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No. 75913-2-I

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

FEDERAL HOME LOAN BANK OF SEATTLE,

Appellant,

v.

BARCLAYS CAPITAL INC.; BCAP LLC;
and BARCLAYS BANK PLC,

Respondents.

RESPONDENTS' BRIEF

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Respondents Barclays Capital Inc., BCAP LLC, and Barclays Bank PLC (collectively, "Barclays") respectfully submit this brief in opposition to the Opening Brief ("Br."), submitted by appellant Federal Home Loan Bank of Seattle ("FHLBS"), in support of its appeal of dismissal of its Washington State Securities Act ("WSSA") claims.

INTRODUCTION

Almost six years ago, in this action brought in connection with FHLBS's purchase of residential mortgage-backed securities ("RMBS") certificates, the trial court reiterated the well-established principle that reasonable reliance is an element of FHLBS's single cause of action under the WSSA (CP 352)—*i.e.*, that, as this Court recently put it, "[t]o establish a claim under the WSSA, an investor must prove that . . . the investor relied on misrepresentations or omissions" by the defendant in making the investment and that such reliance was "reasonable under the surrounding circumstances." *FutureSelect Portfolio Mgmt., Inc. v. Tremont Group Holdings, Inc.*, 175 Wn. App. 840, 868, 309 P.3d 555 (2013), *aff'd in part, rev'd in part and remanded*, 180 Wn.2d 954, 331 P.3d 29 (2013). On that basis, the trial court dismissed certain of FHLBS's claims against Barclays, and against other defendants that FHLBS sued in coordinated actions, on the pleadings, but ruled that, as to FHLBS's remaining claims, discovery should proceed. (CP 355.) After

over five years of fact and expert discovery in the coordinated cases, during which the parties produced millions of pages of documents, deposed and defended over 100 fact witnesses, and collectively submitted over 90 expert reports, Barclays and other defendants moved for summary judgment. The trial court granted Barclays' motion for summary judgment for the two at-issue certificates backed by IndyMac loans and purchased by FHLBS in 2008—two of the last private-label[1] RMBS purchased by FHLBS—on the basis that there was no genuine issue of material fact as to FHLBS's alleged reasonable reliance. The court denied Barclays' motion for summary judgment as to two other certificates that were backed by Countrywide loans and purchased by FHLBS in 2007.

The trial court dismissed FHLBS's WSSA claims as to the BCAP 2008-IND1 ("IND1") and BCAP 2008-IND2 ("IND2") certificates because discovery revealed uncontroverted and very particular facts about those purchases—such that FHLBS cannot establish that it reasonably relied on alleged misstatements in the prospectus supplements for the securities about the underlying mortgage loans. FHLBS itself developed these securities through direct interactions with IndyMac, after which

[1] RMBS are issued either by a government agency or government sponsored entity (referred to as "Agency RMBS") or by a private entity (referred to as "private-label" RMBS). The latter are viewed as riskier than Agency RMBS, including because they lack U.S. Government backing and, during the time period relevant to this action, primarily contained mortgages that did not meet agency standards, including subprime and "Alt-A" mortgages.

Barclays was brought in to help execute the agreed-upon transactions. The record also confirmed that FHLBS—a Federal Home Loan Bank at the epicenter of the burgeoning mortgage crisis, with virtually unparalleled insight into the causes of that crisis—was well aware of information that put it on notice of the very issues about which FHLBS now claims to have been deceived, regarding allegedly inflated appraisals (and resulting understated loan-to-value ratios) and departures from underwriting guidelines.

It is undisputed that FHLBS's senior portfolio manager and principal RMBS investor, Joel Adamo, and Reed Newkirk of IndyMac communicated directly and extensively to put together IND1 and IND2 because FHLBS wanted to buy more RMBS, even though the rest of the market had ground to a halt by 2008. At the time, FHLBS had already determined that IndyMac—which was perceived to have weaknesses in its loan origination practices—was not an approved issuer/seller of RMBS. Therefore, FHLBS and IndyMac considered several candidates to issue the certificates that FHLBS wanted to purchase, and eventually chose Barclays.

FHLBS understood that appraised values could vary from what FHLBS refers to as the "true value" of a property by as much as 10%, and that there were reports of widespread appraisal inflation in the

housing market. FHLBS was also aware that IndyMac's underwriting guidelines had been relaxed, and that loan originators routinely made loans as "exceptions" to their self-imposed underwriting guidelines. What is more, FHLBS also knew that its sister Federal Home Loan Banks had already stopped investing in RMBS by the time FHLBS purchased IND1. FHLBS itself became so concerned about the risks associated with RMBS backed by non-prime "Alt-A" mortgages (the same type of mortgages underlying the at-issue certificates) that, by spring 2008, it had changed its own investment policy to bar further RMBS investments. FHLBS nevertheless created an exception for the IND2 purchase at Adamo's request.

Faced with the trial court's correct ruling based on this clear record, FHLBS resorts to desperate measures in an attempt to save its claims. FHLBS's arguments are entirely unavailing.

First, FHLBS's argument that reasonable reliance is not an element of the WSSA flies in the face of almost fifty years of Washington law. The Washington Supreme Court, this Court, and other Washington courts have repeatedly and consistently held that reasonable reliance is an element of a WSSA claim. These holdings comport with the Washington Legislature's choice to draft the WSSA to follow almost verbatim federal Rule 10b-5—for which reasonable reliance is an element. The

Washington Legislature has never demonstrated any intent to carve out reasonable reliance as an element. After decades of judicial rulings confirming that reasonable reliance is an element of a WSSA claim, the Legislature has never amended the statute to exclude reliance, despite amending various other provisions of the WSSA over the years. With no Washington authority to support its argument, FHLBS instead relies on decisions from courts in other states interpreting other states' laws, which are irrelevant.

Second, FHLBS raises a number of red herrings, none of which render the trial court's decision erroneous. For example, FHLBS argues that because the alleged misstatements were contained in prospectus supplements filed with the U.S. Securities & Exchange Commission, any reliance by FHLBS on such statements was reasonable as a matter of law. But, here again, FHLBS misstates Washington law, which does not provide the exception for SEC filings that FHLBS now urges this Court to create. FHLBS also lists purported "questions" on appeal concerning additional specifics as to FHLBS's role in the transactions, such as why FHLBS did not provide indemnification to Barclays. None of these so-called "questions" create a genuine issue of material fact as to whether it was reasonable for FHLBS to rely on the alleged misstatements. It is undisputed that FHLBS developed the

securities (and was in repeated contact) with IndyMac—collaborating about, among other things: interest rates; which bank's shelf would be "rented" to issue the certificates; payment structure; and which ratings agencies would be used to provide credit ratings for the certificates. It is likewise undisputed that FHLBS intimately understood the mortgage industry, understood that appraisals could vary by as much as 10% from the "true value" of a home, and knew that lenders generally—and IndyMac in particular—had loosened underwriting standards. Furthermore, despite having direct access to IndyMac, FHLBS chose not to ask for additional information regarding the loans that backed IND1 and IND2, as well as the underwriting standards used to originate those loans, which it now claims it needed in order to further evaluate the certificates.

FHLBS pursued an aggressive investment strategy in seeking out RMBS certificates—particularly the ones it put together with IndyMac when the rest of its sister banks, and much of the market, had stopped purchasing such RMBS entirely. As FHLBS personnel noted during a subsequent assessment of FHLBS's purchases of RMBS: "It is not a failure of risk management when: Bank knows risks, Decides to take them, Outcomes are not favorable." (SCP ___.) Furthermore, FHLBS received every penny it was entitled to under its IND1 and IND2 investments. Yet, a year after such purchases, FHLBS turned around and

sued Barclays—which was brought in as a third party to help execute the bespoke transactions that FHLBS had worked directly with IndyMac to create.

The trial court correctly ruled that FHLBS must, and cannot, prove that it reasonably relied on any alleged misrepresentation made by Barclays when deciding to purchase these certificates. This Court should affirm the trial court's grant of summary judgment to Barclays.

STATEMENT OF THE CASE

FHLBS was one of twelve Federal Home Loan Banks established by the federal government to facilitate mortgage lending through its member banks.[2] *See* 12 C.F.R. § 1265.2. As a Federal Home Loan Bank, FHLBS's reason for being was to provide funding to its more than 300 members by extending advances to the member banks against collateral offered by its members—primarily mortgage loans and RMBS—and purchasing mortgage loans directly from its members. (SCP __; CP 159.) FHLBS was also a sophisticated and voracious RMBS investor in the run-up to the financial crisis, eventually amassing an $8 billion portfolio of RMBS. (CP 1618.)

[2] The Federal Home Loan Banks of Seattle and Des Moines merged in 2015.

After the crash, FHLBS filed eleven different lawsuits against the underwriters of its investments, alleging virtually identical claims: that the securities underwriters "materially understated the risk" of the RMBS that FHLBS purchased.[3] Two of the RMBS were backed by loans originated by IndyMac and are at issue here: (1) IND1, in which FHLBS invested $189,416,000 on February 13, 2008 (CP 38-39 (¶¶ 97-98)); and (2) IND2, in which FHLBS invested $232,438,000 on April 15, 2008 (CP 8 (¶¶ 26-27)).[4] The vast majority of the loans backing IND1 were originated between 2005 to 2007, and from 2003 to 2007 for IND2,[5] and were largely issued through stated income/stated asset, no income/no asset verification, and other loan origination programs that did not require full documentation from borrowers.[6]

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[3] The other ten actions were: *Federal Home Loan Bank of Seattle v. Bear, Stearns & Co., Inc. et al.*, No. 09-2-46298-4 SEA; *Federal Home Loan Bank of Seattle v. Banc of America Securities LLC et al.*, No. 09-2-46319-1-SEA; *Federal Home Loan Bank of Seattle v. Countrywide Securities Corporation et al.*, No. 09-2-46321-2 SEA; *Federal Home Loan Bank of Seattle v. RBS Securities, Inc. et al.*, No. 09-2-46347-6 SEA; *Federal Home Loan Bank of Seattle v. Morgan Stanley & Co., Inc. et al.*, No. 09-2-46348-4 SEA; *Federal Home Loan Bank of Seattle v. Goldman, Sachs & Co. et al.*, No. 09-2-46349-2 SEA; *Federal Home Loan Bank of Seattle v. UBS Securities, LLC et al.*, No. 09-2-46350-6 SEA; *Federal Home Loan Bank of Seattle v. Deutsche Bank Securities Inc. et al.*, No. 09-2-46351-4 SEA; *Federal Home Loan Bank of Seattle v. Merrill Lynch, Pierce, Fenner & Smith, Inc. et al.*, No. 09-2-46352-2 SEA; and *Federal Home Loan Bank of Seattle v. Credit Suisse Securities (USA) LLC et al.*, No. 09-2-46353-1 SEA.

[4] FHLBS also purchased two RMBS certificates from Barclays in 2007 (CP 58-59 (¶¶ 154-55); CP 80-81 (¶¶ 216-17)), which are not at issue in this appeal.

[5] *See* CP 1558; CP 1569.

[6] *See* CP 1557 (only 15.07% of the IND1 pool consists of mortgages originated under full documentation programs); CP 1568 (only 43.75% of the IND2 pool consists of mortgages originated under full documentation programs).

I. IND1 And IND2 Were Bespoke Transactions That FHLBS And IndyMac Worked Together To Create

Discovery established that FHLBS's investments in IND1 and IND2 were very unusual transactions and stood out from the rest of the RMBS certificates FHLBS purchased (and as to which it sued all issuers and underwriters in actions like this one). The IND1 and IND2 securities were not only the last two private-label RMBS that FHLBS ever purchased but were in fact bespoke transactions, created specifically for FHLBS by FHLBS and loan originator IndyMac when the mortgage market was in the throes of the financial crisis in early 2008.

The IND1 securitization was conceived during a late-2007 holiday ski trip by Joel Adamo and his longtime friend, Reed Newkirk of IndyMac.[7] "Adamo told Newkirk that he was [still] a buyer of bonds and that he might be able to purchase a security backed with collateral originated by IndyMac." (CP 565.)[8] Adamo considered himself "really

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[7] Adamo previously served as a personal reference for Newkirk and even helped Newkirk get his job at IndyMac. (CP 7435.)

[8] Neither FHLBS nor Adamo initially acknowledged the true origin of the IND1 and IND2 deals. FHLBS stated in an interrogatory response that Adamo had only one phone conversation with Newkirk about the type of collateral that FHLBS would be interested in. (*See* CP 557.) Adamo testified consistently with this during his deposition. (CP 541.) But several days later, FHLBS announced that it would be "supplementing" its interrogatory responses, making an additional document production and reopening Adamo's deposition. (CP 7443-44.) This "supplemental" discovery for the very first time: (1) revealed that the Adamo-Newkirk ski trip was the origin of the IndyMac deals; (2) admitted that Adamo and Newkirk had a number of additional communications about "investment parameters"; and (3) produced as attachments a number of additional

knowledgeable" about RMBS, an expert on "the mortgage market" and "economic environment," and carefully attuned to market developments that impacted FHLBS's mortgage-related assets. (CP 1654-57; *see also* SCP ___.) Even though the mortgage market was imploding, FHLBS believed that RMBS could still be profitable and was eager to use up the hundreds of millions of dollars it had pre-approved for RMBS purchases. (CP 662-63; CP 690-91.) FHLBS's main sales contact at Barclays during the relevant time recalled that Adamo explained that he was working with IndyMac to create IND1 and IND2 for FHLBS because "in times like these, you got to go straight to the source." (CP 704-06.)

The problem, as FHLBS admitted, however, was that FHLBS could not buy the RMBS directly from IndyMac because it was not an approved RMBS counterparty for FHLBS.[9] FHLBS was "shying away from" IndyMac as early as 2006 (SCP __), and by at least November 2007, there were reports indicating that IndyMac's "credit weakness" had "largely been driven by weak underwriting standards." (CP 655.) FHLBS and IndyMac solved their problem by finding a bank from which they

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documents evidencing that FHLBS had structured the deals and picked specific collateral for them. (CP 564-65, 568-69.)

[9] CP 543; CP 557; CP 564 (Adamo told Newkirk that FHLBS "could not deal directly with IndyMac" because FHLBS "could purchase securities only from approved dealers and issuers").

could "rent a shelf" to issue the securities after they had been designed.[10] Shortly after returning from their ski trip, Newkirk and Adamo undertook a search for potential third-party banks from which to rent a shelf, with Newkirk proposing "to contact Barx [Barclays] and CSFB [Credit Suisse] in addition to Greenwich, which I know you don't particularly like." (CP 7438.)

During the process of creating IND1, FHLBS's Adamo weighed in almost continually on collateral parameters, as IndyMac's Newkirk peppered Adamo with questions and updates. For example, on December 20, 2007, Newkirk emailed Adamo, asking him: "quick question, can i use 12 MTA collateral if I put in a basis swap?" (referring to the 12-month treasury average index); Adamo replied: "yes." (CP 7446; CP 7448.) One week later, Newkirk again discussed with Adamo details about which collateral would be acceptable to Adamo.[11] More

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[10] *See* CP 2735 (in an internal email from December 27, 2007, a Barclays salesperson stated: "Reed Newkirk at Indymac would like to talk with Barc about using our BCAP shelf. He's got ~400mm pay-option ARMs that he'd like to issue through BCAP. He's lined up a buyer for the AAAs and Indymac would retain the mez on down. Indymac would take care of the reps and warrants. Reed would like to make this happen by late Jan/early Feb. He's looking at us and a few others."); CP 7433 (as Barclays understood it at the time, "there were two parties that were really coming to terms on a transaction and asking us to be an intermediary.") Barclays Capital, Inc. filed registration statements for BCAP, LLC, in August 2005. (CP 2358-2733.) The BCAP "shelf" was used for Barclays to securitize the RMBS at issue in this action. A "shelf" registration typically serves as a base prospectus for multiple offerings and is supplemented by a specific prospectus supplement for each transaction.

[11] *See* CP 7450 (Newkirk: "for the new FICO's is it OK to use one service to update or the middle of 3?. At origination we use the middle of 3, the weighted average

broadly, in describing Adamo's role in this turbulent period, FHLBS's Treasurer and Adamo's direct supervisor admitted that "for each bond that [Adamo] buys, he spends many, many hours gathering and maintaining market intelligence," "helps monitor credit, running loss simulations through our sophisticated polypaths model," "monitors prepayment trends" and, "[f]or each bond, Joel[Adamo] spends hours screening collateral, even kicking out individual loans." (CP 708.)

On December 28, 2007, Newkirk and Adamo again discussed the deal structure, with Newkirk proposing: "think I'll stick to pushing the p-bond (penalty) cashflows into the [super senior]." Adamo agreed. (CP 2740.) A few days later, Newkirk asked Adamo: "u care if ratings are SP and Fitch?" Adamo replied "thats fine," and Newkirk thanked Adamo for his input. (CP 2742.) Newkirk subsequently asked Adamo: "want me to make the floater 1 m Libor? :)" (*i.e.*, use the London Interbank Offered Rate), to which Adamo responded: "yes please." (CP 1897.) Newkirk explained that he was "try[ing] to be full service." (*Id.*) All of these discussions took place before Barclays was even engaged on

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pool is 1.5 years old and all current. my 2 cents are that the fact that they are all current after a year and a half is more valuable. either way any FICO older than 6 months will be updated by at least one service."); CP 7452 (Adamo: "yes").

the transaction.[12] And when Barclays was actually asked about "using [its] BCAP shelf," IndyMac confirmed it already had "lined up a buyer for AAAs"—FHLBS's Joel Adamo, who wanted to purchase $250 million of super senior AAA bonds. (CP 2735; CP 2737.) As FHLBS noted, "it was not until January 16, 2008 . . . that Barclays first learned that '[t]he buyer on the indymac deal is fhlb seattle'" and that "[t]his deal became BCAP 2008-IND1." (*See* CP 3884 (citing CP 4893).)

Even after FHLBS and IndyMac had decided to rent Barclays' shelf for the securitization, Newkirk continued to provide "full service" to Adamo, providing him, in advance, information about the loans —such as borrower FICO scores, year of origination, loan-to-value ratios, and the extent to which the documentation program used to originate the loans required verification of borrowers' incomes and assets—in tabular form (referred to as collateral stratification tables). (CP 1514-15.) Newkirk then told Barclays that "Joel [Adamo] want [sic] to know if we can get a FICO strat by 10 incremental buckets." (CP 7454-55.) Barclays personnel were concerned that they had "never talked to Joel [Adamo]" and concluded that they should get Newkirk's "ok" before speaking to Adamo directly. (CP 1517-18.) As Barclays understood it at

[12] In a January 16, 2008 email, IndyMac personnel confirmed: "12MAT ($420mm): FHLB still wants to do the trade. We are in talk [sic] with Barclays re renting their shelf as CSFB is less interested in using their shelf for 12 MAT." (CP 7440.)

the time, FHLBS, through its direct interactions with IndyMac, was obtaining "the exact type of collateral and the structure they wanted and the details of the securities" in this "very bespoke security" (CP 7433), which Barclays was then brought in as a third party to help execute.

FHLBS purchased the IND1 certificate in mid-February 2008. Within days, Barclays learned that FHLBS and IndyMac were "looking to do another deal . . . soon" and wanted to increase the size of the new deal. (CP 1926; CP 1928; CP 1931.) When IndyMac reached out to Barclays in February 2008 about IND2, FHLBS was already "on board" and "working with" IndyMac on this second transaction. (CP 5086.) Again, Newkirk and Adamo communicated directly regarding the IND2 certificate, including regarding the collateral (CP 1949; CP 3575), which rating agencies should rate IND2 (CP 3567; CP 3569; CP 3571), and which servicer should be used (CP 3565).

Barclays was engaged again to underwrite and issue IND2 in mid-March 2008. (CP 1955.) But Adamo and Newkirk encountered another problem. While the two were working on the second bond (CP 549-52), FHLBS learned that "all but three of the FHL Banks" had "stopped buying instruments backed by ALT-A collateral." (CP 3694-98) Indeed, another FHLB had been "advised not to buy any additional non-agency backed MBS securities for their investment portfolio." (*Id.*)

FHLBS accordingly considered a moratorium on RMBS purchases and asked its Credit Analysis Manager, Leonard Reininger, and Adamo to vet FHLBS's investment strategy. (CP 662-63.)[13]

Reininger recommended that FHLBS stop investing in RMBS entirely, but Adamo pushed back, proposing that the investment category into which IND2 fell in the "matrix" document FHLBS used to analyze potential RMBS investments remain eligible for purchase.[14] In fact, FHLBS contacted IndyMac "with regard to the lifting of the buying restriction." (CP 1947.) At the time, FHLBS still had several hundred million dollars of leftover pre-approved RMBS purchasing authority (CP 662), and, according to Reininger, even as late as 2008, FHLBS's management believed they "could still make some money" with RMBS investments and were determined to invest their remaining $600 million of RMBS authority (CP 690-91). Ultimately, FHLBS rejected Reininger's proposal and followed Adamo's plan, prohibiting further private-label RMBS purchases because of the risk but allowing Adamo the exception he

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[13] Adamo also testified that, before purchasing the IND1 and IND2 certificates, FHLBS clearly understood that the risks that had occurred in the subprime market would "leak into the rest of the market" and "definitely involve all of the market." (CP 579-80.)

[14] *See, e.g.*, CP 690-95 (deposition testimony by Reininger that agreeing for the IND2 purchase to go forward was a "compromise" from his perspective); CP 1939 (email from Reininger to another FHLBS employee explaining that he had agreed to adjust the restriction following a conversation with Adamo); CP 1944 (FHLBS's Security Checklist and "Macro Analysis" for IND2, indicating that the bond fit within FHLBS's investment eligibility matrix for the "compromise" exception).

needed to invest in IND2. (CP 3744-62; CP 662-63.) FHLBS completed its investment in IND2 in mid-April 2008.

II. By The Time FHLBS Invested In The Two IndyMac Certificates, FHLBS Was Well Aware Of The Risks Of Which It Now Complains And Which Were Disclosed In The Prospectus Supplements

By the time it chose to create and purchase the IND1 and IND2 certificates in 2008, FHLBS's deep and growing knowledge of the mortgage industry gave it unique insight into mortgage lending practices, particularly appraisals, underwriting practices—including specifically at IndyMac—and the inherent risks of the non-prime, "Alt-A" loans backing the securities. As an initial matter, the prospectus supplements disclosed the risks of which FHLBS now complains—including that: (i) the "[v]alue of a mortgaged property used in the calculation of the loan-to-value ratios of the mortgage loans may differ from the . . . actual value of such mortgaged properties" (CP 1548; CP 1562); (ii) that loans were originated "generally" in compliance with guidelines (CP 1551; CP 1563); and (iii) "[e]xceptions to underwriting standards are permitted" in certain situations, including where a borrower has "significant financial reserves," will have a significant reduction in his/her monthly mortgage payment, or

has "long-term employment with the same employer" (CP 1556; CP 1567).[15]

Furthermore, as to appraisals, FHLBS understood that "an appraisal [is at least] +/- 10% of the actual value" and that "there was a risk that the value of the properties that secured mortgages that backed private-label MBS might be lower than the appraisal indicated." (CP 1422; CP 1427.) Similarly, FHLBS received reports that at least "55 percent of licensed appraisers had felt pressure from a mortgage broker or lender to 'hit a certain property value,' with 25 percent of appraisers saying this happens almost half the time" and that appraisal fraud was increasing in prevalence. (CP 1429, 1461; CP 1489-90.) Appraisal inflation was a well-publicized risk long before FHLBS invested in IND1 and IND2,[16] which FHLBS employees admitted they, too, knew.[17]

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[15] FHLBS could not produce a single witness that specifically recalled reviewing any of the statements in the prospectus supplements about appraisals or underwriting guideline compliance before purchasing any of the RMBS at issue in any of the 11 cases. Instead, FHLBS submitted affidavits from Adamo and Beatty stating merely that it was their "habit" and "routine practice . . . to carefully review and consider the parts of the offering documents that are most pertinent to the purchase of the security . . . before . . . authoriz[ing] the transfer of funds on the settlement date to complete a purchase." (CP 14310-11 (¶¶ 5-7); CP 14315-16 (¶¶ 5-7).) Thus, it is not established that FHLBS even read the prospectus supplements. But, even if it did, the prospectus supplements disclosed the risks of which FHLBS now complains, and the record is clear that FHLBS was independently well aware of those risks.

[16] *See, e.g.*, CP 2916-20 (article titled "A View of Refi Boom Pressures From the Appraisal Trenches," published in *American Banker* in February 2004, observing that many viewed problem of inflated appraisals to be much worse than ever before); CP 2924-25 ("Lenders Clamp Down on Inflated Appraisals -- Overly Aggressive Valuations Add Fuel to Housing Boom; Requiring a Second Opinion," *Wall St. J.*, May 2, 2005, noting that "[t]he fluid nature of appraisals has long been an open secret in the real-estate

FHLBS understood that originators took a flexible approach in applying underwriting guidelines to make lending decisions and recognized that an originator's approval of exceptions to underwriting guidelines could be a "reasonable business decision." (SCP ___; SCP ___; SCP ___.) By the time FHLBS and IndyMac collaborated to create the "very bespoke" IND1 and IND2, there were widespread public reports about IndyMac's origination practices:

- FHLBS received, on March 20, 2007, an analyst report that flagged IndyMac (trading as "NDE") as one of two originators cited as "most exposed to the riskier affordability loan products," with "higher reliance" on "riskier Alt-A product." (CP 592, 619, 629.)

- A March 2007 report from Morgan Stanley noted that IndyMac "loosened lending standards in 2006 to gain market share" and "appeared to have stretched their standards the farthest, judging from the increase in size of their risky loan buckets in 2006." The report predicted that, based on performance data, IndyMac would "likely suffer higher losses in the 2006 vintages, both for Alt-A and subprime." (CP 2064-65.)

- A November 2007 report by RBC noted as to IndyMac that "[c]redit weakness thus far has largely been driven by weak underwriting standards." (CP 655.)

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world. Now, the fast-moving housing market has increased worries that inflated appraisals could lead to problems").

[17] *See, e.g.*, CP 2930-32 (FHLBS's principal accounting officer recalled discussing with an appraiser the appraiser's concerns about inflated appraisals.); CP 1427 (FHLBS's Operational Risk Officer stated that, at the time, FHLBS was "aware that there was a risk that the value of the properties that secured mortgages that backed private-label MBS might be lower than the appraisal indicated.").

As for the "Alt-A" loans that backed the IND1 and IND2 certificates, FHLBS accepted that Alt-A borrowers "generally have lower FICO scores and may provide a lower level of income documentation," (CP 1645), and that those loans included interest-only and negatively amortizing loans (CP 1598-1635),[18] which FHLBS understood were among "the most risky products in the mortgage market."[19] (CP 1649.) Reininger reported in November 2007 that the year had seen massive downgrades of RMBS due to the "persistent rise in the level of delinquencies among the Alt-A mortgage loans supporting these transactions." (CP 1957.) As of Fall 2007, Adamo was aware of the "turmoil in the RMBS market," and that a number of loans originated in 2006—and the bonds backed by collateral pools comprised of such loans—were declining in price; he had concluded by October 2007 that "bonds backed by 2006 vintage collateral would never fully recover in price. (CP 534, 537-39.)

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[18] Negative amortization loans constituted 100 percent of the collateral supporting IND1, and interest-only mortgages constituted 87 percent of the collateral supporting IND2, all originated or acquired by IndyMac. (CP 1552; CP 1563.)

[19] An interest-only loan is a loan in which the borrower pays only the interest that accumulates on a monthly basis, without paying down any of the mortgage's principal. *Barron's Dictionary of Fin. & Invest. Terms* 285 (5th ed.). A negatively amortizing loan is a form of interest-only loan where the interest payment during an initial period is not sufficient to cover the full amount of interest accrued that month. *Id.* at 384. The unpaid portion of the interest is added onto the principal balance of the loan.

Reininger also understood that the interest-only mortgages underlying such securities "were also riskier than a typical home loan . . . [f]or the average borrower." (CP 686.) So, too, for the negatively amortizing mortgages backing the securities for which the borrower's "debt on the home is actually growing," such that the "debt might exceed the value of the home itself." (CP 688.) Adamo expressly conceded that he understood RMBS backed by nontraditional loans to be riskier investments, and that the risks were even greater when the nontraditional mortgage loans were made to borrowers with undocumented or undemonstrated repayment capacity (*e.g.*, low- or no-documentation loans). (CP 3737-42.) Further, Reininger noted in a March 2008 internal memorandum, before FHLBS purchased its IND2 certificate for over $232 million, that "[m]any Alt-A pools originated from late 2005 through 2007 are exhibiting higher than expected rates of delinquency, foreclosure, and REO." (CP 2346.) FHLBS was aware of the risks inherent in the collateral underlying IND1 and IND2, but chose to put together and purchase the two certificates as the financial crisis grew.

As explained by its former Treasurer and Senior Portfolio Manager Vince Beatty, FHLBS's continued investment in RMBS—culminating in its 2008 creation and purchase of the two IndyMac certificates—was driven by a simple goal: "Income!" (CP 1577.) IND1

and IND2 ultimately provided FHLBS with the income it was looking for. FHLBS does not dispute that it did not lose a single penny on either of these investments. In fact, as of March 17, 2015—the date on which FHLBS sold all of the remaining securities it purchased prior to (and in the case of the IndyMac deals, during) the housing crash—FHLBS had made nearly $25 million in profit from these two securities. (SCP ___.)

III. FHLBS Brings An Action Against Barclays Alleging It Was Misled As To The IndyMac Certificates And Seeking Rescission Of Its Purchases

FHLBS filed this action against Barclays in December 2009, seeking rescission under the WSSA based on claims that the offering documents for the four RMBS certificates that FHLBS purchased from Barclays contained material misstatements about the credit quality of the underlying mortgage loans backing the certificates. Specifically, FHLBS brought claims under RCW 21.20.010 (the WSSA's substantive liability provision) and RCW 21.20.430 (RCW 21.20.010's enabling and remedy provision), alleging that the offering documents: (i) materially understated the weighted average loan-to-value ratio ("WALTV") of the loans backing the securities due to inflated appraisals for the mortgaged properties (and, therefore, also falsely stated that the appraisals were performed in accordance with the Uniform Standards of Professional Appraisal Practices ("USPAP")); (ii) falsely stated that the underlying

mortgage loans were originated generally in accordance with the applicable originator's underwriting guidelines; (iii) materially misrepresented the number of mortgages for which the mortgaged properties were owner-occupied; and (iv) reported the credit ratings assigned to the securities by major ratings agencies while omitting that those ratings were based in part on allegedly inaccurate information about the underlying mortgage loans and how they were underwritten.

FHLBS brought similar lawsuits against almost every other major financial institution, as to every other RMBS it purchased—including Countrywide, Bank of America, Merrill Lynch, Deutsche Bank, UBS, Goldman Sachs, Bear Stearns (J.P. Morgan), Morgan Stanley, Royal Bank of Scotland ("RBS"), and Credit Suisse. FHLBS's action against Barclays and the ten other actions it filed in King County Superior Court were coordinated before Judge Laura C. Inveen (the "trial court").

Defendants moved to dismiss the FHLBS complaints on several grounds, including because FHLBS failed to sufficiently plead that it "reasonably relied" on the statements in the prospectus supplements. The trial court denied defendants' motions in large part, but dismissed FHLBS's claims against all defendants to the extent they were based on alleged misstatements about the occupancy status of the mortgaged properties. (CP 347-55.) Judge Inveen confirmed that reasonable reliance

was an element of a claim under the WSSA and that, "[a]s a matter of law, it was not reasonable for [FHLBS], the sophisticated investor that it was, to rely upon statements about occupancy," which FHLBS knew "were based solely on the say-so of the borrower." (CP 353.) FHLBS's other claims proceeded.

Over five years' worth of fact and expert discovery ensued. Millions of pages of documents were produced, and the parties took and defended over 100 fact witness depositions and collectively submitted over 90 expert reports. Defendants also successfully moved to strike FHLBS's jury demands. (CP 5511-15.) As a result, in FHLBS's cases against all defendants, including Barclays, the Judge would be the fact-finder at trial.

Defendants jointly moved for summary judgment on the grounds that FHLBS could not show that it reasonably relied upon—or even considered when making its investment decisions—statements in the RMBS offering documents regarding compliance with underwriting guidelines and USPAP. (CP 7499-7575.) Several defendants, including Barclays, also filed individual motions for summary judgment on the basis that FHLBS could not prove that it reasonably relied on the alleged misrepresentations in the offering documents.

Judge Inveen denied defendants' joint motion for summary judgment, but granted Barclays' motion as to FHLBS's claims based on IND1 and IND2, which FHLBS put together with IndyMac and for which Barclays served as a "rent-a-shelf" issuer and underwriter (*see supra* at 9-16).[20]

IV. FHLBS Appeals From The Trial Court's Order Granting Summary Judgment To Barclays On The Certificates At Issue In This Case

FHLBS now appeals from the trial court's subsequent entry of final judgment dismissing its claims related to the IND1 and IND2 certificates. The appeal focuses primarily on the trial court's holding that reasonable reliance is an element of a claim for rescission under the WSSA that plaintiffs must plead and prove. FHLBS is also appealing on this basis from the trial court's orders dismissing its claims against RBS and Credit Suisse.[21] FHLBS also summarily contends that the trial court erred in deciding that there were no genuine issues of material fact as to its reasonable reliance.

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[20] Although the Court did not enter summary judgment as to the Countrywide-backed certificates, it subsequently dismissed those claims with prejudice pursuant to a stipulation of the parties.

[21] *Federal Home Loan Bank of Seattle v. Credit Suisse Securities (USA) LLC, f/k/a Credit Suisse First Boston LLC, et al.*, No. 75770-2-I; *Federal Home Loan Bank of Seattle v. RBS Securities, Inc., f/k/a Greenwich Capital Markets, Inc., et al.*, No. 76326-1-I.

For the reasons described in greater detail herein, Barclays respectfully requests that this Court affirm Judge Inveen's grant of summary judgment as to FHLBS's claims based on the IND1 and IND2 certificates.

ARGUMENT

I. THE TRIAL COURT CORRECTLY HELD THAT REASONABLE RELIANCE IS A REQUIRED ELEMENT OF A WSSA CLAIM

A. The Washington Supreme Court Has Made Clear That Reasonable Reliance Is An Element Of A WSSA Claim

The Washington Supreme Court has held that to establish a claim under the WSSA, a plaintiff must demonstrate that it "*relied on* . . . misrepresentations in connection with the sale of the securities." *Hines v. Data Line Systems, Inc.*, 114 Wn.2d 127, 134, 787 P.2d 8 (1990) (emphasis added). In *Go2Net, Inc. v. Freeyellow.com, Inc.*, the Supreme Court held that the jury's findings—which included reliance on a material misrepresentation or omission—established a violation of the WSSA. 158 Wn.2d 247, 251, 143 P.3d 590 (2006).

FHLBS attempts to write off the clear import of the Supreme Court's decisions, by mischaracterizing the *Hines* holding regarding reliance as "dictum only" and, even more egregiously, contending that *Go2Net* did not set forth—and possibly rejected—reliance as an element. (*See* Br. 44, 40.) FHLBS is wrong on both counts. *Hines*

squarely presented to the Supreme Court the question of what elements must be proven to prevail on a WSSA claim. 14 Wn.2d at 134 (holding that, in order for defendants to be liable under RCW 21.20.010, "[t]he investors need only show that the misrepresentations were material and that they relied on the misrepresentations in connection with the sale of the securities," without an additional requirement of establishing proximate loss causation). The parties disagreed about whether plaintiffs needed to only show transaction causation (*i.e.*, that plaintiff relied on the alleged misrepresentations in entering into the transaction[22])—or had to prove both transaction causation/reliance and proximate loss causation (*i.e.*, that the alleged misrepresentations were the proximate cause of plaintiff's alleged losses).[23] While the Supreme Court declined to require loss causation, it made clear that reliance *is* an element of a WSSA claim: the Court explained that plaintiffs "need only show that the misrepresentations were material and that they relied on the misrepresentations in connection with the sale of the securities." 114 Wn.2d at 134.[24] The Supreme Court

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[22] *See, e.g.*, *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341-42, 125 S. Ct. 1627, 161 L.Ed.2d 577 (2005) (noting that reliance is often referred to as "transaction causation").

[23] *See* Brief for Appellants at 58-65, *Hines v. Data Line Sys., Inc.*, 114 Wn.2d 127 (No. 20506-4-I) (attached as Appendix I); *see also* Brief for Respondents at 31-34, *Hines v. Data Line Sys., Inc.*, 114 Wn.2d 127 (No. 20506-4-I) (attached as Appendix II).

[24] *See also id.* at 135 (holding that "an investor who is *wrongfully induced* to purchase a security may recover his investment without any requirement of showing a decline in the value of the stock") (emphasis added).

went on to hold that the undisputed facts in *Hines* "substantiate[d] that each investor relied on [the challenged] statements." *Id.* Thus, the Supreme Court affirmed in no uncertain terms that reliance is an element of a WSSA claim.

In *Go2Net*, the Supreme Court held that the jury's findings—which included an express determination that the plaintiff "had relied on the [material] misrepresentation or omission in its decision to acquire" the securities at issue—"established [the defendant's] violation" of the WSSA. 158 Wn.2d at 251. *Go2Net* thus further confirms the well-established point that reliance must be proven to establish a WSSA claim.

B. Other Washington Courts—Including This Court—Have Uniformly And Repeatedly Held That Reasonable Reliance Is an Element Under the WSSA

Consistent with the Supreme Court's decisions in *Hines* and *Go2Net*, every court in Washington that has considered whether reliance is an element of a WSSA claim has uniformly held (in cases that cover every stage of litigation) that a securities plaintiff must establish reliance to recover under the WSSA. *See FutureSelect Portfolio Mgmt.*, 175 Wn. App. at 869-70 (pleading standard); *Stewart v. Estate of Steiner*, 122 Wn. App. 258, 274, 93 P.3d 919 (2004) (liability standard); *Helenius v. Chelius*, 131 Wn. App. 421, 443-44, 120 P.3d 954 (2005) (same); *Moore v. Thornwater Co. LP*, No. 01-cv-1944, 2006 WL 1423535, at *8

(W.D. Wash. May 23, 2006) (same); *Shermer v. Baker*, 2 Wn. App. 845, 858, 472 P.2d 589 (1970) (same); *Guarino v. Interactive Objects, Inc.*, 122 Wn. App. 95, 109, 86 P.3d 1175 (2004) (evidentiary presumptions); *In re Intermec Corp. Sec. Litig.*, No. 90-cv-7832, 1991 WL 207370, at *3 (W.D. Wash. June 17, 1991) (class certification); *In re Metro. Sec. Litig.*, No. 04-cv-25, 2009 WL 36776, at *4-5 (E.D. Wash. Jan. 6, 2009) (same); *Graham-Bingham Irrevocable Trust v. John Hancock Life Ins. Co. USA*, 827 F. Supp. 2d 1275, 1284-85 (W.D. Wash. 2011) (summary judgment).

This Court, in particular, has confirmed that a plaintiff must prove more than just actual reliance to prevail on a WSSA claim; a plaintiff must also prove that its reliance was reasonable. *See, e.g.*, *Stewart*, 122 Wn. App. at 265-66. In *Stewart*, this Court held that "[a] purchaser of securities establishes liability for violation of the [WSSA] by proving that the seller and/or others made material misrepresentations or omissions and the purchaser relied on those misrepresentations or omissions." *Id.* at 260. This Court rejected the contention that "mere reliance, not reasonable reliance, on a misrepresentation or an omission is sufficient under the WSSA," *id.* at 265 n.9, and set forth eight factors usually considered to evaluate whether an investor's purported reliance was reasonable. *Id.* at 274.

Similarly, in *Guarino*, this Court expressly held that "[t]he WSSA also requires reliance upon the alleged misrepresentations or omissions." 122 Wn. App. at 109. One year later, in *Helenius*, this Court upheld the trial court's finding of reasonable reliance under RCW 21.20.010 after considering the factors for reasonable reliance set forth in *Stewart*. 131 Wn. App. 421, 444. As recently as 2013, this Court again confirmed that reasonable reliance is required under RCW 21.20.010. *FutureSelect*, 175 Wn. App. at 868 ("To establish a claim under the WSSA, an investor must prove that . . . the investor relied on [material] misrepresentations or omissions. Such reliance must be reasonable under the surrounding circumstances.").

The Court should decline FHLBS's invitation to cast aside almost 50 years[25] of consistent precedent holding that reasonable reliance is an element of a WSSA claim.

C. FHLBS's Contention That The Washington Legislature Did Not Intend Reliance To Be An Element Of The WSSA Is Baseless

Despite this clear, uniform precedent, FHLBS nonetheless contends that the Washington Legislature did not intend for reliance to be a required element for recovery under the WSSA. (*See* Br. 30-40.)

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[25] In 1970, the Washington Supreme Court stated that "in an action brought under RCW 21.20.010," a plaintiff must establish that it "relied upon the misrepresentation or omission of a material fact." *Shermer*, 2 Wn. App. at 858.

FHLBS ignores that: (i) RCW 21.20.010 of the WSSA was written to track Securities and Exchange Commission Rule 10b-5, which has always required reasonable reliance; and (ii) although the Washington Legislature has amended the WSSA multiple times, it has never modified it to indicate that it does not require reasonable reliance, in the face of repeated legal decisions confirming that it does.

As this Court has noted, RCW 21.20.010 of the WSSA was "'patterned after and restates in substantial part the language of the federal [Securities Exchange Act] of 1934' . . . [and] related federal regulation[] . . . Securities and Exchange Commission (SEC) Rule 10b-5." *Guarino*, 122 Wn. App. 95 at 110 (quoting *Clausing v. DeHart*, 83 Wn.2d 70, 72, 515 P.2d 982 (1973)). Indeed, notwithstanding FHLBS's attempt to analogize RCW 21.20.010 to other statutory provisions, the language of RCW 21.20.010 is substantively identical to Rule 10b-5:[26]

SEC Rule 10b-5	RCW 21.20.010
"It shall be unlawful for any person … in connection with the purchase or sale of any security …	"It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:
(a) To employ any device, scheme, or artifice to defraud,	(1) To employ any device, scheme, or artifice to defraud;

[26] Furthermore, although RCW 21.20.430 contains *some* language similar to that in Section 12(a)(2) of the Securities Act of 1933, RCW 21.20.430 is the remedy provision for violations of RCW 21.20.010; the latter is the sole provision that defines liability under the WSSA, and, as discussed, it tracks almost verbatim to SEC Rule 10b-5, which indisputably requires an investor to demonstrate reasonable reliance.

(b) 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, or	(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; or
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . ."	(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

Reliance was a required element under Rule 10b-5 when RCW 21.20.010 was enacted in 1959, and remains a requirement today. *See, e.g.*, *Reed v. Riddle Airlines*, 266 F.2d 314, 319 (5th Cir. 1959); *Speed v. Transamerica Corp.*, 5 F.R.D. 56, 60 (D. Del. 1945); *see also Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2418 n.1 (2014) ("a private plaintiff must prove . . . reliance upon the misrepresentation or omission" (citation omitted)). FHLBS has provided no evidence that, at the time it enacted RCW 21.20.010, the Legislature intended to carve out reasonable reliance.

The Washington Legislature has never demonstrated the purported intent that FHLBS seeks to ascribe to it—even in the face of decision after decision finding that reasonable reliance is, in fact, an element of the WSSA. To the contrary, the Legislature has amended the

WSSA nine times[27] since its enactment to clarify those aspects of the law that it deemed appropriate, during which time Washington courts have handed down numerous decisions holding that reasonable reliance is an element under the WSSA. (*See supra* at 27-29.) Yet the Washington Legislature has *never* amended the WSSA to exclude reliance as an element. The Legislature's inaction demonstrates that, contrary to FHLBS's argument, the courts have *not* consistently misinterpreted the WSSA and the Legislature has *not* needed to clarify its intent. *See Wade*, 915 F.2d at 1332 (observing that the WSSA's 1975 and 1977 amendments "demonstrate [the Washington Legislature's] willingness and ability to correct its own omissions"). FHLBS does not and cannot substantiate its contention that the Washington Legislature intended—originally or at any time thereafter—to exclude reasonable reliance as an element of the WSSA.

D. FHLBS's Invocation Of Other States' Laws Provides No Viable Basis For Overturning Washington Law

Because of the clear Washington precedent that reasonable reliance is an element of a WSSA claim, FHLBS resorts to citing non-

[27] Laws of 1998, ch. 15, § 20; Laws of 1986, ch. 304, § 1; Laws of 1985, ch. 171, § 1; Laws of 1981, ch. 272, § 9; Laws of 1979, Ex. Sess., ch. 68, § 30; Laws of 1977, Ex. Sess., ch. 172, § 4; Laws of 1975, 1st Ex. Sess., ch. 84, § 24; Laws of 1974, Ex. Sess., ch. 77, § 11; Laws of 1967, ch. 199, § 2. *See also, e.g.*, *Wade v. Skipper's, Inc.*, 915 F.2d 1324, 1332 (9th Cir. 1990).

binding, unpersuasive out-of-state case law—which cannot and does not provide a basis for overturning years of Washington law. (Br. 41-43.)

As a threshold matter, FHLBS incorrectly tallies up the states which have held that reliance either is or is not an element under their "blue sky" laws. FHLBS overstates the number of states that have held that reliance is not an element. For example, although FHLBS argues that Colorado, Illinois, Indiana, Ohio and Oregon exclude reliance as an element under their counterparts to the WSSA (Br. 25), courts have held otherwise.[28] Conversely, FHLBS understates the number of states that require reliance. For example, in addition to Georgia and North Carolina,

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[28] *See, e.g.*, *Hosier v. Citigroup Glob. Mkts., Inc.*, 835 F. Supp. 2d 1098, 1107 (D. Colo. 2011) (reliance is an element of a claim under Colo. Rev. Stat. Ann. § 11-51-501); *JJR, LLC v. Turner*, 58 N.E.3d 788, 803 (Ill. App. Ct. 2016) (claims in Illinois securities laws "require that the plaintiffs prove reliance"); *Perry v. Eastman Kodak Co.*, 87-IP-1023, 1991 WL 629728, at *3, *7 (S.D. Ind. Apr. 22, 1991) ("Violations of [Indiana] Section 23-2-1-12 carry the same reliance, causation and duty to disclose requirements as its federal counterpart, Rule 10b-5."); *In re Nat'l Century Fin. Enters., Inc., Inv. Litig.*, 905 F. Supp. 2d 814, 829 (S.D. Ohio 2012), *aff'd sub nom. Pharos Capital Partners, L.P. v. Deloitte & Touche*, 535 F. App'x 522 (6th Cir. 2013) ("justifiable reliance is an element of a[n] [Ohio] § 1707.41(A) claim"); and *State v. Marsh & McLennan Cos.*, 353 Or. 1, 14, 292 P.3d 525 (2012) ("[A] purchaser of securities on the open market must establish some form of reliance . . . in order to establish a claim for damages under [Oregon's] ORS 59.137."). Furthermore, FHLBS is also incorrect that reliance is not required under Pennsylvania law. While reliance may not be required under the Section 12(a)(2) analogue, courts have found reliance *is* required under the provision analogous to Rule 10b-5. *Gilliland v. Hergert*, No. 05-cv-1059, 2008 WL 2682587, at *7 (W.D. Pa. July 1, 2008) (the RCW 21.20.010 equivalent has the same elements of a Rule 10b-5 claim); *accord Fulton Fin. Advisors v. NatCity Invs., Inc.*, No. 09-cv-4855, 2013 WL 5635977, at *10 (E.D. Pa. Oct. 15, 2013).

which FHLBS admits require reliance under their securities laws (*see* Br. 20), Kansas, Maryland, and Minnesota also require reliance.[29]

Even if FHLBS were correct as to other states' laws, however, they are irrelevant. "[T]he Washington Supreme Court is the final arbiter of the meaning of Washington statutory law," *In re Petersen*, 138 Wn.2d 70, 80-81, 980 P.2d 1204 (1999), and has spoken on this issue (*see supra* at 25-27)—as has this Court. Indeed, even states that do not recognize reasonable reliance as an element under their own state laws recognize that, in Washington, reliance is required. *See, e.g.*, *Eagle Fund, Ltd. v. Sarkans*, 63 Mass. App. Ct. 79, 84, 823 N.E.2d 783 (2005) (though not an element under Massachusetts law, "[i]n contrast . . . reasonable reliance is a requirement under § 21.20.010(2) of the Securities Act of Washington") (citing *Hines*).

E. Contrary to FHLBS's Contention, This Court's Precedent Does Not Violate Jurisprudence That The WSSA Should Be Interpreted To Protect Investors

FHLBS's last-ditch contention that *Guarino* and *Stewart* violate jurisprudence that the WSSA is to be interpreted liberally to

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[29] *See Jayhawk Capital Mgmt., LLC v. LSB Indus., Inc.*, No. 08-cv-2561, 2012 WL 4210462, at *8 (D. Kan. Sept. 19, 2012) (reliance is an element of Rule 10b-5 and so plaintiff "must prove these same elements to prevail on his" state law claim); *Sherwood Brands, Inc. v. Levie*, No. 03-cv-1544, 2006 WL 827371, at *20 (D. Md. Mar. 24, 2006) (plaintiff who fails to allege any basis for reasonable reliance does not plead violations of Maryland Securities Act); and *Merry v. Prestige Capital Mkts.*, 944 F. Supp. 2d 702, 709 (D. Minn. 2013) (Minn. Stat. § 80A.68(2) requires allegation of "reliance upon the misrepresentation or omission").

protect investors (Br. 43-44) is similarly meritless. When acknowledging that reliance is an element under the WSSA, this Court has simultaneously recognized that the WSSA is to be interpreted to protect investors.[30] Tellingly, FHLBS cites to no case—and Barclays is aware of none—in which a court expressed concern that Washington investors were not being adequately protected because reliance is an element of a WSSA claim. As the U.S. Supreme Court has noted regarding the analogous Rule 10b-5, erroneously interpreting that rule to allow plaintiffs to recover without proof that they reasonable relied on the alleged misstatements "would effectively convert Rule 10b-5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result." *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 345, 125 S. Ct. 1627, 161 L. Ed.2d 577 (2005) (internal quotation omitted). The WSSA is similarly not an insurance policy against any losses incurred by an investor who was not misled into entering in a transaction.

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[30] *See, e.g.*, *Stewart*, 122 Wn. App. at 264 ("To establish liability under the WSSA, the purchaser of a security must prove that . . . the purchaser relied on those misrepresentations or omissions. Because the primary purpose of the WSSA is to protect investors, we construe it liberally."); *Guarino*, 122 Wn. App. at 109; *FutureSelect*, 175 Wn. App. at 868; *Go2Net*, 158 Wn.2d at 253; *Hines*, 114 Wn.2d at 145. Ironically, FHLBS cites to three of these cases—*Go2Net*, *Hines*, and *FutureSelect*—as authority for its position. (Br. 4 n.5, 43-44.)

II. THE TRIAL COURT CORRECTLY DETERMINED THAT NO GENUINE ISSUE OF MATERIAL FACT EXISTS AS TO FHLBS'S ALLEGED REASONABLE RELIANCE

The trial court properly followed the requirements laid out by this Court: if there is no genuine issue of material fact regarding the plaintiff's reasonable reliance on alleged misrepresentations in entering into a transaction, then "summary judgment is proper." *Stewart*, 122 Wn. App. at 265. Summary judgment should be granted and the action dismissed when, "[u]nder the totality of the circumstances evidenced in the record, there is no basis to conclude that [the plaintiff] reasonably relied on the matters he assert[ed]." *Id.* at 261.

As the Supreme Court has made clear, "[t]he 'facts' required by CR 56(e) to defeat a summary judgment motion are evidentiary in nature." *Overton v. Consol. Ins. Co.*, 145 Wn.2d 417, 430, 38 P.3d 322 (2002) (citation omitted). A plaintiff cannot rely "on speculation [or] argumentative assertions" that unresolved factual issues remain. *Allard v. Bd. of Regents*, 25 Wn. App. 243, 247, 606 P.2d 280 (1980); *accord Seven Gables Corp. v. MGM/UA Entm't. Co.*, 106 Wn.2d 1, 13, 721 P.2d 1 (1986). Moreover, "[i]ssues of material fact cannot be raised by merely claiming contrary facts." *Meyer v. Univ. of Wash.*, 105 Wn.2d 847, 852, 719 P.2d 98 (1986). Rather, the plaintiff must submit evidence "setting forth specific facts, as opposed to general conclusions, to

demonstrate a genuine issue of material fact." *Thompson v. Everett Clinic*, 71 Wn. App. 548, 555, 860 P.2d 1054 (1993). As this Court has noted, when reasonable minds can reach but one conclusion, even questions of fact may be determined as a matter of law. *Barnes v. Cornerstone Invs., Inc.*, 54 Wn. App. 474, 478, 773 P.2d 884 (1989).

Here, FHLBS failed to introduce sufficient evidence to defeat summary judgment.

A. The Trial Court Correctly Found That, Under Washington Law's Eight-Factor Test And Other Applicable Principles, FHLBS Cannot Show That It Reasonably Relied On The Alleged Misrepresentations

Under the WSSA, "reliance must be reasonable under the surrounding circumstances." *FutureSelect*, 175 Wn. App. at 868. The "issue of justifiable reliance" thus necessarily involves "'the question of [the plaintiff's] diligence in ascertaining the facts for himself . . . [and] his exercise of care and judgment in acting upon representations which run counter to knowledge within his possession or reach.'" *Westby v. Gorsuch*, 112 Wn. App. 558, 575, 50 P.3d 284 (2002) (quoting *Rummer v. Throop*, 38 Wn.2d 624, 633, 231 P.2d 313 (1951)). It is well-settled Washington law that a party's right to rely on a representation is "inseparably connected" with the duty to use diligence in evaluating the representation. *Skagit State Bank v. Rasmussen*, 109 Wn. 2d 377, 384,

745 P.2d 37 (1987). "Washington courts have repeatedly held that a party's reliance is unreasonable where the party possesses written documents, knowledge, or expertise indicating the falsity of the representations at issue." *Tandiama v. NovaStar Mortgage, Inc.*, No. 03-cv-909, 2005 WL 1287996, at *3 (W.D. Wash. May 31, 2005); *see also Oates v. Taylor*, 31 Wn.2d 898, 928, 199 P.2d 924 (1949) ("[A] party cannot be permitted to say that he was taken advantage of, if he had means of acquiring the information, or if, because of his business experience or his prior dealings with the other, he should have acquired further information before he acted.").

Against the background of those principles, the undisputed record established that Barclays was entitled to summary judgment under the eight-factor test typically employed by Washington courts to evaluate reasonable reliance:

> (1) the sophistication and expertise of the plaintiff in financial and securities matters, (2) the existence of longstanding business or personal relationships, (3) access to the relevant information, (4) the existence of a fiduciary relationship, (5) concealment of the fraud, (6) the opportunity to detect the fraud, (7) whether the plaintiff initiated the stock transaction or sought to expedite the transaction, and (8) the generality or specificity of the misrepresentations.

Stewart, 122 Wn. App. at 274.

The evidence demonstrates that FHLBS was one of the most sophisticated participants in the RMBS market (*see supra* at 7, 16-21), a factor strongly supporting the trial court's entry of summary judgment for Barclays.[31] It is likewise undisputed that Barclays and FHLBS had neither a longstanding business relationship (factor 2) nor a fiduciary relationship (factor 4). Furthermore, the underwriting guidelines and USPAP disclosures were general, and statements conveying the WALTVs at origination made no specific representations about incorporating purported "true" home values (factor 8).

As for access to relevant information, concealment of the alleged fraud, opportunity to detect the alleged fraud, and how the transaction was initiated and driven (factors 3, 5, 6 and 7): for the reasons set forth below, there is no genuine material dispute that all of these factors weigh heavily against a finding of reasonable reliance.

As an initial matter, FHLBS had the opportunity to access any information it wished to obtain in connection with IND1 and IND2—given that it drove the transactions and communicated directly with

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[31] *See Emergent Capital Inv. Mgmt. v. Stonepath Grp., Inc.*, 165 F. Supp. 2d 615, 623 (S.D.N.Y. Oct. 2, 2001) (plaintiff's sophistication and expertise is a "principal consideration" in evaluating a claim of reasonable reliance); *Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1028 (4th Cir. 1997) ("A sophisticated investor requires less information to call a 'misrepresentation into question' than would an unsophisticated investor."); *Hirsch v. du Pont*, 553 F.2d 750, 763 (2d Cir. 1977) ("The securities laws were not enacted to protect sophisticated businessmen from their own errors of judgment.").

IndyMac. (*See supra* at 9-16.) In addition, the prospectus supplements disclosed risks of which FHLBS now complains. (*See supra* at 16-17.) Furthermore, crucial information was indisputably known to FHLBS at the time regarding the very issues as to which it now complains.

Regarding appraisals, FHLBS does not dispute that:

- By the time it purchased the first securitization at issue from Barclays in March 2007, FHLBS was aware that "an appraisal [is at least] +/- 10% of the actual value." (*See supra* at 17.)[32]
- It was aware in 2006 of a survey of thousands of appraisers of residential real estate stating that appraisal inflation was ubiquitous (which FHLBS cited in its complaint). This was consistent with numerous public reports and media accounts concerning appraisal inflation in the years leading up to FHLBS's purchase of IND1 and IND2,[33] and with FHLBS employees' testimony that they were

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[32] In addition, FHLBS's own purported expert, advanced to provide calculations of the purportedly "true" WALTVs, opined that the WALTVs in the prospectus supplement were *within* the purportedly "true" range of the WALTVs resulting from the expert's calculations for IND1—*i.e.*, there was no underlying appraisal inflation at all in the prospectus supplement for that certificate—and was outside of the purportedly "true" range he calculated by a *de minimis* difference of 1.5% for IND2. (SCP ___.) FHLBS's other purported expert, advanced to opine on materiality, stated that only variations "of three percentage points or more" in the WALTV of a pool of mortgage loans from what was disclosed in the offering documents can be considered material. (CP 4351 (¶ 17).) Therefore, FHLBS cannot even demonstrate that the prospectus supplements contained material misstatements about WALTVs of the mortgage loan pools backing the IndyMac certificates. Although it is not necessary for this Court to affirm on any basis other than FHLBS's failure to advance a genuine issue of material fact as to reasonable reliance, FHLBS's additional failure to advance any evidence of a material misstatement as to WALTVs would provide another independent basis upon which this Court can affirm the trial court's dismissal of FHLBS's claims as to WALTVs. *See Hannum v. Friedt*, 88 Wn. App. 881, 889, 947 P.2d 760 (1997) (affirming dismissal on grounds different from those upon which the trial court granted summary judgment, noting that the appellate court "can affirm on any grounds established by the pleadings and supported by the proof").

[33] Courts recognize that a number of different sources may provide relevant information, including "various reports in the media." *In re Merrill Lynch Auction Rate Sec. Litig.*, 851 F. Supp. 2d 512, 536 (S.D.N.Y. 2012); *see also Heliotrope Gen., Inc. v. Ford Motor Co.*, 189 F.3d 971, 980-81 (9th Cir. 1999); *Banca Cremi*, 132 F.3d at 1031;

aware of appraisal issues. (*See supra* note 17.) Furthermore, FHLBS was expressly notified in March 2007 that appraisal fraud was expected to continue to grow.[34]

- FHLBS's own purported expert on reliance and investor analysis of RMBS held the view—based on publicly available information at the time—that from 2003 through 2008, as more LTVs were related to refinancings, and therefore based on appraisals (rather than purchase prices), "[a]ppraisal errors and biases" made those newer reported LTVs "less reliable measures of collateral coverage on the mortgage loans." (CP 3725-29.)

Regarding underwriting guidelines, the undisputed record also establishes that FHLBS knew or should have known of the potential for guideline departures based on a mountain of information already known to FHLBS. FHLBS does not dispute that:

- FHLBS knew that approval of exceptions to underwriting guidelines could be "a reasonable business decision," and that underwriters sometimes deviated from guidelines in originating loans. (*See supra* at 18.)

- FHLBS understood that the type of mortgages that backed the two IndyMac certificates—interest-only and negatively amortizing loans, in which the borrower's "debt on the home is actually growing," such that the "debt might exceed the value of the home itself"—were riskier than traditional mortgages, particularly negatively amortizing loans which were "one of the most risky products in the mortgage market." (CP 1649; CP 686-88.) These loans had higher risks of defaults and loss—*i.e.*, higher risks that they would not be repaid—when they were made through low- or no-documentation loan programs. (CP 3737-42.) Here, the

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Compania Sud-Americana de Vapores, S.A. v. IBJ Schroder Bank & Trust Co., 785 F. Supp. 411, 419-20 (S.D.N.Y. 1992).

[34] *See* CP 1489-90 (email distribution of Mortgage Bankers Association NewsLink Report, dated March 12, 2007, quoting representative of the Mortgage Asset Research Institute).

prospectus supplements disclosed that the vast majority of the loans were issued through low- or no-documentation loan programs. (*See supra* note 6.)

- By the time FHLBS purchased the IndyMac certificates in 2008, the market was awash with public reports about the loosening of underwriting standards, the relaxation of underwriting criteria, as well as rising delinquencies and defaults of mortgage loans. (*See supra* at 18.) Indeed, according to FHLBS's own purported expert, information about riskier loan production and the loosening of lending standards was available to everyone in the market by 2007. (CP 3722-24.)

- As to each certificate at issue, FHLBS actually alleged in its Amended Complaint that, "[d]uring the time before this securitization, many originators of mortgage loans relaxed their actual lending practices" and that, "[a]s a result of this relaxation, mortgage loans made between 2004 and the date of this securitization have experienced high rates of delinquency and default." (CP 30 (¶ 77); CP 52 (¶ 138).)

- In addition, Adamo, who made the decision on behalf of FHLBS to purchase the IND1 and IND2 certificates, was generally unaware of the underwriting guidelines that applied to the mortgages underlying the certificates, and had never seen a full copy of any of the underwriting guidelines applicable to any of those loans. (CP 12382.) Thus, it is meaningless for FHLBS to claim that it "reasonably relied" on statements in prospectus supplements as guarantees of absolutely strict compliance with detailed guidelines—when Adamo did not even know what such guidelines provided.[35]

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[35] In fact, insofar as the prospectus supplements for the certificates contained high-level descriptions about IndyMac's underwriting guidelines—and stated that the loans "were originated or acquired generally in accordance with the underwriting guidelines described" (CP 1551; CP 1563)—FHLBS's purported expert on underwriting did not analyze whether the sample of loans he reviewed deviated in any way from the underwriting standards as described and laid out in the prospectus supplements. (SCP __.) Barclays' expert found that, even if FHLBS's expert's opinions as to the loans were accepted as true, not a single loan identified by FHLBS as "defective" was originated in a manner inconsistent with the guideline disclosures in the IND1 and IND2 prospectus supplements. (SCP __.) FHLBS offered no rebuttal to these findings, but rather

The sole conclusion that reasonable minds can draw from this record is that FHLBS (i) could not have reasonably relied on the WALTVs, based on appraisals, provided in the prospectus supplements, as reflecting "true" fixed property values with no potential variance, and (ii) FHLBS could not have reasonably relied on statements in the prospectus supplements that the loans were "originated or acquired generally in accordance with the underwriting guidelines described" as assurance of strict compliance, and no departures from, IndyMac's underwriting guidelines. FHLBS's active role in IND1 and IND2 weighs particularly heavily against finding reasonable reliance,[36] all the more so when combined with the plethora of relevant information that FHLBS knew or

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advanced another expert who opined, essentially, that the guideline disclosures in the prospectus supplement—the very statements on which FHLBS based part of its claims—were irrelevant. (SCP __.) Thus, FHLBS did not even demonstrate that there were any material misstatements in the prospectus supplements as to the loans backing the certificates. Again, although it is not necessary for this Court to affirm on any basis other than FHLBS's failure to advance a genuine issue of material fact as to reasonable reliance, FHLBS's additional failure to advance any evidence of a material misstatement as to underwriting guideline statements in the prospectus supplements would provide another independent basis upon which this Court can affirm the trial court's dismissal of FHLBS's claims as to loan underwriting guidelines. *See Hannum*, 88 Wn. App. at 889.

[36] *See Kennedy v. Josephthal & Co.*, 814 F.2d 798, 805 (1st Cir. 1987) (finding reliance unreasonable, where, *inter alia*, "it was [plaintiffs] who sought out this unusual tax shelter, although [defendants] found for them the specific operation"); *In re Merrill Lynch Auction Rate Sec. Litig.*, 704 F. Supp. 2d 378, 402 (S.D.N.Y. 2010) (granting motion to dismiss on reliance grounds where plaintiffs, among other things, "took the opportunity to purchase [the securities at issue] on their own initiative"); *William L. Thorp Revocable Trust v. Ameritas Inv. Corp.*, 57 F. Supp. 3d 508, 525 (E.D.N.C. 2014) (noting that where the plaintiff "initiated the transaction by approaching [the defendant] 'about doing some business,'" this "factor weighs against plaintiffs").

to which it had access, which did or should have put it on notice of the very issues which constitute the gravamen of its claims.[37]

B. FHLBS Provides No Basis To Reverse The Trial Court's Decision

1. FHLBS's Purported "Questions" On Appeal Do Not Raise Genuine Issues Of Material Fact

FHLBS's list of purported "questions" on appeal concerning additional details as to FHLBS's role in the transactions does not create a genuine issue of material fact as to whether it was reasonable for FHLBS to rely on the alleged misstatements. *See Clements v. Travelers Indem. Co.*, 121 Wn.2d 243, 249, 850 P.2d 1298 (1993) ("A material fact is one upon which the outcome of the litigation depends.").

The record is undisputed that FHLBS developed the IndyMac transactions directly with IndyMac, including communicating extensively with IndyMac to determine the structure and collateral loan pools[38] of the certificates that FHLBS wanted to buy—all before IndyMac and FHLBS

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[37] *See, e.g.*, *Banca Cremi*, 132 F.3d at 1031 (no reliance where the bank "had access to an extraordinary wealth of information regarding" the types of securities at issue that illustrated "one overriding point: investments in [such securities], while potentially very profitable, were undoubtedly highly risky"); *see also In re UBS Auction Rate Sec. Litig.*, No. 08-civ-2967, 2010 WL 2541166, at *23 (S.D.N.Y. June 10, 2010) (disclosures in the prospectus combined with "publicly available information . . . generally" were sufficient to preclude reasonable reliance); *Terra Sec. ASA Konkursbo v. Citigroup, Inc.*, 740 F. Supp. 2d 441, 450 (S.D.N.Y. 2010), *aff'd*, 450 F. App'x 32 (2d Cir. 2011) (reliance unreasonable for sophisticated plaintiff where red flags and other circumstances existed that indicated heightened degree of diligence was required).

[38] *See supra* at 9-16.

brought Barclays in to help execute the transactions.[39] Barclays has never contended that FHLBS played the role of an issuer or underwriter as to the IND1 and IND2 certificates, and that FHLBS undertook the work of implementing the structuring of the certificates or reviewing diligence reports or finalizing the legal documents. Nor has Barclays ever claimed that it was acting "on behalf of" FHLBS, as its agent or otherwise, in helping to implement the transactions, or that Barclays regularly provided information directly to FHLBS. Rather, the record is undisputed that FHLBS was interacting directly with IndyMac and that IndyMac was sending information to FHLBS; and it is clear that Barclays had to go through IndyMac, or receive its permission, to even communicate with FHLBS. *See supra* at 9-16. Likewise, the question of whether FHLBS or IndyMac reached out to the other first, or which one reached out to Barclays first, is immaterial: the relevant point, under the principles and factors considered by Washington courts regarding reasonable reliance, is that Barclays was brought in later in order to implement the transaction

[39] Although FHLBS suggests in its opening brief that there is a "question" as to whether the IND1 and IND2 deals were "conceived" in October 2007 by IndyMac and Barclays, FHLBS advanced no evidence supporting this suggestion (in fact, all contemporaneous evidence is exactly to the contrary). FHLBS points to a few documents showing Barclays contemplating a potential transaction involving IndyMac collateral (*see* Br. 18-19 (citing CP 4845-46, 4848, 4852)), but nothing in the record indicates that these documents were at all related to the transactions at issue here. The chronology and communications between FHLBS and IndyMac as to the creation of the IND1 and IND2 transactions is clearly laid out in the record. *See supra* at 9-16.

that FHLBS and IndyMac had already agreed upon.[40] Thus, the purported "questions" raised by FHLBS are red herrings on the critical issue of reasonable reliance.

2. The Purported "Undisputed Facts" To Which FHLBS Points Provide No Basis For Reversal

None of the handful of purported facts invoked by FHLBS create a genuine issue precluding summary judgment for Barclays. First, FHLBS misstates the law in suggesting that a defendant is liable under the WSSA for any alleged misstatement in an offering document filed with the SEC, irrespective of whether the plaintiff can demonstrate it actually and reasonably relied on the alleged misrepresentation.

As set forth above, under Washington law, FHLBS must demonstrate reasonable reliance on the alleged misstatements in entering into the transactions, under all the surrounding circumstances. (*See supra* at 37-38.) The mere fact that the alleged misrepresentations are contained in securities offering documents filed with the SEC does not, as a matter of law, preclude entry of summary judgment in favor of a defendant on the issue of reasonable reliance. *See, e.g.*, *Steed Fin. LDC v. Nomura Secs. Int'l, Inc.*, No. 00-cv-8058, 2004 WL 2072536, at *6-7 (S.D.N.Y. Sept.

[40] As for FHLBS's "question" regarding public information, it ignores not only the crucial information that was well known to FHLBS (*see supra* at 39-42), but also that FHLBS had direct involvement in putting together these specific certificates and communicated extensively, and directly, with the loans' originator, IndyMac.

14, 2004), *aff'd*, 148 F. App'x 66 (2d Cir. 2005) (dismissing Section 10(b) and Rule 10b-5 claims on motion for summary judgment for lack of justifiable reliance on statements in offering materials); *In re Adelphia Commc'ns Corp. Sec. & Deriv. Litig.*, No. 03-md-1529, 2007 WL 2615928, at *6 (S.D.N.Y. Sep. 10, 2007) (granting motion to dismiss section 10(b) and Rule 10b-5 claims brought by sophisticated investors who ignored red flags, finding that plaintiffs could not allege justifiable reliance on company's public filings given availability of information that should have alerted them to alleged misstatements). Indeed, where reliance is an element of a claim, investors are not permitted to blindly rely and claim reasonable reliance on an alleged misrepresentation despite "warning signs" and where critical information is known or readily available. *See Steed*, 2004 WL 2072536, at *7. Otherwise, any investor would be entitled to "close his or her eyes and refuse to investigate in disregard of a known risk or a risk so obvious that the plaintiff must be taken to have been aware of it." *Prof. Serv. Indus., Inc. v. Kimbrell*, 834 F. Supp. 1289, 1301 (D. Kan. 1993). That "would completely eviscerate the justifiable reliance element." *Id.* at 1304.[41]

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[41] *See also, e.g.*, *Ashland Inc. v. Morgan Stanley & Co.*, 700 F. Supp. 2d 453, 471 (S.D.N.Y. 2010), *aff'd*, 652 F.3d 333 (2d Cir. 2011) (dismissing securities claims where "[a]s a sophisticated institution contemplating the investment of tens of millions of dollars, it was unreasonable for [plaintiff] to rely upon the highly general statements alleged as misstatements"); *In re Merrill Lynch Auction Rate Sec. Litig.*, 851 F. Supp.2d

FHLBS similarly cannot avoid the "reasonable reliance" requirement simply because the prospectus supplements included a standard provision intended to protect *issuers and underwriters* from liability for statements made by others, such as representations by brokers.[42] Such a provision certainly does not define the scope of reasonable reliance for an investor—and provided no justification for FHLBS to ignore all of the information which it already had or to which it could gain access.

FHLBS's argument that its reliance could be found reasonable on the sole basis that Barclays sent a marketing presentation in May 2007 that generally described Barclays' due diligence process (Br. 13) is likewise entirely unavailing. To begin with, this argument directly contradicts FHLBS's contention that it did not rely on any information outside of the prospectus supplements. In any event, the marketing presentation had nothing to do with the IND1 and IND2 transactions, and

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512 (S.D.N.Y. 2012) (granting motion to dismiss § 10(b) and Rule 10b-5 claims for lack of reasonable reliance); *Brown v. E.F. Hutton Grp., Inc.*, 991 F.2d 1020, 1031-33 (2d Cir. 1993) (affirming summary judgment order after finding that application of the eight-factor test for reasonable reliance supports the conclusion that justifiable reliance cannot be established); *see also UST Private Equity Inv'rs Fund, Inc. v. Salomon Smith Barney*, 733 N.Y.S.2d 385, 386 (N.Y. App. Div. 2001) (affirming entry of summary judgment for defendant as to sophisticated investors' claims of misrepresentation based on inability to prove justifiable reliance on statements in offering documents when the investors did not conduct sufficient due diligence).

[42] CP 4270-71, 4275 ("You should rely only on the information contained in this prospectus and the accompanying prospectus supplement. We have not authorized anyone to provide you with information that is different from that contained in this prospectus and related prospectus supplement.").

Barclays did not solicit FHLBS to invest in the at-issue securities. Moreover, FHLBS offers no evidence that it even considered—much less relied on—this marketing presentation in deciding to invest in IND1 and IND2 nearly a year later. Nor could it. FHLBS was already "lined up" to purchase these securities well before Barclays was selected to issue them. (*See supra* at 9-14.)

Finally, the fact that the alleged misstatements were about the loans, and that FHLBS claims it did not have access to those loan files, does not create a material fact issue warranting reversal of the trial court's decision. FHLBS had a plethora of relevant information available to it (*see supra* at 39-42); FHLBS's own expert witness testified that information regarding the residential housing and mortgage markets is relevant to RMBS investors even if it does not address the specific individual loans backing the certificates at issue. (CP 3717, 3718-21, 3732-33.) Furthermore, there is no evidence that FHLBS ever tried to obtain loan files from IndyMac—with whom FHLBS communicated extensively in connection with these certificates—or Barclays. Having failed to ask for loan files (or even underwriting guidelines)[43]—despite the

[43] FHLBS never requested or reviewed IndyMac's underwriting guidelines until June 2008 after it purchased IND1 and IND2. (SCP ___.) The "unimportance" to FHLBS of the statements regarding underwriting guideline compliance in the prospectus supplements is particularly "clear" in light of this evidence. *See IKB Int'l S.A. v. Bank of Am. Corp.*, No. 11-ML-2265 MANX, 2015 WL 1650851, at *3-*4 (C.D. Cal. Feb. 23,

wide array of information that disclosed the issues of which it now complains—FHLBS cannot base its claim of reasonable reliance on such lack of files.[44]

In sum, FHLBS failed to put forth any actual evidence that created a genuine issue of material fact as to whether it reasonably relied on the alleged misstatements in the IND1 and IND2 prospectus supplements. Barclays was therefore entitled to summary judgment dismissing FHLBS's claims for lack of reasonable reliance, and the decision below should be affirmed.

CONCLUSION

For the foregoing reasons, this Court should affirm the judgment of the trial court dismissing FHLBS's claims against Barclays as to the IND1 and IND2 certificates.

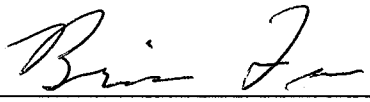
2015) (granting summary judgment and dismissing common law fraud claims on the basis that reasonable reliance on similar statements in offering documents regarding guideline compliance could not be established).

[44] *Phoenix Light SF Ltd. v. Goldman Sachs Grp., Inc.*, 43 Misc. 3d 1233(A), at *6 (N.Y. Sup. Ct. 2014) (plaintiffs failed to demonstrate diligence because they did not "ask[] for the loan files"); *see In re Merrill Lynch Auction Rate Sec. Litig.*, 851 F. Supp. 2d 512, 528 (S.D.N.Y. 2012) (sophisticated investor "was on notice of all information that a diligent inquiry would have disclosed" and "was also free to demand more information" before investing), *aff'd sub nom. La. Pac. Corp. v. Merrill Lynch & Co.*, 571 F. App'x 8 (2d Cir. 2014).

Dated April 19, 2017.

Respectfully submitted,

HILLIS CLARK MARTIN & PETERSON P.S.

By 

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CERTIFICATE OF SERVICE

The undersigned certifies that on this day she caused a copy of this document to be served via email to the last known address of all counsel of record.

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

Dated this 19th day of April 2017, at Seattle, Washington.

Michele R. Steele

Michele R. Steele, Legal Assistant

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APPENDIX I

20506-4-I

NO. 20506-4-I

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

GREGORY HINES, et al.,

Appellants,

v.

DONALD E. BARNARD, BRUNO E. BOIN, and

PERKINS COIE,

Respondents.

REPLY BRIEF OF APPELLANTS
(RE BARNARD AND BOIN)

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I. INTRODUCTION

Appellants (hereafter "Investors") will use this Reply Brief to identify and discuss those areas of the Brief of Respondents Barnard and Boin to which Investors take particular exception. For convenience of the court, Investors' comments will follow the organization of Respondents' brief. Investors will make every effort to limit the contents of this brief to a reply to the brief of Barnard and Boin, and will not reargue areas adequately briefed in Investors' opening brief.

II. FACTS

On pages 5 through 7 of their brief, Barnard and Boin down-play their participation in matters pertaining to the offering of the subject securities. In essence, they argue that their participation was limited to attendance at board meetings where important decisions appear to have been passively and anonymously ratified. Two points must be made here. First, this characterization of the participation of Barnard and Boin is not supported by the record. Pages 46 and 47 of the Brief of Appellants cite ample references to the record below indicating the active participation of Barnard and Boin in the full decision-making and

offering process. Second, and equally important, even if Barnard and Boin had not actively participated, this would be no defense: as directors of the issuing corporation they had a statutory duty both under the Washington Business Corporation Act ("WBCA") and under the Washington State Securities Act ("WSSA") to participate.

On page 8 Barnard and Boin assert that Peterson was back at work in June and "within a month of the operation, was fully recovered." A similar representation is made on page 21. Once again, this is factually incorrect and legally immaterial. Factually, the record establishes that Peterson was not back at work full time or at full speed for quite some time (CP 372-373; CP 384-386). Nor was he "fully recovered" -- he had two remaining brain aneurysms which he described as "a time bomb in my head." (CP 148-150). Moreover, facts pertaining to the <u>initial</u> aneurysm and brain surgery were material items subject to disclosure even if it was true that Peterson <u>appeared</u> to be recovering well.

On page 10 Barnard and Boin list the dates that plaintiffs "purchased their interest in Dataline." The schedule omits one Investor and does not include the dates on which Investors finalized

their investment decisions by tendering a check to the broker retained by Data Line. The complete information is as follows:

Name	Amount Purchased	Date of Purchase	Date of Certificate
William Vieser (d/b/a Circle 5 Associates IV)	$50,000	6/25/82	7/15/82
Richard Swan (D.S. Food Sales Co., Inc.)	50,000	7/9/82	7/15/82
Robert Arnold	50,000	7/13/82	7/15/82
Vance Mylroie	50,000	8/4/82	8/11/82
Gregory Hines	25,000	10/4/82	10/14/82
Gregory Hines (H&H Distributors Pension Fund)	50,000	10/4/82	10/14/82
Arne Midtskog	10,000	11/10/82	8/11/82[1]
Andrew Mathisen	50,000	11/11/82	12/1/82
Michael Schwartz	50,000	11/29/82	1/11/83
Total	$385,000		

1 Although Midtskog made his investment on November 10, 1982, in a decision made by the broker, his investment was recorded as part of an investment made by an investment partnership effective August 11, 1982. Although this does not appear to have been improper, it was done without his knowledge, and the August 11th issuance date on the certificates cannot be attributed to his decision, which was not made until November 10.

On page 11 Barnard and Boin state that Peterson did not decide whether to undergo the second aneurysm operation until sometime in late October, 1982. By this they would have the court believe that since the decision to undergo surgery had not been made, there was nothing to disclose. Although the second surgery may have been speculative prior to October 15, 1982, the existence of the remaining aneurysms was a fact which was known by Peterson and his physicians, easily discoverable by Barnard and Boin, and a highly material item which could have and should have been disclosed.

Also on page 11 Barnard and Boin quote from a letter by Peterson's surgeon written after the second surgery indicating the doctor's opinion that the chances of Peterson having subsequent complications were "very small." The fact that complications did arise resulting in the complete disability of Peterson should be sufficient to indicate that the chances -- though considered by a surgeon to be statistically very small -- would be considered by the reasonable investor to be sufficiently significant to require disclosure.

Finally, on page 12 Barnard and Boin assert that "Dr. Ojemann ultimately concluded that Peterson's health problems were related to depression, not to the aneurysm operations." This is a mischaracterization of Ojemann's testimony. As discussed on page 13 of the Brief of Appellants, although Ojemann concluded that Peterson's health problems were related to the depression, he acknowledged that the depression could in turn have been attributed either to the aneurysms or the surgeries.

III. LAW

A. Control Personal Liability.

On pages 12 through 19 of their brief, Barnard and Boin argue that they can only be liable for securities violations if they qualify as control persons of Data Line as defined by applicable federal laws and case decisions. From here they argue that the trial court properly concluded that neither Barnard nor Boin could be found to be control persons of Data Line. This argument fails for three reasons, each of which will discussed separately below.

1. Direct Liability Under RCW 21.20.430(1).

Shortly after Investors filed their opening brief, the Washington Supreme Court decided Haberman v. WPPSS, 109 Wn.2d 107, ____ P.2d _____ (1987). The Haberman decision expanded the definition of a seller of securities to include those whose participation in the sale was a substantial factor in causing the transaction to take place. As the court noted:

> We conclude that the substantial factor - proximate cause definition of seller prevailing in the federal circuits provides the best guidance for our analysis of seller liability under RCW 21.20.430(1). We note that our conclusion is in accord with the views expressed in the official comments to the recently revised Uniform Securities Act of 1985. Although not adopted in Washington, new Section 605(a) of the Uniform Securities Act contains the language of old Section 410 upon which RCW 21.20.430(1) was based. The official comments to Section 605(a) state that under this definition, 'liability may be imposed on a person in addition to the immediate seller if the person's participation was a substantial contributive factor in the violation.' [Citation deleted]. We believe that this approach best promotes the legislative purpose behind the WSSA, while harmonizing our statutory scheme with federal and other state decisions. We also believe this definition is in harmony with similar developments in general tort law.

Haberman at 130.

The level of participation of Barnard and Boin in the private placement preparation and sales process creates a question of fact as to whether they might be deemed substantial participants directly liable under RCW 21.20.430(1).

2. Per Se Liability Under RCW 21.20.430(3).

Nowhere in their brief to Barnard and Boin confront the uncontested abundance of case law from other jurisdiction precisely on point concluding that directors of a corporation are per se liable for securities violations of the issuer irrespective of control person status and irrespective of culpable conduct. On pages 39 through 41 of Investors' opening brief, five such cases are cited and discussed. In each decision state courts held directors per se liable under blue sky laws substantially identical to the operative provisions of § 21.20.430(3). Barnard and Boin do not in any way refute or even address these cases, and the assertion on page 12 of their brief that Investors' "reading of the Washington State Securities Act is not supported by . . . cases construing other similar state statutes" is simply not true.

Barnard and Boin cite two cases in opposition to the per se liability reading of § 21.20.430(3). The first case is Burgess v. Premier Corporation, 727 F.2d 826 (9th Cir. 1984). As discussed on pages 42 to 43 of Investors' opening brief, for reasons which we cannot know the Burgess court did not address the per se liability argument, and the Burgess decision cannot be cited to negate the express per se liability of directors created by § 21.20.430(3). Respondents' novel claim that Burgess creates different standards of culpability for direct sellers as opposed to outside directors is not supported by statute, case law or logic.

The second case cited is Harman v. Willbern, 374 F. Supp. 1149 (D. Kan. 1974). Barnard and Boin do not point out that Harman was not a securities case, but rather a derivative action against a former director and majority stockholder charged with breach of his fiduciary duty to the company, its creditors and its stockholders. It applied Kansas corporations law, not the securities laws. The Harman case is of no guiding or precedential value.

In summary, Respondents' brief raises no authority to seriously refute the clear language of

§ 21.20.430(3) making directors per se liable regardless of control person status and regardless of culpable participation.

3. Control Personal Status.

The main thrust of Barnard and Boin's argument is that they were not, as a matter of law, control persons of Data Line. Respondents cite two Ninth Circuit cases interpreting federal law which hold an outside director liable as a control person only if (1) he had actual power or influence over the alleged controlled person (in this case, either Data Line or its officers), and (2) he was a culpable participant in the alleged illegal activity. Buhler v. Audio Leasing Corp., 807 F.2d 833 (9th Cir. 1987) and Orloff v. Allman, 819 F.2d 904 (9th Cir. 1987). Although this court is not bound to adopt the interpretation of federal courts, sufficient questions of fact exist as to whether or not Barnard and Boin satisfied the two-part Buhler test even if it is adopted as the law of Washington.

The court noted in Buhler that "whether a defendant has power or influence over an allegedly controlled person is a question of fact." Buhler at 835. The references to the record set forth on pages 46 to 47 of Investors' opening brief are

sufficient for summary judgment purposes to establish that both Barnard and Boin had at least real influence over the private placement preparation and sales activities of Data Line, the legal effect of which can not be negated by a delegation of their power to the officers.

Barnard and Boin do not appear to contest the factual questions surrounding the first element. Rather, they address the second element and assert that there are "no facts upon which an inference can be made that Barnard and Boin culpably participated in any concealment of material facts from potential investors." (p. 19) However, the facts show at least a deliberate decision to avoid knowledge and the appearance of active participation by delegating their important duties to the officers. Under still-evolving Ninth Circuit law, Barnard and Boin may satisfy the second element of the Buhler test by culpably failing to act to prevent the misconduct.

Although initially invoked as a method to impose liability on broker-dealers for failing to supervise their sales agents, two Ninth Circuit cases and one Fifth Circuit case have recognized the applicability of the doctrine to non-broker

dealers under circumstances where a particular defendant had a duty to supervise. Kersh v. General Counsel of Assemblies of God, 804 F.2d 546 (9th Cir. 1986); G.A. Thompson & Co., Inc. v. Partridge, 636 F.2d 945 (5th Cir. 1981); Zweig v. Hearst Corporation, 521 F.2d 1129 (9th Cir. 1975). The court in Zweig set out five factors to be considered in determining whether a duty to supervise should be imposed on persons other than broker-dealers: (a) whether the controlling person derives direct financial gain from the activity of the controlled person; (b) the extent to which the controlled person is tempted to act unlawfully because of the controlling person's policies; (c) the extent to which statutory or regulatory law or the defendant's own policies require supervision; (d) the relationship between the plaintiff and the controlling person; and (e) some public policy need to impose such a requirement. See Zweig, 521 F.2d at 1135 and Kersh, 804 F.2d at 550.

In the present case, analysis of the listed criteria support application of the doctrine to Barnard and Boin: on the one hand, as major shareholders in Data Line they stood to gain financially from a large infusion of capital into the

corporation; on the other hand, the WSSA was promulgated to protect the investing public, who are in a position of inferior knowledge and inferior access to knowledge vis-a-vis corporate directors. Moreover, both the public policy embodied by the WSSA and the clear direction of § 21.20.430(3) support imposing a duty on directors to exercise the supervisory control given to them. At the very least, Barnard and Boin delegated their control and buried their heads in the sand. This culpable failure to act satisfies the participation prong of the Buhler test.

B. Washington Business Corporation Act.

On page 20 of their brief Barnard and Boin quote Miller v. King County, 59 Wn.2d 601, 605, 369 P.2d 304 (1962) for the proposition that "the rules of statutory construction require that statutes be interpreted to give meaning and effect to each, if possible." Investors could not agree more. However, Respondents would have this court render the provisions of RCW 21.20.430(3) meaningless in deference to RCW 23A.08.343. This court should comply with the mandate of Miller and give both statutes meaning and effect, which in the present case is not only possible but quite easy.

Section 23A.08.343 should be given its plain meaning to protect directors against mismanagement claims by shareholders if they exercise good business judgment in corporate matters. In those few and well circumscribed instances in which a corporation issues stock, § 21.20.430(3) should be given its plain meaning to control the conduct of directors for the benefit of the investing public. There is simply no reason to have an identical standard of care apply to two dramatically differently and easily distinguishable situations. A director of reasonable intelligence should be able to understand a statutory mandate that he or she owes a higher duty of care in decisions pertaining to sales of stock than he or she does in managing the day-to-day affairs of the corporation.

This precise issue was confronted by the Oregon Court of Appeals in Everets v. Holtman, 667 P.2d 1028, 1033 (Ore. App. 1983). The court reviewed the language of the Oregon Corporation Code, which is similar to RCW 23A.08.343, and concluded that compliance sheltered a director from liability to the corporation but not from investors with a securities claim. Barnard and Boin offer no

compelling reason why a similar interpretation should not be adopted by the courts of Washington.

C. Duty to Investigate.

Simply put, Respondents ask this Court to read the affirmative defense language of RCW 21.20.430(3) as a passive, good faith, lack of knowledge defense. There is absolutely no logical, statutory or case support for such a reading. By its clear words the statute requires affirmative action on the part of a director who would use it as a shield, i.e., directors are liable unless they:

> did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

Investors are prepared to admit for purposes of this appeal that Bernard and Boin did not know of Peterson's remaining aneurysms.[2] However, they have made no showing whatsoever that in the exercise of reasonable care they could not have known

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2 Of course, they both knew about Peterson's first aneurysm and operation yet chose not to require disclosure concerning this. As set out in their opening brief, Investors contend that this in itself constituted a material omission for which Barnard and Boin are liable.

of Peterson's ongoing health problems. The simple and undisputed fact is that they could easily have known, but chose not to make the least inquiry.

In support of their request to interpret the affirmative investigation language of § 21.20.430(3) to require only passive good faith, Respondents rely by analogy on Section 15 of the Securities Act of 1933 and Section 20(a) of the Securities Exchange Act of 1934. Notwithstanding recitations in the Uniform Securities Act concerning the historical origins of the affirmative defense language contained in § 21.20.430(3), a simple reading of the Section 15 and Section 20(a) language shows that they are distinctly and dramatically different from the language in § 21.20.430(3). Section 15 provides a defense if the defendant has no "reasonable grounds to believe in the existence of" the liability producing facts. Section 20(a) provides a defense if the defendant "acted in good faith." Both of these provisions allow a defense based upon passive ignorance. Section 21.20.430(3) clearly predicates the defense upon <u>action</u> -- the defense is not available unless the liability producing facts <u>could not have been discovered</u> in the exercise of reasonable care.

Barnard and Boin cite only one state case interpreting language similar to the WSSA. Hamilton Bank & Trust Co. v. Holliday, 464 F. Supp. 429 (N.D. Ga. 1979). In order to fairly evaluate the precedential value of Hamilton, the Court should be aware of certain facts not discussed in Respondents' Brief. Defendants in Hamilton were outside directors of HBI, a company which owned HFI as a wholly owned subsidiary. They were not directors of HFI. The only directors of HFI were the inside directors of HBI. The securities violations which were the subject of the suit were conducted by HFI. As a matter of fact, the court found that the outside directors of HBI did not participate, aid, abet or assist in the securities fraud participated by the inside directors on behalf of HFI, and did not learn about the transaction until afterwards. As to whether the outside directors' failure to learn of the fraud was unreasonable, the court concluded:

> It is important to note that in the context of HBI's overall loan reduction goal of $200,000,000, HFI's sale of loan participations totaling $1,800,000 to Plaintiff . . . was not a transaction which the Outside Directors of HBI could reasonably be expected to have investigated. HFI loans amounted to

> only $13,566,824 and constituted only two percent of HBI system's loans.

Hamilton at 1242.

Reasonable investigation by the outside directors of HBI would not have uncovered the unlawful conduct. Barnard and Boin, on the other hand, could have learned of Peterson's ongoing health problems by simply inquiring of Peterson or his physician, or by adequately supervising those to whom they purportedly delegated their responsibilities as directors.

On pages 28-31 of their brief Respondents discuss Lanza v. Drexel & Co., 479 F.2d 1277, 1280 (2d Cir. 1973). Investors are satisfied to stand on the discussion of Lanza contained on pages 41-42 and 49-52 of the opening brief.

D. Materiality.

On page 31 of their brief Bernard and Boin admit that Investors have raised material issues of fact regarding the materiality of Peterson's second brain aneurysms and craniotomy. As far as this admission goes, Investors agree and commend Respondents for their candor. The Court should not lose sight of the fact that Investors also contend that the initial aneurysm and craniotomy were

material facts which should have been disclosed. These were known to Barnard and Boin well in advance of the first closing, and should have been the subject of a supplement to the Private Placement Memorandum.

E. Causation.

On page 31 of their brief Barnard and Boin admit that Investors have raised material issues of fact regarding the element of causation. Respondents go on to invite the Court to comment upon the element of causation for guidance on remand. Investors welcome the guidance of this Court as well.

The parties disagree upon the level of causation required to establish a claim under the WSSA. Specifically, 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. Respondents contend that Investors must also show "loss causation," i.e., that the omission was a substantial contributive factor to the decline in the value of the stock. Investors feel that they adequately briefed this argument on pages 58-65 of their opening brief. They will take this opportunity to

address several new cases raised on pages 32-34 of Respondents' brief.

On page 32 Barnard and Boin cite Alna Capital Associates v. Wagner, 758 F.2d 562, 565 (11th Cir. 1985) for the proposition that "other states also hold that a plaintiff must establish causation to prevail." However, it is clear from reading Alna and the cases it discusses that the causation element referred to is that of transaction causation and not loss causation. Similarly, Respondents on page 33 refer to DuPont v. Brady, giving an incorrect cite. The correct cite is: [1986 Transfer Binder] Blue Sky Rep. (CCH) ¶ 72,457 (S.D.N.Y. 1986). As with Alna, DuPont discusses "proximate damage" in terms of reliance and transaction causation. Neither of these cases support Respondents' contention that other Uniform Securities Act states require loss causation. Indeed, New York is not even a Uniform Securities Act state.

F. Negligent Misrepresentation.

Nowhere does the Brief of Respondents address the negligent misrepresentation issue raised by Investors. This is appropriate, as reversal on the dismissal of Investors' negligent misrepresentation claim against Barnard and Boin seems a foregone

conclusion in light of Haberman v. WPPSS, supra. At pages 161-64 of the decision, the Haberman court adopted the rational discussed on pages 34-38 of Investors' opening brief. Specifically, the court accepted Restatement (Second) of Torts § 552(1), (2) (1977), the text of which is set out on page 28 of Investors' opening brief. Haberman expressly recognizes that an injured investor may state a claim for negligent misrepresentation against participants in a securities issuance based upon information supplied only indirectly by those participants.

In the instant case, Barnard and Boin as directors of Data Line were ultimately responsible for seeing that the information contained in the Private Placement Memorandum was accurate and complete. There is at the very least a question of fact in Investors' favor as to whether Barnard and Boin were negligent in their duty to see that the information supplied to potential investors was accurate and complete.

IV. CONCLUSION

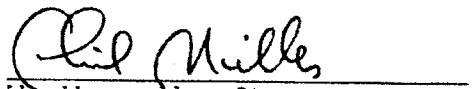
Barnard and Boin repeatedly ask this Court to construe the Washington State Securities Act narrowly to comport with federal statutes which

often are not even remotely similar in language. The Court should recall the Washington Supreme Court's recent pronouncement on this very point:

> We note that while the purpose of federal securities laws is to maintain the integrity of the secondary securities markets and to enforce disclosure, the WSSA is intended to protect investors [citations deleted]. To this end, this Court has construed the WSSA broadly. Haberman, supra, at 125-126.

Respectfully submitted this 18th day of January, 1988.

FERGUSON & BURDELL

By: 

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APPENDIX II

20506-4-I

ORIGINAL

NO. 20506-4-I

COURT OF APPEALS, DIVISION I,
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BRIEF OF APPELLANTS

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I. PROCEDURAL NOTE

This is an appeal from two cases which were consolidated for discovery and trial in the court below. The Hines case was brought by seven plaintiffs. The Swan case was brought by Swan alone. Both cases involve identical allegations against identical defendants. Respondent Perkins Coie was dismissed from the consolidated cases on May 4, 1987 after its motion for summary judgment. Respondents Barnard and Boin were dismissed from the consolidated cases on May 7, 1987 after their motions for summary judgment. Separate appeals were filed by Appellants approximately one week apart. By order of this Court dated June 8, 1987, the two appeals were consolidated. Although the underlying facts are the same as to all Respondents, the legal issues involved in this appeal are largely different as between Perkins Coie on the one hand and Barnard and Boin on the other.

II. ASSIGNMENTS OF ERROR

By separate orders, Honorable Anthony Wartnik dismissed Appellants' claims under the Washington State Securities Act and for negligent misrepresentation against Respondents Perkins Coie and Respondents Barnard and Boin. Neither order con-

tained findings of fact or conclusions of law, nor did either order specify the basis for granting the summary judgments. As such, the issues on this appeal become whether the orders may be upheld upon any ground. The specific issues pertinent to review are as follows:

A. Perkins Coie

Applicability of Washington State Securities Act

1. As a matter of law, can an injured investor state a cause of action against outside counsel for an issuing company pursuant to RCW 21.20.010 and/or RCW 21.20.430(3)?

Materiality

2. Did Perkins Coie establish, as a matter of law, that the health condition of the chief executive officer of the issuing company was not a material fact subject to disclosure?

Negligent Misrepresentation

3. As a matter of law, may injured investors state a cause of action for negligent misrepresentation against outside counsel for an issuing company?

4. Did Perkins Coie establish, as a matter of law, that it was not negligent toward Appellants

in failing to disclose, or insist upon disclosure by the issuing company or its directors, of the health condition of the chief executive officer?

B. Barnard and Boin

Materiality

5. Did Barnard and Boin establish, as a matter of law, that the health condition of the chief executive officer of the issuing company was not a material fact subject to disclosure?

Control Person Liability

6. Are outside directors of an issuing company subject to liability under RCW 21.20.010 and/or RCW 21.20.430(3) only if they are controlling persons of the issuing company?

7. Did Barnard and Boin establish, as a matter of law, that they were not controlling persons of the issuing company at the time of the offering?

Reliance Defense

8. May outside directors rely on officers, inside directors and/or independent counsel to make factual investigations and legal determinations as to what facts are material and therefore subject to disclosure in offering materials?

9. If the law recognizes a "defense of reliance," did Barnard and Boin establish, as a matter of law, that they are entitled to the protection of the defense?

Causation

10. Must an injured investor prove that the specific fact or facts omitted from the offering materials directly caused the security to become worthless?

11. Did Barnard and Boin establish, as a matter of law, that the health condition of the chief executive officer of the issuing company was not a substantial contributing factor to the failure of the company?

Negligent Misrepresentation

12. May injured investors state a cause of action for negligent misrepresentation against outside directors of an issuing company?

13. Did Barnard and Boin establish, as a matter of law, that they were not negligent toward Appellants in failing to disclose, or insist upon disclosure by the issuing company or its directors, of the health condition of the chief executive officer?

III. STATEMENT OF THE CASE

Appellants, who will be hereafter referred to as "Investors," are eight individual purchasers of stock in a now defunct company known as Data Line Systems, Inc. ("Data Line" or the "Company"), pursuant to a private placement of securities. Respondents Barnard and Boin are individuals who served as outside directors (i.e., they were not officers) of Data Line prior to and during the offering. Respondent Perkins Coie is a private law partnership which was retained as outside counsel by Data Line to give advice and assistance to Data Line in connection with the offering.

Also named as defendants in the actions below, although not parties to this appeal, were Data Line, three individuals who were officers and directors of Data Line (and their spouses), two individuals who were also outside directors of Data Line (and their spouses), the underwriter, Evans Llewellyn Securities, Inc., and its principals, Andrew Evans and Ann Llewellyn.

Data Line was founded in June, 1980 by former employees of Key Tronic Corporation, Dale Peterson and Gary Morgan. (CP 339-342) The Company was formed primarily to market an optical character

recognition ("OCR") slot reader combined with a computer terminal for automating the processing of transactions by bank tellers. Although systems such as this were to some extent already in production by several other manufacturers, Data Line was convinced that its product represented a marked improvement in several respects. (CP 343-344)

Senior management of Data Line from its inception throughout the period of the stock offering in question consisted of Dale L. Peterson, director, president and chief executive officer; Gary B. Morgan, chairman of the board and executive vice president; and John T. Mason, director and secretary/treasurer.

Prior to the formation of Data Line, Peterson had been associated with Burroughs Corporation and later held positions of senior responsibility in Key Tronic Corporation in Spokane. At the time of the stock offering he was 47 years old and a capable executive with excellent marketing skills and an ability to attract lender and venture capital. (CP 340-341)

In addition to the three officers/directors named above, there were four other directors at the time of the stock offering. These included Lewis

Zirkle, Robert Cline and Respondents Barnard and Boin. Barnard and Boin purchased a significant interest in the Company -- 11% of the common stock each -- and were voted to the board of directors at the first annual meeting in June of 1980. (CP 339-342; CP 345-346; CP 392-393)

During the first one and one-half years of its existence, the Company was primarily engaged in designing its products. By early 1982, the board of directors had determined that the Company would need substantial outside financing in order to be successful. After reviewing various alternatives, the board authorized its officers to enter into an agreement with Evans Llewellyn Securities, Inc. for the sale of stock pursuant to a private placement memorandum. (CP 351-352) A business plan was prepared and given limited circulation to potential investors, including some of the Appellants. It described Peterson's health as "excellent." (CP 395)

On June 10, 1982, Data Line and Evans Llewellyn caused a private placement memorandum (the "PPM") to be circulated offering for sale to investors meeting certain suitability standards a minimum of 30,000 and a maximum of 70,000 shares of

common stock in Data Line at a price of $25.00 per share. Under the terms of the PPM each investor was to make a minimum purchase of 2,000 shares for $50,000.00. The offering was to be terminated and investors' funds returned with interest if Data Line did not receive and accept subscriptions for at least 30,000 shares within a limited time period. The PPM, provided to each Investor before the actual purchase of stock, included the following disclosure:

> (9) Dependence Upon Key Personnel. The performance of the Company depends upon the active participation of its officers, including Dale L. Peterson, its President and Chief Executive Officer, and Gary B. Morgan, its Chairman of the Board, Executive Vice-President and Chief Operating Officer, and a small group of other technical and management personnel. The loss of any of these qualified personnel could have a material adverse effect upon the Company.

(Emphasis added.) (CP 357-358)

The PPM was published on June 10, 1982. Four days earlier, on June 6, 1982, Dale Peterson was hospitalized in Spokane and on June 7 diagnosed as having multiple aneurysms located in the blood vessels supplying his brain. (CP 359) Peterson was flown to the University Hospital in Seattle, where on June 10, 1982 -- the very day on which the PPM was circulated -- George Ojemann, M.D. opened

his skull and closed off the aneurysm that had bled. (CP 360-362) Dr. Ojemann could not undertake to perform corrective surgery on the remaining aneurysm as it was located in the opposite hemisphere of Peterson's brain.

All of the directors were advised of Peterson's hospitalization and condition prior to his transfer to Seattle for surgery. (CP 366-367) Perkins Coie was advised of Peterson's condition at approximately the same time. (CP 366-367) Shortly after the surgery, Perkins Coie recommended in writing that information regarding Peterson's health problem be disclosed to investors prior to closing of the stock sales. Attorney Stuart Landefeld of Perkins Coie documented this decision in a letter as follows:

> Gary [Morgan] and I have discussed the possibility of Dale writing a letter to all investors on his health in thirty days, or before the closing. This would both provide full information and reassure investors. Let's plan on it.

(CP 370-371)

In spite of the fact that the June surgery was apparently successful, the existence of the remaining aneurysm presented a continuing problem. Following the surgery, and before his discharge on

June 16, Peterson was advised by Ojemann that he should have a second surgery to repair the remaining aneurysm, and that this surgery should take place within six months. (CP 363-365) Without that corrective surgery there could be another sudden bleeding episode which in turn would create a serious risk of death. For the otherwise normal person the risk of this occurring without corrective surgery would be at the cumulative rate of 2% per year. However, Peterson's remaining uncorrected aneurysm was larger than most in size. In addition, he suffered from high blood pressure. This combination of factors significantly increased his risk of another aneurysm explosion up to the time of the second surgery. There was a likelihood that the second surgery would correct the remaining aneurysm in the sense that it would prevent future bleeding. However, with any surgery on an aneurysm buried deeply in the brain there is a distinct risk that the patient's cognitive function will be adversely affected to some degree. (CP 363-365; CP 374-375; CP 376-378; CP 379-380)

Peterson and his wife knew of the doctors' concern and of the need for the future surgery. It does not appear that either Perkins Coie, Barnard

or Boin actually knew of the existence of the remaining aneurysm, the need for future surgery, or the risks involved therewith. However, it is undisputed that neither Perkins Coie, Barnard nor Boin ever checked with Dr. Ojemann or any other treating physician with respect to the progress which Peterson was making. Nor is it disputed that none of the individuals expressly inquired of Peterson as to his exact condition. Rather, all chose merely to observe Peterson and draw lay conclusions from his appearance and behavior.

The eight Appellants subscribed for a total of $385,000.00 of stock in Data Line, which stock was issued pursuant to closings occurring between July 15, 1982 and January 11, 1983. (CP 11)

In mid-October of 1982, Peterson went to California to seek a second medical opinion. A review of an angiogram at that time disclosed the presence of two remaining aneurysms. A doctor there concurred in the advice given by Ojemann. He quoted Peterson describing himself as having a "time bomb in my head." (CP 148-150)

Peterson underwent a second surgery by Dr. Ojemann on December 7, 1982. The two aneurysms which were addressed in this process were located

near the base of the right hemisphere of Peterson's brain. Almost immediately afterwards it became apparent that Peterson was not making a satisfactory recovery. By February of 1983 Peterson was experiencing mental problems including a severe depression. The board of directors became concerned and forced him to tender his resignation as chief executive officer. He did so on March 28, 1983. Later that year he took a medical leave of absence and never returned to Data Line.

Although Respondents argued below that (a) Peterson's depression was not caused by either the aneurysms or the surgery and (b) Peterson's retirement from the Company had nothing to do with its demise, the record in this case clearly supports a contrary finding on both points. Psychiatrist John E. Hamm, an expert consultant retained by Investors, presented an affidavit to the court which concluded that Peterson suffered from (1) organic mental disorder, post-intracranial aneurysm operations and (2) depression secondary to the diagnosis and surgical treatment of intracranial aneurysms. (CP 308-309, ¶ 6) Dr. Hamm concluded that there was a significant causal relationship

between the aneurysms and the depression. (CP 308-309, ¶ 6)

Respondents below mischaracterized the testimony of Peterson's neurosurgeon, Dr. Ojemann, as concluding that Peterson's health problems were related to depression, not to his aneurysm operations. What Dr. Ojemann actually stated was his opinion that Peterson did not sustain frontal lobe damage during the surgery. He went on to say, however:

> What the precipitating factors were for [the depression] I am not totally sure.
>
> . . .
>
> The stress of the operation might have contributed . . . . (CP 387-388)

Nor did Respondents prove as a matter of law that Peterson's retirement was not a contributing factor to Data Line's failure. On June 6, 1983 -- one year after the offering -- Data Line wrote a letter to its shareholders stating:

> [H]owever, we did not meet our projected sales for 1982 nor did we meet our revenue projections. Additionally, we did not meet our expected gross margin percentages.
>
> We can identify the reasons for this poor showing, based upon the following facts:
>
> 1. Dale Peterson, president and CEO, had a brain aneurysm and operations in June and

> December which constrained his participation.
>
> . . .

(CP 384-386)

A draft prospectus approved by Barnard, Boin and the other directors in connection with a failed capitalization effort in 1983 states:

> During the second half of 1982* the efforts of the Company to change its orientation from research and development to marketing and sales were hampered by the serious illness of its then President. This disabling illness persisted throughout the period and eventually required that he take a medical leave of absence. See "Management Remuneration". Also during this period the need for additional working capital became critical and diverted significant executive time and effort from the sales and development of the Company's product line. Both of these factors adversely affected the Company's results, particularly since it had increased its level expenses in anticipation of additional sales.

(Emphasis added) (CP 372-373)

In July of 1984 the corporate stockholders voted to wind up the affairs of Data Line. Stock purchased under the PPM is worthless.

IV. ARGUMENT - PERKINS COIE

A. Investors May State A Cause Of Action Against Perkins Coie As Outside Counsel To The Issuer Pursuant To RCW 21.20.010 And/Or 21.20.430(3).

Perkins Coie's argument against attorney lia-

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* Note that the depression did not begin until 1983.

bility under the Washington State Securities Act (WSSA) is that the language of the WSSA must be literally construed to impose liability only upon those who fall within very narrow definitions of certain identified persons; since nowhere do the statutes expressly make attorneys liable for participating in the issuance of misleading offering materials, Investors have no cause of action against Perkins Coie.

This fits in quite nicely with an argument advanced by Barnard and Boin which would lead to the conclusion that, even admitting that a crucially material fact was omitted from the offering materials, no one is liable to Investors. The argument goes like this:

> The Washington Business Corporation Act specifically allows directors to delegate their duties and rely on the opinions of qualified experts, including attorneys. (RCW 23A.08.343). The Data Line directors delegated decisions regarding materiality to Perkins Coie, and relied on the ultimate recommendation of Perkins Coie not to disclose Peterson's health problems. Since the directors relied on Perkins Coie, it wouldn't be fair to hold them liable for the result. From Perkins Coie's standpoint, since attorneys are not expressly named in the WSSA, it would not be fair to hold Perkins Coie liable.

Investors do not believe that our Legislature intended such an absurd result, and do not feel

that either the pertinent statutes or relevant case law dictate such an absurd result.

The WSSA is codified in RCW 21.20.005, et seq. The basic anti-fraud prohibition is contained in RCW 21.20.010, and provides in pertinent part as follows

> Unlawful offers, sales, purchases. 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 statements made, in the light of the circumstances under which they are made, not misleading. . . .

Washington's civil liabilities section is contained in RCW 21.20.430 and reads, in pertinent part, as follows:

> (1) Any person, who offers or sells a security in violation of 21.20.010 . . . is liable to the person buying the security from him or her, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at eight percent per annum from the date of payment, costs, and reasonable attorneys' fees . . .
>
> . . .
>
> (3) Every person who directly or indirectly controls a seller or buyer liable under subsection (1) . . . above, every partner, officer, director or person who occupies a similar status or performs a similar function of such seller or buyer, every employee of such a seller or buyer who

> materially aids in the transaction, and every broker-dealer, sales person, [or other authorized seller] who materially aids in the transaction is also liable jointly and severally with and to the same extent as the seller or buyer, unless such person sustains the burden of proof that he or she did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

RCW 21.20.430(1) expressly makes the actual issuer of the securities liable. RCW 21.20.430(3) expressly makes every partner, officer and director of the issuer liable, subject to a due diligence defense. In addition to the obvious participants expressly named, the statute should be interpreted to include unaffiliated professionals such as accountants and attorneys who are substantial contributors to the primary violation. The statutes in question leave four basic openings from which to derive independent professional liability under appropriate facts. These are as follows:

(1) Control person liability under RCW 21.20.430(3);

(2) Liability of persons performing a function similar to an officer or director under RCW 21.20.430(3);

(3) Employee liability under RCW 21.20.430(3); and

(4) An implied private right of action for aiding and abetting under RCW 21.20.010, or an "extended privity" argument under RCW 21.20.430(1).

1. Perkins Coie Indirectly Controlled Data Line As To the Pertinent Non-Disclosure.

Subsection (3) of RCW 21.20.430 expressly identifies several classes of individuals who are secondarily liable for securities violations. Included in this list is:

> every person who directly or indirectly controls a seller or buyer liable under [§ 21.20.430(1)].

Perkins Coie would have this Court believe that "control" means a voting majority of the shareholders and directors. In fact, "control" in this context means only the power to influence the pertinent decision. While no Washington case law defines the sweeping phrase "directly or indirectly controls" contained in the statute, case law and administrative interpretations in other jurisdictions construing comparable statutes shed light on these issues. The cases clearly define these terms

broadly enough to encompass persons in positions comparable to that of Perkins Coie.

For example, the "control" language of the WSSA is similar to the broad language contained in Section 15 of the Securities Act of 1933, 15 U.S.C. § 77o. In regulations implementing the federal securities laws, the SEC chose a broad, open-ended definition of "control":

> The term "control" . . . means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the person, whether through the ownership of voting securities, by contract, or otherwise.

17 CFR § 230.405 (1984).

Consistent with the SEC's approach, courts have interpreted Section 15 control person liability to extend to any person or entity that has the power to influence the seller of a security. Pennaluna & Co. v. SEC, 410 F.2d 861 (9th Cir. 1969), cert. denied, 396 U.S. 1007 (1970). Accord, Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968) (control person liability requires "only some indirect means of discipline or influence short of actual direction"); G.A. Thompson v. Partridge, 636 F.2d 945

(5th Cir. 1981); McFarland v. Memorex Corp., 581 F. Supp. 878 (N.D. Cal. 1984).

It is undeniable that Perkins Coie had the power to influence the Data Line directors in their decisions as to which matters were to be deemed material for purposes of disclosure. Indeed, this is one of the express purposes for which Perkins Coie was employed. Director Morgan testified in his deposition that Data Line followed Perkins Coie's advice not to disclose Peterson's health problems. (CP 444-446) In response to questioning by the directors, Perkins Coie affirmatively advised that no additional disclosure was necessary as to Peterson's health problems. (CP 444-446; CP 381-383) Andy Evans, of underwriter Evans Llewellyn, testified at his deposition that this was his company's first underwriting, and that the officers and directors of Data Line as well as his own company were heavily relying on the attorneys' advice as to what should be disclosed. (CP 474-475) Perkins Coie gave an express opinion that no material facts were omitted from the offering materials. Perkins Coie did not establish as a matter of law that it had no "indirect means of

influence" regarding the decision to disclose or conceal.

2. Perkins Coie Performed a Function Similar To That of a Director In Regard to the Non-Disclosed Information.

Subsection (3) of § 21.20.430 also imposes secondary liability on:

> [E]very partner, officer, director or person who occupies a similar status or performs a similar function of [a seller or buyer liable under § 21.20.430(1)]. . . .

Nowhere is the inequity of Perkins Coie's argument more evident than in its denial of liability under this section of the WSSA. It is the primary responsibility of directors, on behalf of a corporate entity, to make the numerous important decisions involved in a public offering of securities. One of the most important of these decisions involves the determination as to what facts are material and therefore required to be disclosed to potential investors. This is one of the primary "functions" of a director. Rightly or wrongly, Barnard, Boin and the other directors expressly attempted to delegate this critical director function to Perkins Coie. There is no logical reason why director liability should not be extended to Perkins Coie in such circumstances.

Failure to extend liability in a case such as this could lead to the creation of an unintended major loophole to liability. Section 23A.08.343 of the Washington Business Corporation Act expressly allows directors to delegate certain duties and rely upon the opinions of qualified experts, including attorneys and accountants. Although this section was intended to enhance the business judgment rule defense available to directors in an action brought by shareholders, there is nothing on the face of the statute to prevent it from implying a new defense to liability under the securities laws, i.e., delegation of the function and any resultant liability to outside experts. However, outside experts will argue, as does Perkins Coie here, that they are not liable under the securities laws because they are not expressly named in RCW 21.20.430(1) or (3).

If both propositions are accepted by the courts, injured investors will be without a remedy. This patently inequitable dilemma can be resolved in either of two ways: courts can refuse to apply the Business Corporation Act delegation defense in securities litigation; or the courts can interpret the "function of a director" language in RCW

21.20.430(3) to have liability stay with whoever performs the actual function of the director. While either solution would be generally acceptable, consistent resolution is critical. The courts of this state cannot allow directors of an issuer to delegate responsibility for materiality disclosure decisions to outside counsel without giving injured investors a direct cause of action against outside counsel.

3. Perkins Coie was an Employee of Data Line.

Perkins Coie was retained (and presumably well paid) to give advice such as it gave regarding the materiality of Peterson's health problems. In Ackerman, Jablonski, Porterfield & DeTure v. Alhadeff [Blue Sky Law Reporter (CCH) ¶ 72,390 (W.D. Wash. 1986)], on a motion to dismiss, the court addressed the issue of whether an independent professional retained by the seller/issuer of securities may be an "employee" within the meaning of the statute. The court held that the accounting firm of Arthur Anderson & Company, which was retained by the issuer/seller to prepare audited financial statements, "could be considered an employee of the seller of the securities who

materially aided the sales transactions." Id. at 71,768. Investors request this Court to interpret the "employee" liability language of Section 430(3) to include outside experts such as Perkins Coie specifically retained to aid in the offering process.

4. "Participant Liability" Beyond Those Literally Named in the Statutes is Recognized in Washington

Perkins Coie argues that RCW 21.20.430(1) requires strict privity between the seller and the purchaser of securities. Since Perkins Coie was not the actual seller of any of the securities, it claims that it cannot be liable under RCW 21.20.430(1). Such a strict and literal reading of the statute runs counter to the principles of interpretation established by the Washington Supreme Court as set forth in McClellan v. Sundholm, 89 Wn.2d 527, 533, 574 P.2d 371, 374 (1978):

> We note also that securities legislation is remedial in nature and has as its purpose broad protection of the public. Thus it is appropriate to construe the statute broadly in order to maximize the protection offered . . . .

Such a narrow reading of the WSSA would also run contrary to its legislative history. Prior to 1977, the civil liability provision of the WSSA,

§ 21.20.430, did not incorporate the prohibitions of § 21.20.010, which had been held to imply a broad private right of action. See Shermer v. Baker, 2 Wn. App. 845, 472 P.2d 589 (1970). In 1977, the Legislature amended the WSSA to broaden the express cause of action contained in § 21.20.430(1) and encompass the prohibitions set forth in § 21.20.010. These prohibitions include conduct that goes far beyond concepts of fraud or misrepresentation by persons in direct privity; § 21.20.010 outlaws all acts done "in connection with the offer, sale or purchase of any security directly or indirectly . . . ." (Emphasis added). An interpretation of § 21.20.430(1) that only sellers who engage in face-to-face transactions with purchasers are liable under the WSSA is plainly inconsistent with the intended incorporation of the broad prohibitions of § 21.20.010 into the express civil liability provisions of the WSSA.

Two Washington Court of Appeals cases expressly accept a "substantial participation" test for purposes of the WSSA. Both hold that "participants" in a transaction are liable under the WSSA even if they did not pass title of the security to the purchaser. In Golberg v. Sanglier, 27 Wn.

App. 179, 616 P.2d 1239 (1980), rev'd on other grounds, 96 Wn.2d 874, 639 P.2d 1347 (1981), the court held:

> Participant liability for a violation of RCW 21.20.010 may result from the rendition of assistance in perpetration of the violation even though the participant is not an actual party to the sale.

Id at 193 (Emphasis added).

Similarly in Kaas v. Privette, 12 Wn. App. 142, 529 P.2d 23 (1974), the court stated:

> Each party who joins in misrepresenting material facts to a prospective purchaser is required to return the defrauded purchaser to his former position when the grounds for rescission are proven. [Citations deleted]. Every participant in a fraud and each one who assists another in the perpetration of the fraud is liable to the injured party.

Id., at 151 (Emphasis added).

While both Goldberg and Kaas concern liability under § 21.20.010 and do not expressly address the provisions of § 21.20.430, the latter section only adds an express remedy to that which had previously been implied under RCW 21.20.010. Burgess v. Premier Corp., 727 F.2d 826, 839 (9th Cir. 1984)). See also Rainier National Bank v. Schnurr [1982-84 transfer binder], Blue Sky Law Reporter (CCH) ¶ 71,760 (Wash. Sup. Ct. 1981) (bank is security seller though it did not pass title).

Decisions of the federal courts construing § 12(2) of the Securities Act of 1933, which contains a parallel provision to the WSSA civil liabilities section, also make it clear that the notion of "seller" comprehends those who assist in the sales process. The Second, Fifth, Sixth and Ninth Circuits, for example, all accept the "substantial participation" test in Section 12(2) cases. E.g., Katz v. Amos Treat & Co., 411 F.2d 1046 (2d Cir. 1969); Hill York Corp. v. American International Franchises, Inc., 448 F.2d 680, 692 (5th Cir. 1971); Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973); Davis v. Avco Financial Services, Inc., 739 F.2d 1057, 1065-68 (6th Cir. 1984), cert. denied, 105 S. Ct. 1359 (1985); Admiralty Fund v. Jones, 677 F.2d 1289, 1294 (9th Cir. 1982); SEC v. Murphy, 626 F.2d 633, 650 (9th Cir. 1980).

Alternatively, if this Court concludes that RCW 21.20.010 and 21.20.430(1) require a showing of privity, there is no reason to apply a definition of privity different than normal tort or contract privity. Section 552 of the Restatement (Second) of Torts states in pertinent part:

> Information negligently supplied for the guidance of others.
>
> (1) One who, in the course of his business, profession or employment . . . supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
>
> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

Attorneys must realize that any information and advice they provide to issuers for use in connection with a securities offering will be passed on to a defined group of individuals -- potential investors -- to be relied upon by them in making their investment decision. Washington courts have held professionals imparting information which they know would be relied upon by others to a high standard of care. See, e.g., Rogers v. Toppenish, 23 Wn. App. 554, 557, 596 P.2d 1096, 1098 (1979).

The courts of other states have also extended the liability of professionals to foreseeable recipients of information without strict privity. See, e.g., Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 57 Cal. App. 3d 104, 110, 128 Cal. Rptr. 901, 905-906 (1976) (the court applied a foreseeability-based balancing test in holding an attorney liable to third parties who relied upon his negligently prepared legal opinion). See also, International Mortgage v. John P. Butler Accountancy Corp., 177 Cal. App. 3d 806, 223 Cal. Rptr. 218 (1986); Bradford Securities Processing Services, Inc. v. Plaza Bank & Trust, 653 P.2d 188 (Okla. 1982).

Investors do not believe that Perkins Coie's assertions regarding strict construction of § 21.20.430(1) adequately address or accurately reflect the state of the law on this subject, and believe that primary liability for "participants" goes well beyond the literal seller of the security.

B. Perkins Coie Did Not Establish, As A Matter Of Law, That Peterson's Health Condition Was Not A Material Fact Subject To Disclosure.

Admittedly, if the trial court found that facts concerning Peterson's health were not material, then that finding alone would completely dispose of Investors' securities claims and probably Investors' negligent misrepresentation claims as well. However, it is impossible for the trial court to have found, as a matter of law, that facts concerning Peterson's health were not material. If anything, it is clear as a matter of law from the evidence presented that such facts were material. The only affidavit directly addressing the question of materiality is that of MacMillan Pringle (CP 303-306), an investment advisor consulted by Investors, which affidavit was uncontested. Mr. Pringle concluded that Peterson's health condition was a fact that a reasonable investor would consider material to his or her investment decision. The facts completely support this conclusion. Pertinent facts include:

(a) That on June 6, 1982, Dale Peterson was hospitalized and on June 7 diagnosed as having multiple brain aneurysms in the blood

vessels to the brain, one of which had bled (CP 359);

(b) That on June 10, Peterson underwent "urgent" intracranial surgery to repair the aneurysm which had bled (CP 360-362; CP 374-375);

(c) That even after the surgery an untreated treated aneurysm remained (CP 363-365); and

(d) That Peterson's physician recommended that he undergo a second craniotomy within six months to repair the untreated aneurysm. (CP 363-365)

Amazingly, Perkins Coie, Barnard and Boin all contend that no reasonable mind could find that an investor would consider Peterson's health problems material facts to be weighed in his or her investment decision. Their logic can be summarized as follows:

> As of the date of the PPM, Peterson appeared to be recovering well from the initial brain surgery. Although facts concerning significant complications might have been material, there is nothing material about a typical recovery from brain surgery. Since the second brain surgery was six months away, potential complications from the second surgery would be speculative as opposed to material. Finally, since his retirement was caused by depression and not by bursting

> aneurysms, nothing concerning aneurysms disclosed in the PPM could possibly have been material in any event.

Not only is this sleight-of-hand logic factually unsupportable, but it misstates the legal standard applied to Investors' security claim.

Respondents asserted that Peterson's doctor had given him a clean bill of health after the first operation and that ". . . any failure to disclose an operation from which a full recovery had been made is not material." (CP 14-15). From this faulty premise they argue that no reasonable investor could attach importance to a past operation from which there was a complete recovery. This argument fails for a number of reasons. First, Dr. Ojemann had not given Peterson a clean bill of health following his first surgery. Peterson's condition post-surgery was that he would have to undergo a period of recovery from the first surgical procedure, that he carried at least one untreated aneurysm with a danger of rupture, and that he should undergo a second brain surgery within six months. (CP 363-365). Respondents also argue that, at least as of the first two closings, the aneurysms had not affected Peterson's health. This, however, is premised upon a false assumption

as to the element of causation, which is discussed in more detail in Section V.E. below. It is sufficient for purposes here to note that there is no requirement that Peterson's disability actually occurred prior to the time the stock was sold.

Just as Respondents did not prove as a matter of law that Peterson's health problems were not significant, they did not prove as a matter of law that Peterson's active participation in Data Line was not crucial. As set forth in the statement of facts above, Data Line made three clear and express admissions on these points:

(1) Peterson was described in the PPM as a key man whose loss "could have a material adverse effect upon the Company" (CP 357-358);

(2) A June 1983 letter from Data Line to its shareholders attributed the Company's poor performance in 1982 to the constraints on Peterson's participation caused by his "brain aneurysm and operations" (CP 384-386); and

(3) A subsequent draft prospectus attributed the Company's poor performance in 1982 to Peterson's "serious" and "disabling illness." (CP 372-373)

It is undeniable that any fact concerning a serious health problem of Peterson would have been material to a reasonable investor. If this is not adequately established by common sense, it is more than adequately documented in the Affidavit of MacMillan Pringle. A grant of summary judgment to Perkins Coie (and to Barnard and Boin as well) cannot be supported by a finding that the facts concerning Peterson's health were not material.

C. Investors May State A Cause Of Action For Negligent Misrepresentation Against Perkins Coie As Outside Counsel For Data Line.

Perkins Coie Did Not Establish, As A Matter Of Law, That It Was Not Negligent Toward Investors In Failing To Disclose, Or Insist Upon Disclosure By Data Line Or Its Directors, Of Peterson s Health Condition.

The court below also granted Perkins Coie summary judgment of dismissal as to Investors' claims against Perkins Coie for negligent misrepresentation. While the order was not specific, the ruling could be justified only upon finding that (a) as a matter of law, Investors may not state a claim for negligent misrepresentation directly against Perkins Coie, or (b) although Investors could state such a claim, Perkins Coie disproved it as a matter of law. Neither of these

contentions can be supported upon review by this Court.

There is ample support for the proposition that Perkins Coie owed a duty of care to Investors, who were part of a foreseeable group of prospective stock purchasers and among the intended recipients of the information provided to Data Line by Perkins Coie.

The Washington courts, adopting the criteria of § 552 of the Restatement (Second) of Torts, have imposed liability on those who supply false information knowing that the information will be given to someone else who will rely on it. The text of § 552 is set forth on p. 28 above, and will not be repeated here.

In Wilbur v. Western Properties, 22 Wn. App. 458, 463-64, 589 P.2d 1273, 1277 (1979), following the principles of the Restatement, the court found a city and county liable for the injuries of plaintiff for misrepresentations made to plaintiff's architect and engineer. The court took no notice of the fact that the misinformation had reached the plaintiff indirectly. In Transamerica Title Ins. Co. v. Johnson. 103 Wn.2d 409, 417, 693 P.2d 697,

affirmative

701 (1985), the Washington Supreme Court reaffirmed the use of Restatement § 552 to analyze negligent misrepresentation. Recovery in Transamerica was denied because plaintiff did not rely on the defendant's misrepresentation. However, in the context of a securities action, reliance will be presumed as to the omission of a fact which is deemed material, i.e., plaintiff need not prove in the negative that he relied on the absence of the omitted fact. E.g., Wilson v. Comtech Telecommunications Corp., 648 F.2d 88, 92 (2d Cir. 1981).

affirmative

but higher standard: scienter

It is also worthy of note that the courts of Washington and other states have held professionals imparting information which they know would be relied upon by others to a high standard of care without a finding of strict privity. See Rogers v. Toppenish, 23 Wn. App. 554, 557, 596 P.2d 1096, 1098 (1979); International Mortgage Co. v. John P. Butler Accountancy Corp., 177 Cal. App. 3d 806, 223 Cal. Rptr. 218 (4th Dist. 1986); Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 57 Cal.App. 3d 104, 110, 128 Cal. Rptr. 901, 905-06 (2nd Dist. 1976); Bradford Securities Processing Services, Inc. v. Plaza Bank & Trust, 653 P.2d 188 (Okla. 1982).

?

These principles of extended liability apply quite appropriately in the instant case. Perkins Coie, by failing to insist on disclosure of the facts concerning Peterson's health problems, effectively supplied false information to Investors -- an obviously foreseeable group of information recipients who would inevitably be relying upon the accuracy and completeness of the information provided to them. Needless to say, Perkins Coie's self-serving disclaimer that no one other than the underwriter was entitled to rely on the "opinion" is no defense.

no - distinguish

Nor can the summary judgment be upheld by finding that Investors' negligent misrepresentation claim failed as a matter of law. It is uncontested that Perkins Coie was aware of the first aneurysm and operation. There are no facts to support a finding that Perkins Coie could not have made simple inquiry of Peterson's physicians. There are no facts to support a contention that Investors were not foreseeable recipients and users of the facts which were the subject of Perkins Coie's opinion on disclosure. Perkins Coie cannot demonstrate as a matter of law that the omitted facts were not material. This Court must conclude that

Investors may state a claim for negligent misrepresentation against Perkins Coie and that such claim was not the proper subject of dismissal by summary judgment.

V. ARGUMENT- BARNARD & BOIN

A. Barnard And Boin Did Not Establish, As A Matter Of Law, That Peterson's Health Condition Was Not A Material Fact Subject To Disclosure.

This issue is factually and legally identical to that discussed in Section IV.B. above, and the argument will not be repeated here. Investors submit that the summary judgment granted to Barnard and Boin cannot be supported on the ground that Peterson's health condition was not material as a matter of law.

B. Outside Directors Of An Issuing Company Are Subject To Liability Under RCW 21.20.010 And 21.20.430(3) Irrespective Of Whether They Are Controlling Persons Of The Issuer.

One possible basis for the trial court's grant of summary judgment was the legal conclusion that outside directors cannot be liable unless they are controlling persons. However, § 21.20.430(3) expressly makes directors of an issuing corporation liable *per se*, subject to a due diligence defense which each director bears the burden of proving. The statute clearly does not distinguish between

"inside" and "outside" directors, and liability may exist without control person status. Although no Washington case directly addresses the specific language in question, the courts of other states with Blue Sky laws identical to Washington's have addressed the question and have concluded that the plain language should be given its obvious meaning.

In Foelker v. Kwake, 568 P.2d 1369 (Ore. S. Ct. 1977), an officer/defendant argued that the evidence did not reflect in any way her participation in any of the illegal transactions. The court responded:

> Under the provisions of ORS 59.115(3), however, no such personal participation need be proved to impose liability, it being sufficient that the defendant was an officer of the corporation, unless the defendant sustains the burden of proof that he or she did not and could not reasonably have had knowledge of the facts on which liability was based. There was evidence in this case that Nancy Kwake was an officer of Verde. She testified that she did not "participate" in the business activities of Verde, but offered no evidence that she did not know or could not reasonably have known of the existence of the facts on which liability was based, as required by ORS 59 115(3).

Id. at 1373 (emphasis added).

Similarly, in Arnold v. Dirrim, 398 N.E.2d 426 (Ind. App. 1979), director Arnold argued that the language of Indiana Code 1971, 23-2-1-19(b),

which is substantially identical to RCW 21.20.430(3), should be read to impose liability only on directors who materially aid in a sale. The court quickly rejected this contention, stating:

> From a grammatical standpoint, with due regard for punctuation, it seems apparent that the statutory provision imposes absolute liability upon the director of a corporation to purchasers of securities sold in violation of the Securities Act based upon his position as a director unless he proves the statutory defense. It should be observed that the [material aid] clause relates only to employees of the seller, broker-dealers or agents. If it had been the intent of the General Assembly to make directors liable only in the event they had materially aided in the sale, it would have been an easy matter to have the statute read "every partner, officer, or director of such a seller who materially aids in the sale."

Arnold at 433-434 (Emphasis added).

In 1977 the Washington Legislature amended § 21.20.430(3) to clearly disjoin the material-aid clause from the language making directors per se liable. While the rule may be different in states where scienter is an element of the offense, per se liability of a director is well established in states with statutes similar to Washington's where scienter is not an element. See, e.g. Moerman v. Zipco, Inc., 302 F. Supp 439 (E.D.N.Y. 1969);

Mitchell v. Beard, 513 S.W.2d 905 (Ark. 1974); Gardner v. Donovan, 613 P.2d 1097 (Ore. App. 1980).

Barnard and Boin cited two cases in support of the proposition that outside directors are held to a different legal standard. Both of these cases are easily distinguished. One of the cases is Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973). In Lanza, the court focused on the liability of outside director Coleman. The facts accepted by the Court demonstrated that Coleman had no actual knowledge of any of the pertinent misrepresentations, nor did he have any other "active participation" in the wrongful conduct. His alleged liability hinged solely upon his status as a director of the issuing company.

An injured investor filed suit against Coleman and others under federal Rule 10b-5. While the language of 10b-5 is substantially identical to RCW 21.20.010, 10b-5 is enforced by an implied right of action, whereas § 21.20.010 is primarily enforced by the express rights of action set forth in § 21.20.430(1) and (3). As recognized in Lanza, courts have held that there is no implied per se individual liability under 10b-5; individual liability requires either active participation in

the wrongdoing or an unjustified failure to act by one in a control capacity. RCW 21.20.430(3), on the other hand, imposes an express legal duty upon directors in excess of the liability implied under 10b-5.

The other case is Burgess v. Premier Corp., 727 F.2d 826 (9th Cir. 1984). In Burgess, outside directors Schrock and Darby were found to have had no active involvement in the misrepresentations, nor -- as a matter of fact -- were they control persons. The court properly held that, absent active participation in the misrepresentation, and absent control person status, a Federal Rule 10b-5 claim could not be established against them.

The court then addressed the WSSA claims against Schrock and Darby. While the court's decision is correct as far as it goes, it failed to address a critical issue. From the structure of the brief passage discussing the WSSA, it is clear that the court did not consider or address the per se liability issue. The court first addressed potential liability under 21.20.010 without regard to the express rights of action created by § 21.20.430. The court concluded that any implied remedy would be the same as under 10b-5, i.e.,

there would be no liability for a director absent some active participation in the misconduct. The court then addressed control person liability as created by § 21.20.430(3). The court concluded that, as with control person liability under 10b-5, some actual participation in the corporation's operation was required. The court quite clearly did not address the language in § 21.20.430(3) expressly making directors liable per se. This omission is not explained. Whatever the reason, the gap clearly exists, and Barnard and Boin cannot cite Burgess to negate the express per se liability of directors created by § 21.20.430(3).

The proper test regarding the per se liability of directors created by § 21.20 430(3) is as stated in Arnold:

> [I]t seems apparent that the statutory provision imposes absolute liability upon the director of a corporation to purchasers of securities sold in violation of the Securities Act based upon his position as a director . . . .

Arnold at 433-34 (Emphasis added).

C. Barnard And Boin Did Not Establish, As A Matter Of Law, That They Were Not Controlling Persons Of Data Line At The Time Of The Offering.

In addition to per se liability as directors, Barnard and Boin are expressly liable under

§ 21.20.430(3) if they directly or indirectly controlled Data Line. Barnard and Boin argued quite strenuously that they were not, as a matter of law, control persons of Data Line. Acceptance of this proposition by the trial court judge is a probable basis for the granting of summary judgment. Investors feel quite strongly that when the law is correctly applied to the facts as they must be assumed for purposes of summary judgment, such judgment was not warranted.

Barnard and Boin argued that Burgess holds that outside directors cannot be liable as control persons. Burgess does not so hold. Rather, it stands for the proposition that control person liability is dependent upon the actual facts of the case, and not upon one's characterization as an inside or outside director. In Burgess, the court found after presentation of all the evidence that two outside directors were not -- as a matter of fact -- control persons. The court noted:

> This court has indicated that there can be no liability if the controlling person "was not a participant in . . . activities which are claimed to violate the securities laws." [Citation deleted]. A director "is not automatically liable as a controlling person. There must be some showing of actual participation in the corporation's operation or

> some influence before the consequences of control may be imposed."

Burgess at 832.

The question then becomes one of establishing whether or not a particular director -- regardless of inside or outside status -- exerted the requisite control. The Burgess court found that the two directors escaping liability (1) were uninvolved in the corporation's day-to-day operations; (2) had no experience in the corporation's business; (3) had no experience in the corporation's industry; (4) had nothing to do with the preparation of the offering materials in question; and (5) (with respect to one of the directors) had minimal interaction, partly due to ill health, and resigned from the board before the investors lost money. Id. at 832-833. Burgess appears to state three tests by which control person liability may be established. As will be shown, Barnard and Boin did not establish as a matter of law that they do not qualify as control persons under one or more of these tests.

The first test is whether the director acted in bad faith and induced the violative conduct. The facts set forth above support the inference that Barnard and Boin, because of their interest in the

success of the offering both as directors of Data Line and as substantial investors, were motivated by self-serving impulses, which inference in turn supports a finding of bad faith on their part in failing to disclose Peterson's serious health problems. The failure to insist upon disclosure of these facts clearly induced the violative conduct complained of here.

The second test is whether the director participated in the violative activities, i.e., the failure to disclose material facts to Investors. Contrary to the assertions that the outside directors had no part in the preparation of the offering materials or in the offering itself, the record is replete with instances of participation by Barnard and Boin in the offering process. Board minutes in January of 1982 reflect a discussion of how to satisfy the Company's financial requirements of from $1.5MM to $2MM over the next 18 months. (CP 351-354) At a February 1982 board meeting, a discussion identifying those underwriters that had been in contact with Data Line regarding financing was presented. The proposal of Evans Llewellyn was thoroughly discussed and several significant changes were recommended as negotiating points.

(CP 355-356) Cline testified at deposition that the Board was actively involved in coaching the officers on the terms of the agreement to be negotiated with Evans Llewellyn's underwriting of the private placement, and that it reviewed the contract between Data Line and Evans Llewellyn before it was entered into. (CP 412-413) Cline also testified that the full board of directors reviewed a number of drafts of the PPM before it was finalized. (CP 414-416)

The third test concerns "actual participation" in or at least "some influence" on the operation of the offending company. Again, the record supports the existence of such participation in or influence on Data Line's operation.

Moreover, the definition of control is not limited to the factors set forth in Burgess. As discussed in Section IV.A. above, there is an abundenace of authority interpreting the control language of Section 15 of the Securities Act of 1933 to the effect that the mere power to influence the critical decision constitutes control. The record amply supports a finding that both Barnard and Boin, as active participating directors, exercised a significant degree of control over the general

operations of Data Line. Nor can it be denied that they had the very real power -- and the very real opportunity -- to insist upon disclosure of Peterson's serious health problems and thereby control and prevent the wrong which occurred here.

Mr. Barnard was elected to the board at Data Line's initial annual meeting. (CP 345-346) He was also a major stockholder of an investor in the corporation (CP 392-393) and brought to the board a significant level of management experience. He had been an owner and president of Seattle Packaging Corporation since 1967 and served on the board of directors of Fray Equipment Co. (CP 339-342)

Mr. Boin also was seated on Data Line's board from the start, having made a substantial investment in the Company. (CP 345-346; CP 392-393) He had been since 1972 a principal with the national actuarial firm of Milliman & Robertson, Inc. (CP 339-342)

In summary, the evidence before the trial court, together with reasonable inferences therefrom, shows an active group of outside directors contributing their seasoned judgment and direction to the management of the young company -- particularly in its efforts to finance the Company by use

of the PPM which is the subject of this suit. By any of the various tests, Barnard and Boin qualified as "direct or indirect" control persons for purposes of RCW 21.20.430(3). Barnard and Boin clearly failed to establish that no reasonable mind could conclude that they were control persons within the meaning of § 20.21.430(3).

As a corollary to their control person argument, Investors anticipate that Barnard and Boin will argue that their duty to disclose was strictly limited to facts within their actual knowledge, and that they had no duty to investigate further. From this they will argue that their actual knowledge was limited to the fact that Peterson had undergone brain surgery and appeared to their inexperienced eyes to be recovering well. In support of this proposition, they will quote a footnote from Lanza pointing out that the language of the Uniform Securities Act does not expressly contain an "affirmative duty of investigation." Lanza at 1309, fn. 105. This is the sole underpinning of their argument that they as individual directors were justified in failing to disclose what they knew and in failing to investigate further. There are three problems with this argument.

First, any argument that individual directors had no duty to investigate facts beyond what they actually knew in no way mitigates their clear obligation to disclose the facts within their actual knowledge. It is a fact that Barnard and Boin knew of Peterson's first brain surgery as of the approximate date that the PPM was issued. This fact was material, and their failure to disclose it renders them liable for all injuries that occurred to Investors. Investors' proof could stop here and they would prevail.

Second, although the PPM was issued on June 10, 1982, the actual closings occurred over the ensuing eight months. It is fundamental securities law that Barnard and Boin had an ongoing duty to supplement and/or amend the PPM to reflect material changes since the initial publication of the PPM. E.g., SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972). While Barnard and Boin may, in fact, not have known about the additional aneurysms and the need for a second craniotomy on June 10, 1982, on January 11, 1983 -- the date of the last closing involving an Investor -- they certainly knew about the second craniotomy which had taken place one month before. Other closings

involving Investors occurred on August 11, 1982, October 14, 1982, and December 1, 1982. Barnard and Boin produced no evidence that they could not have learned about the remaining aneurysms in time to have insisted upon disclosure to Investors who purchased Data Line stock after June 10, 1982.

Third, Lanza fn. 105 does not correctly state the law in Washington. The Lanza court was addressing a director's duty to investigate and to convey information to potential investors under federal Rule 10b-5. As the Lanza court noted in the text of its decision, 10b-5 liability requires a showing of scienter on the part of a defendant, i.e., that he acted with knowledge of the falsity or with reckless disregard as to its truth or falsity. The Lanza court was understandably reluctant to conclude that recklessness or an intent to deceive could be implied to an individual who had no actual knowledge of the problem absent some express duty to investigate. When Lanza was decided in 1973, it was not clear that comparable state Blue Sky laws would not similarily require scienter as an element of state claims. This is the context in which, in pure dicta, the Lanza court commented that the Uniform Securities Act did

not expressly contain an affirmative duty to investigate.

In 1980, the Washington Supreme Court declared that scienter is not an element of a claim under the WSSA. Kittilson v. Ford, 93 Wn.2d 223, 608 P.2d 264 (1980). The standard is one of strict liability. Thus, the logic of Lanza is not compelling -- while it might not be appropriate to imply intent or recklessness from a mere failure to investigate, where strict liability controls, it does not follow that the failure to investigate is pertinent.

This proposition is supported by the clear language of § 21.20.430(3). After making certain classes of individuals expressly liable for securities violations, it goes on to provide a good faith defense. A named person is liable:

> unless such person sustains the burden of proof that he or she did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

(Emphasis added.)

While there may be no express duty to investigate, the statute clearly places the burden of proof upon an individual otherwise liable to negate liability by affirmatively proving that the

individual could not in the exercise of reasonable care have known about the misrepresentation or omission. As discussed above, Barnard and Boin (i) are expressly liable under the terms of § 21.20.430(3); (ii) were in fact aware of Peterson's first brain surgery; (iii) were undeniably aware of the importance of Peterson to the success of Data Line; and (iv) were in a position to command access to Peterson's true medical condition. Neither can credibly contend that it was beyond his reasonable ability to learn the full truth about Peterson's serious medical condition.

D. Barnard And Boin, As Outside Directors, May Not Rely With Impunity On Officers, Inside Directors, And/or Independent Counsel To Make Factual Investigations And Determinations As To What Facts Are Material And Therefore Subject To Disclosure In Offering Materials.

Even If The Law Recognizes A "Defense Of Reliance," Barnard And Boin Did Not Establish, As A Matter Of Law, That They Are Entitled To The Protection Of The Defense.

In their summary judgment motion, Barnard and Boin raised as a defense to liability that they expressly delegated to the inside directors the task of gathering all material facts and making all determinations as to which facts were material and therefore subject to disclosure. While this is not

per se offensive to Investors, it becomes so when Barnard and Boin also seek to place full liability for any resulting mistakes on the inside directors. Further, although the matter was not specifically raised in their summary judgment papers, Barnard and Boin may assert as an additional argument on appeal that they had a similar right to rely on the advice of Perkins Coie as to what facts were material and therefore subject to disclosure.

Barnard and Boin cannot claim justifiable reliance upon the advice of the inside directors. In Arnold v. Dirrim, 398 N.E.2d 426 (Ind. App. 1979), the Court was called upon to interpret Indiana's Blue Sky laws, which are in pertinent part substantially identical to those of Washington. Defendant Arnold attempted to escape liability by claiming that he justifiably relied on assurances of the company's president as to the existence of certain material facts. In rejecting this defense, the court noted:

> Actually, the bulk of Arnold's argument focuses not on his lack of knowledge about the facts but rather that he was unaware the law attached significance to those facts. He directs attention to the portions of the transcript indicating that he relied on [the company president's] representations and judgment that the sales were proper. Moreover, he proposes that an affirmative defense

> requiring a "director need only have a good faith belief that the sales are legal to escape liability" should be engrafted into the statute.
>
> These assertions miss the mark. The statute imposes liability on those who know the applicable facts without regard to their knowledge of the law.

Arnold at 435 (Emphasis added).

This position is clearly reinforced by Rzepka v. Farm Estates, Inc., 269 N.W.2d 270 (Mich. App. 1978). Defendant directors appealed a state securities claim judgment entered against them, claiming in essence that they were not aware of the legal significance of the facts either known to them or within their knowledge. The court rejected this proposition, stating:

> Although no evidence exists that Refior knew of the stock's unregistered status, likewise no evidence appears that he "could not have known" of this fact. Since the individual defendants have clearly failed to establish their lack of knowledge, actual or constructive, we find them liable under [the Michigan blue sky laws] in their positions of directors and officers of the corporation. Their ignorance of Blue Sky Laws is irrelevant for purposes of this statute, as the exception only speaks to the lack of knowledge of "the existence of the facts by reason of which the liability is alleged to exist." Clearly, under the statute, ignorance of the law is no excuse.

Rzepka at 273 (Emphasis added).

Nor can Barnard or Boin claim justifiable reliance on the advice of Perkins Coie. From a

factual standpoint, there is no evidence to dispute that Barnard and Boin had access to the full facts concerning Peterson's health condition in a degree at least equal to that of Perkins Coie. They cannot say that they relied on Perkins Coie to gather the pertinent facts.

Moreover, reliance on the legal advice of Perkins Coie would be no defense to liability in this case. In support of their claim of justifiable reliance, Barnard and Boin cited § 23A.08.343 of the Washington Business Corporation Act. Barnard and Boin will ask this Court to construe this statute to create a new and additional defense to RCW 21.20.430(3). In fact, § 23A.08.343 was designed to implement the business judgment rule vis-a-vis a director's liability to the corporation.[1] Respondents can offer no compelling statutory or case support for an interpretation of § 23A.08.343 that would effectively emasculate the

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1 Indeed, this defense was raised by a director in Everets v. Holtman, 667 P 2d 1028, 1033 (Ore. App. 1983). The court reviewed the language of the Oregon Corporation Code, which is similar to § 23A.08.343, and concluded that compliance sheltered a director from liability to the corporation but not from investors with a securities claim.

liability imposed upon individuals under the WSSA. Nor can they reconcile their desired narrowing of the statute with the pronouncement of the Washington Supreme Court in McClellan v. Sundholm, 89 Wn.2d 527, 533, 574 P.2d 371, 374 (1978):

> We note also that securities legislation is remedial in nature and has as its purpose broad protection of the public. Thus it is appropriate to construe the statute broadly in order to maximize the protection offered.

When the Legislature adopted § 21.20.430(3), it saw fit to provide one defense. If the Legislature had desired to provide the additional defense of reliance on inside directors or outside counsel, it would have been a simple matter to do so.

While no Washington case addresses this point directly, the courts of other states have had the opportunity to consider the question of reliance on outside experts. In Marshall v. Harris, 555 P.2d 756 (Ore. S. Ct. 1976), the defendant attempted to escape liability for failure to register a security by claiming reliance upon advice of counsel that the interest sold was not a security subject to registration. After noting that the Oregon Securities Law must be "liberally construed to afford

the greatest possible protection to the public," the court concluded:

> Consistent with that view, we have held that good faith and even reliance upon advice of counsel is not a defense

Marshall at 760.

Neither Barnard nor Boin can honestly claim ignorance of the facts -- or inability to obtain the full facts -- as to Peterson's serious health problems. They contend that they relied on Perkins Coie to advise them of the legal significance of these facts, and additionally contend that they relied on assurances by the inside directors that Peterson's health condition was not material. However, having either actual knowledge of or reasonable access to the true facts, neither Barnard nor Boin can seek refuge in a claim that he did not know the legal significance of the facts.

E. Investors Need Not Prove That The Specific Fact(s) Omitted From The Offering Materials Directly Caused The Securities To Become Worthless.

Barnard And Boin Did Not Establish, As A Matter Of Law, That Petersons's Health Condition Was Not A Substantial Contributing Factor To The Failure Of Data Line.

Barnard and Boin contended below that traditional tort causation is an element of a claim under the Washington State Securities Act, and that

at trial Investors will bear the burden of proving (i) that Peterson's aneurysms caused his retirement from Data Line and (ii) that Peterson's retirement caused the failure of Data Line. Although Investors believe that the facts support the inference that Peterson's aneurysm operations did indeed substantially contribute to the demise of Data Line, Barnard and Boin are incorrect in their assertion of the level of causation which Investors must prove to establish their case.

Barnard and Boin relied primarily on the case of Shermer v. Baker, 2 Wn. App. 845, 472 P.2d 589 (1970), in support of their contention that causation is an element of a WSSA claim. They are reading far more into Shermer than is there. In Shermer, Division II of tle Court of Appeals approved a jury instruction that, inter alia, "advised the jury that plaintiff had the burden of proving that defendant violated one or more of the legal duties imposed upon him by law" and that "defendant's violation of one or more of the described legal duties caused the plaintiff's damages." Shermer, at 851. Legal research has failed to reveal any other Washington case where the words "cause" or "causation" are used in this context.

Respondents' misunderstanding as to the "element" of causation is understandable. Reliance and causation are terms not always defined consistently by the courts in analyzing securities claims. As the second circuit noted in Wilson v. Comtech Telecommunications Corp., 648 F.2d 88 (2d Cir. 1981):

> The concepts of reliance and causation have often been used interchangeably in the context of rule 10b-5 cases. [Citation deleted]. Indeed, in addressing the issue of reliance, courts have said that "the test is properly one of tort 'causation in fact.'" [Citation deleted]. Although we will speak primarily in terms of reliance, a distinction should be noted between cases involving affirmative misrepresentations and those involving non-disclosure. The concept of reliance in a case of affirmative misrepresentations embodies two separate questions: (1) Did the plaintiff believe what the defendant said, and (2) was this belief the cause of the plaintiff's action?

Id. at 92, n. 6 (Emphasis in original).

Thus, in a typical misrepresentation case, plaintiff would have to prove that he relied on the misrepresentation, that is, that he believed it and that this belief, in part, caused him to purchase the security. Quite clearly, it is not incumbent upon plaintiff to prove that the misrepresented fact was the cause for the security to become worthless.

This doctrine has been expressly reinforced by the Ninth Circuit in Hatrock v. Edward D. Jone & Co., 750 F.2d 767 (9th Cir. 1984). The court addressed a recent trend in federal 10b-5 cases to distinguish between "transaction causation," i.e., whether the violative conduct induced the purchase of securities, and "loss causation," i.e., whether the violative conduct was causally related to the decrease in value of the security. Where plaintiffs are claiming not that the misrepresentation or omission caused them to pay more for the stock than they otherwise would have, but that the misrepresentation or omission caused them to buy the stock in the first place, then loss causation is not an element. The Ninth Circuit stated:

> The plaintiff, however, should not have to prove loss causation where the evil is not the price the investor paid for a security, but the broker's fraudulent inducement of the investor to purchase the security. See Chasins v. Smith, Barney & Co., 438 F.2d 1167, 1173 (2d Cir. 1970).

Hatrock, at 773.

In Kelsey v. Nagy, 410 N.E.2d 1333 (Ind. App. 1980), the Indiana Court of Appeals confronted a similar situation in applying the Indiana State Blue Sky laws, which are substantially identical to those of Washington. The court held:

> Kelsey further argues that the judgment on the evidence was improper because the Nagys did not show that the failure to disclose the source of the stock affected the price of the stock. The Nagys, however, were not seeking damages; they were seeking a rescission of the purchase. It is not necessary that the party seeking to rescind a purchase establish that the facts misrepresented or omitted were such as to affect the price of the stock. It is sufficient if that party shows that the facts misrepresented or omitted were material. Associated Lathing & Plaster Co. v. Louis C. Dunn, Inc., (1955), 135 Cal. App. 2d 40, 286 P.2d 825; E. E. Atkinson & Co. v. Neisner Bros., (1935), 193 Minn. 175, 258 NW 151, 259 NW 185., Fawkes v. Knapp, (1970), 138 Minn. 384, 165 NW 236.

Kelsey at 1337.[2]

Thus, at the very most, Investors here will have to demonstrate at trial a causal nexus not between Peterson's aneurysms and Data Line's demise, but between Respondents' failure to disclose material facts and Investors' decision to purchase the stock. If the law were otherwise, issuers would be tempted to gamble on future events to bail them out of even nominal liability for hiding facts from potential purchasers.

---

2 The use of the word "rescission" by the Kelsey court may be technically imprecise. Under both the Indiana and Washington statutes, the measure of damages is the price paid for the security plus interest and costs, or if it has been sold, the actual loss plus interest until sold and costs. This remedy is effectively that of rescission rather than benefit of the bargain.

Moreover, as clearly pointed out in the Wilson case, in non-disclosure cases reliance will be presumed if the omission is material:

> In a case of non-disclosure, the task of positively proving reliance may become impossible to perform, and although the courts still refer to the element of causation in fact, the question really becomes one of materiality . . . .

Wilson, supra, at 92. This principle has been expressly recognized by the United States Supreme Court:

> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of his decision. [Citations deleted.] This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.

Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54, 92 S.Ct. 1456, 1472, 31 L.Ed.2d 741, 761 (1972). This identical issue was resolved in the same manner by the Indiana Appellate Court in Kelsey, supra, at 1337.

Investors do not have to prove in the negative that they affirmatively relied on the absence of any representations as to Peterson's health condition in reaching their investment decision. List

v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir. 1965). The record amply supports the conclusion that the omissions were material. This fact alone renders the granting of summary judgment based upon a finding of no causation unsupportable.

Even if causation is an element of a WSSA claim, Barnard and Boin did not establish as a matter of law that Peterson's undisclosed health condition was not a significant contributing cause to the demise of Data Line. The information set forth in the affidavit of Dr. Hamm (CP 307-309) and the testimony of Peterson's own treating surgeon, Dr. Ojemann (CP 387-388) at the very least create a material question of fact as to loss causation. As the Second Circuit noted in addressing the so-called "causation" element in Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 540 F.2d 27, 34 (2d Cir. 1976):

> [Plaintiff] was not required to prove that the Laventhol material was the sole and exclusive cause of his action, he must only show that there was "substantial," i.e., a significant contributing cause.

(Emphasis added)

In fact, the court in Herzfeld used the "significant contributing cause" language in connection with the proof of transaction causation. As to the

level of proof required for loss causation, the court in Wilson v. Comtech Telecommunications Corp., supra, stated:

> [D]emonstration of [transaction causation] is the critical issue, as once this is done, [loss causation] is demonstrated rather easily by [the plaintiff's] proof of some form of economic damage -- the loss he suffered upon selling his shares.

Wilson, supra. at 92-93, n. 7.

VI. CONCLUSION

Investors respectfully request this Court to reverse the decisions below and rule that:

(1) Injured investors may state a cause of action directly against outside counsel for an issuer pursuant to RCW 21.20.010, RCW 21.20.430(1) and RCW 21.20.430(3);

(2) Injured investors may state a cause of action for negligent misrepresentation direcily against outside counsel for an issuer;

(3) Injured investors may state a cause of action for negligent misrepresentation against directors of an issuer;

(4) Outside directors are per se liable for violations of the Washington State Securities Act, subject to the defense stated in

RCW 21.20.430(3), irrespective of whether or not they are control persons of the issuer;

(5) Outside directors may not delegate their liability under RCW 21.20.430(3) to officers, inside directors, or independent counsel who are assigned or retained to make factual investigations and/or legal determinations as to what facts are material and therefore subject to disclosure;

(6) Injured investors need not prove "loss causation," i.e., that the omitted fact(s) directly caused the security to become worthless;

Investors also request this Court to declare that material questions of fact exist as to the following:

(a) Whether Peterson's health condition was a material fact subject to disclosure;

(b) Whether Perkins Coie was a control person of Data Line, performed the function of a director of Data Line, or was an employee of Data Line for purposes of RCW 21.20.430(3);

(c) Whether Barnard and Boin were control persons of Data Line for purposes of RCW 21.20.430(3);

(d) Whether Barnard and Boin satisfied the criteria of the defense stated in RCW 21.20.430(3);

(e) Whether Peterson's health condition was a substantial contributing cause to the failure of Data Line;

(f) Whether Perkins Coie, Barnard, and/or Boin were negligent in allowing the facts concerning Peterson's health condition to be omitted from the offering materials.

Respectfully submitted this 16th day of September, 1987.

FERGUSON & BURDELL

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APPENDIX III

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STATE OF WASHINGTON
File No ....

NO. 20506-4-I

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

GREGORY HINES, et al.,

Appellants,

v.

DONALD E. BARNARD, BRUNO V. BOIN,

and

PERKINS COIE,

Respondents.

BRIEF OF RESPONDENTS BARNARD AND BOIN

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0219Z

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12/3/87

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I.

STATEMENT OF ISSUES

1. Whether outside directors who are not controlling persons are subject to liability under the Washington State Securities Act regardless of fault.

2. Whether the Washington Business Corporations Act's definition of a director's duties should be read *in para materia* with the Washington State Securities Act.

3. Whether outside directors who are not controlling persons have a duty under the Washington State Securities Act to investigate representations made by inside directors absent suspicious circumstances.

4. Whether proximate causation is an element of a Washington State Securities Act violation.

II.

STATEMENT OF THE CASE

A. Procedural Posture

This action involves two consolidated cases, one initiated on February 11, 1985, and one initiated February 14, 1986, in which plaintiff investors in Data Line Systems, Inc. ("Data Line") brought suit against Data Line, the directors of the company individually, the underwriting firm of Evans-Llewelyn and the law firm of Perkins Coie, alleging violations of the Washington State

Securities Act, the Washington Unfair Business Practices Act and the common law torts of material misrepresentation and fraud for the defendants' failure to disclose to investors that the chief executive officer of the company had a brain aneurysm.

On November 26, 1986, Data Line and its directors brought a summary judgment motion arguing, among other issues, that the outside directors, e.g., directors who were not officers of the corporation, should be dismissed from the lawsuit because they did not actively participate in the day-to-day management of the company and did not aid in preparing the offering circular upon which liability was alleged. Accordingly, the directors argued that they are not liable under the Washington State Securities Act or the common law torts alleged. Defendant Perkins Coie joined in the motion, arguing that it was not subject to liability under the Washington State Securities Act.

As to Perkins Coie and two of the outside directors, Donald Barnard ("Barnard") and Bruno Boin ("Boin"), the court agreed with defendants and dismissed them from the lawsuit. As to the two other outside directors, Lewis Zirkle ("Zirkle") and Robert Cline ("Cline"), the court dismissed the common law fraud and negligent

misrepresentation claims but did not dismiss the claim based on the Washington State Securities Act. The court refused to grant summary judgment on any issue to the corporation's inside directors or the corporation itself.

Pursuant to C.R. 54, the trial court certified as a final order the dismissal of the claims against Perkins Coie, and Barnard and Boin and the dismissal of the fraud and negligent misrepresentation claims against Cline and Zirkle. Pursuant to that order, plaintiffs appealed the dismissal of the lawsuit against Perkins Coie and Barnard and Boin. Plaintiffs have not appealed the dismissal of the negligent misrepresentation and fraud claims against Cline and Zirkle.

B. Statement of Facts

1. Origins of Data Line

In 1980, Gary Morgan ("Morgan") and Dale Peterson ("Peterson") provided the impetus for the formation of Data Line Systems, Inc., a corporation that designed and marketed a slot reader which optically reads the line across the bottom of a check. The slot reader enables a bank to automate its check verification and proofing functions. The technology was advanced and filled an expressed need of banks.

Data Line's initial board of directors was composed of Peterson who held 5,833 shares of stock, Morgan who held 3,334 shares of stock, and John Mason ("Mason") who held 833 shares of stock. (CP 35) The board's first meeting was held on June 10, 1980. At the meeting, Morgan was elected chairman, Peterson was elected president and treasurer, and Mason was elected secretary. (CP 36) These three were the only officers of the corporation during all material times involved in the lawsuit.

At the first meeting of shareholders held on June 18, 1980, Boin, Barnard and Cline were elected to the board of directors. Each of these board members purchased 2,222 shares at a total price of $41,666. (CP 42) These three never became officers of, nor were they ever employed by, the corporation.

Throughout 1980 and 1981, the corporation was refining and attempting to develop a market for its product. Also during this period the corporation was suffering from inadequate capitalization. (CP 44) To remedy this problem, Peterson was given authority at the April 6, 1981 board meeting to negotiate, subject to final board approval, an agreement with Keytronic Corporation whereby Keytronic would purchase an equity interest in Data Line. (CP 47)

Between the April 6, 1981 board meeting and the July 17, 1981 board meeting, Peterson negotiated an agreement with Keytronic Corporation. (CP 51) On July 20, 1981, the board of directors approved the agreement and elected Zirkle to a seat on the board of directors, as a representative of Keytronic. (CP 53)

2. Preparations for the Private Placement Memorandum

The corporation still needed additional capital and at the board of directors meeting on February 23, 1982, the board of directors passed a motion authorizing Peterson, Morgan and Mason to negotiate a financing plan on behalf of Data Line. (CP 55) On April 19, 1982, Peterson wrote the board of directors to report on his progress regarding the development of the financing plan.

> A letter of intent from Evans, Llewelyn, investment bankers in Bellevue, Washington has been received and signed and agreed to between Evans, Llewelyn and Data Line Systems. A formal proposal and letter is available for this board meeting and the board of directors' approval. After interviewing firms like Piper, Jaffray, Langdon, Simons, E.F. Hutton, et al., we determined Evans, Llewelyn to be the most aggressive, cooperative and business-like of any of the above firm (sic). (CP 57)

In the same letter, Peterson informed the board that:

> A new corporate attorney was selected for SEC experience for use in the

> private offering as well as future public offerings. The firm is Perkins, Coie, Stone, Olsen & Williams of Seattle.

Boin and Barnard did not participate in the decision to hire Evans, Llewelyn or Perkins Coie except that Boin and Barnard attended the April 19 board meeting where the officers' decision was ratified. (CP 149)

In May 1982, Data Line published a business plan that was researched and prepared by the officers. (CP 149) On May 24, 1982 Peterson, on behalf of Data Line, entered into a "Best Efforts Selling Agreement" with Evans, Llewelyn to offer for sale 70,000 shares of common stock of the company at a price of $25 per share. (CP 65) At the June 1, 1982 board meeting, the board of directors ratified this agreement and authorized the sale of 70,000 shares. The board also resolved:

> That the officers of this corporation are hereby authorized, in the name and on behalf of this corporation, in connection with such offering, to take all actions which may be necessary or advisable in order to effect the registration or qualification (or exemption therefrom) of this corporation's common stock for issue, offer, sale or trade under the federal securities laws and the Blue Sky or securities laws of such state or the United States of America as they may deem necessary . . . . (CP 84)

Pursuant to this authorization, the officers worked closely with Perkins Coie and Evans, Llewelyn in preparing

the offering. Barnard and Boin did not participate in the offering's preparation beyond their attendance at board meetings. (CP 149)

3. The First Aneurysm Operation

On June 6, 1982, after having a severe headache, Peterson entered Sacred Heart Hospital in Spokane where he was diagnosed as having a bleeding brain aneurysm on the left side of his brain and was flown to the University of Washington Hospital for surgery. He was treated by Dr. George Ojemann, a nationally respected neurological surgeon. Prior to the surgery, Dr. Ojemann discovered a second aneurysm that was not bleeding on the right side of Peterson's brain. After the surgery, Dr. Ojemann advised Peterson of the second aneurysm. He recommended that Peterson have an operation to repair the second aneurysm, but characterized that as "elective" surgery because the risk of an aneurysm rupturing that has never bled before is approximately 2 percent per year. (CP 90, 91, 150)

Peterson was discharged from the hospital on June 18, 1982. Dr. Ojemann described Peterson's recovery as follows:

> Mr Peterson had a remarkably benign course after the first surgery. The various things that we worry about did

> not seem to occur, and he seemed to--he recovered very quickly. (CP 89)

In the discharge summary, Dr. Ojemann described his recommendation for the remaining aneurysm and Peterson's health condition as follows:

> The patient was discharged on 6/18/82 in excellent condition, and we have given him our opinion that he would benefit from having the remaining aneurysm clipped sometime in the near future, hopefully within a year.

Peterson was back at work in June after being discharged from the hospital and, within a month of the operation, was fully recovered. (CP 149)

Peterson did not disclose the existence of the remaining aneurysm to any other director, until after October 15, 1982. (CP 133-34; 142-45; 215-20)

4. Circulating the Memorandum

At the June 1, 1982 board meeting, which was held prior to any known health problems of Peterson, the board approved the Private Placement Memorandum ("PPM"). On June 10, 1982, Evans, Llewelyn had prepared and began circulating the PPM. Mason informed Perkins Coie and Evans, Llewelyn of the aneurysm operation immediately upon his learning of the operation. Perkins Coie recommended to Mason that investors be informed. (CP 94) However, apparently due to Peterson's recovery, Perkins Coie

changed its opinion and concluded that no disclosure was necessary. Its Opinion Letter dated July 15, 1982, the date of the offering's first closing, stated:

> Although we assume no responsibility for the factual accuracy or completeness of the Private Placement Memorandum, we have participated in the preparation of and have reviewed the Private Placement Memorandum and successive prior drafts thereof. In light of this participation and conferences with representatives of the company, no facts have come to our attention that lead us to believe that the Private Placement Memorandum contains any untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

(Emphasis added). (CP 96)

On the same day, Peterson and Mason issued an officer's certificate which stated

> The Private Placement Memorandum of the company dated June 10, 1982 (the "Private Placement Memorandum"), does not include any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and there has occurred no event required to be set forth in an amendment or supplement to such memorandum which has not been set forth. (CP 99)

Closings were also held on August 11 and October 14, 1982. Prior to each of these closings, Peterson and

Morgan issued Officers Certificates identical to the July 15 certificate and Perkins Coie issued Opinion Letters identical to its July 15 Opinion Letter.

5. Plaintiffs' Investments

Plaintiffs purchased their interest in Data Line as follows:

Plaintiffs' Investments

Name	No. of Shares	Cert. #	Date of Issuance of Cert.
Gregory Hines	1,000	35	10/14/82
Arne Midtskog (Private Investors Ltd.)	2,200	32	8/11/82
Vance Mylroie	2,000	31	8/11/82
Michael Schwartz	2,000	44	1/11/83
Robert Arnold	2,000	16	7/15/82
Andrew Mathisen	2,000	39	12/1/82
William Vieser (d/b/a Circle V Associates IV)	2,000	19	7/15/82
Richard Swan	2,000	28	7/15/82

The earliest any of the plaintiffs was issued a stock certificate was July 15, at which time Peterson was back at work and fully recovered. (CP 147)

6. Peterson's Second Aneurysm Operation

In October, Peterson had not decided whether to undergo surgery for the second aneurysm, and traveled to Los Angeles for a second opinion. (CP 150) The Los Angeles doctors with whom he consulted felt that Peterson should have the second aneurysm operation.

On December 7, 1982, Peterson had the second surgery performed at University Hospital. On December 15, 1982, Dr. Ojemann wrote a letter to Morgan regarding Peterson's anticipated recovery. The letter stated:

> In the course of evaluating him [Peterson] for this repair earlier this month, a repeat arteriogram showed in addition to the known aneurysm on the right side a second, much smaller one a little further out on the middle cerebral artery. We repaired both of these aneurysms at craniotomy earlier this month. Mr. Peterson seems to be making a very uneventful recovery from that operation as well. The nature of the aneurysm repair is such that the chances he will have any further difficulties with aneurysms is very small. He will need to continue taking medication in relation to his blood pressure, and one other at least for some months, to prevent the appearance of seizures from the operation he has had. Other than this, the intercranial problems for which I have been treating him over the last six months should not represent any kind of continuing medical problem for him.

(Emphasis added.) (CP 100) However, Peterson continued to have health problems after the operation.

On March 28, 1983, Peterson submitted his resignation as president and chief executive officer due to health reasons. Dr. Ojemann ultimately concluded that Peterson's health problems were related to depression, not to the aneurysm operations. (CP 111)

Data Line never obtained an adequate market for its product and in July of 1984, the shareholders voted to wind up the corporation's affairs.

III.

ARGUMENT

A. The Standard for Outside Director Liability Under the Washington State Securities Act Should be the Same as the Standard for Control Person Liability Under Federal Law.

Essentially, plaintiffs argue that the Washington State Securities Act imposes strict liability on a seller for any failure to disclose a material fact and further imposes strict liability on an outside director of the issuing company for a seller's failure to disclose a material fact, regardless of whether the outside director knew of the omission or was involved in the preparation of the document upon which liability is alleged. Plaintiffs' reading of the Washington State Securities Act is not supported by cases construing that Act, by sound policy considerations, or by cases construing other similar state statutes or the federal statutes upon which the Washington State Securities Act is based.

To establish a claim under the Washington State Securities Act, the plaintiffs must show:

> First, that the defendant violated one or more of the legal duties owed by him to the plaintiff . . . ;
>
> Second, that plaintiff suffered damages;
>
> Third, that the defendant's violation of one or more of the described legal duties caused the plaintiff's damages.

Shermer v. Baker, 2 Wn. App. 845, 851, 472 P.2d 589 (1970). The legal duties referred to above are contained in RCW 21.20.010, which provides in pertinent part:

> 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 light of the circumstances under which they are made, not misleading.

RCW 21.20.430(1) makes a seller liable for a violation of RCW 21.20.010 and provides in pertinent part:

> Any person, who offers or sells a security in violation of any provisions of RCW 21.20.010 or 21.20.140 through 21.20.230, is liable to the person buying the security from him or her.

(Emphasis added.)

Barnard and Boin did not personally offer or sell a security, and therefore are not liable under

21.20.430(1). See Naye v. Boyd, [1986 Transfer Binder] Blue Sky Rep. (CCH) ¶ 72,393 (W.D. Wash.). Thus, any liability of Barnard and Boin must be premised on RCW 21.20.430(3), which imposes liability on several categories of persons for a seller's violation of RCW 21.20.010. That section provides:

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

The Washington State Securities Act does not explicitly address the level of culpability a seller must have to violate 21.20.010 nor does it address the level of culpability a director must have to be liable for a seller's violation of 21.20.010.

The only case to analyze the level of culpability an outside director must have to violate RCW 21.20.430(3)

held that the standard for outside director liability under the Washington State Securities Act is the same as the standards for "control person" liability under Section 20 of the Securities and Exchange Act of 1934. Burgess v. Premier Corporation, 727 F.2d 826 (9th Cir. 1984). Under Section 20, a control person is liable only if he is a "culpable participant" in the activity upon which liability is based. Durham v. Kelly, 810 F.2d 1500 (9th Cir. 1987).

In Burgess, plaintiff's doctors sued Premier Corporation and each of its five directors individually alleging violations of the Securities and Exchange Act of 1934 and the Washington State Securities Act. Two of the directors sued were outside directors who were not involved with Premier's day-to-day operations and were not involved in the preparation of the prospectus upon which liability was alleged. In dismissing the claim against the two outside directors under the Washington State Securities Act, the court held:

> Darby's and Schrock's motion for directed verdict on the ground that they could not be found liable under the Washington State Securities Act, RCW 21.20.010 and 21.20.430, also should have been granted. First, 21.20.010 closely resembles its federal counterpart, Rule 10b-5. Although scienter is not required under Washington law, Kittilson v. Ford,

> 93 Wn.2d 223, 225-227, 508 P.2d 264, 265 (1980), some liability producing action by Darby and Schrock themselves was required. And because there is no evidence that either Schrock or Darby made any misrepresentations, they are not subject to liability under the statute.

Burgess, 727 F.2d at 833 (emphasis added).

In requiring "liability producing action" for outside directors while, at the same time, explicitly recognizing that seller liability is not premised on scienter, the Burgess court essentially distinguished between what level of culpability results in seller liability under 21.20.010 and what level results in outside director liability under RCW 21.20.430(3). Such a distinction is supported by sound policy considerations. As one court reasoned in rejecting strict liability rule for outside directors:

> [T]he Court is not callous toward the interests of CLIC's investors who suffered considerable financial losses as a consequence of mismanagement and ultimate bankruptcy. Nevertheless, it cannot be impervious to the rights and interests of this defendant. To saddle an innocent director with the responsibility of financial loss occasioned by the acts of others, simply to atone for the injuries suffered by the investors and not because of fault on his part, would be incredibly unjust and would serve to

> undermine, rather than strengthen, corporate responsibility.

Harman v. Willbern, 374 F. Supp. 1149, 1164 (D. Kan. 1974).

In establishing a culpability standard for outside directors, the Burgess court looked to federal law and applied the test of control person liability used under Section 20 of the Securites and Exchange Act of 1934 to the Washington State Securities Act. The court stated:

> While a controlling person could be liable under 21.20.430(3) on derivative liability, there is no reason to infer that "controlling person" has a different meaning in Washington law than in federal law. Since Schrock and Darby were not controlling persons under the federal definition, they could not properly be liable under Washington law.

Burgess, 727 F.2d at 833.

Since Burgess, the Ninth Circuit has refined the standard a plaintiff must meet before liability can be imposed on an outside director for a violation of Section 20. Present Ninth Circuit law holds that an outside director is liable only if:

> (1) The defendant had actual power or influence over the alleged control person, and

> (2) The defendant was a culpable participant in the alleged illegal activity.

Buhler v. Audio Leasing Corp., 807 F.2d 833, 835 (9th Cir. 1987) (emphasis added); see also Orloff v. Allman, 819 F.2d 904 (9th Cir. 1987).

Although Washington courts are not required to construe Washington law in accord with federal securities law, both state statute and case law strive for uniformity of interpretation. As RCW 21.20.900 provides:

> This chapter shall be so construed as to effectuate its general purpose to make uniform the laws of those states in which enacted and to coordinate the interpretation and administration of this chapter with the related federal regulation.

(Emphasis added.); see also Shermer v. Baker, 2 Wn. App. 845, 857, 472 P.2d 589 (1970).

Further, the Ninth Circuit standard of "culpable participation" for control person liability should be adopted for outside director liability under the Washington State Securities Act because the definition successfully balances the rights of investors to recover and the necessity of not deterring qualified individuals from serving on boards of directors. As expressed by one court:

> The day to day affairs of any company are generally, by necessity, largely

> entrusted to managing officers. To mechanically hold directors constructively responsible for the acts of their officers would indirectly do harm to the concept of corporate responsibility by deterring men of good character from becoming directors of companies.

Harman v. Willbern, 374 F. Supp. 149, 161 (D. Kan. 1974).

Here, plaintiffs present no facts upon which an inference can be made that Barnard and Boin culpably participated in any concealment of material facts from potential investors. Thus, this Court should adopt the culpability standard for outside directors and, accordingly, affirm the dismissal of Barnard and Boin from this lawsuit.

B. The Washington Business Corporations Act's Definition of Director Duties Should Be Read In Para Materia With the Washington State Securities Act.

The Washington Business Corporations Act specifically circumscribes the duties of corporate directors. RCW 23A.08.343 provides in pertinent part:

> In performing the duties of director, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data in each case prepared or presented by:
>
> (1) one or more officers or employees of the corporation whom the director believes to be reliable and competent in the manner presented.

> (2) counsel, public accountants, or other persons as to matters which the director believes to be within such person's professional or expert competence.

"The rules of statutory construction require that statutes be interpreted to give meaning and effect to each, if possible." Miller v. King County, 59 Wn.2d 601, 605, 369 P.2d 304 (1962).

Here, Barnard and Boin relied on the officers, counsel and underwriters to research, prepare, circulate and provide opinions regarding the PPM. In doing so, Barnard and Boin complied with their obligations under RCW 23A.08.343.

Plaintiffs argue that the Washington Business Corporations Act relates only to a director's duties to the corporation, not to investors. However, directors' responsibilities cannot be so neatly dichotomized. The duties and obligations of directors to investors and to the corporation overlap and cannot be segregated. Plaintiffs' argument, if adopted, would essentially prohibit directors from relying on the mandate of RCW 23A.08.343 for fear of violating a stricter duty to investors; hence the Washington Business Corporations

Act's attempt to limit and define a director's responsibilities would be rendered meaningless.

C. Outside Directors Who Are Not Controlling Persons Do Not Have a Duty to Investigate Representations Made by Inside Directors Absent Suspicious Circumstances.

Even if this court finds that Barnard and Boin should be strictly liable under the Washington State Securities Act, the trial court correctly granted summary judgment because Barnard and Boin established their affirmative defense under RCW 21.20.430(3) as a matter of law. The affirmative defense provision provides that directors are not liable if they:

> did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.

RCW 21.20.430(3).

It is undisputed that Peterson was back at work and fully recovered by the time of the first closing. It is further undisputed that Barnard and Boin did not know of Peterson's second aneurysm. Thus, any imposition of liability on Barnard and Boin must be predicated on a holding that Barnard and Boin could not establish their affirmative defense unless they undertook to investigate and uncover facts not within their knowledge. Such a finding would do violence to the legislative history of

the Washington State Securities Act and depart from other states' case law construing analogs to the affirmative defense provision of RCW 21.20.430(3).

The affirmative defense provision of the Washington State Securities Act was taken from Section 410(b) of the Uniform Securities Act which uses wording identical to that used in the Washington statute. The Comment to the Uniform Securities Act regarding the affirmative defense provision states:

> The defense of lack of knowledge is modeled on Section 15 of the Securities Act of 1933, 15 U.S.C. § 77B and Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a).

(Emphasis added.) The affirmative defense provision of Section 15 of the Securities Act of 1933 provides a defense to liability if:

> [t]he controlling person has no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

The affirmative defense provision of Section 20(a) of the Securities and Exchange Act of 1934 provides a defense to liability if:

> the controlling person acted in good faith and did not directly or indirectly induce the act or acts

> constituting the violation or cause of action.

Section 15 of the 1933 Act and Section 20(a) of the 1934 Act should be construed identically. Durham v. Kelly, 810 F.2d 1500, 1504 (9th Cir. 1987).

Section 15 of the Securities Act of 1933 was amended in 1934. The purpose of the amendment was explained by one federal court:

> Prior to the amendment, that section held control persons absolutely liable for the Section 11 or Section 12 violations of those whom they controlled. The amendment added the clause "unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." Senator Fletcher's memorandum explained the purpose of a similar amendment to be: "to restrict the scope of the section so as more accurately to carry out its real purpose. The mere existence of control is not made a basis for liability unless that control is effectively exercised to bring about the action upon which liability is based."

Lanza v. Drexel & Co., 479 F.2d 1277, 1298 (2d Cir. 1973). As the Comment to the Uniform Act makes clear, the amended Section 15 was specifically incorporated into the Uniform Securities Act, which Washington adopted.

Based on this analysis of the legislative history of Section 15 and the Uniform Act, the Lanza court stated

that under Washington's Act an outside director has no affirmative duty of investigation:

> Congress was quite aware of the "agonizingly subtle" choice continually facing directors when it passed the Securities Act.[105] . . .
>
> 105 State legislatures were equally aware. State Blue Sky Laws universally exempt directors from liability for fraud perpetrated by corporate officers unless the directors were in some meaningful sense culpable participants in the fraud . . . notice that there is no affirmative duty of investigation . . . Wash. Rev. Code Ann. § 21.20.430(2) (Supp. 1972).

Lanza v. Drexel & Co., 479 F.2d 1277, 1308-09 n.105 (2d Cir. 1973) (emphasis added).

The court in Lanza also compared the language of the Uniform Securities Act with another Section of the 1933 Act, Section 11, which by its plain terms specifically imposes a reasonable duty to investigate. The Lanza court reasoned that the drafters of the Uniform Act had the "duty to investigate" language of Section 11 before it, but chose not to incorporate that language into the Uniform Act. Accordingly, the Lanza court concludes that the Uniform Securities Act's duties of inquiry were similar, not to the 1933 Act, but to SEC Rule 10b-5.

Under Rule 10b-5, an outside director who has not been a participant in the negotiation for the sale of

securities or made any representation with respect thereto may rightfully rely on other officers or directors of the corporation on whose board he sits. Lanza v. Drexel & Co., supra. The Lanza court refused, absent the presence of suspicious circumstances, to impose a duty of inquiry on outside directors. The Lanza court's reasoning is directly applicable here:

> As in all lawsuits, we deal in the sometimes unreal certainties of hindsight. When we move toward the kind of novelty plaintiffs propose for one in the position of Coleman, it may not be amiss to recall the ambiguities of real life. A director like Coleman, not involved in the daily business, may think he "knows" things contrary to what he is told by the management upon which he must of course rely. He may be wrong. His primary loyalties are familiar and stern ones. How and when he must--or may--run off to "warn" or advise outsiders dealing with this corporation could suggest questions of great refinement. At the very least, such action would violate the decorum of the management heiarchy; at most, it could cost him his seat on the Board and a judgment for interfering with the corporate opportunity. If people of stature and creative potential are still wanted for corporate directorship, we must take care how agonizingly subtle their choices are to be . . . . In short, if the type of liability plaintiff's urge ever be imposed, it ought to be reasonably clear that the wrong is palpable and that the balance of advantage lies in that course.

Lanza, 479 F.2d at 1307.

The Lanza analysis was specifically applied to Section 15(b) of the Georgia Securities Act of 1973 which in all material respects is identical to RCW 21.20.430(3). Hamilton Bank and Trust Co. v. Holliday, 464 F. Supp. 1229 (N.D. Ga. 1979). Like RCW 21.20.430(3), Section 15(b) of the Georgia Act provides for liability:

> unless the person whose liability arises under this subsection sustains the burden of proof that he did not know when and in the exercise of reasonable care could not have known of the existence of the facts by reason of which liability is alleged to exist.

In Hamilton Bank, plaintiff Bank brought suit under federal securities law and the Georgia Securities Act against officers and directors of Hamilton Bank Shares, Inc. and Hamilton Factors, Inc. for alleged misrepresentations made in the sale of an interest in a loan pool to the plaintiff. The defendant outside directors brought a summary judgment motion which the court granted. The court framed the issue as follows:

> The real issue confronting the court is the legal question of whether the outside directors had reason to know of the facts by reason of which liability is alleged to exist.

Id. at 1240. Like the Lanza court, the Hamilton Bank Court then compared the affirmative defense provisions of

Section 15 of the Securities Act of 1933, Section 20(a) of the Securities and Exchange Act of 1934 and the Georgia Securities Act. The court found these provisions to be identical in all material respects. The Hamilton Court then adopted the Lanza analysis and applied that analysis to the Georgia Securities Act.

The court held:

> This Court believes that, based on Lanza, the Outside Directors had no duty to insure that all material adverse information was conveyed to plaintiff HB&T in connection with the sale of the loan participations to the plaintiff.

Id. In applying the Lanza rule to the Georgia Securities Act, the court in Hamilton concluded:

> "A director . . . is chargeable [only] with a degree of notice of those facts which the corporate books and the directors' meetings would fairly disclose." Myzel v. Fields, 386 F.2d 718, 736 (8th Cir. 1967), cert. denied, 397 U.S. 951, 88 S. Ct. 1043, 19 L. Ed. 2d 1143 (1968). In addition, a director is entitled to rely on the corporation's officers and is "not . . . required to presume rascality, maintain a constant vigilance over the corporation's business transactions, or assume the responsibilities of the corporation's managing officers." Harman v. Willbern, 374 F. Supp. 1149, 1164 (Dist. Kan. 1974), aff'd, 520 F.2d 1333 (10th Cir. 1975).

Id at 1242.

Plaintiffs attempt to distinguish Lanza on four grounds: (1) Barnard and Boin participated in the wrongful conduct to a greater extent than the defendant in Lanza, (2) Barnard and Boin had a duty to disclose Peterson's first aneurysm operation, (3) that unlike Lanza, scienter is required to establish a violation of 21.20.010, and (4) Barnard and Boin had an ongoing duty to inform investors of material facts as they discovered them. None of these contentions is persuasive. Each contention will be discussed in turn.

1. Lanza Is Not Distinguishable on Its Facts From the Instant Case.

Plaintiffs contend that Lanza is distinguishable because the defendant in that case, Coleman, had less involvement in the alleged wrongful conduct than Barnard and Boin did. That argument simply ignores the facts of Coleman's involvement. The securities transaction involved in Lanza was an exchange of all the stock of the plaintiffs' corporation for the stock in BarChris, with the plaintiffs receiving the BarChris stock. In connection with the exchanged stock, the plaintiffs were found to have been misled and damaged by material misrepresentations and omissions on the part of certain officers and directors of BarChris. Lanza v. Drexel & Co., 479 F.2d 1277, 1280 (2d Cir. 1973). Coleman was

either present at the BarChris directors meetings at which the exchange of stock was discussed and approved or, at least, had read the minutes of that meeting. Id. at 1284. He had substantial information about the general business and financial condition of BarChris. Id. at 1285-86. Several days before the exchange of stock he learned of negative financial developments at BarChris which were not disclosed to the plaintiffs. Id. at 1286-88. The Lanza Court, nonetheless, found that the negative financial developments did not require Coleman to undertake an independent investigation.

Here, like Coleman, Barnard and Boin attended or read the minutes of board of directors meetings. However, unlike Coleman, they did not have knowledge of material information which was not disclosed to the plaintiffs. If any distinction be made between this case and Lanza, it is that Barnard and Boin had less notice of any material omission than did Coleman.

2. Whether Scienter Is Required to Establish a Seller's Violation of RCW 21.20.010 Is Not Relevant to What an Outside Director Must Establish to Meet His Affirmative Defense.

A director is not directly liable for violations of RCW 21.20.010, unless he is also a seller. Any liability of a director is derivative. RCW 21.20.430(3) specifically provides for an affirmative defense to

derivative liability. This court's construction of that affirmative defense provision bears no relation to whether scienter is required before a seller violates 21.20.010.

3. Barnard and Boin Had No Duty to Disclose an Operation From Which a Full Recovery Had Been Made.

Plaintiffs also argue that Barnard and Boin had an obligation to disclose Peterson's first aneurysm operation. However, it is undisputed that by the time of the first closing Peterson was back at work and fully functional. Defendants respectfully submit that an operation from which a full recovery had been made is not a material fact which must be disclosed to potential investors. Further, as discussed above, Barnard and Boin complied with their duties under the Washington Business Corporations Act and rightfully relied on the attorneys and the inside directors to determine what must be disclosed.

4. At the Time Plaintiffs Purchased Their Investments, Barnard and Boin Did Not Fail to Supplement the Private Placement Memorandum.

On the record before this court, all of plaintiffs' investments except for Mathisen's and Schwartz' were made prior to October 15, 1987, the earliest date upon which Barnard and Boin could have known of Peterson's second brain aneurysm. Thus, as to these investors, Barnard and

Boin had no information with which to supplement the Private Placement Memorandum. Further, as to defendant Mathisen, there is no evidence before this court that Barnard and Boin knew of Peterson's second aneurysm operation before the closing of his purchase. Finally, as to defendant Schwartz, his interest was purchased after the second operation and after a doctor's letter was issued stating that Peterson should have no continuing health problem. Thus, Barnard and Boin had no duty, under the facts presented here to supplement the private placement memorandum.

D. Plaintiffs Must Establish That Defendants' Misrepresentation Caused Their Investments to Decline in Value Before They Can Recover Under the Washington State Securities Act

Barnard and Boin admit that plaintiffs have raised material issues of fact regarding the materiality of Peterson's second brain aneurysm and the element of causation. In the event that this Court reverses the trial court's ruling and remands this case for trial, Barnard and Boin submit this argument on causation to enable the Court, if it so desires, to provide guidance to the trial court on the issue of whether causation is an element of 21.20.010.

This court has previously found that a causal relationship is required under the Washington State

Securities Act. Shermer v. Baker, 2 Wn. App. 845, 851, 472 P.2d 589 (1970). In Shermer, the trial court had instructed the jury that:

> The plaintiff has the burden of proving each of the following propositions:
>
> First, the defendant violated one or more of the legal duties owed by him to the plaintiff which duties are described in these instructions;
>
> Second, the plaintiff suffered damages;
>
> Third, the defendant's violation of one or more of the described legal duties caused the plaintiff's damages.

Id. at 851 n.4 (emphasis added). The Court of Appeals specifically approved this instruction stating:

> By instruction 8, the trial court advised the jury plaintiff had the burden of proving that defendant violated one or more of the legal duties imposed upon him by law, and that the plaintiff suffered damages because of such violation . . . . we find no error in the giving of these instructions.

Id. (emphasis added).

Washington, like other states, has adopted the Uniform Securities Act. Other states also hold that a plaintiff must establish causation to prevail. See, e.g., Alna Capital Associates v. Wagner, 758 F.2d 562, 565 (11th Cir. 1985) (construing Florida law) (plaintiff must prove that a misrepresentation or omission "proximately caused"

injury); Dupont v. Brady, [1986 Transfer Binder] Blue Sky Rep. (CCH) ¶ 42,457 (S.D.N.Y. 1986) (proof of proximate damage is requisite for civil liability under New York Act).

Plaintiffs argue that courts often confuse causation with reliance, and only proof of reliance is required under the federal analog to 21.20.010. While plaintiffs are correct that federal courts often confuse these two elements, commentators and courts that clearly distinguish between the two hold that proof of the traditional tort element of causation is a requirement for recovery under the securities law. As the Fifth Circuit stated:

> Causation is related to but distinct from reliance. Reliance is a causa sine qua non, a type of "but for" requirement: had the investor known the truth, he would not have acted. Causation requires one further step in the analysis: even if the investor would not otherwise have acted, was the misrepresented fact a proximate cause of the loss? Herpich v. Wallace, 430 F.2d 792, 810 (5th Cir. 1970). The plaintiff must prove not only that, had he known the truth, he would not have acted, but in addition that the untruth was in some reasonably direct, or proximate way, responsible for his loss. The causation requirement is satisfied in a Rule 10b-5 case only if the misrepresentation touches upon the reasons for the investment's decline in value. If the investment decision is induced by misstatements or omissions that are material and that were relied on by the claimant, but are not the

> proximate reason for his pecuniary loss, recovery under the Rule is not permitted.

Huddleston v. Herman and MacLean, 640 F.2d 534, 549, rehearing denied, 650 F.2d 815 (5th Cir. 1982) affirmed in part and reversed in part on other grounds, 459 U.S. 375, 103 S.Ct. 683, 74 L. Ed. 2d 548 (1983).

A prominent commentator agrees:

> There is little doubt that the causal nexus must exist between the defendants' acts and the plaintiffs' loss, notwithstanding some contrary authority indicating that the relationship should be between the defendants' acts and the plaintiffs' purchase or sale.

Jacobs, The Impact of Rule 10b-5 (rev. ed. 1980) at Section 64.02.

Thus, if this court decides to reach the causation issue, the court should find that, like other tort cases, causation is an element of an RCW 21.20.010 violation.

IV.

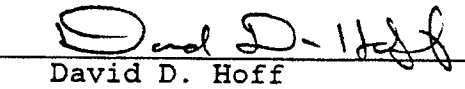
CONCLUSION

The trial court's grant of summary judgment should be affirmed on any of three alternative grounds. First, outside directors who are not controlling persons should not be subject to liability under the Washington State Securities Act when the outside directors did not culpably

participate in the preparation of the private placement memorandum. Second, Barnard and Boin's actions complied with their obligations under the Washington Business Corporations Act, and the Washington State Securities Act should not be read to undermine the Washington Business Corporations Act's mandate. Third, Barnard and Boin did not have a duty to investigate representations made by inside directors absent suspicious circumstances. Finally, if this court reaches the issue of causation it should find that any violation of the Washington State Securities Act was not a proximate cause of plaintiffs' injury.

Dated this 3rd day of December, 1987.

RIDDELL, WILLIAMS, BULLITT & WALKINSHAW

By 
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