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Case No. 72597-1-I



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COURT OF APPEALS FOR DIVISION I
STATE OF WASHINGTON

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STANLEY SMITH,

Appellant,

v.

TERRY MARTIN and M&M TECHNOLOGIES, INC.,

Appellees.

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# APPELLANT'S REPLY BRIEF

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## INTRODUCTION

This case turns on single legal issue, i.e., did the SEC's actions ***prior to*** the execution of the License and Option Agreements, none of which are disputed by the parties, constitute a "claim" as the ordinary meaning of that term was used in the relevant provisions of those agreements? Respondent essentially devotes only one page of its 22-page brief to this issue. The trial court said "no" as a matter of law. CP 125, FF at ¶¶ 3.09, 3.18-3.19; 3.21-3.24; Claims at 4.02; CL at 3. Appellant, Mr. Smith, disagrees. *See* Appendix A.

Answering this legal question is critical for two reasons. First, warranties, unlike representations, provide heightened contractual protection—protection that Mr. Smith did not receive the benefit of if the trial court erred—because warranties preclude all controversy "about the materiality or immateriality of the statement. The only question is, has the warranty been kept? There is no room for construction; no latitude; no equity." *Miller v. Commercial Union Assurance Co.,* 69 Wash. 529, 535, 125 P.2d 782 (1912); *Clausing v. De Hart,* 83 Wn. 2d 70, 515 P.2d 982 (1973). Warranties, therefore, are intended to provide a level of contractual certainty, even where the trial court here, applying a preponderance of the

evidence standard, ruled in Respondent's favor on certain factual findings such as whether Respondent fully disclosed the SEC's actions to Mr. Smith.

And second, the preponderance of the evidence standard is the one of the lowest evidentiary standards at law, such that the trial court's factual rulings, which are to be given substantial deference on appeal, are not necessarily "true;" they are just "more likely than not true", leaving latitude for significant doubt despite the findings. Here, Mr. Smith strongly disagrees with the trial court's factual finding that Respondent fully disclosed the SEC actions; however, he respects and appreciates that this specific finding will be presumed to be true on appeal. It is this very uncertainty and trial court discretion that warranties are designed to protect against; specifically, whether Respondent fully disclosed or did not fully disclose. CP 125, FF at ¶¶ 3.18-3.19; 3.21-3.24; Claims at 4.02; CL at 3. The express warranties of Paragraph 12.1(g) of the parties' License Agreement and Paragraph 5.1(g) of the Option Agreement make this factual finding regarding disclosure irrelevant. If the SEC's actions, all of which are undisputed by either party, constitute a "claim" within the ordinary meaning of that term, the trial court erred and judgment should be entered in favor of Mr.

Smith in the amount of $600,000, plus pre-judgment interest.

## REPLY ARGUMENT

### I. Standard of Review

Respondent incorrectly urges that the proper standard of review is whether the findings of fact "are supported by substantial evidence, and if so, whether those findings support the conclusions." Respondent Brief at p. 16. Mr. Smith is not making an "insufficiency of evidence" argument on appeal. His appeal is from the trial court's conclusion of law, *i.e.,* the interpretation of the word "claim" in paragraph 12.1(g) in the License Agreement and 5.1(g) of the Option Agreement, and whether M & M breached these provisions. Conclusions of law are reviewed *de novo*. *Colorado Structures, Inc. v. Ins. Co. of the West*, 161 Wn.2d 557, 586, 167 P.3d 1125 (2007).

### II. The Trial Court Erred By Concluding As A Matter Of Law That The SEC's Actions Did Not Constitute A Claim Within The Meaning of "Claim" As The Term Is Used In Paragraph 12.1(g) of the parties' License Agreement and Paragraph 5.1(g) of the Option Agreement.

On appeal, Mr. Smith disputes the trial court's findings of fact at 3.09, 3.18-3.19 and 3.21-3.24 of the Findings of Fact and Conclusions of Law ("FF", "CL", and/or "FF/CL") because Respondent did not disclose the information set forth in those

paragraphs.[1] *See* testimony of Mr. Smith at RP 203-207. However, because the findings are based on sufficient evidence to persuade a fair-minded person of the findings' truth, these factual findings must be accepted on appeal. *Goodman v. Boeing Co.*, 75 Wn. App. 60, 82-83, 877 P.2d 703 (1994).

The undisputed facts applicable to Mr. Smith's appeal are unchallenged by Respondent (except for the issue of full disclosure). Specifically, between December 4, 2006 and April 11, 2007 (the date the License and Option Agreements were executed), Mr. Martin and M & M learned that they were the subjects of investigation by the SEC into a Ponzi Scheme operated by an entity, IFC, and several individuals, one of whom, Mac Stevenson, was a business colleague of Mr. Martin at GEM Technology. CP P18-21, 26, D27, 33-38, 41; RP 154-158, 251-271. The exchanges between Mr. Martin and the SEC and the financial records of M & M and CD2E, an investment entity wholly-owned by Mr. Martin, show that Mr. Martin, M & M and CD2E collectively received over $2 million from IFC's illicit criminal

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[1] Notably, Respondent did not dispute in its response brief that M & M's principal, Terry Martin, admitted unequivocally that if the SEC demand had risen to the level of a "claim," the SEC claim would have had a material adverse effect on M & M, and by extension,

activities, not including approximately $300,000 paid directly to Mr. Martin as "consulting fees."[2] RP 188-200. Further, as of March 13, 2007, Mr. Martin was notified by the SEC that M & M was likely to be named as a "relief defendant" (along with CD2E and Mr. Martin, individually) and that the SEC intended to disgorge the ill-gotten funds (including $550,000 paid directly by IFC to M & M). The SEC thereafter filed suit against Mr. Martin, M & M and CD2E on April 9, 2009, which ultimately led to an agreed settlement on July 16, 2008 for the repayment of in excess of $630,000. CP P18-21, 26, D27, 33-38, 41; RP 177-178.

It is the application of these undisputed facts to the word "claim" in the warranty language of Paragraphs 12.1(g) and 5.1(g) of the License and Options agreements, respectively, where the trial court erred. *See* Appendix A. The trial court determined that the "SEC claim against M & M Technologies, as a relief defendant for $550,000, was an inchoate potential claim" only and therefore M & M had not breached either Paragraph 12.1(g) or Paragraph 5.1(g). CP 125 at ¶¶ 3.09, 3.21-3.24, Claims at 4.02, and CL 3.

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Mr. Smith. RP 268-274.

[2] Mr. Martin testified that he didn't know the nature of IFC's business, but acknowledged that he provided $300,000 in consulting fees without knowing. RP 188-190.

The trial court's determination was an error of law and should be reversed. For the SEC's claim to be a "claim" under paragraphs 12.1(g) and 5.1(g), M & M did not need to formally be named and served as a relief defendant in the on-going Ponzi scheme litigation by the SEC. *Cf. Olympic S.S. Co. v. Centennial Ins. Co.,* 117 Wn.2d 37, 52, 811 P.2d 673 (1991)("A 'claim' is a demand for compensation"); *Safeco Title Ins. Co. Gannon*, 54 Wn. App. 330, 335, 774 P.2d. 30 (1989)("'Claim' ordinarily means a demand . . . for damages . . ."); RCW § 4.92.100 (pre-suit claim against State of Washington must be presented to the Office of Risk Management as precondition for filing a lawsuit).

The totality of the SEC's actions—by correspondence, telephone calls, and the filing of the Amended Complaint, all prior to the execution of the License and Option Agreements—make clear, as a matter of law, that the U.S. Government had made a "claim" against M &M. The License and Options Agreements are therefore void, and any damages awarded to Respondent based on the License and Option agreements are therefore null and void. *See* Appendix A (FF at 3.47, Remedy at 5.03, and CL 6, 8 and 11).

## CONCLUSION

For the foregoing reasons, the trial court's finding that M & M

did not breach paragraphs 12.1(g) and 5.1(g) of the License and Option Agreements should be reversed and judgment should be entered in favor of Mr. Smith in the amount of $600,000, plus pre-judgment interest. Reversal and remand is not warranted because M & M's principal, Terry Martin, admitted unequivocally that if the SEC demand had risen to the level of a "claim," the SEC claim would have had a material adverse effect on M & M, and by extension, Mr. Smith. RP 268-274.

Respectfully submitted this 24th day of August, 2015.

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## CERTIFICATE OF SERVICE

I certify under penalty under the laws of the State of Washington that on August 24, 2015, I caused a true and correct copy of the foregoing APPELLANT'S REPLY BRIEF to be delivered by Email and U. S. Mail (1st Class) to the following:

Douglas Shepherd
Shepherd & Abbott
2011 Young St., Suite 202
Bellingham, WA 98225

Kenneth L. Karlberg

## APPENDIX A

Findings of Fact

3.09 M & M Technologies has not breached any of the three (3) agreements referenced above.

3.22 At the time of the first disclosures regarding the SEC on March 15, 2007, and at the time of the signing of the contracts, a SEC claim against M & M Technologies, as a relief defendant for $550,000, was an inchoate potential claim only. . .

3.23 . . . M & M Technologies correctly warranted there was no actual claim against it by the SEC.

3.24 It was disclosed to smith what Martin and M & M Technologies actually knew, for the warranting provision to be violated there needed to [by][sic] an actual claim and there was not.

3.47 M & M Technologies is entitled to retain the first $250,00 paid toward the License Agreement and the $10,000 paid for the Option Agreement.

Claims

4.02 Smith has not prevailed on his breach of warranty claim against M & M Technologies. Neither M & M Technologies nor Martin have [sic] breached any express or implied warranty provided to Smith in any contract.

Remedies

5.03 The liquidated damages provision of the License Agreement allows M & M Technologies to retain the additional $250,000 of the payments made by Smith.

Conclusions of Law

3. Smith failed to prove any claim advanced against M & M Technologies. . . .

6. Under the License Agreement $250,000 paid by Smith was nonrefundable and M & M Technologies is entitled to keep $250,000 paid by Smith pursuant to Section 13.1.

8. Under the contract, M & M Technologies is entitled to keep the $100,000 paid for the Option Agreement.

11. Under the liquidated damages clause of the License Agreement, M & M Technologies is entitled to an additional $250,000 of liquidated damages. M & M Technologies is entitled to keep the additional $250,000 paid by Smith in satisfaction of its liquidated damages claim.