IN THE SUPREME COURT OF THE STATE OF NEVADA

Supreme Court Case No. 78301

ROBERT CHUR, STEVE FOGG, MARK GARBER, CAROL HARTER, ROBERT HURLBUT, BARBARA LUMPKIN, JEFF MARSHALL, ERIC STICKELS;

Petitioner,

v.

EIGHTH JUDICIAL DISTRICT COURT of the State of Nevada, in and for Clark County; THE HONORABLE NANCY L. ALLF, DISTRICT JUDGE, DEPT. 27,

Respondent,

and

UNI-TER UNDERWRITING MANAGEMENT CORP., UNI-TER CLAIMS SERVICES CORP., and U.S. RE CORPORATION; COMMISSIONER OF INSURANCE FOR THE STATE OF NEVADA AS RECEIVER OF LEWIS AND CLARK LTC RISK RETENTION GROUP, INC.

Real Parties in Interest

REPLY IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

I. INTRODUCTION

Respondent's Answering Brief fails to meet head on the real issue raised in Petitioner's Writ Petition – whether allegations of gross negligence alone are sufficient to state a claim for individual liability against officers and directors of a Nevada corporation in satisfaction of all of the requirements of NRS 78.138(7). Instead Respondent reframes the issue with an assertion equating gross negligence with a knowing violation of the law based on its assertion that NRS 78.138(3) imposes a legal obligation on Petitioners to act on an informed basis.[1]

By its plain terms, NRS 78.138 mandates that a director or officer may not be held individually liable "except under circumstances described in subsection 7." NRS 78.138(3). Subsection 7, in turn, states that "a director or officer is **not individually liable** . . . unless" (a) the business judgment rule presumption is rebutted, and (b) the act or failure to act constituted "a breach of . . . fiduciary duties . . .," **and** "[s]uch breach involved intentional misconduct, fraud or a knowing violation of the law." NRS 78.138(7) (emphasis added).

The statute is clear – Respondent must plead that the Directors are not entitled to the protection of the business judgment rule presumption **and also** plead breach of fiduciary duties **and** intentional misconduct, fraud, or a knowing

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[1] NRS 78.138(3), the business judgment rule, provides that directors are presumed to act on an informed basis but this section of the statute does not by itself impose a legal obligation on officers and directors.

violation of the law. Rather than identify specific allegations in the Third Amended Complaint ("TAC"), Respondent first attempts to side-step the analysis altogether and then uses a string citation to recast its allegations into something they are not. Respondent has alleged gross negligence, not intentional misconduct, fraud, or a knowing violation of the law, and NRS 78.138(7) compels dismissal of the TAC.

II. ANALYSIS

A. Mandamus is an Appropriate Remedy

Mandamus is an extraordinary remedy, available only when there is no "plain, speedy and adequate remedy in the ordinary course of law." *See* NRS 34.170; *see also D.R. Horton, Inc. v. Eighth Judicial Dist. Court*, 123 Nev. 468, 474, 168 P.3d 731, 736 (2007). This Court has "recognized on occasion that the availability of a direct appeal from a final judgment may not always be an adequate and speedy remedy." *Okada v. Eighth Judicial Dist. Court*, 134 Nev. Adv. Rep. 2, 408 P.3d 566, 569 (2018). "Whether a future appeal is sufficiently adequate and speedy necessarily turns on the underlying proceedings' status, the types of issues raised in the writ petition, and whether a future appeal will permit this court to meaningfully review the issues presented." *D.R. Horton*, 123 Nev. at 474-75, 168 P.3d at 736. "Thus, consideration of a writ petition may be appropriate 'when an important issue of law needs clarification and sound judicial economy and administration favor the granting of the petition.'" *Okada*, 134 Nev. Adv. Rep. 2,

408 P.3d at 569 (quoting *Nev. Yellow Cab Corp. v. Eighth Judicial Dist. Court*, 132 Nev. Adv. Rep. 77, 383 P.3d 246, 248 (2016)).

First, the Directors present an important issue of law that needs clarification: whether Nevada courts should apply and give meaning to each and every provision in NRS 78.138 *or* whether they can and should ignore some provisions of NRS 78.138 in a duty of care case. Granting the Directors' Petition is the most economical path for resolving this dispute for all the relevant stakeholders involved—the Directors, Respondents, the directors and officers of every Nevada corporation, and Nevada courts—because it would unequivocally endorse the widely held and just position that statutes ought to be applied as they are written without unilateral judicial amendment and would dispense with the need for the a full trial and direct appeal just to arrive at the same result.

Second, the issue squarely before this Court in the Directors' Petition now is no different than the issue that would be presented were the Directors to litigate this matter through a full trial and need to seek relief through a direct appeal. The only material difference would be the considerable sums of money expended only to present this same issue to this Court a second time. Considerations of judicial economy support resolving this issue now.

B. Respondent's Interpretation of NRS 78.138(7) Collapses the Three-Step Exculpatory Provision into a Single Step

In its Answering Brief, Respondent admits that its arguments regarding the

requirements of NRS 78.138 are "circuitous." Answering Br. at p. 17. Indeed, this "circularity" occurs because Respondent claims allegations of gross negligence alone are sufficient to meet each of the three requirements of NRS 78.138(7), effectively collapsing the three-step analysis of NRS 78.138(7) into a single step.[2] *See* Answering Br. at p. 17 ("allegations that sufficiently state gross negligence are by definition equally sufficient to satisfy the **supposed** second 'element' of NRS 78.138.") (emphasis added).

Respondent's approach would render two of the three requirements of the statute entirely superfluous, which is contrary to this Court's well-settled principles of statutory construction. *See Nev. Dep't of Corr. v. York Claims Servs.*, 131 Nev. Adv. Rep. 25, 348 P.3d 1010, 1013 (2015) ("In conducting a plain language reading, we avoid an interpretation that renders language meaningless or superfluous.") (internal citations and quotation marks omitted). This is an untenable absurd result.

C. Respondent's Allegations Fail to Meet the Strictures of NRS 78.138

NRS 78.138(7) must be read to require more than simple allegations of gross

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[2] Again, the three-step analysis of NRS 78.138(7) requires Respondent to:

(1) overcome the business judgment rule presumption;

(2) plead and prove breach of fiduciary duties; and

(3) plead and prove that such breach involved intentional misconduct, fraud, or a knowing violation of the law

negligence to give meaning to each provision of the statute. While the Directors have never disputed that allegations of gross negligence may be sufficient to overcome the business judgment rule presumption in satisfaction of NRS 78.138(7)(a), [3] allegations of gross negligence cannot, at the same time, satisfy NRS 78.138(7)(b)(1) and (b)(2). The legislature must have intended NRS 78.138(7)(b) to have some meaning and this Court must give effect to that intent as expressed in the plain terms of the statute.

In support of its argument that the Third Amended Complaint's allegations of gross negligence are sufficient to satisfy NRS 78.138(7)(b), Respondent cites *Jacobi v. Ergen*, No. 2:12-cv-2075-JAD-GWF, 2015 WL 1442223, at *4 (D. Nev. Mar. 30, 2015), for the proposition that "[a] director's misconduct must rise at least to the level of gross negligence to state a breach-of-the-fiduciary-duty-of-due-care claim . . . ." Answering Br. at p. 17. However, Respondent omits the remainder of that excerpted sentence from *Jacobi*: that a breach must involve "'intentional

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[3] Respondent states that the Directors "concede" that Respondent has overcome the business judgment rule, the first step in the NRS 78.138(7) analysis. Answering Br. at p. 14. That is incorrect. *See* Writ Petition at p. 14 n.3 ("For purposes of this Petition, this Court can **assume, without deciding** that the business judgment rule has been rebutted by allegations in the TAC.") (emphasis added). Likewise, Directors' Motion for Reconsideration, cited by Respondent for the same proposition, actually states that "Director Defendants do not dispute that, at the pleading stage, allegations of gross negligence . . . **may be sufficient** to plead rebuttal of the presumption." 6 APP01392 – 6 APP01393 (emphasis added).

misconduct, fraud, or a knowing violation of the law,' to state a duty-of-loyalty claim – standards that the Nevada Supreme Court characterized in *Shoen* as a 'difficult threshold to meet.'" *Id.* at *4. (quoting *Shoen v. SAC Holding Corp.*, 122 Nev. 621, 640, 137 P.3d 1171, 1184 (2006)).

NRS 78.138(7)(b), by its plain terms, requires allegations of the latter form of director misconduct outlined in *Jacobi* – a breach of fiduciary duty involving intentional misconduct, fraud, or a knowing violation of the law. Thus, allegations of gross negligence alone are insufficient to impose personal liability; a separate or additional factual predicate must be pleaded. Likewise, Respondent must plead more than violations of vague, undefined statutory duties to plead a knowing violation of the law.[4] However, even if a knowing violation of statutory duties could be sufficient to demonstrate a knowing violation of the law sufficient to satisfy NRS 78.138(7)(b)(2), Respondent's allegations still fall short. A clear and meaningful difference exists in the definitions of "gross negligence" and "knowledge." Specifically, "gross negligence" is defined as "A lack of slight diligence or care," or "A conscious, voluntary act or omission ***in reckless disregard of*** a legal duty and of the consequences to another party . . . ." *Gross negligence, Black's Law Dictionary* (11th ed. 2019) (emphasis added). By contrast,

[4] Tellingly, Respondent cites no statutory duty, other than a claimed statutory duty to be informed on the basis of NRS 78.183(3), that Directors have violated. *See supra* n.1 (explaining that NRS 78.138(3) creates a presumption, not a legal duty).

"knowledge" is defined as "An ***awareness or understanding of*** a fact or circumstance; a state of mind in which a person has no substantial doubt about the existence of a fact." *Knowledge*, *Black's Law Dictionary* (11th ed. 2019) (emphasis added). Knowledge necessarily requires a level of *scienter* appreciably higher than that of gross negligence.

Yet, allegations in the Third Amended Complaint, which Respondent cited in summary fashion, without quotation or discussion of the substance of the allegations, fail to allege breach of fiduciary duty or knowing violation of the law[5] and fail to support any claim beyond gross negligence.[6]

For example, paragraph 32, cited by Respondent in support of its breach of fiduciary duty argument, states "The individual defendants include the directors

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[5] Respondent does not assert that it has alleged either intentional misconduct or fraud, relying solely on the "knowing violation of the law" provision of NRS 78.138(7)(b)(2). However, Respondent again supplies misinformation when it states, "The Directors do not even mention this (inconvenient) portion of the statute [knowing violation of the law]." Answering Br. at p. 19. Directors take exception to this statement, as they have always recognized that the proper legal standard requires allegations of intentional misconduct, fraud, or knowing violation of the law. And, Directors cited the "knowing violation of the law" standard fourteen times in their Writ Petition. *See* Writ Petition at pp. 2, 3, 4, 5, 7, 10, 15, 16, 17, 19, 21, 24.

[6] Respondent blatantly misrepresents that the Defendant Directors concede that the Third Amended Complaint adequately pleads gross negligence. Answering Br. at p. 18. The citation to Directors' Writ Petition, which Respondent claims "reiterat[es] that gross negligence claim is 'viable,'" actually states that "the First Amended Complaint did nothing more than add conclusory allegations, based upon information and belief, that **still did not make out a viable cause of action for gross negligence**." Writ Petition at p. 5 (emphasis added).

and officers of L&C at the relevant times, who, among other things, were **grossly negligent** in performing their duties as directors and officers of L&C which resulted in the Receivership Action being filed." I APP00040 at ¶ 32 (emphasis added). Paragraph 105 states, "On information and belief, despite this knowledge of the Board regarding the wholly inadequate and inaccurate information provided by Uni-Ter, the Board's **gross negligence** is manifest in the fact that, the Board failed to exercise even a slight degree of care in verifying whether Praxis was provided accurate information in preparing its reviewing [sic] the claims process." I APP00053 at ¶ 105 (emphasis added).

Paragraph 58 states, "On information and belief, the Board accepted Uni-Ter's direction to obtain the Multi-site Operators, including Sophia Palmer, without adequate information. In fact, the Board failed to even exercise a **slight degree of diligence** in determining whether the acceptance of the Multi-site Operators, including Sophia Palmer, was an appropriate decision." I APP00044 at ¶ 58 (emphasis added). Paragraph 113 states, "On information and belief, the Board **failed to exercise even scant care** in addressing the September 2011 Letter, and failed to correct the staggering financial problems L&C was facing." I APP00055 at ¶ 113 (emphasis added). And, Paragraph 164 states "On information and belief, substantial financial information regarding L&C was available to the Board of which the Board failed entirely to exercise **even a slight degree of care**

to properly inform itself and understand." I APP00063 at ¶ 164 (emphasis added). The remaining paragraphs cited contain substantially similar allegations.[7]

None of these allegations, or any others in the Third Amended Complaint, are sufficient to plead breach of fiduciary duty or knowing violation of the law.

D. Public Policy Favors Applying the Statute as Written

It is sound judicial policy to apply NRS 78.138 as written and avoid creating a lesser standard for imposition of individual liability on officers and directors, and it is sound public policy to maintain a high standard for imposing personal liability on directors and officers of Nevada corporations.

Respondent warns that applying the statute as written would "exonerate" directors from gross negligence, provide "absolute protection," and create a "haven for corporate abuse." This is not and has never been the case, and the Court need not prognosticate as Respondent suggests. Nevada's legislature passed NRS 78.138 more than fifteen years ago, and there are no statistics or evidence to support, or even suggest, that the limitation of personal liability has resulted in Nevada being a haven for "corporate abuse." *See* Senate Bill No. 436, 72nd Sess.,

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[7] Knowledge of certain **facts** are alleged in paragraph 104 ("the Board knew that reliance on information presented to it . . . could not be relied on") and paragraph 121 ("knowledge concerning Mr. Elsass and his recommendations"). *See* I APP00053 at ¶ 104; I APP00056 at ¶ 121. However, the paragraphs immediately following these allegations (paragraph 105 and 122) allege that "despite this knowledge," the Directors were grossly negligent in ignoring those facts. *See* I APP00053 at ¶ 105; I APP00056 at ¶ 122.

at Ch. 485, p. 3084 (Nev. 2003). NRS 78.138 encourages talented people to take board positions in Nevada corporations without risk of personal liability for negligence in performing their duties on the board and with the assurance that they will only be held personally liable for fraudulent, intentional, or knowing violation of the law. In this way, Nevada's corporate statutes protects officers and directors by shielding them from personal liability for negligence, while at the same time protecting its citizens by removing any statutory protections for fraud and/or bad faith conduct.

Shareholders have recourse when directors are negligent, including voting the directors out, and directors have recourse when officers are negligent, including terminating the officers' employment with the corporation. Respondent's doom and gloom forecast is nothing more than second-guessing the legislature without the facts to back it up.

E. Respondent's Attempts to Reframe the Issue Fail

In an apparent attempt to distract the Court from the deficiencies in its pleading, Respondent creates several easily disregarded diversions. First, Respondent's argument regarding the "substantial overlap of Delaware and Nevada law" on the business judgment rule is unsound and irrelevant to this Court's mandate. Although the language of NRS 78.138(3) (the business judgment rule presumption) tracks the language in certain Delaware cases, Nevada departs from

Delaware by providing its directors and officers with greater protection from personal liability. Delaware case law is therefore unpersuasive. *See, e.g., Morefield v. Bailey*, 959 F. Supp. 2d 887, 903 n.8 (E.D. Va. 2013) (recognizing that exculpatory provision in NRS 78.138(7) "diminish[ed] Plaintiff's reliance on Delaware cases to the extent those cases do not consider Nevada's heightened requirement for individual liability."); *Hamilton Partners, L.P. v. Highland Capital Mgmt., L.P.*, 2014 Del. Ch. LEXIS 72, at *66-67 n.159 (Del. Ch. May 7, 2014) (recognizing that Nevada's "exculpatory threshold is distinct from that of Delaware law").[8]

Second, Respondent's argument that the Third Amended Complaint need only satisfy notice pleading standards is yet another distraction.[9] Directors do not dispute that notice pleading is the proper pleading standard and have never argued for a heightened pleading standard. Directors' point is that in order to satisfy the notice pleading standard, Respondent must have pleaded sufficient facts to state a

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[8] Moreover, legislative history cited by Respondent itself in its Opposition to Motion for Judgment on the Pleadings quotes then-Senator Aaron Ford as stating that the 2017 bill proposing amendments to NRS 78.138 "references cases out of Delaware that 'have been, and are hereby, rejected by the Legislature.'" IV APP00893-00894.

[9] Rather than address the merits or deficiencies of its pleading head on, Respondent instead launches into a two-page diversion analyzing the facts of a South Carolina Bankruptcy Court case decided under Delaware law. Answering Br. at 10-12 (citing *In re KNH Aviation Servs., Inc.*, 549 B.R. 356 356, 362-63 (Bankr. D.S.C. 2016)). This case is wholly inapposite given that Delaware law lacks the more protective exculpatory provision that Nevada has adopted.

claim for relief (i.e., a claim for individual liability) under NRS 78.138.

Respondent's quotation of and citation to *F.D.I.C. v. Delaney*, No. 2:13-cv-924 JCM VCF, 2014 U.S. Dist. LEXIS 90147 (D. Nev. July 2, 2014), Answering Br. at 13, is equally unhelpful. *Delaney* involved a federal statute, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which expressly provided for personal liability for gross negligence. *Id.* at *6. Thus, the *Delaney* court determined that "[t]o the extent that the BJR would insulate directors from liability for gross negligence under [the federal statute], it is preempted." *Id.* at *7. And, the court determined that the plaintiff had sufficiently pleaded facts establishing a plausible claim for relief for gross negligence under FIRREA. *Id.* at *8. In contrast, Respondent has failed to allege sufficient facts to support a claim for relief for personal liability under NRS 78.138.

F. Laches Does Not Bar Directors' Petition

Respondent appears to assert two distinct laches arguments. First, Respondent argues that the Defendant Directors' Writ Petition is barred by laches. Second, Respondent claims for the first time that the Defendant Directors delayed in filing their Motion for Judgment on the Pleadings and Motion for Reconsideration, which compels denial of their Writ Petition. Neither of these arguments is defensible.

1. *Respondent Has Waived Its Argument on the Motion for Judgment on the Pleadings and Motion for Reconsideration*

Under Nevada law, an argument not made before the district court is deemed waived. *See Bank of Am., N.A. v. SFR Invs. Pool 1, LLC*, 134 Nev. Adv. Rep. 72, 427 P.3d 113, 119 (2018) (citing *Old Aztec Mine, Inc. v. Brown*, 97 Nev. 49, 52, 623 P.2d 981, 983 (1981)). Respondent argues, for the first time in its Answering Brief, that because the Defendant Directors "waited almost two years to file their 12(c) Motion," and "further delay[ed] by filing an unnecessary Motion for Reconsideration." Answering Br. at p. 23. However, Respondent did not make any argument whatsoever regarding delay in its Opposition to the Motion for Judgment on the Pleadings or in its Opposition to Motion for Reconsideration. IV APP00887-00896 (Opposition to the Motion for Judgment on the Pleadings); VI APP01401-01414 (Opposition to Motion for Reconsideration). Respondent cannot now rely on these arguments, never made before the district court, to prevent consideration of the Directors' Writ Petition. These arguments have been waived.

2. *A "Delay" of 29 Days Following Notice of Entry of Order is Not an Unreasonable Time Within which to File a Writ Petition*

Respondent posits that the Writ Petition should be denied due to the Directors' "unreasonable delay in seeking such relief from this Court." Answering Br. at p. 21. However, the timeline of events illustrates that the Directors promptly sought relief following denial of their Motion for Reconsideration of the district

court's order denying their Motion for Judgment on the Pleadings:

- November 2, 2018: district court enters Order denying the Motion for Judgment on the Pleadings.
- November 7, 2019: Respondent files Notice of Entry of Order
- November 16, 2018: Directors filed a Notice of Association of Counsel notifying the district court that Holland & Hart had associated as counsel.
- November 29, 2018: Directors file Motion for Reconsideration
- December 27, 2018: Respondent files Opposition to Motion for Reconsideration.
- January 4, 2019: Directors file Reply.
- January 9, 2019: Hearing on Directors' Motion for Reconsideration is held.
- February 11, 2019: The District Court issues Decision and Order denying Motion for Reconsideration.
- February 11, 2019: Respondent files Notice of Entry of Decision and Order.
- March 12, 2019: Directors file Writ Petition.

Contrary to Respondent's argument, the Directors filed their writ petition a mere **twenty-nine days** following Notice of Entry of Decision and Order denying their Motion for Reconsideration. Twenty-nine days is hardly an unreasonable amount of time within which to prepare and file a Writ Petition.

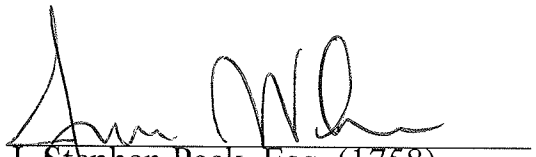
The single case cited by Respondent in support of its laches argument,

Building and Const. Trades Council of Northern Nevada v. State, 108 Nev. 605, 836 P.2d 633 (1992), lacks any relevance to the facts here. The Court's holding affirming the district court's finding that a one-month delay in seeking writ relief was unreasonable and was barred by laches was due to the "peculiar circumstances" of the case – that the contract for the public works project at issue had been awarded and construction had already begun in the month-long delay. *Id.* at 611-12. Thus, the petitioner's delay, and failure to seek a temporary restraining order or preliminary injunction to prevent construction from starting, "substantially prejudiced" respondents. *Id.* at 612. Here, by contrast, nothing occurred in the intervening twenty-nine days to prejudice Respondent. And, the Directors sought and obtained a stay of the case pending consideration of the Writ Petition – a motion in which Respondent joined. Therefore, Respondent has suffered no prejudice and the Directors' Writ Petition is timely.

III. CONCLUSION

The Directors respectfully request that this Court confirm that each and every plain provision of NRS 78.138(7) must be satisfied before a director or officer of a Nevada corporation may be individually liable for damages as a result of any act or failure to act in his or her capacity as a director or officer and compel the district court to apply NRS 78.138(7) as written and dismiss the claims against the Directors contained in Respondents' Third Amended Complaint with prejudice.

DATED this 10th day of July 2019.



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CERTIFICATE OF COMPLIANCE

I hereby certify that I have read this **REPLY IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS**, and to the best of my knowledge, information, and belief, it is not frivolous or interposed for any improper purpose. I further certify that this brief complies with all applicable Nevada Rules of Appellate Procedure, in particular Nev. R. App. P. 28(e), which requires every section of the brief regarding matters in the record to be supported by a reference to the page of the transcript or appendix where the matter is to be found. I understand that I may be subject to sanctions in the event that the accompanying brief is not in conformity with the requirements of the Nevada Rules of Appellate Procedure.

DATED this 10th day of July 2019.

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VERIFICATION

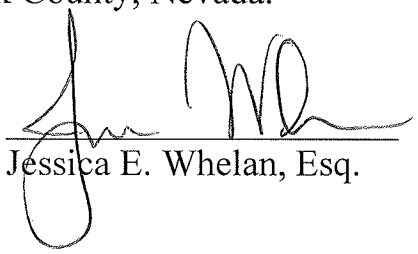
I, Jessica E. Whelan, declare:

1. I am an attorney with Holland & Hart LLP, counsel of record for Petitioners-Defendants Robert Chur, Steve Fogg, Mark Garber, Carol Harter, Robert Hurlbut, Barbara Lumpkin, Jeff Marshall, and Eric Stickels.

2. I verify that I have read the foregoing **REPLY IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS;** that the same is true to my own knowledge, except for matters therein stated on information and belief, and as to those matters, I believe them to be true.

3. I declare under penalty of perjury that the foregoing is true and correct.

Executed this 10th day of July 2019, in Clark County, Nevada.



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I am an employee of Holland & Hart, LLP, and that on this 10th day of July 2019, I electronically filed and served by electronic mail and United States Mail a true and correct copy of the above and foregoing **REPLY IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS** properly addressed to the following:

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