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No. 68130-3-I

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

FUTURESELECT PORTFOLIO MANAGEMENT, INC., FUTURESELECT PRIME ADVISOR II LLC, THE MERRIWELL FUND, L.P. AND TELESIS IIW, LLC,

Plaintiffs/Appellants,

v.

TREMONT GROUP HOLDINGS, INC., TREMONT PARTNERS, INC., OPPENHEIMER ACQUISITION CORPORATION, MASSACHUSETTS MUTUAL LIFE INSURANCE CO. and ERNST & YOUNG LLP,

Defendants/Respondents.

BRIEF OF RESPONDENTS TREMONT GROUP HOLDINGS, INC. and TREMONT PARTNERS, INC.

Timothy J. Filer, WSBA #16285
Attorneys for Respondents
Tremont Group Holdings, Inc. and
Tremont Partners, Inc.

FOSTER PEPPER PLLC
1111 Third Avenue, Suite 3400
Seattle, Washington 98101-3299
Telephone: (206) 447-4400
Facsimile: (206) 447-9700

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Plaintiffs/appellants ("FutureSelect" or "plaintiffs") appeal from the order of the Superior Court of Washington in and for King County (Spector, J.) entered on June 3, 2011 (the "Order"). The Order dismisses the complaint in this action (the "Complaint") for failure to state a claim for relief. For the reasons stated below, defendants/respondents Tremont Partners, Inc. ("TPI") and Tremont Group Holdings, Inc. ("TGH") (collectively, "Tremont") submit that the superior court properly dismissed the Complaint as against Tremont under Civil Rule 12(b)(6), and the Order therefore should be affirmed.

I. INTRODUCTION

Plaintiffs are three hedge funds (the "FutureSelect Funds") and the investment adviser to those funds. These professional – and highly sophisticated – investors wished to invest with Bernard Madoff but could not do so directly because Madoff's firm, Bernard L. Madoff Investment Securities LLC ("BLMIS"), limited the number of accounts it handled. FutureSelect therefore turned to three hedge funds managed by TPI, each of which had access or exposure to BLMIS and thus Madoff.

The three funds managed by TPI, Rye Select Broad Market Fund, L.P. (the "Broad Market Fund"), Rye Select Broad Market Prime Fund, L.P. (the "Prime Fund") and Rye Select Broad Market XL Fund, L.P. (the "XL Fund") (collectively, the "Rye Funds" or the "Funds"), are organized

as limited partnerships under Delaware law. The FutureSelect Funds invested in the Rye Funds by becoming limited partners of those Funds, thereby obtaining their own indirect exposure to Madoff.

As the world now knows, rather than investing the Rye Funds' assets as promised, Madoff misappropriated them and successfully concealed his malfeasance for decades. With Madoff in jail and unable to compensate his victims, FutureSelect sued Tremont in an effort to recoup the losses caused by Madoff's scheme. All of FutureSelect's claims, however, are facially defective and were properly dismissed by the superior court as against Tremont.

One of FutureSelect's claims alleges violations of the Washington State Securities Act ("WSSA," RCW 21.20.010) based on the assertion that Tremont disseminated false and misleading statements concerning TPI's management of the Rye Funds. The WSSA has no application here under governing choice of law rules, however, because the misconduct alleged in the Complaint occurred principally, if not exclusively, in the State of New York. But even if the WSSA were applicable – which it is not – the WSSA claim still would be facially defective in all events because FutureSelect failed adequately to allege an essential element of the claim, *i.e.*, facts sufficient to show that FutureSelect reasonably relied on any misstatement purportedly made by Tremont.

As for the Complaint's claims of negligence and negligent misrepresentation, the superior court properly dismissed them because they are barred by exculpation clauses contained in the limited partnership agreements of the Rye Funds, which govern the investments of all of the Funds' limited partners, including the FutureSelect Funds. Under the terms of the exculpation clauses, Tremont is exculpated against liability for all claims sounding in negligence, and all such claims therefore are properly dismissed on motion where, as here, they are asserted in a complaint. FutureSelect's negligence claim also was properly dismissed because the claim is derivative in nature and FutureSelect lacks standing to assert it. The Order therefore should be affirmed.

II. STATEMENT OF THE ISSUES

1. Did the superior court properly dismiss FutureSelect's WSSA claim given that under the Washington Supreme Court's decision in Haberman v. Washington Public Power Supply System, 109 Wn.2d 107, 744 P.2d 1032 (1987), opinion amended, 109 Wn.2d 107, 750 P.2d 254 (1988), the WSSA does not apply to the New York-based securities transactions at issue in this case?

2. Did the superior court properly dismiss FutureSelect's WSSA claim on the additional ground that the Complaint contains no allegations sufficient to establish for pleading purposes an essential

element of that claim – namely, reasonable reliance on a material misstatement made by Tremont?

3. Did the superior court properly dismiss FutureSelect's claims of negligence and negligent misrepresentation given that they are barred by the exculpation clauses contained in the Rye Funds' limited partnership agreements?

4. Did the superior court also properly dismiss FutureSelect's negligence claim given that the claim is derivative and FutureSelect lacks standing to assert it?

III. STATEMENT OF THE CASE

FutureSelect, the Rye Funds and Tremont

Plaintiff FutureSelect Portfolio Management, Inc. ("FSM") is the investment adviser to the FutureSelect Funds – plaintiffs FutureSelect Prime Advisor II, LLC, The Merriwell Fund, L.P. and Telesis IIW, LLC. (CP 5, 6.) The FutureSelect Funds are "funds of funds," *i.e.*, hedge funds that invest in other hedge funds. (CP 3, 21, 23, 24; FS Br. at 3, 11-12.)

The Rye Funds are New York-based hedge funds organized as limited partnerships under the laws of Delaware. (CP 6, 7, 1051, 1069, 1141, 1151, 1212, 1217.) The Rye Funds sold limited partnership interests to a number of highly sophisticated investors, including the FutureSelect Funds. (CP 3, 6-7.) FSM selected the Rye Funds as an

investment vehicle to enable the FutureSelect Funds to gain exposure to the investment strategy of Bernard Madoff. (CP 9.) The FutureSelect Funds could not invest with Madoff directly because Madoff's firm, BLMIS, limited the number of investors it would accept as clients, and the Rye Funds were among the select few granted access to Madoff. (Id.) Two of the Rye Funds, the Broad Market Fund and the Prime Fund, had accounts with BLMIS and entrusted their assets to that firm for investment. (CP 1057, 1058, 1141, 1142.) One of the Rye Funds, the XL Fund, had indirect exposure to Madoff in that it sought to replicate the returns of the Broad Market Fund on a leveraged basis by entering into swap agreements with third party financial institutions.[1] (CP 1218.)

Defendant TPI is the general partner and manager of the Rye Funds with headquarters in Rye, New York. (CP 6.) It is a wholly-owned subsidiary of defendant TGH, which also is based in New York. (CP 6, 1069, 1217.) Under the terms of the Rye Funds' limited partnership agreements, TPI was authorized to delegate responsibility for investing the

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[1] Swap agreements are contracts pursuant to which one party agrees to pay – often on a leveraged basis – an amount equal to the increase in the value of a security (here, the net asset value of limited partnership interests in the Broad Market Fund) in exchange for other payments (here, interest payments at a specified rate). (See Rye Select Broad Market XL Fund, L.P. Confidential Private Placement Memorandum (CP 1210-68) at CP 1225.) See also CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276, 279-80 (2d Cir. 2011) (discussing nature of swap agreements).

Funds' assets to an asset manager or managers selected in TPI's sole discretion.[2] Pursuant to that authority, TPI invested the assets of the Rye Funds through BLMIS and Madoff. (CP 2, 3.)

The Private Placement Memoranda

Prior to purchasing its limited partnership interests in the Rye Funds, FutureSelect received private placement memoranda disclosing the material terms and risks of its contemplated investments in the Funds (the "PPMs"). (CP 9.) TPI provided the same PPMs to all investors who expressed interest in purchasing the Funds' limited partnership interests, including prospective investors located throughout the United States.[3]

The PPM for the Prime Fund (the "Prime PPM") disclosed that "the partnership allocates its investment portfolio to one Manager" – Madoff – and that "[t]he overall success of the Partnership depends upon the ability of the Designated Manager to be successful in his own strategy."[4] The Prime PPM further disclosed that TPI would rely on information provided by Madoff, stating:

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[2] (Rye Select Broad Market Prime Fund, L.P. Am. and Restated Ltd. P'ship Agreement ("Prime LPA," CP 969-92) § 2.2; Rye Select Broad Market XL Fund, L.P. Am. and Restated Ltd. P'ship Agreement ("XL LPA," CP 993-1016) § 2.2; Rye Select Broad Market Fund, L.P. Am. and Restated Ltd. P'ship Agreement ("Broad Market LPA," CP 1017-48) § 3.03.)

[3] (See, e.g., CP 1054, 1139, 1213.)

[4] (Prime PPM (CP 1049-1133) at CP 1058, 1061, 1070-71, 1097.)

> [T]he Partnership will receive periodic reports from Underlying Managers . . . . The General Partner [TPI] will request detailed information on a continuing basis from each Underlying Manager regarding the Underlying Manager's . . . performance and investment strategies. However, the General Partner may not always be provided with detailed information regarding all the investments made by the Underlying Managers because certain of this information may be considered proprietary information by the Underlying Managers. This lack of access to information may make it more difficult for the General Partner to . . . evaluate the Underlying Managers.[5]

The PPM did not state that TPI would – or could – conduct "due diligence" on Madoff or his investment activity. Nor did it make any representations concerning the Fund's actual or anticipated returns.

The Prime PPM also admonished that investors should not rely on any representations outside the four corners of that document. Indeed, in that regard, the PPM included the following warning in bold text:

> NO PERSON HAS BEEN AUTHORIZED TO MAKE ANY REPRESENTATIONS OR PROVIDE ANY INFORMATION WITH RESPECT TO THE INTERESTS EXCEPT SUCH INFORMATION AS IS CONTAINED IN THIS MEMORANDUM. PROSPECTIVE INVESTORS SHOULD NOT RELY ON ANY INFORMATION NOT CONTAINED IN THIS MEMORANDUM.[6]

The PPMs for the Broad Market Fund (the "Broad Market PPM") and the

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[5] (Prime PPM (CP 1049-1133) at CP 1097.)
[6] (Prime PPM (CP 1049-1133) at CP 1052.)

XL Fund (the "XL PPM") contain similar disclosures.[7]

The Exculpation Provisions

The FutureSelect Funds and all other limited partners of the Rye Funds are parties to and bound by the Funds' limited partnership agreements ("LPAs"), which were attached as exhibits to the Funds' PPMs.[8] The LPAs for the Prime Fund and the XL Fund include provisions expressly exculpating TPI and its members, officers and affiliates from liability to the Funds and their limited partners for all "errors of judgment or for action or inaction, whether or not disclosed, which said party reasonably believed to be in the best interests of the partnership . . . to the fullest extent permitted by law[.]"[9]

The LPA for the Broad Market Fund also contains an exculpation clause. It provides that "[t]he General Partner [TPI] shall not be liable, responsible or accountable in damages or otherwise to any Limited Partners or the Partnership for any act or omission of such General Partner, except for acts or omissions constituting willful misfeasance, bad

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[7] (See generally Broad Market PPM (CP 1134-1209); XL PPM (CP 1210-68).)

[8] (Prime PPM (CP 1049-1133) at CP 1057, 1062, 1070; Broad Market PPM (CP 1134-1209) at CP 1152; XL PPM (CP 1210-68) at CP 1216, 1225.)

[9] (Prime LPA (CP 969-92) § 2.7; XL LPA (CP 993-1016) § 2.6.)

faith, gross negligence or reckless disregard of duty."[10]

FutureSelect's Investments in the Funds

Plaintiffs alleged in their Complaint that the FutureSelect Funds purchased limited partnership interests in the Rye Funds between 1998 and 2008. (CP 10-11.) Prior to making those investments, FSM's principal, Ronald Ward, signed subscription agreements with the Rye Funds representing and warranting that the FutureSelect Funds: (i) possessed sufficient "knowledge and experience in financial and business matters [such] that [they were] capable of evaluating the merits and risks" of investing in the Funds; (ii) had obtained "sufficient information from the [Funds or] authorized representatives to evaluate the merits and risks" of such investments; and (iii) could "afford a partial or complete loss" of their investments.[11] All hedge fund investors are required to make these representations and warranties under the federal securities laws.[12]

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[10] (Broad Market LPA (CP 1017-48) § 3.09(a).)

[11] (XL Fund Subscription Agreement signed by Ronald C. Ward (CP 1308-40) at CP 1323; see also Prime Fund Subscription Agreement signed by Ronald C. Ward (CP 1269-1307) at CP 1291; Broad Market Fund Subscription Agreement signed by Ronald C. Ward (CP 1341-92) at CP 1367.)

[12] For example, hedge fund investors must be: (i) "accredited investors" within the meaning of Regulation D promulgated under the Securities Act of 1933; (ii) "qualified clients" within the meaning of the Investment Advisors Act of 1940; and (iii) "qualified purchasers" as defined in the Investment Company Act of 1940. (Prime PPM (CP 1049-1133) at CP

FutureSelect's Claims

The Complaint alleges that TPI's failure to detect Madoff's fraud before he publicly revealed it demonstrates that TPI must not have monitored the Funds' investments. (CP 14-15.) Based on the conclusory (and erroneous) assertion that any minimal diligence would have revealed Madoff's fraud (CP 2, 14-15), the Complaint alleges claims against Tremont for: (i) violations of the WSSA (Count 1); (ii) negligence (Count 11); and (iii) negligent misrepresentation (Count 12).

IV. ARGUMENT

A. THE SUPERIOR COURT PROPERLY DISMISSED FUTURESELECT'S WSSA CLAIM

1. The WSSA Has No Application Here

The superior court properly dismissed FutureSelect's claim alleging violations of the WSSA because New York has the most significant relationship to the investments at issue in this case. Consequently, the WSSA has no application to the FutureSelect Funds' purchases of limited partnership interests issued by the Rye Funds.

In Haberman v. Washington Public Power Supply System, 109 Wn.2d 107, 744 P.2d 1032 – controlling authority FutureSelect largely

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1090-96; XL PPM (CP 1210-68) at CP 1234-38; Broad Market PPM (CP 1134-1209) at CP 1167-72.)

ignores in its brief[13] – the Washington Supreme Court addressed "the question . . . [of] whether the WSSA applies in an action brought in a Washington forum where out-of-state parties are under this State's jurisdiction." Id. at 134, 744 P.2d 1032. The court held that this question is governed by the "most significant relationship" choice of law test, which determines which state has the closest relationship to the transaction(s) at issue. See id. It does so by weighing, among other factors: (i) the place of alleged injury; (ii) the place where the conduct causing the injury occurred; (iii) the residence of the parties; (iv) the place where their relationship is centered; and (v) the interests of the competing states in regulating the conduct of the parties involved. See id. at 135, 159, 744 P.2d 1032; see also Rice v. Dow Chem. Co., 124 Wn.2d 205, 213, 875 P.2d 1213 (1994).

In Haberman, the Supreme Court weighed these factors and concluded that where the securities laws of two or more states potentially were applicable to plaintiff's securities law claim, the court should apply the law of the state in which: (i) the securities in dispute were issued; (ii)

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[13] Rather than address the choice of law analysis discussed at length by the Haberman court, FutureSelect cites the case for the proposition that the "primary goal of the WSSA is to protect Washington investors" (FS Br. at 20), as if to suggest that this is the principal, if not exclusive factor, driving the applicable choice of law analysis, which it most certainly is not.

the primary defendant resided; (iii) the parties had substantial business dealings; and (iv) the alleged misrepresentations originated. See 109 Wn.2d at 134-35, 744 P.2d 1032.

Analyzing those factors here, it becomes abundantly clear that New York law governs the claims alleged by FutureSelect in its Complaint challenging plaintiffs' securities transactions with the Rye Funds. In that connection, FutureSelect does not and cannot dispute that the limited partnership interests in question were issued by the Funds from their headquarters in New York, or that TPI, TGH and all the other defendants/respondents (except Massachusetts Mutual Life Insurance Company) are based in New York. (CP 9, 11, 1069; see also FS Br. at 19.) Furthermore, the Complaint alleges that FSM's principal, Ronald Ward, regularly traveled to New York to meet with TPI representatives (CP 11-13), and asserts that TPI's purported misconduct occurred in New York. (Id.) According to the Complaint, virtually *every* misrepresentation TPI purportedly made to FutureSelect emanated from TPI's office in New York. (Id.) The lone exception purportedly occurred during a single visit to Washington made by a New York-based representative of TPI in

1997.[14] (CP 9.) It also is significant that Madoff, based in New York, stole the assets of the Funds in New York, making New York the site of FutureSelect's alleged losses.

Ignoring Haberman, FutureSelect urges this Court to apply a different test, one that is unprecedented in this State.[15] According to FutureSelect, it should be able to assert claims against Tremont under the WSSA because TPI's representations reached FutureSelect at its place of business in Washington. (FS Br. at 18.) This argument should be rejected because it is contrary to controlling law, would require (in contravention of Haberman) courts to apply the WSSA to every securities claim asserted by a Washington resident, and is particularly inappropriate in this case given that TPI made many of the same statements to investors in different states. See Kelley v. Microsoft Corp., 251 F.R.D. 544, 552 (W.D. Wash. 2008) (holding that where defendant's conduct allegedly caused harm in two or more states, the "'place where the defendant's conduct occurred will

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[14] While FutureSelect implies that misrepresentations were made during this visit, it does not identify any misrepresentations allegedly made at that time.

[15] This is the "two contact" test mentioned in comment j to Section 148 of the Restatement (Second) of Conflict of Laws (1971). (FS Br. at 18.) The applicable "most significant relationship" test adopted by the Supreme Court is found in Section 145 of the Restatement (Second) of Conflict of Laws (1971). See Rice, 124 Wn.2d at 213, 875 P.2d 1213 ("Washington has adopted the 'most significant relationship' test as set out in the Restatement (Second) of Conflict of Laws *§ 145*." (emphasis added)); see also Haberman, 109 Wn.2d at 134, 744 P.2d 1032.

usually be given particular weight'" (quoting Restatement (Second) of Conflict of Laws § 145 cmt. e (1971))); Greenberg Traurig of N.Y., P.C. v. Moody, 161 S.W.3d 56, 71-72 (Tex. App. 2004) (rejecting "two contacts" test proposed by plaintiffs and applying New York law); see also Rice, 124 Wn.2d at 216, 875 P.2d 1213 (rejecting argument that "Washington law [sh]ould be applied in all tort cases involving any Washington resident").

Ito International Corp. v. Prescott, Inc., 83 Wn. App. 282, 921 P.2d 566 (1996), is not to the contrary, and FutureSelect's reliance on it is misplaced. (FS Br. at 19.) In Ito, the court applied Washington law where, in contrast to this case, the defendant was domiciled in Washington and the transaction at issue was an investment in a building located in Seattle. See 83 Wn. App. at 290, 921 P.2d 566. Here, Tremont is located in New York and the FutureSelect Funds purchased limited partnership interests issued by New York-based limited partnerships that invested assets with Madoff, a New York-based asset manager.[16]

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[16] FutureSelect also mistakenly relies on Peterson v. Graoch Associates # 111 L.P., No. C11-5069BHS, 2012 WL 254264 (W.D. Wash. Jan. 26, 2012), where the court cited Ito in holding that Washington law is applicable whenever Washington and a competing jurisdiction both have "significant contacts" to the transactions at issue. 2012 WL 254264, at *3. Peterson is contrary both to Ito and Haberman.

As for FutureSelect's "public policy" arguments (FS Br. at 20-21), they also have no merit. Where, as here, New York's connections to the transactions alleged in the Complaint are predominant, those connections are dispositive under Haberman. See Zenaida-Garcia v. Recovery Sys. Tech., Inc., 128 Wn. App. 256, 260-61, 115 P.3d 1017 (2005) (public policy arguments need only be considered where contacts are evenly balanced), review denied, 156 Wn.2d 1026, 132 P.3d 1094 (2006). Further, there also is no merit to FutureSelect's suggestion (FS Br. at 21) that New York lacks a strong interest in protecting investors from securities fraud merely because there is no private right of action under New York's securities statute, the Martin Act – the New York analog to the WSSA.[17] New York's interests predominate "because the financial industry is critical to its overall economic health and viability, as well as that of the nation." ExpressJet Airlines, Inc. v. RBC Capital Mkts. Corp.,

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[17] See Carideo v. Dell, Inc., 706 F. Supp. 2d 1122, 1132 (W.D. Wash. 2010) (FS Br. at 18) (rejecting argument that allegedly lower level investor protection under another state's statute weighs against applying the laws of that state to claims asserted by plaintiffs); see also Rice, 124 Wn.2d at 216, 875 P.2d 1213 (holding that Washington's interest in applying its laws does not predominate simply because a foreign state's law would bar plaintiff's claim).

C.A. No. H-09-992, 2009 WL 2244468, at *13 (S.D. Tex. July 27, 2009).[18]

In sum, the Haberman factors compel the conclusion that New York, not Washington, law applies here, and the superior court therefore properly dismissed FutureSelect's WSSA claim as against Tremont.

2. FutureSelect Did Not Adequately Allege Reasonable Reliance

Even if the WSSA were applicable to the securities transactions at issue here – which it is not – the Complaint states no claim for relief under that statute. To establish liability under the WSSA, the purchaser of a security must show that the seller made material misrepresentations of fact concerning the security, and that the purchaser reasonably relied on those misrepresentations. See, e.g., Stewart v. Estate of Steiner, 122 Wn. App. 258, 264, 93 P.3d 919 (2004). In its Complaint, FutureSelect attempted to establish these elements by alleging that Tremont induced plaintiffs' investments in the Funds by misrepresenting that: (i) Tremont "conducted continuous monitoring and oversight" of Madoff (FS Br. at 4 (citing CP 10-12, 31)); and (ii) Tremont "conducted due diligence of Madoff to

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[18] Thus, because the WSSA does not apply here, if FutureSelect still desired to attempt to pursue a securities claim under a state "blue sky" statute, it would need to look to New York's Martin Act, under which it is not entitled to relief. See, e.g., CPC Int'l Inc. v. McKesson Corp., 70 N.Y.2d 268, 275, 514 N.E.2d 116 (N.Y. 1987).

verify the existence of assets Madoff claimed to hold." (Id. (citing CP 9, 11-13).)[19] These allegations are insufficient to state a claim under the WSSA because the alleged misstatements do not appear in the Funds' PPMs, and plaintiffs expressly disclaimed reliance on any statements made outside the four corners of those offering documents.

The PPMs plainly disclose that "NO PERSON HAS BEEN AUTHORIZED TO MAKE ANY REPRESENTATIONS OR PROVIDE ANY INFORMATION WITH RESPECT TO THE INTERESTS EXCEPT SUCH INFORMATION AS IS CONTAINED IN THIS MEMORANDUM."[20] Moreover, in the subscription agreements signed by FutureSelect, plaintiffs represented that when deciding to invest in the Rye Funds, they "relied solely upon the [PPM], the [LPA] and [their] own independent investigations."[21] Plaintiffs therefore cannot base any claim under the WSSA on their alleged reliance upon any statement not found in the PPMs. Indeed, any such alleged reliance is unreasonable as a matter

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[19] The Complaint does not identify the source of these alleged misrepresentations with any particularity. Tremont is alleged to have made essentially the same misstatements in: (i) "offering materials" (CP 9); (ii) "materials Tremont provided to Ward" (CP 10); (iii) "when Ward visited Tremont's offices [in Rye, New York] and discussed the Rye Funds" (CP 9); (iv) in "telephone communications" (CP 11); and (v) in a letter dated July 10, 2001 (CP 12).

[20] (Prime PPM (CP 1049-1133) at CP 1052; Broad Market PPM (CP 1134-1209) at CP 1136; XL PPM (CP 1210-68) at CP 1213.)

[21] (E.g., XL Fund Subscription Agreement (CP 1308-40) at CP 1323.)

of law. See San Diego Cnty. Employees Ret. Ass'n v. Maounis, 749 F. Supp. 2d 104, 120-21 (S.D.N.Y. 2010); In re VMS Ltd. P'ship Sec. Litig., 803 F. Supp. 179, 193-94 (N.D. Ill. 1992).

In light of the representations made in the subscription agreements, FutureSelect cannot state a claim of securities fraud by alleging "'in effect, 'I lied when I told you I wasn't relying on . . . statements [outside the offering materials].'" Stewart, 122 Wn. App. at 268, 93 P.3d 919 (quoting Rissman v. Rissman, 213 F.3d 381, 382 (7th Cir. 2000) (Easterbrook, J.)). Yet FutureSelect attempts to do just that by claiming it relied on allegedly false statements nowhere found in the PPMs. Consequently, the Order dismissing the WSSA claim against Tremont can and should be affirmed on the ground that the Complaint fails to adequately allege the element of reasonable reliance, as required to state a claim under the statute. See Stewart, 122 Wn. App. at 274-75, 93 P.3d 919 (finding that sophisticated investor who had no prior relationship with defendant could not premise WSSA claim on alleged misrepresentations that were not contained in – or were contradicted by – disclosures in private placement memorandum).[22]

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[22] The court in Stewart held that non-reliance clauses are presumptively enforceable and may be "overcome" only by a significant factual showing. 122 Wn. App. at 275, 93 P.3d 919. FutureSelect made no such showing in the Complaint here.

Entirely ignoring Stewart, FutureSelect points to the following allegation in the Complaint and contends it is sufficient to plead reasonable reliance: "'FutureSelect reasonably and justifiably relied on Tremont's misstatements when it purchased securities in Tremont by investing in the Rye Funds.'" (FS Br. at 28 (quoting CP 32).) That allegation, however, is nothing more than a bald conclusion of law, which is insufficient to state a claim for relief. See Haberman, 109 Wn.2d at 120, 744 P.2d 1032 (the "court need not accept legal conclusions as correct"); State ex rel. Pirak v. Schoettler, 45 Wn.2d 367, 370, 274 P.2d 852 (1954) ("A [motion to dismiss] does not admit recitals of conclusions either of fact or law. Only facts stated in the [complaint] which are well-pleaded are to be considered, and conclusions of the pleader are to be disregarded.").[23]

FutureSelect further argues that the superior court should have disregarded the non-reliance provisions of the PPMs. (FS Br. at 28.) But

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[23] In re Metropolitan Securities Litigation, 532 F. Supp. 2d 1260 (E.D. Wash. 2007) (FS Br. at 28), is not to the contrary. The Metropolitan court did not hold that conclusory allegations of reliance are sufficient to state a claim. Rather, it found that under the circumstances of that case, reliance could be presumed and therefore did not have to be alleged in the complaint. See 532 F. Supp. 2d at 1304. In this case, the Complaint alleges nothing to show that FutureSelect is entitled to any presumption of reliance. Indeed, there is and can be no presumption of reliance where, as here, the parties' contracts contain non-reliance clauses. See, e.g., Stewart, 122 Wn. App. at 272, 93 P.3d 919.

this contention is undermined by the Complaint, which repeatedly asserts (albeit in entirely conclusory terms) that the PPMs and other "Offering Materials" contain misrepresentations of material fact. (See, e.g., CP 8, 9.) Given FutureSelect's attack on the accuracy of the contents of the PPMs, it was entirely proper for the superior court to analyze the sufficiency of the attack in light of what the PPMs actually said without blindly accepting FutureSelect's characterization of those documents. See Rodriguez v. Loudeye Corp., 144 Wn. App. 709, 717-28, 189 P.3d 168 (2008); see also Parrino v. FHP, Inc., 146 F.3d 699, 705-06 (9th Cir. 1998); Roe v. Unocal Corp., 70 F. Supp. 2d 1073, 1075 (C.D. Cal. 1999).[24]

FutureSelect fares no better with the fallback that any question of reasonable reliance necessarily raises issues of fact that may not be resolved on a motion to dismiss. (FS Br. at 29.) While such issues may arise from time to time in other cases, they are not presented by the Complaint in this action, where conclusory allegations of reasonable reliance have been made by sophisticated investors bound by non-reliance

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[24] Berge v. Gorton, 88 Wn.2d 757, 567 P.2d 187 (1977) (FS Br. at 28), is readily distinguishable. Although Berge holds generally that "[f]actual allegations of the complaint must be accepted as true for purposes of the motion," id. at 759, 567 P.2d 187, it does not hold that courts must accept as true conclusory allegations flatly contradicted by documents, such as subscription agreements and offering documents, that are integral to the claims alleged in the complaint.

clauses. In San Diego County Employees Retirement Association v. Maounis, 749 F. Supp. 2d 104, for example, a pension plan signed a subscription agreement with a hedge fund containing a non-reliance clause substantially identical to the clause found in the subscription agreements signed by the FutureSelect Funds here. In granting defendants' motion to dismiss the pension plan's fraud claims, the court held that in light of "the sophistication of [the pension plan] and its investment advisor, and the clear, unambiguous language of the non-reliance provisions at issue, the . . . purported reliance on statements made before the execution of the Subscription Agreement [was] unreasonable as a matter of law." Id. at 121. The same conclusion is warranted here. See also In re VMS, 803 F. Supp. at 193-94 (dismissing analogous claim pursuant to non-reliance clause).

B. FUTURESELECT'S NEGLIGENT MISREPRESENTATION CLAIM IS BARRED BY THE EXCULPATION CLAUSES

In its brief, FutureSelect contends that this Court must ignore the exculpation provisions in the Funds' LPAs because they supposedly "go beyond the face" of the Complaint. (FS Br. at 35.) This contention is completely undermined by this Court's decision in Rodriguez, which holds that courts may construe and enforce exculpation clauses when deciding motions to dismiss – even if the contract containing the clause is not

attached to the complaint – provided that the contract is referenced in the complaint and plaintiffs do not dispute the authenticity or contents of the contract. See 144 Wn. App. at 725-26, 189 P.3d 168. Both conditions are satisfied here.

The LPAs of the Funds were attached as exhibits to the PPMs referenced by FutureSelect in its Complaint. (CP 8, 9, 1070, 1152, 1225.) While FutureSelect contends that the LPAs were not signed by plaintiffs (FS Br. at 35 & n.7), FutureSelect does not dispute that the FutureSelect Funds, as limited partners of the Rye Funds, were parties to the LPAs submitted by Tremont to the superior court in connection with its motion to dismiss. FutureSelect also does not dispute that the FutureSelect Funds signed subscription agreements with the Rye Funds in which they expressly represented and warranted that they had read the LPAs and agreed to be bound by the provisions of those contracts. (CP 1291, 1323, 1367.)[25] The LPAs therefore are properly considered by this Court for

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[25] Thus, contrary to FutureSelect's contention, the FutureSelect Funds effectively signed the LPAs. But even if they did not sign those agreements, they still would be bound by the LPAs as matter of Delaware law. See Del. Code tit. 6, § 17-101(12) ("A limited partnership is bound by its partnership agreement whether or not the limited partnership executes the partnership agreement. . . . A written partnership agreement . . . [also s]hall not be unenforceable by reason of its not having been signed by a person being admitted as a limited partner[.]").

purposes of construing and enforcing exculpation clauses indisputably applicable to FutureSelect's claims against Tremont.

Further, public policy strongly favors consideration of exculpation provisions at the outset of a case. As the Delaware Court of Chancery has explained, it is appropriate to consider exculpation provisions when "resolving motions to dismiss . . . because it promotes the efficient allocation of the Court's and the parties' resources." In re Ply Gem Indus., Inc. S'holders Litig., C.A. No. 15779, 2001 WL 755133, at *10 (Del. Ch. June 26, 2001). Indeed, if plaintiffs could avoid application of such governing provisions simply by failing to quote them explicitly or by adding conclusory allegations to their complaints, "contracting parties would be stripped of the substantial benefit of their bargain, that is, avoiding the expense of lengthy litigation." Indus. Risk Insurers v. Port Auth. of N.Y. & N.J., 387 F. Supp. 2d 299, 307 (S.D.N.Y. 2005), aff'd in relevant part, 493 F.3d 283 (2d Cir. 2007); see also Parrino, 146 F.3d at 705-06 (plaintiffs may not "survive a Rule 12(b)(6) motion by deliberately omitting references to documents upon which their claims are based"); Zutty v. Rye Select Broad Mkt. Prime Fund, L.P., 33 Misc. 3d 1226, 939 N.Y.S.2d 745 (table), 2011 WL 5962804, at *7-8 (N.Y. Sup. Ct. Apr. 15, 2011) (dismissing claims against Tremont pursuant to exculpation clause); accord Wn. Super. Ct. Civil Rules, CR 11(b)(3) (pleadings should not be

drafted in a way that would cause "needless increase in the cost of litigation").[26]

With the exculpation clauses properly before the Court, those clauses plainly bar FutureSelect's negligent misrepresentation claim, and FutureSelect cites no authority to the contrary. Under governing Delaware law, see Rodriguez, 144 Wn. App. at 718, 189 P.3d 168 (Delaware law

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[26] While plaintiffs cite Askenazy v. Tremont Group Holdings, Inc., C.A. No. 2010-04801-BLS2, 2012 WL 440675 (Mass. Super. Ct. Jan. 26, 2012), as a case that declined to consider the contents of an exculpation clause in connection with a motion to dismiss, the Askenazy court did so based on the mistaken belief that governing Delaware law precluded the court from considering materials outside the pleadings. See id. at *12. To support this finding, the Askenazy court cited In re Nantucket Island Associates Limited Partnership Unitholders Litigation, C.A. No. 17379, 2002 WL 31926614 (Del. Ch. Dec. 16, 2002), a case that actually held defendants should raise exculpation defenses "early and loudly [because o]ne of the purposes of these defenses is to permit the early termination of cases that fall within their protective ambit." Id. at *4. Nantucket Island declined to consider the defendants' exculpation defense in the particular context of that case only because the defendant "wait[ed] until the eve of trial" to assert the defense. See id. The Delaware Supreme Court has clearly ruled that exculpation "'may be raised on a Rule 12(b)(6) motion to dismiss (with or without the filing of an answer).'" Emerald Partners v. Berlin, 787 A.2d 85, 91-93 & n.35 (Del. 2001) (citation omitted).

To the extent the vacated decision in Cocchi v. Tremont Group Holdings, Inc., No. 502009 CA 016230XXXXMB, 2010 WL 2008086 (Fla. Cir. Ct. Feb. 5, 2010), aff'd sub nom. KPMG LLP v. Cocchi, 51 So.3d 1165 (Fla. Dist. Ct. App. 2010), vacated, 132 S. Ct. 23 (2011), has any precedential value within or without Florida (which it does not, see, e.g., Salitros v. Chrysler Corp., 306 F.3d 562, 575 n.2 (8th Cir. 2002)), it was wrongly decided. Review of the provisions of a limited partnership agreement is appropriate when considering a motion to dismiss claims arising out of that agreement. See Rodriguez, 144 Wn. App. at 726, 189 P.3d 168; see also Parrino, 146 F.3d at 705-06.

governs interpretation of exculpation clauses in the constituent documents of Delaware companies), exculpation clauses of the kind found in the LPAs of the Prime Fund and the XL Fund operate to bar all claims, including those sounding in negligence, unless plaintiffs "plead . . . facts that demonstrate that the [defendants] acted with scienter, i.e., that they had 'actual or constructive knowledge' that their conduct was legally improper." Wood v. Baum, 953 A.2d 136, 141 (Del. 2008) (citation omitted); see also Del. Code tit. 6, § 17-1101(f). And to overcome the bar of the exculpation clause found in the LPA of the Broad Market Fund, which exculpates Tremont from liability for all alleged misconduct falling short of gross negligence, FutureSelect must adequately plead and prove "'reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason.'" In re Lear Corp. S'holder Litig., 967 A.2d 640, 652 & n.45 (Del. Ch. 2008) (citation omitted).

FutureSelect's claim of negligent misrepresentation – which sounds in simple negligence – is bereft of facts sufficient to establish bad faith or "actions which are without the bounds of reason," as illustrated by the decision of this Court in Rodriguez. In that case, plaintiff alleged that the defendant directors breached their fiduciary duties in connection with the sale of a company by failing to conduct an auction of the business, failing

adequately to disclose material information and failing to obtain the best price for the investors of the company – all in an alleged effort to obtain accelerated or enhanced compensation from the purchaser. See Rodriguez, 144 Wn. App. at 716-17; 189 P.3d 168. This Court held that plaintiff's allegations were insufficient to overcome the protections of a Delaware exculpation provision, noting that the complaint contained no "allegations of any conduct . . . "beyond the bounds of reasonable judgment."" Id. at 724, 189 P.3d 168 (citations omitted).

Like the plaintiff in Rodriguez, FutureSelect has failed to allege any *facts*, as opposed to conclusory assertions, sufficient to show that Tremont acted beyond the bounds of reasonable judgment. Accordingly, FutureSelect's negligent misrepresentation claim is barred by the exculpation provisions of the Funds' LPAs, and the superior court therefore properly dismissed the claim as against Tremont.

C. THE SUPERIOR COURT PROPERLY DISMISSED FUTURESELECT'S NEGLIGENCE CLAIM

Because FutureSelect's negligence claim against Tremont is, like its negligent misrepresentation claim, premised on allegations of simple negligence, see, e.g., Musalli Factory for Gold & Jewellry v. JPMorgan Chase Bank, N.A., 261 F.R.D. 13, 27-28 (S.D.N.Y. 2009) (setting out elements of negligence), aff'd, 382 F. App'x 107 (2d Cir. 2010), it also is

barred by the exculpation clauses of the LPAs and thus was properly dismissed on that basis by the superior court. But even in the absence of the exculpation clauses, the negligence claim still would be defective because FutureSelect lacks standing to assert it.

FutureSelect's negligence claim is derivative in nature and thus may be maintained, if at all, solely by or on behalf of the Funds. FutureSelect therefore may not assert the claim – as it purports to do in this case – solely in an individual capacity on its own behalf. See, e.g., Kramer v. W. Pac. Indus., Inc., 546 A.2d 348, 351-53 (Del. 1988) (except in circumstances not present here, derivative claims may only be pursued by the company in which plaintiffs have invested – and not by investors directly).

In determining whether a claim brought by an investor is direct or derivative, the applicable test under governing Delaware law is as follows:[27]

> Where all of a corporation's stockholders are harmed and would recover *pro rata* in proportion with their ownership of the corporation's stock solely because they are stockholders, then the claim is derivative in nature. The mere fact that the alleged harm is ultimately suffered by, or the recovery would ultimately inure to the benefit of, the stockholders does not make a claim direct. . . . In order to

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[27] FutureSelect concedes, as it must, that Delaware law governs the question of "whether a claim is direct or derivative." (FS Br. at 39.) See also Rodriguez, 144 Wn. App. at 718, 189 P.3d 168.

> state a direct claim, the plaintiff must have suffered some individualized harm not suffered by all of the stockholders at large.

Feldman v. Cutaia, 951 A.2d 727, 733 (Del. 2008) (footnotes omitted).

FutureSelect's claim of negligence is derivative because it is premised on conduct that caused alleged injuries – *i.e.*, the loss of Fund assets and the Funds' payment of allegedly unjustified fees to TPI (CP 9-10, 15, 16) – suffered directly by the Rye Funds and only indirectly by plaintiffs pro rata to their interests in the Funds. See Feldman, 951 A.2d at 733; see also Litman v. Prudential-Bache Props., Inc., 611 A.2d 12, 15-16 (Del. Ch. 1992) (finding allegations that "the general partners . . . inadequately investigat[ed] and monitor[ed] investments" to be derivative); Newman v. Family Mgmt. Corp., 748 F. Supp. 2d 299, 315 (S.D.N.Y. 2010) ("'A claim for deficient management or administration of a fund is 'a paradigmatic derivative claim.'" (citations omitted)); West Palm Beach Police Pension Fund v. Collins Capital Low Volatility Performance Fund II, Ltd., No. 09-80846-CIV., 2010 WL 2949856, at *3 (S.D. Fla. July 26, 2010) ("By alleging that Collins Investments failed to conduct the necessary due diligence to discover the Madoff Ponzi scheme, Plaintiff has pled 'a paradigmatic derivative claim.'" (citation omitted)).

FutureSelect contends that its negligence claim is direct, not derivative, arguing that the claim is not based on Fund mismanagement,

but rather, on misrepresentations made directly to FSM's principal Ronald Ward. (See FS Br. at 39-42.) This assertion is foreclosed by the actual allegations of the Complaint, which assert that Tremont failed to "use reasonable care, or the competence or skill of a professional investment advisor, in managing and overseeing FutureSelect's assets that were invested in the . . . Funds." (CP 42.) But even if FutureSelect's negligence claim were premised on misrepresentations, it still would have been properly dismissed below on the ground that any such claim would have been impermissibly duplicative of FutureSelect's claim of negligent misrepresentation. See Francom v. Costco Wholesale Corp., 98 Wn. App. 845, 866, 991 P.2d 1182 (2000) (affirming dismissal of duplicative claim), review denied, 141 Wn.2d 1027, 10 P.3d 1071 (2000); accord Vanguard Mun. Bond Fund, Inc. v. Cantor, Fitzgerald L.P., 40 F. Supp. 2d 183, 188 (S.D.N.Y. 1999) ("the Court does not find any substantial difference between [plaintiff's] negligence and negligent misrepresentation claims and will address them together as a claim for negligent misrepresentation").

V. CONCLUSION

For the foregoing reasons, the Order should be affirmed in all respects.

RESPECTFULLY SUBMITTED this 16th day of May, 2012.

FOSTER PEPPER PLLC

Tim J. Filer, WSBA #16285
1111 Third Avenue, Suite 3400
Seattle, Washington 98101-3299
Telephone: (206) 447-4400
Facsimile: (206) 447-9700
E-mail: FileT@foster.com

Attorneys for
Defendants/Respondents
Tremont Group Holdings, Inc. and
Tremont Partners, Inc.

COURT OF APPEALS
THE STATE OF WASHINGTON
DIVISION I

FUTURESELECT PORTFOLIO MANAGEMENT, INC., et al.,	)	
	)	No. 68130-3-I
Appellants,	)	
	)	PROOF OF SERVICE
v.	)	
	)	
TREMONT GROUP HOLDINGS, INC., et al.,	)	
	)	
Respondents.	)	
	)	

Charles P. Rullman certifies and states: On May 16, 2012, I caused to be served a true and correct copy of the **Brief of Respondents Tremont Group Holdings, Inc. and Tremont Partners, Inc.** on the following counsel of record at their address as stated by the method of service indicated:

Attorneys for Appellants

Jeffrey M. Thomas
Jeffrey I. Tilden
David M. Simmonds
Gordon Tilden Thomas & Cordell
1001 Fourth Avenue Suite 4000
Seattle, WA 98154
Tel: 206-467-6477
Email: jthomas@gordontilden.com
Email: jtilden@gordontilden.com
Email: dsimmonds@gordontilden.com

☒ Via Email
☒ Via Messenger

ORIGINAL

Attorneys for Appellants, Cont.

Steven W. Thomas
Emily Alexander
Mark Forrester
Jessica Rassler
Thomas, Alexander & Forrester LLP
14 -27th Avenue
Venice, CA 90291
Tel: 310-961-2536
Email: steventhomas@tafattorneys.com
Email: emilyalexander@tafattorneys.com
Email: markforrester@tafattorneys.com

☒ Via Email
☒ Via US Mail

Attorneys for Respondent Ernst & Young LLP

Stephen M. Rummage
John A. Goldmark
Davis Wright Tremaine
1201 Third Avenue, Suite 2200
Seattle, WA 98101-3045
Tel: 206-622-3150
Email: steverummage@dwt.com
Email: johngoldmark@dwt.com

☒ Via Email
☒ Via Messenger

Robert B. Hubbell
Morrison & Foerster LLP
555 West Fifth Street, Suite 3500
Los Angeles, CA 90013-1024
Tel: 213-892-3500
Email: rhubbell@mofo.com

☒ Via Email
☒ Via US Mail

Attorneys for Respondent Massachusetts Mutual Life Insurance Company

Christopher H. Howard, WSBA No. 11074
Virginia R. Nicholson, WSBA No. 39601
Claire Louise Been WSBA No. 42178
Schwabe Williamson & Wyatt
U.S. Bank Centre
1420 5th Avenue, Suite 3400
Seattle, WA 98101-4010
Email: choward@schwabe.com
Email: vnicholson@schwabe.com
Email: cbeen@schwabe.com

☒ Via Email
☒ Via Messenger

Joseph L. Kociubes
Carol E. Head
Bingham McCutchen LLP
One Federal Street
Boston, MA 02110-1726
Email: joe.kociubes@bingham.com
Email: carol.head@bingham.com

☒ Via Email
☒ Via US Mail

Attorneys for Respondent Oppenheimer Acquisition Corporation

David F. Taylor
Cori G. Moore
Perkins Coie LLP
1201 Third Avenue, Suite 4800
Seattle, WA 98101-3099

☒ Via Email
☒ Via Messenger

Attorneys for Respondent Oppenheimer Acquisition Corporation, Cont.

William K. Dodds
David A. Kotler
Dechert LLP
1095 Avenue of the Americas
New York, NY 10036

☒ Via Email
☒ Via US Mail

DATED this 16th day of May, 2012.

FOSTER PEPPER PLLC

Tim J. Filer, WSBA No.16285
Charles P. Rullman, WSBA No. 42733
1111 Third Avenue, Suite 3400
Seattle, Washington 98101-3299
E-mail: filet@foster.com
E-mail: rullc@foster.com

Attorneys for Respondents Tremont Group Holdings, Inc., Tremont Partners, Inc.

1111 Third Avenue, Suite 3400
Seattle, Washington 98101-3299
Telephone: (206) 447-4400
Facsimile: (206) 447-9700