

No. 75779-2-1

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

FEDERAL HOME LOAN BANK OF SEATTLE,

Appellant,

v.

CREDIT SUISSE SECURITIES (USA) LLC, f/k/a CREDIT SUISSE
FIRST BOSTON LLC, CREDIT SUISSE FIRST BOSTON MORTGAGE
SECURITIES CORP., and CREDIT SUISSE MANAGEMENT LLC,
f/k/a CREDIT SUISSE FIRST BOSTON MANAGEMENT LLC,

Respondents.

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APPELLANT'S REPLY BRIEF

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Credit Suisse's arguments are unpersuasive for four main reasons.

I. WHETHER A PLAINTIFF MUST PROVE RELIANCE WAS NOT BEFORE THE WASHINGTON SUPREME COURT IN *HINES V. DATA LINE SYSTEMS, INC.*,¹ SO THE SENTENCE IN ITS DECISION ABOUT RELIANCE WAS DICTUM.

In *Hines*, the investor plaintiffs conceded that they had to prove that they actually relied on the allegedly untrue or misleading statements in deciding to buy shares in Data Line. On appeal, the parties disagreed about whether the investors also had to prove loss causation, that is, that those allegedly untrue or misleading statements caused their shares to become worthless. But the question of reliance was never before either this Court or the Washington Supreme Court.

In the assignments of error in their opening brief to this Court, the investors in *Hines* referred only to loss causation, not to reliance.² In their 10th assignment of error, they wrote: "Causation ... Must an injured investor prove that the specific fact or facts omitted from the offering materials directly caused the security to become worthless?"³ Later in their

¹ 114 Wn.2d 127 (1990).

² See Brief of Appellants in *Hines* at 2–4, attached as Appendix II to Credit Suisse's brief.

³ *Id.* at 4.

brief, the investors conceded that they would have to prove that they actually relied on the untrue or misleading statements:

Thus, at the very most, Investors here will have to demonstrate at trial a causal nexus not between Peterson's aneurysms [which were not disclosed in the offering documents] and Data Line's demise, but between Respondent's failure to disclose material facts and Investors' decision to purchase the stock.⁴

In the conclusion of their brief, the investors asked this Court to rule that:

"Injured investors need not prove 'loss causation,' i.e., that the omitted fact(s) directly caused the security to become worthless."⁵ They requested no ruling on reliance. Finally, in their reply brief, the investors acknowledged even more clearly that they were required to prove actual reliance. "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."⁶ Indeed, Credit Suisse itself acknowledges that "[t]he investors argued that the WSSA required only a showing of 'transaction causation', i.e., reliance."⁷

⁴ *Id.* at 62 (emphasis in original).

⁵ *Id.* at 66.

⁶ Reply Brief of Appellants in *Hines* at 18, attached as Appendix I to Credit Suisse's brief.

⁷ Credit Suisse Brief at 7.

Under R.A.P. 12.1(a) (“the appellate court will decide a case only on the basis of issues set forth by the parties in their briefs”) and 13.7(b) (“the Supreme Court will review only the questions raised in . . . the petition for review and the answer”), the question whether a plaintiff in an action under the WSSA must prove reliance was not before either this Court or the Supreme Court.⁸ Whatever a court may say about a question that is not before it is dictum. “Statements in a case that do not relate to an issue before the court and are unnecessary to decide the case constitute obiter dictum, and need not be followed.”⁹ Thus, because the question whether an investor must prove reliance was not before the Washington Supreme Court in *Hines*, its single sentence on that subject was dictum.¹⁰

⁸ See *Richmond v. Thompson*, 130 Wn.2d 368, 389 (1996); *Courtright Cattle Co. v. Dolsen Co.*, 94 Wn.2d 645, 658 (1980). See generally *Clark Cnty. v. W. Wash. Growth Mgmt. Hearings Rev. Bd.*, 177 Wn.2d 136, 144–48 (2013).

⁹ *In re Domingo*, 155 Wn.2d 356, 366 (2005) (quoting *Malted Mousse, Inc. v. Steinmetz*, 150 Wn.2d 518, 531 (2003)).

¹⁰ Nor was a requirement to prove reliance before the Washington Supreme Court in *Go2Net, Inc. v. Freeyellow.com, Inc.*, 158 Wn.2d 247 (2006), which Credit Suisse also cites. Credit Suisse Brief at 8–9. The Supreme Court mentioned reliance in its summary of the findings of the jury. But the issue in the case was whether equitable defenses like waiver and estoppel are available to defendants in actions under the WSSA. That has nothing to do with reliance.

II. THE LEGISLATURE HAS NOT ACQUIESCED IN THE DICTUM IN *SHERMER V. BAKER*.

Credit Suisse argues that the Legislature has not amended the WSSA to exclude a reliance requirement in the “nearly 50 years”¹¹ since Division 2 mentioned reliance in *Shermer v. Baker*.¹² That argument is incorrect for at least two reasons.

First, the question of reliance was not before Division 2 in *Shermer*. That court was asked to consider three questions about the WSSA, none of which had anything to do with a requirement to prove reliance:

1. Does the Securities Act of Washington (R.C.W. 21.20) create an implied civil cause of action available to a seller of stock certificates against the purchaser thereof? [The court answered this question in the affirmative.]
...
3. Did defendant fail to disclose to plaintiff a ‘material fact’? Was the jury properly instructed as what a material fact is? [The court answered these questions in the affirmative.]
4. Is ‘scienter’ one of the necessary elements to plaintiff’s cause of action?¹³

¹¹ Credit Suisse Brief at 18.

¹² 2 Wn. App. 845, 847, 858 (1970).

¹³ *Id.* at 847. The other two questions were: “2. Did a fiduciary relationship exist between [defendant] and [plaintiff]? ... 5. Did the trial court improperly admit exhibit 19, an anonymous letter to the editor of the Kitsap County Herald, for consideration by the jury?” *Id.*

The court answered this last question about proof of scienter in the negative. It stated that in “an action brought under RCW 21.20.010, a plaintiff need neither plead nor prove that defendant intended to deceive him by the misrepresentation or omission.”¹⁴ (As will be discussed below, the court in *Shermer* was the first to decide that proof of scienter is not required. Its decision was endorsed by the Washington Supreme Court 10 years later.)

But having answered the question about scienter that was actually before it, Division 2 then went on to state that “[i]t is sufficient that the plaintiff relied on the misrepresentation or omission of a material fact.”¹⁵ Like the statement in *Hines*, this observation was dictum because no issue of reliance was before Division 2. In the ensuing 47 years, *Shermer* has been cited just once in a published opinion for a requirement to prove reliance, in a decision of Division 2 that the Supreme Court overruled.¹⁶

Second, the cases that Credit Suisse cites to show that inaction by the Legislature signals its acquiescence in a court decision both concerned inaction in response to square holdings by the Washington Supreme

¹⁴ *Id.* at 857–58.

¹⁵ *Id.* at 858.

¹⁶ *Ludwig v. Mutual Real Estate Invs.*, 18 Wn. App. 33, 40 (1977), overruled by *Kittilson v. Ford*, 93 Wn.2d 223 (1980).

Court.¹⁷ Even if the Legislature can be assumed to keep abreast of actual holdings of the Washington Supreme Court and to acquiesce in them by inaction, the same cannot be assumed of dicta instead of holdings, nor of decisions by the Courts of Appeals. Certainly it cannot be assumed that the Legislature is aware of, much less acquiesced in, dictum from a Court of Appeals that has been cited in just one published opinion in 47 years. This is exactly why “[e]vidence of legislative acquiescence is not conclusive, but is merely one factor to consider.”¹⁸

III. THE LEGISLATURE INTENDED THE WSSA TO BE BROADER THAN SEC RULE 10B-5.

Credit Suisse’s argument that the Legislature designed the WSSA to be a clone of SEC Rule 10b-5, and thus to require proof of reliance, just wishes away the contrary decisions of the Washington Supreme Court. Credit Suisse does not dispute that the Supreme Court has held repeatedly that the WSSA was modeled on Section 12(a)(2) of the 1933 Act and the Uniform Securities Act, neither of which requires proof of reliance,¹⁹ as

¹⁷ See *Cty. of Fed. Way v. Koenig*, 167 Wn.2d 341, 345, 348 (2009); *1000 Friends of Wash. v. McFarland*, 159 Wn.2d 165, 175–176, 181–182 (2007).

¹⁸ *Fast v. Kennewick Pub. Hosp. Dist.*, 187 Wn.2d 27, 39 (2016) (internal citation omitted).

¹⁹ Credit Suisse writes that “some courts hold” that liability under Section 12(a)(2) requires no proof of reliance. Credit Suisse Brief at 14. Actually, *all* courts hold that no proof of reliance is required. Seattle Bank cited the decisions of the United States Supreme Court and nine decisions by federal Circuit Courts

well as on Rule 10b-5.²⁰ Never has the Washington Supreme Court held that the WSSA was modeled *only* on Rule 10b-5.

The Washington Supreme Court rejected the “clone of Rule 10b-5” argument in one of its earliest decisions under the WSSA, *Kittilson v. Ford*.²¹ The Court noted that Rule 10b-5 was authorized by, and thus could not be broader than, section 10(b) of the Securities Exchange Act of 1934, which prohibits “manipulative and deceptive” conduct in connection with the purchase or sale of a security. The United States Supreme Court had held that the phrase “manipulative and deceptive” “clearly connotes intentional misconduct,” so proof of scienter was required in an action under section 10(b) and thus under Rule 10b-5.²² The Washington Supreme Court drew two critical distinctions between section 10(b) and Rule 10b-5, on the one hand, and the WSSA on the other. “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

of Appeals to that effect. Seattle Bank Brief at 15. Credit Suisse cites not a single decision to the contrary.

²⁰ See *Go2Net*, 158 Wn.2d at 257 (Uniform Securities Act); *Cellular Eng’g, Ltd. v. O’Neill*, 118 Wn.2d 16, 23–24 (1991) (same); *Hoffer v. State*, 113 Wn.2d 148, 151–52 (1989) (section 12(a)(2) of the 1933 Act); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 125 (1987) (section 12(a)(2) of the 1933 Act and section 410 of the Uniform Securities Act).

²¹ 93 Wn.2d 223 (1980).

²² *Id.* at 225–26 (internal quotation marks omitted).

scheme, the language of Rule 10b-5 is not derivative but is the statute in Washington.”²³ For that reason, the Court concluded, the WSSA, unlike Rule 10b-5, does not require proof of scienter.

Credit Suisse’s discussion of *Kittilson* is quite misleading. Credit Suisse writes:

Kittilson reaffirmed the elements of liability as set forth in the Court of Appeals’ *Shermer* decision, which held that proof of reliance is required, *Kittilson*, 93 Wn.2d at 227 (“[t]he interpretation of RCW 21.20.010 first announced in *Shermer* is the better rule”); *Shermer*, 2 Wn. App. at 858 (“It is sufficient that the plaintiff relied upon the misrepresentation or omission of a material fact” (emphasis added)).²⁴

But in the phrase “the interpretation of RCW 21.20.010 first announced in *Shermer*,” the Washington Supreme Court was referring only to *Shermer*’s holding that proof of scienter is not required in an action under the WSSA, not to its dictum about reliance. Here is the Supreme Court’s discussion of *Shermer*:

RCW 21.20.900 contains the further requirement that the act should be construed so as to make state laws uniform. The only other case discussing an unlawful transaction provision is *Treider v. Doherty & Co.*, 86 N.M. 735, 527 P.2d 498 (1974). The New Mexico provision is in all pertinent particulars identical to RCW 21.20.010. In *Treider*, the New Mexico Court of Appeals construed the statute and said:

²³ *Id.* at 226.

²⁴ Credit Suisse Brief at 15.

The intent with which the defendant makes the statement is irrelevant under the terms of the statute. The statute requires only that the statement made be false and material, or that the omission be of a material fact necessary to make true the statement made.

Treider at 737, 527 P.2d at 500. The interpretation of RCW 21.20.010 first announced in *Shermer* is the better rule.²⁵

The New Mexico decision said nothing about reliance. Nor did the Washington Supreme Court in *Kittilson*. Indeed, the words “rely” and “reliance” do not even appear in *Kittilson*. The reference in *Kittilson* to “[t]he interpretation of RCW 21.20.010 first announced in *Shermer*” does not show that proof of reliance is required; it shows that proof of scienter is not.

Kittilson raises a further question, which Seattle Bank discussed at length in its opening brief and which Credit Suisse ignores. When the Legislature enacted the WSSA in 1959, there were (and still are) two separate and distinct remedies for making an untrue or misleading statement in connection with the sale of a security: the strict-liability remedy first created by section 12(a)(2) of the Securities Act of 1933 and the fraud-based remedy first created by section 10(b) of the Securities Exchange Act of 1934. The latter requires plaintiffs to prove elements of

²⁵ *Kittilson*, 93 Wn.2d at 227.

common-law fraud (including scienter, reliance, loss, and causation) that the former does not. In *Kittilson*, the Washington Supreme Court considered and rejected the argument that a plaintiff in an action under the WSSA must prove scienter. In *Hines*, that Court reached the same conclusion about loss and causation.²⁶ In its opening brief, Seattle Bank asked why the Washington Supreme Court would single out reliance as the sole common-law requirement to graft on to the otherwise strict-liability remedy in the WSSA. Credit Suisse gives no answer.

IV. MOST OTHER STATES REJECT A RELIANCE REQUIREMENT.

Credit Suisse is right that Illinois, Kansas, and Minnesota require proof of reliance in actions under their counterparts of the WSSA (as do Georgia and North Carolina, which Seattle Bank mentioned in its opening brief).²⁷ But the fact remains that 20 states reject a reliance requirement,

²⁶ 114 Wn.2d at 134–35.

²⁷ Seattle Bank does not agree that Maryland and Mississippi also require proof of reliance, as Credit Suisse argues in footnote 9 of its brief. In 2005, the Maryland Court of Appeals noted that the question of a reliance requirement was undecided in Maryland law. *See Lubin v. Agora, Inc.*, 389 Md.1, 26 n.13 (2005) (“Resolving this issue would require us to consider an underlying question of Maryland securities law: whether investor reliance must be proven in order to establish securities fraud under [the Maryland Securities Act]”). The single-sentence, passing observation of a federal district court the next year certainly did not decide that open question of Maryland law. *See Sherwood Brands, Inc. v. Levie*, No Civ. RDB 03-1544, 2006 WL 827371, at *20 (D. Md. Mar. 24, 2006) (“It is nonsensical that [plaintiff] did not know of the alleged falsity of these statements and there is no basis for her to have reasonably relied on [them].”). In 1998, the Supreme Court of Mississippi decided that that state’s counterpart to

including nine in which that decision was reached by the state supreme court.²⁸ Leaving aside the question how to interpret *Hines*, no state

R.C.W. 21.20.010 created no private right of action. See *Allyn v. Wortman*, 725 So.2d 94, 102 (Miss. 1998). Thus, the observation of a federal court seven years earlier that there was “an implicit requirement of reasonable reliance” in actions under that statute, *Geisenberger v. John Hancock Distribs., Inc.*, 774 F. Supp. 1045, 1051 (S.D. Miss. 1991), became moot.

²⁸ Credit Suisse is mistaken that Arizona, Colorado, Indiana, Ohio, and Oregon actually require proof of reliance. Credit Suisse Brief at 21 & n.10.

Arizona: In 1981, the Court of Appeals of Arizona decided squarely that “reliance upon a misrepresentation is not an element of this antifraud provision of our securities laws.” *Rose v. Dobras*, 128 Ariz. 209, 214 (1981). Credit Suisse relies on a 1994 decision of a federal court in Florida that declined to follow *Rose*. See *Jankovich v. Bowen*, 844 F. Supp. 743, 749 (S.D. Fla. 1994). But Credit Suisse does not mention that, since *Jankovich*, both state and federal courts in Arizona have reaffirmed that proof of reliance is not required under Arizona law. See *Aaron v. Fromkin*, 196 Ariz. 224, 227 (2000); *Facciola v. Greenberg Traurig LLP*, 281 F.R.D. 363, 371 (D. Ariz. 2012).

Colorado: Credit Suisse relies on *Hosier v. Citigroup Global Mkts., Inc.*, 835 F. Supp. 2d 1098, 1107–08 (D. Colo. 2011). *Hosier* was a petition to confirm an arbitral award, not a securities action. In passing, the court referred to the decision in *Huffman v. Westmoreland Coal. Co.*, 205 P.3d 501 (Colo. App. 2009), which in turn relied on *Rosenthal v. Dean Witter Reynolds, Inc.*, 908 P.2d 1095 (Colo. 1995). In its opening brief, Seattle Bank noted that *Rosenthal* is inapplicable for the reasons given in *Fed. Deposit Ins. Corp. as Receiver for United Western Bank, F.S.B. v. Countrywide Fin. Corp.*, Nos. 11–ML–02265–MRP (MANx), 11–CV–10400–MRP (MANx), 2013 WL 49727 (C.D. Cal. Jan. 3, 2013). Credit Suisse just ignores that decision.

Indiana: Credit Suisse cites *Perry v. Eastman Kodak Co.*, No. IP 87–1023–C, 1991 WL 629728, at *7 (S.D. Ind. Apr. 22, 1991), in which the court wrote in a single sentence with no citation to authority whatsoever that proof of reliance is required. In decisions that Seattle Bank cited in its opening brief but that Credit Suisse ignores, Indiana courts before and since have held that proof of reliance is not required. *Supernova Sys., Inc. v. Great Am. Broadband, Inc.*, Cause No. 1:10–CV–319, 2012 WL 860408, at *5 (N.D. Ind. Mar. 12, 2012) (“[p]roof of reliance is not an element of a fraud claim under the IUSA”); *Landeen v. PhoneBILLit, Inc.*, 519 F. Supp. 2d 844, 864 (S.D. Ind. 2007) (“proof of reliance is not required”); *Wisconics Eng’g, Inc. v. Fisher*, 466 N.E.2d 745, 759 n.8 (Ind. Ct. App. 1984); *Arnold v. Dirrim*, 398 N.E.2d 426, 435 (Ind. Ct. App. 1979).

supreme court has ever imposed a reliance requirement.²⁹ As required by R.C.W. 21.20.900, the Washington Supreme Court interprets the WSSA to

Ohio: The decision that Credit Suisse relies on construes a provision in the Ohio Revised Code that expressly requires proof of reliance. *See* Ohio Rev. Code § 1707.41(A) (providing remedy “to any person that purchased the security *relying on* the [untrue or misleading] circular”) (emphasis added). *See also In re Nat’l Century Fin. Enters., Inc., Inv. Litig.*, 905 F. Supp. 2d 814, 827–30 (S.D. Ohio 2012). But other provisions of the Ohio Revised Code that deal with the sale of securities require no proof of reliance. *See* Ohio Rev. Code § 1707.44(B)(4) (“No person shall knowingly make or cause to be made any false representation concerning a material and relevant fact, in any oral statement or in any prospectus, circular, description, application, or written statement, for any of the following purposes: . . . Selling any securities in this state.”); Ohio Rev. Code § 1707.44(G) (“No person in purchasing or selling securities shall knowingly engage in any act or practice that is, in this chapter, declared illegal, defined as fraudulent, or prohibited.”); *Stuckey v. Online Res. Corp.*, 909 F. Supp. 2d 912, 938 (S.D. Ohio 2012); *Murphy v. Stargate Defense Sys. Corp.*, 498 F.3d 386, 392 (6th Cir. 2007).

Oregon: *See* fn. 29 below.

²⁹ Like the WSSA in R.C.W. 21.20.010, Oregon law makes it unlawful to make any untrue or misleading statement of a material fact in connection with the purchase or sale of a security. O.R.S. § 59.135. Also like the WSSA in R.C.W. 21.20.430, Oregon law makes a person who sells a security by means of an untrue or misleading statement liable to the person who purchased it. O.R.S. § 59.115. The plaintiff in an action under O.R.S. § 59.115 need not prove that it relied on the untrue or misleading statement in deciding to purchase the security. *Everts v. Holtmann*, 64 Or. App. 145, 152 (1983) (“ORS 59.115(1)(b) imposes liability without regard to whether the buyer relies on the omission or misrepresentation.”).

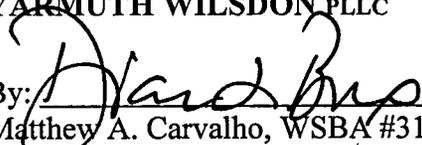
In 2003, the Oregon Legislative Assembly added a second remedy for making an untrue or misleading statement, which has no counterpart in Washington law. Under O.R.S. § 59.137, a purchaser of a security may sue anyone who makes an untrue or misleading statement about that security, *even if that person did not sell the security to the plaintiff*. In *State v. Marsh & McLennan Cos., Inc.*, 353 Or. 1 (2012), for example, a company whose stock was publicly traded allegedly made untrue or misleading statements about its business. When the truth was revealed, the price of the stock dropped by 37%. The plaintiff, which owned shares of the stock, sued the company, even though it had purchased its shares not from the company but on the open market.

make it uniform with the law of other states that have adopted similar statutes. And that Court always interprets the WSSA to protect investors. Nothing in its many decisions under the WSSA suggests that the Washington Supreme Court would ally Washington with the anti-investor decisions of a small minority of other states.

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O.R.S. § 59.137 limits a plaintiff's recovery to "the actual damages caused by the violation." In *Marsh*, the Oregon Supreme Court held that a plaintiff in an action under O.R.S. § 59.137 must prove that it relied on the allegedly untrue or misleading statement in purchasing the security. 353 Or. at 10–11. But the court left undisturbed the decision in *Everts* that a plaintiff in an action under O.R.S. § 59.115 (Oregon's counterpart to R.C.W. 21.20.430) is not required to prove reliance. *Id.*

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this date, I caused a copy of the foregoing *Appellant's Reply Brief* to be served *via email* upon the attorneys of record listed below:

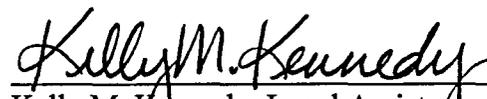
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I hereby certify, under penalty of perjury under the laws of the State of Washington, that the foregoing is true and correct.

DATED: April 3, 2017 at Seattle, Washington.


Kelly M. Kennedy, Legal Assistant