UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

JOSEPH BASTIDA, *et al.*, Plaintiffs, v. NATIONAL HOLDINGS CORPORATION, Defendant.	Case No. C16-388RSL ORDER GRANTING IN PART DEFENDANT'S MOTION TO DISMISS

This matter comes before the Court on "Defendant's Motion to Dismiss Pursuant to FRCP 12(b)(6)," Dkt. # 17. Having reviewed the parties' briefs and the remainder of the record, the Court finds as follows.[1]

BACKGROUND

In the mid-1990s, plaintiffs Joseph Bastida and John and Kathleen Lung became customers of William Gillis, a securities broker. Mot. (Dkt. # 17) at 3. In 2008, Gillis began working at National Securities Corporation ("NSC"), and plaintiffs took their business there shortly thereafter. Id. Plaintiffs invested a large portion of their savings through accounts with Gillis and NSC. Am. Compl. (Dkt. # 7) at ¶¶ 3-4. Plaintiffs allege that Gillis and NSC

[1] The Court finds that this matter can be decided on the papers and therefore denies defendant's request for oral argument.

recommended large investments in high-risk companies that were unsuitable for the financial needs of the plaintiffs, all retired persons over 70 years old, and out of compliance with basic standards of financial portfolio construction. Id. at ¶¶ 3-5. Plaintiffs further allege that in 2015 their accounts lost 80% of their value while the S&P 500 Index increased by 65% over the same time period. Id. at ¶¶ 7-8.

Plaintiffs filed claims against Gillis and NSC in arbitration before the Financial Industry Regulatory Authority ("FINRA"), in accordance with their contracts with Gillis and NSC and federal and state law. Id. at ¶ 9; Mot. (Dkt. # 17) at 3. Plaintiffs also filed a FINRA arbitration claim against defendant National Holdings Corporation, which plaintiffs allege is the complete owner of NSC and had legal "control" over the actions of NSC and Mr. Gillis during the relevant time period. Am. Compl. (Dkt. # 7) at ¶¶ 1, 9. Defendant is not a FINRA member and declined to submit to their jurisdiction. Mot. (Dkt. # 17) at 3.

DISCUSSION

A. Motion to Dismiss Standard

In the context of a motion to dismiss under Fed. R. Civ. P. 12(b)(6), the allegations of the complaint are accepted as true and construed in the light most favorable to the plaintiff. Rowe v. Educ. Credit Mgmt. Corp., 559 F.3d 1028, 1029-30 (9th Cir. 2009). The question for the Court is whether the well-pled facts in the complaint sufficiently state a "plausible" ground for relief. Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007). Although a complaint need not provide detailed factual allegations, it must offer "more than labels and conclusions" and contain more than a "formulaic recitation of the elements of a cause of action." Twombly, 550 U.S. at 555. If the complaint fails to state a cognizable legal theory or fails to provide sufficient facts to support a claim, dismissal is appropriate. Johnson v. Fed. Home Loan Mortg. Corp., 793 F.3d 1005, 1007 (9th Cir. 2015).

B. Request for Judicial Notice

This Court may, at its discretion, choose to incorporate documents outside the pleadings that the complaint necessarily relies upon in deciding a 12(b)(6) motion if the document is referred to in the complaint, is central to the plaintiffs' claim, and its authenticity is unchallenged. Marder v. Lopez, 450 F.3d 445, 448 (9th Cir. 2006). Plaintiffs submitted several documents in their request for judicial notice, none of which were referred to in their FAC, precluding their incorporation by reference. Further, the documents seek to establish facts that were not alleged in the FAC, but were instead raised in plaintiffs' brief in opposition to defendant's motion to dismiss. Plaintiffs cannot save a deficient complaint from dismissal by alleging new facts in an opposition brief or otherwise relying on documents outside the pleadings. See In re Turbodyne Techs., Inc. Sec. Litig., 2000 U.S. Dist. LEXIS 23020 at *30-31 (C.D. Cal. 2000) (citing Schnieder v. California Dep't of Corrections, 151 F.3d 1194, 1197, n.1 (9th Cir. 1998)). Plaintiffs' request for judicial notice is DENIED.

C. Control Person Liability

Defendant argues that plaintiffs fail to state a claim for Counts I and II of the First Amended Complaint ("FAC"), violations of the Washington State Securities Act, RCW § 21.20.430, and Idaho Code § 30-14-509, respectively, because plaintiffs' amended complaint failed to adequately plead that defendant is liable as a "control person" within the meaning of each statute.[2] Mot. (Dkt. # 17) at 5, 8. Defendant contends that plaintiffs' allegation that defendant owns 100% of NSC is conclusory and insufficient to support a plausible claim. However, plaintiffs' allegation that defendant exerts control through its complete ownership of NSC, Am. Compl. (Dkt. # 7) at ¶ 1, goes beyond the mere recitation of the elements by specifying the means defendant allegedly uses to exert the requisite control over NSC, a fact

[2] Counts I and II are addressed simultaneously as the secondary liability provisions in each statute are similar. See Silver Valley Partners, LLC v. De Motte, 2007 U.S. Dist. LEXIS 70591, at *31-32 (D. Idaho Sep. 24, 2007).

sufficient to render the claim plausible. See Twombly, 550 U.S. at 570.

The Washington Supreme Court has applied the two-part federal test for control liability, requiring that the plaintiff show that the defendant exercised control over the operations of the corporation allegedly in violation of the law, and that the defendant had the actual power to control the relevant transactions. Hines v. Data Lines Sys., 114 Wn.2d 127, 136 (1990). Washington does not require the plaintiff to show that the defendant culpably participated in the alleged unlawful behavior. Hines, 114 Wn.2d at 137. Rather, a plaintiff must show that the defendant had "at least some indicia" of control over the defendant. Paracor Fin., Inc. v. GE Capital Corp., 96 F.3d 1151, 1163 (9th Cir. 1996). The Ninth Circuit has identified ownership of shares in the target company as a relevant indicia of control. No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. West Holding Corp., 320 F.3d 920, 945 (9th Cir. 2003).

Defendant contends that complete ownership is not sufficient to establish that a corporate parent has control over a subsidiary within the meaning of RCW § 21.20.430 and IC § 30-14-509. Mot. (Dkt. # 17) at 6-9. This assertion is contrary to the Securities Exchange Commission's definition of "control," cited with approval by the Washington Supreme Court: "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." Hines, 114 Wn.2d at 136 (quoting 17 C.F.R. § 230.405(f)). If defendant owns all shares in NSC as alleged, it follows that it owns a sufficient percentage of voting securities to have achieved the requisite level of control of NSC to support a claim under a theory of control person liability. See King Cty. v. Merrill Lynch & Co., 2011 U.S. Dist. LEXIS 16483 at *11 (W.D. Wash. Feb. 18, 2011). Defendant's motion to dismiss plaintiffs' claims under RCW § 21.20.430 and IC § 30-14-509 is DENIED.

D. Respondeat Superior Liability

Count III of the FAC alleges that defendant is liable under the theory of respondeat

superior for the alleged unlawful actions of Gillis. Am. Compl. (Dkt. # 7) at ¶¶ 57-60. It is a general principle of corporate law that a parent company is not inherently liable for the torts of its subsidiaries. United States v. Bestfoods, 542 U.S. 51, 61 (1998). To establish defendant's liability under the theory of respondeat superior, plaintiffs must go beyond alleging mere ownership to show that defendant had direct involvement in the decisions of NSC. FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc., 175, Wn. App. 840, 881 (2013) (finding that allegations of an agency relationship going "beyond a pure parent-subsidiary relationship" are sufficient to survive a motion under CR 12(b)(6)); see also Cellini v. Harcourt Brace & Co., 51 F. Supp. 2d 1028, 1034 (S.D. Cal. 1999) (finding no agency relationship between defendant corporation and subsidiary for purposes of fair employment statute liability because allegations did not show defendant exercising control of subsidiary's day-to-day employment decisions).

Plaintiffs' FAC fails to plead sufficient facts to support their conclusion that defendant had an agency relationship with NSC. It merely alleges that defendant directly or indirectly "controlled" NSC and Gillis, and that Gillis was an employee of defendant and acted on their behalf. Am. Compl. (Dkt. # 7) at ¶¶ 1, 9, 49, 56, 58-59. Without additional facts, these allegations are insufficient to support a claim of respondeat superior liability because they fail to establish an agency relationship between defendant and NSC or Gillis. Defendant's motion to dismiss Count III is therefore GRANTED.

Leave to amend a complaint that fails to plead sufficient facts is to be freely given under Fed. R. Civ. P. 15(a) absent factors such as "undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc." Foman v. Davis, 371 U.S. 178, 182 (1962). As the Court finds none of these factors present here, plaintiffs are given leave to amend their complaint to address the deficiencies identified in this section.

E. Request for Stay

Defendant requests that the Court stay this litigation until the arbitration proceedings between plaintiffs and NSC and Gillis are resolved. Mot. (Dkt. # 17) at 11. District courts have broad authority to stay proceedings as part of their power to control their docket. Clinton v. Jones, 520 U.S. 681, 705 (1997). However, when deciding whether to stay litigation, courts should weigh the competing interests that would be affected by the stay, including the possible damage that would result, the possible hardship or inequity that would occur if the proceedings were allowed to continue, and how a stay would affect "the orderly course of justice." Avco Corp. v. Crews, 76 F. Supp. 3d 1161, 1164 (W.D. Wash. 2015) (citing CMAX, Inc. v. Hall, 300 F.2d 265, 268 (9th Cir. 1962)). Plaintiffs argue that staying litigation would cause them hardship due to their ages and financial situations. Opp. (Dkt. # 19) at 18.

Defendant does not allege hardship from continuing litigation, but responds that allowing this case to proceed while plaintiffs arbitrate similar claims against NSC and Gillis would offend the Federal Arbitration Act ("FAA") and create a risk of duplicate or inconsistent litigation, while staying litigation would promote judicial efficiency. Mot. (Dkt # 17) at 12. However, defendant concedes that plaintiff's claims against it were not arbitrated because defendant refused to consent to FINRA jurisdiction. Mot. (Dkt # 17) at 3. Because of this the Court does not find continuing this litigation to offend the FAA. Defendant's argument that plaintiffs filed suit seeking improper access to discovery tools unavailable in FINRA arbitration is similarly undermined by this procedural history. Mot. (Dkt. # 17) at 8, 12.

The standards governing FINRA arbitration are substantially different from those of a judicial proceeding, and there is no guarantee that a FINRA ruling would help the Court decide this case. FINRA arbitration is not strictly bound to legal precedent or statutory law. FINRA Dispute Resolution Arbiter's Guide, Financial Industry Regulatory Authority (2015), p. 61, available at https://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf. Nor are FINRA

arbiters required to provide a written explanation for their decisions that could serve as a record for the Court. *See* FINRA manual, Rule 13940, available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4292. Therefore, FINRA's decisions are likely to be of limited precedential or persuasive value to the Court, and a stay is unlikely to promote judicial efficiency. For these reasons, defendant's request for a stay is DENIED.

CONCLUSION

For all of the foregoing reasons, defendant's motion, Dkt. # 17, is GRANTED in part. If plaintiffs believe they can amend their complaint to remedy the deficiencies identified above, they may file an amended complaint within 21 days of the date of this order.

DATED this 4th day of August, 2016.

Robert S. Lasnik
United States District Judge