No. 95991-9

SUPREME COURT
OF THE STATE OF WASHINGTON

(Court of Appeals No. 76326-1-I)

FEDERAL HOME LOAN BANK OF SEATTLE,
a bank created by federal law,

Appellant,

v.

RBS SECURITIES INC., f/k/a GREENWICH CAPITAL MARKETS, INC., a Delaware corporation; GREENWICH CAPITAL ACCEPTANCE, INC., a Delaware corporation; and RBS HOLDINGS USA, INC., f/k/a GREENWICH CAPITAL HOLDINGS, INC., a Delaware corporation,

Respondents.

PETITION FOR REVIEW

Matthew A. Carvalho, WSBA #31201
Diana S. Breaux, WSBA #46112
YARMUTH WILSDON PLLC
1420 Fifth Avenue, Suite 1400
Seattle, WA 98101
(206) 516-3800

David J. Grais (*pro hac vice* pending)
GRAIS & ELLSWORTH LLP
950 Third Avenue, 24th Floor
New York, NY 10022
(212) 755-0100

Attorneys for Petitioner
Federal Home Loan Bank of Seattle

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Page(s)**

Statutes, Rules and Other Authorities

INTRODUCTION

Federal Home Loan Bank of Seattle (Seattle Bank) sued RBS Securities Inc., an investment bank, under the Washington State Securities Act (WSSA) for making untrue or misleading statements of material fact in connection with its sale to Seattle Bank of four residential mortgage-backed securities (RMBS) for hundreds of millions of dollars. RBS made those untrue or misleading statements in offering documents that it was required to deliver to Seattle Bank and to file with the Securities and Exchange Commission before it completed the sale of the RMBS to Seattle Bank. But for one of the RMBS, RBS did so the day after it delivered the RMBS to Seattle Bank and Seattle Bank paid for it. RBS had made nearly identical statements in its SEC filings for at least 23 similar transactions.

Division One of the Court of Appeals affirmed summary judgment dismissing Seattle Bank's complaint because, in its view, the WSSA requires a plaintiff to prove that it relied on the untrue or misleading statements in deciding to buy the security that the defendant sold. Division One concluded that Seattle Bank could not have relied on the statements in the prospectus supplement because it received that document after it purchased the RMBS involved here. The upshot of this decision is that a seller of securities can escape its liability for making untrue or misleading

statements by the simple expedient of filing its offering documents with the SEC late.

Division One relied on its recent decision of the identical issue in *Federal Home Loan Bank of Seattle v. Barclays Capital Inc.*[1] and *Federal Home Loan Bank of Seattle v. Credit Suisse Securities (USA) LLC*.[2] This Court has granted review of those two decisions. It should grant review of this one for the same reasons.

IDENTITY OF THE PETITIONER

The petitioner is Federal Home Loan Bank of Seattle. In May 2015, it merged into the Federal Home Loan Bank of Des Moines, but the caption of this action was not amended.

DECISION OF THE COURT OF APPEALS

On May 21, 2018, the Court of Appeals, Division One, issued a published decision affirming the trial court's grant of summary judgment dismissing Seattle Bank's complaint in its entirety. *Fed. Home Loan Bank of Seattle v. RBS Secs. Inc.*, No. 76326-1-I.

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[1] 1 Wn. App. 551, 406 P.3d 686 (2017), *review granted*, 190 Wn.2d 1018 (2018).

[2] No. 75779-2-I (Wn. App. Dec. 11, 2017) (unpublished), *review granted*, No. 95420-8 (Wn. May 3, 2018) (consolidated with No. 75913-2-I).

ISSUE PRESENTED FOR REVIEW

Whether, in an action under the WSSA, RCW 21.20.010(2),[3] the plaintiff must prove not only that the defendant made an untrue or misleading statement of a material fact in connection with its sale of a security to the plaintiff, but also that the plaintiff relied on the untrue or misleading statement in deciding to buy the security.

STATEMENT OF THE CASE

A. Creating And Selling Residential Mortgage-Backed Securities.

This is one of hundreds of actions by investors in RMBS against the investment banks that created and sold trillions of dollars of such securities from 2004 to 2008. RMBS are not backed by the promise of an entity such as a corporation to pay principal and interest to their holders. Rather, they are backed only by payments that borrowers make on discrete groups of mortgage loans. CP 6724. If those borrowers fall behind in their mortgage payments, and if those payments are not enough to make the promised payments to investors in an RMBS, then the investors will suffer losses because no entity is required to make good the shortfall. *Id*. Sellers of RMBS make detailed statements in their offering documents about the credit

quality of the specific mortgage loans that back the securities. CP 6732. These statements are material to investors in RMBS because payments on those mortgage loans are the sole source of payments to investors. CP 6752–6762.

The process of creating and selling an RMBS takes several weeks. The investment bank that is creating the RMBS chooses the mortgage loans that are to back the RMBS and devises various technical aspects of the RMBS, such as the relative rights of different RMBS that are being sold in the same transaction. CP 6732. The investment bank then solicits investors like Seattle Bank to purchase the forthcoming RMBS. *Id*. The investment bank sends potential investors various preliminary offering documents, such as term sheets, which give details of the specific mortgage loans that will back the RMBS (such as, for example, the rates and terms of the loans, the amount of equity that the borrowers have in their homes, etc.). CP 6732, 6740–6744, 6752–6767. Based on the information in these preliminary offering documents, an investor makes a preliminary decision whether to purchase the offered RMBS.

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[3] RCW 21.20.010(2) makes it "unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly: . . . To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading."

While this process is taking place, the investment bank completes the final offering document for the RMBS, the prospectus supplement that it will deliver to investors and file with the SEC. CP 6732–6733; 8091–8094. The content of prospectus supplements for RMBS is closely prescribed by the SEC.[4] Under federal law, before it can sell an RMBS, an investment bank must both deliver the prospectus supplement to potential investors and also file it with the SEC so it is available to the investing public at large.[5] Both may be done by uploading the prospectus supplement to the SEC's website.

Seattle Bank paid RBS $200,000,000 on June 26, 2006, for the RMBS involved here.

B. The Untrue Or Misleading Statements That RBS Made To Seattle Bank; Seattle Bank's Action Against RBS Under The WSSA.

Seattle Bank alleged that RBS made untrue or misleading statements about the underwriting of the mortgage loans that backed the RMBS and the amount of equity that borrowers had in their homes. In its prospectus supplements, RBS stated that the loans were made in accordance with

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[4] SEC Regulation AB, 17 C.F.R. § 229.1100 *et seq.*

[5] Section 5(b)(2) of the Securities Act of 1933, 15 U.S.C. § 77e(b)(2), makes it "unlawful for any person, directly or indirectly- . . . to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10" of that Act.

specified underwriting criteria. CP 6855, 6894–6900. Such statements are material to investors like Seattle Bank because the credit quality of mortgage loans – and therefore the safety of an RMBS that they back – depends on whether the lenders followed their own guidelines in making the loans.

The amount of equity that borrowers have in their homes is measured by the loan-to-value ratio – that is, the ratio of the amounts of the mortgage loans to the values of the properties that secured those loans. An appraisal of the mortgaged property often provides the denominator in the loan-to-value ratio.[6] In its prospectus supplements, RBS stated that the appraisals of the mortgaged properties were made in compliance with the Uniform Standards of Professional Appraisal Practice, the national standards of the appraisal profession. CP 6740–6744. Such statements are material to investors in RMBS because loan-to-value ratios are a critical factor in the credit quality of mortgage loans, and compliance with professional appraisal standards helps ensure that the ratios are accurate.

Seattle Bank's complaint alleged that the statements described above were untrue or misleading because many of the mortgage loans were not

[6] When a mortgage loan is used to purchase a house, the appraisal provides the denominator if the appraised value is lower than the purchase price of the house. When a mortgage loan is used to refinance an earlier mortgage loan, the appraisal always provides the denominator because there is no purchase price.

made in accordance with the stated underwriting guidelines and many of the appraisals were not made in accordance with the Uniform Standards of Professional Appraisal Practice.

C. RBS's Failure To Deliver And File The Prospectus Supplement On Time.

RBS made nearly identical statements – that the mortgage loans were made in accordance with stated underwriting guidelines and that the appraisals were made in accordance with the Uniform Standards – in the prospectus supplements that RBS filed with the SEC in 23 similar transactions that preceded its sale of the RMBS to Seattle Bank in June 2006 CP 8164–8172.

Although RBS was required to file the prospectus supplements with the SEC before it sold the RMBS to Seattle Bank, it did not do so. RBS filed the prospectus supplement the day after it delivered the RMBS and Seattle Bank paid for it. CP 7709–7717.

ARGUMENT

I. This Court Has Never Directly Considered Whether The WSSA Requires Proof Of Reliance, And Should Clarify That A Single Sentence In The Court's *Hines* Decision Did Not Create Such A Requirement.

This Court has never directly considered whether the WSSA requires proof of reliance. Division One first interjected a reasonable reliance requirement into the WSSA in two nearly simultaneous decisions in 2004,

Guarino v. Interactive Objects, Inc., 122 Wn. App. 95, 86 P.3d 1175 (2004), and *Stewart v. Estate of Steiner*, 122 Wn. App. 258, 93 P.3d 919 (2004). In both, it did so with nothing more than a citation to the italicized phrase in the following sentence of this Court's decision in *Hines v. Data Line Sys., Inc.,* 114 Wn.2d 127, 134, 787 P.2d 8, 15 (1990):

> The [defendants] argue that before they can be liable under RCW 21.20.010, the investors must establish that defendants' misrepresentations were the proximate reason for their investments' decline in value. We disagree. *The investors need only show* that the misrepresentations were material and *that they relied on the misrepresentations in connection with the sale of the securities.*

Guarino, 122 Wn. App. at 109, 86 P.3d at 1182; *Stewart*, 122 Wn. App. at 260 & n.1, 264 & n.7, 93 P.3d at 920 & n.1, 922 & n.7. In two more decisions, Division One either simply assumed that proof of reasonable reliance was required (*Helenius v. Chelius*, 131 Wn. App. 421, 120 P.3d 954 (2005)), or again said so with just a citation to *Hines* and its own decision in *Stewart* (*FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 175 Wn. App. 840, 868 & n.67, 309 P.3d 555, 569 & n.67 (2013), *aff'd*, 180 Wn.2d 954, 331 P.3d 29 (2014)). And finally, in this case as well as two other cases decided in recent months (of which this Court has granted review),[7] Division One again imposed a reliance requirement based on this

[7] *Federal Home Loan Bank of Seattle v. Barclays Capital Inc.*, 1 Wn. App. 551, 406 P.3d 686 (2017), review granted, No. 95436-4 (Wash. May 3, 2018); *Federal*

misapplication of *Hines*. Division One's creation of a reasonable reliance requirement under the WSSA was error for two reasons.

First, the issue of reliance was not before this Court in *Hines*, so its observation about reliance was dictum. *Hines* did not involve a question of reliance, and the quoted passage appeared in a section of the Court's opinion about the elements of loss and loss causation. 114 Wn.2d at 134-35, 787 P.2d at 12-13. The investor plaintiffs assumed that they had to prove transaction causation, which is the same as reliance. In their brief, they wrote that "at the very most, Investors here will have to demonstrate at trial a causal nexus not between [the CEO's] aneurysms [which were not disclosed in the offering documents] and [the company]'s demise, but between Respondent's failure to disclose material facts and Investors' decision to purchase the stock."[8] (Emphasis in original.) What the investor plaintiffs disputed was whether they also had to prove that the untrue or

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Home Loan Bank of Seattle v. Credit Suisse Sec. (USA) LLC, No. 75779-2-I (Wn. App. Dec. 11, 2017) (unpublished), *review granted*, No. 95420-8 (Wn. May 3, 2018) (consolidated with No. 75913-2-I).

[8] Brief of Appellants in *Hines* at 62, attached as Appendix II to Credit Suisse's brief to Division One (emphasis in original). The investors said so again in their reply brief. "Investors contend that they need only show 'transaction causation,' i.e., that the omission was a substantial contributive factor in their decision to purchase the stock." Reply Brief of Appellants in *Hines* at 18, attached as Appendix I to Credit Suisse's brief to Division One.

misleading statements were the cause of their loss.[9] This Court, of course, decided that they did not. In its interpretation of *Hines*, the Court of Appeals disregarded the principle that "general expressions in every opinion are to be confined to the facts then before the court and are to be limited in their relation to the case then decided and to the points actually involved." *Waremart, Inc. v. Progressive Campaigns, Inc.*, 139 Wn.2d 623, 647, 989 P.2d 524, 536 (1999) (internal quotation marks omitted).

Second, by the time Division One decided *Guarino* and *Stewart* in 2004, this Court had decided six cases under the WSSA, all in lengthy opinions and all in favor of the investor-plaintiffs.[10] All of these cases expanded protection for investors under the WSSA, consistent with the statute's "unique" purpose and "special emphasis . . . on protecting investors[.]"[11] (*See also* Section III *infra*.) It is implausible that this Court intended to make a major decision under the WSSA – let alone one that narrowed the protection of investors – in one sentence. This Court, like

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[9] They wrote in their assignments of error: "Causation: . . . Must an injured investor prove that the specific fact or facts omitted from the offering materials directly caused the security to become worthless?" Brief of Appellants in *Hines* at 4.

[10] *Cellular Eng'g, v. O'Neill*, 118 Wn.2d 16, 820 P.2d 941 (1991); *Hoffer v. State*, 113 Wn.2d 148, 776 P.2d 963 (1989); *Hoffer v. State*, 110 Wn.2d 415, 755 P.2d 781 (1988); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 744 P.2d 1032 (1987); *Kittilson v. Ford*, 93 Wn.2d 223, 608 P.2d 264 (1980); *Clausing v. DeHart*, 83 Wn.2d 70, 515 P.2d 982 (1973).

[11] *FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 180 Wn.2d 954, 970-71, 331 P.3d 29, 45-46 (2014).

Congress, "does not . . . hide elephants in mouseholes." *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468, 121 S. Ct. 903, 149 L.Ed.2d 1 (2001).

II. The Decision Of Division One Conflicts With This Court's Settled Doctrine That Section (2) Of The WSSA Is A Strict-Liability Statute.

In its four decisions prior to *Barclays* and *Credit Suisse*, Division One misconstrued the one sentence in *Hines*. The reasoning in *Barclays* and *Credit Suisse*, on which Division One relied in the present decision, conflicts with this Court's jurisprudence under the WSSA: that section (2) of the WSSA is a strict-liability statute, not simply a statutory version of a common-law action for fraud.

A. The Statutory Background.

When the Legislature enacted the WSSA in 1959, there were (and still are) two federal laws against making an untrue or misleading statement of material fact in connection with the sale of a security. The first was section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2) (since renumbered 12(a)(2) but referred to here by its original number). It states:

> Any person who . . . offers or sells a security . . . by means of . . . *an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading* . . . shall be liable … to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less than the amount of any

> income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

(Emphasis added.) As countless courts agree, Section 12(2) creates a strict liability cause of action. Actions under it require no proof of scienter, reliance, loss, or loss causation, all elements of common-law fraud. As Division One acknowledged, "[i]t is undisputed that Section 12(2) of the 1933 Act created a strict liability cause of action." *Barclays*, 406 P.3d at 693.

The second federal law in effect in 1959 was the combination of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. 240.10b-5, which the SEC promulgated in 1942 by authority of section 10(b). Section 10(b) states that:

> It shall be unlawful for any person, directly or indirectly, … [t]o use or employ, in connection with the purchase or sale of any security … any manipulative or deceptive device or contrivance in contravention of [SEC] rules.

Following the language of section 12(2) exactly, Rule 10b-5 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."

When the Legislature enacted the WSSA in 1959, it also followed the language of section 12(2) (and Rule 10b-5) exactly:

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

> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

RCW 21.20.010(2). (The full texts of all the provisions discussed here are set forth in the Appendix.)

B. The Reasoning Of Division One Is Flawed.

Even though Division One agreed that "Section 12(2) of the 1933 Act created a strict liability cause of action," *Barclays*, 406 P.3d at 693, and even though this Court has held that the WSSA was modeled on section 12(2),[12] still Division One rejected the contention "that the legislature intended WSSA actions to be strict liability actions." *Id*. According to Division One, all that the Legislature took from section 12(2) was its private right of action. The "liability provisions" of the WSSA, on the other hand, the Legislature took from Rule 10b-5. *Id.*

Division One reasoned to this conclusion in six steps. *First*, the language of RCW 21.20.010 is the same as the language of Rule 10b-5. *Barclays*, 406 P.3d at 690. *Second*, the words "reasonable reliance" do not appear in Rule 10b-5 or in RCW 21.20.010. *Id*. *Third*, the United States Supreme Court has long required proof of reliance in actions under Rule

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[12] *See Hoffer v. State*, 113 Wn.2d 148, 151-52, 776 P.2d 963, 964-65 (1989); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 125, 744 P.2d 1032, 1048-1049 (1987).

10b-5, starting with its decision in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L.Ed.2d 668 (1976). *Id*. at 690 n.17. *Fourth*, when a court interprets a statute, "that interpretation controls what the statute has always meant." *Id*. at 690. *Fifth*, "[t]hus, Rule 10b-5 has always [since the SEC promulgated it in 1942] required a showing of reasonable reliance, and did so when this state's legislature drew upon it [in 1959] to craft RCW 21.20.010(2)." *Id*. Therefore, *sixth*, "we conclude that the state legislature enacted RCW 21.20.010(2) with the intent that it be construed in the same way as Rule 10b-5 and have the same interpretation as federal case law of that rule. In short, reasonable reliance is a necessary element of this state claim." *Id*.

This chain of reasoning leads to either or both of two absurd conclusions: (i) when taking Rule 10b-5 as a model for RCW 21.20.010(2) in 1959, the Legislature understood that the rule required proof of reasonable reliance even though the rule did not say so and even though the United States Supreme Court would not interpret the rule that way for 17 more years, or (ii) because it modeled RCW 21.20.010 on Rule 10b-5, the Legislature intended that RCW 21.20.010 would thereafter mean whatever the federal courts thought that Rule 10b-5 meant. This Court has long rejected the second conclusion, especially because the purpose of the 1934 Act is to protect the securities markets, whereas "'[t]he Washington Act is

unique; special emphasis is placed on protecting investors from fraudulent schemes.'" *FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 180 Wn.2d 954, 970-71, 331 P.3d 29, 45-46 (2014).

C. This Court Has Rejected The Application of Federal Law Construing Rule 10b-5 To The WSSA, Instead Recognizing Section (2) Of The WSSA As A Strict Liability Statute.

The reasoning in *Barclays* and *Credit Suisse*, on which the present decision depends, conflicts with this Court's interpretation of section (2) of the WSSA as a strict liability statute, and cannot be reconciled with this Court's decision in *Kittilson v. Ford*, 93 Wn.2d 223, 608 P.2d 264 (1980).

Nothing in the language of section (b) of Rule 10b-5 or section (2) of RCW 21.20.010 (both taken verbatim from section 12(2) of the 1933 Act) requires proof of reasonable reliance or any other element of common-law fraud, including scienter, loss, or loss causation. In *Ernst & Ernst v. Hochfelder*, however, the United States Supreme Court held for the first time that an action under Rule 10b-5 requires proof of scienter. It held that the scope of Rule 10b-5 cannot exceed the scope of the statute that gave the SEC the authority to promulgate that rule, section 10(b) of the 1934 Act. 425 U.S. at 214, 96 S. Ct. at 1391. Section 10(b) prohibits "any manipulative or deceptive device or contrivance." The Supreme Court concluded that "[w]hen a statute speaks so specifically in terms of

manipulation and deception, and of implementing devices and contrivances – the commonly understood terminology of intentional wrongdoing – and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct." *Id*. at 214, 96 S. Ct. at 1391.

The year after the decision in *Ernst & Ernst*, Division Two applied it to the WSSA, ruling that a plaintiff in an action under the WSSA must prove no less than nine elements of common-law fraud – including "the [plaintiff]'s reliance on the truth of the representation [and] his right to rely on it" – all by "clear, cogent, and convincing evidence." *Ludwig v. Mut. Real Estate Inv'rs*, 18 Wn. App. 33, 41-42, 567 P.2d 658, 662-63 (1977).

Three years later, in *Kittilson v. Ford*, this Court overruled *Ludwig*, deciding that "the holding in *Ernst & Ernst v. Hochfelder*, *supra*, [is] inapplicable to our Securities Act." This Court explained:

> First, the "manipulative or deceptive" language of section 10(b) of the 1934 act is not included in the Washington act. Secondly, in contrast to the federal scheme, the language of Rule 10b-5 is not derivative but is the statute in Washington. Finally, no legislative history similar or analogous to Congressional legislative history exists in Washington.

93 Wn.2d at 224, 608 P.2d at 264.

This Court extended *Kittilson* in two later decisions. In the first, *Hines*, this Court decided that a plaintiff need not show either loss or loss

causation. 114 Wn.2d at 134-35, 787 P.2d at 12-13. Then, in *Go2Net, Inc. v. FreeYellow.com, Inc.*, 158 Wn.2d 247, 143 P.3d 590 (2006), this Court rejected the argument that equitable defenses of waiver and estoppel should be available in actions under the WSSA. 158 Wn. 2d at 254, 143 P.3d at 593. After reaffirming that the WSSA "requires only proof of the seller's material, preclosing representation or omission," not proof of scienter, loss, or loss causation, *id*. at 253, 143 P.3d at 592, the Court agreed with a different panel of Division One that it was the legislature's "'intention to hold violators strictly accountable.'" *Id*. at 254, 143 P.3d at 593.

Division One believed that this Court imposed a reasonable reliance requirement in *Hines*. Yet it acknowledged that the Court decided in *Kittilson* that a plaintiff need not prove scienter (*Barclays*, 406 P.3d at 692-93), in *Hines* itself that a plaintiff need not prove loss causation (*id*. at 693), and it ignored the Court's decision in *Go2Net*. Division One erred by treating these decisions as just *ad hoc* choices about which elements of common-law fraud do and do not apply in actions under the WSSA, and by ignoring the unifying logic of this Court's decisions. Because the WSSA has no counterpart to section 10(b) of the 1934 Act, a plaintiff need prove no elements of common-law fraud. Once the plaintiff proves that the defendant made an untrue or misleading statement, the defendant's liability is strict.

III. The Decision Of Division One Conflicts With This Court's Fundamental Principle That The WSSA Is To Be Interpreted To Protect Investors.

For more than 30 years, this Court has held consistently that the WSSA is to be interpreted liberally to protect investors. *FutureSelect,* 180 Wn.2d at 970-71, 331 P.3d at 37-38 (collecting earlier decisions of this Court). The result here illustrates how anti-investor a reliance requirement is. Just as happened here, this requirement enables a seller of securities to shift the focus from the truth of its statements to the buyer's reliance on those statements. This Court rejected a similar shift of focus when it held in *Go2Net* that defenses of waiver and estoppel are not available under the WSSA:

> [P]ermitting a seller to assert equitable defenses is contrary to the Act's primary purpose of protecting investors. Because the Act is intended to deter a seller's presale misrepresentations and omissions, a seller should not be permitted to avoid statutory liability by shifting the focus to the postsale conduct of the uninformed investor.

158 Wn.2d at 254, 143 P.3d at 593. Precisely the same is true of a reliance requirement. It gives sellers of securities a route to escape liability for their untrue or misleading statements – in this case by filing the offering documents late – and thereby dilutes the deterrent effect of the WSSA.

IV. Division One Puts Washington At Odds With The Securities Law Of 20 Other States, Including All Nine In Which Sister State Supreme Courts Have Considered (And Rejected) A Reliance Requirement.

The highest courts of California,[13] Connecticut,[14] Massachusetts,[15] Nebraska,[16] New Jersey,[17] South Carolina,[18] Tennessee,[19] Utah,[20] and Wisconsin[21] all have rejected any requirement to prove reliance in actions under the counterpart statutes of the WSSA in their states. Intermediate state appellate courts and federal courts have decided the same under the laws of Arizona,[22] Colorado,[23] Indiana,[24] Kentucky,[25] Missouri,[26] Ohio,[27]

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[13] *Diamond Multimedia Sys., Inc. v. Superior Court,* 19 Cal. 4th 1036, 80 Cal. Rptr. 2d 828, 968 P.2d 539 (1999).

[14] *Conn. Nat'l Bank v. Giacomi*, 242 Conn. 17, 699 A.2d 101 (1997).

[15] *Marram v. Kobrick Offshore Fund, Ltd.*,442 Mass. 43, 809 N.E.2d 1017 (2004).

[16] *DMK Biodiesel, LLC v. McCoy*, 290 Neb. 286, 859 N.W.2d 867 (2015).

[17] *Kaufman v. I-Stat Corp.*, 165 N.J. 94, 754 A.2d 1188 (2000).

[18] *Bradley v. Hullander*, 272 S.C. 6, 249 S.E.2d 486 (1978).

[19] *Green v. Green*, 293 S.W.3d 493 (Tenn. 2009).

[20] *Gohler v. Wood*, 919 P.2d 561 (Utah 1996).

[21] *Esser Distrib. Co., v. Steidl*, 149 Wis. 2d 64, 437 N.W.2d 884 (1989).

[22] *Rose v. Dobras*, 128 Ariz. 209, 624 P.2d 887 (Ct. App. 1981); *Facciola v. Greenberg Traurig LLP*, 281 F.R.D. 363 (D. Ariz. 2012).

[23] *FDIC v. Countrywide Fin. Corp.*, Nos. 11–ML–02265–MRP (MANx), 11–CV–10400–MRP (MANx), 2013 U.S. Dist. LEXIS 1503 (C.D. Cal. Jan. 3, 2013).

[24] *Arnold v. Dirrim*, 398 N.E.2d 426 (Ind. Ct. App. 1979).

[25] *Carothers v. Rice*, 633 F.2d 7 (6th Cir. 1980).

[26] *Alton Box Bd. Co. v. Goldman, Sachs & Co.*, 560 F.2d 916 (8th Cir. 1977).

[27] *Murphy v. Stargate Def. Sys. Corp.*, 498 F.3d 386 (6th Cir. 2007).

Oklahoma,[28] Oregon,[29] Pennsylvania,[30] Texas,[31] and Virginia.[32] Other than Washington (as Division One views its law), only Georgia,[33] Illinois,[34] Kansas,[35] Minnesota,[36] and North Carolina[37] law require a plaintiff to prove reliance, and those interpretations were reached by intermediate appellate courts and federal district courts.

RCW 21.20.900 provides that "[t]his chapter [the WSSA] shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this chapter with the related federal regulation." This Court has done just that.[38] Division One has done just the opposite here.

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[28] *MidAmerica Fed. Sav. & Loan Asso. v. Shearson/American Express Inc.*, 886 F.2d 1249 (10th Cir. 1989).

[29] *Everts v. Holtmann*, 64 Or. App.145, 667 P.2d 1028 (1983).

[30] *Kronenberg v. Katz*, 872 A.2d 568 (Del. Ch. 2004).

[31] *Wood v. Combustion Eng'g, Inc.,* 643 F.2d 339 (5th Cir. 1981).

[32] *Dunn v. Borta*, 369 F.3d 421 (4th Cir. 2004).

[33] *Patel v. Patel*, 761 F. Supp. 2d 1375 (N.D. Ga. 2011).

[34] *JJR, LLC v. Turner*, 2016 IL App (1st) 143051, 405 Ill. Dec. 527, 58 N.E.3d 788, 802 (Ill. App. Ct. 2016).

[35] *Jayhawk Capital Mgmt., LLC v. LSB Indus.*, No 08-2561-EFM, 2012 U.S. Dist. LEXIS 133429, at *8 (D. Kan. Sept 19, 2012).

[36] *Merry v. Prestige Capital Mkts., Ltd.*, 944 F. Supp. 2d 702, 709 (D. Minn. 2013).

[37] *Jadoff v. Gleason*, 140 F.R.D. 330 (M.D.N.C. 1991).

[38] *E.g., Kinney v. Cook*, 159 Wn.2d 837, 843, 154 P.3d 206, 210 (2007); *Cellular Engineering*, 118 Wn.2d at 23–24, 820 P.2d at 945-46; *Kittilson*, 93 Wn.2d at 227, 608 P.2d at 265-66.

CONCLUSION

In the interest of clarifying Washington law for the lower courts, upholding the Legislature's intent to protect investors from fraudulent schemes, and harmonizing Washington law with that of 20 other states that have rejected a reliance requirement under counterpart statutes, the petition for review should be granted.

Dated: June 20, 2018.

Respectfully submitted,

YARMUTH WILSDON PLLC

By: *s/Matthew A. Carvalho*
Matthew A. Carvalho, WSBA #31201
Diana S. Breaux, WSBA #46112
1420 Fifth Avenue, Suite 1400
Seattle, WA 98101

GRAIS & ELLSWORTH LLP
David J. Grais (*pro hac vice* pending)
950 Third Avenue, 24th Floor
New York, NY 10022

Attorneys for Petitioner
Federal Home Loan Bank of Seattle

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

FEDERAL HOME LOAN BANK OF SEATTLE, a bank created by federal law, Appellant, v. RBS SECURITIES, INC., f/k/a GREENWICH CAPITAL MARKETS, INC., a Delaware corporation; GREENWICH CAPITAL ACCEPTANCE, INC., a Delaware corporation; and RBS HOLDINGS USA, INC., f/k/a GREENWICH CAPITAL HOLDINGS, INC., a Delaware corporation, Respondents.	No. 76326-1-I DIVISION ONE PUBLISHED FILED: May 21, 2018

Cox, J. — Under the Washington State Securities Act (WSSA), an investor who sues for violation of this act must prove reasonable reliance on statements or omissions by a defendant.[1] Here, Federal Home Loan Bank of

[1] Hine v. Data Line Sys., Inc., 114 Wn.2d 127, 134, 787 P.2d 8 (1990); Fed. Home Loan Bank of Seattle v. Barclays Capital, Inc., 1 Wn. App. 2d 551, 406 P.3d 686 (2017), review granted, No. 95436-4 (Wash. May 3, 2018) (consolidated with No. 75779-2-I); Fed. Home Loan Bank of Seattle v. Credit Suisse Securities (USA) LLC et al., No. 75779-2-I (Wash. Ct. App. Dec. 11, 2017) (unpublished), http://www.courts.wa.gov/opinions/pdf/757792.PDF, review granted, No. 95420-8 (Wash. May 3, 2018) (consolidated with No. 75913-2-I).

Seattle (FHLBS) sued, as an investor, defendants Royal Bank of Scotland Securities Inc., Greenwich Capital Markets, Inc., Greenwich Capital Acceptance, Inc., and RBS holdings USA, Inc., formerly known as Greenwich Capital Holdings, Inc. (collectively, RBS) for violating the WSSA. There is no genuine issue of material fact whether FHLBS relied on the prospectus supplement for the security that is the basis of its claim. It could not have relied on the prospectus supplement, which was issued after the purchase of the security. And FHLBS's new arguments, first raised in response to RBS's motion for reconsideration, were not properly before the trial court. The trial court did not abuse its discretion in granting reconsideration and dismissing this action. We affirm.

This is the third of a number of consolidated actions under the WSSA by FHLBS to reach this court. As in the two prior cases, this case arises out of FHLBS's purchase of a residential mortgage backed security (RMBS).[2] In our prior decisions, we explained the process of securitization and sale of the pool of residential loans that comprise these types of securities.[3] The same principles apply here. In essence, the stream of income generated by the individual loans in the pool funds the return on investment made by the purchaser of the security. Accordingly, much of the information about the characteristics of the loans in the pool may be material to an investor's decision whether to purchase the security.

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[2] Barclays Capital, Inc., 1 Wn. App. 2d at 554; Credit Suisse Securities (USA) LLC et al., No. 75779-2-I, slip op. at 2-3.

[3] Barclays Capital, Inc., 1 Wn. App. 2d at 554; Credit Suisse Securities (USA) LLC et al., No. 75779-2-I, slip op. at 2-3.

On June 29, 2006, FHLBS purchased the security at issue in this case for $200,000,000.[4] As it turns out, the prospectus supplement for this security was issued one day after this purchase.[5]

On December 23, 2009, FHLBS commenced this action based solely on the WSSA. In its amended complaint, it set forth the allegations supporting its claim for rescission and other relief. Essentially, FHLBS claimed that RBS had made "Untrue or Misleading Statements" about the characteristics of the loans in the security pool. Specifically, these statements concerned the loan to value (LTV) ratios of the loans, the originator's underwriting practices, and the appraisals of the properties securing the loans.

In August 2015, RBS moved for summary dismissal of this action. The trial court denied this motion on the basis that whether FHLBS received the HVMLT 2006-5 prospectus supplement for the security certificate before purchasing the certificate was a material issue of fact.

RBS then moved for reconsideration of the denial of summary judgment. It did so on the basis that the prospectus supplement was not issued until one day after the sale of the security.[6] The court granted this motion, dismissing this action.

This appeal followed.

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[4] Clerk's Papers at 7348.

[5] Id. at 7348, 7722, 7724.

[6] Id. at 7709, 7722, 7724.

REASONABLE RELIANCE IN MARKETING A SECURITY

FHLBS argues in its briefing on appeal that a plaintiff in an action under RCW 21.20.010(2) of the WSSA need not prove that it relied on an untrue or misleading statement of material fact that a defendant made in connection with the sale of a security. We hold that this argument is without merit.

This issue is controlled by two of our recent decisions: Federal Home Loan Bank of Seattle v. Barclays Capital, Inc.[7] and Federal Home Loan Bank of Seattle v. Credit Suisse Securities (USA) LLC.[8] In Barclays Capital, Inc., FHLBS made the same arguments that it makes here. We rejected all of them and do so again.

We held that the legislative intent of the WSSA is evident in the words of the statute, its substantial similarity to its federal counterpart, and an unbroken line of controlling cases holding that reliance is an essential element of this statute. Based on this analysis, we concluded in that case that there were no genuine issues of material fact whether FHLBS's reliance on the prospectus supplement in that case was reasonable. It was not reasonable, and summary dismissal of its claim was proper.

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[7] 1 Wn. App. 2d 551, 556, 406 P.3d 686 (2017), review granted, No. 95436-4 (Wash. May 3, 2018) (consolidated with No. 75779-2-I).

[8] No. 75779-2-I (Wash. Ct. App. Dec. 11, 2017) (unpublished), http://www.courts.wa.gov/opinions/pdf/757792.PDF, review granted, No. 95420-8 (Wash. May 3, 2018) (consolidated with No. 75913-2-I).

In Credit Suisse Securities (USA) LLC, we applied this legal principle of reasonable reliance to hold that FHLBS failed to show that necessary element of its claim. That was because it purchased the security in question before the issuance of the prospectus supplement on which it allegedly relied. Because it was impossible to rely on something that was not issued until after the purchase of the security, there was no genuine issue of material fact on reliance on the supplement. Summary dismissal of its claim was accordingly also proper.

Here, it is undisputed that FHLBS purchased the security at issue before the related prospectus supplement was issued. Specifically, FHLBS alleged in its amended complaint that it purchased the security on June 29, 2006. But this record shows that the prospectus supplement for that security was not issued until the day following the purchase. Thus, FHLBS could not have relied on that prospectus supplement to purchase the security in this action.

We adhere to the principles we articulated in those earlier cases. FHLBS fails to persuasively argue why we should reach any different conclusions here. Reasonable reliance is an essential element of this state securities act claim that FHLBS must prove.

RECONSIDERATION MOTION

While FHLBS argues that reliance is not an essential element of the state securities act claim, it now also argues that it relied on "offering documents" that it received "before settlement and before the final prospectus supplement was received." It further argues that "market practice and the course of dealing between the parties" about what was to be in the prospectus supplement

supports its position. We hold that FHLBS fails to establish that the trial court abused its discretion in rejecting these new arguments, granting reconsideration, and dismissing this action.

We will affirm a summary judgment order "where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. A 'material fact' is one on which the outcome of the litigation depends. We review de novo orders of summary judgment."[9]

But we review for abuse of discretion a trial court decision on a reconsideration motion.[10] The trial court's decision is manifestly unreasonable if it exceeds the range of acceptable choices, in light of the facts and applicable law.[11] "[I]t is based on untenable grounds if the factual findings are unsupported by the record."[12] And "it is based on untenable reasons if it is based on an incorrect standard or the facts do not meet the requirements of the correct standard."[13]

We begin our analysis of the trial court's decision on RBS's motion for reconsideration by examining that motion's context. At that time in the litigation of the consolidated cases, two defendants were similarly situated due to special circumstances: Credit Suisse Securities (USA) LLC and RBS. The special

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[9] Barclays Capital, Inc., 1 Wn. App. 2d at 556.

[10] In re Marriage of Littlefield, 133 Wn.2d 39, 46, 940 P.2d 1362 (1997).

[11] Id.

[12] Id. at 47.

[13] Id.

circumstances were that, in each case, the respective prospectus supplement was issued after consummation of FHLBS's purchase of the related security. These facts appear to have been unknown to the parties throughout the six years of litigating the case below and only discovered shortly before trial.

At the hearing on RBS's motion for reconsideration, counsel for FHLBS candidly explained these circumstances:

> Your Honor, I think it's worth pausing for a moment to understand why these issues have come out now, because Credit Suisse in particular suggests that the plaintiff has sloughed off the issue, that at the last minute it's helping itself to amend the complaint to include much broader evidence of usage and practice. But in fact, the reason why these arise now is a good deal more complicated than that.
>
> As your Honor is aware, all prospective supplements had a date. Throughout the course of this litigation, Seattle Bank and its counsel, certainly including myself, assumed that the defendants filed the prospective [sic] supplement with the SEC on the date when it was dated which proved to be correct in most cases. Credit Suisse must have made the assumption that it filed its prospective supplements with the SEC on the date it was dated, because it wasn't until its reply brief in support of its individual motion for summary judgment that Credit Suisse first thought to check the filing records of the SEC and discovered, apparently for the first time, that it actually did not file its prospective supplements for two of the offerings on time.
>
> Now, RBS came to that realization even more belatedly because they didn't check that out until they read the Court's ruling granting summary judgment to Credit Suisse on the grounds that their prospective supplements were filed after the defective dates.
>
> So it is true that this issue arises late in the case, but it arises late for one reason which applies to all three parties that are interested in it, which is that all counsel assumed that the defendants filed their prospective supplements on the date they were dated; and with respect to the vast majority of them, that turned out to be true.
>
> . . . .

> Your Honor, it's for the same reason that questions about usage of the trade and course of dealing between the parties are coming up now. That evidence is irrelevant when it's clear that a prospective supplement was filed because the prospectus was – filed on time because the prospective supplement is there, the Seattle Bank's practice was to check and confirm that the statements it relied on were reconfirmed in a prospective supplement.
>
> ***The need for evidence of course of dealing and usage of trade arises only from the fact that these two defendants were late in filing these three prospective supplements. So it becomes necessary not just to look at the prospective supplement that was filed on time, but to look at the context in which the prospective supplement was filed late*** to see what were the reasonable expectations of the parties about the contents of that prospective supplement.
>
> So that is again why this issue of reliance on course of dealing and usage of trade comes up only now, because it's only now that all three of us discovered that our assumption was incorrect, that the defendants had filed their prospective supplements on time.[14]

Following the prior denial of summary judgment to RBS, the parties first discovered that a basic premise under which all had operated for over six years was incorrect: that the prospectus supplement for the security was available on or before the June 29, 2006 date of purchase of the security. It is undisputed that the prospectus supplement only became available on June 30, the day after the purchase.

The question, thus, was what impact this newly discovered information had on the case.

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[14] Report of Proceedings Vol. V (Jul. 25, 2016) at 637-40 (emphasis added).

RBS moved for reconsideration, arguing that this newly discovered information showed that FHLBS could not have relied on the prospectus supplement to purchase the security. That was because it was issued after the purchase, not before, as all had assumed.

In response, FHLBS made several arguments. FHLBS responded that it had also relied on statements by RBS in what it calls preliminary "offering documents" in its briefing on appeal. It argued that it had also relied on statements it expected to see in the final prospectus supplement based on market practice and course of dealing between the parties.

The trial court first ruled that "there is no genuine issue of material fact and [FHLBS] will be unable to prove actual reliance on the statements in the prospectus supplement for [this security]."[15] In its briefing on appeal, FHLBS does not challenge this part of the decision that it cannot prove actual reliance on the prospectus supplement. This record plainly shows that the trial court correctly determined that FHLBS could not have relied on a document that was not issued until after it purchased the security. We hold that any argument to the contrary is wholly without merit.

The trial court further ruled that:

> FHLBS argues the issue of reliance also turns on the experience of its traders and certain preliminary materials provided to FHLBS by RBS. However, FHLBS's [amended] complaint identifies alleged misstatements only in the prospectus supplements. At every stage of this litigation, FHLBS has argued that it relied upon the prospectus supplements. . . . To allow FHLBS to pursue what is a new theory would be effectively allowing it to amend its complaint,

[15] Clerk's Papers at 8185.

> six years into the litigation and on the eve of trial. That clearly would prejudice RBS (and other defendants).[16]

The question is whether the trial court abused its discretion in this portion of its ruling. We conclude that it did not.

Opposing reconsideration "does not permit a plaintiff to propose new theories of the case that could have been raised before entry of an adverse decision."[17] "[A] complaint generally cannot be amended through arguments in a response brief to a motion for summary judgment" or asserted on reconsideration.[18] Accordingly, a party cannot raise new legal theories at that juncture without properly amending its complaint under CR 15(a).[19] Our review of the trial court's decision is for manifest abuse of discretion.[20]

Amended Complaint

The trial court read FHLBS's amended complaint to focus on the prospectus supplement for this security as the primary basis for its claim. So do we.

The amended complaint is some 120 pages long. But the material portions of that pleading specify that FHLBS's First Claim for Relief is based on

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[16] Id.

[17] Wilcox v. Lexington Eye Inst., 130 Wn. App. 234, 241, 122 P.3d 729 (2005).

[18] Camp Fin., LLC v. Brazington, 133 Wn. App. 156, 162, 135 P.3d 946 (2006).

[19] Id.

[20] Littlefield, 133 Wn.2d at 46-47.

"Untrue or Misleading Statements" regarding loan to value ratios and appraisals of the properties securing the loans in the security pool. Without exception, the pleadings identify various pages of the prospectus supplement as the sources of the statements. For example, with respect to loan to value ratios, FHLBS alleged:

> In the prospectus supplement and other documents they sent to Seattle Bank, Greenwich Capital Markets and Greenwich Capital Acceptance made the following statements about the LTVs of the mortgage loans in group 2.
>
> a. The original LTVs of the mortgage loans in group 2 ranged from 26.55% to 95%, with a weighted average of 74.96%. HVMLT 2006-5 ***Pros. Sup. S-6.***
>
> b. "Approximately . . . 7.06% of the . . . group 2 mortgage loans . . . are mortgage loans having original loan-to-value ratios greater than 60% . . . ." HVMLT 2006-5 ***Pros. Sup. S-18.***
>
> c. "As of the cut-off date, approximately 7.06% of the . . . group 2 mortgage loans . . . have original loan-to-value ratios in excess of 80% ("80+LTV loans"). HVMLT 2006-5 ***Pros. Sup. S-27.***
>
> d. In "The Mortgage Loan Groups" section, Greenwich Capital Markets and Greenwich Capital Acceptance presented tables of statistics about the mortgage loans in the collateral pool. HVMLT 2006-5 ***Pros. Sup. S-31 to S-61.***[21]

This pattern of specifying the prospectus supplement, without identifying any "other documents," as the source of its claim is repeated throughout the balance of the amended complaint. Notably, nothing in this amended complaint refers to any of the new theories first raised in FHLBS's response to RBS's motion for reconsideration. We conclude that the trial court fairly read the amended complaint as one based primarily on the prospectus supplement. To the extent FHLBS relied on "other documents" in its amended complaint, nothing

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[21] Clerk's Papers at 13 (emphasis added).

there shows how these documents relate to FHLBS's newly raised theories in response to RBS's motion for reconsideration.

FHLBS points to language in the amended complaint stating that it also relied on other unspecified documents that were available prior to its purchase of the security. But this reliance on the broad concept of notice pleading does nothing to fill the gap created by its failure to also allege that these documents related to the new theories raised shortly before trial.

We say this because when considered in contrast to the specification of pages in the prospectus supplement that support the WSSA claim, any reasonable reading of the amended complaint supports the conclusion that the primary focus of the claim was the prospectus supplement, not "other documents."

Arguments During the Litigation

Even if we were to accept the argument that notice pleading saves the day concerning the "other documents" on which FHLBS now relies, we remain unpersuaded that the trial court abused its discretion. That is because the trial court concluded that this new theory was inconsistent with the arguments FHLBS had made during the six-year pendency of this litigation.

For example, nowhere in FHLBS's response to RBS's motion for summary judgment do we find anything that suggests that it departed from its primary reliance on the prospectus supplement for its claims. That would have been the time to clarify that it was alleging reliance on "other documents" in order to ensure a trial. But FHLBS failed to do so.

Most importantly, the trial judge who sat on this case for six years was in the best position to assess what arguments the parties were making. And that judge determined that FHLBS primarily relied on the prospectus supplement for its claims, not "other documents." We will not invade the province of the trial judge in making this discretionary determination.

We further note that counsel for FHLBS candidly and correctly explained at oral argument on RBS's motion for reconsideration why the shift in focus to "other documents" and the new theories was required. That is because no one realized before that time that FHLBS had purchased the security before it saw the prospectus supplement.

We do not fault counsel or any party for the failure to discover this material evidence until shortly before trial. But the fact remains that the newly discovered evidence required the trial court to assess its effect on the disposition of this case. That assessment was based on review of the pleadings and consideration of the various arguments by the parties over the course of six years. We simply cannot conclude that the trial court abused its considerable discretion in making the assessment that it did.

New Theories and Prejudice

This brings us to the final basis of the trial court's decision. The court ruled that the new theories, first raised in the response to the motion for reconsideration, would be prejudicial to RBS. We agree.

In the proceedings below, FHLBS did not appear to contest the trial court's ruling that the theories raised in its response to the motion for reconsideration

were new. We read counsel's statement at the hearing on the motion to be a concession that they were new, explaining why he believed they were necessary to raise for the first time at that point in the litigation.

We turn then to the question of prejudice. Again, the trial court was in the best position to make this determination. The court correctly determined that these new theories, raised for the first time in the response to RBS's motion for reconsideration and without first amending the pleadings, would be prejudicial.

Remarkably, FHLBS argues that there would be no prejudice. But we cannot agree.

At the hearing on the motion for reconsideration, FHLBS explained that during discovery, it had provided RBS responses stating that it had relied on 340 "other documents" before it purchased the security. How FHLBS can now claim there would be no prejudice if the trial court had allowed it to advance its new theories, without reopening discovery and on the eve of trial, is simply beyond our understanding. The trial court properly exercised its discretion in concluding that it would be prejudicial to RBS to allow these new theories to proceed to trial.

We affirm the orders designated in the notice of appeal.

COX, J.

WE CONCUR:

CERTIFICATE OF SERVICE

I certify that on this date, I caused a copy of the foregoing ***Petition for Review*** to be served via U.S. Mail, postage prepaid, and by email to the following:

Ana-Maria Popp
CAIRNCROSS & HEMPELMANN, P.S.
524 Second Avenue, Suite 500
Seattle, WA 98104
Email: apopp@cairncross.com

Howard M. Goodfriend
Catherine W. Smith
SMITH GOODFRIEND, P.S.
1619 8th Avenue North
Seattle, WA 98109-3007
Email: howard@washingtonappeals.com
cate@washingtonappeals.com

Thomas C. Rice
Alan Turner
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York NY 10017
Email: trice@stblaw.com
aturner@stblaw.com

Attorneys for Respondents

I hereby certify, under penalty of perjury under the laws of the State of Washington, that the foregoing is true and correct.

Dated: June 20, 2018 at Seattle, Washington.

s/Sue Stephens
Sue Stephens, Legal Assistant

YARMUTH WILSDON PLLC

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