IN THE SUPREME COURT OF THE STATE OF NEVADA

KENNETH A. BRUNK; RICHARD D. MORITZ; BRADLEY J. BLACKETOR; TIMOTHY HADDON; MARTIN M. HALE, JR.; TREY ANDERSON; RICHARD SAWCHAK; FRANK YU; JOHN W. SHERIDAN; ROGER A NEWELL; RODNEY D. KNUTSON; NATHANIEL KLEIN,

Petitioners,

v.

THE EIGHTH JUDICIAL DISTRICT COURT OF THE STATE OF NEVADA, IN AND FOR THE COUNTY OF CLARK; AND THE HONORABLE NANCY L. ALLF, DISTRICT JUDGE, DEPT. 27,

Respondents,

And

DANIEL E. WOLFUS,

Real Parties in Interest.

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District Court Case No.
A-17-756971-B

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF PROHIBITION OR ALTERNATIVELY, MANDAMUS

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I. INTRODUCTION

The district court dismissed, with prejudice, Plaintiff's claim based on the California state securities statute. Plaintiff's remaining common law claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, fraud, and negligent misrepresentation are not governed by California law but must be determined by Midway's place of incorporation, which is British Columbia, Canada under the internal affairs doctrine, which is recognized in both Nevada and California. This Petition seeks writ relief from the district court's wrongful exercise of subject matter jurisdiction over Plaintiff's common law claims against the former officers and directors of a Canadian corporation.

The Petition presents a novel issue of first impression in Nevada as to the district court's allowing Plaintiff to proceed with what are commonly referred to as "holder" claims—claims alleging that a party was wrongfully induced to hold rather than purchase or sell stock—despite the fact that "holder" claims have never been recognized in Nevada or Canada, have been expressly rejected in federal securities cases, and have been categorically rejected in the vast majority of other jurisdictions in the United States.

In his Answer to the Petition, Plaintiff continues to assert that he does not bring derivative claims governed by the internal affairs doctrine and Canadian law. Rather, he insists that he brings direct claims for being induced into the purchase

and the *holding* of Midway Gold ("Midway") stock, which are recognized under California law, where he resides. This argument is specious. The district court dismissed the only direct claim belonging to Plaintiff, which was a California state securities law claim for failure to allege a purchase or sale in connection with a misrepresentation or omission. Plaintiff's remaining claims are derivative in nature no matter how characterized by Plaintiff.

Next, Plaintiff argues that there is no issue of first impression because the district court relied on California's recognition of "holder" claims when it denied Defendants' motion to dismiss the remaining common law claims. A writ is required in this case because the Nevada court has no subject matter jurisdiction over the remaining claims. Only the Canadian courts have such exclusive jurisdiction.

Plaintiff further argues that even if the Writ is granted, it will not resolve the case because his claims for purchasing *(rather than holding)* Midway stock based on misrepresentations are not addressed by the Petition. Here, Plaintiff ignores the district court's ruling, which dismissed his only direct claim. Plaintiff's only remaining claims are based on *holding* Midway stock as it declined in value. The district court does not have subject matter jurisdiction to hear these claims.

II. ARGUMENT

A. California Law Does Not Apply to Plaintiff's Remaining Common Law Claims for Breach of Fiduciary Duty, Aiding and Abetting Breach of Fiduciary Duty, Fraud and Negligent Misrepresentation and the Court Should Not Recognize Holder Claims.

In the Answer to the Petition, Plaintiff rejects the applicability of the "internal affairs doctrine" and insists that California law must apply to his claims. *See Answer of Real Party in Interest to Petition for Writ of Prohibition or Alternatively, Mandamus* ("RA") at 22. Plaintiff's insistence on the application of California law arises because neither Nevada nor British Columbia, the state of Midway's incorporation, recognize speculative "holder" claims. California law, however, does not govern this case.

Indeed, even if it were so, California has expressly adopted the "internal affairs doctrine" which required the district court to apply the law of the state of incorporation to matters that are peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders. *Becher v. MW. Mut. Life Ins, Co.,* No. 10-6264 PSG (AGRx), 2010 U.S. Dist. LEXIS 135854, at *10 2010 WL 6138910 (C.D.Cal. Dec. 9, 2010). Because all of Plaintiff's claims are based on Defendants' activities as officers or directors of Midway Gold and concern the internal affairs of Midway, which was incorporated in British Columbia, the law of British Columbia is thus applicable to those claims. *See*

Johnson v. Myers, No. CV-11-00092 JF PSG, 2011 WL 4533198, at *8 (N.D. Cal. Sept. 30, 2011) (recognizing claims for breach of fiduciary duty, fraud and misrepresentation concern the "internal affairs" of a British corporation, thus British law applied to such claims). Accordingly, the district court erred in allowing the common law claims to proceed.

1. Canadian Law Governs the Internal Affairs of Midway Including Any Liability By its Directors and Officers For Mismanagement Through Improper Public Disclosures.

The district court should have rejected Plaintiff's attempt to allege "holder" claims because California law does not apply to a British Columbian publicly-traded corporation headquartered in Colorado. Plaintiff offers no authority in support of his suggestion that a "holder" theory of liability would be viable in British Columbia or Nevada. Under the internal affairs doctrine, the law of the state of incorporation governs the liabilities of officers and directors to the corporation and its shareholders.[1] Like Nevada, California follows the internal

[1] *Shaffer v. Heitner,* 433 U.S. 186, 215 n. 44, 97 S.Ct. 2569, 53 L.Ed.2d 683 (1977); *see also CTS Corp. v. Dynamics Corp. of America,* 481 U.S. 69, 89, 107 S.Ct. 1637, 95 L.Ed.2d 67 (1987); *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba,* 462 U.S. 611, 621, 103 S.Ct. 2591, 77 L.Ed.2d 46 (1983); Rest. (Second) of Conflict of Laws § 309 and comment (a). Internal corporate affairs involve those matters that are peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders. *Edgar v. MITE Corp.,* 457 U.S. 624, 645, 102 S.Ct. 2629, 73 L.Ed.2d 269 (1982); *see* Rest. (Second) of Conflict of Laws § 313, comment (a).

affairs doctrine.[2] In fact, the California legislature has codified the internal affairs doctrine. CAL. CORP. CODE § 2116; *see Villari v. Mozilo,* 208 Cal. App. 4th 1470, 1478 n.8 (2012) ("Corporations Code section 2116 codifies [the internal affairs doctrine] in California."). Section 2116 provides, in relevant part:

> The directors of a foreign corporation transacting intrastate business are liable to the corporation, its shareholders, creditors, receiver, liquidator or trustee in bankruptcy for the making of unauthorized dividends, purchase of shares or distribution of assets or false certificates, reports or public notices or other violation of official duty ***according to any applicable laws of the state or place of incorporation or organization, whether committed or done in this state or elsewhere***.

CAL. CORP. CODE § 2116 (emphasis added). The characterization of a claim as direct or derivative is also governed by the laws of the state in which the corporation is incorporated. *Booth v. Strategic Realty Tr., Inc.*, 13-CV-04921-JST, 2014 WL 3749759, at *8 (N.D. Cal. July 29, 2014) (citing *Lapidus v. Hecht*, 232 F.3d 679, 682 (9th Cir. 2000)).

[2] *Johnson*, 2011 WL 4533198, at *8; *In re Verisign, Inc., Derivative Litig.*, 531 F. Supp. 2d 1173, 1214–15 (N.D. Cal. 2007); *see also Batchelder v. Kawamoto*, 147 F.3d 915, 920 (9th Cir. 1998); *Davis & Cox v. Summa Corp.*, 751 F.2d 1507, 1527 (9th Cir. 1985).

Plaintiff erroneously contends that "California law applies when a purchase of stock originates, or when stock is held, in California."[3] RA at 23. However, as recognized in *Johnson*, "internal wrongdoing within a corporation often results in harm to shareholders who are spread out among different jurisdictions. If the presence of California shareholders were enough to discard the internal affairs doctrine on public policy grounds, the doctrine would have little practical effect." *Johnson*, 2011 WL 4533198, at *8 (recognizing claims for breach of fiduciary duty, fraud and misrepresentation concern the "internal affairs" of a British corporation, thus British law applied to such claims).[4]

Here, Midway is a British Columbia corporation and the claims relate to the directors' and officers' alleged mismanagement of the company and their failure to disclose the purported mismanagement in its public statements. IV PA0625-627 ¶¶

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[3] Plaintiff cites to the California Court of Appeal's decision in *Hall v. Superior Ct.*, 150 Cal. App. 3d 411 (2003) in support for its misleading proposition. The Court of Appeals did not make any such holding. Furthermore, *Hall* is inapplicable to this case because it concerned a choice of law provision in a private securities agreement, not the purchase of stock in a publicly-traded corporation.

[4] If the choice of law analysis involving the purported mismanagement of a publicly-traded corporation was simply governed by the location of where the shareholder resides, each jurisdiction's substantive decision to recognize "holder" claims would apply only to its own residents. The natural result would be a "race to the bottom," because each jurisdiction could deprive only its own residents of such claims. No jurisdiction, as a matter of substantive law, could uniformly prohibit such claims. For this reason, only the law of the state of incorporation can establish "reliable and efficient corporate laws," *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175, 181 (Del. 2015), that protect the control of a corporation's board of directors over litigation based on injury to the corporation.

65-66; PA0628 ¶ 70; PA0632 ¶ 86. Therefore, this Court must apply British Columbia law in determining whether Plaintiff's common law claims may stand as a direct action. Plaintiff has not presented any law suggesting that British Columbia would depart from the vast majority of other jurisdictions that do not recognize "holder" claims. Accordingly, the district court erred in allowing the claims to proceed.

As set forth above, because Midway is a Canadian corporation, with its principal place of business in Colorado, Canadian substantive law governs Plaintiff's fraud and misrepresentation claims, not California law.

2. "Holder" Claims Are Abusive and Such Claims Have Not Been Recognized By the District Court Under the Law in the Place of Midway's Incorporation (British Columbia).

In line with the vast weight of authority, the district court should have categorically rejected Plaintiff's "holder" claims. In the alternative, the district court should have rejected Plaintiff's "holder" claims as pleaded in this case. As the district court had already recognized in its original order dismissing Plaintiff's claims, the claims are derivative in nature and, thus, subject to the exclusive jurisdiction of the Supreme Court of British Columbia. III PA0599 ¶ 38; PA0600 ¶ 42.

Moreover, Plaintiff's purported "holder" claims have not been recognized in Nevada or British Columbia. Courts have rejected "holder" claims because they (i)

involve speculative allegations concerning hypothetical transactions, (ii) fail to allege "out-of-pocket" damages (as some states require), and (iii) fail to allege damages proximately caused by the alleged misstatements.[5] California has nonetheless permitted some "holder" claims, subject to heightened standards of pleading and proof. *See Small v. Fritz Cos., Inc.*, 65 P.3d 1255 (Cal. 2003). The district court's decision to allow Plaintiff to proceed with his "holder" claims was clearly erroneous and not supported by the law in this jurisdiction or the vast majority of other jurisdictions.

Nevada has never recognized a "holder" claim. Neither has British Columbia, Midway's place of incorporation. Plaintiff has cited no Nevada law, no British Columbia law, and no analysis of the laws of either jurisdiction suggesting that either would recognize speculative "holder" claims. And this Court should decline the invitation to legislate new Nevada law (or British Columbia law) by recognizing such speculative holder claims. *Rivers v. Wachovia Corp.*, 665 F.3d 610, 616 (4th Cir. 2011) (plaintiff's claim that he was induced to continue to hold his Wachovia shares through a price decline was derivative because such losses

[5] *Calibre Fund, LLC v. BDO Seidman, LLP*, 2010 WL 4517099, at *5 (Conn. Super. Ct. Oct. 20, 2010); *Starr Found. v. Am. Int'l Grp., Inc.*, 901 N.Y.S.2d 246, 248-252 (N.Y. App. Div. 2010); *Harris v. Wachovia Corp.*, 2011 WL 1679625, at *11-13 (N.C. Super. Ct. Feb. 23, 2011)

were "common to all Wachovia shareholders during the credit crisis"); *Arent v. Distribution Sciences, Inc.* 975 F.2d 1370, 1373-74 (8th Cir. 1992) (same).

B. Plaintiff's Common Law Holding Claims Are Not Direct Tort Claims, But Rather Derivative Claims Against Directors and Officers Based on the Concealment of Corporate Mismanagement.

Plaintiff offers circular, conclusory arguments that his claims are direct, not derivative, because "[a]s a purchaser and holder of stock, Wolfus holds the breach of fiduciary duty claims, and will receive the entire benefit if successful." RA at 17. But Plaintiff's simplistic argument, that he lost money in purchasing and holding stock and therefore he would receive any recovery, is entirely without merit.

Plaintiff alleges that the directors and officers failed to report negative information regarding Midway's mismanaged Nevada operations, and that the value of Plaintiff's stock diminished as a result. IV PA0625-627 ¶¶ 65-66; PA0632 ¶ 86; PA0634 ¶¶ 95-96. Accordingly, the harm suffered by the Defendants' purported omission of alleged material facts was a loss in the value of Midway stock. When the district court first analyzed these same claims, it correctly determined that, applying the direct harm test in *Parametric Sound Corp. v. Eighth Judicial Dist. Court*, 133 Nev. Adv. Op. 59, 401 P.3d 1100 (2017), the company suffered the alleged harm and any benefit recovered based upon the non-disclosure of the 2013 and 2014 "Undisclosed Facts" would be recovered by all of

the company's shareholders. III PA0598 ¶ 35. Nothing in the SAC should have changed the district court's analysis, and the district court erred in reversing itself on this issue.

Plaintiff's common law claims in the SAC seek recovery for the diminution in value that the company—and in turn all stockholders on a *pro rata* basis—would have suffered from Defendants' alleged failure to disclose material facts, which means they are derivative under the direct harm test adopted in *Parametric*. 401 P.3d at 1107-08 (Nevada "courts should consider only '(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?'") (quoting *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d. 1031, 1033 (Del. 2004)). Plaintiff's effort to isolate himself from the harm suffered by all shareholders fails. *Feldman v. Cutaia*, 951 A.2d 727, 733 (Del. 2008) ("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."); *Lee v. Marsh & McLennan Companies, Inc.*, 17 Misc. 3d 1138(A), 856 N.Y.S.2d 24 (N.Y. Sup. Ct. 2007) (holding that the wrong is "entirely derivative, since [a]ny devaluation of stock is shared collectively by all the shareholders, rather than independently by the plaintiff or any other individual shareholder.").

1. The Direct Harm Test Controls, Even after Citigroup

Plaintiff argues that the Delaware Supreme Court's decision in *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175 (Del. 2015), permits Plaintiff to escape the direct harm test. However, *NAF Holdings* merely held that a promisee could bring a direct claim against a promisor for breach of a commercial contract, even though the promisee's alleged injury depended on harm suffered by corporation in which the promisee was a shareholder. In holding that the direct harm test did not apply to such a claim, the *NAF Holdings* court relied on the importance of protecting freedom of contract and the enforceability of contracts. But that consent-based rationale has no application to the tort claims at issue here. Whether Plaintiff's claims are direct or derivative in nature is therefore governed by the direct harm test.

Similarly, Plaintiff's reliance on the decision in *Citigroup v. AHW Investment*, 140 A.3d 1125 (Del. 2016) is also misplaced. In *Citigroup*, the Supreme Court of Delaware, confined to the narrow scope of a certified question from the Second Circuit, determined that a "Holder Claim" asserted against a corporation by an investor claiming to have continued to hold the corporation's stock based on the corporation's own misstatements, belonged to the holding stockholder rather than the defendant corporation. *Id.* at 1126-27. The *Citigroup* court ***did not analyze breach of fiduciary duty claims based on a director's***

purported failure to disclose corporate mismanagement, but rather "holder" claims for fraud and negligent misrepresentation and only within the confines of a quasi-hypothetical certified question. In this extremely narrow context, ***where the claim was explicitly created for the investor***, was to be asserted against the corporation, and therefore could "not possibly belong to the corporation," the court found the *Tooley* test was irrelevant. *Id.* ("Delaware law cannot convert a direct claim that another state's law has granted to securities holders by deciding that it actually belongs to the corporation that the securities holder is suing.").[6] Plaintiff's improper conflation of Defendants' arguments concerning breach of fiduciary duty and state-recognized "holder" claims—whether intentional or not—should have been rejected by the district court.

2. After Citigroup, *Delaware Applied the Direct Harm Test To Both Fiduciary Duty and Tort Claims.*

Recent Delaware case law has confirmed that the direct harm test applies to fraud and breach of fiduciary duty claims based upon alleged misrepresentations and omissions contained in public statements. *In re: JMO Wind Down, Inc.*, No. 16-10682, 2018 WL 1792185 (Bankr. D. Del. Apr. 13, 2018) (citing Tooley, 845

[6] The *Citigroup* court warned that allowing "a group of stockholders to sue and recover damages for [] harm to the corporation from mismanagement that was not disclosed," which is precisely what the district court has allowed Plaintiff to do in this case, would be "problematic" and threaten "usurp[ation of] the corporation's own claim . . . [and] the state of incorporation's exclusive right to govern the internal affairs of the corporation." *Id.* at 1137.

A.2d, 1031). In *JMO*, certain directors and officers (the "D&Os") of an online mobile identity company, sought an injunction to preclude a shareholder from asserting certain fraud and breach of fiduciary duty claims in the bankruptcy proceedings. Specifically, the D&Os moved the court to enjoin a certain shareholder from prosecuting certain tort claims, including claims for fraud, misrepresentation and breach of fiduciary duty (*see id.* at *4-5), stemming from alleged misrepresentations and omissions contained in the company's public statements that were purportedly designed to induce the shareholder's purchase and retention of shares where it would not have otherwise acted (*see id.* at *5).

The court found that the shareholder's claims for director mismanagement, breach of fiduciary duty, fraud, unjust enrichment and constructive trust and fraud in the inducement were general to all shareholders and the corporation alike, were, thus, derivative and entered an injunction enjoining the shareholder from asserting the claims in a separate action against the D&Os. *Id.* at *8. In doing so, the court recognized that the D&O's purported hiding of the company's true financial condition and inadequate financial management, by omitting such information in its public disclosures, harmed the corporation in general, as opposed to the shareholder individually. *Id.* The court concluded that "those mismanagement claims would constitute derivative claims because they fall upon all shareholders equally" and that such "equity dilution claims are typically derivative under

Delaware law." *Id.* The shareholder in *JMO* had asserted and was ultimately enjoined from prosecuting disclosure claims, which are materially indistinguishable from Plaintiff's allegations in this case, because the disclosure claims were derivative.[7]

In this case, Plaintiff also asserts claims for fraud, negligent misrepresentation and breach of fiduciary duty against directors and officers arising from omissions in the company's public statements that were purportedly designed to induce Plaintiff's purchase and retention of shares. IV PA0640-612 ¶¶ 113-119 (Fiduciary Duty); PA0644-647 ¶¶ 127-138 (Fraud); PA0647-649 ¶¶ 139-147 (Negligent Misrepresentation). Specifically, Plaintiff claims that he determined from Midway's public statements and the absence of the 2013 Undisclosed Facts and 2014 Undisclosed Facts that profitable mining operations would result in a substantial increase in the value of his Midway shares. IV PA0644-646 ¶¶ 129-136. Plaintiff does not contend that Defendants fraudulently induced him to acquire or hold shares through any direct communication unique to himself. Rather, Plaintiff alleges failure to disclose material facts to ***all*** shareholders. IV PA0604 ¶ 1; PA0625-626 ¶ 65; PA0632 ¶ 86. The specific actions alleged in this case show that Defendants' purported omissions in

[7] The only claims the court found to be not derivative were claims of fraud based on ***direct representations to Plaintiff by one of the defendants***. *In re JMO Wind Down, Inc.*, No. 16-10682 (BLS), 2018 WL 1792185, at *8 (Bankr. D. Del. Apr. 13, 2018)

Midway's public statements were, if anything, harmful to the corporation and shareholders together, not to Plaintiff individually, and thus this claim is derivative. *See Parametric*, 401 P.3d at 1102 (recognizing that the direct harm test requires that "shareholder injury is independent from corporate injury.").

C. Plaintiff's Holder Claims Fail to Satisfy the Heightened Pleading Requirements.[8]

Even if this Court were to determine that Plaintiff's novel "holder" claims are not barred as a matter of law, the district court erred in failing to dismiss the "holder" claims because the claims do not meet the heightened pleading requirements. *First*, even if the Court applies California law, Plaintiff's fraud and negligent misrepresentation claims fail to allege specific reliance or causation. *Second*, Plaintiff's fraud claim fails to allege scienter on the part of Defendants. And *Third*, Plaintiff's negligent misrepresentation claim fails because Defendants cannot negligently misrepresent omitted facts as a matter of law.

1. Plaintiff's Holder Claims Fail to Plead Specific Reliance or Causation.

Plaintiff conveniently contends, in conclusory fashion, that on February 14, 2014, at the very moment Midway stock had hit an all-time high, he omnisciently decided to hold his Midway shares in reliance upon Midway's omissions in press

[8] As discussed in the Petition, Plaintiff's exercises of stock options are not covered by the *Small* decision because the exercise of stock options is an acquisition, not a holding, of shares. Petition at § IV(A)(4)(b).

releases and SEC filings concerning the Pan Mine's prospects. RA at 29. However, conclusory allegations of ***generalized*** reliance on the purported misrepresentations, which fail to allege ***any actions*** taken by Plaintiff that would substantiate the purported reliance, are insufficient to support a holder claim as a matter of law. *See Small v. Fritz*, 30 Cal.4th 167, 184-185 (2003) ("The plaintiff ***must allege actions***, as distinguished from unspoken and unrecorded thoughts and decisions, that would ***indicate that the plaintiff actually relied*** on the misrepresentations.") (emphasis added). Because the SAC relies upon Plaintiff's unspoken and unrecorded thoughts and decisions on February 14, 2014, Plaintiff's holder claims fail as matter of law.

To be sure, in *Small*, the California Supreme Court recognized a cause of action for stockholders who are induced by fraud or negligent misrepresentation to refrain from selling stock—but strictly boxed the availability of such claims given the significant danger of meritless suits filed simply to extort a settlement. *Small*, 30 Cal.4th at 184. In order to assert a cognizable holder claim, Plaintiff must "allege specific reliance" on Defendants purported misstatements, through "***actions***, as distinguished from unspoken and unrecorded thoughts and decisions." *Id.* (emphasis added). The *Small* court defined "actions" to include such details as when the plaintiff decided to hold his stock, what specific misrepresentations he relied upon regarding the company's statements that induced him to hold his stock,

what his plan was for selling the stock, how many shares he would have sold had he known of the misrepresentations contained in the company's statements, or when he would have executed the sale of shares. *Id.* Since Plaintiff failed to allege specific ***actions*** as opposed to unrecorded thoughts, Plaintiff is no different than the "mass of stockholders" who rely on the market. *Id.* at 184-85.

Without a specific reliance requirement, any plaintiff could get past the pleading stage based on his own biased account of what he was thinking (*i.e.*, whether he intended to sell, but decided to hold) even if the relevant events happened years ago, and the plaintiff never once communicated any such intent or decision to any other person at the time, and never recorded any such intent or decision in any contemporaneous writing. For this reason, *Small* forbids allegations of intent to sell or decisions to hold which are solely "unspoken and unrecorded thoughts and decisions." *See id.* at 850. This, however, is all that Plaintiff offers.

Here, Plaintiff failed to allege any concrete actions he took that would demonstrate his intent to sell his shares on February 14, 2014, when the market price had conveniently reached its peak. The allegations in the SAC require this Court to rely on Plaintiff's key "thoughts and decisions," which remain completely "unspoken and unrecorded." *Small*, 30 Cal.4th at 184-85. No objectively verifiable allegation in the SAC establishes how many shares he would have sold, the parties

to whom he would have sold, the price at which he would have sold, or the dates on which he would have sold. To be sure, Plaintiff alleges he "carefully followed the public announcements and filings by Midway." IV PA0632-633 ¶ 87. But the SAC still does not specifically allege any objectively verifiable facts substantiating the date Plaintiff decided to hold his stock (except for his "unspoken and unrecorded" revisionist decision to purportedly hold the shares in February 2014); what specific information he relied on regarding the company's statements in order to hold his stock; what his plan was for selling the stock; how many Midway shares he would have sold if he had known the "Undisclosed Facts;" or when he would have executed each such sale. This is insufficient to plead specific and objectively verifiable reliance.

Plaintiff also failed to allege a causal connection between his purported reliance on the allegedly rosy disclosure of Pan Mine's prospects and his injury. To do so, the SAC must allege that Plaintiff's holding of the shares caused a loss because he would have sold the shares ahead of the stock's decline. However, had Midway in fact publicly revealed the details of its purported Pan Mine troubles as soon as the problems arose, the value of Midway's stock would have decreased at that time, causing the stock price to drop earlier in time. ***Any public announcement of the truth would have made it impossible for Plaintiff to avoid***

the loss.[9] Nor can Plaintiff suggest he was somehow entitled to advance warning, as any private disclosure to Plaintiff alone would have violated federal security laws.

Finally, and not surprisingly, the SAC ***fails to allege any facts demonstrating how Plaintiff would have known to sell his shares at Midway's February 2014 peak***. *Chanoff v. U.S. Surgical Corp.*, 857 F. Supp. 1011, 1018 (D. Conn. 1994) ("plaintiffs have not alleged cognizable loss because plaintiffs cannot claim the right to profit from what they allege was an unlawfully inflated stock value"). Unable to present such particularized allegations of reliance and causation, Plaintiff must stand with the millions of other stockholders—including Defendants—who lost money when Midway's declared bankruptcy in 2015. This Court should issue a writ directing the district court to dismiss Plaintiff's claim.

2. Plaintiff's Fraud Claim Fails For Lack of Scienter.

Plaintiff contends, again in conclusory fashion, that "[s]cienter is alleged." RA at 27. More specifically, Plaintiff argues that paragraphs 105 and 110 of the SAC adequately plead scienter. *Id.* But paragraphs 105 and 110 only make the

[9] Plaintiff could not have suffered cognizable damage from holding stock during a period of alleged fraud when, as he contends, ***the fraud actually produced an artificially high stock value***. *See Crocker v. FDIC*, 826 F.2d 347, 352 (5th Cir. 1987); *Dloogatch v. Brincat*, 296 Ill. App. 3d 842, 851-52 (Ill. Ct. App. 2009) (recognizing that "without the fraud, the plaintiffs 'could never have realized the artificially high profit that they claim to have unjustly lost' and the plaintiffs were not entitled to the fraud-inflated value.") (quoting *Crocker*, 826 F.2d at 352).

conclusory allegation that "the failure by the 2013 [and 2014] Control Defendants to disclose the 2013 [and 2014] Undisclosed Facts was intentional and was done to encourage investors to retain and purchase Midway's common stock." IV PA0638 ¶ 105; PA0639 ¶ 110. While the SAC identifies "Undisclosed Facts" allegedly known by Defendants, but not otherwise disclosed to the public generally or to Plaintiff (RA at 28 (citing IV PA0625-627 ¶¶ 64-66; PA0628 ¶ 70; PA0632 ¶ 86)), Plaintiff does not allege how Defendants knew of the Undisclosed Facts or how they had knowledge of any alleged misrepresentations in the public statements that were made. Rather, Plaintiff relies on the implications of Defendants' membership on the Disclosure Committee in a misplaced attempt to satisfy the knowledge requirement. RA at 28. Nor does Plaintiff allege with particularity how each of these particular alleged omissions contributed to Midway's filing of bankruptcy—as opposed to constituting mere mismanagement of Midway. Of course, Midway's mismanagement in connection with the operation of the Pan Mine cannot support fraud (or negligent misrepresentation) allegations in a holder action. *See Anderson*, 614 F.3d at 367 (explaining that any alleged fraud merely "deferred the time when the stock's price accurately reflected the value of Aon's business").

3. Plaintiff's Negligent Misrepresentation Claim Fails Because Defendants Could Not Negligently Misrepresent Omitted Facts.

Plaintiff's negligent misrepresentation claim fails because Plaintiff has not alleged that Defendants made any false statements of fact, but rather that they omitted certain "Undisclosed Facts." RA at 26 ("The identified statements were fraudulent and misleading mainly because they did not disclose material facts/bad information about Pan."). In the Answer to the Writ Petition, Plaintiff merely lists certain "Undisclosed Facts" allegedly known by each of the Defendants, but not disclosed to the public generally or to Plaintiff. RA at 26 (citing IV PA0625-626 ¶ 65; PA0632 ¶ 86). However, there are no allegations in the SAC regarding which statements, if any, in Midway's press releases and SEC filings are false or misleading. Nor does Plaintiff sufficiently allege how any Defendant made any of the alleged misrepresentations of a past or existing material fact "without reasonable ground for believing it to be true." *Apollo Capital Fund, LLC v. Roth Capital Partners, LLC,* 158 Cal. App. 4th 226, 243, 70 Cal. Rptr. 3d 199, 213 (Cal. Ct. App. 2007) (citing *Shamsian v. Atlantic Richfield Co*., 107 Cal. App. 4th 967, 983, 132 Cal.Rptr.2d 635, 647 (Cal. Ct. App. 2003)).

In his Answer to the Writ Petition, Plaintiff argues that paragraph 63 of the SAC alleges that Midway issued a press release regarding the Record of Decision for the Pan project. *See* RA at 27. But the SAC does not allege that this press

release contained false statements. Nor does Plaintiff allege that the other public statements listed in the SAC were false. However, California law—upon which Plaintiff purportedly relies to support his claim—requires a "positive assertion" by the defendant to sustain a claim for negligent misrepresentation. *Wilson v. Century 21 Great Western Realty*, 15 Cal. App. 4th 298, 306, 18 Cal. Rptr. 2d 779 (1993); *Byrum v. Brand*, 219 Cal. App. 3d 926, 942, 268 Cal. Rptr. 609 (1990). Because Plaintiff does not allege Defendants made a false representation, but rather omitted material facts, the claim for negligent misrepresentation should have been dismissed by the district court. *Gentry v. eBay, Inc.*, 99 Cal. App. 4th 816, 835, 121 Cal. Rptr. 2d 703 (2002) ("An essential element of a cause of action for negligent misrepresentation is that the defendant must have made a misrepresentation as to a past or existing material fact.") (citation omitted).

D. Resolution of the Writ in Favor of Defendants Will Resolve the Underlying Case in its Entirety Because Plaintiff Cannot Assert a Cognizable Claim for Relief in His Capacity As a "Purchaser"

Plaintiff contends that, even if the writ is granted and the "holder" claims are ultimately dismissed, the writ will not resolve the entire case because Plaintiff will still have "purchaser" fraud and negligent misrepresentation claims based on his acquisition of stock. RA at 25-26. However, Plaintiff's only "purchaser" claim was dismissed by the district court below.

The district court expressly dismissed Plaintiff's statutory "purchaser" claims because it found that Plaintiff failed to allege any misrepresentation in connection with a purchase or sale of a security. PA1052 ¶ 23. Under the plain language of the California securities statutes, the district court found that purchases and sales of stock options are deemed to occur at the time the stock options are granted, not at the time the options are later exercised. *Id.* at ¶ 21 (citing CAL. CORP. CODE § 25017(e)). Because the sale at issue in this case occurred in 2009, when Plaintiff's stock options were originally issued, and there are no allegations that the sale in 2009 was based upon any untrue statement of material fact or an omission of the same, Plaintiff's claim for securities fraud failed as a matter of law and was dismissed with prejudice by the district court. ¶ 23. Plaintiff failed to assert a statutory "purchaser" claim.[10]

Furthermore, Plaintiff cannot assert any cognizable common law "purchaser" claims stemming from his purported reliance on Midway's press releases. To state common law claims for fraud and negligent misrepresentation, Plaintiff must allege, among other things, "resulting damage." *Small*, 65 P.3d at 1258 (damage is an element of fraud); *Apollo Capital Fund,* 158 Cal. App. 4th at

[10] Plaintiff's SAC expressly acknowledges that "[t]his [fraud] claim is based on the holding in *Small v. Fritz Companies, Inc.*, 30 Cal.4th 167 (2003)." IV PA0644 ¶ 128. Of course, *Small* involved *only* holder claims—*not* claims for fraud or negligent misrepresentation in connection with a purchase or sale of stock.

243 (damage is an element of negligent misrepresentation). Even if Plaintiff relied upon the purported omissions in Midway's public filings at the time he exercised his stock options, ***he could not have been damaged*** through his acquisition of Midway shares at below-market prices.

As the district court correctly found below, Plaintiff "purchased" stock options in 2009 and there are no allegations of any misrepresentations with respect to the 2009 transaction. VI PA1049 ¶ 6; PA1050-1051 ¶¶ 13-16; PA1052 ¶ 23. The stock options granted Plaintiff the right to acquire stock at a later date at below market prices. In 2014, Plaintiff alleges he exercised his stock options. Plaintiff's exercise of the stock options was based solely on the fact that the exercise price was far below the current market price. Because the exercise price was well below the market price in 2014, ***Plaintiff stood to gain a substantial profit as a result of exercising the options*** and certainly was not injured or damaged. Plaintiff's theory of damages is that Plaintiff continued to ***hold*** the newly acquired stock, after exercising his options at below market prices, and the stock price ultimately declined in value. Thus, Plaintiff's only viable theory of damages arises in his capacity as a "holder" of the stock, not a "purchaser." Because Plaintiff has not and cannot assert that he was damaged as a result of exercising his stock options at below market prices, he cannot assert a cognizable common law claim as a "purchaser." *Small*, 65 P.3d at 1258 (damage is an element of fraud); *Apollo*

Capital Fund, 158 Cal. App. 4th at 243 (damage is an element of negligent misrepresentation). Thus, the resolution of this Writ in favor of Defendants on Plaintiff's derivative and "holder" claims will resolve this matter in its entirety.

III. CONCLUSION

For all the foregoing reasons, this Court should issue a writ of prohibition or mandamus directing the district court to grant the motion to dismiss and joinders thereto, and directing the district court to grant the Motion because it lacks subject matter jurisdiction over Plaintiff's derivative claims and cannot recognize a "holder" theory of liability.

Dated this 29th day of October 2018.

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VERIFICATION

I, David J. Freeman, declare:

1. I am an associate for the law firm of HOLLAND & HART LLP and counsel for Defendants Richard D. Moritz, Bradley J. Blacketor, Timothy Haddon, Richard Sawchak, John W. Sheridan, Frank Yu, Roger A. Newell and Rodney D. Knutson, who are among the Petitioners in the above-entitled case;

2. I verify that I have read the foregoing **REPLY TO ANSWER OF REAL PARTY IN INTEREST TO PETITION FOR WRIT OF PROHIBITION OR ALTERNATIVELY, MANDAMUS** that the same is true to the best of my own knowledge, except for those matters therein stated on information and belief, and, as to those matters, I believe them to be true.

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

EXECUTED this 29th day of October, 2018, in Clark County, Nevada.

/s/ David Freeman
DAVID J. FREEMAN

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the formatting requirements of NRAP 32(a)(4), the typeface requirements of NRAP 32(a)(5) and the type style requirements of NRAP 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word, Version 14.0.7173.5000 (32-bit), in Times New Roman 14-point font, double spaced.

I further certify that this brief complies with the type-volume limitations of NRAP 32(a)(7) because, excluding the parts of the brief exempted by NRAP 32(a)(7)(C), it is proportionately spaced, has a typeface of 14 points, and contains 6068 words.

Finally, I hereby certify that I have read this brief, 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 NRAP 28(e)(1), which requires every assertion in the brief regarding matters in the record to be supported by a reference to the page and volume number, if any, of the transcript or appendix where the matter relied on is to be found. I understand that I may be subject to

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sanctions in the event that the accompanying brief is not in conformity with the requirements of the Nevada Rules of Appellate Procedure.

Dated this 29th day of October 2018.

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CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that on the 29th day of October, 2018, a true and correct copy of **REPLY TO ANSWER OF REAL PARTY IN INTEREST TO PETITION FOR WRIT OF PROHIBITION OR ALTERNATIVELY, MANDAMUS** was electronically filed with the Nevada Supreme Court by using the Nevada Supreme Court's E-filing system.

I further certify that all participants in this case are registered with the Supreme Court of Nevada's E-filing system, and that service has been accomplished to the following individuals through the Court's E-filing System or by depositing same in the United States mail, first class postage fully prepaid to the persons and addresses listed below:

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