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SUPREME COURT  
OF THE STATE OF WASHINGTON

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In re the Marriage of:

TERESA FARMER,

Respondent,

v.

DANIEL J. FARMER,

Petitioner.

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SUPPLEMENTAL BRIEF OF PETITIONER

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EDWARDS, SIEH, SMITH  
& GOODFRIEND, P.S.

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## I. ISSUE ON REVIEW

This Court has framed the issue on review as: “Whether, in an action for damages for breach of a marital property settlement agreement relating to stock options, the trial court properly measured the damages for the wrongfully exercised options as the projected value the options would have had on their expiration dates?”<sup>1</sup>

The answer to this question is “no.” Damages for the conversion of stock options must be assessed at the time of conversion or at some reasonable time after the option owner learns of the conversion, but under no circumstances based on a speculative value after the date of judgment. The trial court’s judgment here was instead based on improper speculation and conjecture both as to the projected stock price when the options expired and as to the parties’ ability and likelihood to delay exercise of the options until the day before each option expired, years after the judgment was entered.

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<sup>1</sup>[http://www.courts.wa.gov/appellate\\_trial\\_courts/supreme/issues/?fa=atc\\_supreme\\_issues.display&fileID=notyetset](http://www.courts.wa.gov/appellate_trial_courts/supreme/issues/?fa=atc_supreme_issues.display&fileID=notyetset)

## II. SUPPLEMENTAL ARGUMENT

### A. Damages For Conversion Of Stock Options Must Be Assessed At The Time Of Conversion Or At Some Reasonable Time After The Option Owner Learns Of The Conversion.

The value of a stock option is the difference between the “strike” price – the price at which the option can be exercised to purchase stock – and the market value of the stock when the option is exercised. See *Marriage of Shui and Rose*, 132 Wn. App. 568, 582, ¶ 22, 125 P.3d 180 (2005), *rev. denied*, 158 Wn.2d 1017 (2006). The value of a stock option is dependent upon the market value of the stock, as its value fluctuates along with the price of the stock. The proper measure of damages for conversion of property with fluctuating value, such as the stock options at issue in this case, is the higher of the value of the options at the time of exercise, as in *Marriage of Langham and Kolde*, 153 Wn.2d 553, 567-68, ¶ 31, 106 P.3d 212 (2005), or the value within a reasonable time after the option owner learns of the conversion. See *Brougham v. Swarva*, 34 Wn. App. 68, 77-78, 661 P.2d 138 (1983).

The courts below improperly awarded damages based not on the value of PACCAR stock options when Mr. Farmer exercised

them, or within a reasonable time after Mrs. Farmer learned of the exercise, but based on speculation about what the price of PACCAR stock might be at dates up to five years after judgment, and long after Mr. Farmer had offered to make Mrs. Farmer whole. While an owner whose property is converted should be protected, she is not entitled to a “windfall of complete umbrella protection by being awarded the highest possible valuation of the property from the time of its taking to the entry of judgment or its return.” **Brougham**, 34 Wn. App. at 78. This Court instead should adopt the New York rule to prevent such a windfall.

The New York rule provides that the measure of damages for conversion of property of fluctuating value is the highest price within a reasonable time after the property owner learns of conversion. **Brougham**, 34 Wn. App. at 77; see *Comment Note – Measure of Damages for Conversion of Corporate Stock or Certificates*, 31 A.L.R.3d 1286, § 5(d). The New York rule generally does not include the time before the party learns of the conversion, because “if he wanted to sell when the stock reached its peak before he learned of the conversion, he would have learned it.” 31 A.L.R.3d 1286, § 5(d). The New York rule is a compromise between the rule applied by this Court in **Langham**, 153 Wn.2d at

567-68, ¶ 31, assessing damages at the time of conversion when the asset has declined in value, and a rule that allows a court to assess damages at the highest value between the time of conversion and trial. 31 A.L.R.3d 1286, § 5(d). The New York rule recognizes that “[m]arket value at the time of conversion seems fair to the victim if the market value is lower when he learns of it, but in a rising market it does not seem adequate. On the other hand, giving him the highest value to the time of trial could be unduly harsh to the converter, who might be helpless to avoid liability for a stock’s growth over a period of years, while the ‘victim’ was getting a free ride on the market.” 31 A.L.R.3d 1286, § 5(d).

The United States Supreme Court held that limiting damages to a “reasonable time” after the plaintiff learns of the conversion was the “correct view of the law” over a century ago. **Gallagher v. Jones**, 129 U.S. 193, 202, 9 S.Ct. 335, 338, 32 L.Ed. 658 (1889). Since then, the New York rule continues to be viewed as “the fairest measure of damages to all involved by indemnifying the plaintiff, the rightful owner of the converted stock, for his loss without affording a windfall at the expense of the defendant.” **Ockey v. Lehmer**, 189 P.3d 51, 62, ¶ 46 (Utah 2008) (*citations omitted*); see also **Bayer v. Airlift Intern., Inc.**, 111 N.J.Super.

461, 470, 268 A.2d 548, 553 (1970); 31 A.L.R.3d 1286, § 2(a) (the New York Rule “appears to work substantial justice in most cases”).

Mrs. Farmer was of course entitled to at least what Mr. Farmer realized as a result of the conversion. *Langham*, 153 Wn.2d at 569, ¶ 33. In this case, however, an award of damages based on the value of the options when they were exercised might not have been equitable, because the price of PACCAR stock began to rise after Mr. Farmer exercised the options. (See CP 598) Thus, as this Court anticipated in *Langham*, an award of damages to Mrs. Farmer based on the date of conversion might not be adequate. 153 Wn.2d at 569, ¶ 33. However, an award of damages to Mrs. Farmer based on a rule that would allow a court to assess damages “at the highest value between the time of conversion and trial” would also not be equitable, both because Mrs. Farmer took no steps to exercise the options in the two months after the exercise (August 14, 2006) (CP 129, 141) before she learned of the conversion (October 24, 2006) (CP 157, 163), and because an additional 18 months passed between when Mr. Farmer admitted the conversion and the trial court entered its judgment (April 14, 2008) (CP 4).

Instead, a “reasonable time” to assess damages was shortly after October 24, 2006 (less than two weeks after the final papers were entered), when Mr. Farmer admitted he had exercised the options a few weeks earlier and proposed depositing nearly \$190,000 (\$20,000 more than he had obtained from exercise of the options) into his attorney’s trust account, in order to secure Mrs. Farmer’s rights in the property. (CP 161-62) Mr. Farmer proposed that these funds be used to allow Mrs. Farmer to “exercise” her options by directing Mr. Farmer to distribute the proceeds that Mrs. Farmer would have received had the options still existed on the day she chose to exercise her options. (CP 161-62) This would have given Mrs. Farmer the practical equivalent of “exercising” the stock options – all that she was entitled to under the parties’ agreement.

The courts below instead completely eliminated Mrs. Farmer’s risk as an owner of stock options, an asset of fluctuating value that “neither extinguishe[s] all risk, nor guarantee[s] a profit.” *Scully v. U.S. WATS, Inc.*, 238 F.3d 497, 512-13 (3<sup>rd</sup> Cir. 2001). The judgment affirmed by Division One gave Mrs. Farmer a “windfall of complete umbrella protection by being awarded” not just “the highest possible valuation of the property from the time of its taking to the entry of judgment or its return,” *Brougham*, 34

Wn. App. at 78, but a wholly speculative “valuation” based on speculation what PACCAR stock might be worth years in the future. See Arg. § B, *infra*. This Court should hold that the courts below erred because damages for the conversion of stock options must be assessed at the higher of the time of conversion or at some reasonable time after the option owner learns of the conversion. Any other rule unjustly penalizes a defendant who promptly admits the conversion and offers to make the plaintiff whole, and gives the option owner an unjustified windfall and “complete umbrella protection” from the vagaries of a fluctuating market that would be inconsistent with this state’s compensatory damages scheme.

**B. Under No Circumstances Can Damages For Conversion Of Stock Options Be Assessed Based On Speculation As To The Value of Stock After The Entry Of Judgment.**

The date of judgment is the “absolute end-point” of the “reasonable time” at which the trial court can assess damages for conversion of an asset of fluctuating value such as the options at issue in this case. See *Roxas v. Marcos*, 89 Hawai’i 91, 969 P.2d 1209, 1270 (1998). The Hawaii Supreme Court in *Roxas* rejected any measure of damages that would allow the court to assess damages beyond the date of trial:

To adopt the highest value between the time of actual conversion and the trial would be to encourage the owner to delay and speculate upon the chances of higher markets, without assuming the chances of lower markets. However readily ascertainable the relevant time period might be pursuant to this rule, we deem the rule's unfairness to outweigh its predictability.

**Roxas**, 969 P.2d at 1269. The **Roxas** Court held that “the date of close of the evidence at trial would, as a matter of law, be the absolute end-point beyond which the ‘reasonable time’ cannot extend, inasmuch as the market values . . . beyond that date would be unknowable to the trier of fact.” 969 P.2d at 1270; *see also* 18 Am. Jur. 2d Conversion § 120 (“In determining what constitutes a ‘reasonable time,’ the outside boundary is the latest date upon which a reasonable investor with adequate funds would have reentered the market by purchasing a replacement, and the date of the close of evidence at trial is an absolute endpoint beyond which a ‘reasonable time’ cannot extend”).

The “absolute end-point” must be the date of judgment because “damages must not rest upon speculation or conjecture.” **Jemo v. Tourist Hotel Co.**, 55 Wash. 595, 604, 104 P. 820 (1909); *see also Gilmartin v. Stevens Inv. Co.*, 43 Wn.2d 289, 302, 261 P.2d 73, 266 P.2d 800 (1953) (“Damages must be proved with all

the certainty the case permits and cannot be left to conjecture, guess, or speculation”) (quoting 25 C.J.S., *Damages*, § 162(2), page 816); **Rorvig v. Douglas**, 123 Wn.2d 854, 861, 873 P.2d 492 (1994) (evidence of damages should “not subject the trier of fact to mere speculation or conjecture”). In this case, for example, the trial court found that *had* Mrs. Farmer been in a position to exercise the stock options on the day before each grant expired, she would have been able to realize \$617,553.00 on future exercises occurring the day each grant expired – April 26, 2009 through January 13, 2013 – based on speculation that the stock price would increase at 20.235% per annum.<sup>2</sup> (FF XX, CP 11) But there was no credible

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<sup>2</sup> The trial court relied on a two-page declaration by wife’s expert, CPA Ronald Nelson, who asserted that “[w]e have computed that over the last 10 years (March 6, 1997 to March 6, 2007) PACCAR had a rate of return of 20.235% per annum.” (CP 137; FF XXIII, CP 12) Based on speculation that this rate of return would continue through 2013, Nelson calculated the net proceeds for each exercise based on the “predicted” stock price on the day before each option expired if this claimed rate of return continued. (CP 137, 142) Adjusting for the 3:2 stock split that occurred after Nelson issued his March 2007 report, Nelson predicted the stock prices as: April 27, 2009 (\$68.14); January 25, 2010 (\$78.17); January 24, 2011 (\$93.95); January 23, 2012 (\$112.90); January 15, 2013 (\$135.23). (See CP 142)

The actual price of PACCAR stock on April 27, 2009 was \$34.16 (not \$68.14). (<http://www.google.com/finance/historical?cid=423184&startdate=4%2F27%2F2009&enddate=4%2F27%2F2009>) The actual price on January 25, 2010 was \$36.11 (not \$78.17). (<http://www.google.com/finance/historical?cid=423184&startdate=1%2F25%2F2010&enddate=1%2F25%2F2010>) Division One wrongly refused to consider the market price of PACCAR stock, which is publicly traded on

evidence in the record to justify the assumption that PACCAR stock would increase at a rate of 20.235% per annum over the next six years.

While expert testimony may be a sufficient basis for an award of damages, "their opinions must be based upon tangible evidence rather than upon speculation and hypothetical situations." **Larsen v. Walton Plywood Co.**, 65 Wn.2d 1, 19, 390 P.2d 677, 396 P.2d 879 (1964); **Anton v. Chicago, M. & St. P. Ry. Co.**, 92 Wash. 305, 308, 159 P. 115 (1916) ("The law demands that verdicts rest upon testimony, and not conjecture."); see also **ESCA Corp. v. KPMG Peat Marwick**, 86 Wn. App. 628, 639, 939 P.2d 1228 (1997) ("[P]roof of damages must be established—by a

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*Footnote continued from previous page:*

NASDAQ, describing it as "new evidence." **Farmer**, 152 Wn. App. 1054, \*9, fn. 8. But this information is not "evidence," but a readily ascertainable fact of indisputable accuracy. See **State ex rel. Humiston v. Meyers**, 61 Wn.2d 772, 779, 380 P.2d 735 (1963) ("Judicial notice . . . is composed of facts capable of immediate and accurate demonstration by resort to easily accessible sources of indisputable accuracy and verifiable certainty."); **La Grasta v. First Union Securities, Inc.**, 358 F.3d 840, 842 (11<sup>th</sup> Cir. 2004) ("[stock] prices are not subject to reasonable dispute, and are a proper subject for judicial notice"). That stock price predictions are inaccurate *is* the reason for the legal rule that damages for conversion of an asset of unpredictably fluctuating value cannot be assessed as of a date after judgment. The Court of Appeals erred in refusing to consider this information. **O'Toole v. Northrop Grumman Corp.**, 499 F.3d 1218, 1224 (10<sup>th</sup> Cir. 2007) (district court abused its discretion in failing to take judicial notice of historical retirement fund earnings found on defendant's website, the reliability of which was not in dispute).

reasonable basis and must not subject trier of fact to mere speculation or conjecture”), *aff’d*, 135 Wn.2d 820, 959 P.2d 651 (1998). Here, the trial court awarded damages based solely on a declaration by the wife’s accountant witness speculating what the stock price *might* be over the next six years, based on its performance between 1997 and 2007 during the largest run-up in stock prices in U.S. history.<sup>3</sup>

Further, the trial court also improperly speculated how the *parties* might behave in the future, contrary to the rule that the court cannot “indulge in speculation or uncertainties, [and] could award damages only for such matters as were reasonably certain to happen as disclosed by the evidence.” *Orme v. Watkins*, 44 Wn.2d 325, 334, 267 P.2d 681 (1954). Here, even if there was evidence to support the trial court’s assumption that PACCAR stock would continue to rise at a rate of 20.235% per annum for the next six years, there was no evidence to support an assumption that Mr.

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<sup>3</sup> The stock market reached record highs between 1996 and 2000. While the stock market dipped in 2000, the market began to steadily rise again in 2003, and once again reached record highs in 2006 and 2007. In the four years from April 2003-2007 – the end of the period selected by CPA Nelson to “predict” the value of PACCAR stock in 2013 – the Dow Jones Industrials Average had a return of over 75%. See <http://genxfinance.com/2007/11/26/a-visual-history-of-the-stock-market-from-1996-2007/>.

Farmer would remain employed at PACCAR for the next six years – a condition for exercise of the options – or that Mrs. Farmer would have waited until the date each option expired in order to exercise her options.

Mr. Farmer was an at-will employee of PACCAR who could be terminated at any time, with or without cause. He would lose the right to exercise stock options no more than 90 days after he left PACCAR if he resigned or was terminated without cause. (CP 312) In fact, Mr. Farmer was no longer employed by PACCAR as of July 2008, requiring the parties to exercise their stock options no later than October 2008. (See 4/15/2009 Appellant's Financial Declaration, CP 312) During that three-month period, the price of PACCAR ranged from \$68.925 (on July 22, 2008), to \$53.58 (on October 1, 2008).<sup>4</sup> Yet the trial court's damage award was based on projected stock prices of \$102.21 (in 2009) to \$202.85 (in 2013). (CP 142)

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<sup>4</sup> These prices reflect the pre-adjusted 3:2 stock split on October 10, 2007. (<http://www.google.com/finance?client=ob&q=NASDAQ:PCAR>) This is how the stock price was calculated by CPA Nelson and in the briefs below.

Even if Mr. Farmer had remained a PACCAR employee, there was no evidence to support the assumption that Mrs. Farmer would have waited to exercise her options until the day before each grant expired. A party is entitled to the highest value reached by the converted property only "if he can prove that he probably would have made a sale while the subject matter was at its highest point in value". *Restatement of Restitution: Quasi Contracts and Constructive Trusts* § 151, comment c (1937). Here, there was no evidence that the parties historically exercised their stock options on the day before each grant expired. Instead, the only evidence was Mrs. Farmer's declaration that: "had affiant been in a position to exercise the stock options, for instance, on the day before each group of stock options expired, affiant would have been able to realize approximately \$617,553." (CP 146) Mrs. Farmer neither asserted that she would have waited to exercise the options, nor that she intended to. Yet she received a money judgment, with

statutory interest, for the speculative value of stock she would not have owned until years in the future.<sup>5</sup>

The Third Circuit rejected an argument similar to Mrs. Farmer's that the court should have calculated damages at the end of a restricted holding period when plaintiff claimed he would have sold his stock in *Scully v. U.S. WATS, Inc.*, 238 F.3d at 512-13. The *Scully* court did not "accept . . . plaintiff's after-the-fact assertion that he would have sold stock at a time that, in hindsight, would have been particularly advantageous" as "unduly speculative," because a "stock option neither extinguishe[s] all risk, nor guarantee[s] a profit." 238 F.3d at 512-13. The Third Circuit held that *only* when "adequate evidence confirmed a plaintiff's professed intent concerning the exercise of security interests" could the plaintiff choose the date to assess damages. *Scully*, 238 F.3d

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<sup>5</sup> It also was error for the trial court to apply a discount rate of 6% when it found that PACCAR stock would have increased at an annual rate of 20.235%. (FF XXIII, CP 12) Present cash value is the "sum of money needed now which, if invested at a reasonable rate of return, would equal the amount of loss at the time in the future when the benefits would have been received." 6 *Washington Practice: Washington Pattern Jury Instructions*, WPI 34.02 at 366 (2005). If PACCAR stock would have provided an annual rate of return of 20.235%, the trial court should have discounted the lost benefit by the same rate of return, as under the court's theory Mrs. Farmer could have immediately purchased PACCAR stock with the judgment and enjoyed that rate of return. By discounting the future lost benefit by only 6%, the trial court once again gave Mrs. Farmer an unjustified windfall.

at 513, fn. 3; see also *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1305 (2<sup>nd</sup> Cir. 1973) (whether plaintiffs would have sold their stocks at its highest value is “too untenable and speculative to support an award of damages”).

Division One attempted to distinguish *Scully* and *Gerstle* on the grounds that “Nelson’s calculations are based on the expiration dates expressly agreed to in the 2A Agreement and set forth in the decree and historical market data.” *Farmer*, 152 Wn. App. 1054, \*10 (2009). But the parties did not “agree” that Mrs. Farmer would exercise her stock options on the day before the stock options expired. Instead, the agreement refers to the expiration dates only to identify the options that were awarded to her. (See CP 181) The parties neither agreed nor was there any evidence that the options could or would be exercised when PACCAR was at its highest value.

The trial court’s judgment here was based both on unwarranted speculation as to the performance of the optioned stock in an unpredictably fluctuating market, and on conjecture as to the parties’ conduct far in the future that was unjustified by their past actions. This Court should confirm that, just as in any calculation of damages for claimed “lost profits,” an award of

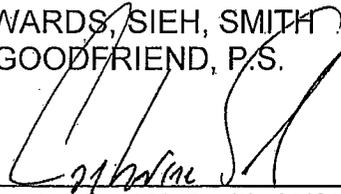
damages for wrongful exercise of stock options cannot be based on speculation and conjecture, but must be based upon the value of the asset at the time of conversion or at some reasonable time after the option owner learns of the conversion, and can in no event be based on speculation what the converted asset might be worth years after the entry of judgment.

### III. CONCLUSION

This Court should reverse the Court of Appeals and hold that in assessing damages for conversion of assets with fluctuating values, the measure of damages should be the higher of the value of the asset at conversion or at some reasonable time after the victim discovers the conversion, but under no circumstances based on a projection of what the asset might be worth years after the date of judgment.

Dated this 7<sup>th</sup> day of October, 2010.

EDWARDS, SIEH, SMITH  
& GOODFRIEND, P.S.

By: 

Catherine W. Smith, WSBA No. 9542

Valerie A. Villacin, WSBA No. 34515

Attorneys for Petitioner

**DECLARATION OF SERVICE**

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on October 7, 2010, I arranged for service of the foregoing Supplemental Brief of Petitioner, to the court and to the parties to this action as follows:

Office of Clerk Washington Supreme Court Temple of Justice P.O. Box 40929 Olympia, WA 98504-0929	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input type="checkbox"/> U.S. Mail <input checked="" type="checkbox"/> E-Mail
Douglas Saar Law Office of Skinner & Saar PS 740 SE Pioneer Way Oak Harbor, WA 98277	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> E-Mail
Gregory M. Miller Carney Badley Spellman, P.S. 701 Fifth Avenue. Suite 3600 Seattle, WA 98104-7010	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> E-Mail
Ken Manni Cohen, Manni & Theune P.O. Box 889 Oak Harbor, WA 98277	<input type="checkbox"/> Facsimile <input type="checkbox"/> Messenger <input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> E-Mail

**DATED** at Seattle, Washington this 7<sup>th</sup> day of October, 2010.

  
\_\_\_\_\_  
Tara D. Friesen

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DECLARATION OF SERVICE

BY RONALD R. CARPENTER The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:  
CLERK

That on October 7, 2010, I arranged for service of the foregoing letter, to the Court and to the parties to this action as follows:

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DATED at Seattle, Washington this 7<sup>th</sup> day of October, 2010.

  
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Attached for filing in .pdf format is the Supplemental Brief of Petitioner, in *Marriage of Farmer*, Cause No. 83960-3. The attorney filing this document is Catherine W. Smith, WSBA No. 9542, e-mail address: [cate@washingtonappeals.com](mailto:cate@washingtonappeals.com).

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