**IN THE SUPREME COURT OF THE STATE OF NEVADA**

DANIEL E. WOLFUS,

Appellant,

v.

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,

Respondents,

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DANIEL E. WOLFUS,

Appellant,

v.

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,

Respondents,

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**APPELLANT'S REPLY BRIEF**

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## I. Introduction.

This appeal involves a straight-forward securities fraud claim committed by Midway Gold Corp. ("Midway") through a massive market manipulation to enhance the value of that stock committed by issuing public filings which were both materially false and misleading in failing to disclose material facts. As a result of this manipulation, which occurred in 2013 and 2014 and after Plaintiff and Appellant Daniel E. Wolfus ("Wolfus") left the Board, and in reliance on the fraudulent statements, Wolfus in 2014 made two stock purchases of 1,200,000 shares of Midway stock for nearly $885,000.

Wolfus' Second Amended Complaint ("SAC") asserted claims based upon California's Corporate Securities Law of 1968, California *Corporations Code* §§ 25000 *et seq.* (the "Act"). The Act is nearly identical to Nevada's Securities (Uniform Act) *NRS* Chapter 90 which also provides the same private right of action for securities fraud as does the California Act. See *NRS* 90.570, 90.660 and 90.670.

As Defendants and Respondents ("Respondents") accurately state, " 'This California law was designed to protect the public from fraud and deception in securities matters, by providing statutory remedies for violations of the California Corporations Code.' *America Online, Inc. v. Superior Court*, 90 Cal. App. 4th 1, 108 Cal. Rptr. 2d 699 (Ct. App. 1st Dist. 2001), as modified, (July 10, 2001)." See

Respondents' Brief at 22. Wolfus is exactly the type of investor that the Act was intended to protect and his claims are exactly the type for which the Act provides a remedy.

While ignoring many of the arguments advanced by Wolfus in his Opening Brief, Respondents essentially attempt to make three arguments.

Respondents primary argument is based on a tortured and contrived interpretation of California *Corporations Code* § 25017(e), while ignoring the plain and extremely broad wording of *Corporations Code* § 25017(a). The interpretation advanced by Respondents, if accepted, leads to an absurd result, namely that a person who purchases shares by exercising a gratuitous employee incentive stock option has no remedy notwithstanding that he was defrauded into making the purchases through massive market manipulation by the seller and issuer of the stock Midway. Contrast that with any other person who purchased shares in any other manner, either directly from Midway or from a third party, who has a clear remedy under the Act against the seller and issuer Midway, who made the false and misleading statements, for those purchasers. As noted above, such a result is contrary to the admitted purpose of securities laws, both federal and state.

Respondents' second argument is that Wolfus failed to make his interpretation arguments in the District Court in the first instance. This argument is belied by the Record on Appeal. See AA at 623-625 and 724-725. Wolfus at all

times has asserted that the applicable section is 25017(a) and not 25017(e) and that Wolfus' position is supported by not only a careful reading of these sections but also the California Supreme Court's holding in *StorMedia v. Superior Court*, 20 Cal. 4th 449, 976 P.2d 214 (Cal. 1999), the interpretation of the same language in *People v. Boles*, 35 Cal. App. 2d 461, 95 P.2d 949 (1939) as well as the holding in *California Amplifier v. RLI Ins.*, 94 Cal.App.4th 102; 113 Cal. Rptr. 2d 915 (2001) that privity is not required for secondary liability to attach to directors and principal officers of Midway.

Respondents' third and equally frivolous argument is that Respondents were not in privity with Wolfus and, thus, cannot be held liable. Wolfus has never claimed that the Respondents are primarily liable under *Corporations Code* §§ 25401 and 25501. Instead, Wolfus has always claimed that Midway, as the seller of the shares and the party who published the false and misleading filings, is primarily liable for the securities fraud. Rather, Wolfus has always asserted that Respondents are secondarily liable pursuant to *Corporations Code* § 25504, This section creates joint and several liability against, among others, every director and principal executive officer of Midway. Liability is created by status and not by acts. Moreover, *California Amplifier, supra* at 109, makes it clear that privity is not required for secondary liability to attach. Note that this is a decision cited by Respondents repeatedly as controlling authority. Wolfus alleged privity with

Midway and alleged that Respondents were either directors or principal officers or both.

Each argument raised by Respondents will be discussed below.

## II. *Corporations Code* § 25017(e) is Inapplicable to this Appeal.

Respondents' primary argument is that this appeal is governed by *Corporations Code* § 25017(e) and Wolfus can't state a claim either in 2009 or in 2014.

In making this assertion, Respondents totally ignore *Corporations Code* § 25017(a) which is the primary definition of "sale" or "sell." That subsection is extremely broad. It defines those terms by using the word "every" and then expands on "every" by listing a variety of other descriptions by using the word "includes." This is the applicable subsection asserted by Wolfus in both this Court and the District Court.[1]

After ignoring subsection (a), Respondents make a tortured interpretation of subsection (e).

Respondents assert that the "plain" language of subsection (e) controls. What Respondents are really saying is that they have been utterly unable to cite this Court to a single case supporting their contrived interpretation.

[1] Nevada has no corollary to 25017(e). If this action were governed by Nevada law, Wolfus would have a remedy based upon his purchases after exercising his gratuitous options.

Respondents then attempt to add meanings and words to subsection (e) which do not exist. Subsection (e) provides:

> (e) Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert the security into another security of the same or another issuer, includes an offer and sale of the other security only at the time of the offer or sale of the warrant or right or convertible security; but neither the exercise of the right to purchase or subscribe or to convert nor the issuance of securities pursuant thereto is an offer or sale.

The first part of this subsection deals with only two types of securities. It says: "Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer…".

The first part clearly states that it applies to a "warrant" which is a type of security. It is a security which is purchased and sold. It is a security which is immediately tradeable. The seller receives "consideration" for its sale and the purchaser parts with consideration for its sale. The seller derives revenue from such a sale. The shares at issue in this appeal are clearly not warrants. Respondents concede by failing to rebut Wolfus explanation of warrants.

The second part applies to the "right to purchase or subscribe to another security of the same or another issuer." This is commonly known as a "convertible security. Like warrants, a convertible security is a security which is purchased and sold. It is a security which is immediately tradeable. The seller receives

"consideration" for its sale and the purchaser parts with consideration for its sale. The seller derives revenue from such a sale.

The subsection then expands on the use of convertible securities by saying that "as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert the security into another security of the same or another issuer. This explanation is meant to include securities which may be converted to a security of a different issuer.

Respondents concede by failing to rebut Wolfus explanation of convertible securities. The shares at issue in this appeal are clearly not convertible securities.

Having defined the two types of securities covered by subsection (e), the statute then makes clear that the "exercise" of a warrant or convertible security is a sale at the time consideration passes hands on their acquisition or when the warrant or convertible security is purchased and the issuer receives consideration, the seller parts with consideration and a marketable security is born.

In his Opening Brief, Wolfus cited the Court to several articles explaining the differences between warrants, convertible securities and stock options, particularly employee incentive stock options. Respondents offer no authority or argument to the contrary and are deemed to have conceded to the accuracy of Wolfus explanation of the distinctions.

What is involved in this appeal are shares acquired by the exercise of a gratuitous grant of employee incentive stock options. The words "option" or "stock options" or "employee incentive stock options" are not found in subsection (e). To reach this result, Respondents argue that the word "right" must be interpreted as "option."

However, an "option," particularly an employee incentive stock option, is an entirely different animal from a warrant or convertible security. First, an incentive stock option is not purchased or sold. It is "granted" which is a word of art. No consideration changes hands. The issuer does not derive revenue. It is equivalent to a "gift" because it is entirely discretionary by the issuer such as Midway. Instead, it is a vehicle designed to encourage the recipient to do well as an officer and/or director of the issuer in order to enhance the value of the stock. At the time of grant, an employee incentive stock option is required to be priced at least at the then current fair market value of the stock. If the incentive is not effective, the stock does not increase in value and there is no reason to exercise the incentive stock option.

What subsection (e) states is that warrants and convertible securities are deemed to be an offer or sale at the time they are "purchase" and "sold." Purchase and sale are commonly understood terms. They imply that "consideration" has

changed hands. If their purchase was induced by fraud, the purchaser has a claim, has suffered a loss of the consideration and has a remedy.

There is no "purchase" or "sale" as commonly understood when stock options are "granted." Because no consideration changes hands, no reasonable person could conclude that it is a purchase or sale. If it is not a purchase or sale, then subsection (e) should not apply to its grant.

A securities fraud claim arises only if a purchaser (or seller) parts with consideration as part of the transaction. The remedy is a return of the consideration plus interest. If no consideration changes hands, there is nothing to return and, thus, there is no viable securities law claim regardless of the fraud which may have been committed by the issuer at the time.

As noted above, the entire purpose of the securities laws is to provide a remedy to a defrauded purchaser or seller. The remedy is return of consideration plus interest. If there is no purchase or sale, there is nothing to remedy.

Clearly, a defrauded purchase of warrants or convertible securities would have a remedy of return of his consideration. Equally clear, a grantee of a stock option should only have a claim when he parts with consideration which is at the time of exercise and not at the time of grant. However, the interpretation of subsection (e) advance by Respondents would deny a purchaser of securities a

remedy if he was induced by fraud to exercise his options. This is an absurd result and clearly not what was intended by subsection (e).

As a result and in order to follow the purpose of the securities laws, Respondents strained interpretation is without merit and should be disregarded.

## III. Applicable California Case Law Supports Wolfus' Position.

As noted above, Respondents assert that there is no need to review case law because the "plain" meaning of subsection (e) is clear on its face. In other words, they can find no supporting cases.

In the District Court and in his Opening Brief, Wolfus cited this Court to *People v. Boles, supra.* At least Respondents discussed this case but gave it short shrift arguing that it is old and did not involve the current Act. However, *Boles* did involve the exact same language contained in subsection (e) and did so in interpreting its applicability under the then California security law. In that case, the defendant on appeal argued that this language applied to stock options and that his conviction must be reversed. The Court of Appeal dismissed this argument as "untenable" noting that the language of the subsection dealt with convertible securities and not with stock options. Defendant made precisely the strained interpretation proffered by Respondents. The Court of Appeals, however, agreed with the interpretation offered by Wolfus.

The second case strongly supporting Wolfus' position that a claim for securities fraud is viable under the Act based upon the date of "exercise" and not the date of "grant" is the California Supreme Court decision in *StorMedia, supra*, cited by Wolfus to the District Court. *StorMedia* involved a class action for securities fraud based upon StorMedia's false and misleading public filings. Because the class included more than individuals exercising employee stock options and making purchase from third parties other than StorMedia, the action was brought under Section 25400 (market manipulation) rather than 25401.[2]

Apparently, StorMedia argued that the exercise date for employee stock options was not the appropriate date. The California Supreme Court was called upon to decide whether the date of exercise governed whether these employee were properly part of the class and stated a securities fraud claim. The Court at 462 held that a claim was stated, as follows:

> "Since StorMedia sold shares to employees pursuant to the employee stock purchase plan, and sold shares pursuant to the exercise of other stock options, it did sell securities during the class period. [Footnote omitted] We conclude on that basis that the complaint does allege facts which, if true, establish that StorMedia was a "person selling or offering for sale or purchasing or offering to purchase" its stock during the class period.

See also Footnote 14 at 462.

[2] Wolfus could have based his claim under market manipulation also because the fraudulent statements of Midway were used to enhance the value of shares for sales to the public and to secure a substantial loan. See AA 332 (¶ 78) and 333 (¶ 80).

Similar statements by the California Supreme Court recognizing the exercise date as the appropriate date for a securities fraud claim both for exercises under a stock purchase plan and employee incentive options can be found at Pages 453, 456-457 including footnote 10, 458 and 461. Such a holdings could not be made if the "grant" date established the purchase of securities.

These two cases establish that subsection (e) does not involve the exercise of options, as contended by Respondents, and instead subsection (a) applies to whether a securities fraud claim may be brought.

## IV. Wolfus Asserted the Same Arguments in the District Court.

Respondents in the District Court asserted that *Corporations Code* § 25017(e) applied to this case. AA 485-486.

Wolfus asserted in the District Court that the applicable provision was *Corporations Code* § 25017(a) and the subsection (e) did not apply, citing *Boles* and *StorMedia*. AA 624-625.

Wolfus argued this position during the hearing on the motion. AA 724-725.

As a result, Wolfus raised the same arguments presented herein in the District Court and Respondents' assertion to the contrary is frivolous.

## V. Respondents are Secondarily Liable because of their Status as Officers and Directors.

Respondents have asserted that they have no liability to Wolfus because they were not in privity with Wolfus. Respondents Brief at 33-36. Respondents advance two arguments. Their first argument is that privity is required for a claim under *Corporations Code* §§ 25401 and 25501. Wolfus does not disagree but Wolfus has not sued Respondents because they were the "sellers." The seller was Midway and Wolfus has stated a claim against Midway as shown above.

Respondents second argument is that because Wolfus has no claim against Midway through their distorted interpretation of *Corporations Code* § 25017(e), the Respondents cannot be secondarily liable under *Corporations Code* § 25504. This is where Respondents argument falls short of the mark.

Wolfus has alleged a 25401/25501 claim against Midway. Because of this, Respondents are secondarily liable because of their status as directors and officers of Midway under 25504. Respondents concede that if Midway is liable, then they are liable by their status. See *California Amplifier, supra,* at 109. See also *Jackson v. Fisher,* 931 F. Supp. 2d 1049 (2013) also cited as controlling by Respondents.

Wolfus has never asserted that Respondents are primarily liable but only secondarily liable although the allegations of the SAC are clear that it was

Respondents who wrote, approved and disseminated Midway's false and misleading statements to the public.

## VI. Issues Raised in Opening Brief which have been Conceded.

Wolfus would be remiss if he did not note the issues he raised in his Opening Brief which Respondents have conceded either directly or by failure to rebut.

Facts as alleged in the SAC are treated as true on this appeal pursuant to *Sanchez v. Wal-Mart Stores, Inc*., 125 Nev. 818, 823; 221 P. 3rd 1276, 1280 (2009). Conceded at Respondents' Brief at Page 4, Footnote 1.

The review by this Court is *de novo.* Respondents Brief at 21.

The issues involved in this appeal were not decided by this Court in *Brunk v. Eighth Judicial Dist. Court of Nev*., 449 P.3rd 1270 (2019). Respondents conceded this assertion at Page 3, Footnote 3 of their brief.

California law applies to Wolfus' claims pursuant to *Corporations Code* § 25008 and *Hall v. Superior Court*, 150 Cal. App. 3d 411; 197 Cal. Rptr. 757 (1983). Conceded by failing to rebut.

The District Court found in Finding of Fact 7 that Wolfus' options were granted and not purchased in 2009. Conceded by failure to rebut.

The grant of options to Wolfus was gratuitous. Conceded by failing to rebut.

Wolfus could suffer no damages because the grant of employee incentive stock options was at the market price on the date of grant and Wolfus paid no consideration for this grant. Conceded by failing to rebut.

All essential elements of Wolfus; securities fraud claim have been pled in the SAC. Conceded by failure to rebut.

The 2013 and 2014 Undisclosed Facts alleged in the SAC were material. Conceded by failure to rebut except as to when the purchase occurred.

Wolfus relied on the material misstatements and omissions in making his 2014 purchases. Conceded by failure to rebut.

Nevada's securities fraud law is nearly identical to the Act. Conceded by failure to rebut.

**VII. Conclusion**.

During late 2013 and 2014, Midway was in desperate need of cash to bring the Pan mine into production. Midway had no operating revenue. The Hale group refused to allow Midway to sell assets. As a result, Midway's only sources of cash were through the sale of its stock and/or loans. Both were dependent on the market value of Midway's stock. Midway did both in 2014.

During the same time period, Midway was suffering from a number of setbacks, which if they became known to the investing public would cause the market price of Midway's stock to drop.

Rather than tell the truth, Midway embarked on a plan of issuing false and misleading public filings to bolster the market value of its stock. This is the type of market manipulation for which applicable securities laws provides a private right of action and a remedy for purchasers of Midway's stock either from Midway or in the market.

Wolfus fell victim to this market manipulation and made two substantial stock purchases directly from Midway in 2014 parting with nearly $885,000. Wolfus' purchases were from the exercise of his stock options. Wolfus was not required to exercise those options. He did so only in reasonable reliance on Midway's false and misleading public filings. Since Midway was the seller, Wolfus claim falls under §§ 25401/25501 of the Act.

Respondents contend, based upon a tortured interpretation of § 25017(e) that Wolfus two purchases occurred in 2009 although Wolfus paid no consideration at that time and received no stock. Respondents have no case authority to support its position but there is case authority which contradicts Respondents' assertions.

Wolfus has carefully explained to this Court as he did in the District Court that § 25017(e) deals with warrants and convertible securities and not employee incentive stock option and the absurd result which follows from reading "options" into that section.

Wolfus has repeatedly cited *Boles, supra,* which is the only case interpreting that very language of 25017(e) and which found that it did not apply to options.

Wolfus has repeatedly cited *StorMedia, supra,* where the California Supreme Court held that a person exercising employee stock options has a securities fraud claim if his exercise occurred during the class period, which was the entire length of the statute of limitations.

Respondents' discussion of *Boles* is weak and of *StorMedia* is non-existent.

Respondents' assertion that Wolfus' arguments were not raised in the District Court is belied by the Record on Appeal, which includes Wolfus' written opposition to the motion to dismiss and the oral argument. The issue was front and center in the District Court.

Respondents were not the seller of the securities. Midway was the seller and primarily liable for the securities law. However, Respondents have joint and several secondary liability for Wolfus claim by virtue of their status as officers and directors. See *Corporations Code* § 25504 and *California Amplifier, supra.*

Having pled all required elements, Wolfus respectfully requests that this Court reverse the District Court and remand this matter for trial.

DATED this 27th day of January, 2021

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## 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 in Times New Roman, 14 pt.

I further certify that this brief complies with the page or type volume limitations of NRAP 32(a)(7) because, excluding the parts of the brief exempted by NRAP 32(a)(7)(C), it is either: [X] Proportionately spaced, has a typeface of 14 points or more and contains 3,622 words; or [ ] Does not exceed ___ pages.

Finally, I hereby certify that I have read this appellate 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

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

DATED this 27th day of January, 2021.

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## CERTIFICATE OF SERVICE

I certify that on the 27th day of January, 2021, a true and correct copy of the foregoing APPELLANT'S REPLY BRIEF was electronically filed with the Nevada Supreme Court by using the Nevada Supreme Court E-Filing System.

I further certify that the following 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:

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