

**UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO**

Civil Action No. 1:11-cv-00198-MSK-MEH

SUN RIVER ENERGY, INC.,

Plaintiff

v.

ERIK S. NELSON;
STEVE STEPHENS; and
CORAL CAPITAL PARTNERS, INC.,

Defendants

DEFENDANTS' TRIAL BRIEF

Defendants Erik S. Nelson, Steve Stephens, and Coral Capital Partners, Inc., through counsel, M. Gabriel McFarland and Cyd Hunt of Evans & McFarland, LLC, respectfully submit this Trial Brief:

Only two claims remain for trial, Defendants' counterclaim against Sun River for violating C.R.S. § 4-8-401 by refusing to remove the restrictive legends from Defendants' Sun River stock certificates, and their related request for declaratory judgment.

VIOLATION OF C.R.S. § 4-8-401

When a shareholder is issued a stock certificate displaying a restrictive legend, he must request the issuance of a replacement certificate with the legend removed before he can trade the stock. *See American Securities Transfer, Incorp. v. Pantheon Indus., Inc.* 871 F. Supp. 400, 405 (D. Colo. 1994) ("The provisions of [§ 401] apply to

the request to reissue the certificate here [without the restrictive legend] as this is a predicate for transfer of the certificate.” The statutory obligations on the issuing entity are the same, whether the request is to register a stock transfer or to remove a restrictive legend. *See id.* at 405; *Clancy Systems Intern., Inc. v. Salazar*, 177 P.3d 1235, 1238-39 (Colo. 2008) (“The remedy provided by the code for loss resulting from a wrongful restriction on a person's ability to alienate a security is therefore the same, whether the loss is caused by the issuer's unreasonable failure to officially acknowledge a transferee's unrestricted ownership by book entry alone [a transfer], or also by refusing to issue a new, unrestricted certificate in his name.”); *Fink v. Atlas Stock Transfer Corp.*, No. B215103, 2010 WL 4887179, *6 (Cal. App. 2 Dist. Dec. 2, 2010) (n.s.o.p.) (“[A] request to issue a new certificate is equivalent to a request to register a transfer of the underlying stock. . . .where the stock is restricted, the issuance of a new, clean certificate to the transferor [owner] is normally the essential first step.”).

“Section 401 both enumerates the circumstances in which an issuer is duty-bound to register a transfer and specifically imposes liability on the issuer for violating that duty.” *Clancy Systems*, 177 P.3d at 1237-38. In the instance of an improper restrictive legend, the statute imposes liability on the issuer “for merely acting unreasonably.” *Id.* at 1239.

A. Elements of the claim

“An issuer is under a duty to register a transfer of a security if the seven elements of section (a) are met.” *Ajjarapu v. AE Biofuels, Inc.*, 728 F. Supp. 2d 1154, 1165 (D. Colo. 2010). The elements of a claim for violation of C.R.S. § 4-8-101(a) are:

1. “Under the terms of the security the person seeking registration is eligible to have the security registered in its name.”

If the company that issued the securities is a “reporting company” in that it is subject to the reporting requirements of the Securities Exchange Act of 1934, the holder of a restricted certificate is eligible to have the security registered in his or her name—*i.e.*, to have the shares reissued without the restrictive legend—after the passage of six months from issuance of the restricted certificate. *See* 17 C.F.R. 230.144(b)(1)(i); *Stuckey v. Online Resources Corp.*, 909 F. Supp. 2d 912, 944 (S.D. Ohio 2012) (expiration of Rule 144 holding period renders owner eligible to request removal of restrictive legend); *accord, Sherwood Brands, Inc. v. Levie*, No. RDB 03–1544, 2006 WL 827371, *19 (D. Md. March 24, 2006).

2. “The indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person.”

“‘Indorsement’ means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring, or redeeming the security. . .” C.R.S. § 4-8-102(a)(11). The “appropriate person” is the person specified by the security certificate. C.R.S. § 4-8-107(a)(1).

3. “Reasonable assurance is given that the indorsement or instruction is genuine and authorized.”

The issuer of the subject security “may require” assurances that the indorsement is genuine and authorized. C.R.S. § 4-8-402(a). Because an issuer is liable for wrongful registration of a transfer if an indorsement is improper, the issuer is allowed, but not required, to request reasonable assurances of genuineness and authority. C.R.S.

§ 4-8-402, Uniform Commercial Code Comment 1. “Genuine” means free of forgery or counterfeiting. C.R.S. § 4-1-201(a)(18). “Authorization” refers to the indorsing party’s status as an appropriate person. *See, e.g., Wilbert, Inc. v. Robb*, No. 83 C 6428, 1986 WL 2092, *2 (N.D. Ill. Jan. 30, 1986) (order appointing executrix of security owner’s estate was appropriate assurance that she was authorized indorser). Upon presentment of indorsements under reasonable assurances, the issuer must register the transfer. *Id.* at *2 (issuer “has not stated that adverse claims have been asserted as to the ownership of this stock, nor has it given any reason why [requesting party’s] evidence should not be accepted.”).

Under C.R.S. § 4-8-114(1), “Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted.”

4. “Any applicable law relating to the collection of taxes has been complied with.”

The requesting stockholder must be in compliance with relevant tax law.

5. “The transfer does not violate any restriction on transfer imposed by the issuer in accordance with section 4-8-204.”

C.R.S. § 4-8-204 provides that, to be effective, a restriction on a certificated security must be conspicuously noted on the certificate. An issuer cannot rely on an “unnoted restriction” in refusing to register a transfer. *See Edina State Bank v. Mr. Steak, Inc.*, 487 F.2d 640, 644 (10th Cir. 1973) (finding issuer liable for refusal to register transfer based on asserted restriction that did not appear on certificate, court noted duty is on issuer to display restriction, not on owner to inquire).

A typical restriction states that the securities represented by the certificate have not been registered under the Securities Act of 1933 and may not be sold or otherwise

disposed of unless they are so registered, or an opinion of counsel is obtained that the proposed disposition is in compliance with a recognized exemption from registration. *E.g., Hefter & Carroll v. Abraham*, No. 07C4137, 2007 WL 3334349, *1 (N.D. Ill. Nov. 8, 2007). This opinion of counsel is known as a “Rule 144 letter.” *E.g., Rice v. Liberty Surplus Ins. Corp.*, 113 Fed. Appx. 116, 120 (6th Cir. 2004) (“Generally speaking, under SEC Rule 144, restricted stock may not be sold unless the issuing corporation files a letter with the SEC certifying that the shares have been held for more than [the required period] and that the number of shares to be sold does not exceed one percent of the total shares outstanding.”).

6. “A demand that the issuer not register transfer has not become effective under section 4-8-403, or the issuer has complied with section 4-8-403(b) but no legal process or indemnity bond is obtained as provided in section 4-8-403(d).”

C.R.S. § 4-8-403 provides that “an appropriate person to make an indorsement or originate an instruction” may notify the issuer of a demand that a transfer not be registered. An “appropriate person” is the person specified by the security certificate. C.R.S. § 4-8-107(a)(1). If such a demand is made, the issuer must promptly communicate any request to register a transfer of the security to the demanding party, and notify both the demanding party and the party requesting registration that the registration will be withheld for a period of time not to exceed thirty days in order for the demanding party to obtain legal process or post a bond to stay the transfer. The purpose of this section of the statute is “to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates.” *Id.*, Uniform Commercial Code Comment 2. Thus, the owner who has lost his certificate notifies the issuer of the missing security, and the issuer must contact the owner if the original

certificate is later presented for registration. *Id.*

In contrast, in the case of a demand by anyone who is not the registered owner of the stock but claims an interest in it, “if there has been an effective indorsement¹ or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process merely by sending notice of the assertion to the issuer. Rather, the adverse claimant must obtain legal process” pursuant to C.R.S. § 4-8-404, *i.e.*, by obtaining an injunction or restraining order against the issuer. *Id.*, Uniform Commercial Code Comment 1. “[T]he present version of section 8-404 ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.” C.R.S. § 4-8-404, Uniform Commercial Code Comment 3.

In the instance of adverse claims to the stocks, the role of the issuer “is one of neutrality between the claimants.” *Bender v. Memory Metals, Inc.*, 514 A.2d 1109, 1117 (Del. Ch. 1986). “Such a neutral position is consistent with the fiduciary position that the corporation occupies with respect to the presenting shareholder.” *Id.*

7. “The transfer is rightful or is to a protected purchaser.”

A transfer is not rightful if it violates the 1933 Securities Act; thus, the transfer agent may require a showing that the transfer does not violate the Act, such as a legal opinion letter to that effect, *i.e.*, a Rule 144 letter. *See Fink*, 2010 WL 4887179 at *6; *see also Charter Oak Bank & Trust Co. v. Registrar & Transfer Co.*, 358 A.2d 505, 509 (N.J. Super. 1976) (“Where reasonable grounds exist to believe a proposed transfer

¹ An indorsement is “effective” if it is made by the appropriate person. C.R.S. § 4-8-107(b)(1).

might be a ‘wrongful’ transfer under the Securities Act, a transfer agent is justified in refusing to make the requested transfer and requesting further information to show that the transfer can be made in accordance with federal law.”). Concomitantly, a rightful transfer is one that complies with, or is exempt from, the requirements of Rule 144.

Bender, 514 A.2d at 1116.

B. C.R.S. § 4-8-401(b): “If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security² or an instruction for registration or to the person’s principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer.”

The securities issuer is liable for any loss resulting from its refusal or failure to register a requested transfer or for any unreasonable delay in doing so. *Ajjarapu*, 728 F. Supp. 2d at 1164; *Clancy*, 177 P.3d at 1238. When a transaction is rightful, the issuer’s refusal to remove a restrictive legend may be unreasonable as a matter of law. *See Bender*, 514 A.2d at 1116. An issuer who “without reasonable justification” refuses to register a transfer does so “at its own peril.” *Loretto Literary & Benevolent Inst. v. Blue Diamond Coal Co.*, 444 A.2d 256, 261 (Del. Ch. 1982) (“[A] refusal to register a transfer must be based on a legitimate ground supported by some credible evidence.”).

“A proper reading of the statute [8-401] is that the right to compel registration and the right to recover damages from the delay or refusal to register are cumulative remedies.” *Burtman v. Technical Chemicals and Products, Inc.*, 724 So.2d 672, 675-76 (Fla. App. 1999) (8-401 specifies both that the issuer “shall register” a transfer upon proper presentation *and* that the issuer is liable for loss resulting from refusal to do so).

²“Certificated security’ means a security that is represented by a certificate.” C.R.S. § 4-8-102(a)(4).

The stockholder may be awarded both specific performance and damages for diminution of the fair market value of the stock between the date of the refusal to register and the date judgment enters. *See, e.g., Fenoglio v. Augat, Inc.*, No. Civ.A. 97-10012-PBS, 2000 WL 294882, *1 (D. Mass. March 16, 2000) (awarding specific performance and damages for refusing request to exercise stock options); *Steranko v. Inforex, Inc.*, 362 N.E. 2d 222, 232 (Mass. App. 1977) (stockholder entitled to specific performance of removal of restrictive legends and damages for diminution of value in stock) (applying New York law).

C. Conclusion

The unreasonable refusal to remove restrictive legends from stock certificates subjects the stock issuer to equitable and legal liability. The issuer may be ordered to remove the legends, and the stockholder may be awarded the diminution in the value of his stock during the period of the wrongful refusal.

DATED this 16th day of October, 2013.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on October 16, 2013, I electronically filed the foregoing **DEFENDANTS' TRIAL BRIEF** with the Clerk of Court using the CM/ECF system, which will send notification of such filing to at least the following via e-mail:

James E. Pennington

s/Cyd Hunt

Cyd Hunt