NO. 73459-8

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WASHINGTON STATE
SUPREME COURT

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

SC# 93614-5

DONALD BURDICK, et al.,

Plaintiffs/Appellants,

v.

ROSENTHAL COLLINS GROUP, LLC,
an Illinois limited liability corporation,

Defendant/Appellee.

E

On Review from King County Superior Court
Case No. 12-2-28409-1 SEA (Hon. Douglass A. North)

PETITION FOR REVIEW

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ORIGINAL

Table of Contents

Table of Authorities

Cases

STATUTES

REGULATIONS

RULES

A. IDENTITY OF PETITIONERS

Petitioners are plaintiffs/appellants Donald Burdick, Bernard Goldberg, Susan Byington, Lisa Carfagno, Peter and Janice Elliot, Paul Golstein, Tom and LaVoe Mulgrew, Susan Rosen, Martin Silverman, Sharon Silverman, and Barry and Robin Stuck (the investors).

B. COURT OF APPEALS DECISION

The petitioners request that this Court review the decision affirming summary judgment against petitioners, *Burdick, et. al., v. Rosenthal Collins Group LLC*, No. 73459-8, contained in the Appendix at pages A-1 through A-23. A copy of the order denying petitioners' motion for reconsideration is in the Appendix at page A-24.

C. ISSUES PRESENTED FOR REVIEW

This case raises two issues: (1) whether respondent Rosenthal Collins Group ("RCG") is secondarily liable under the securities acts of Washington (where liability exists if RCG "materially aids in the transaction") and Ohio (where liability exists for "every person who has participated in or aided the seller in any way in making such sale or contract for sale") when it assisted a nonregistered investment advisor/broker in establishing a commodities pool that RCG knew was illegal and where RCG knew that misrepresentations were being made to potential investors regarding the risks and the legality of the fund; and (2) whether RCG is liable to the investors for its negligence in opening and maintaining that illegal commodity pool, which violated federal regulations and its own internal procedures.

D. STATEMENT OF THE CASE

Factual background. Enrique Villalba, an Ohio self-described investment advisor, approached RCG with a plan to establish an account at that firm with money he intended to raise from investors. Villalba presented RCG with a six page offering circular he prepared to solicit $100 million from investors. It described the investment plan for the account:

(1) Funds from Villalba's investors would be pooled to invest in treasury bills or money market funds "within a vehicle similar to a mutual fund." CP 853.

(2) On occasion, S&P 500 futures contracts would be purchased, based on Villalba's purported expertise in predicting market trends. CP 856-57. Those transactions would add 2% to 5% additional value for his investors. CP 856. The trades in futures contracts would be infrequent, at most a "few days a month." For 90% of the year, "the dollars in the portfolio will remain in non-fluctuating treasury bills or short term commercial paper." *Id.*

(3) The investment had minimal risk because the futures transactions would be made with "little or no leverage" and any risk in the futures trading would be further limited by the use of stop orders set to limit losses. *Id.*

Villalba's plan was problematic on its face: he had no track record or data to show that his program would work, and the concept of trading with "little or no leverage" made no sense in the futures market. More importantly, RCG recognized that Villalba's plan was illegal.

First, RCG knew that although Villalba planned to raise $100 million from investors, he was not registered with any federal or state regulator to sell securities, give investment advice, or trade futures contracts on behalf of others. *Second*, the circular falsely claimed that the fund was not subject to state or federal regulation. RCG recognized that because the account would contain pooled investments, the fund would constitute a commodity pool.[1] That made Villalba, or his company, a commodity pool operator. Neither were registered as commodity pool operators as required by the Commodities Futures Trading Commission. Registration of commodity pool operators is not a mere formality; it is required to protect investors.[2] *Third*, the circular represented to potential investors that there was little risk associated with the investments. RCG knew better. In fact, it had Villalba sign a disclosure acknowledging the trading was risky. CP 1558-59.

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[1] Commodity pools are "the commodity-futures equivalent of a mutual fund." *CFTC v. Equity Fin. Group LLC*, 527 F.3d. 150, 160 (3d. Cir. 2009).

[2] "One of the ways in which unsophisticated traders have lost substantial amounts of money is through commodity advisors and commodity pool operators. This bill will provide for the registration of all such persons, establish procedures under which they will be permitted to operate and specifically eliminate certain undesirable practices which have enticed unsuspecting traders into the markets with, far too often, substantial loss of funds." *CFTC v. Equity Fin. Group LLC*, at 157 (quoting H.R. Rep. No. 93-975, at 79 (1974)).

RCG attempted to address the second problem by having Villalba claim an exemption from having to register as a commodity pool operator. That exemption, however, was only applicable if Villalba neither received any direct or indirect compensation for managing the anticipated $100 million pool, nor advertised for participants. The circular stated, and RCG knew, that he expected to receive management fees from the proceeds and that he would be "offering the securities to the public." Opinion at 5. The exemption was fraudulent.[3]

Thus, RCG knew (1) that Villalba was illegally raising funds from investors because he was not authorized to provide investment advice or sell securities, (2) that the circular describing the program contained misrepresentations regarding the risk of the trades and the legality of the program, and (3) that the account would be used as an illegal commodity pool. RCG was required not to open an account when illegality was suspected.[4] Further, it was prohibited by regulations from conducting business with an unregistered commodity pool operator.[5] Nonetheless, RCG agreed to work with Villalba. It opened an account for his Money Market

[3] Villalba did sell securities to the public and paid himself significant management fees.

[4] CP 1539 (Tanzar Dep. at 80) (emphasis added).

[5] National Futures Association, Bylaw 1101 – Doing Business With Non-Members (quoted in relevant part).

Alternative program and relocated a broker to work with him in Ohio.[6]

After the account was opened, the misrepresentations regarding the program were used to solicit the investors. CP 459. The investors signed agreements with Villalba and sent their money to a bank account where it was then transferred to RCG.[7]

Villalba never followed his purported investment plan. *See* CP 1517-20. Instead of keeping customer money in treasury bills with occasional transactions in S&P 500 futures contracts, Villalba pooled the investors' money to trade risky, highly-leveraged positions in futures contracts at RCG for the chance of substantially higher returns that would allow him to pay himself significant fees while providing his investors with the smaller return described in his offering materials.[8] He traded nearly every day, resulting in more than $1 million in commissions and fees for RCG.[9]

The promised "stop orders" to limit losses were not used. Single day losses of more than $100,000 were not uncommon and, in March 2008 alone, the account lost more than $9 million. Opinion at 5. Villalba admitted

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[6] CP 1511: "the RCG broker assigned to work on the MMA account relocated to Ohio for that purpose."

[7] CP 2086-96, which documents a typical transaction showing money being wire transfer from one of the investors to Villalba and immediately transferred to RCG for trading. The statement by the Court of Appeals that the securities sales were completed well before Villalba would send money to the RCG account (Opinion at 12) is inaccurate.

[8] CP 1517-22.

[9] CP 1525, n. 6. and CP 1363-1495 (RCG account statements).

that the losses stemmed from recklessly using leverage in the RCG account, which accelerated as he attempted to recover those losses.[10]

RCG was required to monitor the account and to detect deviations between the investment plan in the offering circular and actual trading and close the account if there was a material deviation.[11] Despite assigning a broker to work with Villalba in Ohio, who could see first-hand what was transpiring in the account, RCG failed to close the account or stop any trading until Villalba's customers had lost more than $30 million.

Although RCG's records showed the losses and frequency of trading in the commodity pool, the quarterly statements provided to the investors did not. *See* CP 1129, (customer statement for January-March 2008). Villalba fabricated account statements showing that his program was doing well. CP 1119, 1129. When Villalba revealed his fraud to the investors, their account statements indicated an aggregate value of millions of dollars. In actuality, the investors' money was gone. *Id.*

Villalba was sued by the Securities and Exchange Commission and the CFTC. CP 1362-84. He pled guilty to wire fraud and is serving a 105-month prison sentence. CP 292-97. Shortly after Villalba was convicted, the CFTC investigated RCG's role in Villalba's fraud, concluding that RCG failed to

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[10] CP 1518.

[11] CP 1553 (page 202).

properly supervise the MMA account. CP 1522-32. The CFTC found that RCG ignored many "red flags" appearing in the account records and that it should have acted in light of "the lack of regard for trading losses, commissions, and fees in the MMA account." CP 1527-28.

RCG was sued by Villalba's investors in two other cases, both in Ohio: *Pieretti v. RCG Group, LLC,* No. 2011-CV-0051 (Erie County) and *VASA Order v. RCG Group, L.L.C.* No. CV-11-753705 (Cuyahoga County). RCG brought motions for summary judgment in both cases. Both courts refused to dismiss the claims for secondary liability under the Ohio securities act.[12] The *VASA* case went to trial solely on the Ohio securities claims. The jury returned a verdict in favor of the plaintiffs.[13]

Procedural history of this case. The investors filed a motion for summary judgment that their transactions with Villalba were securities under the state securities acts. The trial court granted that motion except for the investments made by customer Bernie Goldberg. The court held that his investments were not securities because Villalba was compensated through a partnership agreement he had with Goldberg.[14]

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[12] Appendices A and C to the appellants' opening brief in the Court of Appeals.

[13] Appendix E to the appellants' opening brief in the Court of Appeals.

[14] The investors appealed that decision, but it was not addressed by the Court of Appeals. The investors request that this Court reverse the Court of Appeals decision below and remand the issue of whether Mr. Goldberg's interest is a security to the Court of Appeals for decision.

The trial court granted RCG's motion for summary judgment, where it: (1) ruled that all of the investors could bring claims under the Ohio securities act, (2) held that the purchases made by the plaintiffs were securities, except for customer Goldberg, (3) dismissed the investors' securities claims, holding that RCG could not be secondarily liable for Villalba's violations of the securities acts, and (4) dismissed the investors' claim for negligent supervision of the account and the Washington Consumer Protection Act claim.

Prior to the summary judgment motions, the trial court granted RCG's motion for a protective order prohibiting discovery of "RCG's inquiries and monitoring of Villalba and the MMA account." This effectively prohibited petitioners from obtaining information regarding all of the facts regarding RCG's role and involvement with Villalba and his account.

On appeal, the Court of Appeals affirmed these decisions.

E. WHY REVIEW SHOULD BE ACCEPTED

1. Review should be granted of the investors' claims under the Washington and Ohio securities acts.

The securities acts of both Washington and Ohio provide that persons other than the seller of a security can be secondarily liable for a seller's violations of those acts. The Court of Appeals decision on the scope of that liability conflicts with this Court's holding in *Haberman v. Wash. Pub.*

Power Supply Sys., 109 Wn.2d 107, 744 P.2d 1032 (1987) and applicable Ohio decisions.

Washington State Securities Act (WSSA)

RCW 21.20.430(1)[15] provides that a seller of a security who violates the WSSA is liable to the person buying the security. Under *Haberman,* non-sellers are also liable under that provision if their "participation was a substantial contributive factor in the violation."[16] Because this requirement arises from the section imposing liability against the seller, secondary liability under that section is levied on parties having the "attributes of a seller" – promoting, soliciting, and participating in the actual sales transaction between the seller and the buyer. *Brin v. Stutzman*, 89 Wn. App. 809, 829, 951 P.2d 291, 302 (1998).

RCW 21.20.430(3)[17] expressly imposes secondary liability on a broker-dealer when it did not sell the security if it "materially aids in the transaction." Noting that there was no previous Washington appellate

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[15] "Any person, who offers or sells a security in violation of any provisions of RCW 21.20.010, 21.20.140 (1) or (2), or 21.20.180 through 21.20.230, is liable to the person buying the security from him or her, who may sue either at law or in equity to recover the consideration paid for the security ...." Appendix at A-25.

[16] *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 130, 744 P.2d 1032, 1051 (1987), *quoting with approval* comment on Uniform Securities Act § 605.

[17] "... 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." Appendix at A-25.

decision on point, the Court of Appeals held that this subsection also requires a showing that the non-seller had the attributes of a seller. Since RCG did not "promote or solicit the sale" of securities and "had absolutely no contact whatsoever with the investors," the court held it could not be liable to the investors despite its role in enabling and acquiescing in Villalba's fraud. Opinion at 12. This holding conflicts with this Court's decision in *Haberman* and the WSSA.

This Court held that that the substantial contributive factor test under RCW 21.20.430(1) "is distinct from the test for participant liability pursuant to RCW 21.20.430(3)."[18] Instead, "RCW 21.20.430(3) liability is based on other defendants' relationships to a seller liable under RCW 21.20.430(1)." Thus, *Haberman* did not intend that liability under RCW 21.20.430(3) include a requirement that the non-seller have the "attributes of a seller" as required by the substantial participation test of RCW 21.20.430(1). Instead it held that non-sellers who do not meet the substantial participation test—thus lacking the attributes of a seller—may still be subject to secondary liability under RCW 21.20.430(3).[19]

While no prior Washington appellate decision addresses the standard for "materially aid" under RCW 21.20.430(3), other courts hold that broker-

[18] *Haberman*, 109 Wn. 2d at 132.
[19] *Haberman*, 109 Wn. 2d at 133.

dealers and others who are not sellers may be liable when they provide assistance to the wrongdoer that does not include soliciting the buyer or promoting the security.

In *Koruga v. Fiserv Correspondent Services, Inc.*,[20] the issue was whether Fiserv, a clearing broker, could be held liable for the fraudulent acts of one of its corresponding brokers. An arbitration panel found that Fiserv was liable under RCW 21.20.430(3) as a broker-dealer who materially aids in a transaction. The court did not detail the corresponding broker's fraud but concluded that Fiserv knew about the illegal activity and "materially participated" when it cleared trades and prepared confirmations, which were "necessary functions related to each of the securities transactions with Plaintiffs."[21] There was no indication that the broker-dealer participated in promoting or selling securities to the investors.

Similarly, the Kansas Supreme Court held that a brokerage firm that cleared trades for an investment firm, but did not participate directly in the transactions between the investment firm and its customers, could be liable under the "materially aid" test contained in a provision of the Kansas securities act that is identical RCW 21.20.430(3).[22] That court recognized

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[20] *Koruga v. Fiserv Correspondent Services, Inc.*, 183 F. Supp. 2d 1245 (D. Or. 2001), *aff'd*, 40 F. App'x. 364 (9th Cir. 2002).
[21] *Koruga*, 183 F. Supp. 2d at 1246.
[22] *Klein v. Oppenheimer & Co.*, 281 Kan. 330, 358-59, 130 P.3d 569, 587 (2006).

that the courts "have taken a rather broad view of activities that may constitute 'material aid'" and found that the firm could be liable when the seller sold unregistered securities to its clients. The Court recognized that the firms handling trades for investment advisors (like RCG did for Villalba) were in the best position to detect fraud and should bear the consequences of choosing to benefit financially from the fraud by continuing to process trades at the expense of the seller's customers.[23]

In Oregon, whose secondary liability statute is similar to Washington's, the "materially aid" requirement is satisfied by acquiescing in a seller's wrongdoing even though the non-seller had no involvement in the sales transaction. *See Ainslie v. First Interstate Bank, N.A.*[24] In *Ainslie*, First Interstate was retained as the escrow agent to hold the proceeds from a securities offering. A minimum amount of money had to be raised within a certain time before proceeds could be distributed to the venture. If that requirement was not met, the offering would be canceled and money returned to the investors. Sales were slow and the venture needed money. The venture's principals instructed Oregon Bank to provide a credit to First Interstate that increased the balance in the escrow account to the level required for funds to be distributed. Those principals then directed First

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[23] *Id.*

[24] *Ainslie v. First Interstate Bank, N.A.*, 148 Or. App. 162, 939 P.2d 125, 137 (1997).

Interstate to provide a credit in the same amount back to Oregon Bank. The net effect was that the escrow account briefly showed sufficient funds in the account so that a distribution was made to the venture, even though no new money had been raised. The investors later sued, claiming that the sales never should have been finalized because the venture failed to meet the funding requirement by the required date.

First Interstate was found liable as a matter of law for participating or aiding in the sale of the securities. The court held that "the extent and importance of the defendant's involvement in a sale can be shown by evidence of its connection with unlawful activities as much as with any other aspects of the sale."

RCG materially aided Villalba in his transactions with the investors. It knowingly helped him establish an illegal commodity pool and conducted the trades that lost millions of dollars. And, unlike other parties that are potentially liable for secondary liability, RCG received money from the investors to pay the commissions for those trades. This Court should review the scope of liability under RCW 21.20.430(3) to determine whether broker-dealers should face consequences for their involvement in these schemes.

<u>Ohio Securities Act</u>

Ohio extends secondary liability for securities violations to those who "participated in" the illegal sale or "aided the seller in any way":

> Every sale or contract for sale made in violation of Chapter 1707 of the Revised Code is voidable at the election of the purchaser. The person making such sale or contract for sale, ***and every person who has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to such purchaser***, ... for the full amount paid by such purchaser and for all taxable court costs, unless the court determines that the violation did not materially affect the protection contemplated by the violated provision.[25]

The Court of Appeals similarly required the investors to offer proof that RCG promoted Villalba's program or solicited investors or had some other direct contact with them regarding the investment to maintain a claim under that statute. Opinion it 17. But "R.C. 1707.43 does not require that a person induce a purchaser to invest in order to be held liable. Rather, the language is very broad, and participating in the sale or aiding the seller in any way is sufficient to form a basis for liability under R.C. 1707.43."[26] "The statute does not require knowledge, intent, or any other mental state on the part of secondary actor, nor does it require reliance, inducement, or proximate cause as between the secondary actor and purchaser."[27]

The trial court in the *Pieretti*[28] case in Ohio that handled claims made

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[25] O.R.C. § 1707.43 (emphasis added). Appendix at A-27.

[26] *Federated Mgmt. Co. v. Coopers & Lybrand*, 137 Ohio App. 3d 366, 384, 738 N.E.2d 842, 855 (2000).

[27] *In re Nat'l Century Fin. Enterprises, Inc., Inv. Litig.*, 755 F. Supp. 2d 857, 884 (S.D. Ohio 2010).

[28] *Pieretti v. RCG Group, LLC,* Erie C. P. No. 2011-CV-0051, Ohio trial court opinions are cited by appellate courts as authority. *See White v. Am. Mfrs. Mut. Ins. Co.,* 2002-Ohio-4125, ¶ 30 (Ct. App.); *Preferred Capital, Inc. v. Power Eng'g Grp., Inc.*, 163 Ohio App. 3d 522, 531, 839 N.E.2d 416, 423 (2005) (quoting Cuyahoga trial court opinion on forum

against RCG by other investors in Villalba's program denied RCG's motion for summary judgment finding that court found that RCG could be liable because it assisted in making Villalba's sale of securities possible, even if it did not help promote those sales.[29] The *Pieretti* court noted: "any kind of aid will do. Liability is not dependent on whether Defendants helped induce the purchaser to invest."[30] "Villalba may not have been able to sell the securities to Plaintiffs unless RCG agreed to be MMA's future commission merchant. RCG opened, maintained, and serviced the futures trading account for MMA. Such activities by RCG may have made the sale of the securities possible."[31] Thus, a jury "could reasonably conclude that RCG knowingly undertook an indispensable role in the fraudulent offering of securities that was to extend well into the future."[32]

Thus, Ohio courts have held that signing a stock certificate to make the sale possible is sufficient for liability under RC 1707.43. *Miller v. Griffith*, 196 N.E.2d 154 (Ct. Com. Pl. 1961). And "approv[ing] a merger agreement, which was a precondition for the merger going forward, is sufficient to

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selection clauses). "All opinions of the courts of appeals issued after May 1, 2002 may be cited as legal authority and weighted as deemed appropriate by the courts without regard to whether the opinion was published or in what form it was published." Ohio S. Ct. Rep. Op. Rule 3.4.

[29] *Pieretti*, Apr. 16, 2013 Order at 7-8, Appendix A to the appellants' opening brief in the Court of Appeals.

[30] *Id.* at 6-7.

[31] *Id.*

[32] *Id.* at 8.

allege that the defendants 'participated in or aided the seller in any way' for purposes of liability under §1707.43(A)." *Escue v. Sequent, Inc.*, 2010 U.S. Dist. LEXIS 87043 (S.D. Ohio 2010).

The Court of Appeals rejected these authorities and instead relied on *Wells Fargo Bank v. Smith,*[33] which opined that a lender who provided funds directly to a buyer at her request that were used to purchase a security was not secondarily liable under the Ohio act for misrepresentations made by the seller of the security. The case is not analogous to RCG's role, and did not persuade either of the Ohio trial courts to grant summary judgment. The *Pieretti* court found *Wells Fargo* neither applicable nor persuasive:

> Neither the mortgage bank nor its loan officer received compensation from the security seller. Id. at ¶30. Further, the loan proceeds were given directly to the investor without any direction to invest with the security seller. Id. at ¶7. Thus, as the mortgage bank and its loan officer's actions primarily aided the investor and not the seller, such ease is materially distinguishable from the present matter.[34]

The Ohio courts expressly do not require a party to promote a security or solicit buyers for secondary liability, as the Court of Appeals suggests. The Ohio statute is very broad and was construed too narrowly by the Court of Appeals. Its decision affirming dismissal of this claim should be reversed

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[33] *Wells Fargo Bank v. Smith*, 2013 Ohio App. LEXIS 751 (Oh. Ct. App. 2013). Unreported cases may be cited as legal authority under Ohio law. *See* fn. 26, *supra*.

[34] *Pieretti v. Rosenthal Collins Group, LLC,* Erie C. P. No. 2011-CV-0051, Opinion and Judgment Entry (May 22, 2013) (attached as Appendix O to the appellants' opening brief in the Court of Appeals).

and this case should be remanded for trial.

2. Review should be granted of the investors' claim for negligent supervision against RCG.

RCG was required to supervise its employees and the accounts it carried.[35] It was obligated to refuse to open an account in the presence of suspicious circumstances,[36] to close an account for suspicious or unusual trading,[37] and to train and supervise employees to monitor accounts and report instances of potential wrongdoing.[38] It had a duty to know what was happening in its customers' accounts. This included monitoring for potential illegal activity by the customer that affected non-customers.[39] RCG and other investment firms accept those regulatory responsibilities in return for the right to make money from handling transactions in a customer's account.

The Court of Appeals held, however, those obligations did not create any duty from RCG to non-customers, including the investors here. Opinion at 20-21. That conclusion conflicts with *Garrison v. SagePoint Fin., Inc.*,[40]

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[35] *Samson Refining Co. v. Drexel Burnham Lambert, Inc.*, 1990 CFTC LEXIS 90 at 32, ("[U]nder Rule 166.3, Drexel had a duty to develop procedures for the 'detection and deterrence of possible wrongdoing by its agents.'").

[36] CP 1539 (Tanzar Dep. at 80) (emphasis added).

[37] CP 1553 (page 202).

[38] 17 C.F.R. § 166.3.

[39] CP 1527-28.

[40] *Garrison v. SagePoint Fin., Inc.*, 185 Wn. App. 461, *review denied*, 183 Wn.2d 1009 (2015).

which holds that rules issued by regulators and an investment firm's own compliance manuals define the scope of the duty owed by a brokerage firm to others, including investors who were not its customers.

Garrison held that the "courts have looked to the [NASD] Rules to define the scope of a common law duty such as negligent supervision,"[41] further concluding that "as a condition of the right to engage in the securities business, broker-dealers and registered representatives must abide by NASD rules and regulations."[42]

Garrison recognizes that a duty to a non-customer can arise <u>when the firm discovers troublesome "red flags"</u>:

> 'sufficiently suspicious' circumstances may place a broker-dealer on notice that her customer is perpetrating fraud on non-customer investors. 49 Cal.App.4th [472], 483, 56 Cal.Rptr.2d 756 [(1996)]. Once aware of troublesome 'red flags,' the broker-dealer may have a duty which runs to non-customers to monitor and investigate any unusual account activity.[43]

"[N]umerous courts have ruled that broker dealers may be held liable under the common law for negligently supervising their registered representatives,

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41 *Garrison* at 486.

42 *Id. See also, McGraw v. Wachovia Sec., LLC*, 756 F. Supp. 2d 1053, 1075 (N.D. Iowa 2010) (recognizing duty based on NASD Rules); *Piper, Jaffray & Hopwood Inc. v. Ladin*, 399 F. Supp. 292, 299 (S.D. Iowa 1975) (concluding NASD and NYSE rules are "admissible as evidence of negligence"); *Mihara v. Dean Witter & Co.*, 619 F.2d 814, 824 (9th Cir. 1980) (NASD and NYSE rules "reflect the standard to which all brokers are held").

43 *Id.*; *McGraw v. Wachovia Sec., LLC*, 756 F. Supp. 2d 1053, 1072 (N.D. Iowa 2010) (quoting *Bear, Stearns*, 23 Fed. App'x at 776, other citations omitted).

even on dealings with investors who had no accounts with the firm."[44]

"Whether a duty exists depends on "mixed considerations of 'logic, common sense, justice, policy, and precedent.'"[45] And when the *Garrison* court focused on the brokerage firm's duty, it turned to the statutes and regulations governing brokerage firms and the goal to "insure fair dealing and to protect investors from harmful or unfair trading practices."[46] Those regulations guided the court in determining the scope of the brokerage firm's duty to supervise.[47]

The Court of Appeals held the investors' reliance on *Garrison* was misplaced because Villalba was not a RCG employee. Opinion at 21. That distinction is irrelevant. Liability arises because a firm ignores "red flags" suggesting persons are being defrauded that it is obligated to address. In *Garrison* liability arose when an independent contractor (Garrison) committed fraud not through a company he was working with (AIG), but through a different firm (Acumen), and where the "red flags" appeared in non-customer accounts held by a third firm (Wells Fargo), which AIG reviewed. AIG's negligence occurred because its employees failed to act on the "red flags" appearing in the Wells Fargo statements. But a firm (RCG)

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[44] *As You Sow v. AIG Fin. Advisors, Inc.*, 584 F. Supp. 2d 1034, 1049 (M.D. Tenn. 2008).
[45] *Shizuko Mita v. Guardsmark, LLC*, 182 Wn. App. 76, 83, 328 P.3d 962, 966 (2014) (citations omitted).
[46] *Garrison*, 185 Wn. App. at 485.
[47] *Id.* at 487.

is also liable in the less-convoluted situation where its improperly supervised employees ignored "red flags" that allow the firm's customer (Villalba) to open in an illegal account to misuse funds from non-customers (the investors) in an account handled by the firm (RCG). That scenario violated CFTC regulations requiring RCG to "know its customers" and monitor accounts for suspicious activity to protect investors, including non-customer victims. That was also the scenario in *Bear, Stearns* and other cases relied on by *Garrison*. The decision below conflicts with the important policies established in *Garrison* regarding the responsibilities of brokerage firms. The decision should be reviewed and reversed.

F. CONCLUSION

This Court should grant review and reverse the decision of the Court of Appeals, and remand for resolution of the investors' securities and negligence claims.

DATED: August 19, 2016.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify, under penalty of perjury and in accordance with the laws of the State of Washington, that on August 19, 2016, I caused a copy of the foregoing document to be served on all counsel of record as indicated below:

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DATED: August 19, 2016, at Seattle, Washington.

Chris R. Youtz (WSBA #7786)

Appendix

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DONALD BURDICK; SUSAN BYINGTON; LISA CARFAGNO; PETER and JANICE ELLIOT, and their marital community; BERNARD E. GOLDBERG; PAUL E. GOLSTEIN; TOM and LaVOE MULGREW, and their marital community; SUSAN ROSEN; MARTIN SILVERMAN; SHARON SILVERMAN; and BARRY and ROBIN STUCK, and their marital community,	DIVISION ONE
Appellants,	No. 73459-8-I
v.	UNPUBLISHED OPINION
ROSENTHAL COLLINS GROUP, LLC, an Illinois limited liability corporation,	
Respondent.	FILED: May 31, 2016

DWYER, J. — This appeal arises from a trial court order granting summary judgment dismissal of securities and negligence claims brought against Rosenthal Collins Group, LLC (RCG) for its alleged role in a Ponzi scheme fraud perpetrated by Enrique Villalba.[1] Because RCG was not involved in the sale of the securities herein at issue and owed no special duty to the investors in Villalba's scheme, we affirm.

[1] Relief is also sought from a protective order obtained by RCG prohibiting discovery of certain information related to the account involved in the fraud. We conclude that this order was proper.

I

A. Villalba's Ponzi Scheme

This case begins with the collapse of a Ponzi scheme perpetrated by Villalba, through his company Money Market Alternatives, LLC (MMA), from late 1996 until September 2009.

Villalba held himself out to investors as an "investment manager" who managed his clients' assets in accordance with their individual investment objectives and by utilizing his trading strategy, which he referred to as the "Money Market Plus Method." In reality, Villalba stole the money that he was supposedly managing. After receiving investors' funds into his bank accounts, Villalba used the funds to, among other things, pay himself huge management fees, fund his lavish lifestyle and other business ventures, and make over $3 million in Ponzi-type payments to other investors. Villalba concealed his theft from his clients with lies and false account statements reflecting steady gains in their accounts.[2] Based upon these fake statements and believing Villalba was earning impressive returns, investors sent more and more money to Villalba for him to manage on their behalf.

The 26 victims of the fraud, who include the appellants herein, lost more than $30 million.

B. Appellants Invest With Villalba

Appellants (the investors) hired Villalba to manage their money and deposited funds with him at different times between 1996 and 2009.

[2] There is no dispute that RCG played no role in creating (and had no knowledge of) these fake account statements.

The investors had different relationships with Villalba and different understandings of how he would manage their money. Bernard Goldberg, for example, met Villalba years before Villalba opened an account at RCG. Goldberg and Villalba formed a general partnership in 1996, through which Goldberg effectively hired Villalba to manage certain assets in return for a share of the trading profits. Given his close, longstanding relationship with Villalba, Goldberg was able to convince many of his friends to hire Villalba as their investment advisor, including (directly or indirectly) all of the other investors in this case.

After being introduced to Villalba, the other investors each entered into Investment Management Agreements (IMA) with Villalba. The IMAs detailed Villalba's role as "investment manager" of individually managed accounts and expressly provided the investor with the right to manage his or her own account and change the investment strategy to conform with his or her investment objectives. The IMAs also gave each investor the right to choose or change the brokerage firm handling the investor's individual account.

The IMAs made no mention of RCG[3] and, by and large, the investors had no knowledge of the brokerage firms that Villalba was using. The investors typically wired money to Villalba by sending money directly to one of his bank accounts. Villalba then transferred money from MMA's bank accounts to futures accounts in MMA's name, including one at RCG, to trade futures. None of the investors sent any money to RCG. Indeed, the investors admitted that they had

[3] RCG also had no knowledge of the IMAs.

no interaction whatsoever with RCG, that they never had a written agreement that mentioned RCG, and that RCG played no role in their decision to invest or in the sale of securities.

C. Villalba's Futures Trading

In June 1998, *18 months after the first of the investors invested with Villalba*, RCG agreed to open a nondiscretionary commodity futures trading account for MMA. RCG is a Futures Commission Merchant (FCM) registered with the Commodities Futures Trading Commission (CFTC) and the National Futures Association (NFA) to conduct trading of futures contracts. As a "nondiscretionary" customer, MMA retained complete control over its futures account and had full responsibility and liability for all trading decisions.

RCG reviewed an offering circular that Villalba prepared to help him solicit $100 million from investors for the MMA account.[4] According to the investment plan described in the circular, funds from Villalba's customers would be pooled to invest in treasury bills or money market funds "within a vehicle similar to a mutual fund." Villalba would also occasionally[5] purchase S&P 500 futures contracts based on his purported expertise in predicting certain market trends. Those transactions would supposedly add 2 percent to 5 percent additional value for his customers. The investment would have "minimal" risk, it asserted, because the futures transactions would be made with "little or no leverage" and stop orders would be used to limit losses.

[4] None of the investors ever saw, received, or signed any subscription agreement or offering circular relating to their investment.

[5] The timing was variously described as "a few days per month," "on average a week per month," and "approximately [1]0% of the year."

The circular claimed that the fund was not subject to state or federal regulation. RCG recognized, however, that because it would contain pooled investments, the fund would constitute a commodity pool.[6] That made Villalba, or his company, a commodity pool operator. Neither were registered as commodity pool operators as required by the CFTC.

A form was provided to Villalba with the new account documents identifying two potential exceptions to the registration requirement. RCG's file shows that Villalba selected an exemption that was only applicable if he neither received any direct or indirect compensation for managing the anticipated $100 million pool, nor advertised for participants. The circular stated, however, that he expected to receive management fees from the proceeds and that MMA would be "offering these securities to the public."

RCG's compliance procedures mandate that a new account should not be opened if illegal activity is suspected. After RCG's review of the offering circular and the other information provided by Villalba, it opened the MMA account for trading.

Villalba never followed his purported investment plan. Instead of keeping the investors' money in treasury bills with occasional transactions in S&P 500 futures contracts, Villalba traded futures with RCG almost daily. Also, the trades were highly leveraged and risky. The promised "stop orders" to limit losses were not used. Single day losses of more than $100,000 were not uncommon and, in March 2008 alone, the MMA account lost more than $9 million.

[6] A "commodity pool" or "pool" is "any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests." 17 C.F.R. § 4.10(d)(1). Essentially, it is the futures industry-equivalent of a mutual fund.

Villalba's scheme began to unravel in 2009, after he suffered significant trading losses, making it difficult for him to pay investors as they requested their money back. Villalba closed his RCG account in June 2009. Around that time, Villalba opened a new futures account at a different firm. In early September 2009, Villalba started ignoring his clients' phone calls and e-mails, arousing their suspicions. By September 2010, after an investigation by the Securities and Exchange Commission and the Federal Bureau of Investigation, Villalba pleaded guilty to felony wire fraud and was ordered to pay over $30 million in restitution and sentenced to almost nine years in federal prison.

D. The CFTC investigates RCG

Shortly after Villalba was convicted, the CFTC investigated RCG's role in Villalba's fraud. In April 2012, RCG entered into a consent order with the CFTC related to its handling of the MMA account. The CFTC found that RCG ignored many "red flags" appearing in the account records and that it should have acted in light of "the lack of regard for trading losses, commissions, and fees in the MMA account." As part of the settlement offer underlying the order, RCG did not admit or deny these findings.[7]

[7] As the trial court below recognized, such consent judgments are not admissible evidence of the allegations stated therein. See In re Platinum and Palladium Commodities Litigation, 828 F. Supp. 2d 588 (S.D.N.Y. 2011) (striking references to a CFTC order from civil complaint); Carpenters Health & Welfare Fund v. The Coca-Cola Co., 2008 WL 9358563, *3 (N.D. Ga. Apr. 23, 2008) (a consent judgment "falls squarely into the class of evidence deemed inadmissible pursuant to Rule 408"). This is so because of the "high public policy value of encouraging entities . . . to settle their disputes with . . . governmental agencies," and the "chilling effect" that "would likely" result from admitting the consent judgment as evidence of wrongdoing by private litigants. Coca-Cola, 2008 WL 9358563, at *3; see also In re Blech Sec. Litig., 2003 WL 1610775 (S.D.N.Y. Mar. 26, 2003); N.J. Turnpike Auth. v. PPG Indus., Inc., 16 F. Supp. 2d 460, 474 (D.N.J. 1998).

E. Procedural history

The investors filed a motion for summary judgment, seeking a ruling that their transactions with Villalba were securities under multiple state securities acts, including the The Securities Act of Washington, chapter 21.20 RCW, and the Ohio Securities Act, chapter 1707 Ohio Rev. Code Ann. The trial court granted that motion, except as to the investments made by Goldberg.[8]

RCG filed two summary judgment motions. The first sought a ruling that claims for some transactions were barred under the Ohio and California statutes of repose. The investors conceded the claims under California's securities act, but contested the applicability of the Ohio provision. That motion was not decided because the trial court granted RCG's second motion for summary judgment in an order that: (1) ruled that the investors could bring claims under the Ohio securities act, (2) dismissed the investors' securities claims, holding that RCG could not be secondarily liable for Villalba's violations of the securities acts, and (3) dismissed the investors' claims for negligent supervision of the account and violation of the Washington Consumer Protection Act. The trial court did not rule on RCG's claim that the state securities acts were preempted by the Commodities Exchange Act.

Prior to the filing of the summary judgment motions, RCG moved the trial court for a protective order from the investors' discovery inquiries concerning RCG's suspicious activity monitoring and investigation practices, particularly regarding the MMA account, under the federal Bank Secrecy Act (BSA), 31

[8] The court ruled that his investments were not securities.

U.S.C. § 5318(g). The court entered that order on March 9, 2015. The investors then moved the court to modify the protective order. On April 23, 2015, the trial court modified the protective order to exclude from its scope any information that was already publicly available or in the investors' possession. The investors also appeal from that modified order.

II

The investors contend that the trial court erred by granting summary judgment dismissal of their state securities claims. This is so, they assert, because RCG is secondarily liable to the investors under the Washington securities act for its role in Villalba's fraud. We disagree.

Our review is de novo. Lokan & Assocs., Inc. v. Am. Beef Processing, LLC, 177 Wn. App. 490, 495, 311 P.3d 1285 (2013). When reviewing an order granting summary judgment, we engage in the same inquiry as the trial court, viewing the facts and all reasonable inferences therefrom in the light most favorable to the nonmoving party. Brown v. Brown, 157 Wn. App. 803, 812, 239 P.3d 602 (2010). "Summary judgment is appropriate if the pleadings, affidavits, depositions, answers to interrogatories, and admissions on file show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." Keithly v. Sanders, 170 Wn. App. 683, 686, 285 P.3d 225 (2012) (citing CR 56(c)).

The investors claim that RCG is liable under RCW 21.20.430, subsections (1) and (3).

RCW 21.20.430(1), which pertains to seller liability, provides, in pertinent part:

> Any person, who offers or sells a security in violation of any provisions of RCW 21.20.010, 21.20.140 (1) or (2), or 21.20.180 through 21.20.230,[9] is liable to the person buying the security from him or her.

"'[L]iability may be imposed [under this provision] on a person in addition to the immediate seller if the person's participation was a *substantial contributive factor* in the violation.'" Haberman v. Wash. Pub. Power Supply Sys., 109 Wn.2d 107, 130, 744 P.2d 1032, 750 P.2d 254 (1987) (emphasis added) (quoting Uniform Securities Act, § 605 cmt., 7B U.L.A. 81 (Supp. 1987)).

RCW 21.20.430(3), which pertains to participant liability, provides, in pertinent part:

> [E]very broker-dealer . . . 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.[10]

(Emphasis added.)

Thus, to establish their claims under this provision, the investors were required to show (1) that they purchased "securities," (2) that Villalba violated the securities laws when he sold those securities to the investors, and (3) that RCG's

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[9] Application of this subsection is triggered by Villalba's violation of RCW 21.20.010 (securities sales involving fraud or deceit) and RCW 21.20.140 (sales of unregistered securities).

[10] Liability under subsection (1) generally stems from being a seller/buyer, whereas liability under subsection (3) generally stems from a party's formal relationship to a seller/buyer. However, as our Supreme Court recognized in Haberman, 109 Wn.2d at 133, by expanding seller liability to cover parties who were not actually sellers/buyers, but who substantially contributed to the sales transaction, it created significant overlap between the parties liable under each of the subsections.

involvement with the scheme was sufficient for secondary liability under either the "substantial[] contribut[ion]" standard or the "material[] aid" standard.

Although the parties focus on the third component of the investors' claims, we begin by briefly addressing the first two components, which help identify the securities transaction to which RCG must have substantially contributed or given material aid. As to the first component, "a security [is defined] as (1) an investment of money (2) in a common enterprise and (3) the efforts of the promoter or a third party must have been fundamentally significant ones that affected the investment's success or failure." Ito v. Int'l Corp. v. Prescott, Inc., 83 Wn. App. 282, 291, 921 P.2d 566 (1996) (citing Cellular Eng'g Ltd. v. O'Neill, 118 Wn.2d 16, 26-31, 820 P.2d 941 (1991)). The trial court granted the investors' motion for summary judgment, ruling that the investors (except Goldberg) purchased securities when they provided money to Villalba's MMA program. No appeal was taken from that decision. Regarding the violation question, it is uncontested that Villalba violated the Washington securities act by selling unregistered securities and defrauding the investors.

As to the contribution standard, in Hines v. Data Line Systems, Inc., 114 Wn.2d 127, 149, 787 P.2d 8 (1990), the controlling case on this subject, our Supreme Court held that service providers, such as RCG, are not a "substantial contributive factor" in a securities offering (i.e., not a "seller"), absent some level of "active participation" in the sales transaction itself. Thus, even though the law firm in Hines had advised the issuer of the security, the court held that it was not a "seller" because it had no "personal contact with any of the investors [and was not] in any way involved in the solicitation process." Hines, 114 Wn.2d at 149.

We have consistently interpreted Hines to mean that a service provider is not a "seller" under the law unless it "take[s] . . . part in the actual sales process by acting as the 'catalyst' between the [seller] and the [purchaser]." Brin v. Stuzman, 89 Wn. App. 809, 830, 951 P.2d 291 (1998). Indeed, "'but for' causation alone does not satisfy proximate causation" of the securities sales transaction. Brin, 89 Wn. App. at 830 (citing Haberman, 109 Wn.2d at 131); accord Viewpoint-North Stafford LLC v. CB Richard Ellis, Inc., 175 Wn. App. 189, 197, 303 P.3d 1096 (2013) (referring purchasers to an investment company was not a "substantial contributive factor" in the sale); Shinn v. Thrust IV, Inc., 56 Wn. App. 827, 851, 786 P.2d 285 (1990) (same).

No Washington appellate court has opined in any significant way on the "materially aids" standard. However, other courts interpreting identical provisions have required the material aid to be given in the course of the sales transaction.[11] See, e.g., Benton v. Merrill Lynch & Co., 524 F.3d 866, 871 (8th Cir. 2008) ("It is not enough for the investors to allege [financial institution] was [investment manager]'s broker-dealer; they must also allege [financial institution] materially aided *in the sale* of the promissory notes." (emphasis added)); Katz v. Sunset

[11] There does not appear to be similar consistency with regard to the quality of actions that might constitute "material[] aid[]." Compare In re Nat'l Century Fin. Enters., Inc., 846 F. Supp. 2d 828, 890 (S.D. Ohio 2012) ("Establishing that the act of assistance was material can be satisfied by showing, among other things, the act influenced or induced the decision to purchase." (citing analogous statutes in several states)) with Nicholas v. Saul Stone & Co. LLC, 1998 WL 34111036, *19 (D.N.J. June 30, 1998), aff'd, 224 F.3d 179 (3d Cir. 2000) ("To establish liability on the part of a broker-dealer for 'materially aid[ing]' in the sale of a security, the plaintiff must demonstrate that the broker-dealer's involvement in the sale is 'considerable, significant or substantial.'" (alteration in original) (quoting Schor v. Hope, 1992 WL 22189, at *6 (E.D. Pa. Feb. 4, 1992))).

Fin. Servs., Inc., 650 F. Supp. 2d 962, 969 (D. Neb. 2009) ("The . . . [c]omplaint is devoid of allegations that [broker-dealer] took any action that could be construed as aiding [investment manager]'s *sale* of promissory notes to Plaintiffs." (emphasis added)); Nicholas v. Saul Stone & Co. LLC, 1998 WL 34111036, *19 (D.N.J. June 30, 1998), aff'd, 224 F.3d 179 (3d Cir. 2000) (analogous provision "requires that the offender must . . . 'materially aid' *in the sale* of th[e] securities" (emphasis added)).

Thus, under either subsection, the substantial contribution must be made, or the material aid given, in the course of the sales transaction. This insight forecloses both of the investors' claims. RCG did not participate at all in Villalba's sale of interest in MMA to the investors. The investors admit that RCG did not factor into their decision to invest with Villalba. RCG did not issue, promote, or solicit the sale of alleged securities and, in fact, had absolutely no contact whatsoever with the investors. The securities sales were completed well before Villalba would send any money to an account at RCG to trade futures. Thus, RCG's role in the sale of the relevant securities was insufficient as a matter of law.

Because RCG had no involvement whatsoever with Villalba's sale of securities, the trial court's order granting summary judgment dismissal of the investors' Washington securities act claims was proper.

III

The investors also brought claims pursuant to the Ohio securities act. RCG contends that these duplicative claims are barred by Washington's well-established conflict of laws principles. This is so, it asserts, because claims may be brought pursuant to only one state's laws and, in this case, Washington law applies.

In general,

> [w]hen parties dispute choice of law, there must be an actual conflict between the laws or interests of Washington and the laws or interests of another state before Washington courts will engage in a conflict of laws analysis. Burnside v. Simpson Paper Co., 123 Wn.2d 93, 100-01, 864 P.2d 937 (1994). When the result of the issues is different under the law of the two states, there is a "real" conflict. Pacific Gamble Robinson Co. v. Lapp, 95 Wn.2d 341, 344-45, 622 P.2d 850 (1980). The situation where laws or interests of concerned states do not conflict is known as a "false" conflict. Burnside, 123 Wn.2d at 101. *If a false conflict exists, the presumptive local law is applied.* Rice v. Dow Chem. Co., 124 Wn.2d 205, 210, 875 P.2d 1213 (1994).

Seizer v. Sessions, 132 Wn.2d 642, 648-49, 940 P.2d 261 (1997) (emphasis added); accord Woodward v. Taylor, 184 Wn.2d 911, 918, 366 P.3d 432 (2016) ("If there is no actual conflict, the local law of the forum applies and the court does not reach the most significant relationship test."); Rice, 124 Wn.2d at 210 ("To engage in a choice of law determination, there must first be an actual conflict between the laws or interests of Washington and the laws or interests of another state. Burnside[, 123 Wn.2d at 100-01]. Where there is no conflict between the laws or interests of two states, the presumptive local law is applied. Burnside, at 101.").

The investors acknowledge that there is no actual conflict between the Washington and Ohio securities laws.[12] Yet, they assert that the result of the

[12] Indeed, the statutes share the same interest of protecting investors.

lack of conflict is that both laws apply. This, however, is not an option in the standard framework.[13]

In effect, the investors are arguing for the adoption of the so-called "Blue Sky exception." See Danielle Beth Rosenthal, Navigating the Stormy Skies: Blue Sky Statutes & Conflict of Laws, 2:1 STAN. J. COMPLEX LIT. 96 (2014). Under the Blue Sky exception, state securities laws, also known as Blue Sky laws, are treated as "additive rather than exclusive." Mass. Mut. Life Ins. Co. v. Countrywide Fin. Corp., 2012 WL 1322884, *2 (C.D. Cal. April 16, 2012). In other words, just as a litigant can bring claims under both state law and federal law, under the Blue Sky exception, so can a litigant can bring claims under multiple state's securities laws. Simms Inv. Co. v. E.F. Hutton & Co., 699 F. Supp. 543, 545 (M.D.N.C. 1988) ("[T]he securities laws of two or more states may be applicable to a single transaction without presenting a conflict of laws question."); Lintz v. Carey Manor Ltd., 613 F. Supp. 543, 551 (W.D. Va. 1985) ("Just as the same act can violate both federal and state law simultaneously, or a state statute as well as state common law, so too can it violate several Blue Sky laws simultaneously."). The Blue Sky exception appears to be the strong majority rule. See Countrywide, 2012 WL 1322884, at *2 (referring to the "growing weight of authority" applying the exception). However, no Washington appellate court has directly addressed whether claims may be brought under multiple states' securities laws.

[13] RCG's contentions are similarly muddled. It asserts both that there is an actual conflict between the securities law of Washington and Ohio and that the outcome is the same under both statutes (namely, that RCG is not secondarily liable for Villalba's fraud). Because an actual conflict of laws requires that "the result of an issue is different under the laws of the interested states," Woodward, 184 Wn.2d at 918, these positions are internally inconsistent.

The Washington case closest to the point is FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc., 180 Wn.2d 954, 331 P.3d 29 (2014). In that case, a Washington purchaser asserted claims under the Washington securities act against a New York seller. FutureSelect, 180 Wn.2d at 959. The New York seller moved to dismiss, arguing that New York securities laws, which do not recognize a private cause of action, controlled the plaintiff's claim. FutureSelect, 180 Wn.2d at 959. Given the actual conflict, the court engaged in a full-scale conflict of law analysis, weighing the contacts with each state and each state's interest in the dispute. FutureSelect, 180 Wn.2d at 967. The court ultimately concluded that "Washington has a more compelling interest in protecting its investors from fraud and misrepresentation than [the seller's state] does in regulating sellers of securities that may have perpetrated [a] fraud or misrepresentation in another state." FutureSelect, 180 Wn.2d at 970.

RCG contends that, by engaging in a full conflict of law analysis, the FutureSelect court implicitly rejected the Blue Sky exception. Adopting the investors' position, it asserts, would render unnecessary the conflict analysis engaged in by the FutureSelect court. The investors contend, by contrast, that FutureSelect is inapposite. A conflict analysis was required therein, they assert, only because the New York securities law was offered to defeat the Washington law claim, rather than to supplement it.

In truth, the FutureSelect opinion permits of both parties' readings. Thus, there is no determinative Washington law on this issue.

As we demonstrate below, the result in this case would be the same regardless of whether we decide this issue. Because it is unnecessary to the case's resolution, our pronouncement—were we to make one—would be mere dicta. For this reason, we decline to further address the question of the applicability of the Blue Sky exception in Washington.

IV

The investors further contend that RCG is also liable under the Ohio securities act. This is so, they assert, because it "participated or aided" Villalba in making the sale. We disagree.

The Ohio securities act extends secondary liability for securities violations to those who "participated in" the illegal sale or "aided the seller in any way."

> [E]very sale or contract for sale made in violation of [the securities law] is voidable at the election of the purchaser. The person making such sale or contract for sale, *and every person [who] has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to the purchaser*, . . . unless the court determines that the violation did not materially affect the protection contemplated by the violated provision.

OHIO REV. CODE ANN. § 1707.43(A) (emphasis added).

The crux of secondary liability under section 1707.43 of the Ohio securities act is participation or aid by the defendant in "making [the] sale." OHIO REV. CODE ANN. § 1707.43(A). Although section 1707.43 extends liability to non-sellers, the act "do[es] not impose liability on anyone who aided the seller 'in any way.' Rather, [it] impose[s] liability on anyone who aided the seller in any way *in making an unlawful sale or contract for sale.*" In re Nat'l Century Fin. Enters., Inc. Inv. Litig., 2006 WL 2849784, *10 (S.D. Ohio Oct. 3, 2006).

The recent Ohio appellate court decision in Wells Fargo v. Smith, 2013 WL 938069 (Ohio Ct. App. Mar. 11, 2013), makes clear the importance of the sales transaction. Therein, the court analyzed and synthesized all of the Ohio cases applying Section 1707.43(A). Wells Fargo, 2013 WL 938069, at *5-6. The court found that Ohio courts consider "several factors in deciding whether a person or entity shall be responsible for the sale of illegal securities under [OHIO REV. CODE ANN.] 1707.43(A)," all of which are directly connected to "making such sale", including: (i) "relaying information, such as the proposed terms of the sale, from the sellers to the investors," (ii) "arranging or attending meetings between the investors and the sellers," (iii) "collecting money for investments," (iv) "distributing promissory notes and other documents to the investors from the sellers," (v) "distributing . . . payments to the investors," and (vi) "actively marketing the security or preparing documents to attract investors." Wells Fargo, 2013 WL 938069, at *5.

As was explained above, in the context of the discussion of liability under the Washington securities act, the investors did not proffer any evidence that RCG "participated or aided" Villalba in "making [the] sale" of securities to them. Thus, even if the Ohio securities act were applicable to this case, summary judgment dismissal was properly granted on the investors' section 1707.43(A) claims.

Because each of the investors' securities claims fails, as explained above, determination of the conflict of law issue is unnecessary to the resolution of this case and any explanation offered in response to that issue would constitute only dicta.

V

The investors also contend that RCG is liable to them in tort for its role in Villalba's fraud. This is so, they assert, because RCG's negligent supervision of the MMA account facilitated Villalba's fraud. We disagree.

A negligence action may proceed only if the plaintiffs can establish that (1) a duty of care was owed to them by the defendant; (2) there was a breach of that duty; (3) that breach was the cause of their harm; and (4) they suffered injury as a result. Keller v. City of Spokane, 146 Wn.2d 237, 242, 44 P.3d 845 (2002). The only element at issue herein is the existence of a duty of care.

Our Supreme Court has repeatedly made clear that "there is no duty to prevent a third party from intentionally harming another unless a 'special relationship exists between the defendant and either the third party or the foreseeable victim.'" Niece v. Elmview Grp. Home, 131 Wn.2d 39, 43, 929 P.2d 420 (1997) (internal quotation marks omitted) (quoting Hutchins v. 1001 Fourth Ave. Assocs., 116 Wn.2d 217, 227, 802 P.2d 1360 (1991)); accord Folsom v. Burger King, 135 Wn.2d 658, 674-75, 958 P.2d 301 (1998) (absent a special relationship "no legal duty to come to the aid of a stranger exists"); RESTATEMENT (SECOND) TORTS § 315.

Consistent with this principle, Washington follows the rule that financial institutions do not owe a duty of care to protect non-customers from fraud. See, e.g., Zabka v. Bank of Am. Corp., 131 Wn. App. 167, 173, 127 P.3d 722 (2005) (bank owed no duty to defrauded investors absent a direct relationship). Zabka illustrates the strength of this rule. Therein, investors sued Bank of America (BA) in tort for its alleged role in a fraud perpetrated by one of the bank's customers using an account at the bank. We held that the investors' negligence claims were properly dismissed for failure to state a claim because the bank owed no duty to the investors, with whom it had no relationship. This was our holding despite evidence to support a finding that the bank had failed to meet certain procedural and monitoring requirements with respect to the account. As we stated:

> There is evidence that BA failed to follow standard procedures and monitor transactions according to its own internal standards. BA's failures may have facilitated the theft of the Zabkas' money, but BA did not have a duty to prevent their loss. The trial court correctly dismissed the negligence claims on a CR 12(b)(6) motion.

Zabka, 131 Wn. App. at 173.

Our approach is in accordance with that taken across the country. Indeed, every court to address the precise issue presented herein has held that FCMs owe no duty to protect non-customers from a customer's fraud. See, e.g., Spitzer Mgmt., Inc. v. Interactive Brokers, LLC, 2013 WL 6827945, *4 (N.D. Ohio Dec. 20, 2013) (FCM did not owe any duty of care to non-customer plaintiffs who lost money in a Ponzi scheme); In re Agape Litig., 681 F. Supp. 2d 352, 357-58, 360 (E.D.N.Y. 2010) (same); Nicholas, 1998 WL 34111036, at *22 (same); Kolbeck v. LIT Am., Inc., 923 F. Supp. 557, 571-72 (S.D.N.Y. 1996), aff'd 152 F.3d 918 (2d Cir. 1998) (same); see also Frederick v. Smith, 7 A.3d 780, 783-84 (N.J. Super. 2010) ("[A] brokerage firm is under no obligation to be a fraud watchdog for non-customers."); Bottom v. Bailey, 767 S.E.2d 883, 896-87 (N.C. App. 2014) (a broker has no legal duty to "supervise" or "monitor" the investments of its customers to protects is customer's clients from fraud); accord Unity House, Inc. v. N. Pac. Inv., Inc., 918 F. Supp. 1384, 1392-93 (D. Haw. 1996) (treating as well-established under Washington law that a brokerage firm has no duty to its own customers—much less non-customers—to prevent unsuitable trading in a nondiscretionary account).

Herein, the evidence established that the investors were not customers of RCG and never did business with RCG. The investors admitted that they had no contact with anyone at RCG before the scheme collapsed and never sent any money or documentation to RCG. In short, the investors had no relationship with RCG, let alone a "special relationship" pursuant to which RCG might have owed them a duty.

Despite their lack of direct connection to RCG, the investors contend that RCG owed a duty—to them—to police the activity and trading in the MMA account. The investors' argument in this regard relies on Garrison v. Sagepoint Fin., Inc., 185 Wn. App. 461, 345 P.3d 792, review denied, 183 Wn.2d 1009 (2015). Therein, we held that AIG Financial Advisors Inc., a securities broker-dealer, could be responsible for negligently supervising the transactions of an employee who was also acting as an independent investment advisor. Garrison, 185 Wn. App. at 484-85; accord McGraw v. Wachovia Sec., LLC, 756 F. Supp. 2d 1053, 1075 (N.D. Iowa 2010) (case upon which Garrison significantly relied).

This case does not involve the particular factual scenario addressed in Garrison. The investors were Villalba's customers, for sure, but Villalba was not RCG's employee and registered agent. Rather, Villalba was RCG's customer or, more precisely, he was the manager of RCG's customer. Thus, the investors' reliance on Garrison is misplaced.

Because RCG owed the investors no special duty to supervise Villalba, the trial court's order granting summary judgment dismissal of the investors' negligence claim was proper.

VI

The investors also challenge the trial court's protective order, asserting that it improperly prevented them from obtaining relevant information from RCG in the discovery process. Because the information was privileged pursuant to the BSA, we disagree.

The investors served RCG discovery requests for information regarding the opening of the MMA account, what RCG did to monitor the account, and any actions it took with respect to the account. While these requests were pending, RCG filed a motion seeking a protective order prohibiting the investors from "conducting discovery relating to RCG's internal investigations and monitoring of suspicious activity," including: (1) RCG's inquiries and monitoring of Villalba and the MMA account specifically; (2) RCG's practices and methods of investigation and monitoring generally; or (3) The identities of RCG employees charged with suspicious activity monitoring and investigations.

The motion contended that this discovery was prohibited under the BSA.

The BSA requires that banks and other financial institutions report certain types of suspicious activity to the federal government in a suspicious activity report (SAR). 31 U.S.C. § 5318(g)(1). The act affords a privilege to the federal government, allowing it to keep these reports confidential, and prohibits disclosure by others of the actual SARs, or other information indicating that an SAR was filed.

The requested order was granted but, pursuant to the investors' motion for reconsideration, the trial court modified the order so that it would not apply to "materials which are already publically available from prior litigation on the MMA account against RCG." The investors contend that the modified order was also erroneous.

We review de novo issues interpreting the privilege provided by the BSA. Norton v. U.S. Bank, 179 Wn. App. 450, 324 P.3d 693, review denied, 180 Wn.2d 1023 (2014).

The trial court's protective order mirrored the order that we affirmed in Norton, a case substantially similar to this one, except that it involved a bank, rather than an FCM.[14] Therein, this court held that a financial institution "may not be ordered to describe or disclose its internal investigations, either generally or those specifically related" to a Ponzi scheme. Norton, 179 Wn. App. at 461-62. As FCMs are expressly included in the BSA's definition of covered "financial institutions," 31 U.S.C. §§ 5312(c)(1)(A), 5318(g), the BSA's protections apply

[14] The protective order affirmed in Norton applied to information related to the bank's monitoring practices and internal investigations "generally or those specifically related" to the activity in question. 179 Wn. App. at 462. By comparison, the order at issue herein protected information related to RCG's "practices and methods of investigation and monitoring generally" and "inquiries and monitoring of Villalba and the MMA account specifically."

equally to RCG as to the bank in Norton.[15]

The trial court's order, which was compelled by our decision in Norton, was proper.

Affirmed.

We concur:

Cox, J.

[15] We are unmoved by the investors' contention that the outcome should be different in this case than in Norton based on differences in the regulations applicable to FCMs versus banks. Even were we to accept the investors' assertion that FCMs in general are exempted by regulation from some SAR reporting requirements as a member of the NFA, RCG was nevertheless required to make these reports. See NFA Interpretive Notice 9045, "NFA Compliance Rule 2-9; FCM and IB Anti-Money Laundering Program."

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DONALD BURDICK; SUSAN BYINGTON; LISA CARFAGNO; PETER and JANICE ELLIOT, and their marital community; BERNARD E. GOLDBERG; PAUL E. GOLSTEIN; TOM and LaVOE MULGREW, and their marital community; SUSAN ROSEN; MARTIN SILVERMAN; SHARON SILVERMAN; and BARRY and ROBIN STUCK, and their marital community, Appellants, v. ROSENTHAL COLLINS GROUP, LLC, an Illinois limited liability corporation, Respondent.	DIVISION ONE No. 73459-8-I ORDER DENYING APPELLANTS' MOTION FOR RECONSIDERATION

The appellants having filed a motion for reconsideration herein, and a majority of the panel having determined that the motion should be denied; now, therefore, it is hereby

ORDERED that the motion for reconsideration be, and the same is, hereby denied.

Dated this 20th day of July, 2016.

FOR THE COURT:

Dwyer, J.

21.20.430. Civil liabilities — Survival, limitation of actions — Waiver of chapter void — Scienter.

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

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

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

(4)

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

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

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

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

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

ORC Ann. 1707.43

Current with Legislation passed by the 131st General Assembly and filed with the Secretary of State through file 123 (HB 483).

Page's Ohio Revised Code Annotated > ***Title 17: Corporations — Partnerships*** > ***Chapter 1707: Securities*** > ***Procedure***

§ 1707.43 Remedies of purchaser in unlawful sale.

(A) Subject to divisions (B) and (C) of this section, every sale or contract for sale made in violation of Chapter 1707. of the Revised Code, is voidable at the election of the purchaser. The person making such sale or contract for sale, and every person that has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to the purchaser, in an action at law in any court of competent jurisdiction, upon tender to the seller in person or in open court of the securities sold or of the contract made, for the full amount paid by the purchaser and for all taxable court costs, unless the court determines that the violation did not materially affect the protection contemplated by the violated provision.

(B) No action for the recovery of the purchase price as provided for in this section, and no other action for any recovery based upon or arising out of a sale or contract for sale made in violation of Chapter 1707. of the Revised Code, shall be brought more than two years after the plaintiff knew, or had reason to know, of the facts by reason of which the actions of the person or director were unlawful, or more than five years from the date of such sale or contract for sale, whichever is the shorter period.

(C) No purchaser is entitled to the benefit of this section who has failed to accept, within thirty days from the date of such offer, an offer in writing made after two weeks from the date of the sale or contract of sale, by the seller or by any person that has participated in or aided the seller in any way in making the sale or contract of sale, to take back the security in question and to refund the full amount paid by the purchaser.