Case No. C082786
Nevada County Superior Court Case No. CU12-078702

IN THE COURT OF APPEAL OF CALIFORNIA
THIRD APPELLATE DISTRICT

Andy and Maryclaire Daus,
Appellants

v.

Paula Howser, Brian Howser and Vaughn Warriner,
Respondents.

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

APPELLANTS' REPLY BRIEF

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I. Arguments in Reply

This case is very important to the world of non-public corporations in California. Respondents are attempting to circumvent the fiduciary duty rule set down in *Jones v. H. F. Ahmanson & Co.* (1969) 1 Cal. 3d 93 ("*Jones*") that majority shareholders must run a company for the economic benefit of all shareholders, not just the majority. They do this by conflating the distinct concepts of corporate ownership and corporate employment. In their minds, Respondents thought that because Appellants did not work for the company after 2010 that they were not entitled to any economic benefit from their 40% ownership in the company. PSUF 65, CT 459:15 to 460:4 | P Ex. 5, Paula Howser Depo., CT 532:23 to 533:1, CT 542:22 to 543:7; P Ex. 7, Warriner Depo., CT 565:22 to 566:6, CT 579:19 to 580:4; P Ex. 6, Brian Howser Depo., CT 551:25 to 552:4, CT 553:12-20, CT 554:11-15. This is not only completely contrary to the fiduciary duty rule set down in Jones, but it also ignores California's express statutory law giving stockholders the right to a *pro rata* distribution of company profits. Opening Brief ("OB"), Introduction, Fn1.

A. Respondents Were Not Given the Company's Profits at the March 22, 2011 Meeting

The trial court's granting of summary judgment on Appellants' Breach of Fiduciary Duty claim was based upon its finding that "the material facts of the transaction relating to compensation were disclosed to the Board". As shown in Appellants' OB, Section VI.A, there is no evidence to support such a finding and the summary judgment must be vacated.

What happened at the March 22, 2011 is crucial to this case. Respondents do not dispute that they pushed through, over the negative votes of Appellants, resolutions creating the compensation committee and

appointing themselves as the only committee members. P. Ex. 13, p.3-4, Minutes of the Special Meeting of the Board of Directors ("Minutes"), CT 640-641. Although Respondents thought they were just fulfilling their desire to get rid of Appellants, see P. Ex. 16, Notice of a Special Meeting of Board of Directors of DC Tech, Inc., CT 667, they were, in fact, creating a conflict of interest under both the company bylaws, P. Ex. 12, Bylaws of DC Tech, Inc., §2.15, CT 628-629; California Corporations Code § 307(b)&(c).

Respondents argue that Appellants' "Approval of Officer Compensation" at the March 22nd meeting gave them *carte blanche* to pay themselves whatever they wanted for 2011 and thereafter. However, the resolution they refer to in P. Ex. 13, p.2, Minutes, CT 639, *does not do that*. The resolution specifically approves the past compensation paid to the officers for 2010 through February 2011. That compensation of officers has never been a subject of this action: only the distribution of company profits to all shareholders *pro rata*. The resolution then says that the board approves the compensation "proposed" for officers for the rest of 2011, but it does not mention specific amounts.[1]

First, the Third Amended Complaint does not allege that the amount of compensation paid to the officers in 2011 was unauthorized. It alleges that the Respondents paid to themselves the *profits* of the company for 2011 that

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[1] P Ex. 17, CT 669, is a chart prepared by Respondents CPA showing the compensation paid to officers for 2004-2011. There is nothing in the March 22, 2011 minutes that discloses that Respondents would pay themselves much higher salaries for 2011 (Paula Howser got a 26.5% increase over 2010 for no additional work, Vaughn Warriner got a 36.5% increase over 2010 for no additional work, and Brian Howser got a 45.8% increase with additional work), plus bonuses of $35,500 for Paula Howser and Vaughn Warriner and $71,000 for Brian Howser.

should have been paid out as dividends to Appellants. P. Ex. 1, Third Amended Complaint for Breach of Fiduciary Duty, Fraud, Conspiracy, Conversion, and Preliminary Injunction ("TAC"), ¶¶ 26-28, 40, 43, CT 485:18 to 486:11, CT 490:7-11, CT 490:23 to 491:1.[2] Second, the absence of any specific compensation numbers in the resolution creates a very important triable issue of fact: what amount of compensation for 2011 did Appellants and Respondents approve? Appellants contend that they only agreed to pay the same officer compensation to Paula Howser and Vaughn Warriner as was paid in 2010 and to pay Brian Howser additional compensation to make up for the extra work he had to perform when he took over from Any Daus. Appellants never agreed to pay Respondents all future company profits. PSUF 44, CT 452:10-26; PSUF 62, CT 458:11-21; PSUF 64, CT 459:2-14; PSUF 66-68, CT 460:5 to 461:24; PSUF 70-71, CT 462:13 to 463:9; PSUF 77-80, CT 464:26 to 466:7 | P Ex. 2, Plaintiffs Answers to RFA, CT 500-506; P Ex. 9, Andy Daus Dec. ¶¶5-7,9,11, CT 613:11 to 614:3, CT 614:11, CT 614:18-23 ; P Ex. 6, Brian Howser depo., CT 557:3-16; P Ex. 8, Jody Brown Depo., CT 588:1 to 589:10, CT 590:12 to 606:20; P Ex. 48, CT 749-775; P Ex. 11, Kris Hall Dec. ¶¶3-6, CT 621:3 to 622:9; P Ex. 16, CT 667; P Ex.s 21-25, CT 683-695; P Ex. 45, CT 742-743; P Ex. 5, Paula Howser Depo., CT 529:16 to 531:21, CT 533:14-25, CT 534:22 to 535:23, CT 536:13 to 537:8, CT 538:19 to 539:15, CT 540:6-19, CT 541:3-23, CT 544:12 to 545:6, CT 545:24 to 546:19, AR 51:7 to AR 52:22; P Ex. 3, Andy Daus Depo., CT 518:13 to 519:17; P Ex. 7, Vaughn Warriner Depo., CT 565:18 to 566:17, CT 567:7-19, CT 568:12 to 569:24, CT 570:5-20, CT 571:5 to 572:8, CT 577:15 to 578:19 (depo. exam. re P. Ex. 17, CT 669 and P Ex. 30, CT 705-707), CT 579:19 to 580:4, CT 581:14 to 582:19; P Ex.

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[2] These correspond to Second Amended Complaint ¶¶ 26-28, 40, 43.

50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795; P Ex. 17, CT 669.

The trial court never considered the factual issues that have to be determined by a jury for 2011, let alone for 2012 and thereafter. There was no disclosure of "material facts relating to compensation" that were disclosed to Appellants at the March 22, 2011 meeting or at any other time.

Indeed, the evidence submitted by Appellants demonstrates that the salaries and bonuses paid to the Respondents was not finally determined until the end of 2011 by the action of the compensation committee (i.e., the unilateral action of Respondents) without any notice to, or approval of, Appellants. P Exs. 28-30, CT 701-707. These exhibits prove that Appellants never approved the actual compensation for Respondents for 2011.

B. **Respondents Ignore Their Fiduciary Duty**

Respondents never mention, let alone discuss, their fiduciary duty to Appellants under *Jones*. Appellants First Cause of Action for Breach of Fiduciary Duty was thoroughly briefed by Appellants in Section VI.B of the OB. Respondents' failure to disagree with the legal argument or any of the cited authorities is a concession that Respondents have no countervailing argument.

Respondents also failed to respond to Appellants' statement of the law that the Business Judgment Rule does not create any exceptions to the fiduciary duty rule. OB, Sections VI.C, VI.F.

Respondents did not disagree with Appellants' position set forth in OB Section VI.D, that the company's bylaws are subordinate to California statutory and judicial rules. Even more important, Respondents did not rebut Appellants' analysis of the legal error made by the trial court in not

considering the portion of the company bylaws, §2.15, that requires that any "conflict of interest transaction" be approved by the vote of the disinterested directors.

C. The Misappropriation of Dividends Was Grossly Unfair

Respondents based their Opposition on a series of factual assertions that were fully rebutted by Appellants. Hence, these are questions of fact for the jury. Here are the most important *questions for a jury*:

1. Shareholders Did Not Have to Work to Receive Dividends

Respondents have continued to present misleading arguments to the Court. In the MSJ, Defendants argued that the understanding of the owners from the beginning was that the shareholders were required to work in order to get paid. CT 412, p. 2:13-15. Respondents made this argument to try to convince the trial court that there was no change in the payment of dividends beginning with the March 22, 2011 Board meeting.

Appellants unequivocally proved this statement to be misleading in both their Opposition to the MSJ and again in their OB at Section VI.H. Now the Respondents have re-worded their argument again with the false hope that this Court will become confused and conflate the payment of dividends based upon stock ownership with the payment of salary and bonus for services as an employee. Respondents' Brief, p. 23.

As Appellants pointed out in the OB, Maryclaire Daus never worked for the company and never received any salary or bonus. However, Maryclaire Daus always received her *pro rata* share of dividends based upon her stock ownership from 2004-2010. Starting with 2011, the Respondents breached their fiduciary duty and paid to themselves, as extra salary and bonus, all of the profits of the company leaving nothing to be paid out as

dividends to Andy and Maryclaire Daus while they paid themselves grossly excessive salary increases and large bonuses that were equal to the amount of company profits leaving no funds to be paid as dividends. Appellants OB, p. 24, subsection "a".

2. Andy Daus' Leave of Absence Did Not Hurt the Company or Give Cause to Not Pay Dividends

Respondents try to divert the Court's attention from the issues on appeal by attempting to justify the diversion of all company profits to themselves because "Andy Daus unilaterally ceased working as an employee" as of June 1, 2010 and "he never provided his co-shareholders with a consistent explanation as to why he left". Appellants' OB points out that the evidence controverts these factual allegations, specifically citing to the evidence that Andy Daus gave three weeks notice and took a *leave of absence* to take care of his wife who had experienced a serious personal trauma. OB, p. 24, subsection "b". More importantly, such factual contentions are simply irrelevant because, even if true, they would not justify the breach of Respondents' fiduciary duty to Appellants by the diversion of all profits to themselves.

Appellants' evidence shows that Brian Howser continued to pay himself additional compensation even after he hired a replacement for Andy Daus. OB, p. 24, subsection (c). This fact, which is not disputed by Respondents, vitiates their entire "equitable" justification for taking all of the company's profits for themselves, leaving Appellants nothing.

D. The Court's Prior Decision Regarding Andy Moore Is Irrelevant

Respondents' improperly try to argue that this Court's decision in *Daus v. Moore,* C075019 (unpublished 2015), is somehow applicable to this action.

This Court made it clear in *Daus v. Moore* at p. 2 that its decision concerning the liability of attorney Andy Moore is not relevant to "[t]he remaining portion of the case as against Howser."

E. **Respondents Planned the Financial Takeover of the Company**

Respondents assert that Appellants did not present any evidence that Respondents planned the financial ouster of Appellants. This is simply false and Appellants evidence on this point is both un-controverted and substantial. OB, p. 24-25, subsections "f -g".

F. **Appellants Submitted Extensive Admissible Evidence**

Respondents make a bizarre argument that Appellants did not have any admissible evidence. Both parties submitted objections to the evidence to the trial court and these objections in substantial part were overruled. AR 7. Respondents did not file any cross appeal on the trial court's evidentiary ruling and have not made any argument in their Opposition Brief that the trial court was in error. Thus, Respondents have waived any argument that the evidence submitted by Appellants is not properly before this Court in its *de novo* review. As shown in Appellants' OB and the foregoing Reply argument, the Appellants' appeal is based upon voluminous admissible evidence that creates triable issues of fact on every aspect of the action.

II. Conclusion

The trial court's ruling was premised upon a factual finding that "material facts of the transaction relating to compensation were disclosed to the Board, as it was other Board members [i.e, Appellants] who voted in the compensation committee." This finding was not supported by any reference to specific evidence, but appears to be a misunderstanding of the minutes of the March 22, 2011 Board Meeting. The evidence is clear that Appellants

never approved the Respondents' *allocation of all company profits* to themselves for 2011 or any year thereafter. Appellants vote to approve the salaries paid in the prior year (2010) and authorize, in general terms, the payment of salaries for 2011. *The question of what would have been reasonable compensation for Respondents, however, is one of fact for a jury*.

The trial court also found in the alternative that Respondents would be protected under the Business Judgment Rule. However, the trial court never even mentioned the fiduciary duty rule or any of the law cited by Appellants showing that there is no Business Judgment Rule exception to the fiduciary duty rule in *Jones*. Moreover, even though the trial court *found that there was a conflict of interest*, it ignored the law cited by Appellants that the Business Judgment rule cannot protect self-dealing and bad faith actions of directors. In addition, the trial court erroneously interpreted the language of the bylaws by ignoring the language that says that where there is a conflict of interest, only the votes of *disinterested directors* are counted. Lastly, the trial court completely misconstrued the Appellants' answers to RFAs to mean the exact opposition of what the answers actually meant in context. This has been clearly shown in Appellants' OB, VI.E.

Appellants introduced extensive evidence that Respondents never relied upon the advice of counsel for the proposition that they could allocate all profits to themselves and ignore Appellants' shareholder rights. OB, VI.G. Indeed, Respondents could not point to a single letter, email, or even time billing entry to such effect by any lawyer. Strikingly, when Paula Howser asked an internet lawyer for advice, she was reminded that her entire "plan" to freeze out the Appellants was wrongful. OB, VI.6, p. 40-41.

The trial court not only ignored the fiduciary duty rule concerning the

First Cause of Action, it then ignored the pleadings for fraud which are based upon concealment, not express representation. Respondents had a duty to disclose, but instead, denied Appellants any knowledge about the management or operation of the company.[3] As soon as Appellants learned that there was financial defalcation, they acted to protect their shareholder right to a fair portion of the company's profits and for participation in management of the company, first sending written demand for full disclosure and then filing suit in June 2012.

With regard to the Motion to Compel, Respondents simply ignore, like the trial court, the fact that their expert witness was the company's CPA *and has exclusive access to the electronic books and records of the company*. It is not possible for Appellants' expert to properly evaluate what would have been the fair allocation between dividends and compensation without being able to verify the financial state of the company, determine the total amount of payments by the company to Respondents, and cross check the printouts that were produced. It is a gross procedural due process violation to allow Respondents to refuse to produce information in a form that Appellants' expert requires for the proper analysis of the claims.

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[3] Appellants are directors. As such they are entitled to all information at the same time as Respondents. They also have aright to vote on all board actions, including those of the compensation committee.

Based upon the foregoing, Appellants respectfully request that this Court vacate the Summary Judgment, grant Appellants' Motion to Compel, and remand for a jury trial. Appellants request an award of costs on appeal.

Respectfully Submitted,

Dated: June 8, 2017

/s/ Patrick H. Dwyer
Patrick H. Dwyer,
Attorney for Appellants

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 II) is approximately 2,650.

/s/ Patrick H. Dwyer
Patrick H. Dwyer,
Attorney for Appellants

Date: June 8, 2017

PROOF OF SERVICE

I hereby certify under penalty of perjury that a copy of the Appellant's Reply Brief in the matter of Andy and Maryclaire Daus v. Paul Howser, Brian Howser, and Vaughn Warriner, Case No.CU12-078702 , appeal No. C082786 was served via electronic email to:

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And by U.S. First Class mail, postage prepaid, upon the following:

1. The Superior Court for the County of Nevada,
201 Church Street
Nevada City, California 95959.

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

/s/ Patrick H. Dwyer
Patrick H. Dwyer,

Date: June 8, 2017

Location: Penn Valley, CA 95946