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No. 71767-7-I

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

LLOYD HARA

Appellant,
v.

KUNATH KARREN RINNE & ATKIN LLC,

Respondent.

BRIEF OF RESPONDENT

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~~COURT OF APPEALS
STATE OF WASHINGTON
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I. INTRODUCTION

This is an appeal from a bench trial decision. King County Superior Court Judge Helen Halpert heard the evidence, made Findings of Fact and Conclusions of Law, and entered judgment. This Court's "review is limited to determining whether substantial evidence supports the findings and, if so, whether the findings in turn support the trial court's conclusions of law and judgment." *Ridgeview Properties v. Starbuck*, 96 Wn.2d 716, 719, 638 P.2d 1231, 1233 (1982). Appellant Lloyd Hara, however, wants to retry his case before this Court and get a different result.

Hara ignores the trial court's findings of fact and instead cites his own trial testimony and summary judgment declarations as proof of his allegations. Hara says that he is appealing the trial court's order denying his motion for summary judgment, but that order is not even appealable. Hara's Assignments of Error identify no factual findings, and he fails to make a meaningful argument whether the findings are supported by substantial evidence.

Hara has failed to make a single serious argument, and his appeal borders on being frivolous. This Court should dispense with oral argument and summarily affirm the trial court's decision.

II. RESPONSE TO ASSIGNMENTS OF ERROR

1. The trial court's order denying summary judgment is not an appealable order because the trial court based that decision on the existence of genuine issues of material fact. CP 107-08. Such orders are not appealable. *Weiss v. Lonquist*, 173 Wn. App. 344, 354, 293 P.3d 1264, 1269 (2013).
2. The trial court correctly ruled that the Severance Agreement was illegal under Washington state law because it was not severable from the illegal employment agreement that preceded it. The trial court correctly ruled that Severance Agreement was illegal under federal law without regard to the prior agreement.
3. The trial court correctly found that the consideration for the Severance Agreement was linked to the Employment Agreement.
4. The trial court properly admitted context evidence to determine the meaning of the Agreement.

III. ISSUES PERTAINING TO ASSIGNMENT OF ERROR

Appellant has not identified any Issues Pertaining to the Assignments of Error. KKRA submits the following Issues pertaining to the Assignments of Error.

1. With regard to the order denying summary judgment, the Issue Pertaining to the Assignment of Error is whether the trial court

denied the motion because of material factual issues, which it did.

2. With regard to whether the Agreement was illegal, the Issues Pertaining to the Assignments of Error are the following:

a. Illegality Under Federal Law

- i. Whether Hara was a Solicitor as defined by the Investment Adviser Act of 1941;
- ii. Whether the payments to Hara under the Severance Agreement were “with respect to solicitation activities;” and
- iii. Whether Hara satisfied the requirements for payments to a solicitor.

b. Illegality under state law:

- i. Whether Hara acted as an Investment Adviser Representative (“IAR”) while employed by KKRA;
- ii. Whether Hara was licensed or registered as an IAR at any time;
- iii. Whether Hara was exempt from a licensing requirement as an IAR; and
- iv. Whether the Severance Agreement was related to the Employment Agreement or independent of it.

3. With regard to the illegality of the Severance Agreement, whether the Severance Agreement was solely supported by consideration independent of the Employment Agreement.

4. With regard to whether the Court improperly admitted parole evidence to interpret the Severance Agreement, whether the Severance Agreement identified independent consideration as the sole basis of the contract.

IV. STATEMENT OF THE CASE

KKRA is an Investment Adviser registered with the United States Securities and Exchange Commission (“SEC”). CP 311-12 (Finding 2). It is subject to regulation by the SEC and the Washington Department of Financial Institutions (“DFI”). CP 312 (Finding 3).

Hara was employed by KKRA in 1996 and 1997 under an oral employment agreement (“the Employment Agreement”) to perform both consulting and marketing work. CP 312 (Finding 5). During his employment, Hara was paid a salary for consulting and commissions for assisting with procuring clients for KKRA. CP 312 (Finding 6).

While at KKRA, Hara was instrumental in procuring the Northwest Arctic Borough and helpful in producing the Muckleshoot Indian Tribe as KKRA clients. CP 312 (Finding 7). KKRA paid Hara commissions in the form of a percentage of its fees from both of those clients. CP 312 (Finding 6); *see also* RP 2/12/2014 at 198.

At trial, Hara disputed that he solicited clients for KKRA or was paid commissions while employed by KKRA. He maintains that position

on appeal, claiming that while at KKRA he only performed consulting activities. Opening Brief of Appellant at 4. However, Hara does not assign error to the trial court's finding that he did solicit clients for KKRA, and the trial court's finding is amply supported by the testimony of KKRA member Ned Karren.

Q. Did you work with Mr. Hara while he was employed by KKRA? Did you actually work side by side with him on anything?

A. Yes.

Q. What did the two of you do together?

A. We solicited several prospective clients, especially in Alaska.

Q. Okay. How did you do that?

A. We went there together and went to a Native American conference in Anchorage, and we visited with several native tribes there and other corporations, and then we went on to Barrow and we solicited the North Slope Artic Borough for investment management.

RP 02-11-14 - Vol. I, (Pages 111:21 to 112:7).

Hara likewise disputed his receipt of commissions for solicitations while employed by KKRA. In his brief, Hara asserts that he only "received a base salary with an opportunity for a bonus" and that he "did not recall entering into an agreement to receive commission payments." Opening Brief at 4. However, Ned Karren of KKRA testified at trial that commissions were in fact paid.

Q. And did you have an agreement with Mr. Hara while he was employed that he would receive commissions of any kind?

A. Yes.

Q. And what was that agreement?

A. That he would receive 3 percent the first year for any new client he brought in, 2 percent the next year, and 1 percent for the third year.

Q. Okay. Did Mr. Hara -- was Mr. Hara paid commissions while he was employed by KKRA?

A. Yes.

RP 02-11-14 - Vol. I, (Pages 112:18 to 113:2). The trial court believed Karren and found that Hara was paid commissions for his solicitation efforts while he was employed by KKRA. CP 312 (Finding 6).

There is no bona fide dispute that Hara solicited clients for KKRA and was compensated with commissions for doing so. The trial court's findings in this regard are supported by overwhelming evidence.

Hara's solicitation activities for KKRA made him an Investment Adviser Representative ("IAR") as that term is defined in RCW 21.20.005(9). CP 313 (Conclusion 3). An IAR must be registered with the Washington Department of Financial Institutions. CP 313-14 (Conclusion 4). It is unlawful for a person to act as an IAR without being registered. RCW 21.20.040(3). It likewise is unlawful for an Investment Adviser such as KKRA to employ an IAR who is not registered. RCW 21.20.040(5)(b).

It is undisputed that Hara has never been registered with the SEC or DFI. CP 312 (Finding 4). The registration requirement has a number of exceptions, but Hara has never argued that any of them apply, and the

trial court correctly found that Hara did not meet any exemption requirements. CP 313 (Conclusion 5).

As a matter of background and context, it therefore is an established fact that Hara's employment with KKRA was unlawful to the extent that he performed or was compensated for solicitation activities. CP 314 (Conclusion 6). It is true that neither Hara nor KKRA realized at the time that the Employment Agreement was illegal, and neither acted in bad faith in connection with the employment (CP 312 (Finding 8)), but as a matter of application of law to fact, the Employment Agreement was plainly illegal.

This case, however, does not concern the legality of the Employment Agreement. Hara's employment with KKRA ended with his resignation on September 17, 1997. CP 312 (Finding 9). On January 15, 1998, Hara and KKRA executed a Severance & Confidentiality Agreement ("the Severance Agreement"). CP 312 (Finding 10). The Severance Agreement is the subject of this case.

Hara claims that the Severance Agreement was separate from and independent of the Employment Agreement. According to Hara, the Severance Agreement was a simple "exchange of payments by KKRA for Mr. Hara's waiver of certain legal and economic rights." Opening Brief of Appellant at 14. Hara further claims that the Severance Agreement is only

“incidentally or indirectly connected with” the Employment Agreement.

Opening Brief of Appellant at 16.

In addition to the absurdity of the notion that a severance agreement can be separate and independent of the prior agreement that it severs, Hara’s position cannot be reconciled with the plain language of the Severance Agreement:

Hara has resigned as a full time employee of KKRA. The purpose of this Agreement is to set forth clearly the terms and conditions of Hara’s departure from employment with KKRA.

* * * *

1. Hara resigned as a full-time employee on September 5, 1997.

* * * *

2. KKRA has paid two weeks salary, less all lawful and required deductions.

* * * *

4. KKRA and Hara further agree that KKRA will provide Hara with additional benefits

A. Two weeks of vacation days . . .

B. Three weeks of additional salary . . .

F. Bill the Muckleshoots on Hara’s behalf for any consulting services provided by Hara but not billed . . .

G. Pay Hara a percentage commission of new investment business at the rate he has been paid in past periods for the quarter ending September 30, 1997.

* * * *

5. . . . KKRA pay Hara, upon execution of this agreement, Hara's share of any collected management fees on those accounts listed in "Exhibit B" at percentages originally established . . .

* * * *

7. Hara unconditionally releases KKRA . . . from any and all claims . . . arising from Hara's employment with KKRA.

Trial Exhibit 1 (Appendix A to Opening Brief of Appellant). Nothing in the Severance Agreement would make any sense without reference to the Employment Agreement, from the amount of the salary and vacation pay to Hara's "share" of collected management fees. Hara simply pretends as if these references to the Employment Agreement did not exist.

It is true that the Severance Agreement also contained a number of other provisions, including confidentiality and noncompete clauses. CP 312-13 (Finding 10). Even there, however, the scope and meaning of the Severance Agreement could only be determined by reference to the Employment Agreement. Whether Hara competed with KKRA could only be determined by reference to his actions while employed.

For these reasons, the trial court correctly found that the consideration for Hara's Severance Agreement "was all tied to his solicitation activities with KKRA." CP 314 (Conclusion 7). As a practical

matter, the same could be said of any severance agreement, but the trial court's finding was supported by specific evidence presented at trial.

For almost twelve years, KKRA paid Hara the amounts owing under the Severance Agreement. During the decade of payments, neither party ever questioned that the payments were commissions. The checks from KKRA contained a notation that they were for "commissions." RP 02-11-14 - Vol. I, (Page 73:14 to 73:23). Likewise, Hara admitted that the IRS Form 1099 that he received annually from KKRA described the payments as "commissions." RP 02-11-14 - Vol. I, (Page 74:9 to 74:20).

Most notably, Hara himself called the payments "commissions" in a sworn public document. After leaving KKRA, Hara was elected to the Port of Seattle and was required to file Form F1 Financial Affairs Statements with the Public Disclosure Commission under RCW 42.17A.700. He admitted at trial that he designed the KKRA payments as "commissions" on his Public Disclosure Commission reports. RP 02-11-14 - Vol. I, (Page 74:3 to 74:8).

Despite this long history, Hara's position at trial was that he never considered the payments to be commissions at all. He said that he never objected to the "commissions" notation on his checks and 1099s because he never really paid attention to what the checks said beyond their amount. RP 02-11-14 - Vol. I, (Page 73:24 to 73:24). But then he testified that he

called the payments “commissions” in his Public Disclosure Commission reports “because that's what [KKRA] called them.” RP 02-11-14 - Vol. I, (Page 59:14 to 59:14). The trial court was well within its rights when it found that the payments were in fact commissions as both parties recognized over the years. CP 314 (Conclusion 7).

At the end of 2009, KKRA ceased making the payments, and in 2012, Hara commenced this action for breach of the Severance Agreement. KKRA asserted illegality as its sole defense. After a bench trial, the trial court found that the Severance Agreement was illegal and unenforceable under state and federal law. CP 315 (Conclusion 13). The trial court further found that both Hara and KKRA had violated applicable laws, and that the Severance Agreement was unenforceable under the *in pari delicto* rule. CP 315 (Conclusion 13).

V. LEGAL ANALYSIS

A. Standard of Review.

The standard of review is important in this case. In this appeal from a bench trial, the Court’s “review is limited to determining whether substantial evidence supports the findings and, if so, whether the findings in turn support the trial court's conclusions of law and judgment.” *Ridgeview Properties v. Starbuck*, 96 Wn.2d 716, 719, 638 P.2d 1231,

1233 (1982). Hara completely ignores that standard and instead asks this Court to substitute its judgment for that of the trial court.

Pursuant to RAP 10.3(g), an appellant's Opening Brief must contain "A separate assignment of error for each finding of fact a party contends was improperly made must be included with reference to the finding by number. The appellate court will only review a claimed error which is included in an assignment of error or clearly disclosed in the associated issue pertaining thereto." Hara's Opening Brief contains no such assignments of error. Pursuant to RAP 10.3(a)(4), a brief also must identify the issues pertaining to the Assignments of Error. No such issues are identified in Hara's brief. The Court should not waste its time with issues that were not properly raised. *BC Tire Corp. v. GTE Directories Corp.*, 46 Wn. App. 351, 355, 730 P.2d 726, 729 (1986) ("This court will not review a claimed error unless it is (1) included in an assignment of error or clearly disclosed in the associated issue pertaining thereto, and (2) supported by argument and citation to legal authority."); *Vern Sims Ford, Inc. v. Hagel*, 42 Wn. App. 675, 683, 713 P.2d 736, 741 (1986) ("Appellate courts will only review a claimed error that is included in an assignment of error or clearly disclosed in the associated issue pertaining thereto and is supported by argument and citations to legal authority.").

The second part of the Court's inquiry is whether the Findings of Fact support the Conclusions of Law. Because Hara never even discusses the findings, he necessarily never engages in this process. Instead, he makes a number of arguments predicated on Hara's own trial testimony and view of the facts. This Court should adhere to the established standard for review of a bench trial and should soundly reject Hara's attempt to retry his case on the merits here.

B. The Trial Court's Findings Are Supported By Substantial Evidence.

The evidence supporting the factual findings that Hara appears to contest is set forth in the factual section above. A party challenging the trial court's factual findings cannot just identify contrary evidence in the record and ask that it be believed, but that is exactly what Hara does.

Reynolds recognizes that, as an appellate court, we cannot retry factual issues. *Evans v. Columbia Int'l Corp.*, 3 Wash.App. 955, 478 P.2d 785 (1970). Reynolds points out, however, that our review of the evidence must persuade us that the findings are supported by Substantial evidence. A major portion of Reynolds' brief is devoted to an analysis of testimony and evidence which, in Reynolds' view, would compel a finding contrary to that of the trial judge. We agree that the proper focus of our review of the evidence is to ascertain if substantial evidence supports the trial judge's finding. We likewise agree with Reynolds that '(b)y 'substantial evidence' is meant that character of evidence which would convince an unprejudiced, thinking mind of the truth of the fact to which the evidence is directed.' *Omeitt v. Department of Labor & Indus.*, 21 Wash.2d 684, 686, 152 P.2d 973, 974 (1944). However, our examination

of the record goes no further than to determine whether there is substantial evidence to sustain the trial court's findings. *Stutz v. Moody*, 3 Wash.App. 457, 476 P.2d 548 (1970). As an appellate court, we cannot weigh conflicting evidence. *McGarvey v. Seattle*, 62 Wash.2d 524, 384 P.2d 127 (1963).

Reynolds Metals Co. v. Elec. Smith Const. & Equip. Co., 4 Wn. App. 695, 698-99, 483 P.2d 880, 882 (1971); see also *Friends of Columbia Gorge, Inc. v. Columbia River Gorge Comm'n*, 126 Wn. App. 363, 374-75, 108 P.3d 134, 139 (2005).

C. The Severance Agreement Was Unlawful.

The second part of the Court's inquiry requires consideration of the legal consequences of the trial court's factual determinations, which in turn requires a discussion of the law governing investment advisers. Hara objects to the trial court's conclusions, but he never even discusses the legal basis for them.

Investment advisers and people who solicit clients for them are subject to overlapping state and federal regulations under a scheme created by the Investment Advisers Act of 1940. Depending on the circumstances, either the United States Securities and Exchange Commission (SEC) or the Washington Department of Financial Institutions (DFI) will have primary regulatory authority.

Investment Advisers with more than \$25 million in assets under management must register with the Securities and Exchange Commission (SEC) and are regulated almost exclusively by the SEC. 15 USC §§ 80b-3(a), 80b-3a(a)(1). The Investment Adviser Act preempts most state regulation of qualified investment advisers. 15 USC §§ 80b-3a(b)(1). Investment advisers registered with the SEC are not required to register with the Washington Department of Financial Institutions (DFI), but are required to submit documentation of their existence. RCW 21.20.040(3)(d); RCW 21.20.050(2). KKRA is regulated by the SEC under federal law. CP 311-12 (Finding 2).

While federal law regulates investment advisers, it generally does not regulate persons who solicit clients for them (called an Investment Adviser Representative or “IAR”). The Securities Act of Washington defines “Investment Adviser Representative to include any person who “Solicits, offers, or negotiates for the sale of or sells investment advisory services” (RCW 21.20.005(9)) and requires all such persons to register with DFI (RCW 21.20.040(3)).

Under this regulatory scheme, KKRA is primarily subject to federal laws and regulations, while Hara was primarily subject to state laws and regulation. The illegality analysis is quite different for KKRA and Hara, but produces the same result under both state and federal law.

1. The Severance Agreement Violated Federal Law.

Although federal law does not regulate the activities of IARs, it does regulate referral fees and fee sharing by investment advisers. As is the case with most regulated professions, the sharing of earned fees by investment advisers is strictly limited. SEC Rule 206(4)-3 (17 CFR 275.206(4)-3) provides that: “It shall be unlawful for any investment adviser required to be registered pursuant to section 203 of the Act to pay a cash fee, directly or indirectly, to a solicitor with respect to solicitation activities” unless an exemption applies. The rule defines a solicitor as “any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser.” 17 CFR 275.206(4)-3(d)(1).

Hara makes two arguments regarding Rule 206(4)-3. First, he argues that the rule does not apply because the Severance Agreement did not require him to engage in further solicitation activities. Second, he says that even if the rule does apply, he qualifies for the employee exception. Neither argument has merit.

Rule 206(4)-3 is not limited to payments in exchange for promises of future solicitation activities or even payments for solicitation activities in general. Rather, it casts a much broader net, barring all payments “**with respect to solicitation activities.**” 17 CFR 275.206(4)-3(d)(1). “‘With respect to’ means with reference to, or relating to, according to Funk &

Wagnalls standard English dictionary.” *In re Weyerhaeuser Timber Co.*, 53 Wn.2d 235, 238, 332 P.2d 947, 949 (1958). Judge Halpert correctly determined that “payment under the Agreement were with respect to solicitation activities.” CP 315 (Conclusion 12).

Hara next seeks refuge in the exception for employees. Rule 206(4)-3 permits payments to a solicitor who “is” an employee of the investment adviser. 17 CFR 275.206(4)-3(a)(2)(ii). However, as Hara is at pains to point out, the Severance Agreement was not even signed until after Hara’s employment with KKRA ended, and he was not employed during the decade when the payments were made. Hara asserts, without any authority whatsoever, “The parole evidence put forth by KKRA at trial indicated that Mr. Hara was an employee of KKRA, meaning that the rule barring payments did not apply to Mr. Hara either during or after his employment.” The rule plainly authorizes some payment to current employees, but Hara’s contention that it authorizes a post-employment severance agreement to pay ongoing commissions is contrary to the plain language of the rule.

Moreover, Hara ignores the requirements to come within the employee exception in the first place. Rule 206(4)-3 goes on to say that payments to employees are permissible “*Provided*, That the status of such solicitor as a partner, officer, director or employee of such investment

adviser or other person, and any affiliation between the investment adviser and such other person, is disclosed to the client at the time of the solicitation or referral.” 17 CFR 275.206(4)-3(a)(2)(ii). No evidence was presented at trial of such disclosures, and Hara does not even argue that they were given. He has failed to prove the exception, and Judge Halpert correctly ruled that “No evidence was introduced at trial that the Agreement was exempt from the general rule.”

KKRA unwittingly violated Rule 206(4)-3 for a dozen years by making unlawful payments to Hara with respect to his solicitation activities. It properly ceased those payments upon its discovery of the violation. The relief sought by Hara in this action would compel KKRA to resume its violation of the rule. Judge Halpert correctly ruled that the Severance Agreement was illegal and unenforceable to the extent that it required KKRA to make those payments.

2. The Severance Agreement Violated State Law.

The violation of state law is slightly more complicated but in the end as clear and certain as the violation of federal law. Because of his solicitation activities, Hara was an Investment Adviser Representative (IAR) while employed by KKRA. RCW 21.20.005(9). It was unlawful for him to act as an IAR unless registered as such with DFI. RCW 21.20.040(3). Hara was not registered. CP 312 (Finding 4). The

Severance Agreement was made in consideration of Hara's unlawful solicitation activities and simply continued his commission payments for his unlawful employment. CP 314 (Conclusion 7); Trial Exhibit 1 at ¶¶ 4(G), 5. Because the Severance Agreement is not severable from the illegal Employment Agreement, it is unenforceable. *Sherwood & Roberts-Yakima, Inc. v. Cohan*, 2 Wn. App. 703, 469 P.2d 574 (1970).

The Securities Act of Washington does not contain a prohibition against sharing of fees by investment advisers because it does not regulate them. The Securities Act instead provides that it is unlawful for individuals to solicit clients for investment advisers unless registered with DFI as an Investment Adviser Representative. RCW 21.20.040(3). Of like effect, RCW 21.20.040(5)(b) makes it unlawful for an investment adviser to employ an unregistered IAR.

Substantial evidence supports the trial court's finding that Hara was an IAR while employed by KKRA, and it is undisputed that Hara has never been registered in any capacity with DFI. Hara never seriously disputes that his employment with KKRA was unlawful to the extent of his solicitation activities.

Hara instead contends that the illegality of the Employment Agreement does not affect the Severance Agreement. He argues that the

two agreements are completely separate from and independent of each other. That argument is utter nonsense.

As a preliminary matter, Hara's receipt of commissions under the Severance Agreement required registration as an IAR. Under its authority conferred by RCW 21.20.450(3)(g) and 21.20.530, DFI issued Interpretive Statement 22 on April 1, 2002. That Interpretive Statement concluded that: "Persons and entities receiving any portion of an advisory fee are "engaged in the business of advising others" and, therefore must be appropriately licensed as investment advisers or investment adviser representatives unless they are exempted from such registration or excluded from the statutory definition." Document available at <http://www.dfi.wa.gov/sd/securitiesinterpretive.htm#is-22>. Receipt of commissions on investment adviser fees is part of the business of an IAR even if the commissions are received after the solicitation.

In any event, a new contract to sever a prior illegal contract by continuing the illegal payments that were made under it is itself illegal. It is not unusual for parties to an illegal relationship to have more than one contract between them, and Washington law provides clear guidance with respect to when agreements ancillary to an illegal contract will be enforced.

Analysis of the question starts with the fundamental proposition that “If a contract is illegal, our courts will leave the parties to that contract where it finds them.” *Golberg v. Sanglier*, 96 Wn.2d 874, 879, 639 P.2d 1347, 1351 (1982). As a matter of common sense and logic, “The same rule applies if the contract grows immediately out of and is connected with an illegal act.” *Id.* At the same time, courts do enforce ancillary agreements that are “only remotely or collaterally related to the illegal transaction.” *Williams v. Burrus*, 20 Wn. App. 494, 497, 581 P.2d 164, 166 (1978); *Chevalier v. Woempner*, 172 Wn. App. 467, 485, 290 P.3d 1031, 1039 (2012) (“Recovery should not be denied if the promise sued upon is only remotely or collaterally related to the illegal transaction and not illegal in and of itself.”).

Hara contends that the Severance Agreement is only “incidentally or indirectly connected” to the Employment Agreement if it is connected at all. Opening Brief of Appellant at 16. He bases this argument on his claim that the Severance Agreement is supported by independent consideration in the form of his agreement not to work for a competing company. *Id.* at 18. Hara bases his argument on an erroneous interpretation of *Sherwood & Roberts-Yakima, Inc. v. Cohan*, 2 Wn. App. 703, 469 P.2d 574 (1970).

In *Sherwood*, Lifetone Electronics marketed fire alarms and intercom systems under a scheme whereby the purchasers signed an installment contract to purchase the items for an inflated price but were promised to recoup at least their investment from commissions on referrals to their friends. Lifetone assigned the sales contracts to Sherwood & Roberts for cash and failed to pay the promised commissions. This left the purchasers owing the inflated purchase price to Sherwood & Roberts.

In *Sherwood & Roberts-Yakima, Inc. v. Leach*, 67 Wn.2d 630, 409 P.2d 160 (1965), the Washington Supreme Court held that the referral agreements were an illegal lottery and that the purchasers' promise to pay the installment contracts was unenforceable for lack of consideration. That left Sherwood & Roberts with worthless installment notes. It then sued Cohan who had guaranteed on behalf of Lifetone that the contracts were valid and enforceable. Lifetone defended the case on the grounds that its guarantee was illegal because it was part and parcel of the illegal referral agreements.

The trial court agreed with Lifetone and dismissed the claims on the warranties. Sherwood & Roberts appealed to this Court. In a thoughtful and detailed opinion, this Court reversed. Hara points to the result in *Cohan* as authority for his position, but it is the Court's analysis that matters.

That analysis commenced with a statement of the general rule that applies in these situations.

Though variously stated, the authorities are in general agreement that if the promise sued upon is related to an illegal transaction, but is not illegal in and of itself, recovery should not be denied, notwithstanding the related illegal transaction, if the aid of the illegal transaction is not relied upon or required, or if the promise sued upon is remote from or collateral to the illegal transaction, or is supported by independent consideration. Considered together, these various tests form what may be termed the 'doctrine of severability.'

Sherwood & Roberts-Yakima, Inc. v. Cohan, 2 Wn. App. 703, 710, 469 P.2d 574, 578-79 (1970). Hara interprets this provision as establishing three separate and unrelated grounds to enforce a collateral agreement, but the *Cohan* court established a more holistic approach.

After discussing the various Washington cases on point, the *Cohan* court established a three-part test to determine whether a collateral agreement was severable from a related illegal contract.

First, whether or not the contracts of assignment and warranty were separate and distinct from the antecedent illegal transactions between Lifetone and its customers. It is important to note that the only illegal transactions were transactions between Lifetone and its individual customers, and those transactions were illegal because the referral commission agreements were made at the same time. It is thus apparent that neither the assignments containing the warranties of enforceability nor the guarantee agreements sued upon are substantially identical with the illegal transactions even though they are causally related. The

warranties and guarantee agreements are therefore only collateral to the conditional sale contracts.

Secondly, an otherwise valid promise, though causally related, is sufficiently remote from the illegal transaction if it is supported by independent consideration. *Sherwood & Roberts-Yakima, Inc. v. Leach, Supra*, may be cited as authority for this proposition. The court, in *Leach*, recognized the doctrine that an agreement will be enforced when collaterally related to an illegal transaction, so long as there is an independent consideration or if the plaintiff does not require the aid of the illegal transaction to make out his case. In *Leach*, the oral promise of the contract-purchaser Leach to pay, regardless of the promises contained in the commission agreement, stood alone and without consideration, and so could not be enforced. In the instant case, the consideration for the assignment and the warranties received by Sherwood & Roberts consisted solely of the cash received and was independent from and not related to the illegal promises made by Lifetone to its customers, and such illegal promises constituted no part of the consideration for the warranties. The consideration for the August 23, 1963, individual guarantee agreement was the promise to purchase Lifetone's contracts.

The third test requiring analysis is whether the warranty agreements sued upon are sufficiently remote, or collateral, or severable from the antecedent illegal transactions so that the enforcement of the agreements sued upon (the warranties) does not result in sanction of the original illegal contract, or conflict with the policy against enforcing illegal contracts. Appellant concedes, and properly so, that one may not enter into a venture involving conduct which one knows, or suspects, to be illegal and attempt to shield himself from the consequences of the wrongful conduct by obtaining from another an agreement by which he will indemnify the other against the monetary consequences of the contemplated wrongdoing. To enforce such an agreement would be to sanction and promote the deliberate violation of the public policies included in the law. *Kansas City Operating Corp. v. Durwood*, 8 Cir., 278 F.2d 354

(1960). Here, it is conceded that both parties acted in good faith and without knowledge that Lifetone's contemplated referral selling program involved a violation of the law.

Id. at 713-15. The Court should apply the test it set forth in *Cohan* to decide this appeal.

First, the two agreements are not “separate and distinct” in the way that the contracts in *Cohan* were. The *Cohan* court found it significant that the illegal contracts were between Lifetone and its customers, while the guarantees were solely between Lifetone and Sherwood & Roberts. *Id.* at 713-14. Here, both agreements were between exactly the same parties. The *Cohan* court also found it significant that the agreements in that case were not “substantially identical,” but instead concerned totally different subjects. Here, the Severance Agreement provided that Hara would continue to receive exactly the same commissions that he did while he was employed.

The second part of the test is whether the collateral agreement is supported by new and independent consideration. Hara would have the Court interpret that to mean that any new or additional consideration rendered the collateral agreement enforceable, but that is not what *Cohan* says. *Cohan* found that the guarantees were supported by new consideration because “the consideration for the assignment and the warranties received by Sherwood & Roberts consisted solely of the cash

received and was independent from and not related to the illegal promises made by Lifetone to its customers, and such illegal promises constituted **no part of the consideration** for the warranties.” *Id.* at 714 (emphasis added). The trial court properly found that Hara’s employment supplied some of the consideration, and the Severance Agreement fails this part of the test as well.

The third and final part of the test is whether the collateral agreement is “sufficiently remote, or collateral, or severable from the antecedent illegal transactions so that the enforcement of the agreements sued upon (the warranties) does not result in sanction of the original illegal contract, or conflict with the policy against enforcing illegal contracts.” *Id.* Here, the Severance Agreement maintains the exact same commission structure that existed during Hara’s employment. It not only sanctions, but also continues the related illegal agreement.

Application of the *Cohan* test leads inexorably to the conclusion that the Severance Agreement is illegal. As a matter of logic and common sense, a severance agreement cannot be remote from or unrelated to the agreement that it severs. The purpose of the Severance Agreement was to set forth the terms of the termination of the Employment Agreement. Under the Agreement, Hara was paid salary and benefits calculated under the Employment Agreement. KKRA agreed to bill the Muckleshoots for

Hara's consulting work under the Employment Agreement. KKRA further agreed to pay Hara his "share" of management fees earned under the Employment Agreement. Hara released his claims relating to the Employment Agreement. The Employment Agreement could not have been more central to or intertwined with the Severance Agreement.

When faced with a similar appeal from a similar set of circumstances in *Williams v. Burrus*, 20 Wn. App. 494, 581 P.2d 164 (1978), this Court spent a scant two pages summarily affirming the trial court. The relevant parts of its decision are concise enough to state here in full:

CONCLUSION. Courts will not assist in the dissolution of an illegal partnership or entertain an action for an accounting or distribution of its assets. The trial court's decision was not erroneous.

Where, as here, no error is assigned to the findings of fact, our review is limited to determining whether the challenged conclusions of law are supported by the findings. *Jordin v. Vauthiers*, 89 Wash.2d 725, 728, 575 P.2d 709 (1978).

No state retail liquor license of any kind can be issued to a partnership unless all of the members thereof are qualified to obtain a license, and no licenseholder can allow any other person to use such a license. RCW 66.24.010(1), RCW 66.24.010(2)(d). See WAC 314-12-010; WAC 314-12-090.

Furthermore, a partnership is dissolved by any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership. RCW 25.04.310(3).

The issue of illegality may be raised at any time. *Waring v. Lobdell*, 63 Wash.2d 532, 533-34, 387 P.2d 979 (1964).

Under the general rule that the courts will not aid either party to an illegal agreement where a partnership is formed to carry out an illegal business or to conduct a lawful business in an illegal manner, the courts will refuse to aid any of the parties thereto in an action against the other. *Brower v. Johnson*, 56 Wash.2d 321, 324-25, 352 P.2d 814 (1960); 59 Am.Jur. 2d *Partnership* § 24 (1971); 68 C.J.S. *Partnership* § 7 (1950). The present case is not one wherein the promise sued upon is only remotely or collaterally related to the illegal transaction and not illegal in and of itself. See *Sherwood & Roberts-Yakima, Inc. v. Cohan*, 2 Wash.App. 703, 710-17, 469 P.2d 574 (1970) and cases therein discussed. The trial court did not err in deciding as it did.

Williams v. Burrus, 20 Wn.App. 494, 496-97, 581 P.2d 164, 166 (1978).

This Court should do the same.

D. The Trial Court Properly Considered Extrinsic Evidence Regarding Consideration.

Hara spends much of his brief complaining that the Court considered evidence other than the wording of the Severance Agreement to determine whether it was supported by independent consideration. Although absent from Hara's brief, Washington law sets forth clear rules for the admissibility of extrinsic evidence of consideration. Under these cases, the trial court's use of extrinsic evidence was entirely proper.

In 1953, the Supreme Court flatly stated that "we have consistently held that parol evidence is admissible to show the true consideration of a

written agreement.” *Dunseath v. Hallauer*, 41 Wn.2d 895, 906, 253 P.2d 408, 414-15 (1953). In 1964, the Supreme Court further explained that the question depended in the first instance on whether the contract specifically identified the consideration as a material term of the contract itself. *Seattle-First Nat. Bank v. Pearson*, 63 Wn.2d 890, 894, 389 P.2d 665, 668-69 (1964).

When a contract specifically identifies the consideration given, extrinsic evidence of other or additional consideration would alter the terms of the agreement and therefore is inadmissible.

Where the consideration consists of a specific and direct promise by one of the parties to do certain things, this part of the contract can no more be changed or modified by parol evidence than any other part. A party has the right to make the consideration of his agreement the essence of the contract. When this is done, the provision, as to consideration, stands on the same plane as other provisions of the contract. They are conclusive and immune from attack by parol or extrinsic evidence.

Ryan v. Ryan, 48 Wn.2d 593, 595, 295 P.2d 1111, 1112 (1956). However, where a contract merely recites the receipt of consideration or is silent, then extrinsic evidence is admissible to identify the actual consideration for the agreement. *Kinne v. Lampson*, 58 Wn.2d 563, 567, 364 P.2d 510, 513 (1961) (“Parol evidence has been held to be admissible to show what the true consideration is where the contract contains a mere recital of consideration (e.g., ‘one dollar and other valuable consideration’) as

contrasted to contracts in which the stated consideration is a ‘contractual element’ of the contract.”).

With this standard in mind, the dispositive question is what the Severance Agreement says about its consideration. The answer to that question is absolutely nothing. The word “consideration” does not appear in the document. Trial Exhibit 1.

Moreover, the terms of the Severance Agreement contain more than an exchange of a covenant not to compete for a stream of payments. KKRA also promised to continue to pay Hara his “share” of commissions earned while employed; it promised to pay Hara both salary and benefits in accordance with the Employment Agreement; and both parties waived any claims relating to the Employment Agreement. Trial Exhibit 1. On the face of the document, the consideration for the Severance Agreement was tied to the Employment Agreement.

VI. CONCLUSION

The decision of the trial court can be affirmed for many reasons, but illegality under federal law is the clearest and simplest path. KKRA and Hara entered into the Severance Agreement with the stated purpose of “set[ting] forth clearly the terms and conditions of Hara’s departure from employment with KKRA.” While at KKRA, Hara solicited clients for KKRA and was paid commissions. The Severance Agreement continued

those payments after Hara's employment. SEC Rule 206(4)-3 prohibits payments to Hara "with respect to solicitation activities." The continued commission payments were with respect to Hara's solicitation activities while employed by KKRA. The promise to pay the commissions therefore was illegal under Rule 206(4)-3 and is unenforceable. None of this is subject to dispute, and this Court should summarily affirm.

DATED this 23rd day of October, 2014.

DAVIS LEARY LLC



A handwritten signature in black ink, appearing to read 'M. F. Davis', is written over a horizontal line. To the left of the line, there is a short, dashed horizontal line.

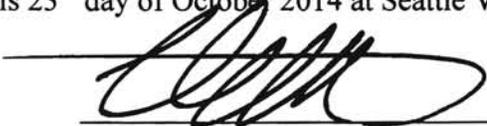
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DECLARATION OF SERVICE

I, Matthew Davis, hereby certify that on November 23, 2014 I filed the foregoing Brief of Respondent with Division One of the Court of Appeals and served the same on Dan Fiorito, 844 NW 48th St., Seattle, WA 98107 by email per agreement of counsel.

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

Dated this 23rd day of October 2014 at Seattle Washington.



Matthew Davis