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' OPENING BRIEF

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February 27, 2017

Certificate of Interested Persons

I hereby certify under penalty of perjury that, to the best of my knowledge and belief, the following "persons" are the only known persons that qualify as "interested" persons:

Paula Howser

Brian Howser

Vaughn Warriner

DC Tech, Inc.

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

Date: February 27, 2017

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I. Introduction

This is an appeal by Appellants Andy and Maryclaire Daus ("Appellants") of a decision by the Nevada County Superior Court granting a summary judgement motion filed by Paula Howser, Brian Howser, and Vaughn Warriner ("Respondents"). Also included in this appeal is a ruling of the trial court denying Appellants' Motion to Compel.

Appellants own forty percent of a company called DC Tech, Inc., a closely-held California corporation ("Company") and are the minority shareholders. Respondents own sixty percent of the Company and are the majority shareholders. The case focuses on the fiduciary duty owed by the majority shareholders to the minority shareholders in a closely-held corporation. Appellants also pleaded fraud, conspiracy, and conversion counts.

The existence of a fiduciary duty on the part of majority shareholders to minority shareholders in a closely-held corporation has a long history in California. The California Supreme Court delineated this duty almost fifty years ago in the landmark decision of *Jones v. H. F. Ahmanson & Co.* (1969) 1 Cal. 3d 93 ("*Jones*"). This fiduciary duty has been affirmed in multiple appellate decisions and was further explained by the Supreme Court in *Stephenson v. Drever* (1997) 16 Cal. 4th 1167, 1178-79 ("*Stephenson*").

In *Jones*, the Supreme Court held that majority shareholders cannot use their voting control of the Board of Directors to exclude minority shareholders from participation in the company's management or to operate the company for the financial benefit of the majority at the expense of the minority. Indeed, the Supreme Court found that the majority had an affirmative duty to "control the corporation in a fair, just, and equitable manner" and that majority

shareholders must use "their power to control the corporation" for the "benefit of all shareholders proportionately." *Jones* at 108.

Appellants have alleged that Respondents took control of the Company in 2011 and have thereafter run the Company for Respondents' exclusive benefit. Every year since, Respondents have paid themselves extra salary and bonuses equal to the amount of the Company's profit, leaving nothing to be paid out as dividends to the shareholders *pro rata* as had been done from 2004 to 2010.[1] This has left Appellants with no economic benefit for their 40% share of the Company.

Respondents have not denied that the Company's profits were mis-allocated from dividends to extra salary and bonuses for themselves. Nor do they aruge that they don't have a fiduciary duty to operate the Company for the benefit of all shareholders. Rather, Respondents argue that the Company's Bylaws grant them immunity because they allegedly acted in 2011 upon the advice of counsel. Assuming, *arguendo*, that they did follow the advice of counsel in 2011, which the evidence shows they did not, Respondents were certainly put on notice in 2012 that their conduct was wrongful when Appellants commenced this legal action.

In its ruling, the trial court never discussed Respondent's fiduciary duty to operate the Company for the benefit of all shareholders. It also did not discuss the applicable law for the Business Judgment Rule and it did not

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[1] California Corporations Code ("Corp. C") §166 establishes the right of a shareholder to receive dividends, *Stephenson v. Drever* , 16 Cal. 4th at 1176-1177, while Corp. C §400 provides that shareholders with the same class and series of stock receive "the same voting, conversion and redemption rights and other rights, preferences, privileges and restrictions, unless the class is divided into series." Here, the Company issued ordinary common stock entitling all shareholders to *pro rata* distribution rights.

discuss the facts presented by Appellants. Instead, the trial court premised its granting of the motion upon a misunderstanding of the law and a series of unsupported and incorrect factual findings.

The trial court began with a correct finding that Respondents were in violation of the conflict of interest provision in the Bylaws because they were the only members of the special committee and they decided the amount of their own salary and bonuses. However, the trial court then erroneously found that the "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." AR 7. However, as shown below, there is *no evidence* that Respondents ever disclosed their votes on compensation to the Board of Directors for 2011 or thereafter, and further, there is *no evidence* that Appellants ever approved any extra salary or bonuses for Respondents.

The trial court further erred by ignoring the evidence that proved that Respondents did *not act upon the advice of counsel* when they excluded Appellants from any participation in the management of the Company and mis-allocated all profits to themselves. The trial court also failed to discuss either the Business Judgment Rule or the evidence showing that Respondent's misconduct was not protected under this doctrine.

Finally, the trial court dismissed the fraud claim based upon its prior erroneous finding that Appellants had approved the mis-allocation of profits.

Simply put, the trial court ignored both the overwhelming evidence submitted by Appellants and the applicable law. The matter should be reversed and remanded for trial.

II. Statement of Appealability

On August 2, 2016, Appellant filed a Notice of Appeal from the:

(a) July 22, 2016, Judgment of Nevada County Superior Court granting Respondents' Motion for Summary Judgment ("Judgment") pursuant to California Code of Civil Procedure ("CCP") §904.1(a)(1); and

(b) denial of Appellants' Motion to Compel pursuant to CCP §906.

CT 957-968. The Notice of Appeal was filed within 60 days of entry of each of the foregoing, and thus, it was timely filed under California Rules of Court, Rule 8.104.

III. The Standard of Review

A. The Standard for Summary Judgment

The standard of review for a decision of a trial court granting summary judgment is *de novo* review. The purpose of a *de novo* review is to determine if there are triable issues of fact that should have been sent to the jury. The facts from the record that was before the trial court when it ruled upon the summary judgment motion, except for evidence to which an objection was sustained, are the basis for the review. The moving party bears the burden of proof and the evidence must be liberally construed to support the party opposing summary judgment and resolve doubts concerning the evidence in favor of that party. California Code of Civil Procedure §437c, subd. (c); *Ennabe v. Manosa* (2014) 58 Cal. 4th 697, 705; *CLoniki v. Sutter Health Central* (2008) 43 Cal. 4th 201, 206; *Yanowitz v. L'Oreal USA, Inc.* (2005) 36 Cal. 4th 1028, 1037.

B. The Standard for a Motion to Compel

Discovery orders are reviewed under a deferential abuse of discretion standard. *Digital Music News LLC v. Superior Court* (2014) 226 Cal. App. 4th 216, 224-225, citing to *Krinsky v. Doe 6* (2008) 159 Cal. App. 4th 1154, 1161. An appellate court may reverse when a trial court " 'applies the wrong legal standards applicable to the issue at hand.' " *Digital Music News LLC* at 224, quoting from *Doe 2 v. Superior Court* (2005) 132 Cal. App.4th 1504, 1517.

IV. Issues on Appeal

A. Summary Judgment

1. Whether the trial court erroneously found that Appellants had approved the amounts of compensation for Respondents for 2011 or any year thereafter;
2. Whether the trial court failed properly to apply the advice of counsel defense, which requires that any action taken pursuant to advice of counsel be done in good faith;
2. Whether the trial court erroneously found that Respondents acted upon the advice of counsel in setting the amount of their own compensation and the distribution of Company profits among the shareholders;
3. Whether corporate bylaws can supercede the State's Corporations Code and judicial decisions;
4. Whether the Business Judgment Rule can supercede the fiduciary duty of close corporation majority shareholders to minority shareholders;
5. Whether the trial court misapplied the Business Judgment Rule;
6. Whether the trial court failed to consider and apply the fiduciary duty rule for majority shareholders toward minority shareholders in a closely-held corporation, where the majority shareholders distributed all Company profits to themselves in the form of excessive salaries and bonuses;
7. Whether the trial court applied the wrong legal standard for evaluating Appellants' fraud claims based upon fraud by concealment, not fraud by misrepresentation; and

8. Whether the concealment of a close corporation's financial information by majority shareholders from minority shareholders, including the basis for the majority's allocation of profit to themselves as salary, is an actionable fraud.

B. **Motion to Compel**

Whether the trial court abused its discretion in denying Appellants' request for evidence that they needed to (a) prove their damages; and (b) enable their expert to analyze and verify the damage information provided by Respondents' expert.

V. Statement of the Case

A. Chronology of Pertinent Events

June 4, 2012	Complaint against Brian Howser, Paula Howser, and Vaughn Warriner for Breach of Fiduciary Duty, Fraud and conversion filed in Nevada County Superior Court.
July 25, 2012	Answer to Complaint by all Defendants.
March 13, 2013	First Amended Complaint adding Andy Moore as a defendant with new causes of action for breach of fiduciary duty, fraud and conspiracy.
June 3, 2013	Defendant Andy Moore filed a demurrer to the First Amended Complaint .
July 26, 2013	Demurrer by Andy Moore was sustained with leave to amend.
August 12, 2013	Second Amended Complaint filed.

August 27, 2013	Defendant Andy Moore filed a demurrer to the Second Amended Complaint.
October 8, 2013	Demurrer was sustained without leave to amend.
October 23, 2013	Appeal of granting of demurrer filed by Appellants.
May 1, 2015	Decision by Third District Court of Appeal affirming trial court's ruling on Defendant Moore's demurrer.
August 14, 2015	Remittitur
April 8, 2016	Defendants Motion for Summary Judgment ("MSJ").
June 24, 2016	Oral argument on Summary Judgment Motion.
July 22, 2016	Judgment entered in favor of Defendants Howser and Warriner.

B. Notes on Format of Factual Citation in Brief

Appellants' citations to supporting evidence is done, first, to the Plaintiffs' Statement of Undisputed and Disputed Facts in Opposition to Defendants' Motion for Summary Judgment (abbreviated "PSUF") in the Clerk's Transcript ("CT"). The citation to the PSUF is followed by a "|" symbol, then Appellants cite to the specific exhibits that are referenced in each PSUF that is cited (abbreviated "P Ex.") and their location in the CT.

Appellants have filed a Motion to Augment the Record along with this brief. Citations to documents included in the Motion to Augment are cited as "AR #".

C. Factual Background

In 2004, Appellants Andy and Maryclaire Daus, along with Respondents Brian Howser, Paula Howser, and Vaughn Warriner, started DC Tech, Inc. ("Company") as a California corporation. The Company provides commercial electrical services. Respondents Brian Howser, Paula Howser, and Vaughn Warriner together own 60% of the outstanding shares ("Majority Shareholders"). Appellants Andy and Maryclaire Daus own the balance (40%) of the outstanding shares ("Minority Shareholders").

The Company elected subchapter S status and has done its accounting on a partnership basis. Each of the five shareholders were (and still are) directors of the Company. From 2004 through May 2010, Andy Daus, Brian Howser, and Vaughn Warriner were full-time salaried employees of the Company, while Paula Howser worked part-time as the Company bookkeeper. Maryclaire Daus had full-time employment with another company.

For 2004 through 2010, the Board of Directors, comprised of the five shareholders, approved all salaries and distributions of profits/losses *pro rata* based upon stock ownership. The Company prepared federal and state tax returns and sent each shareholder a K-1 statement as required by I.R.S. rules. Thus, as owners of 40% of the outstanding stock, Appellants received 40% of the net profit/loss (after all Company salaries were paid) for the years 2004-2010. The Respondents were treated identically, but received 60%.

Appellant Maryclaire Daus experienced a personal trauma in the Spring of 2010. Andy Daus gave three weeks' notice and took a leave of absence from his full-time Company job beginning June 1, 2010, to care for Maryclaire. Andy Daus drew his Company salary through May 2010, but not afterwards. Andy Daus acknowledged to Respondents that his leave of absence created a

burden on Brian Howser who had to cover for Andy until the Company could hire a replacement. Andy Daus said at the time of his leaving that Brian Howser should be paid extra salary and/or bonus for his extra work.

Almost immediately after Andy Daus took leave to care for Maryclaire, Respondents became hostile and took the position that, because Andy Daus was no longer working for the Company, he and Appellant Maryclaire Daus were not entitled to any of the profits of the Company and that their stock was only worth the book value of the Company's physical assets and not any of the intangible assets (e.g., going concern, company name, customer base, necessary licensing, etc.). This is ironic because the shareholders declined to modify the bylaws that would have required each shareholder to work for the Company in order to receive dividends (see Section VI.G, below).

In February, 2011, the Majority Shareholders solicited legal advice from a California attorney about what actions they could take to stop Appellants' participation in the management of the Company and to take Appellants' share of profits for themselves. The attorney recommended a plan to create a special compensation committee composed of only the Respondents. A special board meeting was called, but the agenda included with the meeting notice did not mention any resolution to create the special compensation committee. The special board meeting was held on March 22, 2011, at the attorney's office. There was no disclosure to Appellants of the prior communications between Respondents and the attorney about how Respondents could get rid of Appellants and/or deprive Appellants of any economic value. At the meeting, Appellants voted against the un-announced resolutions to create the special compensation committee and voted against the appointment of Respondents as its only members – facts that were ignored by the trial court.

Since the March 2011 special board meeting, there have been no regular meetings of the board of directors and Appellants have been shut out of the management of the Company, including not receiving any periodic financial statements.[2] Meanwhile, the special compensation committee (i.e., the Respondents) has met informally at the end of each year to set salaries and bonuses retrospectively. Each year since, Respondents have set their salaries and bonuses so that there was no profit left over to distribute to shareholders.[3] Appellants have not received a fair distribution of profit since fiscal year 2010. Meanwhile, Respondents have paid themselves an estimated $ 143,400[4] in salaries and bonuses over what they were entitled to receive.

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[2] There was a Board of Directors meeting called for April 2012, but this turned hostile quickly when Appellants were asked why they expected to have any financial benefit from their stock. PSUF 76, CT 464 |P Ex. 9, Andy Daus Dec. ¶ 7, CT 612-614; P Ex. 49 (April 19, 2012 ltr), CT 777.

[3] Correspondingly, the K-1 statements for these years show nominal profits/losses.

[4] With accrued interest, the amount of dividends is over $177,000.

LEGAL ARGUMENT

VI. Analysis of the Breach of Fiduciary Duty Claim

A. Appellants Never Approved the Compensation Voted by Respondents for 2011 to the Present

The trial court began with the correct finding that Respondents were in violation of the conflict of interest provision in the Bylaws because they were the only members of the special committee and they decided the amount of their own salary and bonuses. However, the trial court then erroneously found that the "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." AR 7.

The trial court does not cite to any supporting evidence for this finding. There is *no evidence* that Appellants ever approved any salary or bonuses for Respondents for 2011 and thereafter. Further, there is *no evidence* that Respondents (who were the only members) ever disclosed their votes on the special compensation committee to the Board for 2011 and thereafter.

It is possible that the trial court became confused over a vote at the March 22, 2011 shareholder meeting. At the beginning of this meeting, the shareholders, including Appellants, approved the *compensation paid* to Company officers *for 2010*. CT 638-339. This vote *did not approve any salaries for 2011 and thereafter*. A few minutes later in the same meeting, the Respondents offered the *surprise* resolution (i.e., this resolution was not on the agenda sent to Appellants) to create the special compensation and contract committees. Appellants voted against it, but Respondents voted in favor of it. Respondents then voted to appoint themselves as the only committee members over the “no” votes of Appellants. CT 640-641 | PSUF 67, CT 460 | P Ex. 16,

CT 667; P Exs. 21-25, CT 683-695; 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.

Here are the *four key facts* on this issue *which the trial court ignored*:

1. Appellants voted against the creation of these special committees at the March 22, 2011 meeting. PSUF 69, CT 461:24 to 462:13| P Exs. 13, 16, 22, 24, CT 638-641, CT 667, CT 686-687, CT 691-693; P Ex. 9, Andy Daus Dec. ¶10, CT 614:12-17; 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; P Ex. 7, Warriner Depo., CT 565:18 to 566:6.

2. The Respondents voted only themselves onto these committees, over Appellants' objection, depriving Appellants of the ability to approve compensation for any employee for the year 2011 and thereafter. PSUF 69, CT 461:24 to 462:13| P Exs. 13, 16, 22, 24, CT 638-641, CT 667, CT 686-687, CT 691-693; P Ex. 9, Andy Daus Dec. ¶10, CT 614:12-17; 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; P Ex. 7, Warriner Depo., CT 565:18 to 566:6;

3. The special compensation committee, i.e., the Respondents, never disclosed its activities to the Appellants who are directors of the Company. PSUF 70, CT 462:13-23|P Ex. 9, Andy Daus Dec. ¶7, CT 613:23 to 614:3; P Ex. 5, Paula Howser Depo, CT 538:19 to 539:15; P Ex. 7, Warriner Depo, CT 567:7-19, CT 570:5-20; and

4. The Respondents used the special compensation committee to pay themselves all profits of the Company for 2011 and thereafter. PSUF 71, CT 462:24-463:9| P Ex. 17, CT 669; P Ex. 9, Andy Daus Dec. ¶9, CT 614:11; P Ex. 11, Kristoffer M. Hall Dec. ¶¶4-6, CT 621:11 to 622:8; P Ex. 7 Vaughn Warriner Depo., CT 568:12 to 569:24, 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. 5, Paula Howser Depo., CT 540:6-19, CT 541:3-23, CT 544:12 to 545:6, CT 545:24 to 546:19.

Quite simply, the failure of the trial court to consider these facts led to its erroneous factual finding and its erroneous granting of summary judgment.

B. **Breach of Fiduciary Duty**

The trial court's Ruling failed to discuss Appellants' primary factual contention in the action: that Respondents breached their fiduciary duty to Appellants by distributing all of the Company's profits to themselves commencing in 2011 and continuing thereafter until the present.

Appellants' Memorandum in Opposition to Respondents' Motion for Summary Judgment ("Opposition") begins with citation to the California Supreme Court decision in *Jones* that confirmed the fiduciary duty on the part of majority shareholders to operate a company for the benefit of all shareholders proportionately. CT 411-412. In the words of the *Jones* Court:

> Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business. *Jones* at 108.

Appellants' Opposition then went into extensive factual detail about how Respondents had breached the duty to share profits *pro rata* as required by *Jones*. Further, the Opposition presented both controverted and un-controverted facts that presented a jury question as to whether Respondents had acted knowingly and in bad faith in the payment of salaries and bonuses

to themselves, thus depriving Appellants of their fair share of the Company's profits. Specifically, Appellants submitted evidence that:

a. controverted Respondents' argument that there was an agreement among the shareholders that each had to work for the Company in order to receive any distributions of profit and proved that, in fact, the shareholders declined to approve such an agreement. SUF 5, CT 438:7-21| P Ex. 9, Andy Daus Dec. ¶2, CT 612:22-28; P Ex. 10, Maryclaire Daus Dec. ¶2, CT 617:22 to 618:1; P Ex. 3, Andy Daus Depo., CT 520:10 to 522:24; P Ex. 14, CT 650-651 sec. 7(x)&(xi);

b. controverted Respondents' contention that Andy Daus had taken a leave of absence in bad faith. PSUF 60, CT 457:22 to 458:2; PSUF 61, CT 458:3-10| P Ex. 9, Andy Daus Dec. ¶¶4-5, CT 613:7-16; P Ex. 10, Maryclaire Dec. ¶¶3-4 CT 618:2-10;

c. proved that Brian Howser had continued to pay himself additional salary even after a replacement for Andy Daus had been hired by the Company. PSUF 62-64, CT 458:11 to 459:14| P Ex. 9, Andy Daus Dec. ¶6, CT 613:17-22; P Ex. 6, Brian Howser depo., CT 555:3-18, CT 556:8 to 557:16; P Ex. 7, Warriner Depo, CT 573:25 to 574:2, CT 576:5-12; 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, CT 621:3-10;

d. proved that Respondents excluded Appellants from any participation in the operation and management of the Company and refused to provide periodic financial documents even though Appellants were directors. PSUF 65, CT 459:15 to 460:4; PSUF 70, CT 462:13-23; PSUF 75-76, CT 464:7-26| P Ex. 5, Paula Howser Depo., CT 532:23 to 533:1, CT 538:19 to 539:15, AR 50:17-25, CT 542:22 to 543:7; P Ex. 7,

Warriner Depo., CT 565:22 to 566:6, 566:24 to AR 54:19, CT 567:7-19, CT 570:5-20, AR 55:7-20, 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; P Ex. 9, Andy Daus Dec. ¶7, CT 614:11; P Ex. 26-40, CT 697-727; P Ex. 44-47, CT 740-747; P Ex. 49, CT 777;

e. demonstrated that Respondents had, in fact, paid themselves excessive salaries and bonuses, thereby leaving no profits to distribute to Appellants. PSUF 71, CT 46:24 to 463:9; PSUF 79-80| P Ex. 17, CT 669; P Ex. 9, Andy Daus Dec. ¶9, CT 614:11; P Ex. 11, Kristoffer M. Hall Dec. ¶¶4-6, CT 621:11 to 622:8; P Ex. 7 Vaughn Warriner Depo., CT 568:12 to 569:24, 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. 5, Paula Howser Depo., CT 540:6-19, CT 541:3-23, CT 544:12 to 545:6, CT 545:24 to 546:19;

f. proved that Respondents hired an outside attorney to advise them about how to take all economic value of the Company for themselves. PSUF 66-67, CT 460:5 to 461:7| P Exs. 21-25, CT 683-695; P Ex. 16, CT 667; 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; P Ex. 3, Andy Daus Depo., CT 518:13 to 519:17; P Ex. 7, Vaughn Warriner Depo., CT 565:18 to 566:6; P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795; and

g. proved that Respondents did not rely upon the advice of legal counsel that they were entitled to pay themselves all of the Company's profits to themselves as extra compensation. PSUF 66-68, CT 460:5 to 461:24; PSUF 73, CT 463:19-27| P Exs. 21-25, CT 683-695;

P Ex. 16, CT 667; 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; P Ex. 3, Andy Daus Depo., CT 518:13 to 519:17; P Ex. 7, Vaughn Warriner Depo., CT 565:18 to 566:6; P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795; P Ex. 43, CT 736-738; P Ex. 20, CT 680-681.

Despite this foregoing overwhelming evidence showing that there had been a breach of Respondents' fiduciary duty to Appellants, the trial court altogether ignored the concept of fiduciary duty by majority shareholders. Instead, the trial court erroneously found that: (1) that the Respondents' actions were protected under the Business Judgment Rule; and (2) that the Respondents' actions were protected under the Company Bylaws.

C. There is No Business Judgment Exception to the Majority Shareholders' Fiduciary Duty

The trial court misunderstood and misapplied the Business Judgment Rule. Under this rule, a court will generally not interfere with the majority vote of a board of directors on matters pertaining to the operation of a company: i.e., a court will not substitute its business judgment for that of the directors. However, there are two significant exceptions to the business judgment rule. First, as discussed above, majority shareholders may not use the Business Judgment Rule to vitiate their fiduciary duty to minority shareholders. *Jones* 1 Cal. 3d at 108-112; *Stephenson* 16 Cal. 4th at 1177-1179. Second, as discussed in Subsection E, below, the Business Judgment Rule is not available to directors when they are acting upon a matter in which they have a conflict of interest: i.e, the Business Judgment Rule does not protect self-dealing and bad faith actions.

Before discussing the Business Judgment Rule further, Appellants address in subsections C and D, below, two other erroneous findings that the trial court incorrectly mixed into its findings on the Business Judgment Rule.

D. The Respondents' Actions Were a Conflict of Interest Under the Bylaws

1. Bylaws Are Subordinate to Statutory and Judicial Law

As Appellants pointed out in their Opposition, the bylaws of a company may not supersede the state's statutory and decisional law. CT 418:19 to 419:15. Thus, even if the Company's bylaws could be construed to allow the Respondents' behavior in this case, that behavior violates the California corporation code and the applicable appellate decisions interpreting that law. California Corporations Code §5151(c); See *Health Maintenance Network of Southern California v. Blue Cross of Southern California* (1988) 202 Cal. App. 3d 1043; *Strougo v Hollander* (2015) 111 A.3d 590, 597 (Delaware Court of Chancery holding that: "The bylaws of a corporation are presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws").

2. The Trial Court's Ruling That All Causes of Action Are Barred by the Bylaws Was Erroneous

Notwithstanding the findings by the trial court that Appellants had shown that: (a) Respondents had a "direct interest" in the allocation of the Company's profits between the shareholders; and (b) that there was a direct conflict for Respondents under Section 2.15 of the Bylaws,[5] the trial court granted summary judgment because, as shown under Section VI.A, *supra*, it

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[5] Section 2.15 of the Bylaws are at CT 626-629.

erroneously found that Appellants had approved the compensation voted by the compensation committee for 2011 to the present.

In addition to this fundamental factual error, the trial court also misinterpreted, as a matter of law, the language of Section 2.15 of the Bylaws. The trial court only looked at the first part of Section 2.15 which concerns whether a "conflict of interest transaction" is "voidable by the Company *solely* because of the Director's interest in the transaction" (Emphasis added.).[6] Erroneously, the trial court ignored the remaining language of Section 2.15 which talks about when a "conflict of interest transaction" *can be authorized by the Board of Directors of the company* . This language makes it crystal clear that conflict of interest transactions by directors *can only be approved by the vote of the directors that have no interest in the matter*. Here is the relevant subsection:

> A conflict of interest transaction is authorized, approved or ratified if it receives the affirmative vote of a majority of the Directors on the Board of Directors, or on the committee, *who have no direct or indirect interest in the transaction*. A transaction may not be authorized, approved or ratified under this section by a single Director. If a majority of the Directors, who have no direct or indirect interest in the transaction vote to authorize, approve or ratified the transaction, a quorum is present for the purpose of taking action under this section. The presence of; or a vote cast by, a Director with a direct or indirect interest in the transaction does not affect the validity

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[6] The trial court apparently relied upon a narrow reading of subsection (a) which reads: "The material facts of the transaction and the Director's interest were disclosed or known to the Board of Directors or a committee of the Board of Directors and the Board of Directors or committee authorized, approved or ratified the transaction".

> of any action taken under these Bylaws if the transaction is otherwise authorized, approved or ratified as provided in this section. (*Emphasis added.*)

This language in Section 2.15 is the most pertinent and directly applicable portion of the Bylaws. Appellants directed the trial court's attention to this specific subsection in their Opposition, and Respondents did not offer any evidence that there had ever been any vote of the disinterested directors approving the compensation committee's votes to pay all of the Company's profits to Respondents. In fact, Appellants offered uncontroverted and overwhelming evidence that they had been completely excluded from any board meetings, any financial information, any operational information, or any other input into the Company's affairs. PSUF 70-72, CT 462:13 to 463:19; PSUF 75-76, CT 464:7-26| P Exs. 12, CT 626-636; P Ex. 17, CT 669; P Exs. 26-40, CT 697-727; P Exs. 44-47, CT 740-747; P Ex. 49, CT 777; P Ex. 5, Paula Howser Depo., 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 50:17-25; P Ex. 9, Andy Daus Dec. ¶7 and ¶9, CT 613:23 to 614:4 and CT 614:11; P Ex. 7, Vaughn Warriner Depo., CT 567:7-19, CT 570:5-20, CT 568:12 to 569:24, 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, CT 566:24 to AR 54:19, AR 55:7-20; P Ex. 11, Kristoffer M. Hall Dec. ¶4, CT 621:11-21.[7]

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[7] Respondents acted as interested directors. Therefore, the votes to create the special committees, and all actions thereafter to allocate the Company's profits to themselves, are void against statutory and judicial law reflecting the public policy of this state. Only disinterested directors are entitled to vote. California Corp. Code § 307(b)&(c), §310; DC Tech Bylaws, Section 2.15. Further, as a scheme to defraud Appellants, the actions are also void. See *Haro v. Ibarra* (2009) 180 Cal. App. 4th 823, 834-835 (assessment on shareholder was void where it was part of a scheme to defraud).

E. The Trial Court's Finding That Appellants Had Admitted that Respondents' Actions Were Correct Under the Business Judgment Rule Was Based Upon a Mistaken Reading of Appellants' Answers to the RFAs

After mis-citing to the Company's Bylaws, the trial court then considered the Respondents' other defense: i.e., "that directors are not liable for their actions if they were done in good faith and thought to be in the best interests of the corporation". Ruling, AR 7. The trial court's analysis of the issue consisted of just a summary conclusion:

> Here, the Court finds no triable issue of material fact as to whether or not such actions relating to there[sic]-structuring of income and dividends and individuals' pay was done pursuant to the business judgment rule. Both Appellants' responses to Request for Admissions admit such assertions. See RFAs 10-13, attached as Exhibit 13 to the motion.

This conclusion was wrong for two reasons. First, the trial court completely misunderstood the Business Judgment Rule. This is discussed in subsection VI.E, below. Second, the trial court completely misunderstood the Appellants' answers to four requests for admission ("RFA"), nos. 10-13. This misunderstanding, *which inverted the meaning of Appellants' answers*, is corrected by careful review of the RFAs, Appellants' answers, and explanations showing the trial court's misunderstanding:

> RFA 10. That DC Tech, Inc. not paying salary to you for the year 2011 was based on reasonable business judgment.
>
> Answer to RFA 10. Admit. CT 102:17-19.

Explanation. The lawsuit is about the failure to pay Appellants' their rightful dividends; it is not about the salary that Andy Daus was paid from

2004 through May, 2010. Appellants agreed that not paying *salary* to Andy Daus for 2011 (i.e., after he stopped working in May 2010) was based upon reasonable business judgment. Andy Daus took a leave of absence from the Company in June 2010 and *he did not work for the Company in 2011.* PSUF 60, CT 457:22 to458:2; PSUF 62, CT 458:11-21| P Ex. 9, Andy Daus Dec. ¶¶4-6, CT 613:7-22; P Ex. 10, Maryclaire Dec. ¶3, CT 618:2-6; P Ex. 6, Brian Howser depo., CT 557:3-16. The Company hired a replacement for Andy Daus in 2011. PSUF 64, CT 459:2-14| 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, CT 621:3-10. Hence, there was no business reason for Andy Daus to draw a salary and it would have *unreasonable* to pay Andy Daus a salary.[8] But this admission did not admit that it was good business judgment not to pay Appellants' their rightful dividend.

> RFA 11. That DC Tech, Inc. not paying bonus to you for the year 2011 was based on reasonable business judgment.
>
> Answer to RFA 11. Admit. CT 102:20-22.

Explanation. Appellants agreed that not paying a *bonus* to Andy Daus for 2011 was based upon reasonable business judgment. Andy Daus took a leave of absence from the Company in June 2010 and *he did not work for the Company in 2011.* PSUF 60, CT 457:22 to458:2; PSUF 62, CT 458:11-21| P

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[8] Appellants have never alleged in the lawsuit that Andy Daus should be paid a salary for 2011; instead, Appellants have alleged that Respondents paid themselves extra salary and bonus for 2011 so that there would be no profits left to distribute based upon shares in the Company of which the Appellants own 40%. Hence, Appellants' answer is consistent with the lawsuit and the trial court read the answers backwards.

Ex. 9, Andy Daus Dec. ¶¶4-6, CT 613:7-22; P Ex. 10, Maryclaire Dec. ¶3, CT 618:2-6; P Ex. 6, Brian Howser depo., CT 557:3-16. The Company hired a replacement for And Daus in 2011. PSUF 64, CT 459:2-14| 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, CT 621:3-10. Hence, there was no business reason for Andy Daus to receive a bonus and it would have been *unreasonable* to pay Andy Daus a bonus.

> RFA 12. That DC Tech, Inc. not paying salary to Maryclaire Daus for the year 2011 was based on reasonable business judgment
>
> Answer to RFA 12. Admit. CT 102:23-25.

Explanation. Appellants agreed that not paying a *salary* to Maryclaire Daus for 2011 was based upon reasonable business judgment. Maryclaire Daus never worked for the Company. SUF 5, CT 438:6-20| P Ex. 9, Andy Daus Dec. ¶2, CT 612:22 to 613:6; P Ex. 10, Maryclaire Daus Dec. ¶2, CT 617:22 to 618:1; P Ex. 3, Andy Daus Depo., CT 520:10 to 522:24; P Ex. 14, CT 650-651 (sec. 7(x) and 7(xi)). Hence, there was no business reason for Maryclaire Daus to receive a salary and it would have *unreasonable* to pay Maryclaire Daus a salary.

> RFA 13. That DC Tech, Inc. not paying bonus to Maryclaire Daus for the year 2011 was based on reasonable business judgment.
>
> Answer to FRA 13. Admit. CT 102:26-28.

Explanation. Appellants agreed that not paying a bonus to Maryclaire Daus for 2011 was based upon reasonable business judgment. Maryclaire Daus never worked for the Company. SUF 5, CT 438:6-20| P Ex. 9, Andy

Daus Dec. ¶2, CT 612:22 to 613:6; P Ex. 10, Maryclaire Daus Dec. ¶2, CT 617:22 to 618:1; P Ex. 3, Andy Daus Depo., CT 520:10 to 522:24; P Ex. 14, CT 650-651 (sec. 7(x) and 7(xi)). Hence, there was no business reason for Maryclaire Daus to receive a bonus and it would have *unreasonable* to pay Maryclaire Daus a bonus.

The foregoing review of these Answers to RFAs 10-13 makes clear that the trial court interpreted Appellants' answers to mean *exactly the opposite* of what Appellants' answers did mean. Thus, the trial courts' finding on this factual issue was completely erroneous.

F. The Business Judgment Rule

1. The Fiduciary Duty of Majority Shareholders Is Not Superceded by the Business Judgment Rule

The Respondents correctly stated in their MSJ Memorandum at p. 9:14-19 that California Courts defer to the business judgment of directors in making decisions about the lawful operation of a business. CT 419-420. However as noted above, the trial court failed to grasp that this case is not about a decision concerning the lawful operation of the Company's business; it is about the majority shareholders (Respondents) operating the Company solely for their personal benefit and the exclusion of Appellants from any economic benefit from their 40% ownership.

As already shown, Respondents had a fiduciary duty to Appellants under *Jones*. Under this duty, Respondents could not pay themselves all of the Company's profits as extra salary and bonus to avoid paying Appellants their rightful (40%) share of such profits. The trial court, however, simply ignored the Respondents' fiduciary duty and analyzed the case as if it were just a business judgment dispute. This was error as a

matter of law.

If the trial court had correctly analyzed the facts under the fiduciary rule standard set out in *Jones*, then it would have found that there was a question of fact for the jury to decide: namely, was the Respondents' payment of the entire year's profit as extra salaries and bonuses solely for themselves a breach of their fiduciary duty to Appellants? Appellants are certain that if this question is presented to the jury the evidence will prove the cause of action.

2. The Business Judgment Rule Is Not Available To Shield Interested Directors or Bad Faith Conduct

Respondents ignored the second obvious bar to their use of the Business Judgment Rule: it may not be invoked by directors who act in bad faith and with a conflict of interest. This equitable predicate to the Business Judgment Rule was summarized by the Court of Appeal in *Everest Investors 8 v. McNeil Partners* (2003) 114 Cal. App. 4th 411, 429-430 as follows:

> An exception to this presumption exists in circumstances which inherently raise an inference of conflict of interest ... The business judgment rule does not shield actions taken without reasonable inquiry, with improper motives, or as a result of a conflict of interest.

California law defines a "disinterested" director as a director that "is independent when he is in a position to base his [or her] decision on the merits of the issue rather than being governed by extraneous considerations or influences." *Tritek Telecom, Inc. v. Superior Court*, 169 Cal. App. 4th 1385, 1390 (2009), quoting from *Katz v. Chevron Corp.*, 22 Cal. App. 4th 1367, 1368 (1994). These cases make it very clear that, as interested directors, the Respondents cannot invoke the business judgment rule as a defense.

The allegations in the complaint are focused upon the Respondents' creation of a special compensation committee, voting themselves as the only members thereof, and then voting to pay all of the profits of the company to themselves as extra salary and bonuses every year from 2011 through 2015.[9] As already shown above, Appellants submitted overwhelming, un-controverted evidence that Respondents, in fact, did these things. Section VI.A, *supra*.

The trial court never even mentioned any of Appellants' evidence in this regard. However, it did express agreement with Appellants' position that Respondents' actions made them "interested directors" because it stated in its Ruling that "[h]ere, the Court finds that ratification could not have occurred under section 2.15 because the individuals who voted had a direct interest." AR 7; CT 626-629. Despite this apparent acknowledgment of Respondents as "interested directors", the trial court then failed to undertake any analysis of the applicable law cited by Appellants and it failed to hold that the Business Judgment Rule was not applicable in cases of bad faith and/or conflict of interest. CT 421:8 to 422:1.

As discussed above, the trial court then made its *unsupported factual finding* that Respondents had made full disclosure of the material facts to the Board (i.e., to themselves), followed by the *unsupported legal conclusion* that the reporting of material facts to themselves (while keeping Appellants in the dark), satisfied the necessary elements under the Bylaws for approving the transactions of interested directors. AR 7.

The un-controverted evidence proves that Respondents acted as interested directors when they: (1) voted themselves to be the only members

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[9] See TAC ¶¶ 26, 28, 37-41, CT 485-486, 488-490.

of the special compensation committee; (2) voted to pay themselves all of the profits of the Company as extra salary and bonuses; (3) never disclosed these votes to the Board or to Appellants; and (4) shut Appellants out of the operation and management of the Company, participation to which they were entitled as directors.

The trial court should have found that all of Respondents' actions on the compensation committee are void under the law. The law requires that the actions of *interested* directors must be disclosed to, and then approved by, the non-interested directors. Cal. Corp. Code § 307(b)&(c), §309, §310; DC Tech Bylaws, Section 2.15.

G. There Was No Advice of Counsel After the Special Board Meeting

Respondents further asserted the affirmative defense of "advice of counsel". PSUF 66-68, CT 460:5 to 461:24; PSUF 73, CT 463:19-27| P Exs. 13, 16, 20-25, 43, CT 638-641, CT 667, CT 680-695, CT 736-738; 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, 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 566:6; P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795. The trial court did not discuss any of the law or facts on this subject, but as noted above in Section VI.C.2, it ruled that "all causes of action are barred under the terms of the bylaws, with the advice of counsel, and Appellants have failed to demonstrate a triable issue of material fact as to this defense."

There is only one[10] pertinent reference to "advice of counsel" in the bylaws, which is in Section 2.14, CT 628, as follows:

> 2.14 Standards of Conduct for Directors. A Director shall discharge the duties of a Director, including the duties as a member of a committee, in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the Director reasonably believes to be in the best interests of the Company.
>
> In discharging the duties of a Director, *a Director is entitled to rely on* information, opinions, reports or statements including financial statements and other financial data, if prepared or presented by an officer or employee of the Company whom the Director reasonably believes to be reliable and competent in the matters presented; *legal counsel*, public accountants or other persons as to matters the Director reasonably believes are within the person's professional or expert competence; or a committee of the Board of Directors of which the Director is not a member if the Director reasonably believes the committee merits confidence.
>
> A Director is not liable for any action taken as a Director, or any failure to take any action, if the Director performed the duties of the Director's office in compliance with these Bylaws. (*Emphasis added.*)

Appellants' Opposition to Respondents' MSJ presented the following four reasons why the advice of counsel defense was unavailable to Respondents:

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[10] There is a second reference in Section 12.2 Indemnity which reads: "[n]either the Company, its Directors nor its officers will be in any way liable to the shareholders where legal counsel has been relied on in a matter." This language does not add to or change the more explanatory language in Section 2.14.

1. Advice of Counsel Is an Affirmative Defense and Respondents Have the Burden of Proof That They Acted in Good Faith

The law is clear that, even if made in good faith, the advice of counsel is not an absolute defense and it does not confer immunity. It is merely one factor to be considered by the trier of fact. As stated by the California Supreme Court in *Bertrero v. National General Corp.* (1974) 13 Cal. 3d 43, 53–54 ("*Bertrero*"):

> "[I]f" the initiator acts in bad faith or withholds from counsel facts he knew or should have known would defeat a cause of action otherwise appearing from the information supplied, that defense fails. ... Similarly, counsel's advise must be sought in good faith ... The burden of proving this affirmative defense is, of course, on the party seeking to benefit by it.

The law places the burden for an affirmative defense of advice of counsel squarely on Respondents. *Bertrero* at 53-54. Not only must they prove that they received such advice, *they must also prove that they acted in good faith*. As shown below, not only was there never any advice given to Respondents that they could legally allocate all Company profit to themselves, but the overall evidence presented by Appellant raised a substantial question for the jury that Respondents breached their fiduciary duty and acted in bad faith.

Appellants presented overwhelming evidence to support their contention that Respondents acted in bad faith. For example, as early as August 2010, just three months after Andy Daus took a leave of absence, Respondents asked an attorney (not the same one that advised them in March 2011) what measures they could take to get rid of Appellants. PSUF 73, CT 463:19-27| P Ex. 20, CT 680-681.

This is followed by the March 3, 2011 email from Respondent's attorney to Paula Howser discussing the various options for accomplishing Respondents' goal behind the Appellants' back. PSUF 66, CT 460:5-14| P Exs. 21-25, CT 683-695. At about the same time, an email from Vaughn Warriner expresses serious reservations about forcing the Dauses out of the Company, but Paula Howser replies to Vaughn that he will have to choose between the Howsers and the Dauses. The "agenda" for the special Board of Directors meeting on March 22, 2011, did not mention any resolution to form any "special" committee. Thus, Appellants had no idea what Respondents were up to going into the special board meeting of March 22, 2011. PSUF 67, CT 460:15 to 461:6| P Exs. 16, 21-25, CT 667, CT 683-695; 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; P Ex. 3, Andy Daus Depo., CT 518:13 to 519:17; P Ex. 7, Vaughn Warriner Depo., CT 565:18 to 566:6; P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795.

2. No Legal Advice Was Ever Given That Respondents Could Allocate All Company Profits to Themselves

Appellants' Opposition to the MSJ included an extensive discussion of why such an affirmative defense was not available to Respondents, but that even if the trial court would allow the defense at all, it would present a question for the jury to decide, not the basis for a summary judgment. However, the trial court never mentioned anything about Appellants' argument or contrary evidence.

The only documentary evidence of discussions between Respondents and the attorney they hired concerning the competing economic interests of the parties is the March 3, 2011, email between Paul Howser and

the attorney. PSUF 66, CT 460:5-14| P Exs. 21-25, CT 683-695. This email discusses the proposed agenda items for the March 22, 2011 meeting, but notably, the email does not contain any legal advice to Respondents saying that the allocation of all Company profits to themselves as extra salary and/or bonuses is proper under either the law or the bylaws.[11]

Nor are there any other documents from after that date, through to the end of 2015, showing that Respondents got any legal advice about permissible allocations of Company profit between dividends and salary/bonuses. This includes the attorney's billing records (produced in discovery) which have no entry relating to giving Respondents any legal advice about allocation between paying dividends pro rata based upon share ownership and paying themselves extra salary and bonuses to absorb the "profit". P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795.

In sharp contrast, however, there is a document that shows Paula Howser asking an internet legal site in March 2012 for advice about whether it was okay for Respondents to withhold all financial information from Appellants. In the internet communication, Paul Howser stated that Respondents allocated all of the Company's profits to themselves. Paula Howser then asked the internet site for advice about how to get rid of "non-working" partners. PSUF 68, CT 461:7-24| P Ex. 43, CT 736-738; P Ex. 5, Paula Howser Depo., AR 51:7 to AR 52:22. This document directly contradicts

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[11] However, at the end of the email on the second page there is a heading "Bottom Line" where the attorney advises Respondents that they can try to buy out Appellants or liquidate the business, but in any event they have a *fiduciary duty* to Appellants, so that Respondents must "be mindful of doing things fairly."

the Respondents' contention that an attorney gave them legal advice to pay themselves all of the Company's profits. Only a jury can decide why Respondents would resort to asking about this subject on the internet in March 2012, a year after the special committees were created, instead of "relying" upon the purported advice of Respondents' attorney. Appellants think the jury will return a direct answer: Respondents never had any legal advice about this area.

3. The Advice of Counsel Defense Expired by June 2012 When This Action Was Filed

Assuming *arguendo* that Respondents did receive some legal advice in 2011 that they could allocate all of the Company profits to themselves, such legal advice could have only provided an affirmative defense until the filing of this action in June 2012. At that time, Respondents became fully notified about the illegality of their actions. Moreover, Respondents have continued year after year (right up to the time of filing of this Opening Brief) to pay themselves extra salary and bonuses so that there was no profit to pay Appellants their *pro rata* share of dividends.[12]

4. The Post March 22, 2011 Meeting

The Respondents have not presented any evidence of any legal advice by any attorney after the March 22, 2011 meeting. For example, Respondents have no evidence that any lawyer advised them that the special compensation committee did not have to report to the Board of Directors or did not have to communicate with Appellants or that Respondents could run this

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[12] There was a small amount of profit reported for 2014-2015, but since 2011 there has been approximately $177,400 that was mis-allocated to Respondents. PSUF 80, CT 465:24 to 466:7| P Ex. 17, CT 669; P Ex. 11, Kristoffer Hall Dec. ¶¶4-6, CT 621:11 to 622:9.

committee in secret by email and telephone. Appellants, however, have produced ample evidence that they did these things without any legal advice. PSUF 66-68 | 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, 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; P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795.

Again, Respondents have no evidence of any lawyer advising them that they did not have to provide Appellants with any financial information about the Company after 2010. In sharp contrast, Appellants have plenty of evidence that Respondents denied Appellants access to any of the company's financial information since that date. Indeed, it was not until Spring of 2012, when Appellants received K-1 statements, that they realized that Respondents had diverted all of the Company's profit (estimated at $71,600 for 2011) to themselves. PSUF 66-68 | 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, 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; P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795.

Respondents have no evidence of any lawyer advising them that they could ignore Appellants' demands to be informed about the operations and finances of the Company. Appellants, however, have ample evidence that Respondents never held any board meetings and never tried to communicate with Appellants. PSUF 70, CT 462:13-23; PSUF 75, CT 764:7-17|P Ex. 9,

Andy Daus Dec. ¶7, CT 613:23 to 614:3; P Ex. 5, Paula Howser Depo, CT 538:19 to 539:15, AR 50:17-25; P Ex. 7, Warriner Depo, CT 567:7-19, CT 570:5-20, CT 566:24 to AR 54:19, AR 55:7-20; P Exs. 26-40, CT 697-727; P Ex.s 44-47, CT 740-747.

Most importantly, the Respondents have no evidence of any lawyer telling them that they could vote to themselves all of the profits of the Company. Appellants, however, have lots of evidence that this is what Respondents did. PSUF 71, CT 462:24 to 463:9; PSUF 79, CT 465:18-23; PSUF 80, CT 465:24 to 466:7| P Ex. 17, CT 669; P Ex. 9, Andy Daus Dec. ¶9, CT 614:11; P Ex. 11, Kristoffer M. Hall Dec. ¶¶4-6, CT 621:11 to 622:8; P Ex. 7 Vaughn Warriner Depo., CT 568:12 to 569:24, 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. 5, Paula Howser Depo., CT 540:6-19, CT 541:3-23, CT 544:12 to 545:6, CT 545:24 to 546:19.

H. There Was No Shareholder Agreement That Only "Working" Shareholders Would Receive Dividends

Respondents also asserted that there was an "oral" agreement among the shareholders that only "working" shareholders would be entitled to dividends, and thus, Appellants lost their right to a *pro rata* share of the Company's profits because Andy Daus stopped working for the Company in 2010. Appellants, however throughly rebutted this argument with documents showing that such an idea was circulated among the shareholders in 2008, but the shareholders declined the change. SUF 5, CT 438:6-20; PSUF 65, CT 459:15 to 460:4| P Ex. 5, Paula Howser Depo., CT 532:23 to 533:1, CT 115:22 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; P Ex. 9, Andy Daus Dec. ¶2, CT 612:22 to 613:6; P Ex. 10, Maryclaire Daus

Dec. ¶2, CT 617:22 to 618:1; P Ex. 3, Andy Daus Depo., CT 520:10 to 522:24; P Ex. 14, CT 650-651, sec. 7(x)&(xi).

Further, the Company's course of performance from its inception in 2004 through 2010 contradicts the assertion of an "oral" agreement. Maryclaire Daus was never employed by the Company, but was nonetheless paid her *pro rata* dividend for each year from 2004 through 2010. The trial court, however, did not address this contention in making its decision. AR 7.

VII. Analysis of the Fraud Claim

A. Introduction

In the trial court's Ruling on the Appellants' fraud claim, there were conceptual legal errors, as well as a failure to review the un-controverted evidence submitted by Appellants. The trial court ruled as follows, AR 8:

> As for the alleged fraud by failing to disclose that Defendants had received legal advice from Andy Moore [Respondents' attorney], such contention is without merit because Plaintiffs learned about his consultation before the March 22, 2011 meeting. See Daus Dep. 67:1-4.
>
> As for the alleged fraud that Defendants failed to inform Plaintiffs about the changes approved by the compensation committee or financial information, Plaintiffs admitted to receiving the information. See Daus Depo. 41-42, 59-62, 119-123.
>
> As for the alleged misrepresentations on tax returns, Plaintiffs have failed to demonstration any reliance to their detriment on such documents or damages therewith.
>
> Plaintiffs have also failed to demonstrate any reliance on any of these purported misrepresentations. As stated by the Third District Court of Appeals, this does not establish reliance because Plaintiffs were always going to be outvoted by the majority shareholders. Thus, Plaintiffs have failed to demonstrate a triable issue of material fact relating to the fraud claims.

B. The Conceptual Legal Flaws

1. Fraud by Concealment

As explained by Appellants in their Opposition to Respondents' MSJ, there were two types of fraud committed by Respondents: fraud by concealment (aka omission) and fraud by misrepresentation. CT 429-432; 492-494 The elements required to plead fraud by omission and fraud by misrepresentation are different in one key respect: for fraud by omission, a plaintiff does not plead reasonable reliance upon a specific representation.; instead, a plaintiff pleads that had the omitted information (i.e., the truth) been disclosed to that plaintiff, the plaintiff would have acted differently. *Kaldenbach v. Mutual Of Omaha Life Insurance Co.* (2009) 178 Cal. App. 4th 830, 850-851; see *also Levine v. Blue Shield Of California* (2011) 189 Cal. App. 4th 1117, 1126-1127 (holding that where the fraud is by *concealment*, the element of justifiable reliance is replaced by alleging that the party harmed must have been unaware of the facts and would have acted differently if that party knew the truth).

As shown below, the trial court never acknowledged that Appellants' fraud count was framed to plead fraud by *concealment* (aka omission) as the primary type of fraud and to plead fraud by misrepresentation as the secondary type of fraud. See TAC §48-52, AR 8. Consequently, the trial court's analysis employed the incorrect pleading standard and was erroneous.

2. The Trial Court Misunderstood the Nature of the Respondents' Fiduciary Duty

The trial court also cited the unpublished decision of this Court in *Daus v. Andy Moore*, C079019. This was improper under CRC 8.1115(a).

However, Appellants address the point raised: that Appellants were "always going to be outvoted by the majority shareholders." The flaw in the trial court's thinking here is twofold. First, the Respondents have a fiduciary duty (see *Jones* and *Stephenson*, supra, Section VI.A) not to run the Company for their exclusive benefit. Thus, they can't just always outvote Appellants.

Moreover, the point of the fraud claim is the allegation at the beginning of TAC ¶48 where Appellants allege that Respondents "*knowingly and intentionally*" failed to disclose any information about their activities in the special compensation committee and failed to disclose any operational and financial information about the Company to Appellants. This is a claim for *intentional wrongdoing* with attendant damages, including punitive damages. Appellants had already pleaded a breach of fiduciary duty under Count 1, and thus, they had already pleaded a theory of liability based upon a duty to disclose to Appellants. Under a fiduciary duty, it does not matter whether the failure to disclose was negligent or intentional, liability still inures.[13]

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[13] Appellants pleaded fraud as an alternative theory of liability. The law is well established that a plaintiff cannot be forced to elect between different legal theories (e.g., breach of contract, negligence, or breach of fiduciary duty) until after the jury has decided the facts. See Witkin, California Procedure, Fifth Edition, General Rules of Pleading, § 406; The Rutter Group, Civil Procedure Before Trial, Pleadings, § 6:249.5. See e.g., *Stanley v. Richmond* (1995) 35 Cal. App. 4th 1070, where the plaintiff sued for all three: negligence, breach of contract, and breach of fiduciary duty and all three went to the jury. The court found that the plaintiff had made out a *prima facie* case for all three. Of course, a jury decision on three different legal theories does not allow for a "double, or triple, recovery".

C. The Specific Allegations of Fraud

1. Respondents Failed to Disclose Their Existing Relationship with the New "Attorney" and the True Purpose of the Special Meeting

Appellants pleaded the following fraudulent omissions (failures to disclose):

> TAC ¶48(a): failed to disclose to Plaintiffs that they had solicited and received legal advice from Andy Moore [Respondents' attorney] regarding the ongoing dispute between the Majority Shareholders and Plaintiffs prior to the Special Meeting as set forth in paragraph 37.

Appellants submitted extensive and un-controverted evidence that Respondents had consulted with an attorney (not the Company's legal counsel) for assistance with depriving Appellants of any economic benefit from their ownership in the Company. In particular, Appellants highlighted for the trial court the March 3, 2011, email between Paula Howser and Respondents' attorney which makes it clear that Respondents hired this attorney to advise them how to get rid of Appellants, or if they could not, how to deprive Appellants of any benefit from their ownership of the Company. Moore then prepared a draft agenda for a special board meeting which was circulated by Paula Howser. PSUF 66-68 | P Ex. 16, CT 667; P Exs. 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, 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; P Ex. 50, Andy Moore's billing records, CT 784-787; P Ex. 50, Steven Philips' billing records, CT 788-795. The email attaches a proposed copy of the agenda for the special meeting: however, the agenda does not

mention any resolution to create any special committee, thereby concealing the true purpose of the special meeting from Appellants. Further, there is nothing in the agenda that discloses the communications between Respondents and their attorney. Even at the special meeting, Appellants were never informed that this attorney had previously advised Respondents about how to deprive Appellants of any value from their ownership. *Ibid.*, see in particular, P Exs. 21-25, CT 683-695. If Appellants had been informed about the relationship between Respondents and their attorney, they would not have voted to make that attorney counsel for the Company. In addition, if Appellants had been informed about the true agenda for the meeting in particular, the creation of the special committees, they could have obtained legal assistance and tried to stop the Respondents. *Respondents did not disclose the truth behind the special meeting to prevent Appellants from acting differently than they did*. That is the essence of a fraud claim based upon omission.

The failure of the trial court to discuss the evidence submitted by Appellants was an abuse of discretion. Had the trial court followed the law, it would have found that there were triable issues of fact for the jury and denied the summary judgment motion.

2. Respondents Failed to Disclose their Actions To Pay Themselves Extra Salary and Bonuses Equal to the Amount of the Company's Profit

Appellants further alleged in the TAC that, after the creation of the special compensation committee, Respondents excluded them from any board meetings and denied them any information about the Company's operations or finances. TAC ¶¶ 26-30, ¶48(b)(c)(d), CT 485-487. Appellants Opposition supported these factual allegations of fraud by omission with

specific un-controverted evidence. PSUF 70, CT 462:13-23; PSUF 75-76, CT 464:7-26| P Ex. 5, Paula Howser Depo., CT 538:19 to 539:15, AR 50:17-25; P Ex. 7, Warriner Depo., CT 566:24 to AR 54:19, CT 567:7-19, CT 570:5-20, AR 55:7-20; P Ex. 9, Andy Daus Dec. ¶7, CT 614:11; P Ex. 26-40, CT 697-727; P Ex. 44-47, CT 740-747; P Ex. 49, CT 777.

The trial court, however, never considered any of this evidence of fraud by omission. Instead, it cited to pages of the Andy Daus deposition that concerned *completely unrelated subjects*. Here is what the trial court stated:

> As for the alleged fraud that Defendants failed to inform Plaintiffs about the changes approved by the compensation committee or financial information, Plaintiffs admitted to receiving the information. See Daus Depo. 41-42, 59-62, 119-123.

Looking at Daus deposition pages 41-42, the questions and answers are about the formation of the Company and its adoption of Sub S status in 2004, and that it issued K-1 statements each year. There is no discussion about Respondents' having withheld any information about the activities of the special compensation committee from Appellants.

Examination of the Daus testimony at pages 59-62 shows that the questions and answers concern Andy Daus' communications shortly after he took his leave of absence in which he told Respondents that Brian Howser, who had to temporarily cover for Andy, should be paid extra money *until a replacement was hired*. Indeed, Appellants discussed this in the beginning of their Opposition, explaining to the trial court with detailed, un-controverted evidence how Andy Daus told Respondents in 2010 to pay Brian Howser extra money until a replacement was hired. Appellants then presented un-controverted evidence that when Respondents hired a replacement for Andy in

2011, they did not reduce Brian's salary back to normal, but continued to pay all three Respondents very large salary increases and bonuses so that there was no profit left to pay to the shareholders pro rata. This is what the lawsuit is all about. PSUF 62-64, CT 458:11 to 459:14; PSUF 78-79, CT 465:8-23| P Ex. 9, Andy Daus Dec. ¶6, CT 613:17-22; P Ex. 6, Brian Howser depo., CT 555:3-18, CT 556:8 to 557:16; P Ex. 7, Warriner Depo, CT 573:25 to 574:3, CT 576:5-12; 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, Kristoffer Hall Dec. ¶3-5, CT 621:3-27; P Ex. 17, CT 669.

Finally, a review of the Daus testimony at pages 119-123 (CT 226-230) reveals that the questions and answers related to the K-1s sent to Appellants for 2012 and why the incorrect Company tax returns for 2012 were a problem.

In sum, *none* of the Andy Daus transcript pages referenced by the trial court had anything to do with the issue before the court: i.e., whether Respondents concealed the actions of the special compensation committee and the Company's operation and financial information from Appellants. Appellants have no plausible explanation for why the trial court made this erroneous, unsupported factual finding.

3. Respondents Failed To Rebut Appellants' Allegations that False Tax Returns Had Been Filed

Appellants alleged in TAC ¶48(d) that Respondents "prepared false and misleading federal and state tax returns for DC Tech for 2011 through 2015." This allegation was, in turn, based upon Appellants' allegations in TAC ¶ 27, CT 485-486, that "DC Tech had an estimated real net profit for 2011 in the approximate amount of $179,000 that should have been

paid out to the Shareholders on a *pro rata* basis of stock ownership and reported as income to partners as required by I.R.S. Subchapter "S" rules" and Appellants' allegations in TAC ¶29, CT 486, that "DC Tech reported a net loss for 2011 of $555 on its federal tax return, and Appellants were given a K1 statement pursuant to I.R.S. Subchapter "S" rules showing their loss to be $144 (Plaintiff Maryclaire Daus) and $78 (Plaintiff Andy Daus)."

Appellants pleaded this matter because Respondents' wrongful mis-allocation of the Company's profits to themselves as extra salary and bonuses was a violation of the federal tax rules for Subchapter S corporations.[14] Consequently, the Company and the individual shareholders (including Appellants) have been put in jeopardy of fines and penalties by the federal and state governments. Appellants' liability for any such fines, penalties, and/or back taxes was the direct result of Respondents' fraudulent acts.

The trial court summarily concluded that Appellants "have failed to demonstration (sic) any reliance to their detriment on such documents or damages therewith", and thus, there was no basis for a fraud claim relating to tax returns. The Respondents' MSJ did not rebut Appellants' factual allegations on this issue. Rather, Respondents deflected responsibility for any

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[14] See e.g., *David E. Watson PC vs. United States* (8th Cir. 2012) 668 F. 3d 1008, 1017-1018, where the Eighth Circuit Court of Appeals affirmed a federal district court decision re-allocating the amounts distributed as *profit* to shareholders versus the amount paid as salary. It applied the established rule that the characterization of funds disbursed by an S corporation as *compensation* to employees and that distributed as *dividends* to shareholders must be based upon a factual analysis of the reasonableness of the amount of compensation.

problems with the Company tax return onto their CPA.[15]

The trial court simply ignored Appellants' discussion about the relevant tax law set forth in Appellants' Opposition to the MSJ. CT 427:21 to 429:22. Further, the trial court either misunderstood or ignored the fact that Appellants' were now exposed to federal and state tax liabilities because of Respondents' fraudulent conduct. In particular, Appellants directed the trial court's attention to the tax problem created by Respondents paying out the Company's profits as extra salary and bonuses to themselves, citing to *Multi-Pak Corporation v. Commissioner of Internal Revenue*, T.C. Memo 2010-139 (2010) ("*Multi-Pak*"). CT 427:21 to 428:25. Here is what the *Multi-Pak* decision says about the tax rules for allocation between "bonuses" and "dividends":

> Finally, evidence of an internal inconsistency in a company's treatment of payments to employees may indicate that the payments go beyond reasonable compensation. ... "Bonuses that have not been awarded under a structured, formal, consistently applied program generally are suspect * * * On the other hand, evidence of a reasonable, longstanding, consistently applied compensation plan is evidence that the compensation paid in the years in question was reasonable." Id. The bonus should not be decided after perusing the year's profits. ... Payment of bonuses at year end when the corporation knows its revenue for that year may enable it to disguise dividends as compensation. *Multi-Pak* at p 12.

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[15] A corporate tax return must be signed by an officer with authority to bind the Company as to the factual representations in the return. This verification is under penalty of perjury. Treas. Reg. 26 CFR §1.6065-1, Verification of Returns. Thus, blaming the tax preparer does not relieve Respondents of liability.

The facts in this case show unequivocally that Respondents egregiously violated these principals. DC Tech had followed the federal rules for 2004 through 2010 and made a reasonable allocation between dividends and compensation. However, this historical approach was completely abandoned by the Respondents after 2010 and they paid all profits to themselves as compensation. PSUF 77, CT 464:26 to 465:7| P Ex 17, CT 669; P Ex. 11, Kristoffer Hall Dec. ¶¶4-5, CT 621:11-27; P Ex. 9, Andy Daus Dec. ¶11, CT 614:18-23. In addition, Respondents did not just temporarily increase Brian's compensation until a replacement was hired, they paid substantial extra salary to Vaughn Warriner and Paula Howser even though they did not have any additional work to do because of Andy Daus' leave of absence. On top of these salary increases, Respondents paid themselves bonuses equal to the rest of the company's profit, leaving nothing for Appellants. PSUF 78, CT 465:8-17; PSUF 79, CT 465: 17-23| P Ex. 17, CT 669; P Ex. 11, Kristoffer Hall Dec. ¶¶4-5, CT 621:11-27; P Ex. 9, Andy Daus Dec. ¶6, CT 613:17-22.

The issue here is that Appellants have a potential liability, including the possibility of fines and penalties, under federal and state tax laws, that they did not have before and this liability is the result of Respondents fraud by omission. Appellants do not have to show reasonable reliance, they just need to show to a jury that if the true facts had been disclosed to them in a timely manner, they would have been able to act differently.[16]

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[16] Appellants observe that the amount of damages they have incurred is unknown at this time. However, Appellants have a right to establish the facts that demonstrate to the tax authorities that they were not the wrongdoers and that only Respondents should be held accountable.

VIII. **Analysis of the Conspiracy Claim**

The trial court ruled that the Third Cause of Action for conspiracy fails for two reasons. The court's first reason was that Respondents attorney was no longer a defendant. While it is true that the allegations against Mr. Moore in the Second Amended Complaint were dismissed, the Appellants had amended the complaint and the new Conspiracy claim, Count Three (TAC ¶¶ 55-58), only alleged a conspiracy by the Majority Shareholders (not Moore) to breach their fiduciary duty and to defraud Appellants. The Respondents are being sued in their individual capacities – this is not a derivative action against the Company. Thus, Appellants correctly pleaded a conspiracy against them.

Second, the trial court ruled that because the breach of fiduciary duty and fraud claims failed, the conspiracy claim must fail because a conspiracy claim is a dependent claim, not an independent tort, citing to *Favila v. Katten Muchin Rosenman LLP* (2010) 188 Cal. App. 4th 189, 206. Appellants agree with the statement of the law, but obviously disagree with the conclusion because, as shown above, the first two counts for breach of fiduciary duty and fraud were more than sufficiently supported by both uncontroverted and controverted evidence that left the ultimate factual issues for a jury to decide.

IX. **Analysis of the Conversion Claim**

The trial court's ruling on this Claim (TAC Count 4) was very unclear. It read as follows, AR 8:

> Defendants argue that the loss of money does not support a claim for conversion unless the amount is capable of identification. Defendants argue that Plaintiffs have only speculated as to their losses.
>
> As to this cause of action, the court finds Defendants'

> argument without merit. Plaintiffs have demonstrated the specific amount of loss as set forth in Exhibit 1 to the Declaration of Hall. Thus, the granting of the motion for summary judgment is not based on the contentions set forth by defendants as to this cause of action alone.

In oral argument, the trial court clarified its Ruling on this claim, saying that summary judgment was granted because Respondents had prevailed on their other defenses to the breach of fiduciary duty and fraud claims, and therefore, there was no wrongful conversion.

X. The Motion to Compel

Appellants filed an ex parte Application for an OST to hear a Motion to Compel the production of the electronic copy of the Company's General Ledger ("Motion") on June 17, 2016, with a hearing on June 20, 2016. The trial court granted the OST on June 20, 2016 and the Motion was heard the same day. CT 799-801, 916-946. However, the trial court denied Appellants' Motion. CT 947-948.

A. The Need For the Electronic Copy

The facts underpinning the Motion are simple. Appellants requested the production of the electronic file(s) containing the Company's general ledger for 2011 to 2015 that was created with the Company's Quickbooks accounting software.[17] AR 12-13. Appellants informed the trial court that the electronic file(s) was needed by their damage expert to complete his review of the Company's information. This would enable him to give an accurate damage estimate and support his testimony on behalf of Appellants. Specifically,

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[17] The electronic files would fit on a single USB thumb drive and could be copied in a matter of minutes, if not seconds.

Appellants' expert, Kristoffer M. Hall, stated in his supporting Declaration at ¶¶ 3-4, that he needed the actual electronic file for the following reasons:

1. To accurately assess the current financial state of DC Tech;
2. To accurately investigate the total amount of payments from DC Tech to the Defendants, in particular, the payment of discretionary expenses, legal fees, and other perquisites; and
3. To verify the accuracy of the printouts used to date.

AR 13, 42-43. Appellants also informed the trial court that Respondents' damage expert, Mr. Steven Philips, was the CPA that the Respondents had been using for the Company since 2010. Appellants explained that Mr. Philips had been in full possession and control of the electronic Quickbooks file(s) for DC Tech and that he had been responsible for preparing the hard copies of the general ledger that had been produced to Appellants. AR 38:23-39:7.

Appellants pointed out that the Respondents' expert had instant access to DC Tech's complete electronic financial records, while Appellants' expert only had the "paper" copy that was purportedly complete. Appellants' expert needed to have the same access to the Company's financial records as Respondents' expert. The only way to have the opposing experts analyze the same financial information for the Company was to make the electronic file available to both. AR 14:10-26.

Appellants further explained to the trial court that Respondents did not object because of relevance, delay, cost, or burden of producing the file(s).[18] Simply put, the Respondents failed to argue anything even remotely

[18] Appellants also pointed out that they owned 40% of the Company and that they were entitled to inspect these records of the Company. AR 15.

amounting to prejudice.

Respondents objected because they had already produced what are purported to be a complete paper version of the General Ledger for 2011 to 2015. CT 942-946. The trial court denied the motion on the grounds that the Respondents had already produced the paper copies of the general ledger. CT 947:24-26

B. **Applicable Law**

Discovery orders are reviewed under a deferential abuse of discretion standard. *Digital Music News LLC v. Superior Court* (2014) 226 Cal. App. 4th 216, 224-225, citing to *Krinsky v. Doe 6* (2008) 159 Cal. App. 4th 1154, 1161. An appellate court may reverse when a trial court " 'applies the wrong legal standards applicable to the issue at hand.' " *Digital Music News LLC* at 224, quoting from *Doe 2 v. Superior Court* (2005) 132 Cal. App.4th 1504, 1517.

A party seeking to compel discovery must meet the requirements of the statute and "set forth specific facts showing good cause justifying the discovery sought." CCP § 2031.310, subd. (b)(1). Further, "[t]o establish good cause, a discovery proponent must identify a disputed fact that is of consequence in the action and explain how the discovery sought will tend in reason to prove or disprove that fact or lead to other evidence that will tend to prove or disprove the fact." *Digital Music News LLC* at 224.

Finally, trial courts are supposed to resolve any doubt about the relevance of requested discovery in favor of allowing it. *Moore v. Mercer* (2016) 4 Cal. App. 5th 424, 448.

C. **Argument**

The trial court erroneously found in its Ruling that Appellants had failed to show that the electronic file(s) was "different" than the purported

hard copy printout. CT 947:24-26. This finding completely ignored the factual basis for the Motion that Appellants had submitted.

Appellants submitted the supporting declarations of their legal counsel, Patrick H. Dwyer, and their expert, Kristoffer M. Hall, that he would not be able to: (a) accurately assess the financial state of the Company; (b) investigate the payments of salary, bonuses and expense items purportedly paid by the Respondents to themselves; and (c) verify the accuracy of the hard copy printouts that he had been forced to work with. Simply put: Appellants' expert needed the electronic file *to confirm the truth* of Respondents and of Respondents' expert.

Appellants also set forth the specific facts it wanted to prove, namely: (a) the amount of compensation paid by Respondents to themselves as salaries and bonuses; (b) the amount of payments of discretionary expenses, legal fees, and other perquisites by or to Respondents; and (c) verify the figures reported by Respondents for the Company's profits. Such facts are at the heart of any such lawsuit and they are essential for Appellants determination of damages. Appellants' request could not have shown more "good cause".

Respondents did not even argue that the requested electronic files were not relevant because the relevancy of the document production was unquestionable. Moreover, a situation in which Respondents' expert had daily access to the electronic files, while Appellants' expert had no access, created a situation that was ripe for manipulation.

Appellants must have the means to review and verify the financial information of the Company to be able to challenge the Respondents' expert testimony. This is basic due process. The trial court's refusal to order the discovery created a grossly unfair, unequal, and prejudicial situation for

Appellants. There was no burden to Respondents to weigh in opposition. Finally, the discovery would greatly facilitate the presentation of evidence for the jury.

XI. Conclusion

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 Section VI.A, there is no evidence to support such a finding.

There is, however, substantial evidence that at the March 22, 2011 meeting, the Respondents pushed through, over the negative votes of Appellants, a resolution creating the compensation committee and another resolution appointing themselves as the only committee members. There is also substantial evidence that Respondents thereafter never informed the Board (i.e., Appellants) about the actions of the special compensation committee. Starting in 2011, the Respondents used the compensation committee to set their own compensation equal to the Company's yearly profits, thereby breaching their fiduciary duty to Appellants to pay out Company profits as dividends *pro rata*.

The trial court somehow misread Appellants answers to RFAs 10-13 and concluded that Appellants had admitted that Respondents acted properly under the Business Judgment Rule with respect to setting compensation for 2011 to the present. However, a thoughtful reading of the Appellants answers to these RFAs forces the opposite factual conclusion. The lawsuit is about whether the Respondents breached their fiduciary duty and/or committed a fraud by paying themselves extra salary and bonus for 2011 (and every year thereafter) in amount equal to the Company's profits, thereby taking for

themselves the 40% of the dividends that should have been paid to Appellants *pro rata*.

Finally, the trial court simply did not understand the pleading rules for fraud by concealment, and as shown above, simply did not understand that Respondents took all of the Company's profits by concealing their wrongful acts from Appellants.

Appellants have presented substantial, if not overwhelming, evidence in support of their allegations. There is no question that the central issues under each cause of action remain as triable issues of fact for the jury.

Lastly, the trial court's decision on the Motion to Compel was an abuse of discretion. Appellants had a right to an electronic copy of the Company's general ledger so that their expert would have the same ability to analyze the Company's financial records as Respondents' expert.

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: February 27, 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 XI) is approximately 13,975.

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

Date: February 27, 2017

Cross Reference of Deposition Exhibits to Plaintiffs' Exhibits

Plaintiff's Ex. No.	Deposition Ex. No.
12	4
13	5
14	14
15	21
16	35
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42	101
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48	114

PROOF OF SERVICE

I hereby certify under penalty of perjury that a copy of the Appellant's Opening Brief in the matter of Andy and Maryclaire Daus v. Paul Howser, Brian Howser, and Vaughn Warriner, Case No.CU12-078702 , appeal No C08786 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: February 28, 2017

Location: Penn Valley, CA 95946