Case No. C063005
Nevada County Case No. 73278

IN THE COURT OF APPEAL OF CALIFORNIA
THIRD APPELLATE DISTRICT

Kaput, et al

Plaintiffs and Appellants

v.

Watson, et al

Defendants and Respondents.

Appeal from the Superior Court for Nevada County
Thomas M. Anderson, Judge

APPELLANTS' OPENING BRIEF

Patrick H. Dwyer,
Specially Appearing *Pro Bono Publico* for Appellants
State Bar Number 137743
P.O. Box 1705
Penn Valley, CA 95946
530-432-5407

January 11, 2010

Table of Contents

Table of Authorities

Statutes

Rules of Court

Secondary Authorities

I. Introduction

This appeal is from the Judgement of Dismissal of the Fourteenth through Eighteenth Causes of Action against the Respondents after an order sustaining a demurrer without leave to amend dated August 24, 2009, in Department 6 of the Superior Court for the State of California, County of Nevada, and which judgement was entered on September 2, 2009.

The grounds for appeal are that the rulings by the trial court sustaining the demurrers of the Respondents to the Fourteenth through Eighteenth Causes of Action without leave to amend are clearly erroneous as a matter of law. The demurrers to each of these causes of action and the trial court's ruling thereon is review in Sections V through IX, below.

This case arises from the ashes of the mortgage fraud debacle that brought the country to its economic knees. As discussed below, the Appellants started out in February 2006 owning their own home in Downieville California with 100% equity. One day they went in search of a loan to purchase a new automobile, and within a short time, they ended up owning two properties encumbered with loans totaling $910,000, along with a half finished house. How this happened is an incredible tale of breach of duty, fraud, and conspiracy.

The Respondents were on the other end of this incredible scheme of embezzlement, fraud, and conspiracy. They were "investors" in fractionalized construction loans sold by Thomas Hastert, the lead defendant in this action. Just like the Appellants, the Respondents were, in all probability, lied to, manipulated, and defrauded by Hastert. And just like the Appellants, they were average people who trusted what Hastert told them and failed to have their investments verified by a reputable professional.

Indeed, in a period of just over three years, Hastert was able to create a financial

nightmare involving over 123 loans and millions of lost dollars. See the Second Amended Felony Complaint against Thomas Hastert. A copy of the Second Amended Complaint is being judicially noticed with the filing of this brief. The Appellants' two loans with Hastert were both charged as part of this complaint, see Counts 1, 54, 55, and 80. Thomas Hastert pleaded guilty to Counts 1, 54, and 55 on August 7, 2009, and is now awaiting sentencing.

As a result of the Hastert scheme, borrowers like the Appellants received loans that were never fully funded and the Respondents received fraudulent fractionalized beneficial interests in various properties. Hastert co-mingled the funds of the investors and moved monies from one borrower trust account to another such that, to date, there has been no way to trace the monies paid by any of the investors, including the Respondents, to any of the specific loan accounts for the borrowers, including the Appellants.[1]

As a consequence, the Appellants had to name the Respondents as defendants in this action to obtain an accounting of the monies that were "invested with" and then "loaned by" Hastert and then seek to clear the title to their property through either a quiet title action and/or action for cancellation of the fraudulent instruments clouding their title. Otherwise, the Appellants face foreclosure on their Downieville property and home that they originally held with 100% equity, and also their Nevada City Property.

---

[1] It is important to note here that all of the documents needed to try and trace the funds of the Respondents into the various trust accounts manipulated by Hastert are under the custody of the Attorney General's office and have never been available for discovery in this action. These documents, including Hastert's main computer and software, are the only materials that can be used to verify the Respondents' investments and where those investments were placed.

II. Statement of the Case

A. Relevant Procedural History

The Appellants filed two actions to obtain redress for the wrongs that they had endured as result of the multiple frauds against them. The first action was filed in Sierra County on January 15, 2008, and its allegations focused on the frauds concerning the Appellants' property in Downieville California in Sierra County (hereafter the Sierra County Action"). The second action was also filed by the Appellants in Nevada County on January 15, 2008, and its allegations focused on the frauds concerning the Appellants' property in Nevada City, California in Nevada County (hereafter the "Nevada County Action"). Although there was substantial overlap between the two actions, especially involving the alleged fraudulent actions of defendants Thomas Hastert, Philip Ruble, Mimi Simmons, Olympic Mortgage and Investment Co., Inc., Pete McKnight, Nancy Selecman, and Debra Newby, the two actions differed in: (a) the real property that was at the heart of the respective actions; and (b) in the defendant lenders that had claims to the Downieville Property and the Nevada City Property.

After all of the demurrers and amendments to the respective actions in both counties were concluded, it became clear that the consolidation of the two actions for all purposes, including trial, would make the best use of everyone's time and resources. Accordingly, upon motion of the Respondents and Appellants, the two cases were consolidated by order of the Nevada County Superior Court on December 1, 2009.[2]

The Second Amended Complaint in Nevada County Superior Court (hereafter "trial court") was filed by Appellants on January 28, 2009. CT 135-266. The Respondents filed a

---

[2] This document has been judicially noticed along with the filing of this brief.

demurrer to the Fourteenth through Eighteenth Causes of Action on March 4, 2009. CT267-297. The Appellants filed their Opposition to the Demurrer on March 20, 2009. CT 346-364. The respondents filed their Reply to the Opposition to the Demurrer on March 26, 2009. CT 365-374. The trial court ruled on the Respondents' demurrer on April 10, 2009, dismissing all of the causes of action against the Respondents/Defendant Lenders. CT 384-387.

Meanwhile, the Sierra County trial court issued a ruling on May 20, 2009, overruling the demurrers filed by the defendant lenders in that action against identical causes of action, except that it pertained to defendant lenders for the Downieville Property, not the Nevada City Property. CT 403-405.

The Appellants file a Motion to Reconsider the Nevada County trial court's ruling sustaining the Respondents' demurrer to the Fourteenth through Eighteenth Cause of Action on June 5, 2009. CT 407-468. The Respondents filed an opposition to the Motion to reconsider on June 26, 2009. CT 469-476. The motion was heard on July 10, 2009, and the trial court issued a ruling the same day denying the Motion to Reconsider. CT 517-521.

The Judgment dismissing the Respondents was entered on August 24, 2009, CT 532. The Appellants filed their Notice to Appeal on September 21, 2009 (Melissa Kaput) and September 25, 2009 (Donald Kaput). CT 540-548.

B. **Relevant Factual History**

In February 2000, Melissa and Donald Kaput and their six children relocated from Woodinville, Washington to Downieville, California. Prior to the events described below, the Kaputs owned their home at 11 Lavezzola Road, Downieville, Sierra County, California (the "Downieville Property"), free of any mortgages, liens or encumbrances.

The Fraudulent Automobile Loan

On or about February 1, 2006, the Kaputs needed to replace their motor vehicle. They went to several car dealerships, but were turned down for poor credit and lack of employment. Finally, an automobile dealership called Weaver Auto in Grass Valley, Nevada County, California said they could arrange an auto loan for the purchase of a used 2001 Chevy Suburban for the price of approximately $26,000, but that financing would have to be arranged through their preferred lender, Olympic Mortgage and Investment Company, Inc. ("Olympic").

On the same or next day, the Kaputs met with a representative of Olympic who interviewed the Kaputs and had them fill out a credit application. The Kaputs explained to Olympic that Donald Kaput was disabled, that both Kaputs had been unemployed since 2000, that they had no income except for public assistance, and that they had poor credit. However, they did own their home free and clear.

When Olympic learned that the Kaputs had full equity in their home, Olympic recommended to the Kaputs that they should borrow against the equity in their home, not just for the $26,000 needed for the vehicle from Weaver Auto, but to purchase real property for speculation. Olympic told the Kaputs that they were losing money by allowing their equity to sit idle and that they needed to put their equity to work. Olympic specifically recommended that

the Kaputs use the equity in their home to buy land and build a spec house. The Kaputs said they were not interested in speculating on real estate and they were in no position to do so given their limited income. The Kaputs repeatedly told Olympic that all they wanted was a car loan. Nevertheless, Olympic continued to pressure them to borrow more against their home equity.

The Kaputs and Olympic had several meetings over the few days "negotiating" the loan for the vehicle at Weaver Auto. Finally, it was agreed that Olympic would make the car loan provided that the Kaputs at least "explore" the spec house idea. Olympic then brought in Mimi Simmons, who was introduced as a real estate broker with another company, Cornerstone Realty Group. Ms. Simmons, too, immediately pressured the Kaputs to consider the spec house idea. At no time did anyone at Olympic or Ms. Simmons ever disclose that she was married to Philip Ruble (the President of Olympic) and that together they owned both Olympic Mortgage and ERA Cornerstone Realty Group.

The Kaputs desperately needed a vehicle and did not think they could get a car loan anywhere else. So reluctantly, they agreed to let Ms. Simmons show them some properties. As soon as the Kaputs agreed to let Ms. Simmons show them properties, Olympic "approved" the car loan and telephoned Weaver Auto and stated that the Kaputs were "approved" to purchase the Suburban "on credit" from Olympic. The Kaputs then went and obtained from Weaver Auto the car they had selected. The Appellants did not sign any loan agreement concerning the Downieville Property with Olympic or Weaver Auto, nor did they pay Weaver Auto any money. The Appellants were told by Weaver Auto that Olympic had taken care of the financing.

The "Revokation" of the Auto Loan

The Kaputs kept their word and arranged for Ms. Simmons to show them properties. On or about February 5, 2006, Ms. Simmons showed them only one property, a vacant parcel at 20431 Banner Quaker Hill Road, Nevada City (the "Nevada City Property"). Following the showing, Ms. Simmons told the Kaputs that the property was a "golden opportunity" and urged them to buy it. The Kaputs said they would have to think it over. Ms. Simmons telephoned repeatedly over the next few days wanting to know if they had made a decision yet, but the Kaputs did not want the property, so they kept putting her off.

The Kaputs then received a telephone call from Olympic saying that the car loan had been revoked. This was approximately two weeks after they had been told the loan was "approved" and Weaver Auto gave them the car. The Kaputs clearly understood that Olympic had "revoked" the car loan because they had not purchased the property that Ms. Simmons wanted them to buy. The Kaputs tried to return the vehicle to Weaver Auto, but Weaver refused to take it back and demanded payment. The Kaputs went back to Olympic and asked what they were now supposed to do. Olympic suggested they go see Thomas Hastert at Loan Sense.

The Home Equity Loan Scheme

The Kaputs met with Thomas Hastert ("Hastert") on or about February 15, 2006. The Kaputs explained their dilemma and asked Hastert if he could get them a loan to pay for the vehicle. Hastert said he was already aware that they had 100% equity in their home and that they might be interested in purchasing land and building a spec house. It was clear from the face to face conversation that Hastert had been briefed by Olympic about their situation. The Kaputs told Hastert that they were not interested in purchasing the land or building a spec house, and that all they wanted was a car loan. Hastert told them he understood and that he would just get

them the car loan. He then had them sign numerous documents in blank, including a promissory note and a deed of trust, which he said he would fill in later, once he determined which loan was right for them.

A few days later, Hastert called the Kaputs in for a meeting. He told them he had arranged a loan against their home in the principal amount of $350,000 (the "Downieville Loan"). The Kaputs were shocked and asked why the loan was so much, since they only wanted to borrow $26,000 to purchase the used vehicle. Hastert said they did not qualify for a simple car loan and that they had to get a sizeable loan to make it worthwhile to the bank. Hastert told the Appellants, "now that you've got the loan, you're paying interest on the funds, so you better invest it." He urged them to reconsider Ms. Simmons' proposal of buying the Nevada City Property and building a spec house.

The Appellants explained that they had little experience or expertise in real estate or construction, but Hastert told them not to worry because he was a both a real estate attorney and a real estate/mortgage broker, and that he would advise and guide them every step of the way. The Appellants also expressed concern about the mortgage payments since they were unemployed and had limited income. However, Hastert assured them that the $350,000 loan against their Downieville Property was enough to pay for the Suburban, buy the land, and cover the mortgage payments until the spec house was completed and sold. Hastert explained that he would set up two bank accounts for the benefit of the Appellants, with himself as the trustee and sole signatory: (i) a "purchases account", which he would use to pay for the Suburban, the land, and all related fees, commissions, and costs, and (ii) a "payments/disbursement account" from which he would make all of their mortgage payments. Hastert said the $350,000 loan proceeds

had been deposited into those two accounts. The Appellants asked why he didn't simply turn over the loan proceeds to them, but Hastert said it was "safer" this way because he would make sure all of the mortgage payments, fees, etc. were timely paid.

Hastert further explained that as soon as they purchased the Nevada City Property, that Hastert would get them a construction loan for the spec house, using the equity in the Nevada City Property as collateral (the "Nevada City Loan"). Hastert said he would again set up two bank accounts for the benefit of the Kaputs to handle the loan proceeds, again with himself as the trustee and sole signatory, (i) a "construction account", which he would use to pay for all labor, materials, and expenses related to the construction, and (ii) a "payment / disbursement account", from which he would make all of their mortgage payments on that loan.

Hastert assured the Kaputs that having him manage both the Downieville Loan and the Nevada City Loan proceeds as "trustee" on their behalf would mean they would not have to worry about making any of the mortgage payments, construction costs, or anything else. In fact, the Appellants later discovered that the Downieville Loan was never fully funded.

The Purchase of the Nevada City Property

Relying upon the representations of Hastert and Simmons, the Kaputs purchased the Nevada City Property with Ms. Simmons acting as their real estate broker and Mr. Hastert acting as their attorney, mortgage broker, lender, and trustee.

The full purchase price of the Nevada City Property was allegedly paid from the Downieville Loan proceeds that Hastert held in trust for the Kaputs. Hastert also used Downieville Loan proceeds to pay Weaver Auto the $26,000 for the car, the loan origination fees charged by Hastert (three points on the total loan amount), the sales commission for Simmons,

and other fees and costs, none of which were disclosed to the Kaputs in advance of disbursement by Hastert.

About five months after the Kaputs purchased the Nevada City Property, Mr. Hastert arranged an additional loan, this time against the Nevada City Property, for the alleged purpose of constructing a "spec' house on the Nevada city Property. Once again, Hastert took his loan fee (three points) up front and without any disclosure to the Kaputs, paid other fees and costs related to this construction loan.

Hastert represented to Appellants that the Nevada City Loan in the amount of $560,000 had been deposited into the various bank trust accounts that he had set up for the benefit of the Appellants. In fact, the Appellants would later discover that the Nevada City Loan had never been fully funded.

Hastert promised to "guide" the Appellants every step of the way in the construction of the "spec" house. However, Hastert delayed the construction of the spec house by failing to timely issue draws to pay for labor, materials and expenses.[3] The Kaputs had to telephone Hastert repeatedly, go to his office, and literally beg for him, or when he was not there, his employees, Nancy Selecman and Pete McKnight, to issue payments. On several occasions, work stopped until Hastert issued payment. At one point, the Kaputs asked Hastert to

[3] As was later learned, Hastert not fully fund the Kaputs' loans up front as required by law and he sold fractionalized loan shares to investors which is a violation of California Corporations Code §25110 and §25401. It was by means of the purchase of such fractionalized loan shares that the Respondents acquired their assignments under the Deed of Trust for the Nevada City Property that are the subject of this Appeal. See the Second Amended Felony Complaint Against Thomas Hastert that has been judicially noticed. Hastert has pleaded guilty to 62 counts of embezzlement and securities fraud, including the counts for the Kaputs' loans, Counts 1, 54, and 55. Hastert is now awaiting sentencing.

simply turn the loan proceeds over to them so they could make sure construction costs were paid in a timely manner, but Mr. Hastert insisted that only he could handle the money.

In October 2006, Hastert informed the Appellants that the Downieville trust accounts had "run out of money". The Appellants were surprised since Hastert had assured them the Downieville Loan was enough to cover all the mortgage payments through completion of the construction. Hastert told the Appellants not to worry because the Nevada City Loan was enough to cover not only the cost of construction, but also the mortgage payments on both the Downieville Loan and Nevada City Loan.

In or about November 2006, the Appellants had reasonable concern that the loans would come due before the "spec" house was completed and sold. Hastert had previously told them that both loans carried a 12-month term and required a balloon payment for the entire principal and accrued interest. In response to their concerns, Hastert told them not to worry, that the loans were "extended". The Appellants asked for the extensions in writing, but Hastert said, "you don't need it in writing, I am the bank."

The Kaputs had to repeatedly demand that Hastert promptly pay draws for labor, materials and other expenses for the construction of the "spec" house. Then, in or about December 2006, Hastert admitted to the Appellants that he had not fully funded either the Downieville Loan or Nevada City loan when they were made, and that he needed to find "new investors" for the rest of the funding. Hastert assured the Appellants that he was actively looking for new investors and that he would catch up paying the construction costs as soon as new money came in.

The Appellants called Hastert on a daily basis, asking if he had funded the loans,

but he kept telling them, “No one wants to invest in real estate loans right now because of the market.” Soon, all of the bank accounts were entirely depleted and/or overdrawn, and several checks bounced. With no means of paying for labor, materials or other expenses for the “spec” house, the construction came to a halt.

Hastert, who had control over the Downieville and Nevada City loan accounts (he was trustee), also stopped making the mortgage payments on both the Downieville Loan and Nevada City Loan, and as a result, both loans went into “default”. Hastert thereafter recorded a “Notice of Default” against the Nevada City Property in the amount of $456,583.25 on or about August 2, 2007, and a “Notice of Default” against the Downieville Property in the amount of $363,512.65 on or about August 3, 2007.

When the Appellants learned that Mr. Hastert had diverted the loan proceeds and depleted / overdrawn all of the accounts, they reported their problems with Hastert to the Grass Valley Police and the District Attorney. This ultimately led to the arrest and conviction of Hastert. See footnote 2, *supra*.

Hastert Prevented an Accounting and Refused to Show Any Loan Records

The Appellants repeatedly asked Hastert for the files relating to their loans, for an accounting of these loans, and for an accounting of each of the borrowers’ trust accounts. The Appellants also asked him for the names of the “investors” on their loans. Hastert refused to provide any accounting for the trust accounts or give them any information or documents. CT 146-147.

For the Downieville Loan, Hastert filled in the original “blank” deed of trust signed, at Hastert’s insistence, by Appellants in favor of “strawman” Nancy Selecman (78.57%),

Brad Prowse (11.43%) and Ernal and Andrea Lee (10%). Neither Hastert, Selecman, or McKnight ever disclosed to, or obtained the consent of, the Appellants for the assignment of the deed of trust or any of the subsequent partial assignments of the deed of trust to Katrina Rose Odonahue-Wilson (1.43%), Thomas and Sharon Edwards (60%), and Mary and Dana Ettlin (17.14%).

To the best of Appellants' knowledge. None of these assignees paid money to Hastert for a specifically designated assignment of a particular interest in the Downieville Deed of Trust. Rather, if any funds were actually paid by the assignees to Hastert: (a) these payments were made as general investments with Hastert which Hastert used to partially fund many loans that he serviced to keep his Ponzi scheme afloat; and (b) Hastert did not assign or otherwise specifically designate any of the assignees' funds, but instead, used such funds generally to service any one of the many loans that he had created. To Appellants' knowledge, Hastert failed to keep sufficient records to allow any "investor" funds to be traced to a specific loan.

For the Nevada City Loan Hastert filled in the original "blank" deed of trust previously signed by Appellants (hereafter the "Deed of Trust") in favor of Nancy Selecman (85.71%), Janis Jablecki (8.93%) and Joseph and Susan Sliakis (5.36%). Ms. Selecman without the consent of, or disclosure to, the Appellants, and without consideration, subsequently made partial assignments of the Deed of Trust to Debra Newby (51.78%), Lori Sabo (8.93%), Wendy Watson (8.93%), Jeffrey Falla (9.82%), and Janet Benham (6.25%). Newby, in turn, made assignments without consideration of the Deed of Trust to Richard and Shannon Arena (17.857%) and Louis and Muriel Ferri (15.178%). Finally, Newby made two further assignments of the Deed of Trust to Hastert for 51.78% and 18.745%. The Appellants allege that

none of the "investor" assignees (who are the Respondents in this appeal) directly paid money to Hastert specifically for an assignment of the purported interest in the Deed of Trust. Rather, if any funds were actually paid by Respondents, they were "invested" with Hastert generally, and Hastert did not assign or otherwise designate any of such funds to then Nevada City Loan, but instead, used such funds to service any number of the many loans that he "serviced" so as to keep his Ponzi scheme afloat. Further, Hastert failed to keep sufficient records to allow any "investor" funds to be traced to a specific loan.

As a result of these and other fraudulent business practices, Hastert has been convicted of sixty two counts of embezzlement and fraud. See footnotes 2-3, *supra*.

The Other Pertinent Defendants

Nancy Selecman was Hastert's secretary during the relevant time period. The Appellants had frequent communications in person and by telephone with Selecman about the Downieville Property, the Downieville Loan, the Nevada City Property, the Nevada City Loan, the associated trust accounts, the status of the funding of the Downieville Loan and the Nevada City Loan, the construction account, and payments that were to be made from the trust accounts. Appellants specifically alleged that Selecman knowingly and intentionally: (a) acted as a "strawman" on the deed of trust for the Downieville Loan and the Nevada City Loan; (b) prepared and caused to be executed and recorded various fraudulent assignments of the deed of trust for the Downieville Property and the Nevada City Property Deed of Trust; (c) never had any real monetary investment in the Downieville Loan or the Nevada City Loan; (d) knew that neither the Downieville Loan nor the Nevada City Loan were ever fully funded; (e) knew that Hastert was involved in a scheme to defraud the Kaput's; (f) assisted Hastert in taking in money

from “investors” and then distributing that money amongst various loan accounts, including those of the Appellants, so as to perpetuate Hastert’s Ponzi scheme; and (g) knowingly committed other acts in furtherance of the fraud against the Kaputs.

Pete McKnight was Hastert’s operations manager during the relevant time period. The Appellants had numerous communications in person and by telephone with McKnight about the Downieville Property, the Downieville Loan, the Nevada City Property, the Nevada City Loan, the associated trust accounts, the status of the funding of the Downieville Loan and the Nevada City Loan, the construction account, and payments that were to be made from the trust accounts. Appellants have specifically alleged that McKnight knowingly and intentionally failed to disclose to the Appellants that: (a) the various assignments of the Deed of Trust for the Downieville Loan and the Nevada City Loan were made without consideration and were intended to further the fraud(s) being committed by Hastert; (b) the dates on various documents which she notarized, including assignments of the Deed of trust on the Downieville Loan and the Nevada City Loan, were knowingly and intentionally backdated dated in furtherance of Hastert’s activities to defraud the Kaputs; (c) McKnight fraudulently notarized the signatures of Selecman on the assignments of the Deed of Trust for the Downieville Loan and the Nevada City Loan and failed to record these notarizations in her notary book as required by law; and (d) assisted Hastert in taking in money from “investors” and then distributing that money amongst various loan accounts, including those of the Appellants, so as to perpetuate Hastert’s Ponzi scheme.

Debra Newby has admitted acting as an “informed holding place” (aka a “strawman”) for Hastert on the assignments of the deed of Trust for the Nevada City Property for

which she neither paid nor received any consideration for, but did execute and deliver pursuant to Hastert's request. Further, Appellants have alleged that Newby acted knowingly and intentionally in failing to disclose these assignments to the Appellants, thereby preventing Appellants from learning about the true nature of the deceitful conduct of Hastert, Selecman, McKnight, and Newby.

III. **Statement of Appealability**

On September 21, 2009, Appellant Melissa Kaput filed a Notice of Appeal from the Judgement entered on July 31, 2009, in Department 6 of the Superior Court for the State of California, County of Nevada. CT 540-542. On September 25, 2009, Appellant Donald Kaput filed a Notice of Appeal from the Judgement entered on July 31, 2009, in Department 6 of the Superior Court for the State of California, County of Nevada. CT 546-548. These Notices of Appeal were timely filed under California Rules of Court, Rule 8.104. The Appeal was made pursuant to California Code of Civil Procedure §904.1(a)(1)(appeal from a judgment).

IV. The Standard of Review of the Sufficiency of a Complaint Against a Demurrer

As set forth in Alfaro v. Community Housing Improvement System & Planning Association, Inc. (2009) 171 Cal. App. 4th 1356, 1371, California law requires that a complaint in a civil action only needs to contain a statement of the facts constituting the cause of action in ordinary and concise language and a demand for judgment for the relief to which the pleader claims to be entitled. California Code of Civil Procedure §425.10(a). The Alfaro court further held that to state a cause of action the plaintiffs must allege facts warranting legal relief and that it does not matter whether a plaintiff has provided apt, inapt, or no labels or titles for causes of action. A general demurrer is a trial of a pure issue of law and presents the question whether the plaintiff has alleged sufficient facts to justify any relief, notwithstanding superfluous allegations or claims for unjustified relief. Alfaro at 1371. The allegations of the complaint must be liberally construed with a view to attaining substantial justice among the parties, California Code of Civil Procedure §452, and pleading defects which do not affect substantial rights of the parties should be disregarded. California Code of Civil Procedure §475. Ibid.

California law requires that in evaluating a demurrer, the court must assume the truth of all material facts properly pleaded in the complaint and that are judicially noticed. California Code of Civil Procedure §§ 430.30(a), 430.70. Blank v. Kirwan 39 Cal. 3d 311, 318. The allegations of the cause of action should be given a reasonable interpretation, reading it as a whole and its parts in their context. Ibid. If a demurrer is sustained and the defect can be cured by amendment, then it is an abuse of discretion not to grant leave to amend. Ibid.

V. The Fourteenth Cause of Action for an Accounting

A. The Allegations in the Pleadings Support An Action for Accounting

The Appellants alleged in the Fourteenth Cause of Action in the SAC that the Respondents "are in possession of the books, records and information pertaining to the purchase of the Nevada City Property, the Downieville Loan, the Nevada City Loan, the funding of the Downieville Loan and the Nevada City Loan, the disposition of the loan proceeds, and the trust accounts, and therefore, the information is unknown to Plaintiffs and cannot be ascertained without an accounting" from the Respondents. CT 170, lines 11-18.

The Appellants further incorporated the allegations of paragraphs 1-59, 92, 114, 119, and 124 of the SAC. CT 170, lines 11-12. SAC paragraph 51 alleges that the Appellants "repeatedly asked Hastert for their files, for an accounting of both loans, and for an accounting of each of the trust accounts", and for the "names of the 'investors' on their loans." The allegations continue that "Hastert has refused to provide any accounting for the trust accounts or give them any information or documents." CT 146, lines 20-23.

Then, in SAC paragraph 53 the Appellants allege that assignments of the fraudulent deed of trust were made to various persons (i.e., the Respondents/Defendant Lenders) without disclosure to, or the consent of the Appellants. The Appellants specifically alleged that:

> none of these assignees directly paid money to Hastert specifically for an assignment of the purported interest in the Nevada City Deed of Trust. Rather, if any funds were actually paid by these persons, they were 'invested' with Hastert generally, and Hastert did not assign or otherwise designate any of such funds to the Nevada City Loan, but instead, used such funds to service any number of the many loans that he 'serviced' so as to keep his Ponzi scheme afloat. Further, Hastert failed to keep sufficient records to allow any 'investor' funds to be traced to a specific loan. CT 147, line19 through CT 148, line 10.

These allegations show that the only persons who had any information about the loans

and their partial funding were Hastert and the Respondents. Thus, the only possible means for the Appellants to obtain an accounting for the missing Downieville and Nevada City Loan funds (which were not put into their loan trust accounts) and to verify the legitimacy of the assignments of beneficial interest in the Deed of Trust was to file a cause of action against the only persons that could provide the necessary information: i.e., Hastert and the Respondents.

That is what the Fourteenth Cause of Action is all about. It is intended to give the Appellants the opportunity to find out: (a) what monies, if any, were actually paid by the Respondents to Hastert; (b) whether the funds paid by the Respondents were specifically designated for the Appellants' loans; and (c) whether any monies actually paid by Respondents made it into the Appellants' loan trust accounts.

It is only when these complex accounting questions are answered that the question of the Respondents' legal interest in the Appellants' property is valid under the respective assignments of the Deed of Trust.

B. **The Applicable Law of For Pleading An Action For Accounting**

It is well established law that an action for accounting is equitable in nature. It may be brought to compel a defendant to account to a plaintiff for money or property where either a fiduciary relationship exists or where, though no such relationship exists, the accounts are so complicated that an ordinary legal action demanding a fixed sum is impracticable. See Witkin California Procedure, 5th Ed., Vol. 5, Pleading, §819, Accounting, p. 236. The Appellants' Fourteenth Cause of Action fits squarely within the situation described by Witkin that the action will lie when the accounts between the plaintiffs and defendants are so complicated that an ordinary legal action demanding a fixed sum is impracticable.

This rule has been upheld in various courts and under similar circumstances. See for example Civic Western Corp. v Zila Industries (1977) 66 Ca. App. 3d 1, 14 (citing the Witkin text) where the Court of Appeal held that an accounting was a proper cause of action to sort out a series of financial transactions between the litigants and that trial on the merits was the proper means to account for all the monies claimed between the parties. Again, in St. James Church v. Superior Court (1955) 135 Cal. App. 2d 352, 359, the court of appeal followed the rule set out in Witkin. Specifically, the Court held that "if an action is for an amount which is unliquidated and unascertained and which cannot be determined without an accounting, it is a suit in equity" citing Kritzer v. Lancaster, 96 Cal.App.2d 1, 6 and Vail v. Pacific Fish Products Co., 76 Cal. App. 58, 78.

The Appellants' Fourteenth Cause of Action fits squarely within this rule. The Appellants do not know of a sum certain paid by any of the Respondents for the assignments of the Deed of Trust. Moreover, the Appellants have no means to trace any monies purportedly paid by the Respondents to Hastert into the specific trust accounts for the Appellants's loans with Hastert. The books and records to make the necessary factual determinations are all in the hands of the Respondents and Hastert.[4]

It is only by reviewing these records in detail and performing an accounting that it can be established whether or not the Respondents have any rightful claim to the specific assignments

[4] Since September, 2007, all of the records of Hastert were seized by the California Attorney General as part of its criminal indictment, prosecution, and now sentencing of Hastert. Appellants have repeatedly tried to gain access to the documents, but the Attorney General has refused to cooperate or produce pursuant to a subpoena. At the time of filing of this brief, the Appellants have a motion before the trial court for an indefinite continuation of the trial pending the release of the documents by the Attorney General so that the Appellants can conduct discovery in the case. See the Request for Judicial Notice, Exhibit 2.

of the Deed of Trust given to them by Hastert. This is especially true in light of the other allegations in the SAC that the assignments of the Deed of Trust were made fraudulently and that Hastert co-mingled funds from many different investors, including investors other than the Respondents, into various loans as necessary to keep his Ponzi scheme afloat. See the SAC, the Sixth through Thirteenth Causes of Action. CT 158-170.

The trial court based its ruling on the finding that there were "no monies paid to or from them [the Respondents] directly to or from plaintiffs; and they had no involvement with the disposition of the loan proceeds or Hastert's trust account." This finding simply ignores the other extensive factual pleadings in the SAC regarding the various frauds by Hastert, along with Selecman, McKnight, and Newby. SAC Sixth to Thirteenth Causes of Action, CT 158-170. Appellants acknowledge that an action for an accounting cannot stand on its own, but must have underlying causes of action to support it. See Duggal v. G.E. Capital Communications Services, Inc. (2000) 81 Cal. App. 4th 81, 95. However, it is very clear in this case that such underlying causes of action clearly exist and that they directly support Appellants' action for accounting. The trial court simply ignored these underlying causes of action and that they provided an overwhelming basis for the accounting claim.

Most importantly, the trial court's ruling ignored the allegations that there is no evidence that: (a) the Respondents ever paid real value for the beneficial interests they received; or (b) any monies paid by the Respondents can be traced to the specific loan trust accounts for the Appellants two loans. See e.g., SAC ¶¶52-53, CT 147-148. The only practical way for these question to be answered is by an accounting.

The burden on the Respondents from prosecution of the Fourteenth Cause of Action is

nominal. All that they would be required to prove at trial is that they paid full value for the assignments of the Deed of Trust that they received, and further, that they had no knowledge of the fraud by Hastert. On the other hand, the irreparable harm to Appellants from not having an accounting is very great. The Appellants face foreclosure on their property. Appellants have a right to have the validity of the assignments to the respondents verified – i.e., that the Respondents paid full value and that the monies they paid were placed by Hastert in the Appellants' two loan accounts and not into an account for Hastert and/or into loan accounts of different Hastert' investors.

VI. The Fifteenth Cause of Action for Quiet Title

A. The Allegations in the Pleadings Support An Action For Quiet Title

The Appellants alleged in the Fifteenth Cause of Action in the SAC that they are the rightful owners in fee of the Nevada City Property.[5] CT 172, lines 3-9. The Appellants further allege that the Respondents claim an interest in the Nevada City Property based upon a deed of trust and subsequent assignments of beneficial interest thereunder and that these documents were fraudulent and created as part of the Hastert scheme. CT 172, lines 10-15.[6] The Appellants request a judicial decree quieting their title in the Nevada City Property against the Respondents. CT 172, lines 16-18.

B. The Court's Ruling Sustaining the Demurrer

Neither the Respondents nor the trial court ever challenged the Appellants' pleading of the essential elements for a cause of action for quiet title under California Code of Civil Procedure §761.020. Rather, the Respondents based their demurrer on three grounds: (a) first, that "where a quiet title action is based on fraud, the claim must be pled with specificity" and that the Appellants did not do so (CT 288, lines 13-22); (b) second, that this "is not the proper case for a quiet title action" but is a case for an action to remove a cloud on title by invalidating a particular instrument ... that requires proof of specific facts to show the invalidity of the apparently invalid instrument" (CT 289, lines 1-8); and (c) third, that there are no "charging allegations ... that implicate the Lender Defendants in any fraud or other actionable

---

[5] See the Request for Judicial Notice, Exhibit 1, that is a certified copy of the deed for the Nevada City Property.

[6] See the Request for Judicial Notice, Exhibit 3, where Hastert pleaded no contest to the Second Amended Felony Complaint, Request for Judicial Notice, Exhibit 4.

wrongdoing." CT at 289, lines 9-10.

The trial court's ruling on the Respondents' demurrer to the Fifteenth Cause of Action of the SAC simply adopts the Court's prior ruling on the First Amended Complaint. The trial court, although it acknowledged that the Appellants had incorporated (by reference) into this cause of action the allegations of fraud against Hastert, Selecman, McKnight and Newby in the creation of the alleged fraudulent deed of trust and the assignments to the Respondents[7], sustained the demurrer simply because there "are absolutely no allegations of any wrongdoing on the part of the lending defendants". CT 385, second and third paragraphs.[8]

C. The Applicable Law of Quiet Title

It is long established that an action for quiet title only needs to meet the general pleading requirements of California Code of Civil Procedure §760.020 and it is clear from the record in this case that neither the Respondents nor the trial court ever found that Appellants had failed to meet those requirements. See eg., CT 350-351.

1. The Appellants Are the Holders of Title of Record and Do not Have to Plead Fraud to Support Their Quiet Title Action

The Respondents' demurrer was based primarily upon the argument that an action

---

[7] It is important to understand here that the trial court overruled the demurrers to the Appellants' cause of actions against Selecman and McKnight for fraud, and together with the causes of action against Hastert which were not opposed, were sustained as good causes of action. In other words, the trial court found that the Appellants' allegations of fraud by Hastert, Selecman and McKnight in the creation of the deed of trust and the assignments of beneficial interests (see the Sixth through Eleventh Causes of Action) had been pleaded with the requisite specificity. CT at 383-384.

[8] The trial court's ruling on the First Amended Complaint said the same thing, that "[t]he allegations of fraud are not based upon the conduct of these defendants." CT 122, second paragraph.

for quiet title that is based upon fraud must be pleaded with specificity, citing to Sterns & S. Ranchos Company v. Atkinson Topeka & Santa Fe Railway Co. (1971) 19 Cal. App 3d 24, 31. CT 288, lines 16-18.

Although there is an exception to the general rule of pleading quiet title under California Code of Civil Procedure §760.020 in cases of fraud, *this exception is limited to those cases in which the defendant has a clear title of record and the plaintiff attacks the deed constituting the defendant's claim to title*. See Kroeker v. Hurlbert (1940) 38 Cal. 2d 261, cited by Witkin California Procedure 5th (2008), Pleading, Quiet Title, §669 Specific Pleading of Fraud, as the leading case on point. In Kroeker, the Court of Appeal stated that the long established rule was that "an action may be brought under Section 738 [now §760.020] of the Code of Civil Procedure to determine any adverse claim *without anticipating the defenses*, unless the case clearly comes within the established exception where a clear record title is in the defendant and the plaintiff cannot show title in himself until he has successfully attacked his adversary's title, in which event he must allege facts to show the fraud or other ground upon which he relies." Id. at 267. (Emphasis Added).

The Respondents have never argued that they have clear title of record and they have tacitly conceded that this belongs to the Appellants. See note 4, *supra*. Thus, the exception for a plaintiff having to plead fraud against the defendant who holds clear title does not apply in this case. The Appellants quite properly pleaded quiet title under the general pleading rules of California Code of Civil Procedure §760.020.

2. The Appellants Pleaded Quiet Title And For The Cancellation of Instruments

The second argument of the Respondents against the Fifteenth Cause of Action was that this "is not the proper case for a quiet title action" but is a case for an action to remove a cloud on title by invalidating a particular instrument ... that requires proof of specific facts to show the invalidity of the apparently invalid instrument." CT 289, lines 1-8.

First of all, this is not an argument that in any way attacks the sufficiency of the pleading of the allegations by Appellants for a decree quieting their title to the Nevada City Property. It is merely a bald assertion that the claims of the Appellants are better considered under a cause of action for cancellation of instruments under Civil Code §3412. Thus, it has no legal weight. Moreover, the Appellants did, in fact, also plead a cause of action for cancellation of the subject instruments under Civil Code §3412, and thus, this argument is considered separately below.

3. The Appellants Did Not Need To Charge The Respondents With Wrongdoing

Lastly, the Respondents argued that there are no "charging allegations ... that implicate the Lender Defendants in any fraud or other actionable wrongdoing." CT at 289, lines 9-10.

Under the general pleading requirements of California Code of Civil Procedure §760.020 for quiet title, *there is no requirement that a plaintiff plead allegations that the defendant was a wrongdoer*. The only requirement under the statute is that there must be allegations showing an adverse claim in the title of the property between the plaintiff and defendant. There is no need to specify either the nature of the defendant's claim or the fact of its

invalidity. See Witkin California Procedure 5th (2008), Pleading, Quiet Title, §668 General Pleading; Kroeker at 266-267; Wolf v. Lipsy (1985) 163 Cal. App 3d 633, 638.

Thus, this argument by the respondent, ***which was the primary argument relied upon by the trial court, is without any merit***. See trial court's ruling, CT at 289, lines 9-10. Accordingly, the demurrer should have been overruled.

4. **The Appellants Did Plead Fraud With Specificity**

Assuming that the Appellants were required to plead a fraud with specificity as argued by the Respondents, the SAC shows on its face that the Appellants did, in fact, successfully "anticipate the defenses" and pleaded the fraud by Hastert, Selecman and McKnight that led to the fraudulent Deed of Trust and assignments of thereunder (SAC Exhibits 4-13, CT 234-266) that are the subject of the quiet title action. See the SAC Sixth to Thirteenth Causes of Action, CT 158-170.

The SAC incorporates by reference the frauds committed by Hastert, Selecman and McKnight in the creation of the deed of trust and the assignments thereunder to the Respondents. CT 171, lines 8-9. All of the elements for the causes of action for fraud against these three individuals were found to have been properly pleaded by the trial court when it overruled the demurrers to the Sixth through Eleventh Causes of Action. See footnotes 5 & 6, *supra*. Moreover, the Appellants specifically pleaded these acts of fraud in the Fifteenth Cause of Action alleging that "[b]oth the Deed of Trust and the assignments under which the Defendant Lenders [claim an interest] were fraudulent and created as part of the fraudulent conspiracy of Thomas Hastert in concert with Nancy Selecman, Pete McKnight, and Debra Newby as alleged in paragraphs 92, 114, 119, and 124." CT 172, lines 10-15. Thus, it is very clear from the face

of the SAC that fraud in the creation of the deed of trust and assignments thereunder was pleaded with the requisite specificity.

VII. **The Sixteenth Cause of Action for Cancellation of Instruments**

A. **The Allegations in the Pleadings Support a Cause of Action For Cancellation**

The Appellants alleged in the Sixteenth Cause of Action in the SAC that the Deed of Trust for the Nevada City Property and all of the assignments thereunder to the Respondents (SAC Exhibits 4-13, CT 234-266) were prepared, executed and delivered as an essential part of Hastert's fraudulent scheme, and therefore, should be voided by judicial decree under Civil Code §1572, §1573, and §3412. SAC ¶¶141-150 at CT 173-177. The Appellants in paragraph 141 allege that the Deed of Trust was fraudulent because Hastert had the Appellants sign a "blank" deed that he later filled in, that the principal holder of the deed was a "strawman" and that the loan was never fully funded. SAC ¶¶53, 141 at CT 147-48, 173. The Appellants then allege that the assignments of the beneficial interests under the Deed of Trust were fraudulent because these documents were prepared, executed and delivered as an essential part of Hastert's fraudulent scheme, that these assignments were backdated, and that these assignments were falsely notarized. SAC ¶¶142-145 at CT 173-175. The Appellants further allege that the assignments of the beneficial interests under the Deed of Trust by Newby were fraudulent because these documents were prepared, executed and delivered as an essential part of Hastert's fraudulent scheme and they were dependent upon the fraudulent assignment from Selecman to Newby. SAC ¶¶146-149 at CT 175-176. Lastly, the Appellants allege that the assignment from Defendant lender Sabo to Patricia Cobb Revocable Trust was void because the beneficial interests held by Sabo were obtained via the fraudulent assignment from Selecman (SAC ¶142 at CT 173) which was an invalid forgery. SAC ¶150 at CT 177.

B. The Respondents' Demurrer Waived Any Claim Under California Commercial Code §3305

The demurrer of the Respondents to the Sixteenth Cause of Action was set forth in the Memorandum of Points and Authorities in Support of Demurrer of Lender Defendants to Second Amended Complaint. CT 279-297. ***Nowhere in this demurrer do the Respondents raise the argument that California Commercial Code §3305 is a complete bar to the cause of action because the Respondents were purportedly bona fide holders in due course.*** Rather, the Respondents ignored the rule that the facts alleged in a complaint must be deemed true for the purposes of the demurrer, and instead, based their demurrer on a series of irrelevant factual arguments that could not and did not provide grounds for their demurrer because the law requires that the facts as alleged must be deemed true for purposes of ruling on a demurrer. See CT 289-293. Since the Respondents never raised the argument in their demurrer, it must be deemed waived. California Code of Civil Procedure §430.80(a); see also Witkin California Procedure 5th (2008), Pleading, Demurrer §958.

Appellants successfully rebutted the factual arguments of Respondents in their Opposition to the Demurrer CT 346-357, while pointing out that rule that the facts alleged in the SAC must be deemed true for purposes of deciding the demurrer. CT 353-354.

Prior to the Trial Court's Ruling, discussed infra, neither Appellants nor Respondents had raised and argued the question of whether the Sixteenth Cause of Action failed to state a cause of action because the Respondents were bona fide holders in due course of their assignments under the Deed of Trust.

C. The Court's Ruling Sustaining the Demurrer Raised California Commercial

Code §3305 Sua Sponte and Appellants were Given No Opportunity To Brief Or Argue The Relevant Law

The trial court ruled on April 10, 2009, that "[a]s to the cause of action for cancellation, it is an equitable one. It is not available against innocent parties, e.g., bona fide purchasers... A complaint seeking cancellation of a deed must allege that the defendants are not bona fide purchasers... Plaintiffs do not make this allegation, nor given the allegations made in all three of their complaints, is there a reasonable possibility that they can allege that the lending defendants are not bona fide purchasers. Under the circumstances, leave to amend is not granted as to the cancellation cause of action."

The basis for the trial court's decision, i.e., that an action for cancellation was not available to Appellants because the Respondents were bona fide holders in due course, was raised sua sponte without any briefing or argument by either side. ***The failure of the Court to ever give the Appellants any opportunity to brief or argue the law of bona fide holders in due course under California Commercial Code §3305 is clear error and is, by itself, grounds for reversal.***

D. **The Ruling In The Sierra County Action**

At the time of the demurrers to the SAC in the Nevada County action were pending, there was also a second amended complaint pending in the Sierra County action that contained identical causes of action dealing with the Downieville Property, except that there are different alleged defendant lenders. These defendant lenders (represented by the same legal counsel) in that action also demurred to the cause of action for quiet title. However, the Sierra County trial

court found on May 20, 2009,[9] that "[g]iven that this case is only at the initial pleading stage, and that while the Lender Defendants may have a viable defense of "*bona fide* lenders", that matter is not technically before the Court in that there is no obligation for the Plaintiffs to 'anticipate the defense' and affirmatively plead any impediment that the Lender Defendants are not *bona fide* lenders for value in order to plead the remedies under the 8th, 9th and 9-A causes of action."[10]

E. **The Motion to Reconsider**

The Appellants filed a Motion to Reconsider the Nevada County trial court's ruling on June 5, 2009. CT 407-443. This motion included a copy of the Appellants' Reply to Supplemental Memorandum of Points and Authorities in Support of Respondents' Demurrer to Second Amended Complaint filed in the Sierra County action. CT 431-442. The Respondents filed an Opposition to the Motion to Reconsider on June 26, 2009, in which they Respondents never opposed the legal authority and allegations of the SAC cited by the Appellants in their Motion to Reconsider or the brief that Appellants had filed in the Sierra County action on this issue. CT 469-476.

The Nevada County trial court heard the Motion to Reconsider on July 10, 2009, and issued a ruling denying the motion. The trail court stated that it denied the motion because it found that the Appellants had not met their burden of showing new or different facts, circumstances, or law, CT 518-519, and then simply reiterated its earlier sua sponte decision that the Appellants had failed to allege that the Respondents were not bona fide holders in due

---

[9] About six weeks after the April 10, 2009 ruling by the Nevada County Trial Court.

[10] These correspond to the causes of action for quiet title, cancellation of instruments, and rescission that were in both complaints.

course. In doing so, the trial court once again discussed that the SAC failed to allege wrongdoing on the part of the Respondents. CT 519-521.

F. The Appellants Properly Pleaded Cancellation Of The Instruments And They Properly Pleaded Complete Defenses To The Respondents As *Bona Fide* Holders in Due Course

Ignoring for now that the Respondents never demurred on the grounds that they were bona fide holders in due course and that the trial court raised this issue *sua sponte* at the time of its ruling, the following discussion demonstrates that: (a) ***the question of whether the Respondents were bona fide holders in due course under California Commercial Code §3305 was a question that was supposed to be raised as an affirmative defense and not by way of demurrer*** (see the ruling of the Sierra County trial court); and (b) ***the Appellants did, in fact, properly plead multiple factual defenses to any bona fide holder in due course under CCC 3305(a)(1)(B)&(C)***.

1. The Appellants Did Not Have To Anticipate The Defense Of A Bona Fide Holder In Due Course Under CCC §3305 By Specifically Alleging That The Respondents Were Not *Bona Fide* Holders

In making its ruling, the Sierra County trial court adopted the Appellants' argument in their Reply to Supplemental Memorandum of Points and Authorities in Support of Respondents' Demurrer to Second Amended Complaint. CT 431-443. The Appellants pointed out that: (a) the Appellants had pleaded three defenses under CCC §3305(a)(1)(B)&(C) to a holder in due course, CT 437-38; and (b) ***that these defenses to a holder in due course must be heard and decided by the trier of fact and not decided on demurrer***.

Specifically, the Appellants cited to Danning v. Bank of America National Trust and Savings Association (1984) 151 Cal. App. 3d 961, 978-979, where the court of appeal held

that:

> California Uniform Commercial Code section 3305, subdivision (2)(b) provides that a holder in due course remains subject to such incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity. The draftsman of the code explained California Uniform Commercial Code section 3305, subdivision (2)(b) as establishing that if under local law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against the holder in due course. Thus, even a holder in due course may not recover where the underlying debt was illegal, unenforceable and otherwise null and void.

The Appellants further cited to Garner v. Rubin (1957) 149 Cal.App. 2d 368, 374-375, where the court of appeal ruled that questions as to whether there was a fraud in the making of the note making it defensible against a holder in due course are questions for the trier of fact. The Garner Court relied, in part, upon the holding of the California Supreme Court in C.I.T. Corp. v. Panac (1944) 25 Cal. 2d 547, 559-560, where the court upheld a trial court verdict finding that fraud in the making of a note was a defense to a *bona fide* holder in due course.

2. **The Appellants Pleaded Facts That Are a Bar To A Holder in Due Course Of the Deed of Trust And The Assignments Thereunder**

As part of their Motion to Reconsider, Appellants set forth in their Reply to Supplemental Memorandum of Points and Authorities in Support of Respondents' Demurrer to Second Amended Complaint, CT 431-443, the applicable provisions of the California Commercial Code §3305(a) which states that "[e]xcept as stated in subdivision (b), the right to enforce the obligation of a party to pay an instrument is subject to all of the following:"

> 1. ... (B) ***duress, lack of legal capacity, or illegality*** of the transaction which, under other law, nullifies the obligation of the obligor, (C) ***fraud that induced the obligor to sign the instrument*** with neither knowledge nor reasonable opportunity to learn of its character or its essential terms.

California Commercial Code §3305(b) goes on to specifically state that "[t]he right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in paragraph (1) of subdivision (a)."

It is important to realize that these defenses are not limited to the original parties that made the instrument, as held by the trial court, but extend to holders in due course such as the Respondents. The Uniform Commercial Code Comments include the statement that "[i]n most cases the holder in due course will be an immediate ***or remote transferee of the payee of the instrument***." Thus, it is clear that the law as adopted was not meant to be limited to the immediate parties to the initial transaction, but that the defenses would extend to even "remote" transferrees of the instrument. California Commercial Code §3305, Uniform Commercial Code Comments, note 2, discussing subsection (a)(2).

a. **The Appellants Pleaded That The Note was Illegal**

California Commercial Code §3305(a)(1)(B) specifically says that "illegality of the transaction" is grounds for a complete defense to the claim of an encumbrancer in due course. The signing of a "blank" deed of trust and promissory note is clearly an "illegal transaction" that is intended to be covered by this code section. The Appellants alleged at SAC ¶53 that the deed of trust and the promissory note were "blank" when signed by them and were filled out later by Hastert for the amount of the loan that Hastert wanted to make, not the small amount of the loan that the Appellants wanted.[11] CT 147.

Indeed, the Respondents admitted that the signing of the note and deed of

[11] The same allegation was made regarding the Deed of Trust for the Downieville Property at SAC ¶52.

trust in "blank" by the Appellants under false representations by Hastert was illegal and "violated other provisions [of the law] regarding transactions in trust deeds set forth at Business and Professions Code section 10230 *et seq*. … and section 10237". See page 6, lines 10-17 of the Respondents Supplemental Memo of P&A.[12] CT 424.

A clearer case of an "illegal" transaction cannot be found and it is a complete bar to the Respondents' claims that they are *bona fide* holders in due course under California Commercial Code §3305.

b. **The Appellants Signed the Deed of Trust Under Duress**

Second, California Commercial Code §3305(a) (1)(B) makes it absolutely clear that **duress** in the making of the instrument is a complete defense to any claim by an encumbrancer in due course. The Appellants have alleged duress in the making of the Note and Deed to Trust upon which all of the Respondents hold their assignments. See the SAC ¶¶23-27 where the Appellants clearly allege that they were under extreme financial duress after Ruble, Simmons and Olympic "revoked" the loan for the automobile. Thus, the Appellants had no choice but to sign the Deed of Trust as demanded by Hastert in order to resolve their car loan problem. SAC ¶¶33-42, & 52-53. CT 139-148.

c. **The Appellants Signed the Deed of Trust Based Upon False Representations**

Third, California Commercial Code §3305(a) (1)(C) plainly states that "**fraud** that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or essential terms" is grounds for defense. The Appellants

[12] This brief was originally submitted to the Sierra County trial court, but which was also submitted to the Nevada County trial court as part of Appellants' Motion to Reconsider.

were defrauded by Hastert in multiple ways that prevented them from learning, prior to signing, what were the essential terms of the Note and Deed of Trust. The Appellants told Hastert they only wanted a car loan. Hastert agreed to do this and had the Appellants sign a blank Deed of Trust and Promissory Note. SAC ¶31-37, 52-53. CT 142-147. It was not until days later that Hastert told them that he had filled out the Note and Deed of Trust for $350,000 against the Downieville Property. The Appellants protested, but Hastert committed further fraud and told Appellants that they did not qualify for a simple car loan and that they had to take out a large loan against their property. Ibid. Hastert lied even further and told Appellants not to worry -- that he would take care of everything, including the monthly and balloon payments. Ibid. Thus, the making of the Deed of Trust was based entirely upon lies told by Hastert and which Appellants had no choice but to rely upon.

It is very clear from the foregoing discussion that the Appellants did plead multiple factual defenses to the Respondents argument that they are bona fide holders in due course under California Commercial Code §3305. The only thing the Appellants did not include in the SAC were the specific words that the Respondents were not "*bona fide* holder in due course". However, under the pleading rules of Alfaro at 1371, *supra*, the law provides that plaintiffs only allege facts warranting legal relief and that a general demurrer is a trial of a pure issue of law and presents the question whether the plaintiff has alleged sufficient facts to justify any relief. If the Appellants needed to specifically allege that the Respondents were not *bona fide* holders in due course, then the trial court should have given them leave to amend.

VIII. The Seventeenth Cause of Action For Rescission

A. The Allegations in the Pleadings Support a Cause of Action for Rescission

The Appellants alleged the Seventeenth Cause of Action in the SAC in the alternative to the Fifteenth and Sixteen Causes of Action. CT 177, lines 10-11. The basis for the rescission claim is set forth in SAC ¶153 which alleges that the Nevada City Loan is void or voidable on the grounds that it was procured by duress, fraud or mistake, and suffers from a lack or failure of consideration. CT 178.

B. The Respondent's Demurrer

The Respondent's demurrer was based on two points: first, that there are no allegations of wrongdoing specifically against the Respondents, CT 294, lines 8-10; and second, that the Appellants did not allege that they "can" perform their offer to repay the Respondents. CT 295 lines 16-18.

C. The Court's Ruling Sustaining the Demurrer

The trial court followed the first argument of the Respondents and adopted its earlier ruling that "[t]here is no basis for recission due to any conduct of these defendants." CT 384, second paragraph, adopting the ruling at CT 122.

D. The Applicable Law For Rescission

To properly plead rescission, there are only three elements that must be alleged: first, a pleading of the contract; second, the grounds for rescission (duress, fraud, mistake or failure of consideration), and third, an offer to repay any monies received. Civil Code §1691.

As discussed thoroughly above, the Appellants have more than adequately alleged the contracts to be rescinded, SAC ¶152 at CT 177, line 14 through CT 178, line 5.

Next, the multiple frauds that would support rescission of the subject Nevada City Loan and its attendant documents (the Deed of Trust and assignment thereunder) were extensively pleaded in the SAC and incorporated by reference. SAC ¶151, CT 177. The fact that defendants Hastert, Selecman, McKnight and Newby were the persons actually perpetrating the frauds does not present any physical impediment to the actual rescission of the Nevada City Loan or to the repayment of the monies paid by the Respondents. *In other words, the legal contract(s) to be rescinded, i.e., the Deed of Trust and assignments thereunder, now run directly between the Appellants and the Respondents, and Hastert, Selecman, McKnight and Newby have nothing to do with the present title to the Nevada City Property.*

Third, the Appellants have offered to repay any and all consideration given by the Respondents to Appellants in exchange for rescission of the instruments through which they hold a claim against the Nevada City Property. SAC ¶154 at CT 178, lines 8-12.

Based upon the foregoing, it is clear that all of the requirements of Civil Code §1691 have been properly pleaded and the argument that the Respondents were not the wrongdoers is simply a red herring that has no factual bearing on a rescission between the Appellants and the Respondents. Thus, the trial court's ruling is simply without any logical basis.

The Respondents also argued in their Demurrer to the SAC that Appellants' offer to restore consideration in the SAC ¶154 is insufficient because the Appellants alleged only an offer to repay all consideration and not that the Appellants are able to repay the consideration. CT 295, lines 11-19. The Respondents' argument is wrong in two respects. First there is no requirement in California Civil Code §1691 that there be allegations that the rescinding party "can" repay the consideration. It only requires that an offer to repay be pleaded. Second, the

Respondents' argument looks outside the allegations of the complaint, which for purposes of a demurrer, must be deemed true, and thus, the Respondents argument is irrelevant at this juncture.[13]

Finally, the Respondents' citation to NMSBPCSLDHB v. County of Fresno (2007) 152 Cal. App. 4th 954, 958, in their Demurrer to the SAC, CT 294, line 11 through CT 295, line 10, is entirely misplaced because it only deals with whether a jury trial was required because the action for rescission was pleaded in equity or at law. There is no such issue here. The only issue is whether Appellants have met the pleading requirements of CC §1691, and it is clear from the foregoing discussion that the Appellants have met all pleading requirements.

IX. The Eighteenth Cause of Action For A Preliminary Injunction

A. The Allegations in the Pleadings Support A Preliminary Injunction

The Appellants' Eighteenth Cause of Action for a Preliminary Injunction is there to prevent the Respondents from attempting to foreclose against the Nevada City Property. SAC ¶¶157-158 at CT 178-179.

B. The Respondent's Demurrer

The Respondent's demurrer was based on the argument that the Appellants have not otherwise pleaded a valid cause of action against them. CT 296, lines 1-6.

C. The Court's Ruling Sustaining the Demurrer

The trial court made no comment in its ruling other than it adopted its earlier ruling that

---

[13] Whether or not the Appellants can obtain the financing for repayment of the consideration given by the Respondents is a hypothetical question of fact that would only become relevant if and when there has been a trial and the Appellants obtain the right to exercise a recission.

"[t]here are no acts supporting grant of an injunction." CT 384, second paragraph, adopting the ruling at CT 122.

D. An Action For A Preliminary Injunction Was Properly Pleaded Because The Appellants Pleaded Other Valid Causes of Action In Support Thereof

The Appellants properly pleaded grounds for a preliminary injunction on the basis of the possibility that the Respondents would attempt to foreclose on the Nevada City Property pursuant to the Deed of trust or assignments thereunder. The Appellants pleaded that the loss of their Nevada City Property in such a foreclosure before trial on the merits of their claims would cause them to suffer great and irreparable injury. SAC ¶¶157-158, CT 178-179.

The trial court's ruling dismissing the preliminary injunction pleading was clearly based upon its dismissal of all of the other causes of action against the Respondents. As shown above, the trial court erred in the dismissal of the Fourteenth through Seventeenth Causes of Action, and therefore, there is more than sufficient grounds for the Eighteenth Cause of Action.

Indeed, the Respondents in the Sierra County action, now consolidated with the Nevada County Action,[14] who are represented by the same legal counsel, are at the time of filing of this brief moving forward with a foreclosure on the Downieville Property. A copy of the Notice of Foreclosure by the Respondents on that property has been judicially noticed at the time of filing of this brief.[15] Clearly, there is need for the Appellants to obtain a preliminary injunction to prevent the foreclosure of both the Downieville and Nevada City Properties pending the outcome of this appeal and the outcome of the case on the merits.

---

[14] See the Request for Judicial Notice, Exhibit 5.

[15] See the Request for Judicial Notice, Exhibit 6.

The demurrer to the Eighteenth Cause of Action should have been overruled to prevent the Respondents from effectively ending the case against them before there could be heard on the merits.

X. Conclusion

The focus of the trial court's rulings sustaining the Respondents' demurrers to the Fourteenth through Eighteenth Causes of Action was that there are no allegations of wrongdoing specifically alleged against the Respondents. This was clear error. None of the causes of action require as a matter of law that the Respondents themselves were the bad actors. What the Appellants needed to plead, and which they did plead with great specificity, were allegations of wrongdoing that led to the creation of the fraudulent Deed of Trust and the fraudulent assignments of interest to the Respondents.

The Appellants are not trying to blame the Respondents. However, it is clear that Appellants were wronged and it appears that the Respondents were also wronged by the Hastert loan fraud scheme. The Respondents should have joined with the Appellants as plaintiffs in the actions and sought to have their interests protected by causes of action against the real wrongdoers here – Hastert, Selecman, McKnight, and Newby.

The real result of the trial court's ruling is to leave the Appellants as the "fall guys" and let the Respondents free to take the Appellants' property without ever having to prove that: (a) they actually paid real, full value for their assignments; and (b) that the monies that they "invested" with Hastert actually went into the loan accounts of the Appellants.

Without such proof at a trial on the merits where the Respondents have to prove that they have rightful claims to the Appellants' property, the trial court is punishing the Appellants while

letting the Respondents take real property that they may not be entitled to. This is grossly unjust and must be corrected by this court.

Respectfully Submitted,

_____
Patrick H. Dwyer, specially
Appearing *Pro Bono Publico*
for Appellants

January ___, 2010

Certificate of Word Count

I hereby certify under penalty of perjury that, to the best of my knowledge and belief, the total number of words in the body of this brief (i.e., Sections I through X) is 12,230.

_____
Patrick H. Dwyer,
Attorney for Appellants

Date: January ___, 2010

PROOF OF SERVICE

I hereby certify under penalty of perjury that a copy of the Appellants' Opening Brief in the matter of Kaput v. Hastert, et al, Case No. 73278 was served via U.S. First Class mail upon the following:

1. Counsel for Appellants and Respondents addressed as follows:

   (a) Melissa Kaput, P.O. Box 1843, Nevada City, CA 95959;

   (b) Donald Kaput, P. O. Box 1843, Nevada City, CA 95959

   (c) Lawrence E. Skidmore, Aronowitz & Skidmore, Inc., 200 Auburn Folsom Road, Suite 305, Auburn CA 95603;

   (d) Zellmer law Group, 360 Sierra College Drive, Suite 220, Grass Valley, CA 95945;

   (e) Patrick H. Dwyer, P.O. Box 1705, Penn Valley, CA 95946;

2. The Superior Court for the County of Nevada, Department 6, 201 Church Street, Nevada City, California 95959;

3. The California Supreme Court, 350 McAllister Street, San Francisco, California 94102.

4. The Court of Appeal, Third Appellate District, 621 Capitol Mall, 10th floor, Sacramento, California 95814-4719.

_____
Signature

_____
Print Name

Date: January __, 20010