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8 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**
9 **FOR THE COUNTY OF SAN BERNARDINO- RANCHO CUCAMONGA**

10
11 MAHENDRA MEHTA, et al.,
12 Plaintiffs,

13 vs.

14 M. ZAMIN FARUKHI, et al.,
15 Defendants.

) CASE NO. CIVRS 800952
) Honorable Janet M. Frangie
) Dept. R-11

) **DEFENDANTS' NOTICE AND MOTION**
) **FOR JUDGMENT ON PLEADING FOR**
) **THE FOURTH AMENDED COMPLAINT;**
) **MEMORANDUM OF POINTS AND**
) **AUTHORITIES IN SUPPORT THEREOF**

16 **DATE: August 4, 2011**
17 **TIME: 8:30 a.m.**
DEPT: R-11

18 Complaint Filed: February 4, 2008
19 Trial Date: None Set

NOTICE AND MOTION

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD HEREIN:

PLEASE TAKE NOTICE that on August 4, 2011 at 8:30 a.m. in Department R-11 of the above-entitled Court, Defendants, M. Zamin Farukhi, M. Fareed Farukhi, Gilbert R. Vasquez, Farukhi & Co., Farukhi & Co., LLP, Vasquez Farukhi & Co., Vasquez Farukhi & Co., LLP (collectively referred to as "Farukhi") will move this Court for an Order entering judgment in their favor and against Mahendra Mehta, Asha Mehta, Mahendrakumar V. Mehta, D.D.S., Inc. Profit Sharing Plan & Trust; Mahendrakumar V. Mehta, D.D.S., Inc. Money Purchase Plan & Trust; Parimal Kansagra; Saila Kansagra, Parimal Kansagra, D.D.S., Inc. Profit Sharing Plan & Trust; Jayantilal R. Keshav, Raksha Keshav, Jayantilal R. Keshav, D.D.S., Inc. Profit Sharing Plan & Trust; Jayantilal R. Keshav, D.D.S., Inc. Money Purchase Plan & Trust; Parag Patel, Sapna Patel, Parag S. Patel, Trustee for Parag S. Patel IRA Rollover; Narendra Vyas, Vina Vyas, Uday Shah and Pragna Shah on the following grounds:

The Fourth Amended Complaint does not set forth fact sufficient to state a cause of action.

Several individuals formerly identified as Plaintiffs in the Third Amended Complaint – Saila Kansagra, Raksha Keshav, Sapna Patel, Vinya Vas, and Pragna Shah – are no longer named in the Fourth Amended Complaint, which contains no allegations as to them. Accordingly, as to them, the pleading sets forth no facts upon which relief could be granted.

Several Plaintiffs – (1) the Mahendrakumar V. Mehta, D.D.S., Inc. Profit Sharing Plan & Trust; (2) the Mahendrakumar V. Mehta, D.D.S., Inc. Money Purchase Plan & Trust; (3) the Parimal Kansagra D.D.S., Inc. Profit Sharing Plan & Trust; (4) the Jayantilal R. Keshav D.D.S., Inc. Profit Sharing Plan and Trust; (5) and the Jayantilal R. Keshav D.D.S., Inc. Money Purchase Plan – are trusts, and lack standing to sue on their own behalf. Because no party is named in the Fourth Amended Complaint with standing to sue on their behalf, all of their claims must be dismissed.

Plaintiffs should have brought this action as a shareholders' derivative suit, because the gravamen of the Fourth Amended Complaint is that Defendants are responsible for acts and omissions that harmed American Power Products by, inter alia, destroying the value of its stock. Even if this action were brought as a shareholders' derivative suit, the Fourth Amended Complaint does not meet the pleading requirements for such actions set forth in Corporations Code section 800.

1 Plaintiffs purport to allege fraud and negligent misrepresentation, but fail to plead these causes
2 of action with particularity.

3 Plaintiffs purport to allege accounting malpractice, but fail to plead facts that, even if true,
4 would satisfy the elements of that cause of action. In any event, this cause of action is untimely.

5
6 DATED: June 2, 2011

CALLAHAN & BLAINE, APLC

7
8 By: 

9 Edward Susolik
10 Robert S. Lawrence
11 Marc S. Ehrlich
12 Attorneys for Defendants, M. ZAMIN FARUKHI,
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16 FARUKHI & CO., LLP and FARUKHI & CO.,
17 LLP
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15 **OTHER AUTHORITIES**

16 1A Ballantine & Sterling, Cal. Corporations Law (4th ed. 1992) § 292.03, pp. 14-19 9
17 5 Witkin, California Procedure (5th) Pleading, § 711 10
18 Friedman, Cal. Practice Guide: Corporations (The Rutter Group 2004) ¶ 6:598, p. 6-127;
19 ¶ 6:601.1, p. 6-128.1; ¶ 6:602.1, p. 6-128.1; ¶ 6:604.1, p. 6-128.2 5-6, 8
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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **I. INTRODUCTION**

3 Plaintiffs are dentists and dental group retirement trusts who bought stock in American Power
4 Products (“APP”), a lighting parts manufacturing and wholesale business. When Plaintiffs sustained
5 losses from that investment, they sued APP, its founder Zamin Farukhi, his brother Fareed Farukhi, his
6 accounting firm and his accounting partner Gilbert Vasquez to recoup their capital losses. Plaintiffs
7 allege Defendants’ supposed breaches of fiduciary duty as officers of APP, Defendants’ supposed
8 fraud in failing to disclose financial data about APP and its suitability as an investment, and purported
9 accounting malpractice by Farukhi and his firm. Despite having had five opportunities to amend their
10 complaint, Plaintiffs still do not state a valid cause of action. Accordingly, Defendants move for
11 judgment on the pleadings.

12 Plaintiffs allege misconduct by Farukhi as a member of board APP’s board of directors causing
13 harm to the company and destroying the value of its stock, but Plaintiffs have not filed a shareholder
14 derivative action. Rather, they purport to assert direct individual breach of duty and fraud claims
15 against Farukhi and his accounting firm, but lack standing to do so. Plaintiffs’ allegations also do not
16 meet the statutory requirement to specifically plead that they presented their grievances to APP’s
17 board, or that such presentation would have been futile. Moreover, even if Plaintiffs had standing to
18 pursue individual shareholder claims, they have not alleged fraud with the requisite particularity.

19 Plaintiffs also seek to target Farukhi, Vazquez and their accounting practice for accounting
20 malpractice, asserting they gave bad investment advice and overcharged for their services. These
21 claims fare no better, as they are predicated on allegations that do not reflect any failure to meet
22 professional standards. Rather, they go only towards Farukhi’s supposed breaches of duty as an officer
23 of APP. In any event, Plaintiffs’ accounting malpractice claims are time-barred.

24 For these reasons, the Fourth Amended Complaint is deficient on its face and the Court should
25 grant Defendants’ Motion for Judgment on the Pleadings. Because Plaintiffs amended their Complaint
26 several times and still cannot state a claim, the Court should grant Defendants’ Motion without leave
27 to amend.

1 **II. FACTUAL AND PROCEDURAL BACKGROUND**

2 Plaintiffs are dentists (Mahendra Mehta, Asha Mehta, Parimal Kansagara, Jayantilal Keshav,
3 Parag Patel, Narendra Vyas, and Uday Shah) (the “Individual Plaintiffs”) and their retirement trusts
4 (Mehta Profit Sharing Plan & Trust, Mehta Money Purchase Plan & Trust, Kansagra Profit Sharing
5 Plan & Trust, Keshav Profit Sharing Plan & Trust, Keshav Money Purchase Plan & Trust, Patel
6 Money Purchase Plan & Trust) (the “Plan Plaintiffs”). (Fourth Am. Compl., ¶ 1.) Defendant Zamin
7 Farukhi is an accountant who, along with his brother Defendant Fareed Farukhi and his partner,
8 Defendant Gilbert Vasquez, provided professional services to the Individual Plaintiffs and the Plan
9 Plaintiffs from 1984 to 2007. (Fourth Am. Compl., ¶¶ 2, 45.) The accounting firms are named as
10 Defendants Vasquez Farukhi & Co., Vasquez Farukhi & Co. LLP, Farukhi & Co., and Farukhi & Co.
11 LLP (the “Defendant Firms”). (Fourth Am. Compl., ¶ 2.)

12 Defendant American Power Products (“APP”) is a California corporation engaged in the
13 lighting parts manufacture and wholesale business. (Fourth Am. Compl., ¶¶ 2, 17.) Plaintiffs allege
14 that Farukhi “controls APP in all meaningful respects,” and that he “formed and owned APP in
15 substantial part.” (Fourth Am. Compl., ¶¶ 2, 14.) Due to his “position within APP,” Farukhi allegedly
16 “directly participated in the management” of APP,” and had access to unfavorable information about
17 APP showing that APP’s “business operations, operational trends, finances, and business prospects”
18 were not promising. (Fourth Am. Compl., ¶¶ 5, 6-7.) Plaintiffs aver that Farukhi, as one of APP’s
19 “officers and directors,” had a duty to provide accurate information about APP’s financial condition
20 and business prospects, “so that the price of APP’s stock and its appropriateness as an investment
21 vehicle would be based upon truthful and accurate information.” (Fourth Am. Compl., ¶ 8.)

22 Plaintiffs allege Farukhi and the Firm Defendants persuaded the Individual Plaintiffs and Plan
23 Plaintiffs to invest a total of \$1,652,500 into APP. (Fourth Am. Compl., ¶ 14.) Farukhi and the Firm
24 Defendants supposedly encouraged Plaintiffs to invest in APP without providing adequate information
25 about the investment, explaining the risks of APP’s business, or justifying the basis for valuing APP
26 stock. They “took the [Plaintiffs’] monies and did what they wanted with those funds,” but Plaintiffs
27 do not allege what happened to the money. (Fourth Am. Compl., ¶ 16.) Plaintiffs profess they were
28 “not qualified to judge the investment worthiness of APP based on the information Defendants gave

1 them.” (Fourth Am. Compl., ¶ 16, 17.) Instead, based on Plaintiffs’ past “relationship of trust and
2 confidence” with Farukhi, Vasquez and the Firm Defendants, and because Plaintiffs “did not know any
3 better,” they never sought “independent counsel and advice” about their investment in APP, even
4 though “Defendants did not explain to [Plaintiffs] how they were going to benefit from APP.” (Fourth
5 Am. Compl., ¶ 17.)

6 According to Plaintiffs, Farukhi and the Firm Defendants assured them that APP’s business
7 was thriving, but did not keep them apprised of APP’s business affairs or provide documentation to
8 substantiate APP’s financial health. (Fourth Am. Compl., ¶¶ 17, 18.) Plaintiffs allege that Defendants
9 encouraged them to loan money to APP, which was then converted to APP stock; that Defendants did
10 not inform Plaintiffs of the share price they were paying for APP stock; and, that Defendants were
11 overcharging Plaintiffs for accounting services. (Fourth Am. Compl., ¶¶ 19, 20.) At some unspecified
12 later time, APP met its “demise.” (Fourth Am. Compl., ¶ 14.)

13 Plaintiffs never describe what events caused the “demise” of APP, when and to what extent the
14 business failed, or how, if at all, that outcome is attributable to decisions made by Farukhi as an officer
15 and director. Rather, Plaintiffs merely insist that, in March 2006, Farukhi and APP solicited them
16 invest more funds in APP, that these “proposals demonstrated to the [Plaintiffs] that their investments
17 in APP were basically worthless,” and that Defendants’ actions constituted breaches of fiduciary duty
18 that harmed Plaintiffs in an amount equal to their entire investment in APP, *i.e.*, \$1,652,500. (Fourth
19 Am. Compl., ¶¶ 22, 23.)

20 Plaintiffs filed suit on February 2, 2008. In the following months, Plaintiffs repeatedly
21 amended their pleading, and now stand on their Fourth Amended Complaint, filed August 31, 2009.

22 **III. LEGAL ARGUMENT**

23 **A. Legal Standard For Judgment On The Pleadings**

24 A motion for judgment on the pleadings has the same function as a general demurrer, but is
25 made after the time for a demurrer has passed. (Code Civ. Proc., § 438(f).) Except as provided by
26 statute, the rules governing demurrers apply, including that the motion may be made on the ground that
27 the complaint on its face, or any cause of action therein, does not state facts sufficient to constitute a
28 cause of action against the moving defendant. (Code Civ. Proc., § 438(c), (d); *Smiley v. Citibank*

1 (*South Dakota*) N.A. (1995) 11 Cal.4th 138, 145-146.)

2 **B. Several Parties Were Named As Plaintiffs In The Third Amended Complaint, But**
3 **Are Absent From The Fourth Amended Complaint And Have Not Been Dismissed**

4 In the Third Amended Complaint, the individuals Saila Kansagra, Raksha Keshav, Sapna Patel,
5 Vinya Vas, and Pragna Shah were named as Plaintiffs in this action. (Request for Judicial Notice
6 (“RJN”), Ex. A [Third Am. Compl.]) None of these persons are listed in the caption of the Fourth
7 Amended Complaint and that pleading contains no allegations pertaining to them. (*See* Fourth Am.
8 Compl.) Nonetheless, Plaintiffs have not filed a notice of dismissal of these individuals from this
9 action. (RJN, Ex. B [Register of Actions in San Bernardino County Superior Court Case No. CIVRS
10 800952].) Given that Plaintiffs make no allegations regarding these parties and, accordingly, they fail
11 to state a cause of action, and the Court should grant Defendants’ motion for judgment on the
12 pleadings as to all causes of action with respect to them.

13 **C. Five Of The Named Plaintiffs Are Trusts That Cannot Bring This Action On**
14 **Their Own Behalf And, Thus, Lack Standing To Sue**

15 Five of the Plaintiffs in this action are identified in the Fourth Amended Complaint as “ERISA
16 Plans,” specifically: (1) the Mahendrakumar V. Mehta, D.D.S., Inc. Profit Sharing Plan & Trust; (2)
17 the Mahendrakumar V. Mehta, D.D.S., Inc. Money Purchase Plan & Trust; (3) the Parimal Kansagra
18 D.D.S., Inc. Profit Sharing Plan & Trust; (4) the Jayantilal R. Keshav D.D.S., Inc. Profit Sharing Plan
19 and Trust; (5) and the Jayantilal R. Keshav D.D.S., Inc. Money Purchase Plan. (Fourth Am. Compl.,
20 ¶ 1.) None of these entities have standing to sue because they are all trusts and, accordingly, cannot
21 bring this action on their own behalf.

22 A trust, like a probate estate, is merely a collection of assets and liabilities. (*Tanner v. Estate*
23 *of Best* (1940) 40 Cal.App.2d 442, 444.) A trust is not a separate legal entity and, thus, lacks both the
24 standing and capacity to sue. (*Galdjie v. Darwish* (2003) 113 Cal.App.4th 1331, 1344. “Legal title to
25 property owned by a trust is held by the trustee, and common law viewed the trustee as the owner of
26 the trust’s property.” (*Id.*) If a tort is committed against the trust, the trustee is “considered the holder
27 of the chose in action with the right to bring suit.” (*Id.*; *Saks v. Damon Raike & Co.* (1992) 7
28 Cal.App.4th 419, 427.) “Because an ordinary express trust is not an entity separate from its trustees,

1 action may not be maintained in the name of the trust. Thus, absent special circumstances, an action
2 prosecuted for the benefit of a trust estate by a person other than the trustee is not brought in the name
3 of the real party in interest and is demurrable.” (*Powers v. Ashton* (1975) 45 Cal.App.3d 783, 787-
4 788.) All of the five aforementioned Plans purport to bring this action on their own behalf, and none
5 of the individual plaintiffs are alleged to be trustees of those entities. (Fourth Am. Compl., ¶ 1.) For
6 this reason, the Fourth Amended Complaint should be dismissed as to them.

7 **D. Plaintiffs Lack Standing Because They Should Have Brought Their Claims In A**
8 **Shareholders’ Derivative Suit**

9 Plaintiffs lack standing because they should have brought their claims as a shareholders’
10 derivative action, but the Fourth Amended Complaint is neither styled as such, nor satisfies the special
11 pleading requirements for derivative claims under Corporations Code section 800(b). Rather,
12 Plaintiffs attempt to plead their claims as direct shareholder’s action. Even if a direct shareholder’s
13 action was proper – and it is not – the Fourth Amended Complaint would still be subject to dismissal,
14 given that Plaintiffs failed to plead their claims as “stock holders” with the requisite specificity.
15

16 **1. Direct And Derivative Shareholders’ Actions Are Mutually Exclusive**

17 Shareholders may bring two types of actions: (1) a direct action filed by the shareholder
18 individually (or on behalf of a class of shareholders) for injury to his interest as a shareholder; or (2) a
19 derivative action filed on behalf of the corporation for injury to the corporation for which it failed or
20 refused to sue. (*Schuster v. Gardner* (2005) 127 Cal.App.4th 305, 311-312 [quoting Friedman, Cal.
21 Practice Guide: Corporations (The Rutter Group 2004) ¶ 6:598, p. 6-127].) These two types of
22 actions are mutually exclusive. The right of action belongs either to the shareholders in a direct action,
23 or to the corporation in a derivative action. (*Ibid.*) In a derivative action, the shareholder is merely a
24 “nominal plaintiff.” (*Id.* [quoting Friedman, *supra*, ¶ 6:602, pp. 6-128.1 – 6:128.2].) Although the
25 corporation is a nominal defendant, it is the real party in interest to which any recovery usually
26 belongs. (*Ibid.*)
27
28

1 **2. A Shareholder Asserting Claims Against A Corporation’s Management**
2 **Based On Alleged Injury To The Corporation Must Bring A Derivative**
3 **Action**

4 “A shareholder cannot bring a direct action for damages against management on the theory that
5 their alleged wrongdoing decreased the value of his or her stock (e.g., by reducing corporate assets and
6 net worth). The corporation itself must bring such an action, or a derivative suit must be brought on
7 the corporation’s behalf.” (*Schuster, supra*, 127 Cal.App.4th at p. 312 [quoting *Friedman, supra*, ¶
8 6:601.1, p. 6-128.1].) The individual shareholder “may not bring an action for indirect personal losses
9 (i.e., decrease in stock value) sustained as a result of the overall harm to the entity.” (*Bader v.*
10 *Anderson* (2009) 179 Cal.App.4th 775, 788; *Nelson v. Anderson* (1999) 72 Cal. App.4th 111, 124.)
11 Thus, where the “gravamen of the complaint is injury to the corporation, or to the whole body of its
12 stock and property without any severance or distribution among individual shareholders, or it seeks to
13 recover assets for the corporation or to prevent the dissipation of its assets,” the shareholder must
14 resort to a derivative action on behalf of the corporation. (*Bader, supra*, 179 Cal.App.4th at p. 793
15 [quoting *Jones v. H.F. Ahmanson & Co.* (1969) 1 Cal.3d 93, 106-107].) Shareholders may bring a
16 derivative action “to enjoin or recover damages for breaches of fiduciary duty” that directors and
17 officers owe to the corporation. (*Schuster, supra*, 127 Cal.App.4th at p. 313 [citing *Friedman, supra*, ¶
18 6:604, p. 6-128.2].)

19 **3. Plaintiffs Should Have Brought Their Claims As A Shareholders’**
20 **Derivative Action**

21 Plaintiffs’ claims are derivative, not direct claims, because all of their purported injuries were
22 “incidental” to any injury to APP. (*H.F. Ahmanson, supra*, 1 Cal.3d at p. 107; *Schuster, supra*, 127
23 Cal.App.4th at pp. 313-314.) Plaintiffs allegedly invested over \$1.65 million in APP, a corporation
24 controlled “in all meaningful respects” by Defendant Farukhi [Fourth Am. Compl., ¶¶ 2, 5, 7, 14-15];
25 Farukhi allegedly had a duty to provide truthful information about APP’s financial condition “so that
26 the price of APP’s stock and its appropriateness as an investment vehicle would be based upon truthful
27 and accurate information” [Fourth Am. Compl., ¶ 8]; Farukhi allegedly made “material
28 misrepresentations” regarding the operation and financial health of APP, and the risks of holding APP

1 stock as an investment, but he and his codefendants “took [Plaintiffs’] monies and did what they
2 wanted with those funds” [Fourth Am. Compl., ¶¶ 9, 13, 16, 17, 18, 19]; as an alleged result of these
3 alleged acts and omissions, Plaintiffs’ APP stock became worthless, justifying compensatory damages
4 equal to their investment [Fourth Am. Compl., ¶¶ 23, 27, 33 ,39, 49.a].

5 Plaintiffs’ claims are similar to those adjudged “derivative” in several other cases. (*See, e.g.,*
6 *Schuster, supra*, 127 Cal.App.4th at pp. 309-310, 314 [Peregrine corporation’s shares fell precipitously
7 due to disclosure of accounting improprieties and resignation of chairman of the board; plaintiff
8 alleged that defendants issued new stock to pay for ill-advised acquisitions, misstated company
9 financial data, failed to make required government disclosure, and plaintiff was harmed when
10 company’s shares declined due to the lack of credibility of its financial reporting; plaintiff lacked
11 standing to sue individually because “diminution in stock value was incidental to the injury to
12 Peregrine”]; *Bader, supra*, 179 Cal.App.4th at p. 800 [plaintiff’s allegations that bonus payments to
13 executives, RSU’s and stock options paid to senior officers in a manner that resulted in their not being
14 tax-deductible “consisted of a reduction in stock caused by the depletion of corporate funds from
15 unauthorized payment and the absence of tax deductions” and thus plaintiff’s damage was “incidental
16 to that of the corporation”]; *Avikian v. WTC Financial Corp.* (2002) 98 Cal.App.4th 1108, 1115-1116
17 [“core claims” of officers’ and directors’ mismanagement and entering into self-serving deals was
18 injury to corporation and, thus, “derivative”]; *PacLink Communications Internat., Inc. v. Superior*
19 *Court* (2001) 90 Cal.App.4th 958, 964 [“essence” of claim based on fraudulent transfer of
20 corporation’s assets without consideration was injury to the corporation and, thus, “derivative”].)
21 Similarly, Plaintiffs here allege mismanagement and failure to disclose information that resulted in the
22 eradication of share value. Plaintiffs’ investment losses that are “incidental” to any damage to APP.
23 Plaintiffs might argue they properly allege direct claims by stockholders to enforce rights that they
24 possess as individuals against the corporation. (*See Bader, supra*, 179 Cal.App.4th at p. 793 [quoting
25 *H.F. Ahmanson, supra*, 1 Cal.3d at p. 107].) That argument would be wrong. An individual cause of
26 action exists only if damages to the shareholders were not “incidental” to damages to the corporation.
27 (*H.F. Ahmanson, supra*, 1 Cal.3d at p. 107). Examples of direct shareholder actions include suits
28 brought to compel the declaration of a dividend, to pay lawfully declared dividends, to enjoin

1 threatened ultra vires acts, or to enforce shareholder voting rights. (*Schuster, supra*, 127 Cal.App.4th
2 305, 313 [citing Friedman, *supra*, ¶ 6:601, p. 6-128].) Plaintiffs' claims do not fit these categories or
3 any like them. Rather, their contentions that Defendants failed to disclose material information and
4 mismanaged APP such that the value of its stock was denuded are innately connected with the alleged
5 resulting harm to APP. Any personal harm to plaintiffs is "incidental" to the harm to APP, and does
6 not justify a direct shareholder action.

7 Plaintiffs cannot avoid the pleading requirements of a derivative action by arguing that
8 Defendant's acts and omissions induced them to hold stock in APP, rather than to buy or sell it. While
9 California recognizes a "holder's action" where a shareholder has wrongfully induced by fraud or
10 negligent misrepresentation to hold stock, that cause of action is limited to shareholders who can make
11 a bona fide showing of actual reliance upon the misrepresentations, and the plaintiff must plead such
12 reliance with requisite specificity. The plaintiff must allege "specific reliance on the defendant's
13 representation; he "must allege actions, as distinguished from unspoken and unrecorded thoughts and
14 decisions, that would indicate that the plaintiff actually relied on the misrepresentations." (*Small v.*
15 *Fritz Companies, Inc.* (2003) 30 Cal.4th 167, 184.) As explained *infra*, Plaintiffs make no specific
16 allegations showing actual reliance on representations by Defendants. Thus, even if they could
17 maintain a direct holder's action, the Fourth Amended Complaint lacks competent allegations of
18 reliance to sustain it.

19 **4. The Fourth Amended Complaint Does Not Comply With Statutory**
20 **Pleading Requirements For Shareholders' Derivative Actions**

21 Corporations Code section 800 imposes strict prerequisites for pleading shareholder's
22 derivative claims. Specifically, it provides that "[n]o action may be instituted or maintained in right of
23 any domestic or foreign corporation" by a shareholder, unless the shareholder plaintiff "alleges in the
24 complaint with particularity plaintiff's efforts to secure from the board such action as plaintiff desires,
25 or the reasons for not making such effort, and alleges further that plaintiff has either informed the
26 corporation or the board in writing of the ultimate facts of each cause of action against each defendant
27 or delivered to the corporation or the board a true copy of the complaint which plaintiff proposes to
28 file." (Corp. Code, § 800(b)(2).) This requirement is intended to discourage the sort of abuse of the

1 derivative action that Plaintiffs are now attempting. (*See Bader, supra*, 179 Cal.App.4th at pp. 789-
2 790 [quoting *Kamen v. Kemper Financial Services, Inc.* (1991) 500 U.S. 90, 96].) Failure to comply
3 with this requirement subjects the complaint to demurrer. (*Shields v. Singleton* (1993) 15 Cal.App.4th
4 1611, 1619.)

5 This requirement may be excused under limited circumstances, such as when the demand
6 would be futile. (*Shields, supra*, 15 Cal.App.4th at pp. 1618-1619 [quoting 1A Ballantine & Sterling,
7 Cal. Corporations Law (4th ed. 1992) § 292.03, pp. 14-19].) However, given that the demand
8 allegations must be made with particularity, “it is clear that general averments that the directors were
9 involved in a conspiracy or aided and abetter the wrongful acts complained of will not suffice to show
10 demand futility.” (*Bader, supra*, 179 Cal.App.4th at p. 790.) “General charges of fraud, conspiracy
11 and bad faith are insufficient” to overcome the presumption that the board of directors acts
12 independently and honestly in declining to prosecute a stockholder’s derivative claims. (*Shields,*
13 *supra*, 15 Cal.App.4th at p. 1621.) “In sum, bare allegations of director wrongdoing without factual
14 support cannot excuse demand.” (*Ibid.*) Rather, “the court must be apprised of the facts specific to
15 each director from which it could conclude that the particular director could or could not be expected
16 to fairly evaluate the claims of the shareholder plaintiff.” (*Id.* [quoting *Shields, supra*, 15 Cal.App.4th
17 at p. 1622].) Thus, “the court, in reviewing the allegations to support demand futility, must be able to
18 determine on a director by director basis whether or not each possesses independence or disinterest
19 such that he or she may fairly evaluate the challenged transaction.” (*Id.* [citing *Oakland Raiders v.*
20 *National Football League* (2001) 93 Cal.App.4th 572, 587].)

21 Plaintiffs have not styled their claims as a shareholder’s derivative action, nor does the Fourth
22 Amended Complaint contain any allegation, however cursory, that Plaintiffs presented their derivative
23 claims to APP, or made any effort to persuade APP’s board of directors to take action to remedy the
24 misconduct Plaintiffs purport to describe. (*See generally* Fourth Am. Compl.; Corp. Code, §
25 800(b)(2).) Neither do Plaintiffs allege that, before filing this action, they informed APP of the
26 “ultimate facts” of each of their causes of action, either by providing them in writing to the board, or
27 delivering a draft copy of the complaint they planned to file. (*See* Fourth Am. Compl.; Corp. Code, §
28 800(b)(2).) Because Plaintiffs fail to meet this pleading requirement, the Fourth Amended Complaint

1 is subject to dismissal. (*Shields, supra*, 5 Cal.App.4th at p. 1619.)

2 **E. Plaintiffs Fail To Allege Fraud Or Negligent Misrepresentation With**
3 **Particularity**

4 Plaintiffs' causes of action for fraud and constructive fraud fail because they are not pled with
5 particularity. (Fourth Am. Compl., ¶¶ 26-28, 29-34.) The elements of fraud are: (1) a representation;
6 (2) with knowledge of its falsity; (3) with the intent to induce another's reliance; (4) justifiable
7 reliance; and (5) resulting damages. (*Conroy v. Regents of University of California* (2009) 45 Cal.4th
8 1244, 1255.) Fraud is a disfavored cause of action and must be pled with particularity; general and
9 conclusory allegations do not suffice. (*Citizens of Humanity, LLC v. Costco Wholesale Corp.* (2009)
10 174 Cal.App.4th 1, 20 [overruled in part on unrelated grounds, *Kwikset Corp. v. Superior Court* (2011)
11 51 Cal.4th 310, 337]; 5 Witkin, California Procedure (5th) Pleading, § 711.) "Thus, a plaintiff must
12 plead facts which show how, when, to whom, and by what means the representations were made.
13 (*Citizens of Humanity, supra*, 174 Cal.App.4th at p. 20 [citing *Lazar v. Superior Court* (1996) 12
14 Cal.4th 631, 645].) When the defendant is a corporate defendant, the plaintiff must further allege the
15 names of the persons who made the representations, their authority to speak, to whom they spoke, what
16 they said or wrote, and when it was said or written. (*Ibid.*)

17 The California Supreme Court has recognized that, in at least two published opinions, the
18 requirement of specificity of pleading has been applied to negligent misrepresentation claims. (*See*
19 *Small v. Fritz Companies* (2003) 30 Cal.4th 167, 184 [citing *Committee on Children's Television, Inc.*
20 *v. General Foods Corp.* (1983) 35 Cal.3d 197, 216; *B.L.M. v. Sabo & Deitsch* (1997) 55 Cal.App.4th
21 823, 835-837].) That heightened pleading requirement should apply to Plaintiffs' negligence
22 misrepresentation claims as well.

23 Plaintiffs have not pled their fraud claims with particularity and, thus, those claims are subject
24 to dismissal. Plaintiffs allege that Defendants could access, but failed to disclose, "adverse
25 information about [APP]'s business operations, operations trends, finances, and business prospects."
26 (Fourth Am. Compl., ¶¶ 5, 7-9.) They allege that Defendants "encouraged and persuaded" them to
27 collectively invest over \$1.65 million in APP without providing "sufficient information concerning"
28

1 the nature or worth of the investment, without explaining the risks of APP's business, and without
2 explaining the rules governing redemption of shares, the amount of shares they were receiving, the
3 price of those shares, or the basis for the valuation of the company. (Fourth Am. Compl., ¶¶ 14-16.)
4 Plaintiffs contend Farukhi made statements that APP's business prospects were good and the company
5 was healthy, but he did not apprise them of APP's "actual business status," provide documentation
6 regarding APP's financial health, disclose supposed "conflicts of interest," or advise them to seek
7 independent financial advice before investing in APP. (Fourth Am. Compl., ¶¶ 17-19.)

8 These vague and conclusory allegations are not sufficient to state claims for fraud. Plaintiffs
9 never explain to whom the alleged misrepresentations were made. Plaintiffs do not allege when and
10 how the alleged misrepresentations were made (*e.g.*, in APP financial statements, investor disclosure
11 or marketing materials, documents generated pursuant to state or federal statutory or regulatory
12 requirements, during shareholder meetings, or otherwise). Plaintiffs attribute certain statements to
13 Farukhi, but they cannot be construed as specific representations intended to induce reliance, and upon
14 which Plaintiffs justifiably could have relied. They contend Farukhi told them "APP was doing great;"
15 "APP is doing fine;" "everything is coming along fine, don't worry about it;" and they "would be able
16 to retire from their investments in APP." (Fourth Am. Compl., ¶ 17.) These general expressions of
17 optimism are not fraudulent misrepresentations because they do not embody specific information about
18 APP's financial status or its business prospects. Plaintiffs never describe when Farukhi made these
19 statements, never explain what Farukhi was referring to (other than vague expressions of optimism
20 about APP), and never state whether Farukhi's statements were extemporaneous or in response to
21 specific questions about APP's business operations, let alone what were those questions, who asked
22 them, or when. Plaintiffs also contend Farukhi withheld unspecified "paperwork" regarding APP's
23 "status and progress," telling them that "paperwork is my job," or "I'll take care of all the paperwork."
24 (Fourth Am. Compl., ¶ 18.) These allegations are also not specific enough to support allegations of
25 fraud. Plaintiffs never describe what tasks Farukhi offered to handle, what documents he circulated,
26 what documents he retained, why the documents were important, what the documents would have
27 shown about the financial health of APP, or whether the documents would have shed light on the
28 valuation and prospects for APP's stock.

1 Accordingly, Plaintiffs' fraud allegations do not meet the heightened pleading standard and
2 should be dismissed. (*Citizens of Humanity, supra*, 171 Cal.App.4th at p. 20 [quoting *Committee on*
3 *Children's Television, supra*, 35 Cal.3d at pp. 216-217.]

4 **F. Plaintiffs Have Not Alleged Facts Sufficient To State A Claim For**
5 **Accounting Malpractice And, In Any Event, It Would Be Time-Barred**

6 Plaintiffs have not pled facts sufficient to state a claim for accounting malpractice. The
7 elements of a cause of action for professional negligence are: (1) the existence of the duty of the
8 professional to use such skill, prudence, and diligence as other members of the profession commonly
9 possess and exercise; (2) breach of that duty; (3) a causal connection between the negligent conduct
10 and the resulting injury; and (4) actual loss or damage resulting from the professional negligence.
11 (*Shopoff & Cavallo LLP v. Hyon* (2008) 167 Cal.App.4th 1489, 1509.) An accountant's duty is "to
12 exercise the ordinary skill and competence of members of their profession;" only a failure to
13 discharge that duty subjects them to liability for professional negligence. (*Lindner v. Barlow, Davis &*
14 *Wood* (1962) 210 Cal.App.2d 660, 665 [quoting *Gagne v. Bertran* (1954) 43 Cal.2d 481, 489].)

15
16 Plaintiffs allege no facts that, if true, would show Farukhi, Vasquez or the Firm Defendants fell
17 below the standard of care in providing professional accounting services. Instead, Plaintiffs attempt to
18 plead professional liability based on alleged conduct that would give rise to a shareholder's derivative
19 claim against a corporation's officers and directors. Whether Farukhi, Vasquez and the Firm
20 Defendants, as officers and directors of APP, provided accurate information about APP stock has
21 nothing to do with whether, as accountants retained by Plaintiffs, they fell below the standard of care
22 in rendering professional services. Plaintiffs do not allege that Farukhi, Vasquez, or the Firm
23 Defendants fell below the standard of care in bookkeeping, preparing tax returns and financial
24 statements, or providing accounting advice. (Fourth Am. Compl. ¶¶ 40-50.) Neither do Plaintiffs
25 allege they were audited, penalized, or subject to any other investigatory or disciplinary action by
26 either the Internal Revenue Service or the California Franchise Tax Board. (*Id.*) Plaintiffs' only
27 discernable attacks on Defendants' accounting services is that they "failed to properly render advice,"
28 and that they were "grossly overbilling" and "block billing" to conceal their excesses. (Fourth Am.

1 Compl. ¶ 47.) Plaintiffs' apparent billing dispute is irrelevant to any claim of professional negligence.
2 Allegations that Defendants gave "investment advice" would not give rise to a malpractice claim
3 because rendering such advice would exceed outside the scope of accounting work.

4 To the extent Plaintiffs allege facts that go to claims of professional negligence, they are time
5 barred. The statute of limitations for accounting malpractice claims is two years. (Code Civ. Proc., §
6 339(1); *Sahadi v. Scheaffer* (2007) 155 Cal.App.4th 704, 714-715. The limitations period commences
7 to run "when (1) the aggrieved party discovers the negligent conduct causing the loss or damage and
8 (2) the aggrieved party has suffered actual injury as a result of the negligent conduct." (*Sahadi, supra*,
9 155 Cal.App.4th at p. 715 [quoting *Apple Valley Unif. Sch. Dist. v. Vavrinek, Trine, Day & Co.* (2002)
10 98 Cal.App.4th 934, 942.] The plaintiff need not be aware of specific facts necessary to establish the
11 claim. "So long as suspicion exists, it is clear that the plaintiff must go find the facts; she cannot wait
12 for the facts to find her." (*Id.* [quoting *Jolly v. Eli Lilly & Co.* (1988) 44 Cal.3d 1103, 1110-1111].)
13 The allegations in the Fourth Amended Complaint clearly show that Plaintiffs had at least a
14 "suspicion" of the facts supposedly giving rise to accounting malpractice, given that they employed
15 Farukhi and his firm for more than twenty years, during which time he gave "investment advice" that
16 included representations about APP predating the filing of the original complaint in this action by
17 more than two years. Moreover, Plaintiffs suffered actionable injury more than two years before filing
18 suit. Under *Apple Valley*, actual injury can occur when a plaintiff detrimentally relies on his
19 accountant, or incurs out-of-pocket expenses attributable to faulty advice. (*Apple Valley Unif. Sch.*
20 *Dist., supra*, 98 Cal.App.4th at pp. 946-947 [citing and quoting *Van Dyke v. Dunker & Aced* (1996) 46
21 Cal.App.4th 446, 452, 454-455; *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison* (1998) 18
22 Cal.4th 739, 743, 751-755].) Here, to the extent Plaintiffs can allege that substandard accounting
23 advice caused them harm due to a diminution in the value of their investment, then such losses were
24 plainly sustained more than two years before they filed suit and, accordingly, such claims are untimely.

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1 **IV. CONCLUSION**

2 For all the reasons explained herein, the Court should grant Defendants' Motion for Judgment
3 on the Pleadings, without leave to amend.

4
5 DATED: June 14, 2011

CALLAHAN & BLAINE, APLC

6
7 By: 

8 Edward Susolik
9 Robert S. Lawrence
10 Marc S. Ehrlich

11 Attorneys for Defendants, M. ZAMIN FARUKHI,
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14 VASQUEZ, FARUKHI & CO., VASQUEZ
15 FARUKHI & CO., LLP and FARUKHI & CO.,
16 LLP

1 **PROOF OF SERVICE**

2 I am employed in the County of Orange, State of California. I am over the age of 18 and not a
3 party to the within action; my business address is: **3 Hutton Centre Drive, Ninth Floor, Santa Ana,
California 92707.**

4 On **June 21, 2011**, I served the foregoing document described as:

5 **DEFENDANTS' NOTICE AND MOTION FOR JUDGMENT ON**
6 **PLEADING FOR THE FOURTH AMENDED COMPLAINT;**
7 **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF**

8 on the interested parties in this action by placing: [] the original [X] a true copy thereof enclosed in
9 a sealed envelope addressed as follows:

10 ****PLEASE SEE ATTACHED SERVICE LIST****

11 **[] BY OVERNITE EXPRESS:** I deposited such envelopes at Santa Ana, California for
12 collection and delivery by Overnight Express with delivery fees paid or provided for in
13 accordance with ordinary business practices. I am "readily familiar" with the firm's practice of
14 collection and processing packages for overnight delivery by Overnight Express. They are
15 deposited with a facility regularly maintained by Overnight Express for receipt on the same day
16 in the ordinary course of business.

17 **[X] BY MAIL:** I deposited such envelope in the mail at Santa Ana, California. The envelope
18 was mailed with postage thereon fully prepaid. I am "readily familiar" with the firm's practice
19 of collection and processing correspondence for mailing. It is deposited with the United
20 States Postal Service on that same day in the ordinary course of business. I am aware that on
21 motion of party served, service is presumed invalid if postal cancellation date or postage
22 meter date is more than one (1) day after date of deposit for mailing in affidavit.

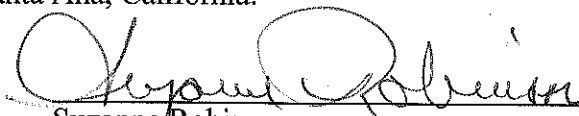
23 **[] BY ELECTRONIC MAIL:** I transmitted the foregoing documents by electronic mail to the
24 party(s) identified on the attached service list by using the electronic mail as indicated. Said
25 electronic mail were verified as complete and without error.

26 **[] BY PERSONAL SERVICE:** I caused such envelope to be hand delivered by First Legal to
27 the addressees below.

28 **[] BY FACSIMILE:** I transmitted the foregoing document by facsimile to the party(s)
identified above by using the facsimile number(s) indicated. Said transmission(s) were
verified as complete and without error.

I declare that I am employed in the office of a member of the bar of this court at whose
direction the service was made. I declare under penalty of perjury under the laws of the United States
of America and the State of California that the foregoing is true and correct.

Executed on **June 21, 2011**, at Santa Ana, California.


Suzanne Robinson

SERVICE LIST

Mehta, et al. v. Farukhi, et al.
Case No.: CIVRS800952

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