73459-8

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**NO. 73459-8**

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION 1

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DONALD BURDICK, et al.

Plaintiffs/Appellants,

v.

ROSENTHAL COLLINS GROUP, LLC
an Illinois limited liability corporation,

Defendant/Appellee

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

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# BRIEF FOR RESPONDENT

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Christian T. Kemnitz
KATTEN MUCHIN ROSENMAN LLP
525 W. Monroe St.
Chicago, Illinois 60661

Gavin W. Skok
RIDDELL WILLIAMS P.S.
1001 Fourth Avenue, Suite 4500
Seattle, Washington 98154
*Attorneys for Respondent*

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## I. INTRODUCTION AND SUMMARY OF THE ARGUMENT

Appellants are complete strangers to Respondent Rosenthal Collins Group, LLC ("RCG"). Yet they argue that RCG should be liable for the criminal fraud of their investment manager, Enrique Villalba ("Villalba"), simply because RCG opened and serviced a futures trading account on behalf of one of his company's, Money Market Alternatives, LP ("MMA"). Appellants avoid any discussion of their relationship with RCG or RCG's participation in their purchase of so-called securities from Villalba because RCG had absolutely no relationship or interaction with Appellants and no involvement in their investments. Indeed, the only alleged sales of the securities in this case were consummated exclusively between Villalba and Appellants, in private conversations or meetings, with no involvement by, or even mention of, RCG.

Contrary to Appellants' unsupported assertions, Villalba did not need RCG, or any FCM, to perpetrate his scheme. Indeed, Appellants began sending money for Villalba to manage at least 18-months before MMA opened a futures trading account at RCG. Villalba used lies, fake account statements, and false investment returns to convince investors and their family friends and family to join. In reality, Villalba stole the money that Appellants deposited into his bank accounts, using it to fund his lavish lifestyle, pay himself and his staff, support his other businesses, make Ponzi payments to Appellants and other investors, and trade futures contracts through accounts he opened at three different Futures Commission Merchants ("FCM"), including RCG. Because Appellants and RCG were complete strangers, the trial court properly granted RCG summary judgment on all of their claims.

Specifically, Appellants' state securities claims under the Washington State Securities Act ("WSSA") and the Ohio Securities Act fail because there is no evidence that RCG had any involvement in Villalba's alleged sale of securities. The trial court properly recognized that RCG had no contact with Villalba's investors, did not encourage anyone to invest, and had no other involvement in the sales process. The Court may also affirm summary judgment on Appellants' state securities claims because of additional bases in the record. First, as the trial court correctly found, Appellant Goldberg's investments with Villalba were not securities but rather contributions to a general partnership. Second, all of Appellants' state securities claims are preempted by the Commodity Exchange Act ("CEA"), which provides the *exclusive* regulatory scheme for the futures markets. Finally, the Ohio Securities Act should not apply under a choice of law analysis set forth in Washington Supreme Court precedent.

Appellants' lack of relationship with RCG also defeats their common law negligence claims. The trial court correctly found that Appellants were not customers of RCG and had no special relationship with RCG that would give rise to any legal duty to protect them from Villalba's fraud. On appeal, Appellants have tried to avoid this inconvenient fact by rebranding their negligence claims as "negligent supervision" claims, and citing a handful of cases against employers whose employees defrauded third parties. But summary judgment should be affirmed because Villalba was a mere customer, not an employee of RCG. No court has imposed such a sweeping duty to police *customers* to protect the general public from a customer's fraud. In fact, every court addressing this precise issue under nearly identical circumstances has held that no such duty exists.

Finally, Appellants' argument that the trial court erred in granting a protective order lacks merit and is irrelevant. Far from being in error, the trial court's order preventing the disclosure of RCG's suspicious activity reporting and monitoring under the Bank Secrecy Act ("BSA") was *compelled* by this Court's holding in *Norton v. U.S. Bank Nat'l Assoc.*, 179 Wn. App. 450 (2014). Moreover, Appellants were not prejudiced because the trial court modified the order during the pendency of RCG's motion for summary judgment, allowing Appellants access to and use of the very evidence they were seeking. Thus, the order should not be vacated and summary judgment should be affirmed.

## II. COUNTERSTATEMENT OF THE ISSUES

1. Did the trial court properly grant summary judgment on Appellants' state securities act claims where RCG had no contact with the investors, engaged in no promotional conduct, and played no role whatsoever in the alleged sale of securities?

2. Can Appellants pursue a claim under the Ohio Securities Act where a conflict of law exists and each Appellant's home state has the most significant relationship to their claims?

3. Are Appellants' securities claims preempted by the CEA because those claims are based entirely on conduct by an FCM related to a futures trading account, which is governed exclusively by the CEA?

4. Did the trial court properly grant summary judgment on Appellants' negligence claims because no duty arose to protect Appellants from Villalba's fraud given that Appellants had no special relationship with RCG and Villalba (the fraudster) was not an employee of RCG?

5. Should the trial court's protective order barring discovery into a limited subset of materials that are privileged under the BSA be vacated in light of *Norton v. U.S. Bank*, 179 Wn. App. 450 and despite the fact that the trial court modified its order prior to summary judgment, allowing Appellants access to the evidence they were seeking?

## III. STATEMENT OF THE CASE

### 1. Procedural Facts

This is an appeal from the order granting summary judgment in favor of RCG on Appellants' WSSA, Ohio Securities Act, and common law negligence claims.

Appellants also appeal the trial court's order granting a modified protective order. RCG initially moved the trial court for a protective order from Appellants' discovery into RCG's suspicious activity monitoring and investigation practices under the BSA. The court entered that order on March 9, 2015. CP 342–43. Appellants then moved the court to modify the protective order, and on April 23, 2015, the trial court modified the protective order to exclude from its protections information that was already publicly available or in Appellants' possession. CP 2373–75.

## 2. Facts in Support of Summary Judgment

### Villalba's Ponzi Scheme

This case arises out of the collapse of a Ponzi scheme conducted by Villalba from approximately 1996—18 months *before* any RCG account was opened—until September 2009. CP 408–09 (30:25–31:7); CP 433–34 (141:25–142:9); CP 447 (¶ 12(A)). Villalba held himself out to Appellants as an "investment manager" who claimed to manage his clients' assets in accordance with their individual investment objectives and by utilizing his trading strategy, which he referred to as the "Money Market Method." *See* CP 456–59; CP 460–96; CP 2–3 (¶¶ 15-18); CP 448 (¶ 12(D)).

In reality, Villalba stole the money 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, purchase commercial real estate in Ohio, support his "Rico Latte" coffee shops, and make over $3 million in Ponzi-type payments to other investors. CP 449 (¶ 12(F)). None of Villalba's investors sent any money to RCG. But Villalba transferred money from MMA's bank accounts to a futures accounts in MMA's name, including one at RCG, to trade futures. (*Id.*)

Villalba concealed his theft from his clients with lies and false account statements reflecting steady gains in their accounts. CP 12 (¶ 53); *see,* *e.g.*, CP 509–10 (63:10–64:7); *see also* CP 514–19. There is no dispute that RCG played no role in creating (and had no knowledge of) these fake account statements. Based upon these fake statements and believing Villalba was earning incredible returns, Appellants sent more and more money to Villalba for him to manage on their behalf. *See, e.g.*, CP 511 (71:6-14); CP 539–540 (102:16–103:4); *see also* CP 450 (¶ 12(H)).

**The Appellants Invest With Villalba**

Appellants in this case hired Villalba to manage their money and deposited funds with him at different times between 1996 and 2009. CP 2–4, 6–7 (¶¶ 16, 20, 31); CP 546–77; CP 460–96. Appellants had different relationships with Villalba and different understandings of how he would manage their money.

Appellant Bernard Goldberg, for example, met Villalba years before Villalba opened an account at RCG. CP 408–09. Goldberg and Villalba formed a general partnership, through which Goldberg effectively hired Villalba to manage certain assets in return for a share of the trading profits. CP 410, 413, 580–86. The "R&B Partnership" (*i.e.*, "Rico" Villalba and "Bernie" Goldberg) vested Goldberg with the rights and responsibilities of a general partner, without limitation. Goldberg's attorney drafted the partnership agreement, which provided that Goldberg and Villalba would both own an interest in the partnership's assets and share 50/50 in the partnership's profits and losses. CP 1636 (33:2-4); CP 1628 (¶ 5). Later, after contributing more money to the partnership, Goldberg negotiated a greater share of the profits for himself (ultimately 90% of the partnership). CP 1640 (40:2-12); CP 1628 (¶ 5).

Given his close, lengthy 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 Appellants in this case. CP 1653 (133:13-14); CP 1654 (134:7-12).

After being introduced to Villalba, the other Appellants each entered into Investment Management Agreements ("IMAs") with Villalba. CP 460–96. The IMAs detailed Villalba's role as "investment manager" of individually managed accounts and expressly provided them with the right (i) to manage his or her account, and (ii) change the investment strategy to conform with their investment objectives. CP 461 (¶ I); CP 463 (¶ V.) RCG had no knowledge of the IMAs. The IMAs make no mention of RCG and, in fact, gave Appellants the right to choose or change the brokerage firm that handled his/her account. CP 461 (¶ II(B).) Appellants, however, trusted Villalba (and his large returns) and did not exercise these rights. By and large, Appellants had no knowledge of the brokerage firms (or FCMs) Villalba was using, and each admitted that this was not a factor they considered when they decided to hire Villalba as their investment manager.[1] Appellants typically wired money to Villalba by sending money directly to one his bank accounts. CP 1814–1843.

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[1] *See* CP 527 (39:2-7); CP 539–40 (102:12–103:4); CP 541 (105:14–106:4); CP 499 (25:19-23); CP 511 (71:6-14); CP 431 (40:7-12); CP 431 (130:20-24); CP 2407 (75:15-21), CP 2415 (115:7-14); CP 2413–14 (102:15–103:2); CP 2405–06 (63:20–64:9); CP 670 (43:14-21); CP 671 (51:10-13); CP 673 (59:6–60:8); CP 687 (90:6-17); CP 684

Appellants' understanding of Villalba's trading strategy varied significantly. Some thought he would invest in futures contracts, some believed he would invest only in securities, and others merely knew he provided strong investment returns.[2] What is consistent among the Appellants, however, are their admissions that (a) RCG played no role in the alleged sale of securities or in their decision to invest,[3] (b) they did not believe that they were purchasing an interest in Villalba's company, MMA (or security in the name of MMA), and (c) they never saw, received (or signed) any subscription agreement or offering circular relating to their investment.[4] Critically, Appellants admit that they had no interaction whatsoever with RCG, never had a written agreement that mentioned RCG, and never did business with RCG in any way.[5]

**Villalba's Trading In Futures Contracts**

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(67:21–23); CP 686 (87:2–10); CP 748–51 (Nos. 1-4, 6-15); CP 2148–49 (79:23–80:5); CP 2150 (84:3-5); CP 703 (73:5-15); CP 706 (81:2–10); CP 704 (75:5-21).

[2] *Compare* CP 505 (51:7-10), CP 2408 (76:13-16) *with* CP 429 (122:15-17) *and with* CP 2152 (96:4-7).

[3] *See* CP 527 (39:2-7), CP 539–40 (102:12–103:4); CP 541 (105:14–106:4); CP 499 (25:19-23), CP 511 (71:6-14), CP 431 (40:7-12); CP 431 (130:20–24); CP 2407 (75:15-21); CP 2415 (115:7-14); CP 2413–14 (102:15–103:2); CP 2405–06 (63:20–64:9); CP 670 (43:14-21); CP 671 (51:10-13); CP 673 (59:6–60:8); CP 687 (90:6–17); CP 684 (67:21–23); CP 686 (87:2-10); CP 748–51 (Nos. 1-4, 6-15); CP 2148–49 (79:23–80:5); CP 2150 (84:3-5); CP 703 (73:5-15); CP 706 (81:2-10); CP 704 (75:5-21).

[4] CP 537 (98:25–99:16); CP 540 (103:17-20); CP 506–07 (57:24–58:8); CP 508 (59:14-22); CP 2409–10 (86:15–87:17); CP 671–72 (51:19–52:1); CP 676 (80:15-18); CP 690 (93:1–10); CP 689 (92:1–6); CP 1743 (61:15–21); CP 1747–48 (67:19–68:3); CP 703–03 (72:21–73:1); CP 705 (80:10-20); CP 408–09 (30:25–31:7); CP 412 (37:9-11); CP 413 (38:1-5).

[5] CP 711–14 (Nos. 1-2, 4, 6-8, 10-13); CP 820–21 (1-2, 4, 6, 8, 10); CP 436–39 (170:20–173:16); CP 830–31 (Nos. 1-3, 5, 7, 9-13); CP 541–42 (105:14–106:4).

In June 1998, 18 months *after* the first Appellant invested with Villalba, Villalba opened a nondiscretionary commodity futures account with RCG in the name of one of his companies, MMA. CP 839–67. RCG is a registered FCM that accepts and clears futures trades on behalf of thousands of customers. As a "nondiscretionary" customer, MMA retained complete control over its futures account and had full responsibility and liability for all trading decisions. CP 843–44.

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. In May 2009, around the time the MMA account at RCG was closed, Villalba opened a new futures account at a different firm, Lind Waldock, in the name of his coffee shop. CP 869–78. Villalba closed his RCG account in June 2009. Villalba deposited over $750,000 into the Lind Waldock account and lost another $600,000 in futures trading. *See* CP 871–91. In early September 2009, Villalba started ignoring his clients' phone calls and e-mails, arousing their suspicions. *See*, *e.g.*, CP 433–34 (141:23–142:1). By September 2010, after an investigation by the SEC and FBI, 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. CP 451 (¶ 12(J)); CP 892–99.

**RCG Settlement with the CFTC**

In April 2012, RCG entered into a consent order with its regulator, the Commodity Futures Trading Commission ("CFTC") related to its handling of the MMA account. Appellants misrepresent the nature of the CFTC

Order as evidence of RCG's wrongdoing.[6] Much to the contrary, the order is a product of a *settlement* entered into between RCG and its regulator. 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*, 2011 WL 4048780 (S.D.N.Y. Sept. 13, 2011) (striking references to a CFTC order from civil complaint); *Carpenters Health & Welfare Fund v. The Coca–Cola Co.*, 2008 WL 9358563 (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.[7] As such, Judge North considered the order as evidence only of "the applicable CFTC regulations and conduct relating to those regulations and the duties of an FCM in opening and monitoring accounts," but not evidence any of the factual allegations stated in the Order. App. D-2 (2:12-23); CP 2388. Appellants did not challenge this ruling, yet rely on this inadmissible evidence on appeal.[8] The Court should disregard Appellants' improper reliance on the CFTC Order.

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[6] *See* Op. Br. 8, 24 & n.54, n.56, 41 & n.105, 42 & n.107.

[7] *See also In re Blech Sec. Litig.*, 2003 WL 1610775 (S.D.N.Y. Mar. 26, 2003); *New Jersey Turnpike Authority v. PPG Industries, Inc.*, 16 F. Supp. 2d 460, 474 (D.N.J. 1998).

[8] *See supra* footnote 6.

## IV. ARGUMENT

### 1. The Court Properly Granted Summary Judgment on Appellants' State Securities Claims Because RCG Did Not Participate or Aid in the "Sale" to Appellants.

The trial court properly granted RCG summary judgment on all of Appellants' state securities claims because Appellants can point to no evidence that RCG played any role whatsoever in the sales transactions between Villalba and his investors. On appeal, Appellants understandably avoid discussing the actual sales of alleged securities or their interactions with Villalba. Instead, Appellants seek to hold RCG responsible for Villalba's sales because RCG missed supposed "red flags" in opening and monitoring the MMA account. Even if this argument was supported by the record (and it is not), none of it is relevant. The WSSA and the Ohio Securities Act do not turn on how well the defendant performed his or her functions (*i.e.*, negligence), but on the role that the defendant played in the illegal sale of securities. *See In re Nat'l Century Fin. Enterps., Inv., Inv. Litig.*, 755 F. Supp. 2d 857, 885 (S.D. Ohio 2010); *Kittilson v. Ford*, 93 Wn.2d 223 (1984).

The only relevant question under both the WSSA and the Ohio Securities Act is whether RCG played a sufficient role in the sales transaction to Appellants to be liable under these statutes. Although these statutes offer differing formulations as to the kind of participation that imposes liability—requiring, for example, the defendant be a "substantial contributing factor" in the sale, provide "material aid" in the sale, or participate or aid in "making the sale,"—the general principle remains the same: the greater the defendant's participation in the illegal sales transaction, the more likely it will be held responsible when fraud occurs.

Appellants can cite no law that would justify abandoning this basic framework of the state securities laws to instead impose liability based on RCG's alleged negligence in handling the MMA account. Here, Appellants admit that RCG did not factor into their decision to invest with Villalba.[9] RCG did not issue, promote or solicit the sale alleged securities and, in fact, had absolutely no contact whatsoever with Appellants.[10] The sales of securities were completed well before Villalba would send any money to an account at RCG to trade futures. Because RCG had no involvement with Villalba's sale of securities, summary judgment was properly granted in RCG's favor.

### A. Appellants' RCW 21.20.430(1) Claims Fail Because There Was No Evidence That RCG Acted as "Seller."

Summary judgment was properly granted to RCG on Appellants' RCW 21.20.430(1) claims because there was no evidence that RCG was a "seller" of securities, as required by the statute. RCW 21.20.430(1). Under Washington law, a defendant is considered a "seller" only if it is a "substantial contributing factor" in the sales transaction. *Hines v. Data Line Systems, Inc.*, 114 Wn.2d 127, 149 (1990). In *Hines*, the controlling case on this subject, the Washington Supreme Court held that service providers, such as RCG, are not a "substantial contributive factor" in a

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[9] *See supra* footnote 1.

[10] *See supra* footnote 3.

securities offering (or a "seller"), absent some level of "active participation" in the sales transaction itself. *Id.* at 149. Thus, even though the law firm in *Hines* had advised the issuer, the Court held that it was not a "seller" because it had no "personal contact with any of the investors [and was not] any way involved in the solicitation process." *Id.*

This Court has consistently interpreted *Hines* to mean that a defendant is not a "seller" under the WSSA unless it "take[s] . . . part in the actual sales process by acting as the 'catalyst' between the [seller] and the [purchaser]." *See Brin v. Stuzman*, 89 Wn. App. 809, 830 (1998) ("but for" causation is not sufficient if the defendant is not involved in the actual sales process); *Viewpoint-North Stafford LLC v. CB Richard Ellis, Inc.*, 175 Wn. App. 189, 197 (2013) (referring purchasers to an investment company was not a "substantial contributing factor" in the sale); *Shinn v. Thrust IV, Inc.*, 56 Wn. App. 827, 851 (1990) (same).[11]

The holdings in *Hines, Brin*, and *Viewpoint-North* preclude liability RCG in this case. In *Hines*, advice from a law firm on the actual securities was not sufficient to support liability. Here, RCG gave no advice to Villalba on his alleged sale of securities. In *Brin*, liability was not found even though the defendant had contact with the plaintiff and was the "but for" cause of her investment. Here, RCG had no contact with the

[11] *See also* Barbara L. Schmidt, Note, *Expanding Seller Liability Under the Securities Act of Washington*, 63 WASH. L. REV. 769, 783 (1988) (noting that courts applying the substantial contributing factor test find liability almost exclusively where actual title passes from the "seller" or where the "seller" is directly involved in the sale process), *cited in Brin*, 89 Wn. App. at 830.

Appellants, and they admit RCG played no role in their decision to invest. Finally, in *Viewpoint-North*, liability was not found even though the defendant received a finder's fee for referring purchasers to the investment company where the sale was completed without defendant's "knowledge, advice, or input."[12] Here, RCG did not refer anyone to Villalba, let alone receive a fee for doing so. Rather, Appellants introduced each other to Villalba.

On appeal, Appellants disregard this Court's well-developed case law interpreting RCW 21.20.430(1) and instead attempt to distinguish *Hines* without effect. First, Appellants argue that *Hines* is limited because it involved legal advice and does not protect all service providers from liability. Op. Br. 28. As *Brin*, *Viewpoint-North*, and *Shinn* demonstrate, *Hines* has never been limited to cases involving legal advice. Moreover, neither RCG nor the trial court relied on *Hines* for a categorical exclusion of all "service providers." Rather, the trial court recognized that *Hines* precludes liability against service providers unless they do "something more" that amounts to "active participation in the sales transaction." *Id.* Thus, RCG cannot be liable for being a service provider because it had no active participation in the sales transaction.

Appellants also argue that RCG is more than a "provider of services" because "[i]t created an account eligible as a commodity pool [sic] to help

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[12] The court found that "the absence of any *real promotional conduct* on the part of the defendant" was fatal to the plaintiff's claim that the defendant was a "seller." *Id.* at 200 (emphasis added).

Villalba sell his program."[13] Op. Br. 28. This statement is false. Opening an account is not "promotional conduct" and there is no evidence in the record that the existence of an actual account "help[ed] Villalba *sell* his program" in any way, much less that RCG opened the account to somehow help Villalba. *Id.* Villalba sold his investments with lies about fake gains in fake accounts listed on fake account statements. In any event, if merely opening an account was enough, then any service provider, including MMA's bank, phone company, and internet provider would all be sellers.

Finally, Appellants argue that "unlike the lawyers in *Hines*, [RCG] directly benefited from commissions for trading from funds invested by customers." Op. Br. 28. This is also untrue. RCG's commissions were not tied to or contingent on Villalba's success in soliciting investors or the sale of any "security" to Appellants. RCG's commissions were solely based on providing services, *i.e.*, clearing futures trades in MMA's account. Even so, the mere fact that RCG received commissions on MMA's futures trades does not make RCG a "catalyst to the sale" between Villalba (or even MMA) and Appellants. Op. Br. 28. *See Viewpoint-North*, 175 Wn. App. at 200 (defendant who received a fee contingent upon consummation of the transaction was not a "seller").

Appellants cannot avoid the fact that all of the alleged transactions in "securities" occurred exclusively between Villalba and Appellants, most

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[13] Appellants are also wrong that the account was a commodity pool. *See supra* Part IV.4.

often in the privacy of their own homes. RCG played absolutely no role in those sales. There is also no dispute that RCG did not market or promote Villalba or MMA or take part in the development or underwriting of Villalba's investment. Villalba began soliciting his investors before MMA even opened an account at RCG. RCG was not a "substantial contributing factor" in the sales at issue. For that reason, summary judgment was properly granted on Appellants' RCW 21.20.430(1) claims.

### B. Appellants' RCW 21.20.430(3) Claims Fail Because RCG Was Not a Securities Broker-Dealer for Villalba and Did Not Materially Aid in the Sales Transaction.

Appellants also contend that the trial court erred in granting summary judgment on their RCW 21.20.430(3) claims. RCW 21.20.430(3) imposes liability only where plaintiff can prove *both* that the defendant (1) is a securities "broker-dealer" for the seller and (2) materially aids in the sales transaction.[14] *See* RCW 21.20.430(3). Because Appellants could establish neither element, the trial court properly granted summary judgment in RCG's favor on these claims.

First, RCG is categorically excluded from liability under RCW 21.20.430(3) because RCG never served as a securities broker-dealer for MMA or Villalba. The definition of "broker-dealer" specifically requires the defendant to be in the business of effecting "securities" transactions for the seller. RCW 21.20.005; *see also Bennett*

[14] RCW 21.20.430(3) also reaches "control persons" and "persons exempt under the provisions of RCW 21.20.040." Appellants do not argue that RCG falls within either category. *See* Op. Br. 29 n.71.

*v. Durham*, 683 F.3d 734, 738–39 (6th Cir. 2012) (a "broker-dealer" must represent the issuer "in effecting or attempting to effect" the sale of securities). RCG did not effect any securities transactions; the only transactions involving RCG were futures transactions executed by MMA in its futures account. Because futures contracts and futures accounts are not "securities," RCG could not have been a securities "broker-dealer" for purposes of RCW 21.20.430(3). *See Sherry v. Diercks*, 29 Wn. App. 433, 441 (1981) ("The nondiscretionary commodity [futures] account involved here is not a 'security.'"); *Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 259, 267 (S.D.N.Y. 1966) (commodity futures are not securities because their price movements are the result of market conditions and not the efforts of any promoters).

Second, summary judgment was also appropriate because there is no evidence that RCG provided any "material aid" in the transactions between Villalba and Appellants. Although this Court has not had the opportunity to opine on the WSSA's "materially aided" provision, other courts have interpreted "material aid" under identical provisions to mean that the defendant's involvement must be "considerable, significant or substantial." *Nicholas v. Saul Stone & Co. LLC*, 1998 WL 34111036, at *19 (D.N.J. June 30, 1998), *aff'd* 224 F.3d 179 (3d Cir. 2000) (quotations omitted) (attached as App. A). RCG, however, played no role whatsoever in any offering of securities by MMA or Villalba, and it had no contact with any of Villalba's investors. Thus, RCG's role was insufficient as a matter of law.

Rather than point to any evidence in the record that RCG "materially aided" in any of the transactions between Villalba and Appellants, Appellants argue that "courts recognize that a firm 'materially aids' a seller's fraud by performing functions such as clearing trades, providing margin accounts and other activities when that firm is aware of illegal activity in the account." Op. Br. 29. Appellants are wrong. As an initial matter, RCG did not clear, provide margin or any other service relating to the alleged securities at issue. But even if RCG did clear Appellants' transactions, clearing brokers are routinely found not liable as secondary participants because they do not serve a material function in the transaction. *See, e.g.*, *Carlson v. Bear, Stearns & Co., Inc.*, 906 F.2d 315, 317–79 (7th Cir. 1990) (clearing brokers generally perform merely operational or ministerial duties and are not material to the underlying transaction). Indeed, the Official Comments to the Uniform Securities Act—upon which the WSSA is modeled—state that "the performance by a clearing broker of the clearing broker's contractual functions . . . without more would not constitute material aid or result in liability." UNIFORM SECURITIES ACT § 509 cmt. 11.

*Koruga v. Fiserv*, the only case upon which Appellants rely, is inapposite. 183 F. Supp. 2d 1245 (D. Or. 2001). As an initial matter, the Oregon district court in *Koruga* merely affirmed an arbitration panel's findings under the highly deferential "manifest disregard for the law" standard. *Id.* at 1246. In any event, the case is readily distinguishable. The clearing broker in *Koruga* had a contractual agreement with plaintiffs, loaned money directly to them for the purpose of purchasing fraudulently offered stocks and prepared and mailed statements directly to the plaintiffs. *Id.* Conversely in this case, Appellants dealt *only* with Villalba, received no loan from RCG and, indeed, had no contact or legal relationship whatsoever with RCG.

In cases presenting similar circumstances, courts have found that an FCM does not "materially aid" a seller of securities. For example, in *Nicholas v. Saul Stone & Co.*, the plaintiffs also argued that that an FCM allegedly aided the seller in a Ponzi scheme by allegedly failing to follow its own internal procedures and violating CFTC regulations and NFA Bylaw 1101. 1998 WL 34111036, at *15–16. *Compare* Op. Br. 21–22. The court rejected these arguments because the CFTC and NFA rules do not bestow any rights on the general public and concluded that the FCM did not "materially aid" in a seller's Ponzi scheme because it had no contact with investors "so as to solicit or persuade plaintiffs to purchase securities." *Id.* at *16–19 (collecting cases); *see also Bache Halsey Stuart Shields, Inc. v. Erdos*, 35 Wn. App. 225, 231 (1983) (violations of CFTC rules, dealer association rules, or internal "house rules" do not give rise to a private cause of action absent actual fraud). For the same reasons, RCG could not have materially aided Villalba's sale because it had no contact (directly or indirectly) with any of his investors.

Finally, even if it were true that courts impose secondary liability on clearing brokers when they are "aware of illegal activity in the account," that argument does not support liability in this case. First, there is absolutely no evidence that "RCG knew of Villalba's illegal activity." The best Appellants' can muster is pure legal argument about RCG's alleged failure to notice supposed "red flags" in the MMA account. Op. Br. 30. Second, cases imposing secondary liability on securities clearing firms have no relevance here because RCG never performed any securities clearing services for MMA, Villalba, or Appellants. The *futures* transactions executed by MMA at RCG are not the fraudulent "sales" of securities upon which Appellants' claims rest (nor could they be because futures are not securities). Rather, Appellants contend that a "security" was created and sold when Villalba solicited Appellants' money to invest in the fraudulent MMA "program." Op. Br. 30–33. Those fraudulent sales were complete once Appellants sent their money to Villalba, so any service RCG provided to MMA *after* those sales were consummated—and related solely to futures contracts—could not have "materially aided" the relevant transactions.

### C. The Ohio Securities Act Is Inapplicable Under Washington Choice of Law Rules.

Appellants also appeal the denial of their Ohio Securities Act claims arising under O.R.C. § 1707.43(A). Under Washington choice of law rules, however, the Ohio Securities Act is inapplicable in this case.

In *FutureSelect Portfolio Management, Inc. v. Tremont Group*, the Washington Supreme Court instructed that where a conflict exists between state securities laws, the court must determine which state has the to determine which state has the "most significant relationship" to the plaintiff's claim. 180 Wn.2d 954, 967 (2014). In that case, a Washington purchaser asserted WSSA claims against a New York seller. *Id.* 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. *Id.* Given the conflict, the Court engaged in a full-scale conflict of law analysis, weighing the contacts with each state and each states interest in the dispute. *Id.* Critically, the Court 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." *Id.* at 970.

Likewise here, a conflict exists between the WSSA and the Ohio Securities Act that is relevant to this dispute. Indeed, the standard for imposing secondary liability is different under the WSSA than the Ohio Securities Act. As discussed above, the WSSA extends liability only to "sellers" of securities and securities "broker dealers." RCW 21.20.430. Secondary liability under the Ohio Securities Act extends liability to any person who participates or aids the seller in "making such sale." O.R.C. § 1707.43(A).

Just as in *FutureSelect*, the home state of each Appellant also has the most significant relationship with their state securities claims against RCG. Critically, Appellants' initial meetings with Villalba all occurred in

Appellants' respective home states.[15] Each Appellant thereafter received and relied on Villalba's fraudulent misrepresentations (in meetings, calls, faxes, and emails) in their home state.[16] Moreover, Ohio has no interest whatsoever in the present dispute between RCG and Appellants, who are all non-residents of Ohio. Because Appellants' home states have the greatest connection to and interest in their securities law claims, the laws of those states supply the cause of action for each Appellants' claim.

Before the trial court, Appellants conceded that Washington has the most significant relationship to their claims, but argued that they are permitted to proceed under multiple, conflicting states' laws under a so-called "Blue Sky exception" accepted in other states. *See* CP 1898. Appellants' position, however, cannot be squared with *FutureSelect*. There, the Court implicitly rejected the Blue Sky exception by engaging in a full-length conflict of law analysis. Appellants' argument would mean that the Supreme Court's entire conflict of law analysis was in vain.[17]

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[15] *See* CP 527 (39:8-23), CP 833–34 (77:24–78:3); CP 834 (78:10–79:14); CP 500–501 (30:17–31:15); CP 2401 (50:11-15); CP 669 (35:3-12); CP 683 (60:16-24); CP 947 (Nos. 5-7); CP 699 (49:15–18); CP 686 (41:22-23); CP 902–06 (Nos. 5, 31); CP 435 (149:14-23).

[16] *See* CP 912, 916 (Nos. 4, 31); CP 687–88 (90:23–91:18); CP 921, 925 (Nos. 5, 31); CP 553–54 (77:24–78:3); CP 902, 906 (5, 31); CP 435 (149:14-23); CP 935, 933 (Nos. 5, 31); CP 696 (41:22-23); CP 947, 951(Nos. 5, 31); CP 2401–02 (50:24–51:10). Silverman's daughters, Rosen, Sharon Silverman, and Carfagno never met Villalba and were California residents during the relevant time period. CP 2403 (52:10-14); CP 956, 959–60 (Nos. 5, 30, 31).

[17] Other courts have similarly rejected the Blue Sky exception as "impractical, confusing and unfair" and certain to "promote jury confusion." *In re Rospatch Sec. Litig.*, 1992 WL 226912, at *15 (W.D. Mich. July 8, 1992); *see also McInis v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 706 F. Supp. 1355, 1358 (M.D. Tenn. 1989).

### D. Appellants' Ohio Securities Act Claims Fail Because There Is No Evidence That RCG "Participated or Aided" Villalba in "Making the Sale" of Securities.

Even if the Ohio Securities Act were applicable to this case, summary judgment was properly granted on Appellants' O.R.C. § 1707.43(A) claims for much the same reason as their WSSA claims: Appellants were unable to supply any evidence that RCG "participated or aided" Villalba in "making [the] sale" to Appellants. O.R.C. § 1707.43(A). The Court of Appeals' recent decision in *Wells Fargo v. Smith*, which Appellants neglect to cite, is controlling and dispositive of Appellants' claims. 2013 WL 938069 (Ohio Ct. App. Mar. 11, 2013) (attached as App. B). And Appellants' reliance on purported compliance failures by RCG are entirely irrelevant to Appellants' strict liability securities claims. The only question before the Court is whether RCG participated or aided in "making the sale" between Villalba and Appellants. *Id.* Having presented no such evidence, Appellants' Ohio Securities Act claims fail as a matter of law.

#### a. The Ohio Court of Appeals' Decision in *Wells Fargo v. Smith* Defeats Appellants' Claims as a Matter of Law.

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." O.R.C. § 1707.43(A). Although Section 1707.43 extends liability to non-sellers, the Act "do[es] <u>not</u> 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*, 2006 WL 2849784, at *10 (S.D. Ohio Oct. 3, 2006) (emphasis in original).

The recent Ohio appellate court decision in *Wells Fargo v. Smith* makes this distinction perfectly clear. Much like this case, *Wells Fargo* involved the fraudulent and unregistered sale of securities by Diversified Lending Group ("DLG") and American Benefits Concepts ("ABC"), who operated a multi-million dollar Ponzi scheme. 2013 WL 938069, at *1. ABC structured the investment so their customers would mortgage their homes to invest with DLG, and DLG would pay the investor's mortgage payments. *Id.* The defendants in *Wells Fargo*, AmeriFirst and Hamminga, aided the seller by providing to prospective investors the mortgages that they knew would be needed to invest in DLG notes. *Id.* Defendants further aided the fraudulent scheme by providing ABC with each client's loan number, loan amount, and the date of the mortgage payment "to facilitate ABC's payments of [the investors'] mortgages every month." *Id.* at *6.

The plaintiff in *Wells Fargo* was one of the victims of the Ponzi scheme orchestrated by DLG and ABC who was able to invest after receiving a mortgage loan from the defendants. *Id.* at *1, 6. Defendants received a referral from ABC and then contacted the plaintiff directly and assisted her with her loan application, which included income the plaintiff expected to receive from the DLG investment. *Id.* Defendants then sent the plaintiff the loan proceeds so that she could invest in the scheme and notified ABC of the loan details to facilitate payments. *Id.* at *1–2, 7.

When the scheme collapsed, the plaintiff filed suit under O.R.C. § 1707.43(A) against defendants for participating and aiding in the sale of the illegal DLG investment. *Id.* at *2, 5.

In affirming summary judgment in the defendants' favor, the Court of Appeals of Ohio analyzed and synthesized all of the Ohio cases applying Section 1707.43(A). *Id.* 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 [O.R.C.] § 1707.43(A)," all of which are directly connected to "making such sale", including: (i) "relaying information, such as proposed terms of the sale, from the sellers to the investors," (ii) "arranging or attending meetings between the investors and 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." *Id.* at *5.

Applying these factors to defendants, the Court of Appeals of Ohio held that there was no genuine issue of material fact as to whether they "participated or aided ABC in selling the DLG investment." Although Hamminga was aware that the mortgage would be invested in the scheme and aided ABC by providing the loan information, the court emphasized that he "never solicited" the investment, never paid ABC for any mortgage referrals, and never "encourage[d] [the plaintiff] to invest the money into DLG." *Id.* at *7. Likewise, the court found that AmeriFirst never "planned, organized or participated in the underwriting of the DLG investment" or prepared any documents "to attract investors to DLG." *Id.* at *2, 6. Thus, even though AmeriFirst and Hamminga unquestionably assisted ABC and DLG by knowingly providing loans so that their potential investors could participate, they were not liable because they were not involved in the actual sale to the plaintiff. *Id.* at 33.

*Wells Fargo* controls this case. Just as in *Wells Fargo*, there is no evidence in this case that RCG participated or aided in "making [the] sale" of alleged securities to Villalba's investors. Indeed, none of the factors identified in *Wells Fargo* are present here. RCG did not relay information from the sellers to the investors. RCG employees did not attend meetings between Appellants and Villalba. RCG did not collect the money for their investments. RCG did not distribute notes or documents to the investors. RCG did not distribute funds to the investors. RCG did not "actively market" the MMA investment. In short, RCG did not do any of things that could have made it a participant in "making [the] sale."

Appellants' reliance on *Federated Mgt. v. Coopers & Lybrand*, 137 Ohio App. 3d 366 (2000), is therefore misplaced. Op. Br. 15–16. In fact, the court in *Wells Fargo* distinguished *Federated* by explaining that the defendant bank in that case went well beyond its normal role as a banking institution by "reorganizing debt" and "directly participating in the underwriting of the investment." *Id.* at *6. Indeed, the defendant in *Federated* was an affiliate of the seller, intimately involved in the illegal sales, and actually "conceived, organized and directly participated in the underwriting of the Note Offering." 137 Ohio App. at 393. Unlike the defendant in *Federated*, RCG was not an affiliate of Villalba and played no role in the development or underwriting of Villalba's scheme. RCG's only role occurred after each sale was consummated, and, even then, only if Villalba chose to transfer some of Appellants' money from MMA's bank accounts to MMA's futures account. That level of involvement is insufficient as a matter of law. *Wells Fargo*, 2013 WL 938069, at *6 ("[t]he willingness of a bank to become the depository of funds does not amount to a personal participation or aid in the making of a sale."); *Boomershine v. Lifetime Cap., Inc.*, 2008 WL 54803, at *2 (Ohio App. Jan. 4, 2008) (defendant that collected and held investor premiums could not be liable under § 1707.43 because its role "came after [plaintiffs] had invested in that instrument").

*Wells Fargo* also defeats Appellants' argument that RCG is liable if "it assisted in making Villalba's sale of securities possible, even if it did not promote those sales." Op. Br. 14. Without a doubt, the defendants in *Wells Fargo* "made the sale possible." In fact, the mortgage that the defendants provided was an essential feature of the investment scheme, which was designed to pay the plaintiff's mortgage. 2013 WL 938069, at *1. Without the defendants' participation, the plaintiff could not have purchased the unregistered security. In this regard, *Wells Fargo* is a stronger case for finding liability than this case. In *Wells Fargo*, the plaintiff could not have invested without the defendants' aid. Whereas here, Appellants could (and in fact did) invest in Villalba's scheme whether or not MMA had an account at RCG.

#### i. RCG's Alleged Failure to Discover Villalba's Fraud Is Irrelevant.

Rather than point to any evidence in the record that RCG participated or aided in making Villalba's "sale" to his investors, Appellants repeatedly argue that RCG was negligent in the opening of MMA's account or should have closed the account earlier because of various "red flags." Op. Br. 17–25. None of this supposed evidence is relevant, however, because, as Appellants admit, § 1707.43(A) is a strict liability statute that does not require recklessness, knowledge or intent. Op. Br. 13. Whether RCG should have been aware of Villalba's fraud is not at issue.[18]

*Wells Fargo* supports RCG's position in this regard. Noticeably absent from the court's analysis is any discussion of whether or not the defendants in that case were on notice of the ABC/DLG fraud or should have acted to stop it. Rather the *Wells Fargo* court dismissed the claim, focusing on the type of behavior of the defendants and whether it was related to the "making the sale," not whether those functions were provided negligently or appropriately. *See also In re Nat'l Century*, 2006 WL 2849784, at *10 ("The complaints may allege that Bank One aided in the scheme to defraud, but they do not allege that Bank One aided National Century in selling notes.") (dismissing § 1707.43(A) claims).

[18] As discussed below, none of the CFTC or NFA rules identified by Appellants impose a duty on RCG running to third parties and are not enforceable by private plaintiffs like Appellants. *See infra* Part IV.4.

Appellants attempt to draw some connection between RCG's alleged compliance failures and Villalba's "sale" by suggesting that Villalba "needed" a complicit FCM to execute his scheme because Villalba's scheme, as he sold it, was intended to involve futures trading. Op. Br. 16–17. At oral argument on RCG's motion, Judge North dispatched this argument with an apt analogy involving a trucking company. App. D-3 (59:9-16.) Under Appellants' theory, Judge North pointed out, if the seller's scheme involved transporting goods and the seller actually hired a trucking company, then that trucking company would be liable simply because they happened to be a part of the seller's "plan." *Id.* In the face of this startling analogy, Appellants' counsel waivered, arguing instead that to be liable there needed to be "that little extra something that says they knew about the fraud or should have known about the fraud." App. D-7 (63:10-13.) Of course, counsel was mistaken. The Ohio Securities Act is a strict liability statute, asking only whether the defendant participated or aided in "making [the] sale"—not whether there was a "little extra something" indicating the defendant was on notice of fraud.

Judge North was right. Appellants' theory of liability would bring every service provider of the seller of securities within the reach of Section 1707.43(A), from the landlord, the bank and internet provider, and would render the "making such sale" language of the statute meaningless.

In truth, the record makes clear that Villalba did not *need* RCG or any other FCM to sell his scheme to investors. Villalba began securing investments from Appellants 18 months *before* MMA ever opened an account at RCG. Appellants had not even heard of RCG before they hired Villalba, and all admitted that RCG was not a factor in their decision to invest.[19] Because Villalba was lying to his investors, keeping them completely in the dark about what he was actually doing with their money, and sending them false statements showing fictitious returns, Villalba did not even need to invest Appellants' money at all; he could have done (and in fact did do) anything he wished with their money. Villalba did not even "need" RCG as a place to deposit Appellants' money because he collected their funds at MMA's bank accounts, where he transferred funds to himself, his other businesses, and made Ponzi payments to other investors.[20] In short, Appellants' theory that Villalba "needed" RCG to execute his scheme is debunked by the facts of this case.

**ii. The Ohio Trial Court Orders Cited by Appellants Are Neither Authoritative nor Persuasive.**

Without even acknowledging the Ohio Court of Appeals decision in *Wells Fargo*, Appellants urge this Court to blindly follow the interlocutory order of the *Pieretti* trial court, which did not apply *Wells Fargo* and has no more precedential value than Judge North's opinion to the contrary in this case. Op. Br. 14, 25–26.[21]

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[19] *See supra* footnote 1.

[20] CP 449.

[21] Appellants also cite the trial court order in *Vasa Order v. RCG Group, LLC*, No. 11-cv-753705 (Cuyahoga County) denying RCG's motion for summary judgment in that case, which also has no precedential value. The *Vasa* court did not issue an opinion in that case and is currently considering RCG's motion for judgment notwithstanding the verdict. If its motion is denied, RCG will appeal the verdict in that case.

As an initial matter, the *Pieretti* court expressly refused to reconsider its prior order in light of *Wells Fargo*[22] because it found that the case was not controlling in that court's district and was still on appeal at the time. *Pieretti*, May 22, 2013 Order at *6. Moreover, the *Pieretti* court's attempts to distinguish *Wells Fargo* were based upon the misapprehension that the *Wells Fargo* defendants' "actions *primarily* aided the investor and not the seller." *Id.* (emphasis added). Yet, as discussed above, the appellate court in *Wells Fargo* clearly detailed how the defendants aided the seller. Indeed, AmeriFirst's mortgage was an essential part of the overall scheme because the seller would use the investment returns to pay the purchaser's mortgage payments. 2013 WL 938069, at *1.

Finally, this case is distinguishable from *Pieretti* because the only connection found between RCG and a "sale" of securities—the MMA offering circular included as part of the account opening documents—is not at issue in this case. Op. Br. App. A, at 8. Discovery in this case revealed that Appellants never even received or saw the supposedly flawed offering circular and never subscribed to any investment in MMA.[23] Rather, each Appellant had a written contract only with Villalba, personally, to serve as their investment manager. CP 460–96. They had no relationship with MMA. Thus, even under the *Pieretti* trial court's

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[22] *Wells Fargo* was decided after the denial of RCG's motion for summary judgment in *Pieretti*, so the *Pieretti* court first considered it in the context of a motion for reconsideration.

[23] *See supra* footnote 4.

flawed reasoning, RCG did not participate or aid in Villalba's sale of securities.

### 2. The Court Properly Granted Summary Judgment on Appellant Goldberg's State Securities Claims Because His Partnership Agreement with Villalba Was Not a Security.

Appellant Goldberg's state securities claims fail, irrespective of the other Appellants' claims, for the independent reason that his investment with Villalba was not a security, but rather a general partnership.

There is a "strong presumption that a general partnership is not a security." *Nunez v. Robin*, 415 Fed. App'x 586, 589 (5th Cir. 2011). Indeed, any "investor who is offered an interest in a general partnership or joint venture should be on notice . . . that his ownership rights are significant and the [securities statutes] will not protect him from a mere failure to exercise his rights." *Id.*; *see also Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 240 (4th Cir. 1988) (same); *Gordon v. Terry*, 684 F.2d 736, 741 (11th Cir. 1982) (same); *Brannon v. Rinzler*, 603 N.E.2d 1049, 1052 (Ohio Ct. App. 1991) (same). To rebut this strong presumption, a partner must put forth evidence that he had so few rights of control and supervision that the agreement was not a bona fide partnership but rather "drafted purposefully to escape the application of securities laws." *Reeves v. Teuscher*, 881 F.2d 1495, 1500 (9th Cir. 1989). "[T]he proper focus must be on the partnership agreement and not how in fact the entity functioned in carrying out its business affairs." *Id.*

Appellant Goldberg could not rebut this strong presumption because his partnership agreement gave him every right afforded by general partnership law to control the activities of the partnership. The partnership agreement was drafted by Goldberg's lawyer and provided Goldberg with *all* of the rights of a general partner. CP 1635–36 (32:24–33:4). Goldberg and Villalba shared an ownership interest in the assets of the partnership and also shared in its profits and losses. There is nothing in the agreement to indicate that Goldberg's rights of control were abridged by Villalba.

Appellants argue that Goldberg purchased a "security" because he had no "control or influence" over the partnership's investments and, without citation to the record, claim that he "could not and did not control Villalba's investment decisions." (Op. Br. 33.) Appellants' position is untenable.

First, Goldberg could and did exercise control of the partnership. The plain terms of the partnership agreement vested Goldberg with full control of the partnership's activities. CP 1635–36 (32:24–33:4). Goldberg understood that he had the right to control all the decisions that were made with his money and he could have changed the partnership's investment strategy (or dissolved the partnership) if he was dissatisfied or his investment objectives changed. CP 1635–36 (32:20–33:1); CP 1643 (43:4-8). Although in practice Villalba managed the day-to-day trading on behalf of the partnership, Goldberg was anything but a passive investor. Goldberg and Villalba consulted with one another frequently about the investment activities of the partnership. CP 1649 (91:11-13). And—at Goldberg's behest—the partnership established a separate account to trade only in gold futures. CP 1650–51 (118:22–119:3).

At any rate, whether or not Goldberg actually exercised some managerial rights as a general partner (which he did) is not material. Rather, the proper focus is on the partnership agreement, which clearly afforded him those rights. *See J&S Enterprises v. Warshawsky*, 714 F. Supp. 278, 280–82 (N.D. Ohio 1989); *accord Brannon*, 603 N.E.2d at 1052; *see also Reeves*, 881 F.2d at 1500 ("Although Sadri presented evidence that showed Teuscher had primary responsibility for managing BMS, he offered nothing to indicate that Teuscher prevented him from exercising his powers under the Triangle partnership agreement.") (applying Washington law). Here, Goldberg had every right to control the partnership's business under the partnership agreement. Thus, even if Villalba managed the partnership's investments on a day-to-day basis, Goldberg's partnership with Villalba is not a security.[24]

### 3. Appellants' State Securities Claims Are Preempted by the CEA.

Appellants' state securities claims also fail because they are preempted by the CEA.[25] The CEA is a comprehensive federal regime designed to regulate conduct in the futures markets and the functions of FCMs, like

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[24] Appellants submit that the "relevant question" is whether Goldberg had control over the "MMA program." (Op. Br. 32.) Goldberg cannot disavow the partnership, which was formed over a year before MMA even existed, and align himself with an illusory "MMA program." Goldberg testified that the funds he gave Villalba—including the money he seeks in this lawsuit—were contributions to or "additional funding for the *partnership*," not MMA. CP 1646 (48:18-23). All of Goldberg's account statements, written agreements, and countless correspondence relate to R&B Partnership and its performance, not MMA. *See, e.g.*, CP 1860–61; CP 1864–72; CP 1873–78.

[25] The trial court did not reach this issue, but this Court "may affirm summary judgment on any ground supported by the record." *Blue Diamond Group, Inc. v. KB Seattle 1, Inc.*, 163 Wn. App. 449, 453 (2011).

RCG. Under the CEA, Congress provided the CFTC with "exclusive jurisdiction with respect to accounts, agreements . . . and transactions" involving commodities futures contracts, thereby preempting securities regulation by states of the commodities field. 7 U.S.C. § 2. As this Court has explained, "[i]n light of Congress' plainly stated intent to have the [CEA] preempt the field of regulation of commodity futures trading, **any claim under federal or state securities statutes is barred**." *Erdos*, 35 Wn. App. at 230 (quotations omitted) (emphasis added).

In *Bache Halsey Stuart Shields, Inc. v. Erdos*, this Court recognized the preemption of the CEA over both federal and state securities law in cases involving commodity futures trading. 35 Wn. App. at 230. Like here, that case also involved a nondiscretionary futures trading account. *Id.* This Court explained that the futures account was governed exclusively by the CEA, that "any claim under federal or state securities statutes is barred," and the only private cause of action available was a violation of the anti-fraud provision of the CEA. *Id.* at 231. Likewise, in *Sherry v. Diercks*, this Court recognized that the nondiscretionary futures trading account in that case was "not a security" but rather governed exclusively by the CEA, and unambiguously held that "unless a customer proves a violation of the antifraud provisions of the [CEA], recovery of damages against a broker is not an available remedy." 29 Wn. App. 433, 441 (1981).

As recognized in *Erdos* and *Sherry*, Appellants' exclusive statutory remedy against RCG for any alleged misfeasance related to MMA's futures trading account was a claim under the antifraud provisions of the CEA. Under the CEA, Appellants would have been required to prove that RCG "willfully" aided a violation of the Act. 7 U.S.C. § 25(a)(1); *see Erdos*, 35 Wn. App. at 231. Although Appellants initially brought CEA claims, those claims were properly dismissed because Appellants could not allege that RCG acted with the requisite knowledge and intent.[26] Appellants did not appeal that ruling and cannot revive those claims under the guise of state securities laws, which do not regulate RCG's conduct. *Erdos*, 35 Wn. App. at 230.

Appellants argued to the trial court that their state securities claims are not preempted by the CEA because investment interests in "commodity pools are 'securities' and are not within the exclusive jurisdiction of the CEA." CP 1930. But the futures account at RCG was not a "commodity pool," as Appellants suggest.[27] *See Sherry*, 29 Wn. App. at 441 ("The nondiscretionary commodity account involved here is not a 'security', but is governed by the [CEA].") A commodity pool is an investment vehicle, not a type of futures account, "in which funds contributed by a number of persons are combined for the purpose of trading futures contracts."[28] A

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[26] *Burdick v. Rosenthal Collins Group*, No. 1:11-cv-02571-SO, ECF No. 51 (N.D. Ohio July 27, 2012) (attached as App. C).

[27] *See* Op. Br. 6 ("the account would become a commodity pool"), 14 ("[Villalba] needed a licensed FCM to establish a commodity pool."), 16 ("RCG [was willing] to provide the commodity pool needed . . ."), & 28 ("[RCG] created an account eligible as a commodity pool . . . .").

[28] *See* Commodity Pool Operator (CPO), National Futures Association, https://www.nfa.futures.org/nfa-registration/cpo/index.HTML.

commodity pool is formed at the moment funds are combined for the purpose of investing in futures, which, as in this case, may happen long before the pool actually opens any futures accounts, or even if it never opens a futures account. As such, only the *formation* of a commodity pool implicates the securities laws; the pool's futures accounts and trading are governed exclusively by the CEA. *Sherry*, 29 Wn. App. at 441.

*Howard Family v. Trimble* provides a good illustration. 259 P.3d 850, 859–60 (Okla. App. 2011). There, the court was faced with similar state securities claims by investors against an FCM. Much like here, investors fell victim to a Ponzi scheme perpetrated by a customer of an FCM, who was holding himself out as an exempt commodity pool operator. *Id.* at 853–57 & n.7. The plaintiffs alleged that the FCM should be liable as an aider or abettor under the Oklahoma Uniform Securities Act because it provided clearing services to the commodity pool. *Id.* In light of the CEA's preemption of the entire field of futures regulation, however, the court held that the investors could not state a claim under state securities laws based on the FCM's performance of clearing services. *Id.* at 858; *see also Bjornson v. Conti-Commodity Services, Inc.*, 1988 WL 51689 (Minn. App. May 24, 1988) (Minnesota Securities Act claims against an FCM were preempted by CEA); *Mallen v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 605 F. Supp. 1105, 1114 (N.D. Ga. 1985) (Georgia Securities Act claims based on futures contracts purchases were preempted by CEA); *Saul Stone & Co. v. Browning*, 615 F. Supp. 20, 22–23 (N.D. Ill. 1985) (WSSA claims preempted by the CEA).

The same is true here. The only connection between Appellants and RCG pertains to RCG's role as an FCM that cleared futures trades in MMA's account. There is no evidence that RCG provided any services to Villalba or MMA other than those provided by every registered FCM. Accordingly, all of RCG's conduct falls squarely within the CEA's exclusive jurisdiction, and Appellants' statutory claims are preempted by the CEA. *Erdos*, 35 Wn. App. at 231.

**4. The Court Properly Granted Summary Judgment on Appellants' Negligence Claims Because RCG Owed Plaintiffs No Duty to Protect Them from Villalba's Fraud.**

Summary judgment was properly granted on Appellants' common law negligence claims for the fundamental reason that RCG owed Appellants no duty to discover and unearth Villalba's fraud. Every court to address this set of facts has found that no such duty exists. Appellants' cases are easily distinguishable, with most involving duties owed by employers. Critically, however, Villalba was not an RCG employee, so those cases are inapplicable here.

**A. Appellants Had No Special Relationship with RCG.**

The Supreme Court of Washington has repeatedly instructed that "there is no duty to prevent a third party from intentionally harming others 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 (1997) (quotations omitted); *Folsom v. Burger King*, 135 Wn.2d 658, 674-75 (1998) (absent a special relationship "no legal duty to come to the aid of a stranger exists"); RESTATEMENT (SECOND) TORTS § 315. As such, Washington follows the nearly universal 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, 174 (2005) (bank owed no duty to defrauded investors absent a direct relationship).

Discovery in this case established that Appellants were not customers of RCG and never did business with RCG. Appellants admitted that they had no contact with anyone at RCG before the scheme collapsed and never sent any money or documentation to RCG.[29] In short, Appellant had no relationship with RCG, let alone a "special relationship."

Despite having had no contact with RCG throughout the entire time they invested with Villalba, Appellants now argue that RCG owed them a duty to vigilantly police the activity and trading in the MMA account, determine who MMA's investors were, and then unearth and prevent Villalba's fraud. *See* Op. Br. 39–41. No such duty exists. Quite the contrary, every court to address this precise issue has held that FCMs owe no duties to protect non-customers from a customer's fraud. *See, e.g.*, *Spitzer v. Interactive Brokers*, 2013 WL 6827945 (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

[29] *See* CP 711–14 (Nos. 1-2, 4, 6-8, 10-13); CP 503–04 (39:21–40:12); CP 510 (64:20-22); CP 2404 (62:24-25); CP 2405–06 (63:20–64:9); CP 684 (67:21-23), CP 687 (90:6-17); CP 748–51 (Nos. 1-4, 6-15); CP 704 (75:5-21); CP 671 (51:10-18); CP 820–21 (1-2, 4, 6, 8, 10); CP 436–39 (170:20–173:16); CP 830–31 (Nos. 1-3, 5, 7, 9-13); CP 541–42 (105:14–106:4); CP 528 (49:13-21); CP (97:11-13).

*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.") (collecting cases); *Bottom v. Bailey*, 767 S.E.2d 883, 896–97 (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); *Unity House v. North Pacific Inv.*, 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 customer—much less non-customers—to prevent unsuitable trading in a nondiscretionary account).[30]

Although the weight of authority speaks for itself, *Nicholas v. Saul Stone* is illustrative. The fraudster in that case, Kohli, raised millions of dollars by falsely holding himself out as an experienced futures trader. 1998 WL 34111036, at *5. Kohli opened accounts at various FCMs and operated a Ponzi scheme. *Id.* at *4. Investors lost $55 million in the scheme and sued the FCMs that held accounts for Kohli's business. *Id.* The investors argued that the FCMs: should have required Kohli to submit additional documents before allowing him to open accounts; failed to follow know-your-customer rules; were aware of suspicious wire

[30] Appellants selectively rely on the *Pieretti* and *Vasa* trial court orders, yet ignore the parts of those orders relating to negligence claims. Both of those trial courts dismissed negligence claims against RCG because it owed Villalba's investors no duty to monitor MMA's account and discover Villalba's fraud. *See* Op. Br. App. A-10; Op. Br. App. B-8.

transfers; and knew that Kohli's trading activity was inconsistent with the information on account opening forms. *Id.* at *6–7, 22. The court found all of these allegations irrelevant and dismissed the claim because of the "absolute absence of a relationship between plaintiff[s] and defendants." *Id.* at *22. The court held that even if the defendants "knew . . . that Kohli was trading for third parties," that could not create a duty because plaintiffs did not allege "that defendants had any contact with plaintiffs to solicit business or provide advice." *Id.*

Likewise here, because the undisputed facts establish that Appellants had no special relationship with RCG—they were not customers of RCG, had no contact with RCG, did not rely on any representations of RCG, and transferred no money to RCG—no duty arose to protect them from fraud.

### B. *Garrison v. SagePoint* Is Inapplicable Because Villalba Was Not an RCG Employee.

Disregarding the cases across the country which hold that FCMs do not owe a duty to protect non-customers from the fraud of their customers, Appellants rely almost exclusively on *Garrison v. Sagepoint*, 185 Wn. App. 461 (2015). There, the Court held that AIG could be responsible for negligently supervising its *employee*, Mark Garrison, who allegedly misappropriated money from third parties. Applying common law rules pertaining to negligent supervision of employees, the Court found a duty to control the employee for the protection of third parties. *Id.* at 484-85.

Appellants misrepresent *Garrison* to argue that "a duty to a non-customer **can arise** when the firm discovers troublesome 'red flags.'"

Op. Br. 36 (emphasis added). In fact, it was undisputed in *Garrison* that AIG already owed a limited common law "duty to control an employee for the protection of third parties." *Garrison*, 185 Wn. App. at 484. The only dispute was "the *scope* of AIG's duty to supervise . . . [its] investment advisor." *Id.* at 487 (emphasis added). Thus, contrary to Appellants' claim, *Garrison* does not provide that NASD rules or "red flags" can *create* a duty to non-customers, (Op. Br. 36); the duty in *Garrison* was created by the common law employer/employee relationship between AIG and the wrongdoer, Garrison.[31]

Unlike the defendant in *Garrison*, RCG had no equivalent common law duty to supervise its *customer* (or more accurately, its customer's manager) to protect complete strangers from fraud. In fact, no court has ever imposed such a duty.[32] Of course, the distinction between

[31] That the duty in *Garrison* arose because of the employment relationship between AIG and Garrison is confirmed by the cases the court relied upon, including *Niece v. Elmview Group Home*, in which the Washington Supreme Court specifically identified the employer/employee relationship as the kind of "special relationship" that may give rise to a duty to protect third-parties from injury. 131 Wn.2d 39, 51 (citing RESTATEMENT (2ND) TORTS § 315). Likewise, the court relied upon *LaPlant v. Snohomish County*, which specifically provides that "an employer has a limited duty to control an employee for the protection of a third person . . . that can give rise to an action for negligent hiring, training, and supervision." 162 Wn. App. 476, 479 (2011).

[32] For the same reason, Appellants' reliance on *McGraw v. Wachovia Sec., LLC*, 756 F. Supp. 1053 (N.D. Iowa 2010) and *As You Sow v. AIG Fin. Advisors, Inc.*, 584 F. Supp. 2d 1034, 1049 (M.D. Tenn. 2008) is misplaced. Both of those cases involved fraud and misappropriation by the defendant's own registered representative, not its customer. *Javitch v. First Montauk* is inapposite because that case turned on the fact that the broker knew that investors' money was escrowed. 279 F. Supp. 2d 931, 941 (N.D. Ohio 2003) (J. Katz). In fact, the author of *First Montauk* later distinguished his prior ruling, refusing to "impose a broad duty on [a brokerage firm] towards non-customers with whom they have no direct relationship." *Javitch v. Capwill*, 2011 WL 1002744, at *7 (N.D. Ohio Mar. 15, 2011) (J. Katz).

supervising employees and supervising customers is significant. RCG has thousands of customers and no ability or authority to control their actions.

Appellants' remaining case, *Bear, Stearns & Co. v. Buehler*, is easily distinguishable. 432 F. Supp. 2d 1024 (C.D. Cal. 2000).[33] The brokerage firm in that peculiar case had substantial contact with the claimants and, in fact, actively encouraged them to invest with the advisor "*by making positive statements about his investment record and skills*." *Id.* at 1027–28 (emphasis added). On those facts, an arbitration panel may have found a special relationship giving rise to a duty. Here, however, Appellants admitted that they never had any contact with RCG whatsoever. *See Global Acq. Net. v. Bank of Am. Corp.*, 2013 WL 604159, at *7 (C.D. Cal. Feb. 19, 2013) (distinguishing *Buehler* where defendant did not actively encourage the investment); *Spitzer*, 2013 WL 6827945, at *4 (distinguishing *Buehler* where FCM had no contact with the third parties).

### C. CFTC Rule 166.3 and NFA Rules Do Not Require RCG to Supervise Customers to Protect Strangers.

Unlike the NASD and NYSE rules in *Garrison*, which specifically required AIG to supervise Garrison's outside business activities, the CFTC supervision rule, Rule 166.3, invoked by Appellants does not impose any duty on RCG to supervise customers. *See* Op. Br. 40. Rather, the purpose of Rule 166.3 "is to ensure that *employees* are properly supervised, not to impose a general duty to police the trading in every account." *Bennett v.*

[33] *Buehler* has little, if any, precedential value because the court merely affirmed an arbitration award under a manifest disregard of the law standard.

*E.F. Hutton Co., Inc.*, 597 F. Supp. 1547, 1555 (N.D. Ohio 1984) (quoting *Sherman v. Sokoloff*, 570 F. Supp. 1266, 1271 (S.D.N.Y. 1983)) (emphasis in original). Accordingly, courts consistently hold that Rule 166.3 "does not provide a cause of action against a company for the alleged failure of its employees to prevent a non-employee from committing commodity fraud." *Id.*; *see also Khalid Bin Alwaleed Found. V. E.F. Hutton & Co.*, 709 F. Supp. 815, 818 (N.D. Ill. 1989) (same); *Fustok v. Conticommodity Servs., Inc.*, 618 F. Supp. 1069 (S.D.N.Y. 1985) (same).[34]

Appellants also misstate the so-called "know your customer" rules, established by National Futures Association ("NFA") Rule 2-30, to argue that RCG was "required to carefully review information provided when a potential client seeks to open an account to trade futures." Op. Br. 17 & n.27. **Critically, Rule 2-30 did not apply when MMA opened its account in 1998.** It applied only to "individuals," not entities like MMA.[35] In fact, no statute or rule required RCG to confirm MMA's representations before it opened a nondiscretionary futures trading account

[34] The duties Appellants would impose on RCG in this case are far greater than any duty RCG owes to its own customers. It has long been the law that "the duty of care owed by a broker carrying a nondiscretionary account is an exceedingly narrow one, consisting at most of a duty to properly carry out transactions ordered by the customer." *First Am. Disc. Corp. v. Jacobs*, 756 N.E.2d 273, 284–85 (Ill. App. Ct. 2001) (citations omitted); *see also de Kwiatkowski v. Bear, Stearns*, 306 F.3d 1293, 1302 (2d Cir. 2002); *Sherry*, 29 Wn. App. at 442 ("A broker whose client maintains a nondiscretionary account has no common law duty to ascertain the suitability of a customer to make investments.").

[35] A copy of the July 1, 1998 version of the NFA Rule 2-30, Customer Information and Risk Disclosure is included as App. E; *see also* Interpretive Notice 9004 – NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (effective June 1, 1986) (App. E-8.).

in 1998.[36] But even if "know your customer" obligations had applied to this account in 1998, the Interpretative Notice to the Rule 2-30 explicitly provides that the Rule "should not be construed to expose Members to increased potential liability for damages . . . [because] a business conduct standard promulgated by a self-regulatory organization does not create a private cause of action . . . [and] Rule 2-30 is not an antifraud rule."[37] The NFA also expressly refused to impose any obligation to confirm or question the information provided by a customer in the account opening process, concluding that "the decision whether to confirm customer data is best left to the Member's sound business judgment."[38]

For much the same reason, Appellants' reliance on NFA Bylaw 1101 is also inappropriate. NFA rules are agreements between the FCM and its self-regulatory body. They do not create any rights in or obligations owing to third parties. *See Nicholas*, 1998 WL 34111036, at *18 (NFA Bylaw 1101 imposed no duty on an FCM to the confirm registration status of a commodity pool operating a Ponzi scheme for the benefit of third parties) (collecting cases).

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[36] NFA Bylaw 1101, which prohibits Members from doing business with non-NFA members, is no different. The interpretive notice to that Rule merely suggests that Members confirm that a CPO has filed exemptions as one of many prudent steps to avoid violating NFA Bylaw 1101, which is a strict liability rule. *See* Op. Br. App. K. No statute or rule required an FCM in 1998 to confirm that MMA had filed an exemption notice.

[37] Interpretive Notice 9004 – NFA Compliance Rule 2-30: Customer Information and Risk Disclosure (effective June 1, 1986) (App. E-8).

[38] *Id.*

No legislature, regulatory body or court has ever imposed the sweeping duty Appellants seek that would require an FCM to police its customers to protect non-customers, and sound policy reasons caution against doing so here. The reasoning behind *not* imposing such a duty is "simple and sensible" and intended to avoid imposing insurer-like liability on financial institutions which would "expose [them] to unlimited liability for unforeseeable frauds." *Spitzer*, 2013 WL 6827945, at *4 (quotations omitted).

### 5. Appellants' Challenge to the Trial Court's Modified Protective Order Is Meritless.

Appellants also appeal the trial court's modified protective order, which prohibited discovery of documents or information relating to RCG's monitoring of suspicious activity in the MMA account for compliance with the BSA. Appellants' challenge ignores controlling law and contorts the statutory language to create novel exceptions to the well-established legal protections of the BSA. More importantly, Appellants' request is futile: the protective order was modified to permit them access to the very information they sought. CP 2373–75.

#### A. This Court's Decision in *Norton* Compelled the Trial Court's Decision.

The trial court's protective order mirrored this Court's decision in *Norton v. U.S. Bank*, 179 Wn. App. 450. In *Norton*, a case with virtually indistinguishable facts to this one, 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. *Id.* at 461–62. Here, the BSA's protections apply equally to RCG as it did to the bank in *Norton*, as FCMs are expressly included in the BSA's definition of "financial institutions," 31 U.S.C. §§ 5312(c)(1)(A), 5318(g). Thus, *Norton* compelled the trial court's protective order over the same information and documents.[39]

**i. Villalba's Ponzi Scheme Was a "Suspicious Activity" That, If Discovered, Would Have Been Reported to FinCEN.**

To circumvent *Norton*, Appellants argue that the trial court failed to appreciate 31 C.F.R. § 1026.320's "requirements and exemptions" applicable only to FCMs, like RCG. Whatever the merits of this statutory "exemption" (and there are none, as discussed below), the suspicious activity at issue in this case would have required reporting to FinCEN and, therefore, was squarely protected by the BSA.

The International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, which amended the BSA, imposed significant anti-money laundering ("AML") obligations on all financial institutions, including FCMs. As a result, the BSA requires financial institutions to establish AML programs to monitor for financial crimes. Indeed, both the CFTC and the NFA recognize that FCMs' AML responsibilities stem from

[39] *Compare Norton*, 179 Wn. App. at 461–62 (protecting information relating to a financial institution's monitoring practices "generally or those specifically related" to the case at issue) *with* CP 2373–75 (protecting information relating to RCG's "practices and methods of investigation and monitoring generally" and "inquiries and monitoring of Villalba and the MMA account specifically").

the U.S. Treasury and the BSA.[40] FinCEN specifically identifies "pyramid schemes" as a type of financial crime that must be reported.[41]

Appellants suggest, however, that RCG would have been obligated to report the conduct at issue to the CFTC or the NFA, not FinCEN. Op. Br. 46; *see* 31 C.F.R. § 1026.320(c)(1)(ii). Appellants do not cite any CFTC or NFA reporting requirement that would have bound RCG here,[42] but it matters little. NFA Rules require an FCM to file an SAR with FinCEN if the activity violates the BSA, regardless of whether it also violates the CEA or exchange rules.[43] Just like the scheme in *Norton*, Villalba's Ponzi scheme, if it were discovered, would have required RCG to file an SAR with FinCEN.

**ii. Section 1026.320(e) Does Not Protect Only SARs That Are *Required* to Be Filed with FinCEN.**

Appellants are also wrong that 31 C.F.R. § 1026.320 does not protect SARs or information relating to SARs that are not required to be filed with FinCEN. *See* Op. Br. 46.

First, Appellants misread Section 1026.320(e). By noting that SARs

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[40] *See* NFA, "Anti-Money Laundering," *available at* http://www.nfa.futures.org/nfa-compliance/NFA-introducing-brokers/anti-money-laundering.HTML; CFTC, "Anti-Money Laundering," *available at* http://www.cftc.gov/IndustryOversight/AntiMoney Laundering/index.htm#P22_4541.

[41] *See* FinCEN Suspicious Activity Report Electronic Filing Instructions, at 97–98, *available at* https://www.fincen.gov/forms/files/FinCEN%20SAR%20ElectronicFilingInstructions-%20Stand%20Alone%20doc.pdf

[42] Indeed, Appellants' cite only to CFTC Rule 166.3, which imposes responsibilities to supervise *employees*, not customers, but also imposes no reporting obligations.

[43] *See* CP 1239 (Interpretive Notice 9045 – NFA Compliance Rule 2-9; FCM and IB Anti-Money Laundering Program, at 3).

filed with FinCEN are "include[d]" in its protections, subsection (e) does not *limit* its coverage to FinCEN-filed SARs. *Id.* Second, although Section 1026.320 allows an FCM to forego filing an SAR with FinCEN if the activity must also be reported to the CFTC or NFA, it by no means prohibits an FCM from doing so, and it certainly does not render an SAR that *may* not be filed with FinCEN non-confidential. In fact, NFA Rules *require* an FCM to file an SAR with FinCEN if, as in this case, the reportable activity also violates the BSA:

> If [the] activity also involves a violation of the BSA, a firm ***must file the form SAR with FinCEN*** regardless of whether it has reported the activity to the CFTC or other appropriate regulator.[44]

Even though NFA rules require FCMs to file an SAR with FinCEN, under Appellants' theory, however, an SAR reported to FinCEN that was not required to be under Subsection (c)(1)(ii) (*i.e.*, because the activity *also* violated the CEA or exchange rules), would not be protected at all. All told, Appellants' untenable theory merits no weight.

### B. The Trial Court's Modified Protective Order Afforded Appellants All the Discovery They Sought.

Vacating the modified protective order would have no effect in this case. Once the protective order was modified, Appellants were permitted to access and use essentially all of the information they sought.[45]

Indeed, at the time the trial court entered the original protective order,

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[44] *Id.* (emphasis added).

[45] Every withheld document, except filed SARs, was identified on RCG's privilege log. The *only* evidence which Appellants would not have access to under the trial court's modified protective order is the SAR itself (if one were filed) and RCG AML Reports, which were never produced in the related litigation.

Appellants were already in possession of the documents RCG sought to protect, consisting largely of deposition transcripts and RCG's AML compliance materials and manuals, which had been produced in other litigation. Appellants moved the trial court to modify the order, arguing that the protective order should not prohibit them from accessing "publicly available" information. The trial court modified the protective order to exclude documents made available in the related litigation. CP 2373–74. Effectively, the modified order permitted Appellants access to all discovery from the related litigation.

Once the order was modified, Appellants never sought leave to introduce any evidence from the other litigation before summary judgment was granted. And despite receiving detailed privilege logs from RCG, which detailed all documents (except an actual SAR) that were withheld pursuant to the BSA privilege, Appellants still have not identified a single document that they claim is not privileged under the BSA. Thus, Appellants were not in any way prejudiced by the modified order, so this Court need not labor to distinguish *Norton* or vacate the modified protective order.

## V. CONCLUSION

For these reasons stated here, the Court should affirm the trial court's order granting summary judgment in favor of RCG on all counts.

Respectfully submitted this 7th day of December 2015.

RIDDELL WILLIAMS P.S.

By ______________________________
Gavin W. Skok, WSBA #29766
1001 Fourth Avenue, Suite 4500
Seattle, WA 98154
(206) 624-3000

KATTEN MUCHIN ROSENMAN LLP

Christian T. Kemnitz (pro hac vice)
525 West Monroe Street
Chicago, IL 60661
(312) 902-5200

*Attorneys for Rosenthal Collins Group, LLC*

## CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the date written below, a true and correct copy of the foregoing document was served on the following attorneys, by the means indicated:

| Service List | |
|---|---|
| Chris R. Youtz, WSBA #7786<br>Richard E. Spoonemore, WSBA #21833<br>Charles D. Sirianni, WSBA #40421<br>**Sirianni Youtz Spoonemore Hamburger**<br>999 Third Avenue, Suite 3650<br>Seattle, WA 98104<br>Tel. (206) 223-0303<br>Fax: (206) 223-0246<br>chris@sylaw.com<br>rspoonemore@sylaw.com<br>csirianni@sylaw.com<br>Theresa@sylaw.com<br>Matt@sylaw.com<br><br>*Attorneys for Plaintiff* | ☐ U.S. Mail<br>☐ By Facsimile<br>☒ By Messenger<br>☐ By Federal Express |

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct and that this declaration was executed on the 7th day of December, 2015, at Seattle, Washington.

Courtney R. Tracy

Courtney R. Tracy

# APPENDIX A

1998 WL 34111036
Only the Westlaw citation is currently available.
United States District Court,
D. New Jersey.

Richard NICHOLAS, Lynn Nicholas. Robert M. Blackburn, Cheryl S. Blackburn, On Behalf of Themselves and On Behalf of the Class of All Others Similarly Situated, Plaintiffs,
v.
SAUL STONE & COMPANY LLC f/k/a Saul Stone and Company, et. al, Defendants.

No. Civ. 97–860(AET). | June 30, 1998.

**Attorneys and Law Firms**

Edward M. Bernstein, Lawrenceville, NJ, for Plaintiffs.

Nola R. Bencze, Parker, McCay & Criscuolo, PA, Marlton, NJ, Kenneth N. Laptook, Wolff & Samson, Esqs., Roseland, NJ, David J. Libowsky, Bressler, Amery & Ross, Florham Park, NJ, for Defendants.

**Opinion**

***OPINION***

THOMPSON, Chief J.

***1** This matter comes before the Court on the motions of various defendants to dismiss plaintiffs' complaint pursuant to Fed.R.Civ.P. 12(b)(2) and 12(b)(6) as well as defendants' motion for sanctions pursuant to Fed.R.Civ.P. 11. This matter was decided after oral argument held on June 9, 1998. For the reasons stated below, plaintiffs' complaint will be dismissed in its entirety and defendants's motion for sanctions will be denied.

**BACKGROUND**

**1. The Parties**

The instant action was commenced by certain investors against the named defendants, most of whom are Futures Commission Merchants or broker-dealers with which the Sigma Entities conducted transactions between February of 1991 and April of 1995. The named defendants in the complaint consist of 11 distinct Futures Commission Merchants ("the "FCMs"), the National Futures Association ("NFA") and two individuals who are officers of one of the FCMs and also hold unsalaried positions on certain NFA committees. In addition, plaintiffs seek to assert claims against various unnamed employees of the FCMs. ("FCM EMPLOYEES").

Plaintiffs in this case are a number of individuals who invested money in the "Ponzi" scheme of "Chuckles" Kohli and the Sigma Entities and lost some or all of the funds they invested due to the fraud of the Sigma principals. Plaintiffs are contending that the actions or inactions of defendants in this case are actionable and expose them to liability as well.

The majority of the defendants in this case are Futures Commission Merchants, institutional clearing firms which open and clear customer accounts and hold customer funds within the commodities industry. Defendant Saul Stone was an Illinois corporation and is now an Illinois limited liability company registered with the Commodity Futures Trading Commission under Section 4f of the CEA as a Futures Commission Merchant. Defendant Saul Stone is engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts and is a clearing member of the Chicago Mercantile Exchange as well as a member of the National Futures Association. Also named as a defendant is John Doe, an individual alleged to be an employee or agent of defendant Saul Stone who acted under the titles of "account executive," "registered representative," "associated person," "Commission broker," and "introducing broker" for Saul Stone and was acting within the actual or apparent scope of his employment or agency.

Defendant First Option was a Delaware corporation registered with the CFTC under Section 4f of the CEA engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant First Options is a clearing member of the Chicago Mercantile Exchange as well as a member of the National Futures Association. Also named as a defendant is Joan Doe, an individual employed by or an agent of defendant acting within the scope of her employment or agency.

***2** Defendant Smith Barney was a Delaware corporation engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Smith Barney is a clearing member of the Chicago Board of Trade and the National Futures Association. Also named as a defendant is Smith Barney's employee and/or agent Joseph Doe acting within the scope of his employment or agency.

Defendant Linnco was an Illinois corporation and is now an Illinois limited liability company engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Linnco is a clearing member of the Chicago Mercantile Exchange as well as a member of the National Futures Association. Also named as a defendant is Linnco's employee and/or agent Jane Doe.

Defendant GNI, Incorporated was an Illinois corporation registered with the CFTC under Section 4f and engaged in the business of brokerage in connection with the sale of commodities and commodity futures. GNI is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Defendant GNI Limited was a foreign broker within the meaning of 17 CFR Sections 15 through 17, engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Plaintiffs contend that GNI Incorporated and GNI Limited are part of a group or family of companies that hold themselves out to the public and operate under the designation of GNI for all purposes. Also named as a defendant is GNI's employee and/or agent "Jack Doe".

Defendant Dean Witter was a Delaware corporation registered with the CFTC under Section 4f of the CEA as a FCM and is engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Dean Witter is a clearing member of the Chicago Mercantile Exchange as well as a member of the NFA. Also named as a defendant is Jeff Doe, an employee and/or agent of defendant Dean Witter.

Defendant ING was an Illinois corporation registered with the CFTC under Section 4f of the CEA as a FCM and is engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant ING is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Also named as a defendant is Jean Doe, an employee and/or agent of defendant ING.

Defendant Merrill was a Delaware corporation registered with the CFTC under Section 4f of the CEA engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Merrill is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Also named as a defendant is James Doe, an employee and/or agent of Merrill.

Defendant Prudential was a Delaware corporation registered with the CFTC under Section 4f of the CEA and engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Prudential is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Also named as a defendant is Jill Doe, an employee and/or agent of defendant Prudential. ¶ 25.

***3** Defendant Rosenthal was an Illinois corporation and is now an Illinois limited partnership registered with the CFTC under Section 4f of the CEA and engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Rosenthal is a clearing member of the Chicago Mercantile Exchange as well as a member of the NFA. Also named as a defendant is Jill Doe, an employee and/or agent of defendant Rosenthal. ¶ 27.

Defendant E D & F was a Delaware corporation registered with the CFTC under Section 4f and engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant E D & F is a clearing member of the Chicago Mercantile Exchange as well as a member of the NFA. Also named as a defendant in this action is Joel Doe, an employee and/or agent of defendant E D & F. ¶ 29.

Defendants Saul Stone, First Options, Smith Barney, Linnco, GNI Incorporated, Dean Witter, ING, Merrill, Prudential, Rosenthal and E D & F are all registered with the CFTC as a FCM and are referred to collectively as "FCMs". Defendants John Doe, Joan Doe, Jack Doe, Joseph Doe, Jane Doe, Jake does Jeff Ode, Jean Doe, James Doe, Jill Doe, and Joel Doe each of whom are employees or his or her respective defendant FCMs are collectively referred to as FCM EMPLOYEES.

Defendant the National Futures Association is a Delaware corporation which is a Registered Futures Association pursuant to 7 U.S.C. § 17 of the CEA that transacts business as the future's industry's self-regulatory organization It was established in 1976 to become the futures industry's self-regulatory organization under 7 U.S.C. § 21. As a self-regulatory organization, the NFA performs screening to determine fitness to become or remain an NFA Member, establishes and enforces rules and standards, audits and investigates members and conducts arbitration of futures related disputes. No person or firm may engage in any business which involves buying or selling futures contracts for the public without being an NFA member. ¶ 34. Plaintiffs in this case are seeking to recover from defendant NFA alleging that the NFA breached contractual (Count Two) and fiduciary (Count VII) duties which it owed to these plaintiffs and that the NFA "acted in bad faith in failing to enforce its own Bylaws and Rules as set forth in the NFA manual pursuant to 7 U.S.C. § 21(b)(8). (Count III)

Also named as defendants in this action are Clarence Delbridge and Thomas Stone. Defendant Clarence Delbridge, a principal of Saul Stone, is a member of the NFA as an associated person and an elected member of the Regional Business Conduct Committees of the NFA for the Central Region. ¶ 32. Defendant Thomas Stone was employed as Chairman of the Board of Saul Stone, is a member of the NFA as a Floor Broker and serves as an elected member of the Advisory Committee of the NFA for Futures Commission Merchants. ¶ 33. Plaintiffs contend that in their positions, Delbridge and Stone acted as agents for both Saul Stone and the NFA.

***4** Mr. Stone is Chairman of the Board of Saul Stone & Co. He has been employed by Saul Stone for thirty two years and has worked out of Saul Stone's offices at 30 South Wacker Drive, Chicago, Illinois since 1982. He has been a domiciliary of Illinois and has lived in Illinois for at least thirty one years.

Mr. Delbridge is an Executive Vice–President of Saul Stone & Co. He has been employed by Saul Stone since 1987 and has worked out of Saul Stone's offices at 30 South Wacker Drive in Chicago, Illinois during his employment. Mr. Delbridge has been a domiciliary of Illinois since at least 1987. From February 1988 until March 15, 1995, Mr. Delbridge was a member of the NFA's Business Conduct Committee for the Central Region which was comprised of the following states: Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Michigan, Mississippi, Ohio, Tennessee, Texas and Wisconsin. The NFA Business Conduct Committee for the Cental Region reviewed disciplinary actions brought to their attention by NFA staff members for improprieties alleged to have occurred in the Central Region. On March 15, 1994 the NFA restructured the Business Conduct Committee and its function. As of that date, the Committee is no longer engaged in fact-finding or imposing discipline but rather its role is now limited to determining whether regulatory actions should be brought against those members before the Hearing Committee. The Hearing Committee is now the body which conducts fact-finding and imposes discipline.

### 2. Other Relevant Entities and Individuals

Sigma, Inc. is a Delaware corporation that was engaged in the solicitation, pooling and investment of clients' funds in the securities, commodities futures and options markets.

Chuckles Kohli was one of two directors and a principal officer of Sigma and other related enterprises. On March 6, 1996, Kohli plead guilty to federal charges of commodities fraud, wire fraud and income tax evasion. *United States v. Chuckles Kohli,* Criminal No. 96–132(AET).

Ramchandran was also one of two directors and a principal officer of Sigma. He is currently the subject of investigation by the United States Attorney's Office.

### 3. Plaintiffs' Allegations

#### A. General Allegations

The plaintiffs' Amended Complaint charges generally, that from as early as 1989 and until April 12, 1995, Kohli and Ramchandran, the sole shareholders and officers of the Sigma entities, solicited, on Sigma's behalf, approximately $41 million from 400 investors by falsely holding themselves out as experienced commodities and options traders. The majority of these funds was placed with the defendants. The Amended Complaint alleges that Kohli and Ramchandran solicited these funds from members of the public, including plaintiffs, to invest in commodities for future delivery as well as other commodities, future contracts and commodity options. Kohli and Ramchandran conducted this activity using the business names of Sigma, Inc.; Geronimo, Inc.; Vol Partners, L.P.; and Savid Group. The investor plaintiffs were informed their funds would be pooled and used to trade in the currency and other markets and signed Powers of Attorney giving Kohli, Ramchandran and the Sigma Entities discretionary authority over investing funds and trading decisions. Throughout the relevant time period, Kohli, Ramchandran and Sigma were engaged in fraudulent activity commonly referred to as a "Ponzi" scheme. A Ponzi scheme is one in which early investors who seek to withdraw their funds or their purported profits are paid with funds invested by subsequent investors, and ultimately the later funds are lost due to the fraud of the principals.

***5** The Amended Complaint alleges generally, with respect to the named defendants, that Sigma opened one or more accounts with each of the defendants and entered trades through these accounts. The defendants aided in the execution of trades and sent confirmations and monthly account statements reflecting the transactions which had been executed. The Amended Complaint alleges that defendants never conducted due diligence or made inquiries with respect to the financial condition of Sigma or the source of the deposited funds. The Amended Complaint further alleges that the defendants never inquired into the status of the CFTC registration and NFA membership of Kohli, Ramchandran or Sigma and that defendants knew or should have known of the "Ponzi" scheme being perpetrated by Kohli and Ramchandran. The Amended Complaint asserts that as a result of the fraudulent "Ponzi" scheme, in which defendants participated, the investor plaintiffs lost approximately $55 million.

More specifically, plaintiffs allege that along with Kohli, Chandran and the Sigma Entities, the defendants "knowingly, with intent to deceive, with reckless disregard for the truth or conscious avoidance of the truth, in bad faith, withheld and/or failed to disclose" to plaintiff investors the following: 1) that Kohli, Chandran and the Sigma Entities were not appropriately registered or licensed; 2) that Kohli, Chandran and the Sigma Entities were not members of the NFA; 3) that the securities solicited and sold to plaintiffs were not registered as securities under state or Federal laws or regulation; 4) that Kohli and Chandran were not investing all funds obtained from the plaintiffs in commodity futures contracts or other legitimate investments, but were also using said funds to pay phony "profits" and for other business and personal purposes; 5) that defendant FCMs and FCM EMPLOYEES earned commissions on every commodity futures contract trade made through the FCMs; 6) that defendant FCMs had not followed the rules and regulations of the CFTC and the NFA Manual concerning disclosure of information as required to be made to third party investors; 7) that some of the plaintiffs' funds were going to repay defendant FCMs for debit balances; and 8) that Kohli and Chandran had very little knowledge about commodity futures trading, did not maintain accurate and complete records, did not comply with the rules and regulations of the CFTC and the NFA Manual and created fictitious account statements. ¶ 90

**B. Sigma's Relationship with Defendants**

Plaintiffs' Amended Complaint alleges that Kohli, Chandran and the Sigma Entities approached each of the defendant FCMs some time between January 1, 1989 and April 12, 1995 to place orders to purchase or sell futures contracts. ¶ 64. Plaintiffs further allege that, "Once Kohli, Chandran and the Sigma Entities secured the initial core of plaintiff investors, they induced additional persons to invest through the Sigma Entities' false appearance of legitimacy. The appearance of legitimacy stemmed from the fact that although only a properly registered and licensed FCM or CPO may hold customers' money in an omnibus account, the FCMs allowed the Sigma Entities to deposit customers' funds in an account with the FCMs even though they were not registered as an FCM or a CPO." ¶ 65

***6** Plaintiffs contend that during the relevant time period, the FCM defendants opened Special Accounts for investment in commodities for Kohli and Chandran through business names of Sigma, Inc., Geronimo, Inc., Vol Partners, L.P. and Savid Group and these Special Accounts were all corporate and/or partnership accounts whose forms were completed by Kohli. ¶¶ 68, 69. Plaintiffs contend that in connection with opening a new account, the FCMs should have required the Sigma Entities to submit certain documentation and information, including financial statements and/or information of the principals of the company as well as certification indicating who from the company was authorized to conduct trades and transfers of money in and out of the account, but that the defendant FCMs failed to take such action. ¶ 69.

According to plaintiffs' Amended Complaint, the financial information which Kohli provided to the FCMs on account forms was inconsistent with the magnitude of the trading activity conducted in the accounts and the substantial losses sustained in the accounts over the relevant period and the volume of trading and trading losses as sustained in the accounts frequently exceeded the equity in the accounts and the net worth of the Sigma entities as shown on the financial information submitted to the defendant FCMs. ¶ 70. Plaintiffs assert that "in light of the material discrepancies between the reported financial information of the Sigma Entities, the volume of trading conducted in the accounts, the substantial losses which were being sustained in the accounts and the number of different individuals who were listed with trading authority on the accounts, defendant FCMs were aware that the accounts were being operated as commodity pools comprised of funds solicited from third party investors, therefore requiring registration pursuant to CFTC regulations and NFA rules." Plaintiffs assert that the failure of the FCMs to perform minimal diligence with regard to the background of Kohli, Chandran and the Sigma entities was reckless and without regard for the truth. ¶ 71.

At various times, the accounts of Kohli and Chandran under the business names of the Sigma Entities carried lower balances with the defendant FCMs than necessary to meet the withdrawal demands of the plaintiffs and at times carried negative balances. According to plaintiffs, at these points Kohli and Chandran had to solicit additional funds from new investors so that the new investors' money could be placed in the accounts, thus concealing from the plaintiffs the true diminished value of their accounts. ¶ 85. Plaintiffs contend that defendant FCMs and FCM EMPLOYEES knew or should have known that most of the funds in the accounts of the Sigma Entities during the period of January 1, 1989 and April 12, 1995 had been obtained by Kohli and Chandran from third party investors by false pretenses and without proper regard to the requirements of the CEA, CFTC Regulations and the NFA Manual concerning commodity pool investments. ¶ 86. Plaintiffs also contend that defendants knew or should have known that the account of the Sigma Entities contained funds that Kohli, Chandran and the Sigma Entities were soliciting from the plaintiff class members who were innocent investors who believed their money was being pooled legally and properly invested in the commodities market. ¶ 88.

**C. Disclosure Documents, Registrations Requirements and "Due Diligence"**

*7 Plaintiffs' Amended Complaint also contains allegations that the defendants failed to ascertain whether the proper documents were filed or delivered to plaintiffs. Plaintiffs contend that the defendant FCMs and FCM EMPLOYEES never received from the plaintiffs an acknowledgment for receipt of the required Disclosure Document pursuant to 17 CFR § 4.24 from Kohli, Chandran and the Sigma Entities, nor a Written Statement explaining why a Disclosure Document is not required pursuant to NFA Compliance Rule 2–8(e). ¶ 77. Plaintiffs also assert that the FCMs and FCM EMPLOYEES did not confirm delivery of the required Disclosure Document by Kohli, Chandran and the Sigma Entities pursuant to 17 CFR § 4.21 of the CFTC Regulations and NFA Compliance Rule 2–13. ¶ 79. Plaintiffs also allege, upon information and belief, that the defendant FCMs and FCM EMPLOYEES did not deliver to plaintiffs the required Disclosure Document in the form mandated by 17 CFR § 1.55 and NFA Compliance Rule 2–26. ¶ 83.

Plaintiffs claim that the defendant FCMs and FCM EMPLOYEES failed to investigate and know their customers and failed to perform minimum due diligence by not contacting the CFTC and NFA to gather information regarding Kohli, Chandran and the Sigma Entities as the agents for the plaintiffs pursuant to NFA Compliance Rule 20–8a9e. ¶ 81. Plaintiffs further contend that the defendant FCMs and FCM EMPLOYEES violated the NFA Articles of Incorporation, Article III, § 1(f) and NFA Bylaw 1101 by carrying accounts, accepting and handling transactions in commodity futures contracts on behalf of non-members of the NFA who were required to be registered with the CFTC and transacting business with an unregistered person pursuant to the statutory makeup of 7 U.S.C. Sections 6d., 6e., 6k., and 6n. ¶ 82.

**D. Allegations Against Saul Stone**

Plaintiffs contend that defendant Saul Stone in particular knew or had reason to know of the illicit activities of Kohli, Chandran and the Sigma Entities because of prior involvement in similar "Ponzi" schemes. According to plaintiffs, in September of 1982 defendant Saul Stone received actual notice of a similar "Ponzi" scheme of fraud and deceitful practices perpetrated through and with the assistance of Saul Stone's offices and personnel. Plaintiffs contend that this put Saul Stone on notice as to the likelihood and foreseeability of such "Ponzi" schemes developing when it did not diligently supervise the activities of its personnel and when it did not comply with the rules and regulations of the CFTC, CME and NFA. ¶ 93. Further, in June of 1985, Saul Stone also received actual notice of a "Ponzi" scheme perpetrated through and with the assistance of its offices and personnel. ¶ 94. Plaintiffs contend that the failure of defendant Saul Stone and the other defendant FCMs to properly and diligently train, manage, supervise and investigate the activities of their respective FCM EMPLOYEES as well as Kohli, Chandran and the Sigma Entities, facilitated the occurrence of the activities complained of. ¶ 95.

**E. NFA Failure to take Action**

*8 Plaintiffs assert that despite the fact that defendant FCMs and FCM EMPLOYEES carried accounts, accepted orders and handled transactions on behalf of parties not members of the NFA—no disciplinary action has been taken by the defendant NFA and no thorough, diligent and vigorous investigative action has been initiated by the NFA concerning the management and conduct of the FCMs and FCM EMPLOYEES. Further, plaintiffs contend that the NFA knew or should have known that defendant FCMs were failing to submit certain forms as required by 17 CFR § 17.01 and thus knew or should have known that Kohli was illegally acting as a Third Party Account Controller and took no action. ¶ 102. According to plaintiffs' Amended Complaint, the NFA received substantial income due to the trades and therefore, "due to the high volume of income generated by defendant FCMs for the benefit of the NFA, the NFA had an ulterior motive with little or no motivation to conduct a thorough and vigorous disciplinary investigation of the FCMs." ¶ 106

**F. FCM Failure to Cease Trading with Sigma**

Plaintiffs similarly contend that defendant FCMs failed to cease trading with the Sigma Entities, despite knowledge of its fraudulent activities, because of commissions obtained through such trading. Plaintiffs assert that at various times beginning in 1989, the defendant FCMs authorized and permitted their employees to hold themselves out as agents of their employers and as such accepted orders from Kohli, Chandran and the Sigma Entities for commodity futures transactions for which they received substantial commissions. ¶ 103. Plaintiffs contend that there were approximately 10,000 trades per month which were excessive under the circumstances, contrary to the best interests of investors and constituted "churning" of the account and due to the high volume of commissions generated by FCM EMPLOYEES the FCMs had little or no motivation to conduct a thorough and vigorous investigation of FCM EMPLOYEES and the activities of Kohli, Chandran and the Sigma Entities. ¶ 103.

**G. Improper Transfers**

Plaintiffs also contend that $710,000 in the Sigma Entities' Special Accounts at certain of the defendant FCMs were improperly transferred by those defendant FCMs upon instructions from Kohli to personal accounts maintained by Kohli. ¶ 73. Plaintiffs contend that a total of $590,000.00 was transferred from at least one account in the name of Geronimo at defendant Merrill Lynch to Kohli's personal account at Charles Schwab or Dean Witter. ¶ 74. Further, according to plaintiffs, $80,000 was transferred from a Merrill account in the name of Geronimo to Kohli's personal joint account with his wife at Schwab. ¶ 76. Plaintiffs also contend that a transfer in the amount of $40,000 was made from a Prudential account in the name of Sigma to Kohli's personal joint account with his then wife at Schwab. ¶ 76.

**H. Involvement of FCM EMPLOYEES**

Plaintiffs allege, as stated above, that as a result of the "Ponzi" scheme perpetrated by the Sigma Entities, they lost $ 55 million. Plaintiffs allege, upon information and belief that as of February 28, 1995, reports issued by Kohli and Chandran showed in the aggregate that the commodity pools operated by Kohli and Chandran had assets totaling at least $68 million and of this amount $55 million was lost through trading activities, and an additional $5 million was spent by Kohli and Chandran and $11.6 million was returned to investors. ¶ 60. Plaintiffs allege, upon information and belief that a portion of the $5 million spent by Kohli and Chandran was used to entertain FCM EMPLOYEES including employees of defendant Merrill Lynch at a December 1994 Florida golf trip and employees of defendant First Options at golf outings, football games and other events in either New Jersey or Las Vegas in 1994. ¶ 61.

***9** Further, with regard to the aforementioned $5 million of investor funds plaintiffs assert that some of the funds were used to pay for personal trips to Florida by Steve Kaczmer, who was employed first by defendant Linnco and then by defendant First Options. ¶ 62. Further, plaintiffs contend that the funds were used to pay a $10,000 per month salary to Kaczmer who, while trading during the day at First Options, traded at night for the Sigma Entities from his home terminal. Kaczmer also received from Kohli the sum of $60,0000 in the form of a "loan" of which only $40,000 was repaid; the remaining balance was "forgiven" by Kohli. ¶ 63.

**I. Plaintiffs' Complaint**

As a result of the above stated factual scenario, on February 13, 1997 the investor plaintiffs filed an eleven count Complaint against the named defendants. The following causes of action were asserted in the original Complaint: Count One alleges a violation of the Commodities Exchange Act; Count Two alleges a breach of contract under New Jersey common law; Count Three alleges bad faith failure to enforce NFA rules; Count Four alleges a violation of the New Jersey Uniform Securities Law; Count Five alleges violations of the Securities Act of 1933, Count Six alleges violations of the Securities Act of 1934; Count Seven alleges a breach of fiduciary duty; Count Eight asserts negligence; Count Nine alleges a violation of RICO; Court Ten alleges fraud and civil conspiracy; and Court Eleven alleges a violation of the New Jersey Consumer Protection statute. On November 24, 1997, plaintiffs filed their First Amended Class Action Complaint. The Amended Complaint contained the same claims as the original with the exception of Counts Five and Six, which were omitted.

Defendants now move to dismiss plaintiffs' complaint in its entirety for a variety of reasons. Defendant have also moved for the imposition of sanctions pursuant to Fed.R.Civ.P. 11.

## DISCUSSION

### 1. Personal Jurisdiction—Defendants Delbridge and Stone

The only specifically identified individual defendants in the instant case are Clarence Delbridge and Thomas Stone. Mr. Delbridge and Mr. Stone are named in the claims for breach of contract, bad faith failure to enforce NFA rules, and breach of fiduciary duties. According to plaintiffs' Amended Complaint, defendants Delbridge and Stone's wrongdoing stems from their dual capacity as (a) executives of Saul Stone & Co., and (b) members of certain National Futures Association committees. The Amended Complaint alleges that the individual defendants are liable to plaintiffs because they failed to detect and report to the NFA various misdeeds of non-parties.

The individual defendants have not consented to the exercise of personal jurisdiction by this Court and they contend that there are no relevant contacts between either Mr. Delbridge or Mr. Stone and this forum and the fact that they are employed by Saul Stone & Company or serve on NFA committees does not create personal jurisdiction over them. They have moved to dismiss the claims against them pursuant to Fed.R.Civ.P. 12(b)(2). As their motion raises issues of this Court's jurisdiction, this Court will address it as an initial matter.

***10** When a defendant challenges the court's in personam jurisdiction, the plaintiff must show that the defendant had sufficient contacts with the forum. *Time Share Vacation Club v. Atlantic Resorts, Ltd.,* 735 F.2d 61, 63(3d Cir.1984). Where the issue is presented in a motion to dismiss, the Court must accept as true the allegations in the complaint and resolve disputed issues of fact in favor of the plaintiff. *Carteret Savings Bank v. Shushan,* 954 F.2d 141, 142 n. 1(3d Cir.) *cert. denied,* 506 U.S. 817, 113 S.Ct. 61, 121 L.Ed.2d 29 (1992).

Generally, the law of the state in which the district court sits governs whether the district court may assert personal jurisdiction over a nonresident defendant. Fed.R.Civ.P. 4(e); *Dent v. Cunningham,* 786 F.2d 173, 175 (3d Cir.1986). A Federal Court sitting in New Jersey, therefore may exercise jurisdiction over any person who would be subject to the jurisdiction of the courts of the state of New Jersey. Fed.R.Civ.P. 4(e); *North Penn Gas Co. v. Corning Natural Gas Corp.,* 897 F.2d 687, 689(3d Cir.) *cert. denied,* 498 U.S. 847, 111 S.Ct. 133, 112 L.Ed.2d 101(1990). New Jersey's long arm statute, Civil Practice Rule 4:4–4(c)(2), allows a court to exercise personal jurisdiction over non-resident defendants to the fullest extent permitted by the Due Process Clause of the Fourteenth Amendment to the United States Constitution. *DeJames v. Magnificence Carriers, Inc.,* 654 F.2d 280, 284(3d Cir.) *cert. denied,* 454 U.S. 1085, 102 S.Ct. 642, 70 L.Ed.2d 620(1981).

For the exercise of jurisdiction to conform with the Fourteenth Amendment, it must be shown that a defendant has had "minimum contacts" with the forum state, so that it would be " 'reasonable ... to require the corporation to defend the particular suit which is brought there." ' *World–Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 291–292 (1980) (quoting *International Shoe Co. v. State of Washington Office of Unemployment,* 326 U.S. 310, 317, 66 S.Ct. 154, 90 L.Ed. 95 (1945)). There are two grounds for asserting *in personam* jurisdiction. First, the court may find that the defendant has had sufficiently continuous and systematic contacts with the forum to support "general jurisdiction." *Helicopteros Nacionales de Columbia, S.A. v. Hall,* 466 U.S. 408, 414 n. 8, 104 S.Ct. 1868, 80 L.Ed.2d 404 (1983). Second, if the cause of action is related to or arises out of the defendant's activities within the forum, the court may exercise "specific jurisdiction." *Id.*

Personal jurisdiction over the defendants does not exist simply because they are agents or employees of organizations which presumably are amenable to personal jurisdiction in this Court. *Keeton v. Hustler Magazine, Inc.,* 465 U.S. 770, 781, 104 S.Ct. 1473, 79 L.Ed.2d 790(1984). The law is clear that a corporate officer or agent who has contact with the forum state only with regard to the performance of corporate duties does not thereby become subject to jurisdiction in his or her individual capacity. *Forsythe v. Overmyer,* 576 F.2d 779, 783–84(9th Cir.) *cert. denied,* 439 U.S. 864, 99 S.Ct. 188, 58 L.Ed.2d 174(1978); *Arkansas Rice Growers v. Alchemy Industries, Inc.,* 797 F.2d 565(8th Cir.1986). Further, a person generally acting as an agent on behalf of a corporation is not individually subject to personal jurisdiction merely based on his actions in a corporate capacity. *TJS Brokerage & Co. v. Mahoney,* 940 F.Supp. 784, 788–89(E.D.Pa.1996). Each defendant's contacts with the forum state must, therefore, be evaluated individually. *See Rush v. Savchuk,* 444 U.S. 320, 332, 100 S.Ct. 571, 62 L.Ed.2d 516(1980). *See also PSC Prof. Serv. Group v. American Digital Systems,* 555 F.Supp. 788, 791 n. 5(E.D.Pa.1983) (It is well settled that, absent allegations that the corporate shield is a sham, jurisdiction over the corporation does not subject officers, directors and shareholders of the corporation to personal jurisdiction). Therefore, this Court must assess the contact of defendants Delbridge and Stone with the forum state in their individual capacities.

***11** In the instant case, plaintiffs have not alleged any contact defendants Delbridge and Stone had with the forum New Jersey. Defendants Delbridge and Stone did not reside in New Jersey, did not visit here, did not own property here or even have any personal contact with the forum state. This Court cannot, therefore, find that defendants have systematic and continuous contacts with New Jersey. Further, defendants Delbridge and Stone never communicated with plaintiffs in New Jersey and never spoke or corresponded with anyone purporting to represent the Sigma entities. Therefore, this court cannot find that defendants Delbridge and Stone took any action by which they purposefully availed themselves of the privilege of conducting activities within the forum state or that would justify haling them into Court in this state. Considering this lack of any allegation that defendants had the requisite minimum contacts in their individual capacities, this Court cannot find that either specific or general jurisdiction exists over them.

As a final matter, this Court notes that plaintiffs have argued that subsection 25(c) of the Commodity Exchange Act provides this Court with personal jurisdiction over defendants Delbridge and Stone. Subsection 25(c) of the CEA provides, in pertinent part, that "any action brought under subsection (a) of this section may be brought in any judicial district wherein a defendant is found, resides, or transacts business, or in the judicial district wherein any act or transaction constituting the violation occurs." 7 U.S.C. § 25(c). However, defendants contend, and this Court agrees that the above-stated provision is a venue provision, not a jurisdictional one, and as such, does not provide this Court with personal jurisdiction over the individual defendants. Therefore, while venue may be appropriate in the District of New Jersey—without an independent basis of personal jurisdiction over defendants, the above stated venue provision cannot provide this Court with such jurisdiction.

**2. Fed.R.Civ.P. 12(b)(6)**

The court cannot dismiss an action under Rule 12(b)(6) unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claims as plead which would entitle the plaintiff to relief. *Conley v. Gibson,* 355 U.S. 41, 45–46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957). The factual allegations raised in the complaint must be assumed to be true. *Jenkins v. McKeithen,* 395 U.S. 411, 421, 89 S.Ct. 1843, 23 L.Ed.2d 404 (1969); *Kost v. Kozakiewicz,* 1 F.3d 176, 183 (3d Cir.1993). The complaint should be construed liberally in the plaintiff's favor, giving that party the benefit of all fair inferences which may be drawn from the allegations. *Wilson v. Rackmill,* 878 F.2d 772, 775 (3d Cir.1989). "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheuer v. Rhodes,* 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974).

**3. Defendants GNI Incorporated and GNI Limited**

This Court notes that defendants GNI Incorporated and GNI Limited filed motions to dismiss the Complaint with regard to them, however as the parties have stipulated to the dismissal of these defendants, and an Order to that effect has been entered, this Court will deny the motions of GNI Incorporated and GNI Limited as moot.

**4. Count One: The Commodities Exchange Act**

***12** Count One of plaintiffs' Amended Complaint alleges a violation of the Commodities Exchange Act by defendant FCMs and FCM employees, asserting that these defendants carried accounts, accepted orders and handled commodity futures contracts for Kohli, Chandran and the Sigma Entities, all non-Members of the NFA, exceeding their authority, as agents for the plaintiffs. ¶ 127. Plaintiffs further contend that Kohli, Chandran and the Sigma Entities were a fiction under the CEA of which the FCMs and FCM employees were aware, or with required minimal due diligence would have discovered. ¶ 128. In Count One of the Amended Complaint, plaintiffs contend that defendants were both primary violators of the Commodity Exchange Act and aiders and abettors of Commodity Exchange Act violations.

Section 25 of the Commodity Act provides, in pertinent part, that:

> Any person(other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures

the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person—

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery(or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property(or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of —

(i) an option subject to section 6c of this title(other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 23 of this title, or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

7 U.S.C. § 25(a)(1)(A)-(D). Section 25(a)(2) states that, except under certain circumstances not relevant here, "the rights of action authorized by this subsection ... shall be the exclusive remedies under this chapter available to any person who sustains loss as a result of any alleged violation of this chapter." 7 U.S.C. § 25(a)(2). The Commodity Act also provides at 7 U.S.C. § 13c(a) that:

> Any person who commits, or willfully aids abets, counsels, commands, induces, or procures the commission of a violation of any of the provision of [the Commodity Act], or any of the rules, regulations, or orders issued pursuant to [the Commodity Act], ... may be held responsible for such violations as a principal.

***13** Therefore, the CEA creates a private cause of action in limited circumstances for both direct violations of the CEA and aiding and abetting violations of the CEA.

**A. Direct Violations**

Plaintiffs contend that defendants are primary violators of subparagraphs (A), (B) and (C) of 7 U.S.C. § 25(a)(1). Plaintiffs first contend that the defendant FCM's provided trading advice to plaintiffs for a fee in violation of subparagraph (A) because they regularly advised the Sigma entities what they could or could not trade. More specifically, plaintiffs contend that defendants gave advice to guide plaintiffs accounts around margin requirements and to allow Kohli to maximize the number of trades in order to maximize their own commission fees." Plaintiffs contend that this places defendant FCM in the shoes of "such person" listed in subparagraph (A).

As the FCM defendants had no contact with the investor plaintiffs, there is no allegation in the instant case that defendants directly gave plaintiffs advice, rather plaintiffs allege an "agency" theory in which defendants' alleged acts of giving trading advice to Kohli, who is alleged to be plaintiffs' agent, constitutes the giving of advice to plaintiffs in satisfaction of subparagraph (A). Plaintiffs have provided no authority for allowing a section 25 relationship to be established through an agency theory and there is no indication in the statute indicating the availability of such relief. Further, this Court notes that allowing such a theory in the instant case, where Kohli, although technically the agent of the plaintiff, was clearly not operating in plaintiffs' interest does not seem appropriate.

Subparagraph B of Section 25(a)(1) which relates to contracts for sale of commodities for future delivery, will support a cause of action if the plaintiff made the contract of sale through the defendant or deposited with or paid to the defendant money, securities or property in connection with the order to make such a contract. 7 U.S.C. § 25(a)(1)(B); *Grossman v. Citrus Assoc. of the New York Cotton Exchange, Inc.,* 706 F.Supp. 221, 230(S.D.N.Y.1989). Plaintiffs also contend that defendants accepted orders from plaintiffs for futures and options contracts and/or accepted deposits from plaintiffs in violation of subparagaph (B). This argument is based on the theory that as Kohli was the agent of the plaintiffs, accepting trades from him was the equivalent of accepting trades from plaintiffs in violation of 7 U.S.C. § 25(a)(1)(B). For the reasons stated above, this court finds that plaintiffs have failed to establish a relationship under Subparagraph B of § 25.

Subparagraph C permits an individual to maintain a private action against persons who purchased an interest or participation in a commodity pool or sold such an interest to that pool. Plaintiffs contend that defendants created pool interests by allowing the Sigma entities to trade without margin and that undermargined positions were eventually transferred to plaintiff and that "this overt act of ignoring required margins places defendant FCM's in the position of both primary violator of subparagraph C and as a aiders and abettors of such a violation." Plaintiffs do not allege that the FCM defendants sold them any such interest, but rather admit that the interest or participation in commodity pools were sold to them by Kohli, Chandran and the Sigma entities. As plaintiffs again rely on an agency theory, this Court does not find that plaintiffs have stated the required relationship under Subparagraph C.

***14** As plaintiffs have failed to state any of the required relationships under § 25(a), their claim for a direct violation of the CEA must be dismissed.

**B. Aiding and Abetting Liability**

Plaintiffs's Amended Complaint also alleges that defendants aided and abetted violations of the CEA. Plaintiffs contend that they were denied the opportunity to properly evaluate investing in Sigma because Kohli and Sigma were unregistered and that by allowing Kohli to open accounts and by ignoring or relaxing margin rules, the FCM defendants aided and abetted Sigma to continue trading when underfunded. Plaintiffs contend that as Kohli was not properly registered as required under the CEA and as the defendant FCMs carried accounts, accepted orders and handled futures contracts for Sigma that "common sense dictates that the FCM defendants also aided and abetted Kohli and the Sigma entities."

Defendants contend that plaintiffs' claim of aiding and abetting CEA violations cannot be maintained against them because they are not parties that can be held liable under the statute. This Court must determine, therefore, against whom the private right of action for aiding and abetting can be maintained. Defendants assert that plaintiffs' claims for aiding and abetting commodities fraud violations must be dismissed because there is not a "buyer-seller relationship" between the FCM defendants and the plaintiffs and such relationship is a condition precedent to a private right of action under the Commodities Exchange Act. Plaintiffs contend that the statute does not require that the alleged aider and abettor be in one of the relationships set out in 7 U.S.C. § 25(a)(1)(A)—(D) with the plaintiff, but rather that only the principal must satisfy this requirement.

This Court notes that this issue is not settled. With the exception of this Court, no Court in the Third Circuit has spoken on this issue. However, this Court held in *Manley v. Stark & Stark,* Civ. No. 97–524(AET) that under section 25(a)(1) a primary violator must be the "such person" who commits one of the enumerated acts in subsections (A)-(D); in other words defendants must have provided plaintiffs with trading advice for a fee, made any contract of sale of any commodity for future delivery or accepted the deposit of money, securities or property in connection with any order to make such contract; or sold to or accepted the order for the purchase or sale of or interest or participation in a commodity pool. In so finding, this Court followed the majority of Courts to have spoken on this issue and found that in order to establish aider and abettor liability, plaintiffs must be in one of the four above stated relationships with the defendants. *See also Damato v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 878 F.Supp. 1156, 1161 (N.D.Ill.1995)(holding that the only persons subject to a private right of action under § 25(a) of the CEA are those who sold or took orders for interests in the commodity pool); *Davis v. Coopers & Lybrand,* 787 F.Supp. 787 (N.D.Ill., 1992) (same); *In re Lakes States Commodities, Inc.,* 936 F.Supp. 1461, 1467 (N.D.Ill.1996) (Stating, "Congress could not have more clearly pronounced its intention to create only one vehicle for private causes of action ... and given recent Supreme Court teachings on statutory construction, we are loathe to imply a private right of action into § 13(a)."); *Grossman v. Citrus Assoc. of N.Y. Cotton Exchange,* 706 F.Supp. 221, 2312 (S.D.N.Y.1989); *Kolbeck v. LIT America, Inc.,* 923 F.Supp. 557, 566 (S.D.N.Y.1996).

***15** Plaintiffs argue that this Court should reverse its earlier decision, and ignore the above stated cases and find that a buyer-seller relationship is not required in order to state a cause of action for aiding and abetting under the Commodities Exchange Act. In support of this position, plaintiffs have provided this Court with an amicus curiae brief submitted by the CFTC to the Seventh Circuit Court of Appeals in the *D'Amato* case advocating a broader reading of possible aiding and abetting liability. Although noting the argument of the CFTC to the contrary, this Court finds that the statute on its face appears to preclude private rights of action against either a principal or an aider and abettor absent the existence of one of the four relationships described in § 25(a)(1). Further, it would appear from reading § 25(a)(2) that a private right of action is not available outside the confines of § 25(a)(1). Therefore, this Court will follow the reasoning of the majority of courts to speak on this issue and preclude a private right of action absent one of the relationships listed in § 25. As this Court has found above that no such relationship has been adequately alleged in the instant case, Count I must be dismissed.

**5. Count Two: Breach of Contract**

In the second count of their Amended Complaint, plaintiffs allege a violation of New Jersey common law regarding contracts against defendants FCMs, FCM EMPLOYEES and the NFA. More specifically, plaintiffs allege that they were third party beneficiaries of the agreements between the NFA and its members. ¶ 137. In particular, plaintiffs rely upon NFA Bylaw 1101 and NFA Compliance Rule 2–8(e) as the sources of their purported contractual rights. ¶ 143

NFA Bylaw 1101 provides that:

> No Member may carry on an account, accept an order or handle a transaction in commodities futures contracts for or on behalf of any non-Member of the NFA, or suspended Member, that is required to be registered with the Commission[CFTC] as an FCM, IB [Introducing Broker], CPO, CTA or LTM[Leverage Transaction Merchant], and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or other person.

The interpretive notice regarding Bylaw 1101 states in part that, "the Rule, by its terms imposes strict liability on any Member conducting customer business with a non-Member that is required to be registered. The Rule does not require proof that the Member firm was at fault or failed to exercise due diligence—simply that it transacted customer business with a non-Member that is required to be registered." NFA Compliance Rule 2–8(e) provides the "[n]o member FCM shall accept a customer account and no Member FCM or IB shall introduce a customer account over which a third party, not an associate of such FCM or IB, is to exercise discretion" without first obtaining an authorization from the customer and an acknowledgment from that customer that they received certain disclosure documents.

***16** Based on the alleged violation of this Bylaw and Compliance Rule, plaintiffs contend they are entitled to bring a claim for breach of contract as third party beneficiaries of the contract between the defendant NFA and its members, the defendant FCMs. Plaintiffs claim that members of the general public are third party beneficiaries of the NFA Manual and are entitled to recover from the NFA under a breach of contract theory every time that a scheme to defraud involving the futures market is perpetrated. Defendants contend that this claim must fail as the general public are not third party beneficiaries of the NFA's contract with its members. The defendants further contend that general statements of the NFA's desire to benefit the general investing public cannot support a third party beneficiary claim for breach of contract as there is no evidence that the NFA and its members intended to bestow contractual rights on the general public under the NFA Manual or Bylaws.

In New Jersey, a third party beneficiary may sue upon a contract made for his or her benefit without being privy to the contract. *Rieder Communities, Inc., v. North Brunswick Tp.,* 227 N.J.Super. 214, 222, 546 A.2d 563(App.Div.1988), *cert. denied,* 113 N.J. 638, 552 A.2d 164 (1988); *see also* N.J.S.A. 2A:15–2 (providing that a person for whose benefit a contract is made may sue on the contract in any court). The standard for determining third-party beneficiary status is "whether the contracting parties intended that a third party should receive a benefit which might be enforced in the courts ..." *Rieder,* 227 N.J.Super. at 222, 546 A.2d 563 (quoting *Brooklawn v. Brooklawn Housing Corp.,* 124 N.J.L. 73, 77, 11 A.2d 83(E & A, 1940). Absent such a conclusion derived from the contract or surrounding circumstances, "a third party has no cause of action despite the fact that it may derive an incidental benefit from the contract's performance." *Rieder,* 227 N.J.Super., at 222, 546 A.2d 563(citing *Gold Mills, Inc. v. Orbit Processing Corp.,* 121 N.J.Super. 370, 373, 297 A.2d 203(Law Div.1972).

When considering the intent of the contracting parties, however, "it is not necessary that an intended beneficiary be identified when the contract containing the promise is made," nor is it necessary for the promises's obligation to the intended beneficiary to be in existence at the formation of the contract. *Werrmann v. Aratusa, LTD.,* 266 N.J.Super. 471, 476–77, 630

A.2d 302 (App.Div.1993). The "real test" in determining if a party is a third-party beneficiary to a contract is "whether the contracting parties intended that a third party should receive a benefit which might be enforced in the courts." *Brooklawn v. Brooklawn Housing Corp.,* 124 N.J.L. 73, 11 A.2d 83 (1940); *accord Air Master Sales Co. v. Northbridge Park Co-op, Inc.,* 748 F.Supp. 1110, 1117 (D.N.J.1990). A third-party, who is not an intended beneficiary, but incidentally benefits from a contract, has no contractual right to enforce the contract. *See Grant v. Coca–Cola Bottling Co.,* 780 F.Supp. 246, 249 (D.N.J.1991).

***17** There is simply no indication in the instant case that plaintiffs were the intended beneficiaries of the contractual relationship between the NFA and its FCM members. Plaintiffs find evidence of an intent to benefit them in the broad proclamations made concerning the association's desire to protect the investing public and the following language from Interpretive Notice regarding Bylaw 1101, "the suggested procedures should help foster ... greater protection to the investing public." This language does not affirmatively indicate any desire to permit non-parties to enforce its terms. The Bylaw and Compliance Rule relied upon by the plaintiffs in this case do not indicate that non-parties have the right to seek private judicial remedies to enforce the agreement.

Further, third party enforcement of the rules of a self-regulatory organization has been considered and rejected by a number of other Courts. *See Lake States Commodities,* 936 F.Supp. 1461(N.D.Ill.1996) (NFA Bylaw 1101 and Compliance Rule 2–8(e), relied upon by plaintiffs in this case do not indicate that non-parties have the right to seek private judicial remedies to enforce the agreement. Without such language, the plaintiffs cannot claim third-party beneficiary status); *Bloch v. Prudential–Bache Sec.,* 707 F.Supp. 189, 195–96 (W.D.Pa.1989) (concluding that allowing third-party beneficiary claims under NYSE and NASD rules seems incongruous with the large body of case law holding that no private cause of action exists for violations of the rules of self-regulatory organizations); *Pittsburgh Terminal Corp. v. Baltimore & Ohio R. Co.,* 509 F.Supp. 1002(W.D.Pa.1981) *rev'd on other grounds,* 680 F.2d 933 (3d Cir.) *cert. denied* 459 U.S. 1056 (1982) (Court refused to allow a third party claim for violation of NYSE rules);

Plaintiffs have cited several New Jersey cases in which third party beneficiary status has been found in the context of insurance. *See Eschle v. Eastern Freight Ways, Inc.,* 128 N.J.Super., 299, 306, 319 A.2d 786(1974); *Wermann v. Aratus, Ltd.,* 266 N.J.Super. 471, 630 A.2d 302 (App.Div.1993). However, these cases are clearly distinguishable and do not support a finding by this Court that a third party beneficiary relationship, upon which a private right of action can be based was created by the contractual relationship between the NFA and the FCM defendants. As there is no indication that the NFA and its members intended to bestow contractual rights on the public under the NFA Manuals or Bylaws, plaintiffs' third party beneficiary claim must be dismissed. Therefore, Count II of plaintiffs' Amended Complaint alleging breach of contract will be dismissed.

### 6. Count Three: Bad Faith Failure to Enforce NFA Rules

Count Three is asserted by plaintiffs pursuant to the CEA, 7 U.S.C. § 25(b) and the regulations established pursuant to the CFTC against defendant NFA. Plaintiff asserts that the NFA acted in bad faith in failing to enforce its own Bylaws and Rules as set forth in the NFA Manual, pursuant to 7 U.S.C. § 21(b)(8).

***18** Section 21(b)(8) states that "the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violations of its rules." The CEA states at § 25(b)(2) that a registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title, or in enforcing any such bylaw or rule violates this chapter or any Commission rule, regulation or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule. In order to be liable under these provisions, a contract market or clearing market must fail to enforce a bylaw, rule or regulation that is required to be enforced by Section 17 of the CEA.

Defendants allege that the NFA prohibition against doing business with non-members that is contained in Bylaw 1101 is not a bylaw required by Section 17 of the CEA and thus no private cause of action can be enforced for its non-enforcement. The NFA adopted Bylaw 1101, which indirectly compels membership in the NFA for all Commission registered FCMs pursuant to Section 17(m) of the CEA. Section 17(m) of the CEA provides that "the

Commission may approve rules of futures associations that, directly or indirectly, require persons eligible for membership in such associations to become members of at least one such association ..." Defendants contend, and this Court agrees, that the plain meaning of the word "may" in Section 17(m) permits the NFA to adopt rules such as Bylaw 1101, but does not require the NFA to do so as a condition.

Similarly, Rule 2–8(e) is not one of the Rules which the CFTC required under § 17 of the CEA as a condition to its authorization to the NFA to be a RFA. In fact, the CFTC approved the NFA's application for membership before Rule 2–8(e) was in existence, thus indicating that any requirements of the CEA were fully satisfied by the existing Rules 2–8(a) through 2–8(d). The NFA was in existence for four years before Rule 2–8(e) was added. This Court cannot, therefore, find that Rule 2–8(e) was a rule required by the CFTC, but rather it is a discretionary Rule passed by the NFA only to assist its members in their own internal compliance with Bylaw 1101 and as such, it cannot provide the basis for a private right of action against the NFA.

Courts have consistently held that Section 22 does not provide any private remedy for purported violations of CFTC Regulations and NFA Bylaws and rules. Courts have declined to imply a private cause of action into NFA Bylaw 1101 and its Interpretive Notice. *Lake States Commodities, Inc.,* 936 F.Supp. 1461, 1469 (N.D.Ill.1996) (declining to imply a cause of action into [NFA] Bylaw 1101 and its Interpretive Notice and holding that plaintiffs who had invested money with unregistered commodity pool operator failed to state a claim under the CEA against futures commission merchant). Courts have similarly declined to imply a private cause of action into other NFA rules. *See In re Indemnified Capital Invs., S.A. v. R.J. O'Brien & Associates, Inc.,* 12 F.3d 1406, 1412 (7th Cir.1993). *See also Davis v. Coopers and Lybrand,* 787 F.Supp. 787(N.D.Ill.1992) (The exclusive private remedy under CEA does not include a cause of action for violations of CFTC regulations.); *In re Soybean Futures Litigation,* 892 F.Supp. 1025(N.D.Ill.1995) (Neither Section 4a nor Section 22 authorize private enforcement of CFTC regulations nor have courts been willing to recognize such a claim); *Khalid Bin Alwaleed Found. v. E.F. Hutton & Co.,* 709 F.Supp. 815, 820(N.D.Ill.1989) (finding that Congress did not intend that the rules promulgated by the CFTC should give rise to a private cause of action); *Unity House, Inc. v. First Commercial Financial Group,* 1997 WL 701345 at * 4(N.D.Ill. Nov.5, 1997) (the CFTC and the NFA rules do not provide causes of action); *Indemnified Capital Investments, S.A. v. R.J. O'Brien & Assoc.,* 12 F.3d 1406, 1412 (7th Cir.1993) (dismissing investment company's action against FCM because no independent private right of action existed under NFA Compliance Rule 2–4 concerning just and equitable principles of trade); *Birotte v. Merrill Lynch, Pierce, Fenner and Smith, Inc.,* 468 F.Supp. 1172, 1180 (D.N.J.1979) (holding that there is no implied federal right of action for alleged violations of the New York Stock Exchange and Chicago Board Options Exchange Rules).

**7. Count Four: New Jersey Uniform Securities Law**

***19** Count Four is asserted pursuant to the New Jersey Uniform Securities Law, N.J.S.A. 49:3–47 *et seq.,* against defendants FCMs and FCM EMPLOYEES as primary offenders, or in the alternative, as secondary offenders.

N.J.S.A. 49:3–71(a)(2) and (b) provide:

> (a) Any person who
>
> (2) Offers or sells a security in violation of subsection (a) or (c) of [N.J.S.A.] or by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), is liable to the person buying the security from him ...
>
> (b) Every person who directly or indirectly controls a seller is liable under paragraph (a) ... and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the nonseller who is so liable sustains the burden of proof that he 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.

The text of Section 49:3–71, therefore, requires that the offender must offer or sell securities to the aggrieved purchaser of those securities, or "materially aid" in the sale of those securities.

To be a "seller" of securities the defendant must pass title to the security to the plaintiff, or defendant must solicit plaintiff to purchase the security. *Pinter v. Dahl,* 486 U.S. 622, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988). Mere allegations that the defendant's participation in the transaction was a substantial factor in causing the sale to occur is insufficient to establish that the defendant is a statutory seller. *Zendell v. Newport Oil Corp.,* 226 N.J.Super. 431, 440–441, 544 A.2d 878 (App.Div.1988). 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." *Schor v. Hope,* 1992 U.S. Dist. LEXIS 1003, 15–17 (E.D.Pa.1992).

Defendants contend that the FCM defendants are not alleged to have "offered or sold" any securities so as to incur liability under the statute and further that they did not "materially aid in the sale" of securities so as to face liability under the statute. Defendants further contend that plaintiffs have also failed to allege that the FCM defendants played a "substantial role in persuading or seducing the purchasers into buying securities." *Craighead v. E.F. Hutton & Co.,* 899 F.2d 485, 493 (6th Cir.1990).

This Court finds no allegation which supports a finding that defendants either passed title to the securities in question or were involved in the sale to the extent required by law. There are no allegations that defendants in this case had any contact with plaintiffs, so as to solicit or persuade plaintiffs to purchase securities.

***20** Plaintiffs also contend that defendants aided and abetted in a violation of the statute. The Restatement of Torts provides that a person is liable for harm resulting to a third person from the conduct of another when he "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the others so to conduct himself. Restatement (Second) of Torts § 876(b). Courts have recognized that the Restatement provision sets forth the standard for civil aiding and abetting, *See Landy v. Federal Deposit Ins. Corp.,* 486 F.2d 139, 162(3d Cir.1973) *cert. denied* 416 U.S. 960, 94 S.Ct. 1979, 40 L.Ed.2d 312 (1974).

In this case, this Court cannot find that plaintiffs' allegations support a claim that defendants aided and abetted a violation of the statute. Even accepting all of plaintiffs' allegations as true and reading all inferences in favor of plaintiffs, plaintiffs have not alleged sufficient facts to indicate that defendants gave Kohli substantial and knowing assistance in the sale of securities. Therefore, Count IV fails to state a claim for either a direct violation of or aiding and abetting a violation of the Uniform Securities Act.

**8. Count Seven: Breach of Fiduciary Duties**

Count Seven is brought pursuant to common law and is asserted against defendant FCMs, FCM EMPLOYEES, Delbridge, Stone and the NFA. Plaintiffs assert that the named defendants knew or should have known in the exercise of reasonable care that the money invested by Kohli and Chandran was the property of the plaintiff class members and that defendants, as fiduciaries with respect to the plaintiff class members were required to exercise reasonable and prudent discretion in connection with such transactions in the best interest of plaintiffs. ¶ 182. Plaintiffs contend that the NFA as a non-profit organization charged with self-regulation, had a duty to protect the public interest, and thus had a duty to protect the plaintiffs in this case. Plaintiffs further contend that the NFA breached that fiduciary duty to the investing public when it failed to uncover the fraud at issue in the instant case. Defendants argue that in the absence of any allegation of a transactional relationship or other dealings between plaintiffs and defendants, defendants clearly owe no fiduciary duty to plaintiffs.

Under New Jersey Law, a confidential or fiduciary relationship encompasses all relationships "whether legal, natural, or conventional in their origin, in which confidence is naturally inspired, or in fact, reasonably exists." *Pascale v. Pascale,* 113 N.J. 20, 33–34, 549 A.2d 782 (1988). A fiduciary, therefore is a person with a duty to act primarily for the benefit of another. For a breach of fiduciary duty claim to succeed, plaintiff must show that either the particular relationship presumes fiduciary duties, or that the particular facts indicate that within this particular relationship, fiduciary duties have arisen. *Hensler v. Busey Bark,* 231 Ill.App.3d 920, 927, 173 Ill.Dec. 390, 596 N.E.2d 1269 (4th Dist.1992).

***21** Plaintiffs claim that the NFA manual and the CEA make the NFA "fiduciaries or quasi-fiduciaries" to the plaintiffs in their dealings with Kohli, Chandran and Sigma which required the NFA to exercise reasonable and prudent discretion in connection with such transactions in the best interest of plaintiffs, and that defendants breached such duty. This Court disagrees. Plaintiffs contend that the NFA breached a fiduciary duty to the investing public when it failed to uncover the fraud at issue here. Plaintiffs have provided no support for their contention that a fiduciary duty is owed to them by with the NFA or the FCM defendants. Further, the lack of relationship between the plaintiffs and defendants forecloses the possibility that a fiduciary relationship existed between them. *See Melrose v. Shearson/American Express,* 1988 WL 9042, *12–13 (N.D.Ill.1998) (lack of interaction bars a fiduciary duty claim—a fiduciary duty is created by interaction between two parties, plaintiff cannot unilaterally impose a fiduciary duty upon the defendant). Considering these factors, this Court will follow a number of other Courts which have held that neither federal commodities laws, nor the NFA's Rules or Bylaws give rise to a relationship of trust and dominance so as to establish a fiduciary relationship. *See Indemnified Capital Invs. S.A. v. R.J. O'Brien & Assocs.,* 12 F.3d 1406, 1411–12 (7th Cir.1993) (no fiduciary duty created by NFA Compliance Rule 2–4); *Baird v. Franklin,* 141 F.2d 238, 239 (2d Cir.1944) (no fiduciary duty arising from the stock exchange's requirement to investigate member wrongdoing); *Spicer v. Chicago Board of Trade,* 1990 WL 172712 at *15 (N.D.Ill. October 30, 1990) *aff'd* 977 F.2d 255 (7th Cir.1992) (fiduciary duties are not lightly inferred ... we conclude that the CBOE and OCC are not in a fiduciary relationship with investors who buy or sell options through their facilities); *Arneil v. Ramsey,* 414 F.Supp. 334, 343 (S.D.N.Y.1976) (no fiduciary relationship between exchange and public customers of member firms); *Piemonte v. Chicago Board of Options Exchange, Inc.,* 405 F.Supp. 711, 718 n. 4 (S.D.N.Y.1975) (same); *Steinberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 1974 WL 411 at *1 (S.D.N.Y.1974) (New York Stock Exchange has no fiduciary duty to investors arising from its statutory duty to supervise brokers). Therefore, this Court finds that even accepting plaintiffs' allegations as true and reading all inferences in favor of plaintiffs, they have failed to state a claim upon which relief can be granted and their claim for breach of fiduciary duty is dismissed.

This Court notes that defendant NFA has raised the issue of preemption with regard to the common law claims made against it in plaintiffs' complaint. The NFA states that allowing a plaintiff to bring a state law claim against a self regulatory organization which is an integral part of the CEA's self-regulatory scheme would frustrate Congress' intent to bring the markets under a uniform set of regulations. However, as all of the plaintiffs' claims which named the NFA as a defendant have failed to state a claim upon which relief can be granted and thus cannot be maintained, this Court need not address defendant NFA's contention that the maintenance of claims against it would be inappropriate.

**9. Count Eight: Negligence**

***22** In Count Eight, plaintiffs assert a claim pursuant to common law against defendants FCMs and FCM EMPLOYEES for failure to exercise reasonable care and acting in a negligent manner. ¶ 189–190. Plaintiff contends that the FCMs and FCM EMPLOYEEs were negligent in failing to conduct a more thorough investigation of the source of funds invested by Kohli and Chandran; by assisting and encouraging Kohli and Chandran in soliciting investors for commodity futures trades; by failing to adequately train their respective agents with regard to the laws and regulations governing commodity futures trading and the NFA Ethics Rules and in failing to diligently supervise the activities at their respective offices and solicitation of accounts traded through their respective offices.¶ 190. Defendants contend that as they owed no duty to the plaintiffs, they cannot be held liable under a negligence theory.

New Jersey law applies to plaintiffs' claim of negligence. New Jersey law requires that in order to state a cause of action for negligence, a plaintiff must allege and prove a set of facts showing he has a substantive right entitling him to maintain a cause of action and that there is a violation of that right by defendant which causes injury or damage. *Ryans v. Lowell,* 197 N.J.Super. 266, 274, 484 A.2d 1253 (App.Div.1984). In order to state a claim for negligence, a plaintiff must first establish that a duty is owed to the plaintiff by a defendant. *Strachan v. JFK Memorial Hospital,* 109 N.J. 523, 529, 538 A.2d 346 (1988). The question of whether a duty exists is a matter of law properly decided by the Court, and is largely a question of fairness and policy. *Wang v. Allstate Co.,* 125 N.J. 2, 15, 592 A.2d 527 (1991). If this Court finds no duty exists, there can be no action for negligence. *Ryan,* 197 N.J.Super. at 275, 484 A.2d 1253.

A duty of care exists when an actor creates an unreasonable risk of foreseeable harm or when such a duty is judicially imposed by policy considerations. *Griesenback v. Kutter v. Walker,* 199 N.J.Super. 132, 136, 488 A.2d 1038 (App.Div.1985) *cert. denied* 101 N.J. 264, 501 A.2d 932 (1985). In order for a Court to find the existence of a duty, this Court must make a "value judgment, based on an analysis of public policy, that the actor owed the injured party a duty of reasonable care." *Kelly v. Gwinnell,* 96 N.J. 538, 544, 476 A.2d 1219 (1984). This value judgment requires a "weighing of the relationship of the parties, the nature of the risk, and the public interest in the proposed solution." *Goldberg v. Housing Auth. of Newark,* 38 N.J. 578, 583, 186 A.2d 291 (1962); *Carvalho v. Toll Brothers and Developers,* 143 N.J. 565, 675 A.2d 209 (1996).

In the instant case, there was no relationship between plaintiffs and defendants. Although it is alleged that defendants knew or should have known that Kohli was trading for third parties, there are no allegations that defendants had any contact with plaintiffs to solicit business or provide advice. Considering the absolute absence of a relationship between plaintiff and defendants, this Court cannot find that defendants' actions created an unreasonable risk of harm to plaintiffs or that the injury to plaintiffs was foreseeable in the instant case. *See Riggs v. Schappell,* 939 F.Supp. 321, 332 (D.N.J.1996) (Finding that a clearing broker does not owe the customer of an introducing broker a "broad fiduciary duty" sufficient to support a negligence action under New Jersey law); *Kolbeck v. LIT America, Inc.,* 923 F.Supp. 557 (S.D.N.Y.1996) (Securities brokers do not owe a general duty of care or disclosure to the public simply because they are market professionals. A duty of care arises only when the broker does business with the plaintiff and then the duty of the broker is to attend to the plaintiff's business with care). Therefore, Count VIII of plaintiffs' Amended Complaint will be dismissed.

### 10. Count Nine: RICO, 18 U.S.C. § 1962(c) and § 1962(d)

***23** In Count Nine, plaintiffs allege that the defendants violated the provisions of the Racketeer Influenced and Corrupt Organizations Act. 18 U.S.C. §§ 1961 et seq. Specifically, plaintiffs allege a violation of Section 1962(c) which provides in relevant part:

> It shall be unlawful for any person employed by or associated with any enterprise ... to conduct or participate, directly or indirectly in the conduct of such enterprise's affairs through a pattern or practice of racketeering activity or collection of an unlawful debt.

18 U.S.C. § 1962(c). Section 1962(c) requires the plaintiff to plead the following: 1) the existence of an enterprise whose activities affect interstate commerce; 2) that defendants participated in the conduct of the affairs of the enterprise; and 3) that the participation took the form, at least in part, of racketeering activities. Plaintiffs must also plead that they were injured in their business or property by reason of a violation of § 1962(c).

Liability under § 1962(c) only attaches to persons who participate in the operation or management of the RICO enterprise. *Reves v. Ernst & Young,* 507 U.S. 170, 113 S.Ct. 1163, 1172–74, 122 L.Ed.2d 525 (1993). This means that § 1962(c) may not be imposed on one who merely "carries on" or "participates" in an enterprise, but rather, in order to be liable, "one must have some part in directing those affairs." *Id.* at 1168–70. The mere rendering of professional services does not constitute participation in the direction of the corporation to whom those services were provided. *University of Maryland v. Peat, Marwick, Main,* 996 F.2d 1534, 1539 (3d Cir.1993). "Simply because one provides goods or services that ultimately benefit the enterprise does not mean that one becomes liable under RICO as a result. There must be a nexus between the person and the conduct in the affairs of an enterprise. The operation or management test goes to that nexus." *University of Maryland,* 996 F.2d at 1539. "Outsiders" may be liable under § 1962(c) if they are "associated with" an enterprise and participate in the conduct of its affairs to the point that they in some way direct the enterprise. *Reves,* 507 U.S. at 185. Under this test, not even action involving some degree of decisionmaking constitutes participation in the affairs of an enterprise. *University of Maryland,* 996 F.2d at 1538.

Many courts faced with post-Reves § 1962(c) claims against outside professionals have agreed that providing important services to a racketeering enterprise is not the same as directing the affairs of the enterprise. *See e.g. Azrielli v. Cohen Law Offices,* 21 F.3d 512, 521–22 (2d Cir.1994) (provision of legal services related to fraudulent real estate transaction was not management of the RICO enterprise conducting the fraudulent transaction); *University of Maryland at Baltimore at Maryland v. Peat, Marwick, Main & Co.,* 996 F.2d 1534, 1539 (3d Cir.1993) ("Simply because one provides goods or services that ultimately benefit the enterprise does not mean that one becomes liable under RICO as a result); *Fidelity Federal Sav. & Loan Ass'n v. Felicetti,* 830 F.Supp. 257, 260 (E.D.Pa.1993) (even if appraiser's reports are "keystone" of enterprise's perpetration of fraud, appraiser cannot be liable under section 1962(c)); *United States v. Oreto,* 37 F.3d 739, 750 (1st Cir.1994) (accountants in Reves were not liable because":while they were undeniably involved in the enterprise's decisions, they neither made those decisions nor carried them out; in other words, the accountants were outside the chain of command), *cert. denied* 513 U.S. 1177, 115 S.Ct. 1161, 130 L.Ed.2d 1116(1995); *Baumer v. Pachl,* 8 F.3d 1341, 1344 (9th Cir.1993) (providing legal services to an enterprise did not satisfy "operation or management" test); *Stone v. Kirk,* 8 F.3d 1079, 1092 (6th Cir.1993) (sales representative did not participate in "operation or management" of the enterprise).

***24** Plaintiffs contend that defendants directly participated in the RICO enterprise by carrying the accounts of the Sigma Entities and by transacting the business of the Sigma entities through the clearing of commodity futures contracts and options transactions. Plaintiffs contend that within the customer account agreements between the Sigma entities and the defendant FCMs there is a clear and undisputable right to exercise control over the Sigma entities because the defendant FCMs had the right to limit or cease the trading of Sigma if the Sigma accounts failed to meet certain financial conditions or violated reasonable risk parameters. According to defendants, this inactivity is insufficient to qualify as "taking some part in directing the enterprise's affairs."

This Court cannot find that plaintiffs have adequately alleged that defendants participated in the operation or management of the Sigma entities. While plaintiffs have alleged that defendants' inaction allowed the Sigma entities to continue trading, there are no allegations that any of the defendants had decisionmaking authority at Sigma, or along with Kohli and Chandran was directing the fraudulent enterprise. Therefore, even reading plaintiffs' allegations as true, this Court finds that plaintiffs' have failed to state a claim upon which relief can be granted, and their RICO claim must be dismissed.

Plaintiffs have also alleged that defendants conspired to violate RICO in contravention of § 1962(d). Conspiracy to violate any other provision of § 1962 is a separate RICO violation. To plead conspiracy adequately, a plaintiff must set forth allegations that address the period of the conspiracy, the object of the conspiracy, and the certain actions of the alleged conspirators taken to achieve that purpose. *Kalmanovitz v. G. Heileman Brewing Co.,* 595 F.Supp. 1385, 1400–1401 (D.Del.1984) *aff'd* 769 F.2d 152 (3d Cir.1985). A defendant must knowingly agree to participate in the enterprise through a pattern of racketeering. *United States v. Riccobene,* 709 F.2d 214, 220–21 (3d Cir.) *cert. denied* 464 U.S. 849, 104 S.Ct. 157, 78 L.Ed.2d 145 (1983). Additional elements include agreement to commit predicate acts and knowledge that the acts were part of a pattern of racketeering activity. *Shearin v. E.F. Hutton Group, Inc.,* 885 F.2d 1162, 1167(3d Cir.1989); *Odesser v. Continental Bank,* 676 F.Supp. 1305, 1312–1313(E.D.Pa.1987).

This Court notes that a § 1962(d) claim can exist in the absence of a viable claim under § 1962(c). *See United States v. Antar,* 53 F.3d 568(3d Cir.1995); *see e.g. United States v. Viola,* 35 F.3d 37, 43(2d Cir.1994) (a "RICO conspiracy charge is proven if the defendant embraced the objective of the alleged conspiracy and agreed to commit two predicate acts in furtherance thereof, irrespective of the fact the defendant did not participate in the operation or management of the enterprise). However, liability is limited to those who conspire to operate or manage an enterprise, and does not extend to those who conspire with someone who is operating or managing the enterprise. *See Antar,* 53 F.3d 568, 581(3d Cir.1995). In the instant case, plaintiffs have not alleged that defendants conspired to operate or manage the enterprise, but merely that they conspired with the individuals who did so. Therefore, plaintiffs have failed to state a claim under § 1962(d) and this claim will be dismissed.

**11. Count Ten: Fraud and Civil Conspiracy**

***25** In Count Ten, brought pursuant to New Jersey common law against defendants FCMs and FCM EMPLOYEES, plaintiffs assert claims of fraud and civil conspiracy. Plaintiffs contend that defendant FCMs and FCM EMPLOYEES breached their duties by aiding and abetting Kohli, Chandran and the Sigma Entities in their frauds and conspiring with them to commit these frauds or acting in concert with them in these frauds by concealing the true nature of their activities from plaintiffs. ¶ 212. Further, plaintiffs contend that defendant FCMs defrauded plaintiffs by intentionally creating the false public perception that the unregistered pool was large, profitable and legitimate and by failing to disclose material facts to plaintiffs. ¶ 213. With regard to their claim of conspiracy, plaintiffs contend that defendant FCMs conspired in combination with Kohli, Chandran and the Sigma Entities to commit criminal or unlawful acts including but not limited to conspiring to obtain funds from the plaintiff class members by misrepresentation or fraud and conspiracy to cover up the true nature of Kohli and Chandran's "Ponzi" scheme. ¶ 216.

Under New Jersey law, the elements of civil fraud are: 1) the making of a misrepresentation of material fact; 2) which is made with the knowledge of its falsity; 3) that plaintiffs rely upon to their detriment. *Jewish Center of Sussex County v. Whale,* 86 N.J. 619, 624–25, 432 A.2d 521 (1981). There can be no liability for misrepresentations based on failure to disclose unless a duty to disclose exists. *See Lightning Lube, Inc. v. Witco Corp.,* 4 F.3d 1153, 1185, 1187 (3d Cir.1993). As this Court finds that there was no duty imposed upon defendants with regard to plaintiffs, this Court cannot find that the failure of defendants to disclose information it is alleged to have knowledge of constitutes fraud. Therefore, plaintiffs claim of fraud must be dismissed.

A civil conspiracy is "a combination of two or more persons acting in concert to commit an unlawful act or to commit a lawful act by unlawful means, the principal element of which is an agreement between the parties to inflict a wrong or injury upon another, and an overt act that results in damage." *Morgan v. Union County Board of Chosen Freeholders,* 268 N.J.Super. 337, 364, 633 A.2d 985 (App.Div.1993). "The gist of the claim is not the unlawful agreement, but the underlying wrong which, absent the conspiracy, would give a right of action." *Id.* In order to show civil conspiracy, an act must be committed by at least one of the co-conspirators towards the fulfillment of the conspiracy, and this action must cause some injury to the plaintiff. A conspiracy need not be proven directly, but rather can be inferred from the circumstances. A co-conspirator is liable for all of the acts of his fellow conspirator made in furtherance of the conspiracy. *Morgan v. Union County Board of Chosen Freeholders,* 268 N.J.Super. 337, 364–366, 633 A.2d 985 (App.Div.1993). Proof of a conspiracy makes the conspirators jointly liable for the wrong and the resulting damages. *Board of Education of the City of Asbury Park v. Hoek,* 38 N.J. 213, 183 A.2d 633 (1962). As direct evidence of an unlawful agreement is rare, the Supreme Court has stated that "the question of whether an agreement exists should not be taken from the jury in a civil conspiracy case so long as there is a possibility that the jury can infer from the circumstances [the alleged conspirators] had a meeting of the minds and thus reached an understanding to achieve the conspiracy's objectives." *Addickes v. S.H. Kress,* 398 U.S. 144, 158, 90 S.Ct. 1598, 26 L.Ed.2d 142 (1970).

***26** In the instant case. Plaintiffs have failed to allege facts from which this Court could infer a meeting of the minds or an agreement to carry out the fraudulent scheme. Therefore, plaintiffs' claim for civil conspiracy must be dismissed.

### 12. Count Eleven: New Jersey Consumer Fraud Act, N.J.S.A. 56:8–1, et seq.

In Count Eleven, plaintiffs assert a claim under the New Jersey Consumer Fraud Act against defendants FCMs and FCM EMPLOYEES. Plaintiffs contend that the named defendants have violated the New Jersey Consumer Fraud Act by allowing Kohli, Chandran and the Sigma Entities to trade commodities, futures contracts, commodity options and contracts for sale of commodities for future delivery, on behalf of non-Members of the NFA that are required to be registered with the CFTC, thereby causing the acts of Kohli, Chandran and the Sigma Entities to appear to be legal. Plaintiffs assert that defendants' acts constitute unfair or deceptive trade practices and are in violation of the New Jersey Consumer Fraud Act in that defendants knowingly concealed and suppressed the material fact that Kohli, Chandran and the Sigma Entities were not registered with the CFTC as an AP, a CPO or a CTA nor a member of the NFA, in connection with the sale of merchandise and that such actions are in violation of Federal and state statutes enacted in the public interest and therefore constitute a violation of the New Jersey Consumer Fraud Act. ¶ 221.

The New Jersey Consumer Fraud Act provides that:

> ... [T]he knowing, concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission in connection with the sale or advertisement of any merchandise or real estate ... is declared to be an unlawful practice.

N.J.S.A. § 56:8–2(1996). Merchandise is broadly defined as "any objects, wares, goods, commodities, services, or anything offered, directly or indirectly to the public for sale." N.J. Stat. Ann, tit. 56 § 8–1(c). The New Jersey Consumer Fraud Act is, as its name implies, designed to protect consumers from deceptive sales or advertising practices. Its broad language evidences "legislative concern over sharp practices and dealings in the marketing of merchandise and real estate whereby the consumer could be victimized by being lured into a purchase through fraudulent, deceptive or other similar kind of selling or advertising practice." *Daaleman v. ElizabethtownGas Co.,* 77 N.J. 267, 271, 390 A.2d 566 (1978).

The New Jersey Consumer Fraud Act does not apply to the sale of "securities". *Bramblewood Investors, Ltd. v. C & G Assoc.,* 262 N.J.Super., 96, 109 n. 6, 619 A.2d 1332 (Law Div.1992); *In re Catanella,* 583 F.Supp. 1388, 1441–44 (E.D.Pa.1984). Part of the reason for such exclusion is the differentiation between professional or semi-professional services and traditional "consumer" services. *In re Catanalla,* 583 F.Supp. 1388(1984) ("there is a distinction ... between the policies underlying the protection of consumers in general and the protection of investors in particular. .... Securities fraud is qualitatively different from the archetypal installment credit sale scam where the uneducated are duped into buying inferior consumer goods at exorbitant prices. The rationale behind the Consumer Fraud Act is inapposite in the securities fraud area). Moreover, the very existence of a carefully drawn state securities law militates against the application of the

Consumer Fraud Act to securities." *Catanella,* 583 F.Supp. at 1443.

***27** Therefore, plaintiffs' claim based upon the Consumer Fraud Act is dismissed.

### 13. Rule 11 Sanctions

Defendants Saul Stone & Company LC, First Options of Chicago, Inc ., Smith Barney, Inc, L.G., LC, GNI Incorporated, GNI Limited, Dean Witter Reynolds, Inc., ING (U.S.) Securities Future & Options, Inc. (d/b/a ING Futures & Options), Merrill Lynch. Pierce, Fenner & Smith, Inc., Prudential Securities, Incorporated, Rosenthal Collins Group, L.P. (f/k/a Rosenthal & Company), E.D. & F. Man International, Inc. and the National Futures Association ("NFA") have also moved for an Order sanctioning plaintiffs and their attorneys for asserting claims in violation of Fed.R.Civ.P. 11. Defendants have further moved for an award of their reasonable attorneys' fees and costs incurred as a result of the violation.

Defendants contend that despite repeated opportunities to withdraw or amend their complaint voluntarily, plaintiffs have persisted in their assertion of claims which are not well grounded in fact or supported by existing law or a good faith modification of that law. Defendants further contend that this deliberate refusal to comply with Rule 11 warrants the application of monetary sanctions, including the payment by plaintiffs and their counsel of the reasonable fees and costs incurred by defendants. Defendants, "recognizing that the CFTC's brief on the issue represents a nonfrivolous argument for the extension, modification or reversal of the existing law under Rule 11" have withdrawn their motion for sanctions insofar as it relates to the Section 22 aiding and abetting claim brought on behalf of the plaintiffs. Defendants, however, continue to seek sanctions with regard to plaintiffs' claims of direct liability under Section 22, RICO and state claims, and claims against defendants GNI, Inc. and GNI Limited claiming that such claims are without basis in fact or law.

Pursuant to Fed.R.Civ.P. 11(b), attorneys and *pro se* litigants must comply with certain standards of propriety:

> (b) *Representations to Court.* By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,—
>
> (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

***28** Where an attorney, law firm or litigant has failed to comply with Rule 11(b), the Court may, after notice and a reasonable opportunity to respond, impose sanctions. However, "[r]ule 11 is intended for only exceptional circumstances." *Morristown Daily Record, Inc. v. Graphic Communications, Union Local 8N,* 832 F.2d 31, 32 n. 1 (3d Cir.1987). In deciding whether sanctions are appropriate, the Court should "avoid using the wisdom of hindsight and should test the signer's conduct by inquiring what was reasonable to believe at the time the pleading, motion or other paper was submitted." *Auchmuty & Greenwald v. Holtzman,* 775 F.2d 535, 540 (3d Cir.1985).

> The Rule imposes an obligation on counsel and client analogous to the railroad crossing sign, "Stop, Look and Listen." It may be rephrased, "Stop, Think, Investigate and Research" before filing papers either to initiate a suit or to conduct the litigation. These obligations conform to those practices which responsible lawyers have always employed in vigorously representing their clients while recognizing the court's duty to serve the public efficiently.

*Gaiardo v. Ethyl Corp.,* 835 F.2d 479, 483 (3d Cir.1987). Rule 11 should not be utilized as a fee shifting device in order to avoid requiring each party to cover its own legal expenses. *Id.* at 483.

The Supreme Court has concluded that "the central purpose of Rule 11 is to deter baseless filing in district court and thus, consistent with the Rules Enabling Act's grant of authority, streamline the administration and procedure of the federal courts." *Cooter & Gell v. Hartmarx Corp.,* 496 U.S. 384, 393, 110 S.Ct. 2447, 110 L.Ed.2d 359 (1990). The reasonable inquiry element is measured by an objective standard of reasonableness under the circumstances. *See Chambers v. NASCO, Inc.,* 501 U.S. 32, 47, 111 S.Ct. 2123, 115 L.Ed.2d 27 (1991). Subjective good faith on the part of the attorney is insufficient to avoid sanctions.

The court must use its own discretion to set proper sanctions under Rule 11, which may or may not include attorney's fees. *Doering v. Union County Bd. of Chosen Freeholders,* 857 F.2d 191, 194 (3d Cir.1988). Sanctions are imposed under Rule 11 only to the extent necessary to deter unfounded claims. *Doering,* 857 F.2d at 194. The rule is not intended as a punishment. *See id.* at 196. The court should impose the least sanction necessary to serve as an adequate deterrence. *Id.* at 194.

In the instant case, plaintiffs have advanced a number of claims which this Court has not found to be viable. However, the analysis required close defining of legal theory. This Court is not persuaded that the claims were so unreasonable as to warrant Rule 11 sanctions.

## CONCLUSION

For the foregoing reasons, the various motions of defendants to dismiss plaintiffs' complaint are granted, defendants' motion for Rule 11 sanctions is denied and this case is closed. An appropriate order is filed herewith.

End of Document

# APPENDIX B

2013 WL 938069

CHECK OHIO SUPREME COURT RULES FOR REPORTING OF OPINIONS AND WEIGHT OF LEGAL AUTHORITY.

Court of Appeals of Ohio,
Twelfth District, Brown County.

WELLS FARGO BANK, Plaintiff/Appellee,
v.
Donald Ray SMITH, Executor of The Estate of Evelen May Smith, Defendant/ Third–Party Plaintiff/ Appellant,
v.
Amerifirst Financial, et al., Third–Party Defendants/Appellees.

No. CA2012–04–006.
| Decided March 11, 2013.

Civil Appeal from Butler County Court of Common Pleas, Case No. CVE20101299.

**Attorneys and Law Firms**

Scott A. King, Austin Landing, Dayton, OH, for plaintiff/ appellee.

Andrew M. Engel, Centerville, OH, for plaintiff-appellee, Wells Fargo Bank and defendant/third-party plaintiff/ appellant, Donald Ray Smith, Executor of the Estate of Evelyn Mae Smith.

Sebaly, Shillito & Dyer, Dianne F. Marx, Dayton, OH, for third-party defendants/appellees, Amerifirst Financial and Gary Hamminga.

James Winkelman, Amelia, OH, third-party defendant, pro se.

**Opinion**

M. POWELL, J.

***1** {¶ 1} Third-party plaintiff/appellant, Donald Ray Smith, Executor of the Estate of Evelyn Mae Smith (Mrs. Smith), deceased, appeals a decision of the Brown County Court of Common Pleas granting summary judgment to third-party defendants/appellees, AmeriFirst Financial Corporation and Gary Hamminga. For the reasons stated below, we affirm.

{¶ 2} This case involves a failed investment in fraudulent unregistered securities purchased by Mrs. Smith. The fraudulent securities were part of a multi-million dollar Ponzi scheme run by Diversified Lending Group (DLG). American Benefits Concepts (ABC), a company that sold Medicare supplemental insurance and investments, offered the DLG investment to its clients. ABC structured the financing of the investment so that their clients would mortgage their homes and apply the proceeds to purchase the DLG investment. In return, DLG was to make the customer's monthly mortgage payments. Any extra proceeds from the customer's investments would be given directly to the customer. In order to close the loans, ABC used several mortgage banking firms, including AmeriFirst. Eventually, DLG was unable to meet its obligations and the Ponzi scheme collapsed.

{¶ 3} AmeriFirst started closing mortgage loans for ABC's clients in 2007. This relationship began when Gary Hamminga, a loan officer with AmeriFirst, unexpectedly encountered an acquaintance at a restaurant who was an ABC employee. The employee expressed to Hamminga that ABC was looking for banks to close mortgages for its customers that were investing with DLG and explained the DLG investment. Hamminga agreed to look at some of ABC's customers to see if he could assist them in obtaining a mortgage. Hamminga received many referrals from ABC during 2007 and 2008. Most of the referrals he received from ABC were customers who wished to invest in DLG.

{¶ 4} During the relationship with ABC, Hamminga did not solicit clients to invest in DLG or promote DLG in any way. Hamminga did not contact ABC's clients directly, instead an ABC employee would notify Hamminga if a customer was interested in obtaining a mortgage or the client would contact Hamminga directly. The compensation arrangement between the companies was customary, neither AmeriFirst nor ABC gave the other compensation for referrals. Instead, AmeriFirst earned money once the loan was closed and the loan officers received their customary 40 percent of the gross revenue earned by AmeriFirst on the loan. AmeriFirst also did not plan or organize underwriting of the mortgage loans. There was no legal relationship between the two companies.

{¶ 5} In the fall of 2007, Hamminga was informed by an ABC salesman that Mrs. Smith was interested in obtaining a mortgage. Hamminga then contacted Mrs. Smith who told him that she was not interested in a mortgage. Hamminga relayed this information to ABC and did not speak with Mrs. Smith further. About a month later, Hamminga was contacted by an ABC employee who told him that Mrs. Smith had changed her mind about procuring a mortgage. Hamminga called her a second time. During this conversation, he reminded her that she previously did not want a mortgage. Mrs. Smith assured Hamminga that she had changed her mind and wanted a mortgage. Hamminga then proceeded with the mortgage process.

***2** {¶ 6} After this conversation, Hamminga obtained financial information from Mrs. Smith and confirmed that she qualified for a mortgage. When filling out the loan application, Hamminga included the income Mrs. Smith expected to receive from the DLG investment on her application even though this income was not needed in order to qualify her for the mortgage loan. Hamminga then arranged a date for Mrs. Smith to sign documents so that she could close on the loan. During this process, Hamminga believed that Mrs. Smith was competent and not confused about the events that were taking place. Hamminga kept ABC informed of the status of Mrs. Smith's loan application even though this was not his normal custom. Except for this communication, Hamminga performed his normal banking procedures for closing a mortgage.

{¶ 7} In January 2008, Mrs. Smith closed on the mortgage loan. Three days after the closing, AmeriFirst performed its normal business practice of giving the loan proceeds directly to Mrs. Smith. AmeriFirst did not advise Mrs. Smith as to how to invest her money. Subsequently, Mrs. Smith used the loan proceeds to invest in the DLG notes. After Mrs. Smith's loan was closed, Hamminga provided information regarding Mrs. Smith's loan number, account number, and mortgage payment to ABC although this was not his normal custom. Hamminga communicated this information to ABC to facilitate DLG's payment of Mrs. Smith's mortgage as she had agreed. All other communications between the companies were according to Hamminga's normal business practices.

{¶ 8} Eventually, DLG ceased paying Mrs. Smith's mortgage. Following a SEC investigation, DLG was placed into a receivership in March of 2009. In December 2010, Wells Fargo filed a complaint for foreclosure.[1] Mrs. Smith responded and filed a third-party complaint against AmeriFirst and Hamminga alleging, among other things, that the parties participated in and aided the illegal sale of unregistered securities. In July 2011, Mrs. Smith passed away and her son, Donald Ray Smith, as the executor of her estate, proceeded with the suit. AmeriFirst and Hamminga moved for summary judgment on all the claims against them. On March 12, 2012, the trial court granted AmeriFirst and Hamminga's motion for summary judgment.

{¶ 9} Executor now appeals, raising two assignments of error.

{¶ 10} Assignment of Error No. 1:

{¶ 11} THE TRIAL COURT ERRED IN IMPLICITY OVERRULING [EXECUTOR'S] MOTION TO STRIKE THE AFFIDAVIT OF JASON JUBERG.

{¶ 12} Executor argues that the court erred in overruling his motion to strike the affidavit of Jason Juberg. Juberg was the president of ABC and submitted an affidavit that discussed ABC's relationship with AmeriFirst. Executor contends that Juberg's affidavit violated Civ.R. 56(E) because Juberg testified to the conduct of persons without setting forth the proper foundation for his personal knowledge of that conduct. Additionally, executor maintains that the affidavit was improper because it referenced certain documents that were not attached to the affidavit.

***3** {¶ 13} The determination of a motion to strike is within the trial court's broad discretion. *Ireton v. JTD Realty Invests., L.L.C.,* 12th Dist. No. CA2010–04–023, 2011–Ohio670, ¶ 19. A court's ruling on a motion to strike will be not reversed on appeal absent an abuse of that discretion. *State ex rel. Ebbing v. Ricketts,* 133 Ohio St.3d 339, 978 N.E.2d 188, 2012–Ohio4699, ¶ 13. A decision constitutes an abuse of discretion when it is unreasonable, arbitrary, or unconscionable. *State ex rel. Striker v. Cline,* 130 Ohio St.3d 214, 957 N.E.2d 19, 2011–Ohio–5350, ¶ 11.

{¶ 14} The trial court did not expressly rule on executor's motion to strike Juberg's affidavit in its final judgment entry. Generally, when a trial court fails to rule on a motion, the appellate court will presume the trial court overruled the motion. *Lee v. Barber,* 12th Dist. No. CA2000–02–014, 2001 WL 733449, *3 (July 2, 2001). Therefore, executor's pending motion to strike Juberg's affidavit was implicitly overruled by the grant of summary judgment in favor of AmeriFirst and Hamminga.

{¶ 15} Civ.R. 56(C) provides an exclusive list of materials that a trial court may consider when deciding a motion for summary judgment. *State ex rel. Varnau v. Wenninger,* 12th Dist. No. CA2009–02–010, 2011–Ohio–3904, ¶ 7. Those materials are "pleadings, depositions, answers to interrogatories, written admissions, affidavits, transcripts of evidence, and written stipulations of fact." Civ.R. 56(C). To be considered in a summary judgment motion, an affidavit "shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify as to the matters stated in the affidavit." Civ.R. 56(E).

{¶ 16} Personal knowledge is defined as "knowledge of the truth in regard to a particular fact or allegation, which is original, and does not depend on information or hearsay." *Re v. Kessinger,* 12th Dist. No. CA2007–02–044, 2008–Ohio–167, ¶ 32. Absent evidence to the contrary, an affiant's statement that his affidavit is based on personal knowledge will suffice to meet the requirement of Civ.R. 56(E). *Churchill v. G.M.C.,* 12th Dist. No. CA2002–10–263, 2003–Ohio–4001, ¶ 11. Additionally, in the absence of a specific statement, personal knowledge may be inferred from the contents of an affidavit. *Bank One, N.A. v. Swartz,* 9th Dist. No. 03CA008308, 2004–Ohio–1986, ¶ 15. However, "[i]f particular averments contained in an affidavit suggest that it is unlikely that the affiant has personal knowledge of those facts, then * * * something more than a conclusory averment that the affiant has knowledge of the facts would be required." *Id.* at ¶ 14, quoting *Merchants Natl. Bank v. Leslie,* 2d Dist. No. 3072, 1994 WL 12433 (Jan. 21, 1994).

{¶ 17} Additionally, documents that are referred to in an affidavit must be attached to the affidavit and must be sworn or certified copies. Civ.R. 56(E). When an affiant relies on documents in his affidavit and does not attach those documents, the portions of the affidavit that reference those document must be stricken. *Third Federal S. & L. Assn. of Cleveland v. Farno,* 12th Dist. No. CA2012–04–028, 2012–Ohio–5245, ¶ 10. *See Wenninger* at ¶ 10 (striking portions of affidavit where documents were reviewed and relied upon in drafting affidavit but not attached to affidavit or served therewith).

*4 {¶ 18} In the case at bar, Juberg's affidavit contained several paragraphs which outlined the background of ABC's involvement with DLG, and ABC's and AmeriFirst's actions regarding Mrs. Smith and the DLG investment. Juberg explained that he was president of ABC and that ABC offered an investment to its clients through DLG. Juberg then states that he is named as a defendant in a separate civil case filed by Mrs. Smith and that he is "familiar with the claims" made in this case and has "reviewed relevant documents relating to it," including "telephone logs Bates labeled ABC Wert 0349–0571." Juberg avers in paragraph 11 that based on his review of these documents, any communication between ABC and AmeriFirst regarding Mrs. Smith's investment was solely for the purposes of determining if DLG had paid the monthly mortgage payment for Mrs. Smith. These documents were not attached to Juberg's affidavit. Additionally, Juberg makes statements regarding AmeriFirst's actions in paragraphs 11, 13, 14, and 16–19. For example, Juberg states that AmeriFirst never planned or organized the underwriting of the DLG investment, AmeriFirst never prepared any documents for ABC to attract potential investors, and AmeriFirst never offered any confidential information to ABC regarding Mrs. Smith.

{¶ 19} We find that the court abused its discretion when it admitted portions of Juberg's affidavit. First, the admission of the paragraphs of Juberg's affidavit that relied on his review of the telephone logs and other records was in error as these documents were not attached to the affidavit. Second, the court erred in admitting portions of Juberg's affidavits that discussed AmeriFirst's conduct in Mrs. Smith's transaction and the DLG investment in general. While Juberg's statement that he was president of ABC during all relevant times was sufficient to demonstrate personal knowledge of ABC's actions, this statement did not demonstrate how he acquired personal knowledge of AmeriFirst's conduct. We cannot infer Juberg's personal knowledge of AmeriFirst's behavior from the statements made in the affidavit as Juberg did not aver that he was also employed with AmeriFirst or had some other relationship that would provide him with this information. Juberg is not competent to testify regarding Amerifirst's actions without providing a basis for his personal knowledge of AmeriFirst.

{¶ 20} Therefore, the court abused its discretion when it admitted portions of Juberg's affidavit that relied on documents that were not attached to the affidavit. Additionally, the court erred when it admitted the portions of Juberg's affidavit that discussed AmeriFirst's actions when these statements were not based on personal knowledge. Thus, paragraphs 7, 9, 11, 13, 14, 16–19 are stricken. The rest of the affidavit is admissible.

{¶ 21} Executor's first assignment of error is partially sustained.

{¶ 22} Assignment of Error No. 2:

{¶ 23} THE COURT OF COMMON PLEAS ERRED IN GRANTING APPELLEE'S MOTION FOR SUMMARY JUDGMENT.

***5** {¶ 24} In his second assignment of error, executor argues the court erred in granting summary judgment on a number of issues. This court's review of a trial court's ruling on a summary judgment motion is de novo, which means we review the judgment independently and without deference to the trial court's determination. *Simmons v. Yingling,* 12th Dist. No. CA2010–11–117, 2011–Ohio–4041, ¶ 18, citing *Burgess v. Tackas,* 125 Ohio App.3d 294, 296, 708 N.E.2d 285 (8th Dist.1998). We utilize the same standard in our review that the trial court uses in its evaluation of the motion.

{¶ 25} Summary judgment is appropriate when there are no genuine issues of material fact to be litigated, the moving party is entitled to judgment as a matter of law, reasonable minds can come to only one conclusion, and that conclusion is adverse to the nonmoving party. Civ.R. 56(C); *Williams v. McFarland Properties, L.L.C.,* 177 Ohio App.3d 490, 895 N.E.2d 208, 2008–Ohio–3594, ¶ 7 (12th Dist.). To prevail on a motion for summary judgment, the moving party must be able to point to evidentiary materials that show there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. *Dresher v. Burt,* 75 Ohio St.3d 280, 293, 662 N.E.2d 264 (1996). The nonmoving party must then present evidence that some issue of material fact remains to be resolved; it may not rest on the mere allegations or denials in its pleadings. *Id.* All evidence submitted in connection with a motion for summary judgment must be construed most strongly in favor of the party against whom the motion is made. *Morris v. First Natl. Bank & Trust Co.,* 21 Ohio St.2d 25, 28, 254 N.E.2d 683 (1970).

### *R.C. 1707.43*

{¶ 26} Executor first contends that the trial court erred when it granted summary judgment in favor of AmeriFirst and Hamminga for his claim under R.C. 1707.43. Executor argues there was a genuine issue of material fact regarding whether AmeriFirst and Hamminga aided or participated in the sale of the DLG investment.

{¶ 27} R.C. 1707.43 provides remedies for a purchaser in an unlawful sale of securities. The statute allows a purchaser to void every sale or contract for sale made in violation of Chapter 1707. *Id.* at (A). The statute goes on to state, "[t]he 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 * * *." (Emphasis added.) *Id.* The language in this provision has been held to be broad in scope. *Fed. Mgt. Co. v. Coopers & Lybrand,* 137 Ohio App.3d 366, 391, 738 N.E.2d 842 (10th Dist.2000).

{¶ 28} Courts have considered several factors in deciding whether a person or entity shall be responsible for the sale of illegal securities under R.C. 1707.43(A). These factors include relaying information, such as the proposed terms of the sale, from the sellers to the investors, arranging or attending meetings between the investors and the sellers, collecting money for investments, distributing promissory notes and other documents to the investors from the sellers, distributing principal and interest payments to the investors, and actively marketing the security or preparing documents to attract investors. *Boland v. Hammond,* 144 Ohio App.3d 89, 94, 759 N.E.2d 789 (4th Dist.2001). *See Gerlach v. Wergowski,* 65 Ohio App.3d 510, 513–514, 584 N.E.2d 1220 (1st Dist.1989); *Perkowski v. Megas Corp.,* 55 Ohio App.3d 234, 563 N.E.2d 378 (9th Dist.1990).

***6** {¶ 29} In a case involving whether a creditor bank could be held liable under R.C. 1707.43(A), the Tenth District noted that an important factor for determining liability is whether the bank's actions went beyond normal commercial banking activities. *Fed Mgt. Co.* at 393, 738 N.E.2d 842. In *Fed. Mgt. Co.,* summary judgment was inappropriate where a bank's action in reorganizing debt, directly participating in the underwriting of the investment, and sharing secret information about the investment with other bankers were not normal banking activities. *Id.* at 377, 738 N.E.2d 842. On the other hand, a bank was not liable for the illegal sale of securities when the bank simply collected and held premiums from investors, facilitated payments from the investment, and assisted in distribution of the investment. *Boomershire v. Lifetime Capital, Inc.,* 2nd Dist. No. 22179, 2008–Ohio–14, ¶ 15. Instead, "[t]he willingness of a bank to become the depository of funds does not amount to a personal participation or aid in the making of a sale." *Hild v. Woodcrest Assn.,* 59 Ohio Misc. 13, 30, 391 N.E.2d 1047 (M.C.1977).

{¶ 30} We find that there was no genuine issue of material fact as to whether AmeriFirst or Hamminga "participated in or aided" ABC in selling the DLG investment. The evidence established that both AmeriFirst and Hamminga engaged in normal banking procedures in regards to the DLG investment. In Hamminga's deposition, he testified that he would often receive referrals from ABC regarding mortgages that needed to be closed. Hamminga was aware that most of the mortgages would be used for an investment into DLG but he never solicited clients for this investment. AmeriFirst never paid ABC any compensation for these referrals and neither AmeriFirst nor Hamminga ever received a referral fee from ABC. Hamminga communicated with ABC like all other companies from which he received a referral except that he informed ABC of the client's loan number, loan amount, and the date the mortgage payment was due. He explained he did this to facilitate ABC's payments of these clients' mortgages every month. Further, the president of AmeriFirst averred that there was no legal relationship between the two companies, no AmeriFirst employees ever planned, organized, or participated in the underwriting of the DLG investment, and AmeriFirst did not prepare any documents for ABC to attract investors to DLG.

{¶ 31} The evidence also established that Hamminga's actions in processing Mrs. Smith's mortgage did not amount to "participating in or aiding" an illegal sale of securities. Hamminga did not solicit Mrs. Smith. Hamminga first contacted Mrs. Smith when an ABC representative told him she was interested in obtaining a mortgage on her home. However, Hamminga did not proceed with the mortgage at that time because Mrs. Smith told him that she was not interested in obtaining a mortgage. Approximately one month later, Hamminga contacted Mrs. Smith again after an ABC employee told him she was interested. Hamminga reminded her that she previously declined the mortgage offer, but she indicated that was she interested this time.

*7 {¶ 32} Hamminga proceeded with his normal routine of obtaining the borrower's information and sending the loan to processing and underwriting. Hamminga acknowledged that he included the potential DLG income on Mrs. Smith's loan application but stated that she qualified for the mortgage without the inclusion of this income. Mrs. Smith's loan was closed and Hamminga directly forwarded her the proceeds of the loan as this was his usual practice. Hamminga did not encourage Mrs. Smith to invest the money into DLG. AmeriFirst and Hamminga's knowledge of Mrs. Smith's use of the money, investing in what they believed to be a lawful company, does not equate to participating in or aiding in the sale of securities. Further there was no evidence that Mrs. Smith was incompetent.

{¶ 33} Therefore, there were no genuine issues of material fact regarding whether AmeriFirst or Hamminga participated in or aided the illegal sale of securities. Thus, we find that the trial court did not err in finding summary judgment was appropriate for executor's R.C. 1707.43 claim.

***Tort of Aiding and Abetting Fraud***

{¶ 34} Executor next argues that the trial court erred when it granted summary judgment to executor's civil claim of "aiding and abetting." While executor does not specify what tortious act AmeriFirst or Hamminga aided and abetted, he essentially argues that they aided and abetted fraud.[2] The trial court found that Ohio does not recognize a claim of aiding and abetting fraud.

{¶ 35} Until recently, Ohio courts of appeals expressed differing opinions regarding whether a claim for aiding and abetting tortious conduct was cognizable as outlined by 4 Restatement of the Law 2d, Torts Section 876 (1979). *See Fed Mgt. Co.,* 137 Ohio App.3d at 382, 738 N.E.2d 842; *Whelan v. Vanderwist of Cincinnati, Inc.,* 11th Dist. No.2012–G–2999, 2011–Ohio6844, ¶ 19; *Collins v. Natl. City Bank,* 2nd Dist. No. 19884, 2003–Ohio–6893, ¶ 32. This Restatement section provides that a person acting in concert with a wrongdoer is liable if the person:

> (a) Does a tortious act in concert with the other or pursuant to a common design with him, or
>
> (b) Knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself, or
>
> (c) Gives substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person.

{¶ 36} The Ohio Supreme Court recently stated that "[t]his court has never recognized a claim under 4 Restatement 2d of Torts, Section 876 (1979), and we decline to do so under the circumstances of this case." *De Vries Dairy, L.L.C. v. White Eagle Coop. Assn., Inc.,* 132 Ohio St.3d 516, 974 N.E.2d 1194, 2012–Ohio–3828, ¶ 2. *See Sacksteder v. Senney,* 2nd Dist. No. 24993, 2012–Ohio–4452, ¶ 76. Therefore, Ohio does not recognize a cause of action for aiding and abetting a tortious act. A person is liable only if he engages in behavior that is unlawful and not simply because he aided or abetted wrongful conduct. *Fed. Mgt. Co.* at 381, 738 N.E.2d 842. *See In re Natl. Century Fin. Ent., Inc., Invest. Litigation v. Deloitte & Touche, L .L.P.*, ––F.Supp.2d ––, 2012 WL 5334027, *20 (Oct. 26, 2012). Consequently, the trial court did not err in granting summary judgment as to executor's aiding and abetting claim.

### *R.C. 1345.031*

***8** {¶ 37} Executor contends the trial court erred when it granted summary judgment on his claim under R.C. 1345.031. R.C. 1345.031(B)(8) requires suppliers of consumer residential mortgages to provide consumers with a disclosure form informing consumers of their rights when completing a mortgage transaction. Executor argues that the court erred when it relied on an affidavit which discussed this disclosure form but did not attach the form to the affidavit. Executor also asserts that genuine issues of material fact remain as to whether AmeriFirst or Hamminga violated the disclosure requirements under the statute.

{¶ 38} We begin by addressing executor's first argument, whether the court erred in relying on paragraphs of an affidavit that mentioned the disclosure form when the form was not attached to the affidavit. In support of their motion for summary judgment, AmeriFirst and Hamminga submitted an affidavit of Mark Jones, President of AmeriFirst. Jones' affidavit outlined AmeriFirst's relationship with ABC and the company's role in closing Mrs. Smith's mortgage. Paragraphs 15 and 16 of Jones' affidavit referenced the disclosure form that AmeriFirst provided Mrs. Smith in compliance with R.C. 1345.031(B)(8). Jones stated that Mrs. Smith signed and returned this form. AmeriFirst and Hamminga did not provide a copy of this form to the trial court.

{¶ 39} We find that the trial court did not err in relying on paragraphs 15 and 16 of Jones' affidavit. While executor did not cite any legal authority in his brief to explain why the court erred in relying on this affidavit, it appears executor argues that the affidavit did not comply with Civ.R. 56(E). As discussed in the first assignment of error, Civ.R. 56(E) requires that all documents referenced in an affidavit be attached to that affidavit. When a party does not attach those documents, the portions of the affidavit that refer to the documents must be stricken. *Third Federal S. & L. Assn. of Cleveland,* 12th Dist. No. CA2012–04–028, 2012–Ohio–5245, ¶ 10. However, a party waives this argument if it fails to file a motion to strike the affidavit. *Hammock v. Sav. of Am.,* 12th Dist. No. CA90–01–006 (Sept. 10, 1990); *Darner v. Richard E. Jacobs Group, Inc.,* 8th Dist. No. 89611, 2008–Ohio–959, ¶ 15. In this case executor did not move to strike Jones' affidavit. Therefore, executor has waived this argument on appeal and the trial court properly considered Jones' affidavit under the R .C. 1345.031 claim.

{¶ 40} Next, we determine whether the trial court erred in granting summary judgment to AmeriFirst and Hamminga regarding this claim. R.C. 1345.031(A) provides that no supplier shall commit an unconscionable act in connection with a consumer residential mortgage. An unconscionable act includes:

> [f]ailing to disclose to the consumer at the closing of the consumer transaction that a consumer is not required to complete a consumer transaction merely because the consumer has received prior estimates of closing costs or has signed an application and should not close a transaction that contains different terms and conditions than those the consumer was promised.

***9** *Id.* at (B)(8).

{¶ 41} Ohio Adm.Code 109:4–3–23(A) provides that no suppliers shall fail to disclose to the consumer at the closing of the consumer transaction the above mentioned disclosures. To comply with R.C. 1345.031, "a supplier must provide the notice attached to this rule as addendum A * * *." *Id.* at (B).

{¶ 42} In support of its motion for summary judgment, AmeriFirst and Hamminga submitted Mark Jones' affidavit and Greg Hamminga's deposition. In Hamminga's deposition, he explained that the company utilizes a computer system to insure AmeriFirst complies with each state's mortgage and consumer protection laws. Under this system, the loan processor enters a state name which in turn generates the application and all the required closing documents for that state. He used this system to ensure he complied with Ohio's laws in closing a mortgage. In Jones' affidavit, he stated:

> 15. AmeriFirst provided a form for Evelyn Mae Smith to sign at her closing on January 25, 2008. This form was computer generated and complied with R.C. 1345.031(8). [sic]

16. To the best of my knowledge, Evelyn Mae Smith returned the form referenced in paragraph 15, executed and dated. * * *

{¶ 43} The evidence established that AmeriFirst utilized a form that complied with R.C. 1345.031(B)(8) and this was given to Mrs. Smith. Hamminga explained that AmeriFirst closes mortgages in many states and utilizes a system to ensure compliance with each state's laws. Jones' affidavit clearly stated that the R.C. 1345.031(B)(8) form was utilized in Mrs. Smith's mortgage closing. Therefore, AmeriFirst pointed to evidentiary materials that showed there was no genuine issue as to any material fact and that they were entitled to judgment as a matter of law. Executor's response to appellee's evidence was that Jones stated that his company provided a form in compliance with "R.C. 1345.031(8)" instead of R .C. 1345.031(B)(8). In light of the fact that there is no subsection 8 in R.C. 1345.031 and there was no doubt that the specific provision, R.C. 1345.031(B)(8) was at issue during the summary judgment motions, we find executor's argument unpersuasive. As discussed above, the evidence established that there was no genuine fact that AmeriFirst complied with R.C. 1345.031(B)(8). Therefore, the court did not err in granting summary judgment for this claim.

**R.C. 1349.41**

{¶ 44} Executor contends that AmeriFirst and Hamminga violated R.C. 1349.41 when they engaged in a transaction that was fraudulent and not in good faith and fair dealing. In particular, executor argues that the transaction was unfair because AmeriFirst and Hamminga failed to comply with R.C. 1345.031(B)(8) and provide Mrs. Smith a disclosure form. Additionally, executor asserts that there were genuine issues of material fact regarding whether AmeriFirst and Hamminga acted in good faith because they knew and specifically intended for Mrs. Smith to invest in a highly questionable investment that was ultimately fraudulent.

***10** {¶ 45} R.C. 1349.41(B) provides, "[a] lender shall not engage in a transaction, practice, or course of business that is not in good faith or fair dealing, or that operates a fraud upon any person, in connection with the attempted or actual making, purchase, or sale of any mortgage loan." This statute was enacted in 2007 and the parties have not cited any Ohio case law interpreting this statute. Based upon our research, the interpretation of this statute appears to be one of first impression in Ohio.

{¶ 46} Good faith has been defined generally as " 'honesty in fact in the conduct or transaction concerned.' " *DiPasquale v. Costas,* 186 Ohio App.3d 121, 926 N.E.2d 682, 2010–Ohio–832 (2nd Dist.), ¶ 126–127, quoting *Casserlie v. Shell Oil Co.,* 121 Ohio St.3d 55, 57, 902 N.E.2d 1, 2009–Ohio–3, ¶ 10. The Supreme Court of Ohio has also defined the term as follows:

> A lack of good faith is the equivalent of bad faith, and bad faith, although not susceptible of concrete definition, embraces more than bad judgment or negligence. It imports a dishonest purpose, moral obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill will partaking of the nature of fraud. It also embraces actual intent to mislead or deceive another.

*Hoskins v. Aetna Life Ins. Co.,* 6 Ohio St.3d 272, 276, 452 N.E.2d 1315 (1983).

{¶ 47} Fraud has been defined as "[a] knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." *Black's Law Dictionary* (9th Ed.2009). *See Williams v. Aetna Fin. Co.,* 83 Ohio St.3d 464, 475, 700 N.E.2d 859 (1998).

{¶ 48} We find that the evidence established that AmeriFirst and Hamminga did not violate R.C. 1349.41 in participating in the closing of Mrs. Smith's mortgage loan. First, AmeriFirst and Hamminga did not act in bad faith or perpetrate a fraud on Mrs. Smith in regards to the disclosure form required by R.C. 1345.031(B)(8). As discussed in the previous issue, the evidence showed that AmeriFirst provided this form. Mark Jones' affidavit and Greg Hamminga's deposition explained AmeriFirst's actions in providing the disclosure form to Mrs. Smith and the general process AmeriFirst uses to provide consumers with the disclosure form. Thus, since the evidence established that the disclosure form was provided, this court refuses to find any bad faith associated with the alleged failure to provide this form.

{¶ 49} Additionally, there was no evidence that AmeriFirst and Hamminga did not act in good faith, fair dealing, or perpetrated a fraud on Mrs. Smith. In Hamminga's deposition, he explained that AmeriFirst engaged in normal banking procedures when it closed Mrs. Smith's loan. He did not solicit Mrs. Smith; he stopped contact with Mrs. Smith when she told him that she was not interested in obtaining a mortgage, and then reinitiated contact only when ABC informed Hamminga that Mrs. Smith was interested in acquiring a mortgage again. Additionally, after closing the loan, Hamminga gave Mrs. Smith the mortgage proceeds directly, as this was his usual custom after closing a mortgage. Hamminga also testified that Mrs. Smith understood the loan she was entering into and did not seem incompetent. The evidence also established that there was no legal relationship between ABC and AmeriFirst. AmeriFirst never received nor gave any referral fees to ABC, and neither AmeriFirst nor Hamminga solicited clients or promoted the DLG investment.

***11** {¶ 50} Therefore, the trial court did not err in granting summary judgment to AmeriFirst and Hamminga on the R.C. 1349.41 claim. There was no evidence that AmeriFirst or Hamminga did not act in good faith, fair dealing or operated a fraud upon Mrs. Smith.

### *Civil Conspiracy*

{¶ 51} In his last issue, executor argues the court erred when it granted summary judgment on the civil conspiracy claim. Specifically, executor contends that the trial court erred when it *sua sponte* granted summary judgment as AmeriFirst and Hamminga did not move for summary judgment on this issue.

{¶ 52} It is well-settled that a trial court "may not *sua sponte* grant summary judgment premised on issues not raised by the parties." *Safe Auto Ins. Co. v. Semenov,* 12th Dist. No. CA2008–10–123, 2009–Ohio–2334, ¶ 10 quoting *Ranallo v. First Energy Corp.,* 11th Dist. No.2005–L–187, 2006–Ohio–6105, ¶ 26. When seeking summary judgment, a party must specifically delineate the basis upon which the motion is brought. Such specificity is necessary "in order to allow the opposing party a meaningful opportunity to respond." *Patterson v. Ahmed,* 176 Ohio App.3d 596, 2008–Ohio–632 (6th Dist.), ¶ 13, quoting *Mitseff v. Wheeler,* 38 Ohio St.3d 112, 526 N.E.2d 798 (1988), syllabus. Contrary to executor's assertion, AmeriFirst and Hamminga did move for summary judgment on the civil conspiracy claim. AmeriFirst stated numerous times in its motion for summary judgment that it was seeking summary judgment "on all of Third Party Plaintiff's claims." Thus, the trial court's grant of summary judgment on the civil conspiracy claim was not *sua sponte* as AmeriFirst moved for this relief on the claim.

{¶ 53} Additionally we note that there was no genuine issue of material fact regarding whether AmeriFirst or Hamminga were liable for civil conspiracy. A civil conspiracy is a "malicious combination of two or more persons to injure another person or property, in a way not competent for one alone, resulting in actual damages." *Mohme v. Deaton,* 12th Dist. No. CA2005–12–133, 2006–Ohio–7042, ¶ 36, citing *Kenty v. Transamerica Premium Ins. Co.,* 72 Ohio St.3d 415, 419, 650 N.E.2d 863 (1995). An action for civil conspiracy cannot be maintained unless an underlying unlawful act is committed. *Wilson v. Harvey,* 164 Ohio App.3d 278, 842 N.E.2d 83, 2005–Ohio5722 (8th Dist.), ¶ 41.

{¶ 54} We have held that the trial court correctly granted summary judgment in favor of AmeriFirst and Hamminga on all counts alleged against them. Without an underlying tort, executor cannot establish a claim for civil conspiracy. In addition, there is no evidence in the record to support a claim that AmeriFirst or Hamminga conspired with any other entity to harm Mrs. Smith. Consequently, the trial court did not err in granting summary judgment in favor of AmeriFirst and Hamminga on the civil conspiracy claim.

{¶ 55} Executor's second assignment of error is overruled.

***12** {¶ 56} The trial court's judgment is affirmed. Executor's first assignment of error is sustained to the extent the court erred in admitting portions of Jason Juberg's affidavit. Executor's second assignment of error is overruled as the remaining admissible evidence established that AmeriFirst and Hamminga were entitled to judgment as a matter of law and that there were no genuine issues of material fact on all of executor's claims. Thus, the court did not err in granting summary judgment in favor of AmeriFirst and Hamminga against executor.

{¶ 57} Judgment Affirmed.

RINGLAND, P.J., and PIPER, J., concur.

**Parallel Citations**

2013 -Ohio- 855

Footnotes

1 Mrs. Smith initially filed a suit against AmeriFirst and Hamminga in a separate, earlier action. However, this case was voluntarily dismissed.

2 Count XIII of executor's amended complaint alleges that AmeriFirst and Ham minga aided and abetted ABC and Winkleman in defrauding Mrs. Smith. However, executor's precise argument of the type of tortious act that the parties have concert liability for is irrelevant due to the Ohio Supreme Court's recent decision discussed below.

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# APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

| | | |
|---|---|---|
| DONALD BURDICK, *et al.*, | ) | Case No.: 1:11 CV 2571 |
| | ) | |
| Plaintiffs | ) | |
| | ) | |
| v. | ) | JUDGE SOLOMON OLIVER, JR. |
| | ) | |
| ROSENTHAL COLLINS GROUP, LLC, | ) | |
| | ) | |
| Defendant | ) | <u>ORDER</u> |

Plaintiffs Donald Burdick, Susan Byington, Lisa Carfagno, Peter and Janice Elliot, Bernard E. Goldberg, Paul E. Goldstein, Tom and LaVoe Mulgrew, Susan Rosen, Martin Silverman, Sharon Silverman, and Barry and Robin Stuck (collectively, "Plaintiffs") bring the instant action against Rosenthal Collins Group, LLC ("RCG"). Currently pending before the court is RCG's Motion to Dismiss the First Amended Complaint, Motion to Strike and, in the Alternative, Motion to Transfer Venue. (ECF No. 10.) For the reasons stated herein, the court grants RCG's Motion to Dismiss Plaintiffs' federal claim for violations of the Commodity Exchange Act for failure to state a claim and hereby dismisses the state law claims pursuant to 28 U.S.C. § 1367(c)(3). [1]

## I. BACKGROUND

### A. The Alleged Investment Scheme

This case arises out of failed investments made by non-party Enrique Villalba ("Villalba") on behalf of Plaintiffs, who assert they have lost a cumulative total of nearly $14 million as a result

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[1] The Motion to Transfer Venue was previously before the Western District of Washington, which granted the motion and transferred the case to this court. (ECF No. 19).

of Villalba's trading activities. (Am. Compl. ¶ ¶ 14, 54, ECF No. 4.) Specifically, Plaintiffs allege that Villalba solicited them, as prospective investors, to place funds into Money Market Alternatives ("MMA"), an Ohio corporation created by Villalba for the purpose of investing money received from investors. (*Id.* at ¶ 14.) Villalba allegedly represented that he developed a system that would provide above-average returns while exposing investors to minimal risk. (*Id.* at ¶ 15.) According to his alleged system, Villalba would place Plaintiffs'

> funds in money market accounts that paid interest, until his calculations showed the appropriate times each month to enter the commodities market and purchase futures contracts based on the Standard and Poor's 500 index ("S&P 500 futures contracts") for the accounts. Villalba said that the timing of these transactions was based on when 401(k) retirement plans and pension funds entered or left the market.

(*Id.* at ¶ 16.) Villalba asserted that at those "precise moments, he would buy or sell S&P 500 futures contracts to take advantage of slight up or down ticks in the price of those contracts" and then move the funds back to the safety of the money market account. (*Id.*)

According to Plaintiffs, Villalba portrayed this investment strategy, which involved only temporary entry into the commodities futures market, as relatively safe. (*Id.*) Villalba represented that "the portfolio may attain a double-digit rate of return without the same market risk associated with diversified stock or bond portfolios that move with the market itself." (*Id.*) In addition, he stated that protective sell stops would be utilized to limit losses. (*Id.*)

Villalba then explained to Plaintiffs that the actual trading activity of MMA would be conducted through a broker with RCG, a futures commission merchant in Chicago. (*Id.* at ¶¶ 18, 29.) Villalba also stated that each MMA investor would have his or her own account at MMA and RCG. (*Id.*) However, Villalba did not open separate accounts for each individual MMA investor.

(*Id.* at ¶¶ 18, 24.) Instead, he opened a single account at RCG in the name of MMA and pooled the funds of all investors into it. (*Id.*) As of June 2009, Plaintiffs allege that MMA had attracted over $39 million in client funds from approximately 31 clients. (*Id.* at ¶ 22.)

Plaintiffs assert that Villalba "traded the investors' funds in the futures market virtually every day, contrary to his statements that most of the time the plaintiffs' money would be invested in money market funds." (*Id.* at ¶ 24.) This trading practice entailed significantly more risk. (*Id.* at ¶ 25.) Specifically, Villalba maintained MMA's trading account at RCG at "extraordinarily high leverage ratios" that rendered his trading activity "extraordinarily risky." (*Id.* at ¶ ¶ 39-40.) The "highly risky" trading activity by Villalba resulted in "catastrophic losses" that ultimately led to Plaintiffs' loss of $14 million. (*Id.* at ¶¶ 25-28.) Despite the catastrophic losses incurred by Villalba's trading practices, Plaintiffs allege that Villalba kept them in the dark by sending quarterly MMA account statements falsely portraying gains in what they believed to be their individual accounts. (*Id.* at ¶¶ 19-23.) The 2008 year-end statements provided to Plaintiffs, for example, showed positive returns ranging from 22% to 33%, whereas Plaintiffs assert they actually sustained significant losses. (*Id.* at ¶¶ 21, 25-28.)

In the fall of 2009, Villalba stopped communicating with Plaintiffs and ignored requests for withdrawal of funds from their supposed accounts. (*Id.* at ¶ 49.) That turn of events sparked a flood of litigation. In March of 2010, the Securities and Exchange Commission ("SEC") and the Commodities Futures Trading Commission ("CFTC") initiated separate fraud actions against Villalba in the Northern District of Ohio. (*Id.* ¶¶ 50-51) Villalba was also indicted in the Northern District of Ohio for wire fraud and other crimes. (*Id.* at ¶ 52.) In September 2010, Villalba pled guilty to wire fraud, was sentenced to 105 months in prison, and ordered to make restitution. (*Id.*

at ¶ 53.) The SEC obtained an order barring Villalba from further association with any investment advisor. (*Id.*) The CFTC obtained an order, *inter alia*, barring him from trading commodities or futures thereof in any capacity. *See CFTC v. Villalba*, No. 5:10-cv-00647, ECF No. 26.

In October 2009, Plaintiffs filed suit against Villalba, MMA, and others in the Western District of Washington, and obtained a default judgment for over $20 million in November 2010. *See Burdick v. Villalba*, No. 09-cv-01932 (W.D. Wash.). On April 1, 2011, Plaintiffs initiated the instant action against RCG in the Western District of Washington. (ECF No. 1.) On November 28, 2011, the case was transferred to the Northern District of Ohio. (ECF No. 20.) Several others who entrusted money to Villalba filed similar actions against RCG in Ohio state courts in 2011. *See Pieretti v. Rosenthal Collins Grp., LLC*, No. 2011-CV-0051 (Ohio C.P. Erie Cnty.); *VASA Order of America v. Rosenthal Collins Grp., LLC*, No. CV-11-753705 (Ohio C.P. Cuyahoga Cnty.).

**B. RCG's Role in the Investment Scheme**

Plaintiffs initiated the instant action on the basis that "Villalba's scheme could not have been accomplished without the assistance of RCG." (Am. Compl. at ¶ 29, ECF No. 4.) In particular, Plaintiffs assert that RCG permitted Villalba to make investments notwithstanding knowledge that he failed to register as an investment advisor under state and federal securities laws. (*Id.* at ¶ 29.) For example, Plaintiffs allege that RCG knew that Villalba used the MMA account to trade on the behalf of individual investors, and was therefore operating a commodity pool that was required by statute to be registered with the CFTC. (*Id.* at ¶ 31.) It is further alleged that RCG knew or should have known that the investors' payments into the MMA account constituted a sale of securities under federal and state law, and that the MMA fund should have been registered as such. (*Id.* at ¶ 32.) Finally, Plaintiffs allege that "RCG's compliance reporting [department] should have flagged the MMA account as suspicious because of the high volume of activity, high leverage, number of overnight holdings, influx of large deposits that clearly did not originate with Villalba . . ., and huge trading losses." (*Id.* at ¶ 40.)

Plaintiffs claim that RCG "knew, or should have known, that Villalba was trading illegally" but failed to take action because it was in their financial interest to permit him to continue making trades. (*Id.* at ¶¶ 31, 65.) Plaintiffs bring claims against RCG for violations of the: (1) the Commodity Exchange Act; (2) the Ohio Securities Act; (3) the Securities Act of Washington; (4) the Corporations Act of California; and (5) the Washington Consumer Protection Act; and for (6) common law negligence.

## II. STANDARD OF REVIEW

The court examines the legal sufficiency of a plaintiff's claim under Federal Rule of Civil Procedure 12(b)(6). *See Mayer v. Mulod*, 988 F.2d 635, 638 (6th Cir. 1993). The Supreme Court in *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007) and subsequently in *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1949-50 (2009) clarified the law regarding what the plaintiff must plead in order to survive a Rule 12(b)(6) motion.

When determining whether a plaintiff has stated a claim upon which relief can be granted, the court must construe the Complaint in the light most favorable to the plaintiff, accept all factual allegations as true, and determine whether the Complaint contains "enough facts to state a claim to relief that is plausible on its face." *Twombly*, 550 U.S. at 570. A plaintiff's obligation to provide the grounds for relief "requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Id.* at 555. Even though a Complaint need not contain "detailed" factual allegations, its "[f]actual allegations must be enough to raise a right to relief above the speculative level on the assumption that all the allegations in the Complaint are true." *Id.* A court is "not bound to accept as true a legal conclusion couched as a factual allegation." *Papasan v. Allain*, 478 U.S. 265, 286 (1986).

The Court in *Iqbal*, 129 S.Ct. at 1949, further explains the "plausibility" requirement, stating that "[a] claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Furthermore, "[t]he plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant acted unlawfully." *Id.* This determination is a "context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Id.* at 1950.

The Sixth Circuit has held that a court may consider allegations contained in the Complaint, as well as exhibits attached to or otherwise incorporated in the Complaint, all without converting a Motion to Dismiss to a Motion for Summary Judgment. Fed. R. Civ. P. 10(c); *Weiner v. Klais & Co.*, 108 F.3d 86, 89 (6th Cir. 1997). In addition, "[a] court that is ruling on a 12(b)(6) motion may consider materials in addition to the complaint if such materials are public records or are otherwise appropriate for the taking of judicial notice." *Gordon v. England*, 354 Fed. Appx. 975, 978 (6th Cir. 2009) (quoting *New England Health Care Emps. Pension Fund v. Ernst & Young, LLP*, 336 F.3d 495, 501 (6th Cir. 2003)). The Sixth Circuit has further held that documents a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's Complaint and are central to her claim. *See Gardner v. U.S.*, 443 F. App'x. 70 (6th Cir. 2011).

## III. ANALYSIS

### A. Violation of the CEA

1. Aider or Abettor

Plaintiffs must allege that RCG acted knowingly in order to state a cause of action for aiding and abetting liability under 7 U.S.C. § 25(a)(1). RCG argues that Plaintiffs merely assert, without any factual support, that "'RCG knowingly aided, abetted, counseled, induced, and/or procured the violations of the CEA[,]' and that 'RCG did so knowing of Villalba's and MMA's violations of law, and willfully intended to assist those violations.'" (Mot. at 16, ECF No. 10.) RCG maintains that the First Amended Complaint does not contain any allegations that "RCG participated in, encouraged, or even knew of the canard Villalba told to plaintiffs with respect to their MMA 'accounts'" or that "RCG communicated with plaintiffs in any fashion during Villalba's fundraising efforts." (*Id.*) RCG contends that

> [t]he only facts plaintiffs plead to support their claim that RCG 'willfully' aided and abetted and provided 'substantial assistance' to Villalba's scheme are that RCG (1) permitted Villalba to open the MMA Commodities Account, (2) 'assigned a broker to exclusively handle the MMA account,' (3) 'relocated' the broker to Cleveland, Ohio, (4) 'handled' the MMA Commodities Account's funds through its office in Chicago, and (5) cleared the commodities transactions entered into by the MMA Commodities Account.

(*Id.* at 16-17.) RCG maintains that these facts merely show that it "was providing usual brokerage services to the MMA Commodities Account, and nothing more," which cannot serve as a basis for aiding and abetting liability. (Mot. at 17, ECF No. 10.)

Plaintiffs assert that the allegations in the First Amended Complaint show

> 1) that RCG knew that the funds being traded in the MMA commodity pool came from outside investors; 2) that neither Villalba nor the commodity pool were registered as required by law; 3) that it was likely that investors were not being told the truth about MMA's disastrous trading practices because substantial deposits continued to come in through Villalba. It is reasonable to infer that experienced commodities traders, such as RCG, would conclude from the trading

> records and other information available to them that to the extent additional money came from existing investors in the fund, they were likely not being told about their extensive losses and if the additional deposits came from new investors, they were not being told about the poor performance of the fund.

(Opp. at 20, ECF No. 13.) Plaintiffs contend that if the fund and Villalba had been registered as required, they would have been required to submit reports with regulatory agencies as well as to the investors, which would have ended the scheme. (*Id.* at 20-21.) However, Plaintiffs maintain that RCG "had a powerful incentive to have the scheme continue," as they received more than $1.25 million in fees and commissions from the pooled funds. (*Id.* at 21.) Plaintiffs argue that their allegations of recklessness are sufficient to support an aiding and abetting claim under the CEA.

The CEA creates a private right of action for "actual damages" caused by "[a]ny person . . . who violates this chapter or who willfully aids [or] abets . . . the commission of a violation of this chapter." 7 U.S.C. § 25(a)(1). The dispute boils down to whether the definition of "willfully" requires knowledge and specific intent, as desired by RCG, or recklessness, as argued by Plaintiffs.

The three circuit courts that have considered this particular question have held that "willfully" as used in § 25(a)(1) requires actual knowledge. *See Amacker v. Renaissance Asset Mgmt. LLC*, 657 F.3d 252, 256 (5th Cir. 2011); *Nicholas v. Saul Stone & Co. LLC*, 224 F.3d 179, 189 (3d Cir. 2000); *Damato v. Hermanson*, 153 F.3d 464, 472 (7th Cir. 1998). In reaching its decision, the Seventh Circuit found the elements of aider and abettor liability under § 25(a)(1) to be the same as those necessary under the federal criminal aider and abettor statute, 18 U.S.C. § 2. *Damato*, 153 F.3d at 473; *see also Amacker*, 657 F.3d at 256 (finding the Seventh Circuit's interpretation to be persuasive); *Nicholas*, 224 F.3d at 189 (agreeing "with the Seventh Circuit that aiding and abetting in the context of the CEA is congruent with aiding and abetting as defined by 18 U.S.C. § 2"). It therefore concluded that "in order to state . . . a claim against [a defendant,] . . . plaintiffs must allege that [the defendant] (1) had knowledge of the principal's . . . intent to commit a violation of the Act; (2) had the intent to further that violation; and (3) committed some act in furtherance of the principal's objective." *Damato*, 153 F.3d at 473; *see also Goodman v. Mady*, No. 04-75011, 2005 WL 2417209, at *9 (E.D. Mich. Sept. 30, 2005) (adopting the *Damato* test without explanation). This interpretation is in harmony with both the Sixth Circuit's traditional understanding of what is meant by "aiding and abetting" and with the language of § 25(a)(1) which contemplates liability for one "who *willfully* aids [and] abets . . . the commission of a violation" of the CEA. *See United States v. Davis*, 306 F.3d 398, 409 (6th Cir. 2002) (stating "that aiding and abetting involves (1) an act by a defendant which contributes to the execution of a crime; and (2) the intent to aid in its commission") (citing *U.S. v. Lowery*, 60 F.3d 1199, 1202 (6th Cir. 1995)); *see also Amacker*, 657 F.3d at 256 (citing 7 U.S.C. § 25(a)(1)). The court finds the Seventh Circuit's reasoning persuasive.

In the present case, Plaintiffs allege that RCG knew or recklessly disregarded facts that Villalba was involved in conduct that violated the CEA. Specifically, Plaintiffs point to the trading practices of Villalba, which were alleged to be extraordinarily risky, to support their argument that RCG should have been aware that Villalba was violating the CEA. In addition, Plaintiffs allege that RCG knew or should have known that Villalba was operating an unregistered commodities pool. However, Plaintiffs fail to allege that RCG had the requisite knowledge or guilty intent as required for aiding and abetting in the context of the CEA. *See Nicholas*, 224 F.3d at 189 (finding the same). As stated by the Third Circuit in a case with similar allegations of inadequate supervision of the primary violator, Plaintiffs "alleged, at most, that the [Defendants] acted recklessly," but "these allegations [were] a far cry from an allegation that the [Defendants] not only had knowledge of the intent of the [primary violators] to violate the CEA, but . . . [also], the intent to further that violation." *Id.* at 190; *see also Damato*, 153 F.3d at 473 n.12 (finding that plaintiffs' allegations suggesting that the defendant was negligent in monitoring an account "do not satisfy the scienter requirement of an aiding and abetting claim under the CEA").

The authorities cited by Plaintiffs do not change this conclusion. Plaintiffs cite *Ikuno v. Yip*, 912 F.2d 306 (9th Cir. 1990), to demonstrate that their allegations are sufficient to support an aiding and abetting claim under the CEA. However, *Ikuno* is inapposite as it involved an individual who actively assisted his client, a corporation, by filing an annual corporate report preventing it from being dissolved administratively, failing to advise that selling commodities without a license was unlawful, and possibly authoring a letter advising investors to be patient while the corporation was shut down for an audit. Here, Plaintiffs do not allege that RCG assisted Villalba or MMA with communications to their investors or took any other actions to further Villalba's relationship with investors. Plaintiffs cite *In re Western*, CFTC No. 81-18, 1983 WL 29657 (C.F.T.C. Oct. 14, 1983), to demonstrate that "maintaining a business relationship with someone known to be engaged in illegal activity supports aiding and abetting liability." (Opp. at 20, ECF No. 13.) However, this case is also inapposite because in that proceeding, the futures commission merchant ("FCM") had an undisclosed commission-sharing arrangement with a commodity pool operator ("CPO") and therefore knew that in order to be associated with the FCM in this capacity, that the CPO should have been registered. This is readily distinguishable from the instant case where Plaintiffs allege that MMA was merely RCG's customer. Therefore, because Plaintiffs fail to allege that RCG had the requisite knowledge or guilty intent as required for aiding and abetting in the context of the CEA, RCG is entitled to dismissal of this claim on this basis.

<u>2. Primary Violator</u>

Plaintiffs' claim also fails under their alternative theory to support their claim that RCG violated the CEA. Plaintiffs allege that RCG was a primary violator of the CEA because it violated

7 U.S.C. § 6k by permitting Villalba to trade in the commodities market without being registered with the Commodity Futures Trading Commission ("CFTC"). Plaintiffs believe that they would not have suffered losses at the hands of Villalba if RCG properly inquired into his registration status. RCG argues that the CEA imposes no duty upon a broker to inquire into the registration status of one of its customers. Plaintiffs neither dispute RCG's argument, nor do they address the validity of their CEA claim in relation to § 6k. RCG argues in its Reply that Plaintiffs abandoned their claim that RCG violated § 6k. Regardless of whether Plaintiffs abandoned their claim alleging RCG's violation of § 6k, the court finds that Plaintiffs have not stated a claim for relief that is plausible on its face.

Under § 6k(1) it is unlawful for:

> any person to be associated with a futures commission merchant as a partner, officer, or employee, or to be associated with an introducing broker as a partner, officer, employee, or agent (or any person occupying a similar status or performing similar functions) in any capacity that involves (i) the solicitation or acceptance of customers' orders . . . unless such person is registered with the [CFTC] . . . .

The statute further provides that:

> [i]t shall be unlawful for a futures commission merchant or introducing broker to permit such a person to become or remain associated with the futures commission merchant or introducing broker in any such capacity if such futures commission merchant or introducing broker knew or should have known that such person was not so registered . . . .

As previously determined by the Fifth Circuit, this statute "does not impose a duty on merchants to inquire into the registration status of its customers 'merely because that customer may be acting on behalf of other individuals.'" *Amacker*, 657 F.3d at 257 (quoting *Brown v. Royce Brokerage, Inc.*, 632 F.2d 652, 654 (5th Cir. 1980)). Section 6k(1) imposes liability if a partner, officer, employee or any person occupying a similar status or performing similar function is unlicensed and the merchant knows or has reason to know of the violation. *See* 7 U.S.C. § 6k(1).

Plaintiffs' First Amended Complaint does not suggest, nor do Plaintiffs argue, that Villalba was a partner, officer, employee or any person occupying a similar status or performing similar function at RCG. Unlike a partner, officer, or employee of RCG, Villalba solicited and accepted orders from his own customers, and merely executed those orders through RCG. Plaintiffs do not allege that RCG knew the identity of Villalba's customers, the nature of their accounts, or their investment goals and objectives. They only allege that RCG knew Villalba invested on behalf of other investors. (Am. Compl. at ¶ 31, ECF No. 4.) Therefore, Plaintiffs' claim fails under both of their theories, and RCG is entitled to dismissal of this claim.[2]

**B. State Law Claims**

Plaintiffs also allege violations of the following state laws: (1) the Ohio Securities Act; (2) the Securities Act of Washington; (3) the Corporations Act of California; (4) the Washington Consumer Protection Act; and (5) common law negligence. This court had federal question jurisdiction over Plaintiffs' federal claim pursuant to 28 U.S.C. § 1331 and supplemental jurisdiction over Plaintiffs' state claims pursuant to 28 U.S.C. § 1367. Section 1367(c)(3) provides that "the district courts may decline to exercise supplemental jurisdiction over a claim . . . if the district court has dismissed all claims over which it has original jurisdiction." Inasmuch as the court has dismissed Plaintiffs' only federal claim, the court exercises its discretion to decline to exercise supplemental jurisdiction over Plaintiffs' state law claims.

**IV. CONCLUSION**

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[2] RCG also argues that Plaintiffs' CEA claim is not pled with the particularity required by Fed. R. Civ. P. 9(b) and therefore it should be dismissed. Plaintiffs concede that their CEA claim must satisfy the particularity requirements of Rule 9(b), yet do not provide the court with argument demonstrating that their CEA claim meets the requisite requirements. In any event, because this claim fails on another basis, the court need not address this argument.

For the foregoing reasons, the court Grants RCG's Motion to Dismiss (ECF No. 10) as to the federal claim, and declines to exercise supplemental jurisdiction over Plaintiffs' state law claims.

IT IS SO ORDERED.

/s/ *SOLOMON OLIVER, JR.*
CHIEF JUDGE
UNITED STATES DISTRICT COURT

July 26, 2012

# APPENDIX D

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON

IN AND FOR THE COUNTY OF KING

| | |
|---|---|
| DONALD BURDICK, et al.,<br>Plaintiffs,<br>v.<br>ROSENTHAL COLLINS GROUP, LLC,<br>Defendant. | VERBATIM REPORT OF PROCEEDINGS<br>No. 12-2-28409-1 SEA |

TRANSCRIPT

Of proceedings had in the above-entitled cause before the HONORABLE DOUGLASS NORTH, Superior Court Judge, on Friday, April 24, 2015.

APPEARANCES:

FOR THE PLAINTIFFS: CHRIS R. YOUTZ and CHARLES SIRIANI
Attorneys at Law

FOR THE DEFENDANT: CHRISTIAN T. KEMNITZ and J. MATTHEW HAWS
Attorneys at Law
GAVIN W. SKOK, Attorney at Law

TRANSCRIBED BY:
CATHY L. SWANSON
1001 4th Avenue, Ste. 4000
Seattle, WA 98154
(206) 805-6603
(253) 350-4457

JULY 24, 2015

THE COURT: Good morning.

MR. YOUTZ: Good morning, Your Honor.

THE COURT: I didn't realize at the point where you guys had asked for permission to file overlength reply brief that Rosenthal Collins Group had already exceeded the rules on length of briefs by filing not only a motion for summary judgment, but a motion for partial summary judgment as well. It really sort of strains the Court's resources when counsel insists on being as verbose as it is here. In any event, we're now ready to go forward with all the motions here.

Preliminarily, I'll deny the request to strike the CFTC's 2012 Order. I certainly recognize that the portions of that Order that relate to an actual settlement between it and Rosenthal Collins are not admissible and something the Court can rely on, but I do think that it's discussion of the applicable CFTC regulations and conduct relating to those regulations and the duties of an FCM in opening and monitoring accounts are relevant to the Court's consideration and are appropriate for that purpose. So I recognize that I certainly can't rely on the things that are actual settlements there, but those other aspects of it, I think, are useful.

security to actually take place, the opening up this account to make this whole enterprise work, that satisfies our law. That's sufficient. And I'm not going to go in the other cases, but we've cited in our brief the cases that follow that same concept, that if you do something to make the whole scheme work to, a necessary step, and that's - - you're liable under that provision of the statute.

THE COURT: I guess what I'm - - doesn't it in some way have to contribute to the sale? I mean, suppose that, you know, the scheme involves, I don't know, transporting something somewhere and they hire a trucking company to transport the stuff, does that make the trucking company then part of the scheme and liable just because they were, you know, they paid them off to - - you know, they hired them to truck the stuff somewhere?

MR. YOUTZ: Well, you know, I think there's an example used in one of the cases where - - in fact, the case held that the preparation of documents itself would satisfy that in any way, and it said no, wait a minute, where do we draw the line? Do we say that because the typist set down and typed out the documents, does that make him or her responsible? Or is it, and it's - - well, no.

But what about the person who's responsible for coming up with the documents and saying no, this is the way we're going to do it, and do it to make this happen, does that make that person liable? Yes. And - -

THE COURT: But wouldn't those, don't those documents have to actually have been shown to the plaintiffs at some point? I mean you can't, you can't just have prepared documents that are filed away in a file bin somewhere that the plaintiffs never see and be part of it, can he?

MR. YOUTZ: Absolutely not. Absolutely not. And that's - - there's a couple cases that - - it's *Century Financial*, or I think it's a litigation that apparently went on over about, it must have been 10 years the way the cases read because there's a series of cases. And one of them was mentioned by RCG about what - - that involved a trustee, and actually what was being sued. A trustee for one of the notes - - this is kind of is reminiscent of WPPSS days where a trustee was sued for notes saying the trustee was involved and should have recognized things were going on with the notes. Money should have been coming in and it wasn't after that sale - - the notes were already sold and everything was done. And the trustee was found possibly liable on tons of things:

breach of fiduciary duty and so on, but not on securities because he didn't do anything with the securities.

But that case also talks about the fact that it can be literally anything at all it takes to make the sale happen. Ultimately to have the necessary nexus before the whole program can work. And that's - - what we have here is a program that has to work through an SCM, and it's got to be about that. It just can't happen.

And here, it's so much more direct anyway, because what happens is the plaintiffs understand that money is going to go into Villalba to the black box, but that money is, in fact, going to go to this other place, and that's really what finalizes everything that happens, is that extra step that goes through the black box into Rosenthal Collins, where the magic is supposed to happen.

And so there's all this awareness that there's that stage of this. When I was talking about the *National Century* case, one of the main points that it makes is under the Ohio statute, to be liable under that statute, secondary, you have to have absolutely zero role in inducing people to purchase. Meaning, typically when we think about documents being produced for people you say, well, are they liable, you're producing a document because you want to give it to somebody and say hey, look at this, buy my security. Promotional, purely promotional.

Under the Ohio act, the Court makes it very clear that for a third person to be liable they don't have to have any role in inducing the sale, period, they just have to be able to make it happen. And that's why the *Pieretti* court said, yeah, that's all you need here because here, without FBFCM being available to make this happen, it wouldn't have happened.

And you don't need the FCM, in this case, Rosenthal Collins to send anything to the plaintiffs to induce them, you don't have to have them send in account statements or anything else, they just have to make the whole scheme function, and for that you can be liable under that Ohio state act.

THE COURT: So, I mean, I guess I'm - - that gives it a pretty broad sweep. I mean it basically means that anybody who was in Rosenthal Collins' position, whether it's any other broker, is going to be responsible regardless of whether they actually did anything to (indiscernible).

MR. YOUTZ: Well, not necessarily, Your Honor. And you know, when you look at what has happened in these cases, there always seems to be a little element of something else. It's what - - I think the example of the truck or the secretary typing is one thing - - but there's always another little element that makes a difference. And we, in there, talk about cases where third parties are - - there's liability to third parties by people who aren't, you know, like clearing brokers and stuff like that, even though they didn't make any misrepresentations, and supposedly all they do is process stuff, which is important because they have to - - somebody has to clear the trade.

They - - all those cases where they find yeah, you can be liable - - there's always that little extra something that says they knew about the fraud or should have known about the fraud; there was something there. And that's what we have here. Because here, you know, maybe this would be a different story if RCG wasn't presented with the scheme upfront that said this is the offering circular, this is what we're going to do. Oh, you're going to need an exemption? Oh, okay, we'll just make that up. And all of a sudden you go through all of that, and then that makes something happen that should not happen.

And I think sometimes the courts do look at that little feature to come around and say, yeah, you were important because nobody else should have opened up this account. So in Ohio I think it does make a difference. And I

STATE OF WASHINGTON )
) ss.
KING COUNTY SUPERIOR COURT )

I, CATHY L. SWANSON, an Official Transcriptionist for the King County Superior Court, State of Washington, hereby certify that the foregoing pages, 1 through 85, inclusive, comprise a full, true and correct transcript of the proceedings in the above-entitled cause to the best of my ability; that I am not related to any of the parties to this litigation and have no interest in the outcome of said litigation.

DATED this 30th day of October, 2015.

Cathy L. Swanson

CATHY L. SWANSON
Official Transcriptionist

# APPENDIX E

# NATIONAL FUTURES ASSOCIATION MANUAL

VOLUME FOUR, NUMBER FOUR
(AS OF JULY 1, 1998)

200 W. MADISON STREET
SUITE 1600
CHICAGO, ILLINOIS 60606-3447
312-781-1300

120 BROADWAY
SUITE 1125
NEW YORK, NEW YORK 10271
212-608-8660

NFA

# NATIONAL FUTURES ASSOCIATION MANUAL

**VOLUME 4, NO. 4**
**(AS OF JULY 1, 1998)**

NATIONAL FUTURES ASSOCIATION

200 W. Madison Street
Suite 1600
Chicago, IL 60606-3447
(312) 781-1300

120 Broadway
Suite 1125
New York, NY 10271
(212) 608-8660

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Chicago, Illinois 60609
Telephone: (773) 247-4141
Fax: (773) 247-1313

procedures shall require prior review and approval of all promotional material by an officer, general partner, sole proprietor, branch office manager or other supervisory employee other than the individual who prepared such material (unless such material was prepared by the only individual qualified to review and approve such material).

(f) **Recordkeeping.**

Copies of all promotional material along with a record of the review and approval required under paragraph (e) of this Rule must be maintained by each Member and be available for examination for a period of three years from the date of the last use. Each Member who uses promotional material of the type described in paragraph (c) of this Rule shall demonstrate the basis for any hypothetical results to NFA upon request.

(g) **Filing with NFA.**

The Compliance Director may require any Member for any specified period to file copies of all promotional material with NFA promptly after its first use.

(h) **Definition.**

For purposes of this Rule "promotional material" includes: (1) Any text of a standardized oral presentation, or any communication for publication in any newspaper, magazine or similar medium, or for broadcast over television, radio, or other electronic medium, which is disseminated or directed to the public concerning a futures account, agreement or transaction; (2) any standardized form of report, letter, circular, memorandum or publication which is disseminated or directed to the public; and (3) any other written material disseminated or directed to the public for the purpose of soliciting a futures account, agreement or transaction.

*[See Interpretive Notices at ¶9003, ¶9009 and ¶9025.]*

**[¶5147.25] RULE 2-30. CUSTOMER INFORMATION AND RISK DISCLOSURE.**

(a) Each Member or Associate shall, in accordance with the provisions of this Rule, obtain information about its futures customers who are individuals and provide such customers with disclosure of the risks of futures trading.

(b) The Member or Associate shall obtain the information and provide the risk disclosure at or before the time a customer first opens a futures trading account to be carried or introduced by the Member, or first authorizes the Member to direct trading in a futures account for the customer.

(c) The information to be obtained from the customer shall include at least the following:

(1) the customer's true name and address, and principal occupation or business;

(2) the customer's current estimated annual income and net worth;
(3) the customer's approximate age; and
(4) an indication of the customer's previous investment and futures trading experience.

(d) The risk disclosure to be provided to the customer shall include at least the following:

(1) the Risk Disclosure Statement required by CFTC Regulation 1.55, if the Member is required by that Regulation to provide it;
(2) the Disclosure Document required by CFTC Regulation 4.31, if the Member is required by that Regulation to provide it;
(3) the Options Disclosure Statement required by CFTC Regulation 33.7, if the Member is required by that Regulation to provide it; and
(4) the Disclosure Document required by CFTC Regulation 31.11, if the Member is required by that Regulation to provide it.

(e) In the case of an account which is introduced by an FCM or IB or for which a CTA directs trading, it shall be the responsibility of the Member soliciting the account to comply with this Rule.

(f) A Member or Associate shall be entitled to rely on the customer as the sole source for the information obtained under Section (c) of this Rule and shall not be required to verify such information.

(g) Each Member or Associate shall make or obtain a record containing the information obtained under Section (c) of this Rule at the time the information is obtained. If a customer declines to provide the information set forth in Section (c) of this Rule, the Member or Associate shall make a record that the customer declined, except that such a record need not be made in the case of a non-U.S. customer. Subject to the provisions of Section (i) of this Rule, a Member may open, introduce or agree to direct a futures trading account for a customer only upon the approval of a partner, officer, director, branch office manager or supervisory employee of the Member. Each Member shall keep copies of all records made pursuant to this Rule in the form and for the period of time set forth in CFTC Regulation 1.31.

(h) Each Member shall establish and enforce adequate procedures to review all records made pursuant to this Rule and to supervise the activities of its Associates in obtaining customer information and providing risk disclosure.

(i) Nothing herein shall relieve any Member from the obligation to comply with all applicable CFTC Regulations and NFA Requirements.
*[See Interpretive Notices at ¶9004 and ¶9013.]*

**[¶5147.30] RULE 2-31. FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS.**

Any Member who violates any of the CFTC Part 30 Regulations shall be deemed to have violated an NFA Requirement.

means that Members must maintain the records necessary to document how the hypothetical results were calculated.

**Section (f) Filing with NFA**

This Section is intended to allow NFA to maintain close review of promotional material in circumstances where special scrutiny is warranted.

**[¶9004] NFA COMPLIANCE RULE 2-30: CUSTOMER INFORMATION AND RISK DISCLOSURE** (Board of Directors, effective June 1, 1986)

## INTERPRETIVE NOTICE

**I. Introduction**

NFA Compliance Rule 2-4 requires Members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their futures business. NFA's FCM Advisory Committee ("the Committee") has been considering ways in which the general standard of Rule 2-4 can be further defined in order to develop uniform industrywide standards which will offer guidance to the Members. In the course of its work the Committee noted the increasing level of commentary, in public and regulatory forums, on the absence of a "know your customer" or "suitability" rule in the futures industry and a perception on the part of some that there is a concomitant lack of protection for futures customers. NFA's Executive Committee also became aware of these comments and asked the Committee to study the matter and make appropriate recommendations. Based on its knowledge and experience in the industry, the Committee believed that any careful consideration of this issue would have to take into account the important role that risk disclosure plays whenever a customer opens a futures account or selects a commodity trading advisor, and the extent to which futures professionals were already obtaining information about their customers.

To learn more about the current level of inquiry conducted through the new account opening procedures now being used in the industry, NFA sent a questionnaire to all of its Members. The Committee also reviewed research on the evolution of the suitability and "know your customer" doctrines in the securities industry and noted that although there are several different formulations of the rule, all are based on the same premise: that different types of securities can have widely varying degrees of risk potential and serve very different investment objectives. For that reason, the securities suitability rules are cast in terms of the suitability of a particular transaction.

The Committee noted that the futures industry differs from the securities industry in several crucial ways. Most importantly, futures contracts in general are recognized as highly volatile instruments. It therefore makes little sense to presume that a certain futures trade may be appropriate for a customer while others are not. An appreciation of the risks of futures trading must be gained and a determination of its appropriateness made at the time each customer makes a decision to trade futures in the first place. This is true regardless of whether the customer will rely on recommendations by futures professionals or the customer will make his or her own trading decisions.

The futures industry has traditionally met this need through risk disclosure designed to encourage the customer to make an informed decision as to whether futures trading is suitable for that customer. The Risk Disclosure Statement and the Options Disclosure Statement mandated by CFTC Regulations 1.55 and 33.7, respectively, and the Disclosure Document required by the CFTC Part 4 Regulations each are designed to bring the suitability issue to the customer's attention.[1]

In the specific area of exchange-traded options, the CFTC has previously noted the importance of risk disclosure and the need for the futures professional to learn enough about the customer in order to provide risk disclosure. When the Options Disclosure Statement requirement was enacted in 1981 as part of the options pilot program, the CFTC stated in its Federal Register release [46 Fed. Reg. 54500 (1980-82 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶21,263] that:

> ". . . the FCM must acquaint itself sufficiently with the personal circumstances of each option customer to determine what further facts, explanations and disclosures are needed in order for that particular option customer to make an informed decision whether to trade options . . . . While this requirement is not a "suitability" rule as such rules have been composed in the securities industry, before the opening of an option account the FCM has a duty to acquaint itself with the personal circumstances of an option customer."

The CFTC went on to state that "the extent of the inquiry should be left to the prudent judgment of the FCM."

NFA was concerned that allowing suitability or know your customer standards to develop outside of the self-regulatory framework carried with it the possibility that a poorly defined or inappropriate duty would be fashioned on a case-by-case basis, perhaps by ill-considered analogy to the securities industry rules. Because NFA construes its rules on a case-by-case basis through the decisions of the Business Conduct Committees ("BCCs") which are composed of informed futures professionals, NFA is uniquely positioned to set an ethical business standard which will be construed by Members evaluating the conduct of other Members.

The Committee determined that the exchange of information between a new customer and a futures professional—the customer providing personal data

[1] The risk disclosure statements required by CFTC Regulations 1.55 and 4.31 direct the customer to "carefully consider whether [futures] trading is suitable for you in light of your financial condition": the one required by CFTC Regulation 33.7 informs the customer that "commodity option transactions are not suitable for many members of the public."

and the Member providing disclosure about the risks of futures trading—was the focal point around which to structure a sound customer protection rule. On August 9, 1985, the Committee released for public comment a Proposed Rule on Customer Information and Risk Disclosure. The comments received were considered in the drafting of the Rule in final form, and Rule 2-30 was adopted by NFA's Board of November 21, 1985.

When the CFTC declined in 1978 to adopt a "suitability" rule, after releasing a proposed rule for comment, it stated that it was unable "to formulate meaningful standards of universal application." [43 Fed. Reg. 31886 (1977-1979 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶20,642] NFA found the same difficulty, and for that reason the Rule is premised on NFA's conclusion that the customer is in the best position to determine the suitability of futures trading if the customer receives an understandable disclosure of risks from a futures professional who "knows the customer." NFA believes that the approach taken in Rule 2-30 is preferable to one which would erect an inflexible standard that would bar some persons from using the futures markets.

### II. Section-by-Section Analysis

#### Section (a): General Rule

Rule 2-30 is intended to define "high standards of commercial honor and just and equitable principles of trade" as applied to a Member's procedures for exchanging information with new futures customers at the time they become customers.[1] Section (a) sets forth the basic requirement: obtain information and provide risk disclosure which includes the disclosures required by the Rule plus, in some cases, additional disclosure. Rule 2-30 is a "know your customer" rule; however, it does not require the Member or Associate to make the final determination that a customer should be barred from futures trading on suitability grounds. Some "know your customer" rules in the securities industry (New York Stock Exchange Rule 405, for example) have been construed in that manner; these interpretations do not apply to Rule 2-30.

NFA's enactment of the Rule 2-30 should not be construed to expose Members to increased potential liability for damages in customer litigation or reparation proceedings, for several reasons. First, a business conduct standard promulgated by a self-regulatory organization does not create a private cause of action. Furthermore, Rule 2-30 is not an antifraud rule. In order to prove a violation, there is no requirement to prove any intent on the part of the Member to deceive. Therefore, evidence of a violation of Rule 2-30 would not in and of itself constitute evidence of a violation of any antifraud rule or statute. Finally, to the extent that personal information about a customer is germane to the issues in a reparations or arbitration case, it is undoubtedly

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[1] NFA Bylaws define "futures" to include domestic exchange-traded options and dealer options. See Compliance Rule 1-1(g).

already being considered even in the absence of a formal rule requiring Members to obtain it.

Section (a) provides that the Rule applies only to customers who are individuals; this includes individuals who open accounts jointly with others. Although accounts opened by business entities such as corporations and partnerships present other concerns (such as compliance with NFA Bylaw 1101, which prohibits Members from transacting customer business with non-Members who are required to be registered), the scope of Rule 2-30 is limited to natural persons, who may lack the sophistication of institutional customers.

**Section (b): New Customers**

The Member's obligation to obtain information and provide risk disclosure under the Rule is limited to the first time the customer establishes a futures account with the Member. This limitation was the result of the balancing of the benefits of repeated information exchange against the burden of imposing additional requirements on the already extensive account-opening procedures for subsequent accounts for the same customers.[2]

**Section (c): Information To Be Obtained**

Item (1) is essentially the information required by CFTC Regulation 1.37(a), which applies to FCMs and IBs. Item (2) includes estimated annual income and net worth, information which the Committee found is commonly sought from new customers. Item (3), the customer's age, is also a commonly sought item which the Committee thought would be helpful in putting the customer's financial condition, ability to understand and level of sophistication into perspective for the Member. Most Members responding to the questionnaire indicated that they require information about previous futures trading experience; a smaller number responded that they ask about securities or options trading experience. NFA believes that experience with these types of investments may be relevant and has therefore included it.

Information on age, estimated annual income and net worth may be obtained through the use of brackets or "in excess of" descriptions so long as these are reasonably designed to elicit the required information in a meaningful manner.

The information specified in Section (c) is a minimum requirement, intended to serve as a core of basic information that should always be obtained. Some Members routinely elicit additional items, such as liquid net worth, risk capital, or number of dependents, which may be quite useful, and NFA received comments on the Rule when it was drafted suggesting that these items be required by the Rule. NFA concluded, however, that the better approach was to adopt a Rule that would specify the minimum required information and allow Members to obtain other information as they deemed appropriate.

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[2] Certain CFTC Regulations and NFA Requirements will apply with respect to each account or interest entered into: the discussion above refers to those aspects of Rule 2-30 which are additional requirements. See Section (i) of the Rule.

**Section (d): Risk Disclosure**

The risk disclosures incorporated into this Section are required by CFTC Regulations. (There are other disclosures required by CFTC Regulations, such as the Regulation 32.5 dealer options disclosure statement and the Regulation 190.10(c) disclosure statement for non-cash margin, which may apply to particular accounts.) These disclosures are only the minimum required. NFA believes that the decision with respect to what additional disclosure, if any, should be given to the customer is best left to the Member, whose conduct is subject to review by the BCCs. There may be some customers for whom the additional disclosure will portray futures trading as too risky for that customer. However, NFA believes that a determination of who those customers are cannot be made except on a case-by-case basis, because no objective criteria can be established that will apply to all customers. The essential feature of the Rule is the link between "knowing the customer" and providing risk disclosure. Once that has been done, the customer is free to make the decision whether to trade futures.

**Section (e): Introduced and Third-Party Controller Accounts**

The purpose of this Section is to place the obligation to obtain information and provide risk disclosure on the Member who deals directly with the customer when an account is introduced to a carrying FCM by an IB or another FCM doing business on a fully disclosed basis, or when a CTA controls the trading in a customer's account pursuant to written authorization. NFA believes that the Member or Associate who solicits the customer and communicates with the customer in the process of the account opening is the appropriate party to comply with the Rule. In some cases, this may be the Member introducing or controlling the account; in other cases, it may be the carrying FCM.

Of course, each Member remains responsible for compliance with all applicable CFTC Regulations and NFA Requirements. For example, an FCM (or, in the case of an introduced account, the IB) must furnish a Regulation 1.55 Risk Disclosure Statement to each customer, including those whose accounts were solicited by and will be traded by CTAs. Similarly, a CTA must deliver a Disclosure Document to each customer, including those who were solicited by the FCM. Section (i), which is discussed below, clarifies each Member's obligation to comply with other requirements.

**Section (f): Reliance on the Customer as the Source of the Information**

Some Members confirm financial data because of concern about the creditworthiness of the customer. NFA believes, however, that the decision whether to confirm customer data is best left to the Member's sound business judgment and is irrelevant to a customer protection rule aimed at providing information to a customer.

Rule 2-30 contemplates a good faith exchange of information between the customer and the Member or Associate. A customer who gives incorrect information would still receive all the required risk disclosure statements but would have impaired the Member's ability to consider fully the customer's ability to understand the risk disclosures or whether additional disclosure was necessary. However, Section (f) will not operate as a "safe harbor" for a Member or Associate who falsifies information or who induces or suggests falsification by the customer. Information invented by the Member or Associate does not constitute "information about the customer" as required by the general rule. Members and Associates engaging in such conduct will be subject to appropriate disciplinary action.

**Section (g): Recordkeeping: Customers Who Decline to Provide Information**

In order to allow NFA to audit for compliance with the Rule, Section (g) requires that a timely record be made or obtained which contains the information obtained from the customer. Customers who decline to provide information (beyond that required by CFTC Regulation 1.37(a), which must always be obtained) may still open accounts, but NFA would expect Members to take appropriate action upon learning that an inordinate number of a particular Associate's customers apparently "decline" to provide basis information. Because Section (a) imposes an affirmative duty on Members to obtain information, a Member who engages in (or allows Associates to engage in) a course of conduct which is designed to or has the effect of eliciting or prompting refusals by customers to provide that information would not have discharged that duty and could not use Section (g) as a shield from disciplinary action.

The approval requirement has been broadened to apply to all new accounts. This is consistent with the Member's responsibility to supervise the futures activities of its employees diligently pursuant to NFA Compliance Rule 2-9.

In the case of non-U.S. customers (those who neither reside in nor are citizens of the United States) a record that the customer declined to provide the information need not be made.

**Section (h): Review Procedures**

The requirement that a Member establish adequate review and compliance procedures provides Members with the flexibility to design procedures that are tailored to the way the Member does business. NFA's audit staff will, in the routine course of an examination, check these procedures for adequacy, taking into account the facts and circumstances of the particular Member.

**Section (i): Relationship to Other Requirements**

Rule 2-30 incorporates certain CFTC Regulations, but its requirements are in addition to any imposed by those Regulations or other NFA Requirements. For example, the Rule requires a CTA to provide a Disclosure Document, if required to do so by CFTC Regulation 4.31, at the time a customer first authorizes the Member to direct trading in a futures account for the customer.

This is because Rule 2-30 is intended to apply to "account opening" or its equivalent. However, CFTC Regulation 4.31 requires that the Disclosure Document be delivered at the time of solicitation. Other examples of CFTC Regulations which affect the process covered by the Rule have been cited in the discussion of Sections (b), (d), (e) and (g) above. Section (i) serves to clarify the ongoing obligation of Members to comply with all CFTC Regulations and NFA Requirements.

**[¶9005] INTERPRETATION OF NFA COMPLIANCE RULE 2-4: GUIDELINE FOR THE DISCLOSURE BY FCMS AND IBS OF COSTS ASSOCIATED WITH FUTURES TRANSACTIONS** (Board of Directors, effective June 1, 1986)

## INTERPRETIVE NOTICE

National Futures Association ("NFA") Compliance Rule 2-4 provides that "Members and Associates shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business." NFA Compliance Rule 2-4 requires that each FCM Member, or in the case of introduced accounts, the Member introducing the account make available to its customers, prior to the commencement of trading, information concerning the costs associated with futures transactions.[1]

If fees and charges associated with futures transactions are not determined on a per trade or round-turn trade basis, the Member must provide the customer with a complete written explanation of such fees and charges, including a reasonable example or examples of such fees and charges on a per trade or round-turn trade basis. Where the per trade or round-turn trade equivalent of the fees or charges may vary widely the most appropriate disclosure would be to explain this fact and to provide examples demonstrating the reasonably expected range of the fees or charges. This additional disclosure is *not* required if:

1. the customer has been given a Disclosure Document required by NFA Compliance Rule 2-13 and CFTC Part 4 Regulations;
2. the customer is an NFA Member;
3. the customer has privileges of membership on a contract market; or
4. the customer is not an individual.

To further ensure that information concerning fees and charges has been made available to customers, FCM Members must provide customers with purchase and sale or confirmation statements which include a reasonable breakdown of all fees and charges assessed in connection with all transactions. NFA assessment fees must either be separately itemized from commission or, if they are included among other fees (such as exchange fees),

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[1] NFA Bylaws defined "futures" to include domestic exchange-traded options and dealer options. See NFA Compliance Rule 1-1(g).

NFA