

1 KASSANDRA MCQUILLEN, SBN 227914
2 ATTORNEY AT LAW
3 208 S. Green Street, Suite 6
4 Tehachapi, CA 93561
5 Telephone: (661) 823-9454
6 Facsimile: (661) 823-9492

7 Attorney for Plaintiffs
8 DONALD PESTELL, HANNA PESTELL,
9 PESTELL INTERNATIONAL

10 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**
11 **COUNTY OF KERN, METROPOLITAN DIVISION – UNLIMITED CIVIL**

12 DONALD PESTELL; HANNA PESTELL;) Case No.: S-1500-CV-264437 WDP
13 and PESTELL INTERNATIONAL MINING)
14 AND EXPLORATION, LTD., a Canadian)
15 Corporation,) **PLAINTIFFS’ POST TRIAL OPENING**
16) **BRIEF**

17 Plaintiffs,)
18 vs.)

19 AMERICAN CARRIAGE, INC.; MARK)
20 FECHNER; JOCELYN FECHNER; MARK)
21 AND JOCELYN FECHNER TRUST, and)
22 DOES 1-20, inclusive,)
23 Defendants.)

24 _____)
25 AMERICAN CARRIAGE, INC.; MARK)
26 FECHNER; JOCELYN FECHNER; MARK)
27 AND JOCELYN FECHNER TRUST,)

28 Cross-Complainants,)

vs.)

29 DONALD PESTELL; HANNA PESTELL;)
30 and PESTELL INTERNATIONAL MINING)
31 AND EXPLORATION, LTD, a Canadian)
32 company; and ROES 1-20, inclusive,)

Cross-Defendants.)

Honorable William D. Palmer

Trial Date: December 19, 2009

Time: 9:00 a.m.

Dept.: 15

1 On December 19, 2009, at a post-trial conference in the above-captioned matter, the court
2 asked the parties to prepare post trial briefs on the issues listed below:

- 3 1. Whether American Carriage, Inc. (ACI) owes the Pestells under the breach of
4 contract claim:
 - 5 a. Have the terms of the loan agreement been met?
 - 6 b. Is there any reason ACI should not repay its obligations to plaintiffs?
- 7 2. Does ACI's obligation to plaintiffs transfer to the Fechners as individuals and to their
8 family trust?
- 9 3. Can a subchapter S corporation approve commingling?
- 10 4. The court stated it did not think the intent requirement for the cause of action for

11 Fraudulent Misrepresentation had been proven. Plaintiffs will show otherwise.

12 This opening brief shall address the above issues.

1 **POINTS AND AUTHORITIES**

2

3 **I. DOES ACI OWE THE PESTELLS AND PESTELL INTL. ANY MONEY?**

4 It has been established through the stipulated facts, trial exhibits 3 and 4, and the testimony
5 of all the parties at trial that the terms of the four loan payments beginning in November 2007
6 and ending in February 2008, totaling \$565,000, were that the loaned monies be used specifically
7 for the purpose of completing the Pestells' motorcoach and be repaid through either the sale of
8 ACI and its assets or future coach orders as anticipated at the time the loan agreement was made.

9 The second loan, in the amount of \$425,000, was not included in any written contract but
10 was loaned from Pestell International Mining & Exploration, LTD ("Pestell Intl.") to ACI in
11 March 2008 and has not been repaid.

12 All parties testified that the monies received by ACI from the Pestells and Pestell Intl.
13 were loans and repayment was expected by the Pestells and Pestell Intl. at the time the monies
14 were lent. So, yes, ACI owes the money it borrowed from the Pestells and Pestell Intl.

15

16 **A. HAVE THE TERMS OF THE LOAN AGREEMENT BEEN MET?**

17 No. ACI breached or waived through bad faith conduct every term it was required to
18 perform under.

19 ***BREACH #1: The loan money was not used for its intended purpose.***

20 ACI owes the \$565,000 to the Pestells because it breached the loan agreement by using
21 the loan monies for purposes other than the completion of the Pestells' coach beginning in
22 November 2007 and continuing beyond the close of ACI for business in March 2008.

23 ACI and its officers, Mark and Jocelyn Fechner, used the Pestell loan monies for a
24 multitude of personal purposes, including the following: unlawful issuance of unearned and
25 unauthorized shareholder dividends, personal purchases and perks for corporate officers in the
26 form of daily meals, payment for all personal vehicle expenses of the Fechners, college
27 registration fees for the Fechners' daughter, jewelry, birthday gifts, all expenses relating to
28 family vacations to Seattle, San Francisco, and Maui, company Christmas parties and gifts,

1 payment of advertising and incorporation expenses for Serious Off Road Parts, LLC (a new
2 business venture of the Fechners), severance bonuses for all employees, and, perhaps most
3 egregious of all, the diversion of an entire loan installment in the amount of \$140,000 to the
4 personal bank account of Mark and Jocelyn Fechner for payment of a family trust debt on the
5 1401 Goodrick property in which ACI was housed.

6 Additionally, the Fechners continued to pay personal and other non-ACI business
7 expenses from the loan monies after the close of ACI for several months.

8 From November 28, 2007 (date of deposit of first Pestell loan installment per Trial
9 Exhibit 51_0013) through March 10, 2008 (date of delivery of Pestell coach per testimony at
10 trial), ACI received a total of \$64,539.72 in deposits to its checking account that were not
11 provided through loans from the Pestells (Trial Exhibit 51, pages 17, 21, 25, and 29).

12 The alleged payment by Serious Off Road Parts, LLC to ACI for the “service truck”,
13 which plaintiffs contend was either payment for a personal vehicle of the Fechners, a sale of a
14 corporate asset, and a fraudulent conveyance, constitutes \$51,569.97 of that \$64,539.72.

15 If the court removes the service truck purchase payment (Exhibit 51_0021) from the mix,
16 ACI received only \$12,969.97 (\$64,539.72-\$51,569.97) in deposits to its bank account during
17 the time of the Pestell loans.

18 Logic would dictate that since ACI promised to use the loan funds from Pestell for the
19 completion of his coach, any monies in excess of \$12,969.97 used during that period were the
20 Pestell loan monies. And because the Pestells were the only customer of ACI during 2007, and
21 ACI had outstanding debts in excess of \$400,000 for parts on the Pestell coach from August
22 2007 to the date of the first loan installment, and Aci had no other documented or secured
23 obligations in 2007, it is reasonable to believe that any money received by ACI from August
24 2007 to the date of the first Pestell loan was also Pestell money under the original coach
25 agreement (Trial Exhibit 1).

26 Exhibit A attached hereto is a summary of some of the items paid by ACI from
27 November 28, 2007 to March 10, 2008, listed by date, description, amount, and trial exhibit
28 reference, that in no way contributed to the completion of the Pestells’ motorcoach. These

1 expenses include meals, personal travel (Maui, Seattle, San Francisco, and Big Bear),
2 “dividends”, personal auto expenses, undocumented loan payments of which Mr. Pestell was
3 neither informed of nor advised he would be paying for, employee bonuses, personal purchases,
4 “promotional” charges such as t-shirts, Christmas parties and gifts for the Fechners and their
5 employees, and monies spent on the advertising and incorporation of Serious Off Road Parts,
6 LLC.

7 Exhibit A to this brief was created by plaintiffs’ counsel and includes items paid by ACI
8 between November 28, 2007 and March 10, 2008 that do not obviously relate to either the Pestell
9 coach or the office expenses, payroll, building maintenance, shop expenses, and reasonable
10 operating costs of ACI during that period based entirely on exhibits entered into evidence at trial.

11 Exhibit A shows that ACI paid \$219,160.40 toward non-Pestell related expenses during
12 the period of the loan agreement. More than half this amount, \$140,000, was the fraudulently
13 diverted January loan installment from the Pestells payable to ACI which Mrs. Fechner
14 appropriated for payment of family trust debts (Jocelyn Fechner trial testimony, Dec. 15, 2009).

15 ACI breached the only term of the loan agreement it had to adhere to – that the loan
16 monies be used for completion of the Pestells’ coach. ACI diverted nearly 39% of the loaned
17 monies for purposes other than the completion of the Pestell coach. In doing so it breached the
18 contract and is liable for the obligation owed thereon in the amount of \$565,000, plus interest at
19 the legal rate from the date of the first breach of the loan agreement.

20
21 ***BREACH #2: No reasonable attempt at selling ACI and its assets was made.***

22 The rule concerning modification of a written contract (California Civil Code § 1698) is
23 subject to the exception that a party to a contract may by conduct or representations waive the
24 performance of a condition or be estopped because of conduct or representations, to deny that the
25 party has waived the performance *Panno v. Russo (1947) 82 Cal.App.2d 408, 412.*

26 Defendants testified that they attempted to sell ACI through VR Business Brokers by
27 signing a listing agreement with VR Business Brokers on February 25, 2008 (Trial Exhibit 40).
28 The listing, based on valuation information submitted in October 2007, prior to the Pestell loans,

1 was not entered into in good faith. It was not executed until after ACI had lost its building,
2 terminated all employees, borrowed \$970,000, and notified its customers that it was closing its
3 doors.

4 No reasonable business person could expect to sell a business that had been plundered
5 and left owing by its owners. There was no good faith attempt to sell ACI or its assets in 2008. In
6 fact, Jocelyn Fechner testified at trial that she never followed up on the faxed representation
7 agreement and does not know what other efforts were made to sell ACI. There was never any
8 valid attempt to sell ACI for a reasonable value to a third party buyer and so this condition of the
9 loan agreement has been waived and defendants should be estopped from claiming the contract
10 conditions have not been met.

11
12 ***BREACH #3 ACI later fraudulently conveyed its assets to Mark Fechner to avoid***
13 ***payment to Mr. Pestell.***

14 It was not until the summer of 2009 that the Fechners took it upon themselves to liquidate
15 the assets of ACI for use in Mark Fechner's new endeavor, Motorcoach Services, a business
16 substantially similar to ACI which used ACI assets, that ACI had any possibility of attempting to
17 meet the repayment terms of its contract with the Pestells.

18 When ACI sold its assets for an unknown amount at an unknown date to the shareholders
19 of ACI, it did not send the proceeds of the sale to Mr. Pestell per the loan agreement, rather, it
20 spent the money on attorney fees to defend ACI and its owners against Mr. Pestell's present
21 claim (testimony of Mark Fechner). The Pestell obligation was incurred prior to the need for
22 attorney fees and the Pestell loan agreement contained a specific provision for repayment from
23 the sale of ACI and its assets and supercedes any later-incurred debts in the form of shareholder
24 perks.

25 This behavior was a breach of the contract with Mr. Pestell, which predated the
26 incurrence of legal expenses by ACI and the Fechners, in which it was specifically stated that
27 Mr. Pestell would be repaid from the sale of ACI and its assets.

1 This diversion of the assets is also a fraudulent conveyance pursuant to the Uniform
2 Fraudulent Conveyances Act, California Civil Code § 3439.04, which reads in pertinent part:

- 3 (a) A transfer made or obligation incurred by a debtor is fraudulent to a
4 creditor, whether creditor's claim arose before or after the transfer was
5 made or the obligation was incurred, if the debtor made the transfer or
6 incurred the obligation as follows:
(1.) With actual intent to hinder, delay, or defraud any creditor of the
debtor.
- 7 (b) In determining actual intent under paragraph (1) of subdivision (a),
8 consideration may be given, among other factors, to any or all of the
following
9 (1) Whether the transfer or obligation was to an insider.
10 (2) Whether the debtor retained possession or control of the property
11 transferred after the transfer.
12 (3) Whether the transfer or obligation was disclosed or concealed.
13 (4) Whether before the transfer was made or obligation was incurred,
14 the debtor had been sued or threatened with suit.
15 (5) Whether the transfer was of substantially all the debtor's assets.
16 (6) Whether the debtor absconded.
17 (7) Whether the debtor removed or concealed assets.
18 (8) Whether the value of the consideration received by the debtor was
19 reasonably equivalent to the value of the asset transferred or the
20 amount of the obligation incurred.
21 (9) Whether the debtor was insolvent or became insolvent after the
22 transfer was made or the obligation was incurred.
23 (10) Whether the transfer occurred shortly before or shortly after a
24 substantial debt was incurred.
25 (11) Whether the debtor transferred the essential assets of the business
26 to a lienholder who transferred the assets to an insider of the
27 debtor.
28

20 The sale of ACI's assets in summer 2009 to Mark Fechner, still president and shareholder
21 of ACI receiving compensation from ACI in the form of payment of attorney fees, was a
22 fraudulent conveyance within the meaning of Section 3439.04. Nearly every factor to be
23 considered in determining intent is met: 1. Mr. Fechner was an insider, who 2. Retained
24 possession and control of the property, and 3. Concealed the transfer from the creditor, 4. After
25 suit had been brought, 5. Of all of the known remaining assets of ACI. 8. The value of the assets
26 was determined by a cursory search on eBay (testimony of Mark Fechner, December 14, 2009)
27
28

1 and no third party appraisal was obtained, though the assets were listed as being worth \$400,000
2 in a valuation profile signed in October 2007 (trial exhibit 38_0002).

3 ACI made no attempt between February 25, 2008 and the summer of 2009 to sell the
4 assets of ACI. It was only after the depositions of Mark and Jocelyn Fechner were taken in May
5 2009 that the ACI assets were sold, and not to repay Mr. Pestell per the terms of the loan
6 agreement, rather to pay Mr. Brumfield to continue to defend this matter.
7

8 No accounting of the sale of ACI's assets was made and the sale was not discovered until
9 trial. Now it appears the Fechners have made it impossible to perform under the first term of
10 repayment of the loan monies and thereby breached the agreement as to that term as well and
11 should be estopped from asserting this as a defense to the breach of contract claim.
12

13
14 ***BREACH #4: ACI is closed but Mark Fechner is still performing ACI work and has***
15 ***refused to accept other coach orders.***
16

17 Mark Fechner testified at deposition and trial that he gave himself the ACI customer list
18 and used it to start a new business, less than ¼ mile from ACI's previous location, performing
19 service work on ACI coaches (Mark Fechner trial testimony 12/14/2009, trial exhibits 54 and
20 56). Mr. Fechner went on to testify that he has been contacted since the close of ACI to build
21 ACI coaches but has not made any effort or attempt to do so.
22

23 The term allowing for repayment of the Pestell loans through future coach orders has
24 been waived and is estopped by these actions under the doctrine of promissory estoppel.

25 Additionally, this contract term, as to repayment through future coach orders, was
26 frustrated by ACI closing its business, it gave up its leasehold rights (trial exhibit 57_0001) by
27 allowing the termination of a five year lease prior to completion of the lease term, terminating its
28

1 entire staff, and notifying ACI customers of its closure. Mr. Fechner stated that when he started
2 ACI he could complete one coach per year with a staff of himself and three assistants.

3 Mr. Fechner could have kept ACI in operation, as his actions in creating and operating
4 Motorcoach Services using the ACI customer list and assets show. He created the new entity
5 merely to avoid repayment of ACI's debts to Mr. Pestell and Pestell International Mining &
6 Exploration and so has made it impossible for ACI to meet the term of future coach orders in the
7 Pestell loan agreement.
8

9 ***BREACH #4: ACI breached the implied covenant of good faith and fair dealing.***

10 California law recognizes an implied covenant of good faith and fair dealing in every
11 contract. *Quigley v. Pet, Inc. (1984) 162 Cal. App. 3d 877, 889-890.*

12 The covenant is to the effect that neither party to the contract will do anything
13 deliberately to deprive the other of the benefits of the agreement *Pasadena Live, LLC v. City of*
14 *Pasadena (2004) 114 Cal. App. 4th 1089, 1092-1094.*

15 A breach of the implied covenant of good faith and fair dealing involves something more
16 than a breach of a contractual duty itself. It involves unfair dealing (which may or may not also
17 constitute a breach of an express contract term) in the form of a conscious and deliberate act that
18 unfairly frustrates the agreed common purpose of the contract and disappoints the reasonable
19 expectations of the other party to the contract. *Celador Int'l Ltd. v. Walt Disney Co. (C.D. Cal.*
20 *2004) 347 F. Supp. 2d 846, 852 , citing Careau & Co. v. Security Pac. Bus. Credit, Inc. (1990)*
21 *222 Cal. App. 3d 1371, 1394*

22 The sale of ACI's assets to Mark Fechner for use in his new business servicing ACI
23 coaches is a breach of the covenant of good faith and fair dealing implicit in every contract. ACI
24 now has no assets to sell and Mark Fechner has created a new entity doing substantially the same
25 work as ACI once did but refusing to take new ACI business. Mr. Fechner is still president of
26 ACI but through his self-dealing has made it impossible for ACI ever to comply with the terms
27 of the loan agreement with Don Pestell so those terms should be voided and repayment of the
28 \$565,000 loaned pursuant to that agreement plus interest at the legal rate ordered.

1
2
3 ***COMMON COUNT: ACI received \$425,000 from Pestell International Mining &***
4 ***Exploration, Ltd. as a loan and has not repaid it.***

5 Under current law there are three essential allegations for a common count, 1. A
6 statement of indebtedness in a certain sum, 2. Consideration given (that is, goods sold or
7 services provided), and 3. Nonpayment. *First Interstate Bank. State of California (1987) 197*
8 *Cal.App.3d 627, 635*

9 The last loan payment, from Pestell International Mining & Exploration, Ltd. to ACI in
10 the amount of \$425,000, was not included in the initial written agreement so the terms of the first
11 loan installments do not apply and is therefore due and payable immediately as money loaned
12 and not repaid. Pestell International Mining & Exploration loaned the money, ACI received it
13 and spent it, and ACI owes it.

14
15 **A. IS THERE ANY REASON ACI SHOULD NOT REPAY ITS OBLIGATIONS**
16 **TO PLAINTIFFS?**

17 No. ACI is still an active corporation and has made no attempt as dissolution or winding
18 up in the 20 months since its closure. Its officers continue to take from the corporation rather
19 than attempt to satisfy its obligations. ACI and its officers, through their actions in making the
20 repayment conditions impossible are therefore promissory estopped from claiming those
21 conditions as a defense in this matter.

22
23 **2. DOES ACI'S OBLIGATION TO PLAINTIFFS TRANSFER TO THE FECHNERS**
24 **AND TO THEIR FAMILY TRUST?**

25
26 **A. Alter ego liability authority in general.**

27 The two requirements for application of the alter ego doctrine are (1) that there be such a
28 unity of interest and ownership that the separate personalities of the corporation and the

1 individual no longer exist; and (2) that, if the acts are treated as those of the corporation alone, an
2 inequitable result will follow. *Associated Vendors, Inc. v. Oakland Meat Co., Inc.* (1962) 210
3 Cal.App.2d 825, 837.

4 A variety of factors are pertinent to the trial court's determination of alter ego liability in
5 each case. Factors for consideration by the trial court that are applicable to the case at bar
6 include:

- 7 1. Commingling of funds and other assets, failure to segregate funds of the separate
8 entities, and the unauthorized diversion of funds or assets to other than corporate
9 uses;
- 10 2. The failure to maintain minutes or adequate corporate records;
- 11 3. The identical equitable ownership among the entities; the identification of the
12 equitable owners thereof with the domination and control of the two entities;
13 identification of the directors and officers of the entities in the responsible supervision
14 and management;
- 15 4. Sole ownership of all of the stock in a corporation by one individual or members of a
16 family;
- 17 5. The employment of the same employees and/or attorney;
- 18 6. The failure to adequately capitalize a corporation, or the total absence of corporate
19 assets and undercapitalization;
- 20 7. The use of the corporation as a mere shell, instrumentality or conduit for a single
21 venture or the business of an individual or another corporation;
- 22 8. The concealment and misrepresentation of the identity of the responsible ownership,
23 management and financial interest, or concealment of personal business activities;
- 24 9. The disregard of legal formalities and the failure to maintain arm's length
25 relationships among related entities;
- 26 10. The use of the corporate entity to procure labor, services or merchandise for another
27 person or entity;
- 28

- 1 11. The diversion of assets from a corporation by or to a stockholder or other person or
2 entity to the detriment of creditors;
- 3 12. The manipulation of assets and liabilities between entities so as to concentrate the
4 assets in one and the liabilities in another;
- 5 13. The contracting with another with intent to avoid performance by use of a corporate
6 entity as a shield against personal liability;
- 7 14. The formation and use of a corporation to transfer to it the existing liability of another
8 person or entity. (see *Associated Vendors, supra.* 210 Cal.App.2d at 838-840)

9 Also extremely relevant in determining the propriety of the actions of the Fechners and their
10 family trust relative to this matter are California Corporations Code Sections 166, 309,
11 310, 316, 500, 501, 506, and 507 as were outlined in Plaintiffs' Corporations Code Summary
12 submitted to this court on December 17, 2009 and incorporated fully herein by this reference.

13
14 **B. ALTER EGO LIABILITY OF FECHNERS AS INDIVIDUALS**

15 There is no doubt that the Fechners did not know the difference between ACI's finances,
16 assets and business and their own and that this unity of interest was so great that the separate
17 existence of ACI and the Fechners should be disregarded. To find that the Fechners and ACI are
18 separate would result in a grave injustice to the plaintiffs. The *Associated Vendors* factors (*supra.*
19 210 Cal.App.2d at 838-840) are outlined below as they apply to the facts and evidence presented
20 at trial:

- 21 **1. Commingling of funds and other assets, failure to segregate funds of**
22 **the separate entities, and the unauthorized diversion of funds or**
23 **assets to other than corporate uses;**

24 The court stated in its preliminary findings that there was commingling by the Fechners
25 so I will not expound upon this at this time.

- 26 **2. The failure to maintain minutes or adequate corporate records;**

27 ACI board and shareholder minutes do not authorize any of the alleged shareholder loans,
28

1 trust loans, loan repayment, terms of repayment, self-dealing in the form of the sale of the
2 service truck or the company assets, dividend issuance, procedures for issuance of dividends or
3 distribution, termination of the lease for the 1401 Goodrick property, guarantee on the loans
4 obtained by the Fechners for the construction of the 1401 Goodrick property (stipulated facts),
5 guarantees on any loans by the Fechners, use of credit cards for the personal benefit of the
6 Fechners, payment of loan interest on non-ACI loans, termination of the entire staff of ACI in
7 February, closing of ACI in March, plans for wind-up of ACI. In fact, the only things that appear
8 to be authorized by ACI through recorded meetings are the authorization for payment of personal
9 benefits of its officers and the loans from the Pestells. The board and shareholder minutes are
10 greatly lacking in recording the major business decisions of ACI in the past three years.

11
12 **3. The identical equitable ownership among the entities; the**
13 **identification of the equitable owners thereof with the domination**
14 **and control of the two entities; identification of the directors and**
15 **officers of the entities in the responsible supervision and**
16 **management;**

17 Mark and Jocelyn Fechner were the sole shareholders and officers of ACI, they are also
18 the sole trustees of the Mark and Jocelyn Fechner family trust, and the only shareholders and
19 officers of Serious Off Road Parts, LLC, and Mark Fechner is the sole proprietor of Motorcoach
20 Services. None of these facts are in dispute. Mark and Jocelyn Fechner and ACI are the only
21 guarantors on the loans for the construction of the 1401 Goodrick property, which was
22 transferred to the Fechner Family Trust for no consideration after the loans were secured.

23 **4. Sole ownership of all of the stock in a corporation by one individual**
24 **or members of a family;**

25 Mark and Jocelyn Fechner own all stock in ACI and Serious Off Road Parts, LLC.

26 **5. The employment of the same employees and/or attorney;**

27 Mark and Jocelyn Fechner both testified that prior to the filing of this action William
28 Kruse was the attorney for both ACI and the Fechner family trust.

1 **6. The failure to adequately capitalize a corporation, or the total**
2 **absence of corporate assets and undercapitalization;**

3 Both experts testified that in 2007 and 2008 ACI was undercapitalized given its recorded
4 liabilities. These determinations were made without considering the undocumented \$412,000
5 past due shell balance, the undocumented alleged \$395,000 shareholder loan established at trial,
6 and the Pestell loans. This is not including the more than \$700,000 discrepancy in retained
7 earnings between the 2003 and 2004 federal taxes that could not be explained by ACI's own
8 expert at trial..

9 **7. The concealment and misrepresentation of the identity of the**
10 **responsible ownership, management and financial interest, or**
11 **concealment of personal business activities;**

12 There is no documentation of alleged shareholder loans to ACI which ACI chose to pay
13 in lieu of documented obligations. The Fechners concealed these debts from the business
14 valuation expert hired to assess the value of the business, from Mr. Pestell, and from all creditors
15 of ACI.

16 Mark and Jocelyn Fechner owned all of the assets of value at the corporation, including
17 all equipment save some hand tools and office equipment. The family trust owed the building,
18 though ACI was a guarantor on the notes for the building (stipulated facts). ACI owned less than
19 \$100,000 in assets but regularly carried more than five times that amount in liabilities to produce
20 a product worth ten times the value of its assets. This is undercapitalization.

21 **8. The disregard of legal formalities and the failure to maintain arm's**
22 **length relationships among related entities;**

23 ACI paid for trust debts, personal debts of shareholders, and business expenses for new
24 ventures of the shareholders of ACI, and basically lived out of the corporation's bank account
25 through abuses in fuel purchases, meal purchases, travel expenses, and unearned "dividends".
26 ACI was also a guarantor on the small business administration loan used to construct the facility
27 it leased from the Fechners (stipulated facts). None of the loans or financial relationships
28

1 between the Fechners and/or their trust and ACI were ever documented anywhere and Jocelyn
2 Fechner had sole control over the finances of all three entities.

3 **9. The use of the corporate entity to procure labor, services or**
4 **merchandise for another person or entity;**

5 ACI paid for advertising, incorporation, and a promotional vehicle for Serious Off Road
6 Parts and gave its customer list to Motorcoach Services. ACI also sold its assets to Motorcoach
7 Services through a fraudulent conveyance.

8
9 **10. The diversion of assets from a corporation by or to a stockholder or**
10 **other person or entity to the detriment of creditors;**

11 See above.

12 **11. The manipulation of assets and liabilities between entities so as to**
13 **concentrate the assets in one and the liabilities in another;**

14 The Fechners made sure the undocumented loans for which they and their family trust
15 were liable were paid by ACI before any other liabilities of the corporation. From January 2007
16 to March 2008 the Fechners paid themselves more than \$590,000 of corporate funds for alleged
17 undocumented, unauthorized loans to ACI (Trial Exhibit 68_0171) and charged off more than
18 \$400,000 in alleged “distributions” (Trial Exhibit 66_0002). This amounts to the taking of more
19 than \$990,000 from ACI by the Fechners in 2007 and 2008 alone, more than the amount of the
20 Pestell loans. In diverting these funds and discharging the shareholder debts through
21 “distributions”, the Fechners manipulated the assets and liabilities of ACI so that the Pestells
22 absorbed all of the liabilities of ACI and the Fechners.

23
24 **2. DOES ACI’S OBLIGATION TO PLAINTIFFS TRANSFER TO THE**
25 **FECHNERS AS INDIVIDUALS AND TO THEIR FAMILY TRUST?**

26 Yes. The alter ego factors are present as to the Fechners, who treated ACI’s bank account
27 as their own personal bank account. The alter ego factors are also present as to the Fechner
28 Family Trust because the equity line of credit from which the Fechners claim they loaned money

1 to ACI was against an asset owned by the Family Trust that the Fechners, as trustees, made
2 without documentation. Additionally, in January 2008, Jocelyn Fechner took a \$140,000 loan
3 installment check payable to ACI and deposited it directly into an account for the benefit of the
4 Family trust. In doing so she treated ACI's asset as that of the family trust. Additionally,
5 throughout their testimony the Fechners referred to loans they made to ACI under an equity line.
6 These loans, that they personally claim, were actually from the Family Trust. The Fechners never
7 treated the family trust as a separate entity and did not even have a separate bank account from
8 their personal account during all times relevant to this action.

9 10 **3. CAN A SUBCHAPTER S CORPORATION APPROVE COMMINGLING?**

11 A Subchapter S election permits the S corporation to retain the corporate advantage of
12 limited liability for its shareholders while being treated for income tax purposes as if it were a
13 partnership, passing through to its shareholders items of income, loss, deduction, or credit with
14 minimal taxation at the corporate level. Internal Revenue Code § 1363, 1366; California
15 Revenue & Tax Code § 23802.5

16 A corporation that has a valid election under I.R.C. § 1362(a) in effect for federal
17 purposes will be an S corporation under California tax law California Rev. & Tax Code §
18 23801(a), (b), and its shareholders will be shareholders of an S corporation, without regard to
19 whether the corporation is qualified to do business or is incorporated in California Rev. & Tax §
20 23801(b).

21 The designation "Subchapter S" is merely a tax designation for a corporation. It has
22 nothing to do with the fiduciary duties and responsibilities of the officers and shareholders of a
23 corporation. The California Corporations Code does not have any special provisions for
24 distributions or conduct of officers of "S" corporations. In California, a corporation is a
25 corporation and must adhere to the laws of the state, regardless of its tax designation.

26 To ignore the fiduciary requirements of any corporation to the detriment of its creditors
27 would violate public policy and defeat the purpose of having the protective veil of a corporation.
28

1 The governing law in California regarding shareholder distributions is California
2 Corporations Code § 501, which states, “Neither a corporation nor any of its subsidiaries shall
3 make any distribution to the corporation’s shareholders (Section 166) if the corporation or its
4 subsidiary making the distribution is, or as a result thereof would be, likely to be unable to meet
5 its liabilities (except those whose payment is otherwise adequately provided for) as they mature.”

6 California Corporations Code § 300 says a corporation may only make distributions to its
7 shareholders out of retained earnings or if its assets are equal to 1 ¼ times its liabilities. Both
8 experts at trial testified that ACI had no retained earnings in 2007 or 2008 and that the liabilities
9 of ACI exceeded its assets in 2007 and 2008. The Fechners took more than \$400,000 in unlawful
10 distributions during the time they had business relations with the Pestells.

11
12 **4. THE INTENT REQUIREMENT FOR FRAUDULANT MISREPRESENTATION**
13 **HAS BEEN SHOWN**

14 Fraudulent misrepresentation, or deceit, is governed by California Civil Code § 1709,
15 which states, “One who willfully deceives another with intent to induce him to alter his position
16 to his injury or risk, is liable for any damage which he thereby suffers.”

17 The Civil Code defines deceit in the next section, Section 1710:

18 A deceit, within the meaning of the last section, is either:

- 19 **1.** The suggestion, as a fact, of that which is not true, by one who does not
20 believe it to be true;
21 **2.** The assertion, as a fact, of that which is not true, by one who has no reasonable
22 ground for believing it to be true;
23 **3.** The suppression of a fact, by one who is bound to disclose it, or who gives
24 information of other facts which are likely to mislead for want of communication
25 of that fact; or,
26 **4.** A promise, made without any intention of performing it.

27 In its tentative decision the court stated it did not see that the intent requirement for fraud
28 had been met. Plaintiffs believe the evidence and testimony at trial show intent as defined by
statute and case law.

1 Intent to defraud is not of essence of suit for deceit; it is intent to induce action by other
2 person that counts. *Ashburn v. Miller (1958, Cal App 2d Dist) 161 Cal App 2d 71.*

3 Elements of actionable deceit are false representation of material fact made with knowledge
4 of its falsity, recklessly or without reasonable grounds for believing its truth, and with intent to
5 induce reliance thereon, on which plaintiff justifiably relies to his injury. *Regus v. Schartkoff*
6 *(1957, Cal App 2d Dist) 156 Cal App 2d 382.*

7
8 On October 29, 2007 defendants sent an e-mail, Trial Exhibit 2, stating that ACI was out of
9 capital, could not complete the Pestells' coach, and would close by the end of the week if an
10 injection of capital was not received.

11
12 The Fechners both testified that their intent in sending this e-mail was to induce Mr. Pestell
13 to invest or loan additional money to ACI. ACI was not in fact out of capital when it made these
14 representations.

15
16 On October 29, 2007, ACI had more than \$350,000 in its checking account, nearly three
17 months' operating capital (Trial Exhibit 51_0012). On November 1, 2007 ACI paid more than
18 \$110,000 (Trial Exhibit 23) toward an alleged undocumented, unsecured loan from ACI's
19 owners for an item the Fechners had told both Mr. Pestell and Richard Schammel just three
20 weeks before the payoff was their personal vehicle (Don Pestell trial testimony, Trial Exhibit
21 34_0001, Item 1, bullet point two). Mark Fechner later admitted at trial that the vehicle was sold
22 for less than \$45,000 to Serious Off Road Parts in January 2008. Serious Off Road Parts was not
23 incorporated until March 2008 (testimony of Jocelyn Fechner) so the vehicle was actually "sold"
24 to the Fechners themselves at a loss to ACI of more than \$55,000 during a time it was out of
25 operating capital. There is also a note receivable from shareholders for "shop equipment" in the
26 amount of \$55,000 in the general ledger dated November 1, 2007 (Trial Exhibit 68_0076), the
27
28

1 same date ACI claimed it sold the ACI “Service Truck” on its federal income tax for the amount
2 of \$55,000 (Trial Exhibit 61_0028). Based on this evidence and the inability of Jocelyn Fechner
3 to explain the receivable and tax document at trial, that the Fechners had ACI give them the
4 “Service Truck” as a distribution for half the amount of an undocumented loan payoff in lieu of
5 paying for the truck they had previously claimed was a personal vehicle.
6

7 Based on the October 29, 2007 e-mail, the amount of capital in the ACI bank account at
8 the time it was represented that ACI was out of capital, the misrepresentations as to the assets of
9 ACI, and the actions of the Fechners in paying off \$110,000 in unsecured personal debt for an
10 item they own to this day within days of claiming ACI was out of capital in order to induce Mr.
11 Pestell to loan money to ACI, the elements of fraudulent misrepresentation have been met.
12

13 Where any relation of confidence and trust exists between parties which demands that
14 information communicated respecting the subject of their dealings be full and complete, any
15 concealment or misrepresentation will amount to fraud sufficient to entitle injured party to an
16 action. *Kruse v. Miller (1956, Cal App 4th Dist) 143 Cal App 2d 656.*
17

18 Plaintiff seeking relief from fraud will not be denied relief because he reposed too much
19 confidence in person who actually defrauded him, where it cannot be said that his conduct in
20 light of his own intelligence and information was manifestly unreasonable. *Anderson v. Thacher*
21 *(1946, Cal App) 76 Cal App 2d 50.*
22

23 To be material the false representation must be of such a character that, if it had not been
24 made, the contract or transaction would not have been entered into. *Andrew v. Bankers &*
25 *Shippers Ins. Co. (1929, Cal App) 101 Cal App 566.*
26

27 Mr. Pestell testified at trial that had he known that ACI had more than \$350,000 in its bank
28 account at the time Mark and Jocelyn Fechner told him ACI was out of operating capital, he

1 would not have loaned the money. He also testified he did not know about any shareholder loans
2 or debts of ACI at the time the monies were lent.

3 One who learns that his statements, even if thought to be true when made, have become false
4 through change in circumstances, has duty before his statements are acted upon to disclose the
5 new conditions to party relying on his original representations. *Stevens v. Marco (1956, Cal App*
6 *2d Dist) 147 Cal App 2d 357.*

8 If the initial fraudulent misrepresentations made by the Fechners through the October 29,
9 2007 e-mail were not enough to rise to the level the court believes is needed to find a fraudulent
10 misrepresentation was made by ACI and its owners, the actions of ACI and the Fechners in
11 January 2008 should prove ample evidence of fraudulent misrepresentation and even fraudulent
12 intent that is not required under the present action:

14 On January 3, 2008, Jocelyn Fechner sent an e-mail to Don Pestell stating, “We need the
15 January installment by the first of next week if we are to continue work on your coach.” (Trial
16 Exhibit 05_0001, first paragraph).

18 Based on this representation, Mr. Pestell sent the installment the very next day. Three days
19 later the check was cashed, but not put into ACI’s bank account to continue work on Mr.
20 Pestell’s coach. Rather, it was diverted under direct instructions by ACI’s Treasurer, Jocelyn
21 Fechner, into her own personal bank account for payment of trust debt against a building the
22 trust was in negotiations to sell (trial testimony of Jocelyn Fechner, Trial Exhibit 25). Not a dime
23 of the money represented to be needed to continue work on Mr. Pestell’s coach went to ACI or
24 Mr. Pestell’s coach.

25 Mr. Pestell also testified that Mark Fechner represented to him in early November 2007 that
26 ACI owned all of the assets and the building in which it was housed. He testified that Mark
27 Fechner told him the equipment and tools owned by ACI were worth more than \$400,000, a
28 representation that Jocelyn Fechner had made to VR Business brokers in writing just weeks

1 Not once has ACI or the Fechners acknowledged or attempted to repay the amounts owing.
2 Instead, they sit in their 3800 square foot home on 10 acres in Bear Valley living off rental
3 income from properties purchased with the Pestells' money. To allow the Fechners to walk away
4 from ACI's debts after they themselves broke every rule in the book relating to keeping a
5 separateness between themselves and ACI solely for their own personal financial gain would
6 result in a grave injustice to the Pestells.

7 Defendants should be held liable, each of them, for the entire loaned amount of \$970,000
8 plus interest at the legal rate from March 2008 to present. Defendants should also be ordered to
9 pay punitives damages in the amount of \$2,000,000 for their fraudulant behavior. Defendants
10 should also be required to pay the attorney fees and costs associated with the bringing of this
11 action.

12
13
14 Respectfully submitted,

15
16 December 28, 2009

17 _____
18 KASSANDRA MCQUILLEN, Counsel for
19 Plaintiffs DONALD PESTELL, HANNA
20 PESTELL, and PESTELL INTERNATIONAL
21 MINING & EXPLORATION, LTD.
22
23
24
25
26
27
28