Case No. C075019
Nevada County Case No. 78702

IN THE COURT OF APPEAL OF CALIFORNIA
THIRD APPELLATE DISTRICT

Andy and Maryclaire Daus,
Plaintiffs and Appellants

v.

Andy Moore,
Defendant and Respondent.

PETITION FOR REHEARING

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

Attorney For Appellants
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May 22, 2015

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I. Introduction

Appellants are requesting a rehearing of the Court's Decision of May 1, 2015 ("Decision") because of numerous errors of law and fact. The two most prominent legal errors are: (a) the Court's application of the wrong elements for Appellants' cause of action for actual fraud by concealment; and (b) the failure to properly evaluate whether Respondent Moore ("Moore") owed Appellants a special duty under existing judicial authority.

Even more fundamental, however, is the Court's failure to address the wrongfulness of the majority shareholder misappropriation of the entire economic value of the Company on a factual basis. The Court was of the opinion that the majority shareholders had the "votes" to do what they wanted and the Appellants are just out of luck. In combination with this, the Court expressed the opinion that the Appellants had failed to plead what they could have done differently and that they were not actually harmed. Under these misconceptions, the Court did not see how the actions of Moore gave rise to liability.

Before, addressing these assignments of error, a short summary of the factual allegations is presented to refresh the case for the Court.

II. Factual Summary

The facts of this case present a classical portrait of actual fraud in a corporate setting. Brian and Paula Howser and Vaughn Warringer are the owners of sixty percent of the shares (the "Majority") in a California close corporation called DC Tech ("Company") and Appellants Andy and Maryclaire Daus own the remaining forty percent. All of the shareholders were directors of the Company. All of the shareholders worked for the Company since its inception in 2004, except for Maryclair Daus. The Company had always operated under an IRS "S" election enabling partnership taxation treatment for the Company's profits and losses. The working shareholders were paid salaries and the profits or losses of the Company were paid out each year *pro rata* based upon stock ownership to each shareholder. In 2011, Appellant Andy Daus had to stop working for personal reasons. He recommended to the Majority that they hire a replacement for him and/or pay themselves some extra salary to make up for any additional work they might have to perform. The Majority, however, decided that if Appellant Andy Daus was not going to work, then they Appellants were no longer entitled to *any profit from the Company*. Simply put, the Majority decided to take for themselves all of the economic value of Appellants' stock. Not knowing how to do this as a matter of "corporate procedure", the Majority sought the services of a

corporate attorney, Respondent Andy Moore ("Moore").

Rather than tell the Majority that they had a fiduciary duty to Appellants that obligated them to treat Appellants ownership interest equitably, Moore devised the plan whereby the Majority would set up a compensation committee, appoint themselves as the only members of the committee, and then pay themselves all of the profits of the Company as salary and bonus, leaving nothing for Appellants.

Moore went even further: he designed the entire scheme whereby there would be a shareholder meeting to elect new officers, create new director compensation and contract committees, and then have the Majority elected as the Company officers and as the only members of these new committees. The Appellants would then have the choice of owning valueless shares or selling for a "song".

Moore did not stop there. He wrote the agenda for the meeting, drafted the resolutions and arranged for the meeting to be held in his office. Moore never disclosed at any time before or during the shareholder meeting that he had an existing attorney-client relationship with the Majority and that he had advised the Majority how they could take the entire economic value of the Company for themselves. And one more thing: Moore had himself elected as new corporate legal counsel to be *paid by the Company* , not the Majority.

Had Appellants known about the plan, they could of confronted the Majority before the shareholder meeting, and if that had been unsuccessful, they could have filed a straightforward action for declaratory and injunctive relief and prevented the Majority from carrying out the plan.[1] This would have prevented the misappropriation of the Appellants' share of the profits (over several hundred thousand dollars) and it would have prevented this law suit.

As it turned out, Moore's concealment of the true nature and intent of his plan completely mislead the Appellants. They did not know learn what the Majority had done for almost three years, until well into discovery in this action when the email communications between the Majority and Moore were disclosed. When they learned what had been done, Appellants amended the complaint to add Moore as a defendant.

III. Omissions And Errors In The Decision

A. The Majority Had A Duty Not To Violate *Jones*

The Appellants argued in their briefs, and Respondent never disagreed, that the Majority had a fiduciary duty not to deprive the Appellants of their economic value in the Company under the doctrine established in *Jones v. H. F. Ahmanson & Co.* (1969) 1 Cal. 3d. 93 ("*Jones*"). The Decision also

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[1] See SAC ¶¶ 26, 28-33.

mentioned *Jones* in its introduction, but then never discussed the substantive relevancy of *Jones* to this case, and in particular, never discussed whether the Majority's secret expropriation of all economic value of the Company was unlawful. Indeed, the tenor of the Court's decision implied that the Court felt the Majority had done nothing wrong. For example, the Court commented that the "Howser[s] had the votes to pass the planned changes with or without Daus' votes." Decision at 10.

Appellants strongly disagree with the Court's approach and conclusion on this issue. The unlawfulness of the Majority's conduct is a crucial foundational fact. See e.g., SAC at 20-22, 35, 66. *If the Appellants are correct that the alleged conduct of the Majority was a breach of their fiduciary duty, then the conduct of Moore in designing and participating in the scheme that effected that breach of that fiduciary duty, was itself, wrongful, and was as an act in furtherance of an actual fraud.*[2]

Similarly, this finding directly supports the pleading of constructive fraud as a basis for breach of fiduciary duty and negligence. SAC ¶¶ 83, 91. As shown below, Moore's wrongful advice to the Majority had to be disclosed to Appellants when Moore became corporate counsel because he had a duty to

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[2] See the discussion in Subsection III.F, below, on Moore's duty to disclose under Rule 3-210 which forbids knowingly giving wrongful advice.

all directors to make full disclosure prior to, and at the time or, his approval as new corporate counsel.

The Court needs to correct its Decision by substantively applying, not just acknowledging, the doctrine established in *Jones* that majority shareholders owe a fiduciary duty to minority shareholders and may not deprive minority shareholders of all economic value of their shares.[3] As a corollary to this, the Court should also make clear that any "vote" by majority shareholders that deprives minority shareholders of their rightful value in a company is *void as a matter of public policy.*[4]

B. **Essential Facts About Moore Were Omitted From The Decision**

The Decision never considered the allegations that the Majority asked Moore to find a way to deprive the Appellants of all economic value in the Company. See SAC at ¶¶ 21, 67. The Court also never discussed the

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[3] The absurdity and harm of holding otherwise is brought to a focus with the simple question: what person would ever become a minority shareholder if it is legal for the majority to extract all economic value of a company for themselves?

[4] Contrary to the assertion in the Decision that the Majority had the "votes" to pass the items in the agenda, Appellants would contend that the votes of the Majority were *void* for being in violation of public policy (i.e., in violation of *Jones*), in violation of corporate law (only disinterested directors entitled to vote Cal. Corp. Code § 307(b)&(c), §310), and as a scheme to defraud. See., e.g., *Haro v. Ibarra* (2009) 180 Cal App. 4th 823, 834-835 (holding that assessment on shareholder was void where it was part of a scheme to defraud).

allegations that Moore responded to the Majority's request for advice by devising the plan to defraud Appellants and then participated in the plan by holding the shareholder meeting in his office. See SAC at ¶¶ 74-76. These are important foundational facts for both actual fraud and constructive fraud because they establish that Moore knew from the outset that *the purpose of his engagement was to harm the Appellants*. Moreover, these facts provide the basis for imputing a duty from Moore to Appellants under the judicial authority and the Professional Rules Of Conduct discussed further in Subsection III.E, below.

C. **The Appellants Were Seriously Harmed**

Pervasive throughout the Decision is the Court's opinion that Appellants were not harmed. See e.g., Decision at pp. 7-8, 10.[5] There were two components to this perspective. First, as just discussed, the Court made it clear that it believed that the Majority had the power to do what it did regardless of whether Appellants had known about the plan. Second, the Court indicated that Appellants had not alleged any real harm as a result of the plan and Moore's conduct. Even further, the Court remarked that the

[5] The Court appeared to ignore the factual allegations of financial harm to Appellants and found that Appellants fail to show "what harm flowed from the allegedly-false minutes". Decision at 8.

Appellants "fail to explain how ... [they] could have stopped or averted anything." Decision at 7.

These assumptions are wrong as a matter of law, see *Jones*, and they ignore the specific factual allegations to the contrary. Appellants clearly alleged how they did not discover the plan for over two years after the scheme was effected and long after having to file a law suit against the Majority. SAC ¶¶ 27-33. Appellants clearly alleged the economic harm that they suffered. SAC ¶¶ 79-80, 86-87, 93, 97.

It is obvious that if Appellants had known the true purpose of the plan, i.e., that the Majority was creating a special compensation committee with only themselves as members, and further, that they would use this committee to pay themselves all profits of the Company by means of bonuses and salary increases, Appellants would have taken immediate action to stop the scheme by filing an action for declaratory and injunctive relief. In short, knowledge of the plan would have prevented the defalcation and would have limited any legal action to a much simpler action for declaratory and/or injunctive relief. This would have prevented the hundred of thousands of dollars in damage to Appellants. These factual allegations and argument were presented by the Appellants, but there were not adequately addressed by the Court. See Appellants' Opening Brief p. 25-26; Appellants' Reply Brief p. 6-7.

D. **Justifiable Reliance Was The Wrong Test**

Appellants alleged in the Sixth Cause of Action that Moore's conduct constituted *actual fraud*. Specifically, Appellants alleged that Moore *concealed* and misrepresented by omission the intent and purposes of the plan he brought to the shareholder meeting, and that Appellants would have acted differently if they had known the truth. SAC ¶¶ 66-76, 83.

The Court's Decision, however, is mistakenly based upon the *elements for actual fraud for an affirmative misrepresentation*. Specifically, the Court found that Appellants fail "to explain with particularity what actions he took in justifiable reliance on anything Moore did." Decision at 7.

A claim for actual fraud based primarily upon omission or concealment *does not employ the element of justifiable reliance* because there is nothing to rely upon. Instead, a plaintiff alleges that he/she "must have been unaware of the fact and would not have acted as he did if he had known of the concealed or suppressed fact". *Levine v. Blue Shield Of California* (2011) 189 Cal. App. 4th 1117, 1126-1127. See *Kaldenbach v. Mutual Of Omaha Life Insurance Co.* (2009) 178 Cal. App. 4th 830, 850 ("*Kaldenbach*").[6]

As set forth in *Kaldenbach* at 850, the correct approach is to ask

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[6] Counsel for Appellants was queried at oral argument about justifiable reliance and responded that this case was not about specific affirmative misrepresentations, but about the concealment by Moore.

whether the victim *would have acted differently if the truth had been known*. As already discussed in Subsection III.C, above, the Appellants correctly pleaded that they would have acted differently had they known the truth. SAC ¶¶ 33, 86. Accordingly, the Court applied the wrong test and this error was a determining factor in reaching the Decision.

E. There Were Ample Allegations To Support A Special Duty

The Fifth and Seventh Causes of Action are based upon constructive fraud: i.e., that Moore had a *special duty* to Appellants to fully disclose the purpose and details of the plan to have the Majority take all of the economic value of the Company for themselves.

Appellants presented three separate bases for finding that Moore had such a special duty: (a) Moore was obligated as an attorney under Professional Rules Of Conduct, Rule 3-210, not to give wrongful advice, and when he did so, it was with the intent to harm the Appellants, thereby giving rise to a special duty to disclose (i.e., a duty to prevent the harm he intended); (b) Moore had himself appointed as corporate counsel at the shareholder meeting, and as such, he had an express duty under Professional Rules Of Conduct, Rule 3-600 and 3-310 to make full disclosure of his prior representation of the Majority and the conflict created by his scheme to deprive Appellants of all economic value in the Company; and (c) as a matter

of public policy a duty should be imputed because Moore's conduct met all of the criteria for imputing a special duty as described in *Skarbrevik v. Cohen, England & Whitfield* (1991) 231 Cal. App. 3d 692,711("*Skarbrevik*") and other cases. See e.g., the decisions cited in Subsection III.E, *supra*; see also, Appellants Opening Brief pp. 19-21.

The Court, however, never addressed the criteria for imputing a special duty as explained in *Skarbrevik* and it summarily dismissed Appellants arguments based upon the Professional Rules with the oblique comment that these have "no relevance." Decision at 10-11. Instead, it based its decision on the erroneous argument that Appellants had not alleged facts showing *justifiable reliance*. See Subsection III.D, *supra*.

1. **Rule 3-210 Exists To Protect Third Parties**

Moore had an *imputed special duty* to the Appellants under Professional Rule 3-210 that forbade him from *knowingly* giving wrongful legal advice. It is apparent from the face of the Rule that, because a client has a remedy for the giving of negligent advice (i.e., an action for negligence and/or breach of fiduciary duty), the Rule must be intended *to protect third parties (not a client) from the consequences of knowingly wrongful advice*. Thus, the language of the Rule removes its violation from the realm of negligence and places it squarely in the courtyard of an intentional tort.

This case exemplifies why the Rule exists: Moore gave advice that he knew was wrongful and would help his clients to the detriment of the Appellants. This conduct was an intentional tort directed at Appellants, not an act of negligence towards his clients. Hence, to give any effect to the Rule, it must be construed to give rise to a special duty of care between the attorney and the third parties it is designed to protect.

2. **Moore Had A Special Duty Under Rule 3-600**

Corporate counsel has a duty to avoid conflicts and act fairly and equally towards all shareholders, including the *duty to make full disclosure to all directors*. This special duty is set forth clearly in Professional Rules Of Conduct, Rule 3-600 and 3-310. Judicial authority fully supports such a duty and makes favoring some shareholders over another unlawful. Appellants remind the Court of its citation to *Goldstein v. Lees* (1975) 46 Cal App. 3d 614, 622 ("*Goldstein*") in their Opening Brief. The *Goldstein* court quoted the following comment from the Committee on Professional Ethics and Grievances of the American Bar Association in Opinion 86:

> In acting as the corporation's legal advisor he [legal counsel] must refrain from taking part in any controversies or factional differences which may exist among shareholders as to its control. When his opinion is sought by those entitled to it, or when it becomes his duty to voice it, he must be in a position to give it without bias or prejudice and to have it

> recognized as being so given. Unless he is in that position his usefulness to his client is impaired.

In fact, the *Skarbrevik* court reviewed both Business and Professions Code §6068(e) and the Professional Rules of Conduct, Rule 3-600D, and found that "[t]he attorney [for the company] is obligated to explain to the organization's directors, officers, employees, members, shareholders, or other constituents the identity of the client for whom the attorney is acting, and shall not mislead such a constituent …" A clearer basis for finding a special duty on the part of Moore to disclose to Appellants could hardly be found.

Appellants were directors and shareholders on an equal standing with the Majority under the law. Moore had himself made corporate counsel for compensation. Consequently, he had a duty under these rules to make full and fair disclosure and to avoid any conflicts.

3. **The Court Failed To Consider Public Policy**

The most important reason for the imputing of a special duty to Moore is public policy. It is shocking to think that a lawyer can give unlawful advice to a client that is intended to harm a third party and escape any liability because of the lack of privity. A license to practice law is not a license to harm others for the benefit of a client.

There is ample judicial authority in support of Appellants on the

grounds of public policy and it was cited thoroughly to the Court in Appellants' briefs. The Decision, however, makes no mention of it and this was an error that should be corrected.

In particular, the *Skarbrevik* decision that was the central authority for the Respondent, makes it crystal clear that under the appropriate circumstances, an attorney should have a special duty to a third party imputed as a matter of public policy. In the words of that court, the question "involves a judicial weighing of the policy considerations for and against the imposition of liability under the circumstances." Citing to *Goodman v. Kennedy* (1976) 18 Cal. 3d 335, 342; *Schick v. Lerner* (1987) 193 Cal. App. 3d 1321, 1329. The *Skarbrevik* court enunciated four criteria to use in evaluating the public policy question. These were discussed in detail in the Opening Brief and it is obvious that the facts of this case fit perfectly into the public policy exception. Appellants urge this Court to review this aspect of its decision.

F. Actual Fraud Does Not Require A Special Duty

The Court's Decision also mistakenly confuses the two different concepts of the duty required for *actual fraud* versus *constructive fraud*.

With actual fraud, the *general duty* of every person not to defraud another is assumed. Moreover, actual fraud requires the pleading of specific

intent, while constructive fraud does not. Thus, it is not necessary to plead *general duty* as an element of actual fraud.

In contrast, constructive fraud does not require the pleading of intent because it requires, instead, the pleading of a *special duty* to not to commit the wrong. It is the existence of a *special duty* that mandates full and complete disclosure of all material facts *regardless of intent*.[7] This is in a sense, a form of strict liability.

The elements for pleading fraud were made clear by the Supreme Court in *Lazar v. Superior Court* (1996) 12 Cal. 4th 631, 638 ("*Lazar*"), where they are set forth as follows:

> "The elements of fraud, which give rise to the tort action for deceit, are (a) misrepresentation *(false representation, concealment, or nondisclosure)*; (b) knowledge of falsity (or 'scienter'); (c) intent to defraud, i.e., to induce reliance; (d) justifiable reliance; and (e) resulting damage." (Emphasis added.)

This statement of the elements for fraud does not include the pleading of a special duty when the deceit is done by concealment or non-disclosure.[8]

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[7] The legislature made this perfectly clear in the field of contracts by enacting California Civil Code §1572 (actual fraud requires "intent to deceive") with the language of Civil Code §1573 (constructive fraud requires "breach of duty").

[8] Appellants note that there appears to be some confusion in the courts on the requirements for pleading actual fraud compared to

The Appellants' allegation of actual fraud in Count 6 *contains the necessary element of specific intent* (SAC ¶ 83). Consequently, there was no need for Appellants to also allege that Moore had a special duty to disclose. Moore's *general duty* not to commit fraud was sufficient. See *Lazar*.

Indeed, all of cases cited by the Court in the Decision concerning whether there were sufficient allegations to support a finding of a special duty by Moore, contain explicit holdings that no special duty must be pleaded

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constructive fraud. As just cited in *Lazar*, the element of misrepresentation can be interchangeably pleaded with concealment and non-disclosure. In some cases where there are no other actions, events or circumstances alleged as part of the actual fraud, the court of appeal has required the additional pleading of a special duty. See e.g., *Kaldenbach*, *supra*, which oddly, cites to *Lazar*.

The legislature enacted CC §1709 to make deceit (fraud) an actionable tort. It also enacted CC §1710 which defines deceit. In §1710(3), deceit includes the suppression of a fact by one who has a duty to disclose and the suppression of a fact by one who gives information of other facts which are likely to mislead if the concealed fact(s) is not disclosed. Moore's conduct as alleged fits squarely within the latter part of the definition because he carefully disclosed certain facts (e.g., a meeting agenda), but did not disclose his advice to the Majority, the intent and purpose of the meeting, or the true nature of the agenda matters. This partial disclosure meets the definition actual fraud under §1710(3), and therefore, there is no need to plead a special duty to disclose.

In this case, Appellants have alleged additional conduct and facts evidencing the scheme to defraud, and hence, it is distinguishable from *Kaldenbach* on that basis as well. Thus, no special duty is required. *Lazar*. If however, the Court disagrees with *Lazar* as cited, Appellants have also pleaded facts in the SAC that provide a solid basis for the finding of a special duty. See Subsection III.F, below.

for actual fraud and that lawyers were subject to the general duty not to defraud and are not a special category unto themselves. See e.g., *Doctors' Co. v. Superior Court* (1989) 49 Cal 3d 39, 46-47; *Goodman v. Kennedy* (1976) 19 Cal. 3d 335, 346; *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal. App. 4th 282, 291; *Skarbrevik at* 711; *Cicone v. URS Corp.* (1986) 183 Cal. App. 3d 194, 202.

Thus, the Court's focus on a failure of Appellants to allege facts showing a special duty to support the Sixth Cause of Action was misplaced. Simply put, it did not matter that Moore was an attorney for purposes of Count 6. Moore's scheme to take the Appellants' money was a fraud and it would have been wrongful for anyone (e.g., a business consultant) to assist or cooperate with the Majority in the design and implementation of such a scheme. *Moore owed the same general duty to Appellants that any citizen owes to another person not to defraud them.* No special duty on the part of Moore had to be alleged. This is especially true because he participated in the fraud for his own gain (i.e., for compensation and appointment as counsel for the Company).

IV. Conclusion

When the Majority first approached Moore, he should have told them that what they were seeking was unlawful and that they could not seize the economic value of the Company for themselves. If the Majority persisted, Moore was obligated under the Professional Rules to decline any representation. Appellants believe that, in fact, the prior corporate counsel was approached by the Majority before they approached Moore, but that he declined to give any unlawful advice. SAC at 23-24.

Although the Decision acknowledges the *Jones* decision and that the majority has a fiduciary duty to the minority, the Court never develops this rule or applies it to the allegations in the SAC. This led to several errors in the Decision.

Moreover, the Court did not really think through the conceptual and economic consequences of its Decision. Who would ever want to be a minority shareholder if corporate counsel was free to secretly advise majority shareholders to take all economic value for themselves? We would simply end up with only single shareholder companies.

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For the foregoing reasons, the Petition for Rehearing should be granted.

Respectfully Submitted,

Dated: May 22, 2015

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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 IV) is approximately 4180.

_____
Patrick H. Dwyer,
Attorney for Appellants

Date: May 22, 2015

PROOF OF SERVICE

I hereby certify under penalty of perjury that a copy of the Appellants' Petition For Reheaing in the matter of Daus v. Andy Moore, Case No. 78702, appeal No C075019 was served on May 22th, 2015, via U.S. First Class mail, postage prepaid, upon the following:

1. Counsel for Defendant and Respondent addressed as follows:

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

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

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

_____
Signature

_____
Print Name

Date: May __, 2015

Location: Penn Valley, CA 95946