. This brief refers to Respondent as "AIG/SagePoint."

Group—which was an independent firm with no connection to AIG/SagePoint—do not establish any duty owed by AIG/SagePoint to non-customers the Garrison Entities concerning the trades in the Wells Fargo accounts. The Garrison Entities fail to establish that this Court should premise a duty on NASD Conduct Rules or Notices to Members. Even if NASD Conduct Rules inform whether AIG/SagePoint owed these non-customers a duty, this Court should conclude no duty existed because Rule 3050, not Rule 3040, applies to these transactions where Mark had complete discretionary authority over and a financial interest in the accounts. Rule 3040 specifically excepts such transactions from its ambit.

The Garrison Entities invite this Court to make new law. *See Amended Opening Brief* ("Op. Br."), 7 ("This case raises an issue of first impression in Washington on a unique and somewhat complex issue . . . .") ("There is little case law on point . . . ."). This invitation acknowledges the obvious: existing law does not support their claims. No case adopts the Garrison Entities' theories on facts similar to these. No case endorses the duty they seek to establish. In order to revive their claims, the Garrison Entities seek an unwarranted extension of law contrary to well-established duty principles and sound policy. This Court should reject the invitation to expand Washington law. This Court should affirm the judgment, which correctly applies existing law.

II. STATEMENT OF THE ISSUES

1. Did the trial court correctly rule as a matter of law that AIG/SagePoint owed no duty to non-customers the Garrison Entities to

supervise the conduct or suitability of trades directed by family member and trustee/manager Mark Garrison in their Wells Fargo accounts through Wells-Fargo brokers where AIG/SagePoint has no connection to Wells Fargo or Mark's investment advice company, the transactions at issue occurred in Mark's activities "outside" AIG/SagePoint, and/or where NASD Conduct Rule 3040 creates no such duty?

2. Did the trial court rule correctly as a matter of law that AIG/SagePoint was not secondarily liable to non-customers the Garrison Entities as a "control person" under the Washington State Securities Act, RCW 21.20.430, where the undisputed evidence demonstrates that AIG/SagePoint had no control over Mark concerning these outside trades and did not materially aid the transactions?

3. Did the trial court correctly rule as a matter of law that AIG/SagePoint cannot be liable in *respondeat superior* to the Garrison Entities where the undisputed evidence demonstrates that Mark was not an employee, Mark committed no tort as an AIG/SagePoint office manager against the Garrison Entities, and where no manager of any AIG/SagePoint branch office including Mark owed a duty to non-clients the Garrison Entities?

4. Did the trial court properly exercise its discretion to deny the Garrison Entities' Motion for Reconsideration because nothing raised in the Motion supported a different outcome?

III. STATEMENT OF THE CASE

The Garrison Entities allege that family member Mark Garrison

("Mark") lost the family fortune through an improvident investment strategy that he pursued in 2007 and 2008 as trustee and manager for the family trusts in accounts that the family had long held at Wells Fargo. All parties agree that as to AIG/SagePoint these activities were "outside business activities," i.e., not activities pursued at AIG/SagePoint. Mark's investment advice company Acumen Financial Group provided investment advice for the trusts. The broker-dealer Wells Fargo implemented the trades through Wells Fargo stockbrokers. AIG/SagePoint has no connection to these entities.

Despite that the Garrison Entities are not AIG/SagePoint customers and that the accounts and trading occurred "outside" AIG/SagePoint, the Garrison Entities audaciously look to recover from AIG/SagePoint. The trial court recognized that Washington law does not recognize their claims on these facts and dismissed the claims on summary judgment. This Court now reviews the legal correctness of those dismissals.

A. Non-Customers the Garrison Entities Concede and the Undisputed Facts Demonstrate That AIG/SagePoint Was a Stranger to the Wells Fargo Transactions At Issue That Occurred as Part of Stockbroker Mark Garrison's "Outside Activities."

The Garrison Entities wisely do not pretend that AIG/SagePoint actively participated in the conduct at issue. They concede the following salient facts that are well supported by the record: 1) Mark was trustee and manager of their brokerage accounts at Wells Fargo (*Op. Br.*, 4); 2)

Mark's business Acumen Financial Group provided them investment advice (*Op. Br.*, 4); 3) their assets were lost when Mark directed trades in the Wells Fargo accounts through Wells Fargo broker-dealers; 4) they were not customers of AIG/SagePoint (*Op. Br.*, 20); 5) AIG/SagePoint had no duty to supervises Mark's conduct as a stockbroker because Mark was not their stockbroker (*Op. Br.*, 20); Wells Fargo handled all of the brokerage functions for their accounts (*Op. Br.*, 20); Mark was their "fiduciary with discretionary control over these accounts as trustee and LLC manager." (*Op. Br.*, 21); and Mark's investment advice to them was an "outside business activity." (*Op. Br.*, 21). Additionally, it is undisputed that AIG/SagePoint was not compensated in any manner, directly or indirectly, in connection with the transactions at issue.

Although Mark was a stockbroker registered with broker-dealer AIG/SagePoint and served as an independent contractor—not an employee—with AIG/SagePoint (CP 238-44), it is uncontested that the trades at issue occurred "outside" AIG/SagePoint at Wells Fargo. None of the conduct at issue involved Mark's actions as a stockbroker for AIG/SagePoint. The conduct at issue exclusively concerned both Mark's other job as an investment advisor for Acumen Financial and his role as trustee/manager for the Garrison Entities. The Garrison Entities concede that a broker-dealer like AIG/SagePoint may employ a stockbroker like Mark "while allowing them to be employed by a different firm as an investment advisor." *Op. Br.*, 10. Mark wore different hats for different jobs and responsibilities he had. This did not make his "outside"

responsibilities those of AIG/SagePoint.

The Garrison Entities inaccurately seek to bend the record when they assert that "Mark had no personal financial or ownership interest in the Revocable Trust or Family LLC." *Op. Br.*, 8. For some reason, the Garrison Entities assert that Mark had "an *interest* in the accounts" but not a "*financial* interest." *Op. Br.*, 8 n.7 (emphasis original). They fail to explain what difference they are parsing. Whether Mark had an interest is not determinative because the Garrison Entities do not dispute that Mark had full discretionary authority over the accounts as Trustee, an issue relevant to which NASD Rule applies. But the false assertion contradicts their allegations in the Complaint, which repeatedly assert Mark's interest. *See* CP 13, ¶ 53-7.[2] The Garrison Entities alleged Mark's "financial interest" and "interest" interchangeably.

Further, the Garrison Entities concede and the record shows that both Mark and his sister Lesa Neugent were sole beneficiaries of two subtrusts, CP 406, and remainder beneficiaries of the other trusts holding Wells Fargo accounts. *See Op. Br.*, 8; CP 409 at Article II(A); CP 3 ¶ 2.

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[2] The Garrison Entities' allegations include: "As trustee of the Revocable Trust and Manager of the Garrison Family LLC Mark did have discretionary authority over and an interest in both entities' accounts." (CP 13, ¶ 53); "Wells Fargo and Mark did notify AIG that Mark had discretionary control over, and/or a financial interest in, the Revocable Trust and the Garrison Family LLC brokerage accounts at Wells Fargo" (CP 13, ¶ 54); Wells Fargo provided AIG with duplicate copies "with respect to accounts at Wells Fargo over which Mark had discretionary authority or in which he had a financial interest." (CP 13, ¶ 55).

B. Wells Fargo and AIG/SagePoint Treated the Transactions at Issue as NASD Conduct Rule 3050 Transactions That Did Not Require Any "Suitability" Assessment by AIG/SagePoint.

The evidence is undisputed that Wells Fargo and AIG/SagePoint treated the transactions at issue as NASD Conduct Rule 3050 ("Rule 3050") transactions. Appellants argue that based on NASD Conduct Rule 3040 ("Rule 3040"), AIG/SagePoint should have reviewed the transactions as if they had occurred at AIG/SagePoint. But Rule 3040 excepts Rule 3050 transactions. Rule 3050, entitled "Transactions for or by Associated Persons," applies whenever an associated person like Mark "has or will have a financial interest in, or discretionary authority over, any existing or proposed account carried by the executing member." [3]

Wells Fargo notified Acumen that Mark had discretionary control over, and/or a financial interest in, the Garrison Revocable Trust and the Garrison Family LLC Wells Fargo brokerage accounts. CP 129 ¶ 18; CP 154. In the letter, Wells Fargo requested a "Rule 407 letter," i.e. the New York Stock Exchange rule equivalent of Rule 3050, approving Mark's role as trustee/manager of the accounts. CP 154. Mark forwarded this notification from Wells Fargo to AIG/SagePoint. CP 156.

AIG/SagePoint responded to Mark by letter dated November 14 2006 letter, permitting Mark to engage in transactions in the disclosed Wells Fargo accounts over which he had discretionary control or in which

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[3] NASD Conduct Rules 3040 and 3050 are set forth in Appendix A. These rules are discussed in detail *infra*, V.A.2, pp. 23-42.

he had an interest. CP 274-5. The letter prohibited Mark from acting as the stockbroker for the Wells Fargo accounts, stating in part:

> You may not act as the representative of record [i.e., stockbroker] for these or any other accounts of Garrison (held at Wells Fargo or elsewhere). You are limited to acting solely as the trustee, owner, and manager for the above-referenced accounts. You are otherwise prohibited from acting in any capacity as the trustee, owner, and manager for anyone and/or any accounts outside of your *immediate family*.

CP 274 (original emphasis).

AIG/SagePoint then sent the requested Rule 407 letter dated November 22, 2006, permitting Mark's role in the Wells Fargo accounts. CP 161-2. It included notice that SagePoint would receive duplicate confirms and statements for supervision purposes. *Id.* AIG/SagePoint elaborated on the "supervision purposes" in an attachment entitled "Addendum—First Line Supervisor Responsibilities for Outside Personal Brokerage Accounts." CP 162. This document communicated that AIG/SagePoint's would review the outside accounts for "Insider Trading," "Prearranged Trading," "Adjusted Training," "Wash or Cross Transactions," "Orders at the Opening or Close," "Parking Securities," "Front Running" and "Freeriding," i.e., activities harmful to its own or its clients' interests. *Id.*

These specified activities are unrelated to the "suitability" of the transactions for the non-clients the Garrison Entities. "Suitability" refers to whether a transaction or investment strategy is suitable "for the customer,"

as explained in FINRA's suitability rule:

> **2111. Suitability**
>
> (a) A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

To determine suitability requires customer disclosure of "(i) the customer's financial status; (ii) the customer's tax status; (iii) the customer's investment objectives; and (iv) such other information used or considered to be reasonable by such representative making recommendations to the customer." *McGraw v. Wachovia Securities, LLC*, 756 F. Supp. 2d 1053, 1084–85 (N. D. Iowa 2010). The responsibility to assess suitability arises from what is known as the "know your customer" regulations. *See Javitch v. First Montauk Fin. Corp.*, 279 F. Supp. 2d 931, 938 (N. Dist. Ohio 2003). *See also Ives v. Ramsden*, 142 Wn. App. 369, 393–94, 174 P.3d 1231 (2008) (discussing suitability rule in context of customer relationship). "[T]he suitability rule may set brokers' common law duty of care *toward clients*." *Id.* at 391 (emphasis added). *See also* RCW 21.20.702 (WSSA's suitability rule applies "[i]n recommending

[securities] to a customer.").

The Garrison Entities concede that this correspondence between AIG/SagePoint, Wells Fargo and Mark occurred pursuant to the requirements of Rule 3050. *Op. Br.*, 11-12 (discussing requirements of Rule 3050 and these 407 letters).

Consistent with these facts and the understanding that Mark's activities fell within Rule 3050, Wells Fargo sent another letter to Acumen in January 2008 identifying Mark as trustee/manager of additional accounts and requesting a Rule 407 letter. CP 245-6 ¶ 3. Mark again forwarded that letter to SagePoint's Compliance Department, and SagePoint again shortly thereafter permitted Mark's role in these outside activities. CP 245-46 (testimony of Leslie Ayers for AIG/SagePoint).

Appellants assert that Mark disclosed in his annual "Outside Business Questionnaire" to AIG/SagePoint these outside activities as an investment advisor with his business Acumen Financial Group, Inc. in October 2007. *Op. Br.*, 13. CP 186-87. These disclosures were consistent with the 407 letters and the activities stated in the confirmation slips and account statements. This is not a case concerning undiscovered fraud or undetected "selling away" activities.

Mark's AIG/SagePoint supervisor Michelle Nielsen in fact monitored the confirmation slips and account statements "pursuant to NASD Conduct Rule 3050" and its internal "Addendum- First Line Supervisor Responsibilities for Outside Personal Brokerage Accounts" provided with the November 22, 2006 Rule 407 letter. CP 192-195

(*Nielsen Decl.*); CP 246-7 ¶¶ 5-6 (*Ayers Decl.*). Ms. Nielsen monitored "to ensure that Mark Garrison was not executing transactions that adversely affected the interests of SagePoint or SagePoint's customers." CP 194 ¶ 7. This included monitoring for insider trading, front running and the like. Such monitoring occurred after the trades had been executed.

Not only did SagePoint and Wells Fargo treat the transactions as subject to NYSE Rule 407 and NASD Conduct Rule 3050, AIG/SagePoint had no information about non-clients the Garrison Entities by which it could assess the suitability of the trades. No evidence suggests that such assessment by AIG/SagePoint was contemplated by AIG/SagePoint, Wells Fargo, Mark or the Garrison Entities. The Garrison Entities offered no testimony that they relied on AIG/SagePoint or considered AIG/SagePoint to have any connection to the Wells Fargo accounts.

C. Expert Testimony on NASD Conduct Rules 3040 and 3050

The parties submitted dueling expert testimony regarding whether Rules 3040 or 3050 applied to the transactions at issue. CP 196-212 (July 6, 2012 *Declaration of David Paulukaitis*); CP 276-85 (July 21, 2012 *Second Declaration of David Paulukaitis*); CP 324-35 (July 23, 2012 *Declaration of John H. Chung*); and CP 400-04 (July 27, 2012 *Declaration of John H. Chung*).

AIG/SagePoint's expert Mr. Paulukaitis testified that AIG/SagePoint owed no duty to the Garrison Entities for the breaches they allege based on securities industry rules and regulations. CP 202. He

testified to the following three conclusions:

1. The transactions effected by Mark in the Wells Fargo Accounts and the Ameritrade Personal Accounts were outside the scope of his association with SagePoint but were not "private securities transactions" as defined under NASD Conduct Rule 3040. Thus, SagePoint was not obligated to record those transactions on its books and records or otherwise supervise the transactions in those accounts.

2. Securities industry rules and regulations place no duty on SagePoint to supervise the activity in the Wells Fargo Accounts or the Ameritrade Personal Accounts. SagePoint's duty with respect to those accounts was limited to monitoring the transactions in those accounts to ensure that they did not conflict with the interests to SagePoint or SagePoint's customers.

3. Securities industry rules and regulations place no duty on SagePoint to supervise the business activities engaged in by Mark outside the scope of his association with SagePoint, including those as an independent RIA [Registered Investment Advisor].

CP 202. He also opined, "Since the Garrison Revocable Trust and the Garrison Family LLC were not SagePoint customers, SagePoint had no express or implied duty under Rule 3050 to protect them." CP 209. His opinions and the bases for them are discussed at length. CP 202-12. CP 276-85.

The Garrison Entities' expert Mr. Chang testified that Rule 3040 applied because Mark was receiving selling compensation. Based on application of Rule 3040, Mr. Chang opined that AIG/SagePoint should have supervised Mark's outside activities as an investment advisor "as if

the transaction were executed on behalf of the member [AIG/SagePoint]." CP 327-6 ¶¶ 6-7. Mr. Chang relies on the fact that the first exclusion of Rule 3040 "is immediately followed by the modifying clause: " . . . for which no associated person receives any selling compensation." CP 330-31 ¶14. He concludes that because Mark received selling compensation, the first exception of Rule 3040(e) does not apply.

Mr. Paulukaitis disputed Mr. Chang's interpretation, noting that Mr. Chang incorrectly quoted Rule 3040(e)'s exclusionary language, re-arranging the structure of the sentence and applying a qualification to the first exception that is not part of the rule. CP 277-79. Mr. Paulukaitis testified that Rule 3050 transactions are excluded from the Rule 3040 requirements "whether or not the associated person [Mark] receives selling compensation in connection with those transactions." CP 278 ¶ 5. Mr. Paulukaitis also noted that Rule 3040 does impose supervisory duties on a broker-dealer if the transactions "are effected by an associated person [Mark] for an account he owns or controls." CP 279 This makes sense according to Mr. Paulukaitis because "Rule 3040 requires broker/dealers to protect the interests of their customers but it does not similarly require broker/dealers to protect the interests of their associated persons." CP 279.

At oral argument the Garrison Entities, however, conceded that Rule 3050 "on its face" applies to all the transactions at issue. VBR at 15. They urged the trial court to look beyond the face of the rules. *Id.* They argued for a "new application." *Id.* at 16.

D. Summary Judgment Dismissal of the Garrison Entities' Claims Against AIG/SagePoint for Lack of Duty.

The Garrison Entities sued AIG/SagePoint in April 2011. CP 1-43. AIG/SagePoint moved for summary judgment dismissing all claims for lack of duty. CP 213-37. After briefing and oral argument, the trial court granted summary judgment to AIG/SagePoint. CP 643-45. The trial court denied the Garrison Entities' cross motion on the duty issue. CP 481-83.

The Garrison Entities moved for reconsideration. CP 487-503. The sole basis for reconsideration was whether a newly submitted AIG/SagePoint Supervisor Manual altered the duty analysis. CP 487-503. The trial court denied reconsideration. CP 612-13.

In November 2012 the trial court certified the summary judgment orders as final and appealable pursuant to CR 54(b) and entered final judgment. CP 643-45; 646-47. The Garrison Entities timely appealed. CP 653-73. This Court accepted review.

IV. STANDARDS OF REVIEW

The Garrison Entities fail to address a standard of review. This Court reviews summary judgment orders *de novo*. *Castro v. Stanwood Sch. Dist. No. 401*, 151 Wn.2d 221, 224, 86 P.3d 1166 (2004). "Summary judgment is proper when a plaintiff fails to produce sufficient evidence of an essential element of his or her case; that failure renders all other facts immaterial." *Pope v. Douglas Cnty. Public Util. Dist. No. 1*, 158 Wn. App. 23, 28, 241 P.3d 797 (2010). A defendant may move for summary judgment on the ground that the plaintiff lacks competent evidence to

support his or her claims. *Young v. Key Pharm., Inc.*, 112 Wn.2d 216, 225, 770 P.2d 182 (1989). Here, the trial court properly granted summary judgment to AIG/SagePoint because the Garrison Entities could not establish the required element of duty.

The Garrison Entities mistakenly assert that whether AIG/SagePoint owed them a duty of care is a question of fact. *Op. Brief* 1-4. Throughout their issue statements, they ask whether "reasonable minds [could] differ" on whether AIG/SagePoint owed Appellants a duty to supervise Mark's activities in their Wells Fargo Investments accounts. *Id.* at 2, #2(a). This mistake arises from the Garrison Entities' conflation of standard of care with duty.[4] After discussing what is necessary to establish the standard of care, the Garrison Entities recite a supposedly "general rule" that "when each side's evidence is sufficient standing alone to make a prima facie showing of the fact question, conflicts in expert testimony must be resolved by the trier of fact. . . ." *Op. Br.* 42. The Garrison Entities then argue that whether a duty existed should not have been decided on summary judgment. *Op. Br.* 42.

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[4] As one example of this conflation, the Garrison Entities state:

> Appellants do not allege that AIG violated any particular statute or NASD rule as the basis for their negligent supervision claim. Appellants allege that AIG failed to meet the securities industry's standard of reasonable care in supervising Mark.

CP 24. The Garrison Entities put the cart before the horse. Before demonstrating that AIG failed to meet the standard of care, they first must establish a legal duty.

This is incorrect. The existence of a legal duty is a question of law, not fact. *Bernethy v. Walt Failor's, Inc.*, 97 Wn.2d 929, 933, 653 P.2d 280 (1982) ("Common law principles of negligence provide that duty is a question addressed to the court."); *Schooley v. Pinch's Deli Market, Inc.*, 134 Wn.2d 468, 474, 951 P.2d 749 (1998) (same). Since the existence of a duty is "ordinarily an issue of law, it is only where duty depends on proofs of facts that are disputed that summary judgment is inappropriate." *Hymas v. UAP Dist., Inc.*, 167 Wn. App. 136, 150, 272 P.3d 889 (citation omitted). *See also Davis v. Niagara Mach. Co.*, 90 Wn.2d 342, 346, 581 P.2d 1344 (1978) (affirming dismissal on summary judgment for lack of duty); *Linville v. State*, 137 Wn. App. 201, 208, 151 P.3d 1073 (2007) (same). Here, no disputed issues of fact prevent summary judgment on the legal issue of duty. Even viewing the Garrison Entities' evidence in their favor, summary judgment was proper.

Construction of agency regulations is a question of law reviewed de novo under the error of law standard. *Linville*, 137 Wn. App. at 209.

Motions for reconsideration are addressed to the sound discretion of the trial court; a reviewing court will not reverse a trial court's ruling absent a showing of manifest abuse of that discretion. *Wagner Dev. v. Fidelity & Deposit*, 95 Wn. App. 896, 906, 977 P.2d 639 (1999). A trial court abuses its discretion when it exercises it in a manifestly unreasonable manner or bases it upon untenable grounds or reasons. *Id.*

Applying these standards, this Court should affirm.

V. ARGUMENT

The Garrison Entities establish no legal error to revive the three causes of action they raise on appeal: (1) negligent supervision, (2) secondary liability as a "control person" under the Washington State Securities Act ("WSSA"), RCW 21.20.430, and (3) *respondeat superior* liability for negligence.[5] The trial court correctly dismissed these claims against AIG/SagePoint by non-customers the Garrison Entities. The Garrison Entities fail to establish that AIG/SagePoint owed them the legal duty to supervise the suitability of the trades or monitor the accounts as if they were AIG/SagePoint accounts.

The Garrison Entities and AIG/SagePoint are strangers. Mark Garrison managed his family's trusts independently as part of his activities "outside" AIG/SagePoint. The trades at issue in Wells Fargo accounts were made through broker-dealer Wells-Fargo by its stockbrokers upon the advice of investment adviser Acumen Financial at the express direction of interested party and family member Mark, who had complete discretionary authority for the accounts. The Garrison Entities assert no contact with AIG/SagePoint and no reliance upon AIG/SagePoint for anything having to do with their Wells Fargo accounts. There simply was no relationship at any time between the Garrison Entities and

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[5] These are their Second, Fourth and Fifth claims in their Complaint. CP 35-36 at ¶¶ 175-77, CP 37 at ¶¶ 181-84, and CP 37-41 at ¶¶ 185-204.

AIG/SagePoint. These facts fail to establish any duty owed by AIG/SagePoint to the Garrison Entities, properly resulting in dismissal.

The Garrison Entities argue that a duty existed because AIG/SagePoint allowed Mark to "be employed by a different firm as an investment adviser" and in these circumstances "securities industry rules and standards" required it to "supervise the stockbrokers' investment advisory activities in accounts held at a different brokerage firm." *Op. Br.*, 20. This is incorrect. To support the theory, the Garrison Entities assert NASD Rules, recasting the plain text of these rules to suit their purposes. But neither Washington law nor the NASD Rules establish any duty on these facts. The Garrison Entities offer no judicial decision adopting the broad duty to third parties that they espouse. The Garrison Entities entreat this Court to make new law and expand *ex post facto* SagePoint's duties under the law and applicable regulations well beyond any recognized or sensible limits. This Court should decline the invitation and affirm. Based on the undisputed facts, existing law and common sense, AIG/SagePoint owed no legal duty to the Garrison Entities.

A. This Court should affirm the trial court's dismissal on summary judgment of the negligent supervision claim because non-customers the Garrison Entities did not meet their burden to establish that AIG/SagePoint owed them a duty to supervise the trading in their Wells Fargo accounts.

The trial court correctly dismissed the negligent supervision claim because AIG/SagePoint owed no duty to non-customers the Garrison

Entities to monitor their Wells Fargo accounts as if they were at AIG/SagePoint and to supervise and discover the alleged unsuitability of the trades made by Wells Fargo stockbrokers in the Wells Fargo accounts at Mark's direction as trustee/manager. This ruling was correct as a matter of law based on the undisputed facts. This Court should affirm dismissal of the negligent supervision claim. Neither existing precedent nor the plain language of the NASD Rules supports their novel duty theory.

In a negligence action the threshold question is whether the defendant owes a duty of care to the plaintiff. *Schooley*, 134 Wn.2d at 474. "If there is no duty, appellants have no claim." *Burg v. Shannon & Wilson, Inc.*, 110 Wn. App. 798, 804, 43 P.3d 526 (2002) (affirming summary judgment for lack of duty) (citing *Folsom v. Burger King*, 135 Wn.2d 658, 671, 958 P.2d 301 (1998) (same)).

The plaintiff has the burden of establishing the existence of a duty. *Id.* Appellants incorrectly attempt to reverse this burden. *See Op. Br.*, 49 (arguing AIG/SagePoint failed to meet its burden to disprove a duty).

The Garrison Entities formulate nine issue statements supposedly related to whether such a duty existed. *Op. Br.*, 1-3. As noted above in *IV. Standards of Review*, the issues are misstated where they include references to whether "reasonable minds" could differ. The issue of duty before this Court is purely legal. *Supra*, IV.

The Garrison Entities argue that AIG/SagePoint's duty is established based on a "special relationship" between AIG/SagePoint and Mark. *Op. Br.*, 16-17. The Garrison Entities rely on *Funkhouser v.*

Wilson, 89 Wn. App. 644, 950 P.2d 501 (1998), which held that a church and church leader had a sufficiently special relationship with children of the church to prevent them from being sexually molested by someone who other church members knew previously had been accused of molestation.

The issue on review regarding the negligent supervision claim, therefore, is this: simply because Mark was a registered AIG/SagePoint stockbroker, did AIG/SagePoint have a sufficiently special relationship with Mark that created the responsibility to evaluate on behalf of strangers and non-AIG/SagePoint clients the suitability and conduct of trades Mark pursued for them in these outside transactions? This Court should conclude that no such duty existed.

The Garrison Entities address generally the duty of a broker-dealer to supervise its stockbrokers, but cannot tie the "supervisory component" of AIG/SagePoint's relationship with Mark to his *outside activities* with persons who were not AIG/SagePoint clients. The Garrison Entities attempt to rely on NASD Conduct Rule 3040 to do that. But, even if relevant to explore the duty issue, Rule 3040 nowhere establishes that AIG/SagePoint had a duty to supervise the conduct or suitability of these outside trades for the benefit of non-customers the Garrison Entities. Such a duty does not exist, and would be highly problematic.

1. Dismissal of the negligent supervision claim for lack of duty was proper on these undisputed facts because no sufficiently special relationship existed and Mark Garrison did not pose a known risk.

The Garrison Entities failed to establish the essential element of duty, and therefore do not pass the first hurdle of their claim for negligent supervision. Such a claim is a form of vicarious liability premised on the special relationship between an employer and an employee. *Niece v. Elmview Group Home*, 131 Wn.2d 39, 48–49, 929 P.2d 420 (1997). The employer/employee relationship gives rise to a *limited* duty to "prevent the tasks, premises, or instrumentalities entrusted to an employee from endangering others." *Id.* at 48. The Garrison Entities assert that Mark's role as a registered AIG/SagePoint stockbroker was sufficient to create such a relationship, but offer no authority to support this assertion. Here, even if one assumes that that relationship between Mark and AIG/SagePoint might qualify to support a duty in the abstract, the Garrison Entities fail to make any connection between the tasks, premises, or instrumentalities entrusted to him in that capacity and the harm they suffered from his other outside activities. No connection exists between Mark's role as an AIG/SagePoint stockbroker and the actions he took that damaged the Garrison Entities. The relationship, therefore, is insufficiently special given the facts of this case.

Second, even if the relationship was sufficiently special, the Garrison Entities still fail to establish a duty. Under Washington law, an

employer is not liable for negligent supervision unless the employer knew or should have known that the employee posed a risk of danger to others. *Niece*, 131 Wn.2d at 48–49. *See also Smith v. Sacred Heart Med. Ctr.*, 144 Wn. App. 537, 544–54, 184 P.3d 646 (2008) (negligent supervision claim failed where plaintiff failed to show that employer hospital knew or should have known that employee posed any danger to its patients); *Tift v. Snohomish County*, 764 F. Supp. 2d 1247, 1256–57 (W.D. Wash. 2011); *Allen v. Washington*, No. C05-5502KLS, 2006 U.S. Dist. LEXIS 87270, at *43 (W.D. Wash. Nov. 27, 2006) (negligent supervision claim failed where plaintiff failed to show that the defendant employer either knew or should have known that any police officer employees had prior dangerous tendencies or otherwise presented an unreasonable risk to others).

The Garrison Entities fail to address this or to show that AIG/SagePoint had *any* prior knowledge that Mark posed a danger to the Garrison Entities. This Court will not consider issues on appeal that are not supported by argument and citation to authority. RAP 10.3(a)(6); *McKee v. Am. Home Prods. Corp.*, 113 Wn.2d 701, 705, 782 P.2d 1045 (1989). The Garrison Entities cannot correct this deficiency on reply, because an issue raised and argued for the first time in a reply brief will not be considered by a reviewing court. *Cowiche Canyon Conservancy v. Bosley*, 118 Wn.2d 801, 809, 828 P.2d 549 (1992). For these failures, this Court should affirm.

Even if the Court were to overlook this deficiency and examine the required elements against the record evidence, nothing shows that Mark

presented a risk of harm to the Garrison Entities when he took control of the family accounts, or that AIG/SagePoint should have known it. Nothing in the record shows any indication that Mark would be unable to properly perform his fiduciary roles for the Garrison Entities. The supposed "red flags" that the Garrison Entities raise, *see Op. Br.*, 35-9, are not conduct that occurred *prior* to the wrongful conduct at issue: they are the very wrongful conduct at issue. This is insufficient evidence that AIG/SagePoint could have known beforehand that Mark posed any risk. In truth, nothing demonstrates that Mark posed any risk to the trusts or that AIG/SagePoint knew or should have known (or even could have known) that he did. The fact that Mark later allegedly breached his duties to the Garrison Entities does not support a claim for negligent supervision.

AIG/SagePoint did not have a sufficiently special relationship with Mark to trigger any liability for Mark's allegedly wrongful conduct. And, the Garrison Entities fail to articulate a theory that AIG/SagePoint knew or could have known that Mark posed an unreasonable risk to others; nothing in the record supports such a theory. Accordingly, this Court should affirm dismissal of the common law negligent supervision claim.

2. This Court should not create a new duty to supervise outside accounts for noncustomers as if the accounts were held at AIG/SagePoint based on NASD Conduct Rule 3040, which the Garrison Entities misread.

If the Court goes beyond this straightforward analysis of the

negligent supervision claim and considers NASD Conduct Rules, it still should affirm. The Garrison Entities seek reversal based on their argument that NASD Conduct Rule 3040 imposed an affirmative obligation on AIG/SagePoint to supervise and asses the suitability of the trading in the Wells Fargo accounts. *Op. Br.*, 22-31. This is wrong.

First, the NASD Conduct Rules neither provide a private right of action nor purport to establish a legal duty. The Garrison Entities offer no persuasive authority, evidence or expert testimony that the NASD Conduct Rules establish clear industry standards applicable to the facts of this case. Even if this Court considered the NASD Rules to inform its evaluation of the duty element of the negligent supervision claim, it should reject the Garrison Entities' reading of the rules. Their reading of Rule 3040 is flawed. Rule 3040 specifically ***excludes*** all transactions that are within the ambit of NASD Conduct Rule 3050. The transactions at issue were within the ambit of Rule 3050 because, at a minimum, Mark had discretionary authority over the accounts, whether selling compensation is involved or not. The appeal therefore fails.

A duty may arise "either from common law principles or from a statute or regulation." *Murphy v. State*, 115 Wn. App. 297, 305, 62 P.3d 533 (2003). The plaintiff has the burden to establish the existence of a duty. *Burg*, 110 Wn. App. at 804 (citation omitted). In *McKee*, for example, the court weighed the implications of various statutes and regulations to determine the scope of a pharmacist's duty. *See McKee*, 113 Wn.2d at 701. NASD Conduct Rules do not determine for Washington

courts whether a duty exists under Washington law. Even if this Court considers these rules, the Garrison Entities did not meet their burden to show that Rule 3040 supports a relevant duty.

a. Because Rule 3040 excepts the Wells Fargo transactions at issue, Rule 3040 does not support a duty.

Rule 3040 does not apply to support any duty owed by AIG/SagePoint to the Garrison Entities in these circumstances. Rule 3040 applies only to defined "private securities transactions." The definition of "private securities transactions" specifically excludes transactions subject to Rule 3050, as follows:

> (1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, ***provided however that transactions subject to the notification requirements of Rule 3050,*** transactions among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, ***shall be excluded.*** [Emphasis added.]

NASD Conduct Rule 3040(e)(1) (emphasis added). In other words, Rule 3040 delineates three distinct categories of transactions that are expressly ***excluded*** from the definition of "private securities transaction" for purposes of Rule 3040:

1. transactions subject to the notification

requirements of Rule 3050;

2. transactions among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation; and

3. personal transactions in investment company and variable annuity securities.

Id. Under the first exclusion, Rule 3040 applies only to transactions not subject to Rule 3050. To affirm this Court only need conclude that the first exclusion applies.

The first exclusion does apply. The transactions at issue are subject to Rule 3050. Rule 3050, entitled "Transactions for or by Associated Persons," applies whenever an associated person such as Mark (associated with AIG/SagePoint) "has or will have a financial interest in, or discretionary authority over, any existing or proposed account carried by the executing member." [6] (emphasis added). Here, it is uncontested that Mark was a person associated with AIG/SagePoint who had discretionary authority over accounts carried at Wells Fargo. As a second basis for the applicability of Rule 3050, Mark also had or "will have" a financial interest in the accounts as present beneficiary or remainder beneficiary. CP 406, 409, 13 at ¶¶ 53-55. The transactions at issue are subject to Rule 3050. This excludes them from Rule 3040.

The Garrison Entities do not contest that if the first exclusion is construed as set forth above, with no additional qualification, it applies

[6] Rules 3040 and 3050 are set forth in Appendix A.

based on the facts here. This is the correct conclusion because there is no dispute that the Wells Fargo accounts were "accounts over which [Mark as Plaintiffs' trustee/manager] had discretionary authority." *See Op. Br.*, 21 (admitting same). The transactions, therefore, are squarely within Rule 3050 and excluded from Rule 3040.

To avoid the obvious conclusion that the transactions are not subject to Rule 3040, the Garrison Entities offer an incorrect construction of Rule 3040. They attempt to convince this Court to rewrite the first exclusion and connect the provision regarding selling compensation not to the second exclusion for "transactions among immediate family members," which it properly modifies, but to the first exclusion. They ask this Court to construe Rule 3040 as applicable to Rule 3050 transactions where an associated person receives any selling compensation, rewriting the first exclusion to read "transactions subject to the notification requirements of Rule 3050, for which no associated person receives any selling compensation." The first exclusion, however, is unqualified. Their argument seeks to rearrange the provision to suit their purposes.

The Court should reject this rewriting of Rule 3040. It contravenes the plain text of the rule. Washington adheres to the last antecedent rule providing that "[w]here no contrary intention appears . . . relative and qualifying words and phrases, both grammatically and legally, refer to the last antecedent." *Davis v. Gibbs*, 39 Wn.2d 481, 483, 236 P.2d 545 (1951); *City of Pasco v. Pub. Employment Relations Comm'n*, 119 Wn.2d 504, 509–10, 833 P.2d 381 (1992). Pursuant to the last antecedent rule, the

qualifying phrase "for which no associated person receives any selling compensation" refers only to the second exception regarding transactions among immediate family members. This rule of construction requires rejection of the Garrison Entities' argument.

Because the transactions at issue were subject to the requirements of Rule 3050, no duty arises by virtue of Rule 3040. Summary judgment was proper.

This Court also should reject the Garrison Entities' argument because it is inconsistent with the history of these rules and their concessions. The Garrison Entities admit that when Rules 3040 and 3050 were drafted, it was not common for independent contractors at broker-dealer agencies separately to work as investment advisors for different clients. *Op. Br.*, 26; VBR 16. They further admit that "none" of the NASD Rules "on their face" "addressed a stockbroker's activities as an investment advisor for non-customers at a different firm." *Op. Br.*, 22. And, they acknowledge that Rule 3050 "doesn't say anything about the employer broker-dealer's supervisory duties relating to these accounts." *Op. Br.*, 24. *See also id.* at 49 (alleged duty is not "express" in NASD Rules). These admissions put the Garrison Entities in the position of arguing that Rules 3040 and 3050 mean something that the rules do not state and admittedly were not intended to mean.

Rule 3050 by its express terms imposes no obligations on AIG/SagePoint, but instead imposes notification obligations on the associated person, Mark Garrison, and the broker-dealer executing the

transactions, Wells Fargo. NASD Conduct Rule 3050(a)-(c) (App. A); CP 204-10 (*Paulukaitis Decl.*, ¶¶ 21-44). Rule 3050 requires the executing broker-dealer (Wells Fargo), upon request to provide to the broker-dealer with which the associated person (Mark Garrison) is employed or associated (SagePoint) duplicate copies of confirmation slips and account statements for the referenced brokerage accounts (Appellants' Wells Fargo Accounts). This requirement allows AIG/SagePoint to review and monitor as necessary to protect the interests of AIG/SagePoint and AIG/SagePoint's customers against insider trading, front running, and the like. CP 207-209 ¶¶ 32-40 (*Paulukaitis Decl.*); CP 246-7 ¶ 6 (*Ayers Decl.*). Thus, when AIG/SagePoint received the transaction reports—after the trades had occurred—AIG/SagePoint reviewed them to ensure that the transactions did not adversely affect the interests of AIG/SagePoint and its customers. CP 192-195 (*Nielsen Decl.*); CP 246-7 ¶¶ 5-6 (*Ayers Decl.*). AIG/SagePoint had no obligation to review the suitability of the trades or evaluate the investment advice received by non-customers the Garrison Entities for their benefit in these circumstances. *See also* CP 210-11 ¶¶ 46-8 (Paulukaitis testimony regarding NASD Rule 3030 and Notice to Members 05-50) (firm is not required to supervise or even approve an outside business activity).

The Garrison Entities have the burden to establish a duty. They do not meet it. The NASD Rules do not support imposition of the alleged duty. A 2011 industry commentary cited by Appellants acknowledges that the rules for regulation of outside business activities "are undergoing

significant change." Uhlenhop, Paul B., "Outside Business Activity," *Practical Compliance & Risk Management for the Securities Industry*, 41 (Nov-Dec. 2011) (http://lksu.com/pdf/Uhlenhop-Monical-Goldberg_PCRM_06-11.pdf). The authors offer no definitive guidance, often stating what the NASD Rules "appear" to require. *Id.* at 29. They remark that no standard supervisory system exists, but that the regulators "want firms to utilize a risk-based approach which tailors the firm's supervisory system to the firm's business and to the products that are being sold. Consequently, there is no standard set of compliance procedures or supervisory procedures to control outside business activities." *Id.* at 35. The Garrison Entities fail to establish that their reading of the NASD rules is the industry standard.

The Garrison Entities raise multiple Notices to Members, but the guidance in these notices does not support their assertions regarding AIG/SagePoint's duty in the circumstances of this case. One thing is clear: the Rules express concern over unsupervised trading. But this concern is not implicated by the facts of this case because the trades occurred at Wells Fargo through Wells Fargo stockbrokers. Wells Fargo clearly had a duty to its clients the Garrison Entities. There is no gap to fill by establishing a duty on AIG/SagePoint's part when the Garrison Entities' accounts were "on the books" of Wells Fargo.

In sum, this Court should conclude that the record does not warrant creation of the legal duty asserted by the Garrison Entities.

b. Evidence of the conduct of Wells Fargo, SagePoint and the Garrison Entities demonstrates that Rule 3050, not Rule 3040, applied to the Wells Fargo transactions at issue.

As further evidence that Rule 3050 and not Rule 3040 applies, this Court should consider the conduct of Wells Fargo and AIG/SagePoint. As noted *supra*, III.B., Wells Fargo and AIG/SagePoint treated the transactions as subject to Rule 3050, not Rule 3040. This is demonstrated by the Rule 407 letters exchanged in relation to the accounts. CP 129, 154, 156, 161-2, 245-6 and 274-5. The evidence also demonstrates that AIG/SagePoint reviewed the confirmation slips and account statements to detect what Rule 3050 seeks to guard against: insider trading, front running, and the like. CP 192-195; CP 246-7 ¶¶ 5-6. This evidence further establishes the practice in the industry, supporting the conclusion that Rule 3040 is inapplicable.

Additionally, the Garrison Entities provided no remuneration to AIG/SagePoint for anything. They had no contact with AIG/SagePoint and assert no reliance upon AIG/SagePoint for anything having to do with their Wells Fargo accounts. There simply was no relationship or contact at any time between the Garrison Entities and AIG/SagePoint. The Garrison Entities had a broker-dealer active in these transactions who had client relationships with them and was being well-compensated for their services: Wells Fargo.

c. Expert testimony supports the conclusion that Rule 3040 does not establish the alleged duty

The plain language of Rule 3040 and 3050 should suffice to warrant affirmance. The conduct of Wells Fargo and AIG/SagePoint regarding the applicability of Rule 3050 further supports the conclusion that AIG/SagePoint had no duty under Rule 3040 to supervise for the Garrison Entities' benefit the trades at issue for suitability. This Court also can draw on the expert testimony to bolster that conclusion.

The testimony of AIG/SagePoint's expert is persuasive that AIG/SagePoint had no duty to supervise the suitability of the trades in the Wells Fargo accounts. See CP 196-212 (*Decl. of Paulukaitis*); CP 277-79 (*Second Decl. of Paulukaitis*). This conclusion is consistent with the plain language of Rules 3040 and 3050. *See supra* III.C. In contrast, the opinion of the Garrison Entities' expert John Chung that AIG/SagePoint had a duty to assess suitability and the conduct in the account for the protection of the Garrison Entities is inconsistent with the plain text of these rules. *See* generally CP 324-35, 400-4 (Chung testimony).

Mr. Chung's position also suffers from a host of impracticalities that weigh against adoption of such a duty. AIG/SagePoint had no information about the Garrison Entities and their circumstances. As a practical matter, AIG/SagePoint could not have evaluated "whether the transaction and/or portfolio meet the client's risk tolerance and investment objective." AIG/SagePoint also had no advance notice or real time ability to weigh in. The confirmations and account activity reports were delivered

to AIG/SagePoint by Wells Fargo after Wells Fargo executed the transactions. AIG/SagePoint had no license to meddle in the Garrison Entities' relationship with Mark and Wells Fargo, relationships to which it was a complete stranger.

To the extent that this Court finds the expert testimony illuminative of the duty issue, the testimony supports the conclusion that no duty exists.

d. The Garrison Entities' asserted interest in having AIG/SagePoint supervise Mark's investment strategy and the suitability of the trades was not intended to be protected by Rule 3040.

Even if Rule 3040 has relevancy, this Court should conclude that no duty applies because it was not intended to protect the Garrison Entities from the harm at issue. Washington courts may impose a legal duty based upon a statute or regulation, but only if the injured person "be within the class of persons the statute [or regulation] was intended to protect." *Schooley*, 134 Wn.2d at 474–75 (citing Restatement (Second) of Torts § 286 (1965)).[7] This test is not satisfied for multiple reasons.

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[7] Restatement (Second) of Torts Section 286 provides:

> The court may adopt as the standard of conduct of a reasonable man the requirements of a legislative enactment or administrative regulation whose purpose is found to be exclusively or in part (a) to protect a class of persons which includes the one whose interest is invaded, and (b) to protect the particular interest which is invaded, and (c) to protect that interest against the kind of harm which has resulted, and (d) to protect that interest against the particular hazard from which the harm results.

First, the Garrison Entities are not within the class of persons Rule 3040 intends to protect. "While a duty may, in some circumstances, be founded on a statute or regulation, *that duty extends only to persons in the class intended to be protected by the statute or regulation.*" *Davis*, 90 Wn.2d at 346 (emphasis added). The Supreme Court in *Davis* refused to recognize a duty owed by an employer to a manufacturer based on a Washington health and safety regulation. In upholding the summary judgment against the claim for lack of duty, the Court noted both that the regulation was intended to assure safe working conditions for employees and that nothing in the act "suggests an intent to protect third-party manufacturers." *Id.* at 346.

The same analysis and conclusion apply here. Nothing in Rule 3040 demonstrates an intent to protect third party non-customers of AIG/SagePoint's from allegedly unsuitable investment advice given outside of AIG/SagePoint. For any individualized duty to exist, the statute or regulation must indicate "a 'clear intent' to identify and protect a 'particular and circumscribed class of persons' of which the plaintiff is a member." *Stannik v. Bellingham-Whatcom Cnty. Dist. Bd. of Health*, 48 Wn. App. 160, 163, 737 P.2d 1054 (1987) (citing *Halvorson v. Dahl*, 89 Wn.2d 673, 676, 574 P.2d 1190 (1978)). As Division I explained in *Stannik*, a statute or regulation "which merely evidences an intent to protect 'the public health and welfare' does not create the sort of individualized duty upon which liability can be founded." *Id.* at 163.

Here, the Garrison Entities' discussion and authorities address as

the purpose of NASD Rule 3040 an intent to protect "investors" or "the public." *Op. Br.*, 25-6. This is insufficient to establish an intent to protect a particular class of persons, especially an intent to protect non-client third parties from bad investment advice such as the Garrison Entities who have no relationship with AIG/SagePoint. At the most, in these circumstances the NASD rules contemplate protection of AIG/SagePoint's customers from insider trading, front running and the like. Alternatively, this Court might read the rules to seek to protect third parties from undetected "selling away." But this case does not concern undetected "selling away."

None of the cited NASD Conduct Rules impose any duty or obligation on SagePoint to supervise the outside transactions or intervene in the investment strategy to protect non-clients the Garrison Entities from bad strategy. The interest Appellants' assert in this appeal— the right to have SagePoint protect their interests in their Wells Fargo accounts from unwise investment strategy and unsuitable trades by their chosen adviser and trustee—was not intended to be protected by Rule 3040.

3. The Garrison Entities offer no authority recognizing the novel, expanded duty they seek; the authorities they raise are off-point

The Garrison Entities offer no authority applying the NASD rules as they urge. They offer no authority recognizing the duty they urge that AIG/SagePoint review for suitability the trades in Appellants' Wells Fargo accounts. This failure should convince this Court to affirm.

The Garrison Entities raise three inapposite cases from other jurisdictions: *McGraw v. Wachovia Sec., L.L.C.*, 756 F. Supp. 2d 1053 (N.D. Iowa 2010); *As You Sow v. AIG/SagePoint Fin. Advisors, Inc.*, 584 F. Supp. 2d 1034 (M.D. Tenn. 2008); and *Colbert & Winstead, P.C. v. AIG Fin. Advisors, Inc.*, 2008 U.S. Dist. LEXIS 53179 (M.D. Tenn. July 8, 2008). *See Op. Br.*, 56-7. All of those cases involved "private securities transactions" that fell within the scope of NASD Conduct Rule 3040. None of those cases involved "account[s] over which [the] associated person] had discretionary authority." Rule 3050, thus, did not come into play and was not addressed or considered in any of those decisions.

These cases are off-point in other respects as well. In *McGraw v. Wachovia*, the alleged duty was one "to supervise and detect undisclosed outside business activity" through which the defendants' stockbroker was stealing money that clients thought was associated with accounts of the defendant broker-dealers. 756 F. Supp. 2d at 1057–58, 1069. Because the facts suggested the broker-dealers had notice that the stockbroker was involved in outside activities that the stockbroker had failed to disclose to the broker-dealers in violation of Rule 3040, the Court held that the broker-dealer may have violated a duty to assure the stockbroker's compliance with Rule 3040. *Id.* at 1074–78. Suitability was nowhere raised to support the negligence claim.[8] Unlike in *McGraw*, here Mark had

[8] Note that the court denied summary judgment because the underlying facts were disputed, 756 F. Supp. 2d at 1077, unlike in this case.

disclosed to AIG/SagePoint the outside activities at issue. The case does not present undisclosed outside activities like in *McGraw*. *McGraw* does not apply and does not support recognition of the duty Appellants allege.

Similarly, in *As You Sow v. AIG Financial Advisors, Inc.*, the duty at issue was different. The plaintiffs alleged a duty to prevent an associated person who was *both* a registered securities representative and an investment advisor of the defendant broker-dealer from engaging in illegal activities, i.e., creating fictitious accounts to steal the clients' money. 584 F. Supp. 2d at 1037, 1041. The case also is unavailing based on the factual distinction that Mark was not an investment advisor with AIG/SagePoint, unlike the stockbroker in *As You Sow*. And nowhere does the case address a duty to supervise for suitability. The case also is procedurally distinguishable, arising in the context of a CR 12(b) motion to dismiss. *Id.* at 1038.

In *Colbert & Winstead, P.C. v. AIG Fin. Advisors*, the CR 12(b) posture of the case also distinguishes it from the case at bar. 2008 U.S. Dist. LEXIS 53179, at *7–8. Also unlike the case at bar, the plaintiffs were mutual clients of *both* the stockbroker and the defendant broker-dealer under whose auspices the stockbroker worked as an investment adviser. 2008 U.S. Dist. LEXIS, at *2. Various "red flags" were alleged preceding the stockbroker's eventual theft of the mutual clients' money, which plaintiffs asserted created "a greater than usual obligation to supervise the activities of Mr. Stokes." *Id.* at *5–6 n.3. These "red flags" included prior to the stockbroker's association with the broker-dealer

defendant an erratic employment history, a prior termination for failure to cooperate in an investigation concerning client funds, and a formal caution from the NASD for failure to disclose certain outside activities. *Id.* The case does not support the duty asserted by the Garrison Entities.

Acknowledging that existing law does not support their claims, the Garrison Entities invite this Court to make new law by rearranging the text of Rule 3040 and inventing a new limit on the exception for transactions falling under Rule 3050. The Court should reject the invitation.

As to "red flags," the Garrison Entities posit that an annual review of outside activities is required. *Op. Br.*, 37 citing NTM 94-44. If this does apply, AIG/SagePoint complied. It is undisputed that Mark lost the assets in a one-year period. CP 25-8, 128 ¶¶ 16-7 (Mark allocated almost all of Plaintiffs' Wells Fargo assets to shares of leveraged "ProShares Ultra" or "ProShares Ultrashort" Funds, and the account actually increased in value in 2007; by the end of 2008, Plaintiffs' $26 million was almost completely gone). Nothing supports the conclusion that AIG/SagePoint had sufficient notice (let alone ability) to arrest this dramatic, sudden course before it occurred. The Garrison Entities do not present any evidence of "red flags" *prior to* the trades at issue. No facts in the record support the conclusion that AIG/SagePoint should have withheld consent in 2007 and early 2008 in its 407 letters concerning the Wells Fargo accounts based on any known issues with Mark's abilities or performance.

McGraw discusses *Bear Stearns* in which the Ninth Circuit states the "general rule" that "a broker-dealer owes no duty to a non-customer

who has invested money through an independent investment advisor." *Bear Stearns & Co. v. Buehler*, 23 Fed. Appx. 773, 775 (9th Cir. 2001). This general rule supports the trial court's judgment in favor of AIG/SagePoint. The *Bear Stearns* court goes on to state that a duty may be triggered if there is "additional involvement" by the broker-dealer such as "sufficiently suspicious" circumstances alerting the broker-dealer to the stockbroker's fraud. 23 Fed. Appx. at 776. Here, the record does not support this necessary showing. The transactions were consistent with Mark's disclosures of his outside activities and the 407 letters. *Bear Stearns* does not provide any support for the Garrison Entities contention that AIG/SagePoint should have interfered with the investment strategy. *Bear Stearns* does not support reversal.

For all of these reasons, this Court should affirm the trial court's ruling that AIG/SagePoint owed no duty to the Garrison Entities.

4. Policy and practical considerations do not support a duty in these circumstances.

Policy and practical considerations do not support the duty urged by the Garrison Entities. In deciding questions of duty, courts evaluate public policy considerations. *Bernethy*, 97 Wn.2d at 933. The Garrison Entities offer absolutely no discussion of public policy considerations. Yet, they ask this Court to announce a duty that turns AIG/SagePoint into an insurer of Mark's outside activities simply based on his stockbroker status, ignoring that Mark's actionable conduct was unrelated to his role as a stockbroker at AIG/SagePoint and that the Garrison Entities and

AIG/SagePoint were absolute strangers. The Garrison Entities had stockbrokers responsible for these transactions: the Wells Fargo stockbrokers. Wells Fargo was responsible for their supervision and had a client relationship with the Garrison Entities. Wells Fargo also was compensated for taking on these responsibilities. There is no gap to fill. Public policy considerations do not support a duty.

As discussed, the urged duty is unworkable because AIG/SagePoint had insufficient information about strangers the Garrison Entities in order to evaluate suitability. The proposed duty also is unworkable giving the timing. The transactions occurred at Wells Fargo long before they later were reported to AIG/SagePoint. AIG/SagePoint was never in a position to evaluate the trades before they happened. These facts are incompatible with a duty that required AIG/SagePoint to evaluate whether the trades would be in the trusts' interests.

The duty urged by the Garrison Entities also should be rejected as contrary to the interests of market participants, i.e., people involved in the stock market. Market participants like the Garrison Entities are entitled to access the market. They are entitled to use the stockbrokers of their choice. They are entitled to pursue their investment strategies. They are entitled to hire investment advisers. When directing trades, market participants are entitled to immediate action and execution of their directions. The duty alleged here would intrude upon all of these imperatives. It would have required AIG/SagePoint to interfere in the trusts' relationships with its chosen professionals and to interfere with

their trades. While the recognition of such a duty might meet the Garrison Entities' present objective to find a solvent liable party, it is incompatible with the larger system and rights of market participants.

In addition to being undesirable from a market-participant standard, such a duty would be highly problematic for broker-dealers like AIG/SagePoint, who would be required to meddle and interfere in the business activities of other stockbrokers and broker-dealers and the business affairs of non-customers. In reality, AIG/SagePoint had no license to interfere in the Garrison Entities' relationship with Wells Fargo or Acumen Financial, or with the Garrison Entities' choice of Mark as their trustee/manager, even had it wished to do so.

The duty also is unwarranted where AIG/SagePoint received no compensation for anything related to these transactions. If such a duty were to be created, the public as a result would bear increased fees, interference, reduced choice of which broker-dealers and investment advisers to use, or complete lack of access to their chosen professionals.

Additionally, as noted the NASD Rules neither provide a private right of action nor purport to establish a legal duty. They contain many ambiguities and few bright lines. These rules offer no compelling reason for this Court to create a new duty in Washington. FINRA is free to regulate AIG/SagePoint as it wishes. Additionally, "[the Washington] legislature decided that private individuals can sue investment brokers under some provisions of the [Washington State] Securities Act but cannot sue for violations of the suitability rule. Accordingly, no private cause of

action exists for violations of the suitability rule." *Ives*, 142 Wn. App. at 390 (citing RCW 21.20.702). While this does not prevent Washington courts from creating a new duty, it indicates that after considerable study of the securities industry the Washington legislature rejected expansion of liability in the direction Appellants seek.

The Garrison Entities inform this Court that their arbitrated claims against Wells Fargo did not result in recovery. *Op. Brief*, 5 n.3. Neither the arbitration award nor the reasons therefore are before this Court. It would be an unjustified result in this case if AIG/SagePoint, a stranger to the transactions at issue, had greater responsibility than the actual broker-dealer directly involved in these trades that both held the accounts for its customers the Garrison Entities and executed the trades. The conclusion correctly reached by the trial court that AIG/SagePoint has no duty to non-customers the Garrison Entities concerning these events should come as no surprise. An entity that did not hold the accounts, execute the trades or profit from them should not be expected to have greater responsibility than Wells Fargo. Application of the law on duty to this case produces the correct result. The trial court properly dismissed the claims.

The duty espoused by the Garrison Entities is unwise and problematic. It does not exist, nor should it.

B. This Court should affirm the trial court's summary judgment dismissing the Washington State Securities Act claim for secondary liability under RCW 21.20.430(3) because the undisputed evidence shows that AIG/SagePoint was not a "control person" of the specific transactions at issue.

The trial court correctly rejected the Garrison Entities' Washington State Securities Act ("WSSA") claim that AIG/SagePoint is secondarily liable for Mark's conduct. On appeal the Garrison Entities drop their claim that AIG/SagePoint was primarily liable as a "seller" under the WSSA and seek only reinstatement of the claim for secondary liability as a "control person." *Op. Br.*, 57-60. The claim for secondary liability requires that the Garrison Entities establish that AIG/SagePoint was a "control person" under RCW 21.20.430(3). Based on the undisputed facts, SagePoint was not a "control person." Dismissal, therefore, was proper.

In Washington, a broker-dealer like AIG/SagePoint may be liable as a control person only where it directly or indirectly controlled the liable seller or buyer (Mark) and it materially aided the transaction, as follows:

> 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. [Emphasis added.]

RCW 21.20.430(3). Here, on the undisputed facts AIG/SagePoint did not directly or indirectly control Mark's operations at issue, nor did it materially aid the transactions.

The Washington Supreme Court established the test for "control person" liability in *Hines v. Data Line Systems*, adopting the test outlined by the Eighth Circuit that requires actual participation in the operations at issue generally and the "power to control the specific transaction or activity" upon which the primary violation is predicated. 114 Wn.2d 127, 136, 787 P.2d 8 (1990), citing *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985).[9]

Division I since has examined that test, reiterating that not only must a plaintiff establish actual participant in the general operations, but the power to control the specific activity underlying the claims, as follows,

> plaintiffs must establish, first, that the defendant [] "**actually participated in (i.e., exercised control over)**

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[9] The power of defendants to control the specific transactions at issue in *Hines* was established "by virtue of their presence at board meetings where the placement memorandum was fully discussed," their knowledge of facts allegedly wrongfully omitted, and their participation "in the omissions of material facts from the placement memorandum." *Hines*, 114 Wn.2d at 137. "Clear control over" the primary actor was established by their holding a majority of the stock in the primary actor, having invested "substantial sums of money" with the company, having "actively directed and influenced the management of the company." *Id.* at 141. The Garrison Entities offer no similar facts.

> **the operations of the corporation in general; *then* he must prove that the defendant possessed the power to control the specific transaction or activity** upon which the primary violation is predicated, but he need not prove that this later power was exercised."

Herrington v. Hawthorne, 111 Wn. App. 824, 835–36, 47 P.3d 567 (2002) (emphasis added) (quoting *Metge*, 762 F.2d at 631).

Applying this test, this Court in *Herrington* held that an associate of a seller of fraudulent notes was not a "control person" under the Act notwithstanding his participation in one of the companies owned by the seller because plaintiff offered no evidence that the associate actually participated in or exercised control over the operations of the seller or that he had the actual authority to control the sales of the fraudulent notes. *Id.* at 836. This Court rejected the plaintiff's argument that the statute required only a showing that the associate had some general control over the seller. *Id.* The *Herrington* court explained: "The term 'seller' in this context means control of the seller in his or her ***capacity as a seller***, as in control of the company selling securities or of the ***person's actions as a seller***. It does not mean control of a person in some abstract or general sense." *Id.* at 837 (emphasis added). This Court therefore affirmed dismissal of the claim for secondary liability. *Id.* at 838.

Here, the same analysis and result apply. The Garrison Entities fail to make both necessary showings. At most, the Garrison Entities offer only some abstract or general control unrelated to Mark's allegedly actionable conduct. There is no evidence that AIG/SagePoint

"participated" generally in Mark's actions as trustee, manager or investment advisor for the Garrison Entities. It is undisputed these were outside activities, i.e., operations of Mark's in which AIG/SagePoint played no role. And, like in *Herrington*, there is no evidence that AIG/SagePoint actually participated in, or exercised control over, any of the *specific transactions or activities* in the Wells Fargo accounts at issue. At the most, AIG/SagePoint received after-the-fact confirmations of trades executed by Wells Fargo brokers at Mark's direction. The evidence viewed favorably to Appellants does not support a conclusion that AIG/SagePoint had the actual ability to control Mark in his capacity as Plaintiffs' trustee/manager, the investment advice of Acuman Financial or the specific trades executed by Wells Fargo's brokers. Accordingly, and consistent with controlling Washington authorities, SagePoint was not a "control person" for purposes of imposing secondary liability under RCW 21.20.430(3).

Additionally, the evidence does not show that AIG/SagePoint materially aided the transactions. No fact finder could conclude on this record that SagePoint materially aided Mark in effecting the transactions in the Wells Fargo accounts. Mark had the ability and opportunity to effectuate the transactions both as trustee with sole discretionary authority and as the hired investment advisor for these accounts. He effectuated them through the Wells Fargo brokers. He did not need AIG/SagePoint. All of the participants received compensation. AIG/SagePoint, on the other hand, did not participate in or have advance notice of the

transactions. The record is clear that AIG/SagePoint played no material role in the actual transactions at issue.

The Garrison Entities make two arguments for reversal. They fail to cite *Hines* and misconstrue applicable law. This Court should reject their arguments.

The Garrison Entities argue that AIG/SagePoint controlled "whether or not Mark could act as a trustee or manager" of their accounts, referring to the fact that upon receiving the 407 letters from Wells Fargo, AIG/SagePoint could have declined to permit Mark to proceed in these outside activities. *Op. Br.*, 59. In fact, the commentator cited by the Garrison Entities has pointed out that Rule 3040 does not specifically allow disapproval. *See Uhlenhop*, *supra*, at 26. Moreover, even if true this does not support reversal. The Garrison Entities admit in their briefing that permitting Mark to pursue these outside activities in and of itself was perfectly permissible, stating, "Broker dealers can employ dually licensed stockbrokers solely as a stockbroker, while allowing them to be employed by a different firm as an investment adviser." *Op. Br.*, 10. At the most, the fact that AIG/SagePoint did not prohibit Mark from assuming the role of trustee/manager amounts to control only in some abstract or general sense.

AIG/SagePoint did not "actually participate" in these outside activities of Mark's. It remains undisputed that Mark ran these operations independently, with no benefit to or participation by AIG/SagePoint. And, AIG/SagePoint also did not control Mark's specific actions as a seller. The "specific transactions or activities" upon which the primary liability is

predicated are the actual advice and trades that Mark directed at Wells Fargo. The Garrison Entities offer no evidence that AIG/SagePoint had any control or influence in how Mark managed the accounts, the investment strategy he chose, the directions he gave Wells Fargo, or the actions of the Wells Fargo brokers in managing the accounts. The record is plain that AIG/SagePoint did not and could not control these specific transactions. They occurred "outside" of AIG/SagePoint, not based on any connection to AIG/SagePoint.

The Garrison Entities also argue that this Court should reverse based on a supposed "general rule" that a broker-dealer like AIG/SagePoint "is a control person of its stockbrokers." *Op. Br.*, 58. While the Garrison Entities assert that "Washington law" so holds, they cite only a Ninth Circuit decision *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990), that interpreted Section 20(a) of the Federal Securities Exchange Act of 1934. This authority is unavailing. *Hollinger* did not concern the WSSA, a significant point that the Garrison Entities fail to mention. Division I in *Stewart v. Estate of Steiner* addressed the *Hollinger* decision, specifically noting that Section 20(a) and RCW 21.20.430(3) are worded differently. 122 Wn. App. 258, 277, 93 P.3d 919 (2004). The federal act does not require a showing that the broker-dealer "materially aided" the transaction at issue to be held liable as a controlling person, whereas the state act does. The Garrison Entities' incomplete discussion of *Hollinger* and *Stewart* does not support reversal.

Hollinger also must be read in the context of its facts. Primary

liability arose from activities by the stockbroker at the broker-dealer's business. 914 F.2d at 1566. In other words, the activities were not "outside business activities" or "selling away." They were activities at the broker-dealer's business. The Ninth Circuit's "general rule" applies only in such circumstances. Nothing suggests that it would apply to the wholly different facts of this case where the primary liability arose from "outside business activities." The *Hollinger* court itself repeatedly points to the context of the case. *See* 914 F.2d at 1575 n.24. The *Hollinger* court expressly allows that a broker-dealer may "of course" "rely on a contention that the representative was acting outside of the broker-dealer's statutory 'control.'" *Id.* at 1775 n.26. It also provided an example that perfectly fits the present case and shows that no liability attaches:

> The broker-dealer may also, of course, rely on a contention that the representative was acting outside of the broker-dealer's statutory "control." For example, Titan could argue that when appellants entrusted their money to Wilkowski they were not reasonably relying upon him as a registered representative of Titan, but were placing the money with Wilkowski for purposes other than investment in markets to which Wilkowski had access only by reason of his relationship with broker-dealer Titan.

Id. This describes the case at bar where the Garrison Entities assert no reliance on AIG/SagePoint and were relying on Mark for transactions in other markets, not markets accessible only through AIG/SagePoint. The Ninth Circuit expressly views these circumstances as defeating secondary liability. Even if applicable, which it is not, [10] *Hollinger* is factually

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[10] The federal courts recognize Washington's adoption of the "two-prong"

distinguishable and its "general rule" inapplicable.

The Garrison Entities failed to make the necessary evidentiary showing pursuant to controlling precedent to sustain their claim for secondary liability under the WSSA. The Washington Supreme Court has adopted not *Hollinger* but *Metge v. Baehler* to establish the Washington standard. This Court is bound to apply the *Metge* standards, which results in the conclusion that secondary liability as a control person liability does not apply. No Washington case supports the conclusion that AIG/SagePoint was a control person for the transactions at issue.[11]

C. This Court should affirm the trial court's summary judgment dismissing the *respondeat superior* claim because the undisputed facts do not support the necessary elements.

This Court should affirm the proper dismissal of the Garrison Entities' *respondeat superior* claim. Whether *respondeat superior* liability exists is properly resolved on summary judgment when there can be only one reasonable conclusion from the undisputed facts. *Rahman v. State*, 170 Wn.2d 810, 816, 246 P.3d 182 (2011). Because Mark Garrison was

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test derived from *Metge* and do not apply *Hollinger* to WSSA claims. *See Sung v. Mission Valley Renewable Energy LLC*, CV-11-5163-RMP, 2013 U.S. Dist. LEXIS 40580, at *6-7 (E.D. Wash. Mar. 22, 2013) (affirming summary judgment dismissing claim against bank for secondary liability under WSSA based on *Metge* standards where sale of securities was not part of bank's business and mere fact of employment with bank and dealings "on company time" was insufficient to establish ability to control specific transactions).

[11] In the event of reversal and remand, AIG/SagePoint specifically reserves its right to establish applicability of the good faith defense.

not an employee of AIG/SagePoint, *respondeat superior* liability is inapplicable. Additionally, the same duty deficiency that defeats the negligent supervision claim also defeats the Garrison Entities' novel *respondeat superior* theory that Mark's role as manager of AIG/SagePoint's local office somehow creates liability in AIG/SagePoint. The trial court properly dismissed this ill-founded claim.

The Garrison Entities attempt to convince this Court that they can bend a *respondeat superior* claim to the facts of this case. They cannot. To support their claim, the Garrison Entities focus exclusively on Mark's role as manager of the local AIG/SagePoint office. They assert that Mark's failings as manager trigger *respondeat superior* liability. *Op. Br.*, 3 at ¶ 5, 61-63.[12] This argument fails.

The *respondeat superior* claim first fails as a matter of law because it is undisputed that Mark was not an employee of AIG/SagePoint but an independent contractor. CP 238-44. In Washington, *respondeat superior* liability requires the establishment of a master and servant relation. The general rule in Washington is that an entity is not liable under respondeat superior for the torts of an independent contractor. As the Washington

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[12] Mark's role as financial advisor, manager and trustee for the Garrison Entities was unrelated to AIG/SagePoint and is not the basis for the respondeat superior claim. *Op. Br.*, 63 ("Mark's conduct as trustee" "was never the basis of Appellants' *respondeat superior* claim."). To apply the doctrine of *respondeat superior*, a tort must be committed within the scope of employment and in furtherance of the employer's interest. *Breedlove v. Stout*, 104 Wn. App. 67, 70, 14 P.3d 897 (2001). That was not the case as to any of Mark's conduct as financial advisor, manager or trustee. Nor do the Garrison Entities argue that it was.

Supreme Court explained in *Bill v. Gattavara*, 24 Wn.2d 819, 837, 167 P.2d 434 (1946), this is because with independent contractors, "the employer does not possess the power of controlling the person employed as to the details of the stipulated work; and it is therefore, a necessary judicial consequence that the employer shall not be answerable for an injury resulting from the manner in which the details of the work are carried out by the independent contractor." Other Washington decisions before and after *Bill* are consistent. *Fenimore v. Donald M. Drake Constr. Co.*, 87 Wn.2d 85, 94–95, 549 P.2d 483 (1976); *Larson v. American Bridge Co.*, 40 Wash. 224, 227–28, 82 P. 294 (1905).

The Garrison Entities do not dispute that Mark was an independent contractor, and failed to offer any evidence that AIG/SagePoint had or asserted control over the details of the work he carried out as manager. *Respondeat superior* liability does not lie.

A narrow exception to the general rule that entities are not liable for the torts of their independent contractors arises concerning workplace safety. The Garrison Entities rely on *Kelley v. Howard S. Wright Constr. Co.*, 90 Wn.2d 323, 330, 582 P.2d 500 (1978) (*see Op. Br.*, 62), which addresses this narrow safety-focused exception. *Kelley* establishes that an employer who hires an independent contractor is not ordinarily vicariously liable for injuries at its workplace resulting from the independent contractor's work, but that a general contractor may fall within an exception if it retains control over the work. 90 Wn.2d at 330–34. *Kelley* explains that this workplace-safety exception has its roots in the tort

doctrine of the non-delegable duty to require workplace safety precautions and a non-delegable statutory duty to provide a safe place of work. *Id.* at 332–33. Because the Garrison Entities' claims do not deal with workplace safety or injuries, the exception in *Kelley* cannot apply.

Additionally, the Garrison Entities do not meet their burden to establish that any of Mark's alleged failings as manager of AIG/SagePoint's branch office constitute a tort against them in the first place. The Garrison Entities did not and cannot show that any manager of the AIG/SagePoint branch, including Mark, had a duty to the Garrison Entities as non-customers concerning their Wells Fargo accounts. At the most, any of the manager's supervisory duties were owed to AIG/SagePoint customers and AIG/SagePoint itself, but not to non-AIG/SagePoint customers. Appellants' convoluted theory of *respondeat superior* liability premised on Mark's managerial role simply leads back to the same impediment to liability for negligent supervision: no duty was owed to non-customers the Garrison Entities. There is, thus, no tort by any AIG/SagePoint manager including Mark against the Garrison Entities for which AIG/SagePoint could be secondarily liable. This ends the inquiry.

The Garrison Entities make no cogent argument that Mark's status as manager supports a claim against AIG/SagePoint for vicarious liability. This Court should affirm dismissal of the *respondeat superior* claim.

D. This Court should affirm the trial court's denial of the Motion for Reconsideration where that Motion raised no issue or evidence justifying a different outcome.

The Garrison Entities provide no basis for reversal of the trial court's denial of their motion for reconsideration. On appeal, the Garrison Entities offer no authority or argument regarding the basis of their assertion that the trial court abused its discretion. *Op. Br.*, 63-5. Again, because this is deficient under RAP 10.3(a)(6) and *McKee*, 113 Wn.2d at 705, the Court should not consider the issue.

An examination of the Motion for Reconsideration (CP 487-503) leads to the conclusion that it offered insufficient grounds for any change to the original decision.[13] Nothing in the Motion establishes that failure to reconsider was an abuse of discretion. Nothing contained in the internal Supervisory Manual solves the problem with the Garrison Entities' claims that AIG/SagePoint owed them no duty.

The Garrison Entities argued that provisions in AIG/SagePoint's Supervisory Manual altered the duty analysis and supported their claims. CP 494; 496 ("Had the Court had the opportunity to review the contents of the late-produced Supervisory Manuals, it could not have reached the same decision on the parties' summary judgment motions.") But they offered, and offer this Court, no authority that the internal supervisory

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[13] The Garrison Entities' appeal of the order denying reconsideration is properly limited to whether the trial court should have reconsidered the summary judgment. They do not argue or seek reversal of the denial without prejudice of their request for sanctions.

manual could establish a legal duty owed to third party non-customers. The Garrison Entities again incorrectly focus on "standard of care" and case law addressing the same, CP 494-95, which is different than the *duty* analysis at issue. Additionally, they offer no authority or evidence that this internal supervisory manual establishes the industry standard or a minimum standard as opposed to a best practice or desired procedure. By its plain terms it does not establish minimum industry standards. CP 575 ("The purpose of this chapter is to help ensure that the Adviser conducts its business in compliance with all applicable federal and state laws, rules and regulations in keeping with the highest level of professional and ethical standards")

Moreover, Appellants misread the manual. The Supervisory Manual does not require AIG/SagePoint supervisors to "monitor" the Wells Fargo transactions "for suitability and breaches of fiduciary duty and to disapprove trades that are unsuitable or constitute a breach of fiduciary duties." *See* CP 491. First, Section 23.8 is directed to investment advisers working *for* AIG/SagePoint, i.e. within AIG/SagePoint's investment advising branch. CP 575 ("This chapter shall be followed by all personnel in the conduct of their responsibilities on behalf of AIG Financial Advisers, Inc.") Next, the Garrison Entities incorrectly argue that the Supervisory Manual at Section 23.8 instructed supervisors to approve or reject trades based on criteria including appropriateness. *Op. Br.*, 33. Section 2.4.2 on employee outside accounts (any outside accounts in which an employee has a partial ownership or beneficial interest or

possesses trading authority including as trustee) in fact reiterates the testimony of expert David Paulukaitis that such accounts fall within Rule 3050. CP 567. In this context, the Supervisory Manual references Rule 3050, discusses 407 letters, and identifies transaction review aimed at detecting activities that could harm AIG/SagePoint and its clients. CP 568-69. It addresses, for example, Insider Trading at length. CP 570-71. The Supervisory Manual focuses on protecting not third parties but AIG/SagePoint and its customers: "AIGFA has a vital interest in its reputation, the reputation of its associates, and in the integrity of the securities markets." CP 571. The Supervisor's Manual does not establish that AIG/SagePoint owes duties to third parties like the Garrison Entities.

Similarly, Section 23 (CP 575-88) addresses "Investment Advisors" within the context of ensuring that advisers conduct their business "in compliance with all applicable federal and state laws, rules and regulations and in keeping with the highest level of professional and ethical standards." It purports neither to state minimum duties for advisers or broker-dealers, or to impose obligations for the benefit of third parties. It expressly identifies a duty that an adviser owes as a fiduciary "to its advisory Clients," while nowhere identifying any duty owed by AIG/SagePoint to third parties. CP 575 at 23.2. Section 23 covers a variety of subject-matters, including advisers' registration, eligibility, renewals, training, disclosures, record keeping, contracts, compensation, billing methods, suitability, personal securities transactions, and insider training. CP 575-588. That does not mean, however, that AIG/SagePoint has

obligations to third parties regarding any or all of such conduct.

A central assumption of the entire section is that with rare exceptions investment advisers will hold accounts on behalf of their clients with AIG/SagePoint. CP 588 (advisers "are not permitted to maintain a securities account at another firm unless the FLS approves the account in writing."). If an exception is granted, the confirmations and duplicate monthly statements should be sent and AIG/SagePoint "will review all account confirmations and statements for potential conflicts of interest and for frequency and type of account activity." CP 588. The review identified in the next paragraphs, including for "client[']s risk tolerance" and "investment objectives," pertains to clients of AIG/SagePoint. It does not pertain to the rare exception when the adviser has outside accounts and AIG/SagePoint has no information about the client. The Garrison Entities attempt to read too much into Section 23.8.

Section 23.8 should not alter the conclusion that AIG/SagePoint owed no duty to the Garrison Entities to review on their behalves the activities in its Wells Fargo accounts to protect them from unsuitable trades and investment strategy. For all of the reasons already briefed, AIG/SagePoint had no duty to supervise the suitability of trades directed by family member and trustee Mark Garrison in their Wells Fargo accounts through Wells-Fargo brokers. The trial court, therefore, did not abuse its discretion in denying reconsideration.

VI. CONCLUSION

AIG/SagePoint respectfully requests that this Court uphold the trial court's summary judgment. The Garrison Entities present no legal claim against AIG/SagePoint because the element of duty is lacking. No legal "hook" exists on which the Garrison Entities can hang a claim against AIG/SagePoint.

Based on the undisputed facts, AIG/SagePoint owed no duty to the Garrison Entities under any statute, regulation or the common law. Without any conventional or legitimate grounds on which to base a claim, the Garrison Entities urge this Court to expand the law. But they offer no compelling reasons to do so. This Court should conclude that existing law does not support their claims and that the trial court did not err. There is nothing for this Court to correct. It should affirm.

DATED this 31st day of July, 2013.

Respectfully submitted,

SCHWABE, WILLIAMSON & WYATT, P.C.

By: Averil Rothrock

Troy Greenfield, WSBA #21578
Email: tgreenfield@schwabe.com
Averil Rothrock, WSBA #24248
Email: arothrock@schwabe.com
Attorneys for SagePoint Financial, Inc.

Appendix - I

Attachment to Second Declaration of David E. Paulukaitis
NASD Conduct Rule 3040

FINRA

Print

3040. Private Securities Transactions of an Associated Person

(a) Applicability

No person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of this Rule.

(b) Written Notice

Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice.

(c) Transactions for Compensation

(1) In the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice pursuant to paragraph (b) shall advise the associated person in writing stating whether the member:

(A) approves the person's participation in the proposed transaction; or

(B) disapproves the person's participation in the proposed transaction.

(2) If the member approves a person's participation in a transaction pursuant to paragraph (c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the person's participation in the transaction as if the transaction were executed on behalf of the member.

(3) If the member disapproves a person's participation pursuant to paragraph (c)(1), the person shall not participate in the transaction in any manner, directly or indirectly.

(d) Transactions Not for Compensation

In the case of a transaction or a series of related transactions in which an associated person has not and will not receive any selling compensation, a member which has received notice pursuant to paragraph (b) shall provide the associated person prompt written acknowledgment of said notice and may, at its discretion, require the person to adhere to specified conditions in connection with his participation in the transaction.

(e) Definitions

For purposes of this Rule, the following terms shall have the stated meanings:

(1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in Rule 2790), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

(2) "Selling compensation" shall mean any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions; finder's fees; securities or rights to acquire securities; rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements.

Amended by SR-NASD-99-60 eff. March 23, 2004.
Adopted by SR-NASD-85-28 eff. Nov. 12, 1985.

Selected Notices: 75-34, 80-62, 82-39, 85-21, 85-54, 85-84, 91-32, 94-44, 96-33, 01-79, 03-79.

Appendix - II

Attachment to Second Declaration of David E. Paulukaitis

NASD Conduct Rule 3050

FINRA

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3050. Transactions for or by Associated Persons

(a) Determine Adverse Interest

A member ("executing member") who knowingly executes a transaction for the purchase or sale of a security for the account of a person associated with another member ("employer member"), or for any account over which such associated person has discretionary authority, shall use reasonable diligence to determine that the execution of such transaction will not adversely affect the interests of the employer member.

(b) Obligations of Executing Member

Where an executing member knows that a person associated with an employer member has or will have a financial interest in, or discretionary authority over, any existing or proposed account carried by the executing member, the executing member shall:

(1) notify the employer member in writing, prior to the execution of a transaction for such account, of the executing member's intention to open or maintain such an account;

(2) upon written request by the employer member, transmit duplicate copies of confirmations, statements, or other information with respect to such account; and

(3) notify the person associated with the employer member of the executing member's intention to provide the notice and information required by subparagraphs (1) and (2).

(c) Obligations of Associated Persons Concerning an Account with a Member

A person associated with a member, prior to opening an account or placing an initial order for the purchase or sale of securities with another member, shall notify both the employer member and the executing member, in writing, of his or her association with the other member; provided, however, that if the account was established prior to the association of the person with the employer member, the associated person shall notify both members in writing promptly after becoming so associated.

(d) Obligations of Associated Persons Concerning an Account with a Notice-Registered Broker/Dealer, Investment Adviser, Bank, or Other Financial Institution

A person associated with a member who opens a securities account or places an order for the purchase or sale of securities with a broker/dealer that is registered pursuant to Section 15(b)(11) of the Act ("notice-registered broker/dealer"), a domestic or foreign investment adviser, bank, or other financial institution, except a member, shall:

(1) notify his or her employer member in writing, prior to the execution of any initial transactions, of the intention to open the account or place the order; and

(2) upon written request by the employer member, request in writing and assure that the notice-registered broker/dealer, investment adviser, bank, or other financial institution provides the employer member with duplicate copies of confirmations, statements, or other information concerning the account or order;

provided, however, that if an account subject to this paragraph (d) was established prior to a person's association with a member, the person shall comply with this paragraph promptly after becoming so associated.

(e) Paragraphs (c) and (d) shall apply only to an account or order in which an associated person has a financial interest or with respect to which such person has discretionary authority.

(f) Exemption for Transactions In Investment Company Shares and Unit Investment Trusts

The provisions of this Rule shall not be applicable to transactions in unit investment trusts and variable contracts or redeemable securities of companies registered under the Investment Company Act of 1940, as amended, or to accounts which are limited to transactions in such securities.

Amended by SR-NASD-2002-40 eff. Oct. 15, 2002.
Amended by SR-NASD-90-58 eff. June 1, 1991.
Amended by SR-NASD-86-29 eff. Dec. 15, 1986; Mar. 14, 1991.
Amended by SR-NASD-82-25 eff. Feb. 28, 1983.

Selected Notices: 82-21, 82-44, 83-17, 85-41, 87-2, 91-27, 97-25, 02-73.

CERTIFICATE OF SERVICE

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

That on the 31st day of July, 2013, I served the foregoing **RESPONDENT'S BRIEF** to the parties to this action as follows:

Jason Dennett
Carl J. Carlson
Tousley Brain Stephens PLLC
1700 7th Avenue, Suite 2200
Seattle, WA 98101-4416
Telephone: (206) 682-5600
Facsimile: (206) 682-2992
E-Mail: jdennett@tousley.com
E-Mail: ccarlson@tousley.com

Attorneys for Appellants

Mark M. Garrison
Michelle Garrison
592 Summerfield Drive
Chanhassen, MN 55317

by:

- ☒ U.S. Postal Service, ordinary first class mail
- ☐ U.S. Postal Service, certified or registered mail, return receipt requested
- ☐ hand delivery
- ☐ facsimile
- ☐ electronic service
- ☐ other (specify) _____

Averil Rothrock

PDX\124201\190061\AAR\11685304.8