**Case No. C075019**
**Nevada County Case No. 78702**

**IN THE COURT OF APPEAL OF CALIFORNIA**
**THIRD APPELLATE DISTRICT**

**Andy and Maryclaire Daus,**
**Plaintiffs and Appellants**

**v.**

**Andy Moore,**
**Defendant and Respondent.**

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**Appeal from the Superior Court for Nevada County**
**Sean P. Dowling, Judge**

# APPELLANTS' REPLY BRIEF

**Patrick H. Dwyer,**
**State Bar Number 137743**
**P.O. Box 1705**
**Penn Valley, CA 95946**
**530-432-5407**
**pdwyer@pdwyerlaw.com**

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I. **Moore's Duty To Appellants**

A. **An Attorney Has A General Duty Not To Commit Actual Fraud**

Appellants have alleged a straightforward case of actual fraud as a result of Moore's conduct in devising, enacting, and participating in the scheme described in Sixth and Eighth Causes of Action in the Second Amended Complaint ("SAC"). Respondent argues that because he is an attorney and did not make any specific affirmative misleading statements to Appellants, that he cannot be held accountable for actual fraud.

Respondent has not cited any authority contradicting the established rule that actual fraud can be committed by any manner of "surprise, trick, cunning, dissembling, and unfair ways" and not just written or oral misrepresentations. *Wells v. Zenz* (1927) 83 Cal. App. 137, 140 ("*Wells*"). Moore's creation of the scheme, coupled with his direct participation, constituted an actual fraud regardless of whether Moore said anything orally or in writing that was misleading.

Further, Respondent has not cited any contrary authority or otherwise distinguished the long held rule that a lawyer is liable for actual fraud, just like everyone else. *Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2003) 107 Cal. App. 4th 54, 69 ("*Shafer*"); *Cicone v. URS Corp.* (1986) 183 Cal. App. 3d 194, 201-202 ("*Cicone*").

In *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal. App. 4th 282, 292 ("*Vega*"),[1] a case about misrepresentation in a merger transaction, the defendant law firm similarly argued to Respondent that it was not liable (to a shareholder) because it had no duty to disclose for lack of privity and that there was only an

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[1] Appellants apologize to the Court for not citing this case in the Opening Brief. The case was not timely found. Appellants feel the decision is significant and should be brought to the attention of the Court. Appellant has no objection to a supplemental brief being filed by Respondent addressed this case.

omission and no express misrepresentation. The Court of Appeal upheld the allegations against the law firm, finding that the "allegations state an active concealment or suppression of facts. ... So long as the remaining elements of a fraud claim are met ..., we are unable to conclude these allegations are deficient." citing to 5 Witkin, Cal. Procedure (4th ed. 1997), Pleading, § 678, now 5 Witkin, Cal. Procedure (5th ed.), Procedure §722. Further, the Court found that:

> Even where no duty to disclose would otherwise exist, "where one does speak he must speak the whole truth to the end that he does not conceal any facts which materially qualify those stated. [Citation.] One who is asked for or volunteers information must be truthful, and the telling of a half-truth calculated to deceive is fraud." Citing to *Cicone* at 201 and Shafer at 72.

In other words, "active concealment" is just one type of actual fraud, see *Wells*, *supra*, and should not be analyzed under the doctrine of constructive fraud. See I.B, *infra*. In this case, Moore did "speak" when he prepared and sent the meeting agenda to Appellants, he spoke again at the meeting itself which he held at his office and acted as the secretary, and he spoke again when he recorded (incorrectly) the votes of Appellants. When Moore "spoke" in this matter, he had an obligation to speak the whole truth.

Respondent tries to focus this Court on the rule that an attorney does not typically owe a duty of care to a person with whom there is no privity. While it is true that in the context of a professional negligence claim a lawyer's duty of care does not generally extend to third parties that are not the lawyer's client, it is also true that there are exceptions and a duty of care to third parties will be imputed under appropriate circumstances.

### B. An Attorney Has An Imputed Duty Of Care Where The Conduct Is Intended To Harm A Third Party

The appears to be agreement that actual fraud requires the pleading of *intent*, whereas, constructive fraud replaces the element of intent with a duty of

care between the lawyer and the person harmed. *See Worthington v. Davi* (2012) 208 Cal App. 4th 263, 283; *compare* Civil Code §1572 (actual fraud requires element of intent) with Civil Code §1573 (intent replaced with duty of care).

In the Fifth Cause of Action, Appellants allege a form of constructive fraud based upon an imputed duty of care. This duty of care arises from the wrongful nature and intent of Moore's conduct in devising, enacting, and participating in the scheme to harm Appellants.

Respondent relies upon *Skarbrevik v.Cohen, England & Whitfield* (1991) 231 Cal. App. 3d 692 ("*Skarbrevik*") for the rule that lawyers will not be found liable for constructive fraud to third parties based solely upon omission.[2] He asserts that he owed no duty of care to Appellants because there was no privity between them and he did not make any affirmative misrepresentations to Appellants.

Not surprisingly, Respondent fails to address the flip side of the coin that was also discussed in *Skarbrevik*: i.e., that a duty of care will be imputed to a lawyer when the victim was the intended beneficiary of the lawyer's services or the harm to a third party was readily foreseeable. *Id*. at 701-702.

Appellants have alleged overwhelming facts supporting an imputed duty of care under the criteria set out in *Skarbrevik*. Respondent does not cite contrary authority to the *Skarbrevik* analysis for finding imputed liability and Respondent does not specifically challenge Appellants' application of their allegations to these criteria. Instead, Respondent just keeps leaning on the refrain that he had no privity with Appellants, thus no duty to Appellants, and thus, he cannot be held liable for mere omission.

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[2] This is sometimes stated as the requirement of privity between the lawyer the party alleging harm by fraud.

Appellants' allegations establish that Moore's conduct meets all of the criteria set forth by *Skarbrevik*. Moore's scheme was directed at them. Moreover, the allegations demonstrate the foreseeability of harm to Appellants. The allegations then enumerate the specific harm that Appellants suffered as the direct result of the scheme. Clearly, public policy requires that Moore's conduct be deemed to impute a duty of care to Appellants pursuant to the *Skarbrevik* analysis and that he should have to answer for the allegations of the Fifth Cause of Action.

C. **Additional Factors Creating A Fiduciary Duty**

Appellants acknowledge that the Seventh Cause of Action for breach of fiduciary duty by Moore is unusual. However, the facts of this case are exceptional and support the imputation of a fiduciary duty.

While the Professional Rules of Conduct do not, *per se*, create liability for an attorney for breach of a fiduciary duty, they are very important in defining the nature and boundaries of the fiduciary obligations of an attorney. *Stanley v. Richmond* (1995) 35 Cal. App. 4th 1070, 1087 ("Stanley"). In *Stanley, at 1087*, the Court of Appeal stated the interrelationship of the Professional Rules and the fiduciary duties of a lawyer this way:

> The scope of an attorney's fiduciary duty may be determined as a matter of law based on the Rules of Professional Conduct which, "together with statutes and general principles relating to other fiduciary relationships, all help define the duty component of the fiduciary duty which an attorney owes to his [or her] client." Mirabito v. Liccardo (1992) 4 Cal. App.4th 41, 45; David Welch Co. v. Erskine & Tulley (1988) 203 Cal .App.3d 884, 890.

Moore had a duty under the Rules of Professional Conduct, Rule 3-210, to give advice that was within the bounds of the law. That meant that he had to counsel the Majority Shareholders about the rules laid out in *Jones v. H. F. Ahmanson & Co.* (1969) 1 Cal. 3d 93 ("*Ahmanson*") in a manner that would encourage them to fulfill their fiduciary duty to Appellants. If he knew that the

Majority Shareholders intended to forsake their fiduciary duty to Appellants, he should have withdrawn representation. Moore, however, not only failed to withdraw, he devised and then participated in the scheme whereby the Majority breached their fiduciary duty and dispossessed Appellants of the economic value of their stake in the company.

Moore also had a duty under the Rules of Professional Responsibility Rule 3-310 and Rule 3-600(D) to avoid conflicts of interest arising out of controversies between groups of shareholders, especially conflicts about control of the company and the sharing of its economic value. Here, Moore knew about the conflict between the shareholders and then decided to help the majority over the minority. Further, Moore never disclosed his relationship with the Majority Shareholders to Appellants. It was not until documents were found during discovery that Moore's prior relationship with the Majority Shareholders was discovered, see IV, *infra*.

In addition to the Rules of Professional Responsibility, case law has held that legal counsel for a company may not "act as proxy for one contending group of shareholders" against another. *Goldstein v. Lees 46* (1975) Cal App. 3d 614, 622 ("*Goldstein*"). As the allegations show, Moore went far beyond acting as a proxy for the majority against the minority, he devised the scheme for the majority that completely divested Appellants of all economic interest in the company.

Finally, Appellants were directors of the company. The moment that Moore had himself elected as new company counsel he had a fiduciary duty to the company as his client. Rules of Professional Responsibility Rule 3-600(A). Under California Corporations Code §300, "the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board." Moore had a fiduciary duty to the company to disclose his prior relationship with the Majority Shareholders. Consequently, Moore had a fiduciary duty to disclose this prior relationship to Appellants as

directors, especially since they were the only disinterested directors.

Ironically, in the very case that Moore depends upon so dearly, *Skarbrevik*, the court expressly found that an attorney in Moore's position is "obligated to explain to the organization's directors, officers, employees, members, shareholders, or other constituents the identity of the client for whom the attorney is acting, and shall not mislead such a constituent …" *Id.* at 704.

Combining the foregoing Rules of Professional Responsibility with the California Corporations Code, Appellants believe that Respondent had an imputed fiduciary duty to Appellants that he unequivocally breached.

## II. **Harm and Causation**

Respondents do not question that Appellants suffered serious harm. Instead, Moore focuses his argument on the element of causation by asserting that the Majority had the right to compensate themselves exactly in the manner that they did: i.e., paying themselves the entire amount of the corporate profit when they held only 60 percent of the shares. In the words of Respondent, "[t]he Majority Shareholders always had the power to pay themselves as they did, over Appellant's objections, regardless of Respondent's advice or involvement in corporate governance matters." RB 29-30.

Based upon this purported "absolute power" of the majority, Moore argues that there can be no causal nexus between his alleged conduct and the harm suffered by Appellants because the majority shareholders could have done the same thing without Moore's participation.

There are three serious flaws in Moore's argument. First, majority shareholders do not have absolute power and they are not free to pay themselves the entire amount of company profit. Moore continues to ignore the holding of *Ahmanson*, which unequivocally ruled that majority shareholders have a fiduciary duty to the minority shareholders and may not run a company as their

personal piggy bank to the detriment of the minority.[3] In particular, *Ahmanson* expressly states that majority shareholders must "control the corporation ... [to] benefit all shareholders proportionately ... ." *Id.* at 108. The logical consequences of Moore's unsupported contention are revealed with a simple question: if all majority shareholders had the legal right to pay themselves the entire earnings of the company, who would ever be foolish enough to be a minority shareholder? Moore's proposition would render the entire model of corporate ownership economically futile. Obviously, this is not the law.

Second, Moore's advice to the Majority Shareholders was a significant factor in their actions: i.e., but for Moore's design of the scheme, the Majority Shareholders night have embarked upon some other course of action concerning their dispute with Appellants.[4]

Third, Moore's direct participation in the scheme was, itself, seriously misleading to the Appellants. They did not think that Moore, *a lawyer*, would plot against them. Appellants presumed, like most lay people, that Moore would give lawful advice. The effect of this mis-perception through his professional status was reinforced when Moore had himself elected as new corporate counsel for the company. Simply put, Moore's actions exemplify why lawyers are licensed, subject to a fiduciary duty, and presumed to be acting in accordance with the law. Public policy is intended to make this a reality, not the subject of more jokes.

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[3] The company had elected Subchapter S status under IRS rules at the commencement of operation. This election caused the profits and losses of the company to be treated on a partnership basis and they were passed through pro rata based upon percentage ownership. The course of conduct from 2004 through 2010 had been to share profits/losses pro rata based upon stock ownership. SAC ¶19.

[4] Documents found during discovery reveal that the transfer of all of the company's assets to a new company owned solely by the Majority (leaving DC Tech an empty shell) was another option discussed with Moore.

## III. Moore's Responsibility To His Clients

The Majority did not have the knowledge and expertise in corporate law to devise or effectuate a plan to take the company away from Appellants. This was their desired end result and they hired Moore to help them accomplish it.

In this appeal we are looking at what Moore should have done when the Majority Shareholders asked him how they could take all of the economic value of the company for themselves. Moore had a choice to make. He could either: (a) advise the majority to abide by their fiduciary duty and operate the company for the economic welfare of all of its shareholders; (b) assist the Majority Shareholders with lawful negotiations to resolve the matter; or (c) if the Majority refused to heed any warning about their fiduciary duty to the Appellants, then refuse to advise or assist the majority with their desire to wrest the company entirely away from Appellants.

What did Moore do? He not only told the Majority Shareholders how they could take all economic value away from the minority, he drew up the documents to effect the plan, held the meeting at his office, never disclosed to Appellants his prior relationship with the Majority, had himself elected as new company counsel, acted as secretary of the March 22, 2011 meeting, managed the meeting and called the agenda items that he had prepared, and then wrongfully recorded the votes cast at the meeting. *Respondent took these actions for pay and with a view towards further fees as company counsel*. SAC ¶ 24.

Moore's conduct was the direct cause of the harm to Appellants. Moore is liable because he formulated the fraud, drew up the papers to effect the fraud, participated in the fraud, and failed to make disclosure to Appellants. He cannot now claim that the Majority Shareholders are solely responsible.

## IV. The Statute Of Limitations Did Not Run

Respondent continues to argue that the statute of limitations ran before Appellants amended the complaint to name Moore. The allegations of SAC ¶ 33

show that Appellants were unaware of the prior relationship between Moore and the Majority Shareholders (or any of the other conduct alleged in ¶¶ 21-25) until Appellants found documents in the discovery production by the Majority Shareholders that revealed Moore's hidden role in the scheme.

The question is not whether the means to discovering the truth about a fraud are open to a party (as contended by Moore), but rather, would a prudent man *under the circumstances* have been made to inquire about a fraud. See *Vega*, *supra*, at 296-299. In this case, the mere fact that the meeting was conducted in Moore's office was not sufficient to make Appellants suspicious because, as far as Appellant's new, Moore was just being nominated to replace a prior company counsel. It would have been unreasonable, indeed fanciful, for Appellants to have imagined that Moore and the Majority Shareholders had already devised an entire scheme to take the value of the company for themselves and that the purpose of the meeting was to effect that plan. *At that time the parties had worked together successfully for over six years and there was still a modicum of respect and trust.* The profits of the company had been split *pro rata* from 2004 through 2010 and Appellants had no reason to suspect that the meeting of March 22, 2011, was part of a plan to deprive them of all future economic value, and further, that Moore was the mastermind.

## V. **Summary And Conclusion**

Respondent's interpretation of the law and Rules of Professional Responsibility would allow an attorney to advise majority shareholders to take for themselves all economic value of a company. Further, the majority shareholders could then defend against minority shareholders on the theory that they acted under the "advice of counsel" to escape liability (e.g., no liability for fraud absent

intent) or to defeat exemplary damages (i.e, acted in good faith).[5] Indeed, this is exactly what the Majority Shareholders have pleaded in their Answer to the Second Amended Complaint. Respondent's majority-take-all approach would vitiate the rules set down in *Ahmanson* and turn our corporate economic system inside out.

For the foregoing reasons, the trial court's ruling sustaining the demurrer of Andy Moore to Appellants' Second Amended Complaint should be reversed and the case remanded.

Respectfully Submitted,

Dated: July __, 2014 ______________________________
Patrick H. Dwyer, Attorney for Appellants

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[5] See e.g. *Rosener v Sears Roebuck & Co.* (1980) 110 Cal App 3rd 740, 756; *State Farm Mutual Insurance Company v. Superior Court* (1991) 228 Cal. App. 3d 721.

## 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 VI) is approximately 2385.

______________________________
Patrick H. Dwyer,
Attorney for Appellants

Date: July __, 2014

## PROOF OF SERVICE

I hereby certify under penalty of perjury that a copy of the Appellants' Reply Brief in the matter of Daus v. Andy Moore, Case No. 78702, appeal No C075019 was served on April 4th, 2014, via U.S. First Class mail, postage prepaid, upon the following:

1. Counsel for Defendant and Respondent addressed as follows:

   Gregory S. Cavallo, Shopoff Cavallo & Kirsh LLP, 100 Pine Street, Suite 750, San Francisco 94111; email address: Gregory Cavallo <greg@scklegal.com>

2. The Superior Court for the County of Nevada, Department 6, 201 Church Street, Nevada City, California 95959 (one copy).

A further copy is served upon the California Supreme Court by the electronic submission to the Court of Appeal, Third Appellate District.

I declare under penalty of perjury under the laws of California that the foregoing certification is true and correct.

______________________________
Signature

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Print Name

Date: July __, 2014

Location: Penn Valley, CA 95946