CALLAHAN & BLAINE
A Professional Law Corporation
Edward Susolik (Bar No. 151081)
Robert Lawrence (Bar No. 207099)
Matthew A. Arigo (Bar No. 254781)
3 Hutton Centre Drive, Ninth Floor
Santa Ana, California 92707
Tel: (714) 241-4444/Fax: (714) 241-4445

Attorneys for Defendants, M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, FARUKHI & CO., FARUKHI & CO., LLP, VASQUEZ FARUKHI & CO., and VASQUEZ FARUKHI & CO., LLP

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN BERNARDINO– RANCHO CUCAMONGA

MAHENDRA MEHTA, individually and as Trustee of the MAHENDRAKUMAR V. MEHTA, D.D.S. INC., PROFIT SHARING PLAN & TRUST and MAHENDRAKUMAR V. MEHTA D.D.S. INC., MONEY PURCHASE PLAN & TRUST; ASHA MEHTA, an individual; PARIMAL KANSAGRA, individually and as Trustee of the PARIMAL KANSAGRA D.D.S., INC., PROFIT SHARING PLAN & TRUST; JAYANTILAL R. KESHAV, individually and as Trustee of the JAYANTILAL R. KESHAV, D.D.S., INC., PROFIT SHARING PLAN & TRUST and JAYANTILAL R. KESHAV D.D.S., INC., MONEY PURCHASE PLAN & TRUST; PARAG PATEL, individually and as Trustee for PARAG S. PATEL IRA ROLLOVER; NARENDRA VYAS, an individual; and UDAY SHAH, an individual,

Plaintiffs,

vs.

M. ZAMIN FARUKHI, an individual; AMERICAN POWER PRODUCTS, INC., a California Corporation; GILBERT R. VASQUEZ, an individual; M. FAREED FARUKHI, an individual; VASQUEZ FARUKHI & CO., an accountancy partnership; FARUKHI & COMPANY, LLP, a limited liability partnership; VASQUEZ FARUKHI & CO., LLP, a limited liability partnership; FARUKHI & COMPANY, an accountancy partnership; and DOES 1 through 50, inclusive,

Defendants.

CASE NO. CIVRS 800952

NOTICE OF DEMURRER AND DEMURRER TO FIFTH AMENDED COMPLAINT OF DEFENDANTS: (1) M. ZAMIN FARUKHI, (2) M. FAREED FARUKHI, (3) GILBERT R. VASQUEZ, (4) VASQUEZ FARUKHI & CO., (5) FARUKHI & COMPANY, LLP, (6)VASQUEZ FARUKHI & CO., LLP, and (7) FARUKHI & COMPANY; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

Date: January 5, 2012
Time: 8:30 a.m.
Dept.: R-11

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

Assigned for all purposes to Hon. Janet M. Frangie

TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE that on **January 5, 2012,** at **8:30 a.m.,** or as soon thereafter as the matter may be heard in Department R-11 of the above-entitled Court, located at 8303 N. Haven Avenue, Rancho Cucamonga, California 91730, Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY will and hereby do demur pursuant to CCP §§430.10 and 430.30 to the Fifth Amended Complaint filed herein by Plaintiffs MAHENDRA MEHTA; MAHENDRAKUMAR V. MEHTA, D.D.S. INC., PROFIT SHARING PLAN & TRUST; MAHENDRAKUMAR V. MEHTA D.D.S. INC., MONEY PURCHASE PLAN & TRUST; ASHA MEHTA; PARIMAL KANSAGRA; PARIMAL KANSAGRA D.D.S., INC., PROFIT SHARING PLAN & TRUST; JAYANTILAL R. 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; PARAG S. PATEL IRA ROLLOVER; NARENDRA VYAS; and UDAY SHAH, on the grounds that the pleading is uncertain and does not state facts sufficient to constitute any cause of action against these defendants.

This Demurrer is and will be based on this Notice, the accompanying Demurrer and Memorandum of Points and Authorities, and all matters on file or deemed to be on file and of which the Court takes judicial notice at the hearing, and on such evidence and oral argument as may be presented at the hearing of this Demurrer.

DATED: November 15, 2011 **CALLAHAN & BLAINE, APLC**

By: _____
Robert S. Lawrence

Attorneys for Defendants, M. ZAMIN FARUKHI;
GILBERT R. VASQUEZ; M. FAREED FARUKHI; VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP; VASQUEZ FARUKHI & CO.; FARUKHI & COMPANY, LLP; VASQUEZ FARUKHI & CO., LLP; and FARUKHI & COMPANY

DEMURRER

Demurrer to Count I for Breach of Fiduciary Duties

1. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count I for Breach of Fiduciary Duties fails to state facts sufficient to constitute a cause of action.

2. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count I for Breach of Fiduciary Duties is uncertain, ambiguous and unintelligible.

Demurrer to Count II for Constructive Fraud

1. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count II for Constructive Fraud fails to state facts sufficient to constitute a cause of action.

2. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count II for Constructive Fraud is uncertain, ambiguous and unintelligible.

Demurrer to Count III for Fraud.

1. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count III for Fraud fails to state facts sufficient to

constitute a cause of action.

2. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count III for Fraud is uncertain, ambiguous and unintelligible.

Demurrer to Count IV for Negligent Misrepresentation

1. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count IV for Negligent Misrepresentation fails to state facts sufficient to constitute a cause of action.

2. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count IV for Negligent Misrepresentation is uncertain, ambiguous and unintelligible.

Demurrer to Count V for Accounting for Secret Profits

1. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count V for Accounting for Secret Profits fails to state facts sufficient to constitute a cause of action.

2. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count V for Accounting for Secret Profits is uncertain, ambiguous and unintelligible.

Demurrer to Count VI for Accounting Malpractice

1. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count VI for Accounting Malpractice fails to state facts sufficient to constitute a cause of action.

2. Defendants M. ZAMIN FARUKHI, M. FAREED FARUKHI, GILBERT R. VASQUEZ, VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP, VASQUEZ FARUKHI & CO., LLP, and FARUKHI & COMPANY demur to the complaint on the grounds that Count VI for Accounting Malpractice is unclear, ambiguous and unintelligible.

DATED: November 15, 2011

CALLAHAN & BLAINE, APLC

By: _____
Robert S. Lawrence

Attorneys for Defendants, M. ZAMIN FARUKHI; GILBERT R. VASQUEZ; M. FAREED FARUKHI; VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP; VASQUEZ FARUKHI & CO.; FARUKHI & COMPANY, LLP; VASQUEZ FARUKHI & CO., LLP; and FARUKHI & COMPANY

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

After five failed attempts to state a viable complaint, plaintiffs were granted leave to amend once again to state their fraud claims with the requisite particularity. Instead of calling out specific instances of misrepresentations made by any of the individual defendants, in their Fifth Amended Complaint ("FFAC") plaintiffs have merely added a few dates – e.g., "in or about April 1992" – to fraud allegations which cannot amount to actionable conduct. Plaintiffs merely allege that between 1992 - 1995 they invested in defendant American Power Products ("APP") based on vague statements by defendant Zamin Farukhi to the effect that the company was "doing fine" or "would be a great investment" (FFAC, pp. 11-12), without even bothering to review any financial information about the company. Some sixteen years after they invested in APP – after the company foundered – plaintiffs are suffering from investors' remorse and now claim that Farukhi's historical predictions about APP's once-bright future were fraudulent.

What plaintiffs fail to acknowledge, however, is that predictions about a company's future performance cannot constitute fraud as a matter of law. Moreover, vague statements about the performance or value of APP are mere puffery that cannot give rise to an action for fraud. Farukhi saying "APP is a great company" is no more actionable than a car salesman saying "the Ford Mustang is a wonderful car." While plaintiffs try out any number of variations of the statement "the company is great," regardless of how many different synonyms they use it remains a statement of opinion incapable of forming the basis for a fraud complaint.

Plaintiffs' remaining causes of action fare no better, as no factual basis exists (or is alleged) that would support a claim for accounting malpractice, accounting or breach of fiduciary duty. With the filing of their Fifth Amended Complaint, plaintiffs have made it abundantly clear that no facts exist to support any of their claims for relief. This demurrer should therefore be sustained without leave to amend.

II. PLAINTIFFS' FRAUD CLAIMS FAIL AS A MATTER OF LAW

A. The Legal Standard

Fraud is never presumed. *Cooper v. Leslie Salt Co.* (1969) 70 Cal.2d 627. To state a claim for

fraud, plaintiffs herein are required to allege in specific detail all of the following elements:

(1) a false representation or suppression of a fact by one who is bound to disclose it;

(2) made with knowledge of its falsity (i.e., scienter);

(3) with the intent to induce the person to whom the statement is made to act on it;

(4) an act made by that person made in justifiable reliance; and

(5) resulting in damage to that person.

South Tahoe Gas Co. v. Hofmann Land Improvement Co. (1972) 25 Cal.App.2d 750, 765.

Moreover, because fraud actions are subject to strict requirements of particularity in pleading, "every fact constituting the fraud must be alleged." *Furia v. Helm* (2003) 111 Cal.App.4th 945, 956. Thus, plaintiffs must plead facts which show "how, when, where, to whom, and by what means the representations were tendered." *Lazar v. Superior Court* (1996) 12 Cal.4th 631, 645; *see also Tarmann v. State Farm Mut. Auto. Ins. Co.* (1991) 2 Cal.App.4th 153, 157-58; *Robinson Helicopter Co. v. Dana Corp.* (2004) 34 Cal.4th 979, 993. Mere legal conclusions averring fraud do not suffice to prove fraud as a matter of law. *Lesperance v. North Am. Aviation, Inc.* (1963) 217 Cal.App.2d 336, 344.

B. <u>Plaintiffs Have Failed to Allege Any Actionable False Statements By Defendants</u>

Expressions of opinion are not treated as representations of fact, and thus are not grounds for a fraud action. *Neu-Visions Sports v. Soren/McAdam/Bartells* (2000) 86 Cal.App.4th 303, 308; *see also, e.g.*, 5 Witkin, Summary of Cal. Law (9th ed. 1988) Torts, § 678, pp. 779-780. Here, the complaint is rife with statements alleged to have been made by Zamin Farukhi which are incontrovertibly statements of opinion rather than statements of fact that could give rise to any cause of action for fraud or misrepresentation. According to plaintiffs, the following list is the complete catalogue of misstatements made by Zamin Farukhi to plaintiffs between 1992 and 1995 to induce them to invest in APP:

<u>As to plaintiff Mahendra Mehta</u>:

1. APP was an "up and coming company" (FFAC, ¶36(a));
2. APP was "starting to do very well" (Id.);
3. APP was "an excellent investment" (Id.);
4. APP had "great potential" (Id.);
5. Plaintiff would "make a lot of money" (Id.);

6. Plaintiff would "become a millionaire" (Id.).

As to plaintiff Uday Shaw:

7. APP was "a fast growing company" (FFAC, ¶36(b));

8. APP was "an excellent investment" (Id.);

9. Plaintiff would make "a substantial amount of money" (Id.);

As to plaintiff Jeyantilal Keshav:

10. APP was "a great investment" (Id, ¶36(c));

11. APP "would produce substantial profits" (Id.);

As to plaintiff Parag Patel:

12. APP "would be a great investment" (Id, ¶36(d));

13. Plaintiff "would make a significant profit from the investment" (Id.)

As to plaintiff Parimal Kansagra:

14. APP "would be a great investment" (Id., ¶36(e));

15. APP "had a great future" (Id.);

16. APP "would make Kansagra a lot of money and profits" (Id.);

17. Plaintiff could "retire" on his investment in APP (Id.);

As to plaintiff Narendra Vyas:

18. If he invested in APP, he "would be rewarded handsomely" (Id, ¶36(f));

As to plaintiff Asha Mehta:

19. APP "was a good investment" ((Id, ¶36(g));

20. APP "was doing very well" (Id.);

21. Plaintiff "could retire rich as a result of this investment." (Id.).

The question presented for the court on these facts is, quite simply, what is the fraud alleged? Plaintiffs do not claim that, at the time they invested in APP, any one of these statements was untrue or capable of being proved untrue, nor do they point to any facts that could even circumstantially support such a proposition. The only "fact" that plaintiffs bring out in their complaint is that well over a decade after they invested in APP, they learned that the company had never achieved the success that was predicted at the time of their investment. The fact that defendant's statements about what he hoped

would happen in the future – i.e., that APP would be extremely successful – did not turn out as planned is not an argument for fraud, but simply another tale of a company whose once-bright future did not pan out as anticipated. Simply put, for every Google, there is a WebVan.[1]

Promising investors about what they can ultimately expect ("you'll be able to retire on this investment") has never been held to subject someone to a fraud claim, because it is rightly considered to be a prediction about what is going to happen sometime in the future – and there can be no "reasonable reliance" on what the future will hold given its inherently unpredictable nature. While we love to hear the latest predictions about what the future may hold, our justice system does not permit suit against pundits nor prophets when their predictions do not come true. *See, e.g., Pacesetter Homes, Inc. v. Brodkin* (1970) 5 Cal. App. 3d 206, 211 (prediction of potential future rental income not a statement of fact capable of supporting fraud claim). Moreover, it is black letter law that an actionable misrepresentation must be made about past or existing facts, and that "statements regarding future events are merely deemed opinions." *Neu-Visions Sports, supra,* 86 Cal.App.4th at pp. 309-310 (quoting *San Francisco Design Center Associates v. Portman Companies* (1995) 41 Cal.App.4th 29, 43-44.

Sellers will express favorable opinions concerning what they have to sell. When this praise is in general terms, without specific content or reference to facts, buyers are expected to understand that they are not entitled to rely literally upon the words. Such statements of opinion, or "puffing," are non-actionable. *Hauter v. Zogarts* (1975) 14 Cal.3d 104, 111. In the context of investment decisions, "vague, generalized, and unspecific assertions" of corporate optimism or statements of "mere puffing" are not actionable material misstatements of fact. *See Glen Holly Entertainment, Inc. v. Tektronix, Inc.*, 352 F.3d 367, 379 (9th Cir. 2003). Generally, such statements consist of forward-looking or

---

[1]WebVan (online grocer that lost an estimated $1 billion); *see also, e.g.,* Pets.com (raised $82.5 million in an IPO in February 2000 before collapsing nine months later); Boo.com (spent $13 million in 18 months and then liquidated); Kozmo.com (lost $250 million trying to sell city dwellers on the idea of toothpaste and ice cream delivered to their door by bicycle delivery boys); Iam.com (which lost $48 million trying to convince models and actors to post their portfolios on the Net), OnlineChoice.com (which spent $20 million to learn consumers weren't interested in group buys of electricity and other utilities), HeavenlyDoor.com (which sunk $26 million into a site peddling caskets and burial plots), and Eppraisals.com (which dropped $15 million on an effort to sell online evaluations of antiques).

generalized statements of optimism that are "not capable of objective verification," and "lack a standard against which a reasonable investor could expect them to be pegged." *Grossman v. Novell, Inc*., 120 F.3d 1112, 1119 (10th Cir. 1997). Statements that fall within the rule tend to use terms that are not measurable and not tethered to facts that "a reasonable person would deem important to a securities investment decision." *City of Monroe Employees Retirement Sys. v. Bridgestone Corp*., 387 F.3d 468, 489 (6th Cir. 2004).

Caselaw interpreting the "mere puffery" rule distinguishes between definitive positive projections and statements projecting "excellent results," "blowout winner" products, "significant sales gains," and a "10% to 30% growth rate over the next several years," and hold that statements of the latter sort are not actionable as fraud. *See Grossman*, 120 F.3d at 1119.[2] In the case at bar, plaintiffs' allegations that Zamin Farukhi told them in vague terms that APP would be a "great investment" and "had a great future" fall into that category of statements upon which an investor is not entitled to reasonably rely. Every one of the statements attributed to Farukhi is either a statement regarding future events or a vague statement about APP's performance or prospects. Such statements as a matter of law cannot form the basis of any fraud cause of action. *Neu-Visions Sports v. Soren/McAdam/Bartells*, *supra*, at pp. 308-310.

---

[2]See, e.g., *Raab v. General Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993) (statements in Annual Report that company expected "10% to 30% growth rate over the next several years" and was "poised to carry the growth and success of 1991 well into the future" held to be immaterial "soft 'puffing'" statements); *San Leandro Emergency Medical Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 811 (2d Cir. 1996) (statement that company was "'optimistic' about [its earnings] in 1993" and that it "should deliver income growth consistent with its historically superior performance" held to be mere "puffery" and to "lack the sort of definitive positive projections that might require later correction"); *Hillson Partners Ltd. v. Adage, Inc*., 42 F.3d 204, 212-14 (4th Cir. 1994) (statements in press release that year would "produce excellent results" and that "significant sales gains should be seen as the year progresses" held to be mere general predictions and not material as a matter of law); *Searls v. Glasser*, 64 F.3d 1061, 1066-67 (7th Cir. 1995) (holding that statements that a company was "recession-resistant" and that it would maintain a "high" level of growth were too vague to constitute material statements of fact); *In re Storage Technology Corp. Sec. Litig.*, 804 F. Supp. 1368, 1372 (D. Colo. 1992) (statement of being "proud" of a particular product and opining that it would be a "blowout winner" were mere puffing and could not support a claim because no reasonable person would be misled by them); *In re Software Publishing Sec. Litig*., 1994 WL 261365, at *4-*7 (N.D. Cal. Feb. 2, 1994) (dismissing claims based on statement that company believed it had "the combination of people and products in place to be successful" and was "now positioned to effectively compete") *Compare Marx v. Computer Sciences Corp*., 507 F.2d 485, 490 (9th Cir. 1974) (prediction that company "expects . . . a net income of approximately $ 1.00 a share" for fiscal year to close in two months held to be a material statement).

C. Plaintiffs Have Failed to Allege Any Instance Where Defendants Suppressed Any Fact They Were Bound to Disclose

Fraud may, of course, also consist of the suppression of a material fact by one who is bound to disclose it. *See, e.g., People v. Highland Fed. Sav. & Loan* (1993) 14 Cal.App.4th 1692, 1718. Here, plaintiffs have not alleged any instance where defendants had a duty to disclose a material fact and failed to disclose it. Although it is alleged by plaintiffs that prior to the time they invested in the company they (a) did not receive any documents concerning APP's finances, (b) were not informed of any restrictions on the sale of APP stock, and (c) were not provided with private placement memoranda, plaintiffs' conclusory allegations as to the materiality of these alleged failures does not make this a case of fraud by "material omission."

Caselaw discussing what constitutes a "material omission" for purposes of meeting the reasonable investor standard is primarily concerned with a failure to provide information that is contextually relevant. Thus, for example, a pharmaceutical company's failure to disclose reports of a possible link between its leading product, a cold remedy, and loss of smell, rendered other statements made by the company potentially misleading to investors. *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1313 (2011). Similarly, where a defendant made misleading statements denying that it was engaged in merger negotiations when it was, in fact, conducting preliminary negotiations, this was deemed to be a material omission that was relevant to investment decisions. *See Basic Inc. v. Levinson*, 108 S. Ct. 978 (1988). Another recent Ninth Circuit case noted that where a start-up company issued a press release entitled "Platforms Unveils New Airborne Wireless Communications 'Zer0Gravity AeroStructures'" and discussed the performance characteristics of the system – but failed to mention that the product was only in the design phase – "defendants cannot plausibly argue that omitting the fact that the ARC System did not exist was not a highly unreasonable omission." *SEC v. Platforms Wireless Int'l Corp.*, 2010 U.S. App. LEXIS 15328 (9th Cir. Cal. July 27, 2010).

Here, plaintiffs do not claim that they were provided with investment information that omitted material facts a reasonable investor would have deemed relevant, nor that these materials would have had any influence on their decisions to invest in APP. Instead, they claim that they invested millions of dollars without bothering to ask for financial records or any other information about APP. These

allegations do not speak to material omissions by defendants designed to mislead investors, but to plaintiffs' utter failure to act as "reasonable investors." There can be no fraud absent reasonable reliance on misleading information conveyed by defendant; and there can be no reasonable reliance where plaintiffs abjure their responsibilities to act reasonably.

D. Plaintiffs' Theory of Fraud By Hindsight is Defective

Plaintiffs' claims that they were informed that APP was a "great investment" (in 1992-1995) and then later discovered (in 2006) that their stock had dramatically declined in value is not evidence of fraud. Securities fraud cases often involve some catastrophic event occurring between the time of the complained-of statement and the time a more sobering truth comes to light. Such events might include a decline in the stock market (e.g., the stock market crash of 2000), a decline in other markets affecting the company's product, a shift in consumer demand, the appearance of a new competitor, or a major lawsuit. When such an event has occurred, it is insufficient for plaintiffs to say that the later revelations somehow render the prior optimistic statements false. *In re Remec Inc. Sec. Litig*., 702 F. Supp. 2d 1202, 1217 (S.D. Cal. 2010) ("The fact that an allegedly fraudulent statement and a later statement are different does not necessarily establish falsity because the statement must be evaluated at the time it was made and not by hindsight.")

In the face of such intervening events, plaintiffs are required to set forth, as part of the circumstances constituting fraud, an explanation as to why the disputed statements were untrue or misleading when made. *Blake v. Dierdorff*, 856 F.2d 1365 (9th Cir. 1988) (plaintiffs must set forth "specific descriptions of the representations made, and the reasons for their falsity.") Generally, this is accomplished by pointing to inconsistent contemporaneous statements or information (such as internal reports) which were made by or available to the defendants. In the case at bar, plaintiffs point to no inconsistent statements, nor to any facts that would tend to show that anything alleged to have been said by Zamin Farukhi was false. They merely claim that, because their APP stock is now valueless, this fact somehow proves they were defrauded. (FFAC, ¶36(h)). Courts have been quick to recognize that this sort of illogic is insufficient to support fraud claims. *See, e.g.*, *Denny v. Barber*, 576 F.2d 465, 469-70 (2d Cir. 1978)(where bank's fortunes declined because of, inter alia, the 1970's oil embargo and New York City's near-bankruptcy in 1975, plaintiff's contention that defendants should have

disclosed the downturn in the company's fortunes earlier was insupportable; plaintiff could not allege "fraud by hindsight"); *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir.) (plaintiff may not simply allege that the difference between a company's earlier statements of good health and later statements of failing health "must be" attributable to fraud), *cert. denied,* 111 S. Ct. 347 (1990**);** *Semegen v. Weidner*, 780 F.2d 727 (9th Cir. Ariz. 1985) (holding that it is insufficient to "set forth conclusory allegations of fraud . . . punctuated by a handful of neutral facts")**.**

III. PLAINTIFFS' NEGLIGENT MISREPRESENTATION CLAIMS FAIL AS A MATTER OF LAW

California statutes classify negligent misrepresentation, like fraud itself, as a form of deceit. *See* Civ. Code §1710(2); *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 370, 407. The only significant difference between fraud and negligent misrepresentation from the standpoint of pleading is the element of scienter. *Century Surety Co. v. Crosby Ins.* (2004) 124 Cal.App.4th 116, 129; *see also* 5 Witkin Cal. Procedure (4th Ed.) §683. The elements for negligent misrepresentation consist of the following:

(1) a positive misrepresentation of a past or existing material fact;

(2) made without objectively reasonable grounds for believing it to be true;

(3) with the intent to induce another's reliance on the facts misrepresented;

(4) with ignorance of the truth and justifiable reliance thereon by the party to who the misrepresentation was directed; and

(5) resulting damages.

Fox v. Pollack, (1986) 181 Cal.App.3d 954, 962.

As noted earlier in the analysis of plaintiffs' fraud allegations, plaintiffs have failed to allege a single affirmative misrepresentation of fact made by any defendant. Plaintiffs' cause of action for negligent misrepresentation necessarily fails for those same reasons.

Moreover, to the extent this cause of action is construed as an attempt to state a "holder's action" for negligent misrepresentation, it fails to do so. Though the Fifth Amended Complaint contains throwaway allegations that, in order to induce plaintiffs to "hold" their APP stock, defendants failed to supply plaintiffs with certain information about the company (FFAC, ¶40), plaintiffs fail to specify

what information was withheld and how it was material to their decision to retain their stock in APP. This is a fatal defect in plaintiffs' claims, as in a holder's action a plaintiff must allege specific reliance on the defendants' representations: e.g., that "if the plaintiff had read a truthful account of the corporation's financial status the plaintiff would have sold the stock, how many shares the plaintiff would have sold, and when the sale would have taken place. The plaintiff must allege actions, as distinguished from unspoken and unrecorded thoughts and decisions, that would indicate that the plaintiff actually relied on the misrepresentations." *Small v. Fritz Companies, Inc*. (2003) 30 Cal. 4th 167, 184. Having failed to supply the required information with the requisite particularity, *Id*., plaintiffs' cause of action fails as a matter of law.

IV. PLAINTIFFS' BREACH OF FIDUCIARY DUTY CLAIMS FAIL AS A MATTER OF LAW

A. Plaintiffs Have Failed to Adequately Allege a Fiduciary Relationship With Any Individual Defendant

Where defendants are not fiduciaries of the plaintiff, no claim for breach of fiduciary duty can lie. *City of Atascadero v. Merrill Lynch* (1998) 68 Cal.App.4th 445, 483; *see Children 's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 222. To plead breach of fiduciary duty, plaintiffs must allege facts sufficient to support the following:

(1) the existence of a fiduciary relationship;

(2) its breach; and

(3) damage proximately caused by that breach.

City of Atascadero, supra, 68 Cal.App.4th at p. 483.

In the case at bar, plaintiffs' complaint is devoid of facts that would give rise to a permissible inference that a fiduciary relationship existed between any plaintiff and any individual defendant. Plaintiffs allege that defendants were their accountants (FFAC, ¶18), assert that they had "faith, confidence, and trust" in them (FFAC, ¶19), and then simply conclude *ipso facto* that all defendants were plaintiffs' fiduciaries. (FFAC, ¶20). This conclusion does not follow as a matter of either logic or law, however, since "the mere placing of a trust in another person does not create a fiduciary relationship." *Zumbrun v. University of Southern California* (1972) 25 Cal. App. 3d 1, 13. Moreover, accountants are not deemed to be fiduciaries absent a special relationship with the client that goes

beyond the ordinary trust one places in any retained professional. *Stainton v. Tarantino*, 637 F. Supp. 1051, 1066 (E.D. Pa. 1986). The creation of a fiduciary obligation or duty must, at a minimum, arise "from facts demonstrating the formation of a confidential relationship." *Richard B. LeVine, Inc. v. Higashi* (2005) 131 Cal. App. 4th 566, 586. In the case at bar, no such facts are alleged.

Although plaintiffs claim that "defendants" gave them investment advice, they fail to specify who provided such advice, when such advice was provided, or the nature of the advice. This does not suffice to prove a fiduciary relationship between plaintiffs and the individual defendants. The Fifth Amended Complaint suffers here from plaintiffs' wilful blindness to the distinction between the individual defendants and their eagerness to aver that all defendants are responsible for the actions of all other defendants without tying those accusations to any facts at all. Despite plaintiffs' claim that all defendants are plaintiffs' fiduciaries, the Fifth Amended Complaint does not contain a single allegation that defendants Fareed Farukhi or Gilbert Vasquez (as opposed to Zamin Farukhi) provided any services or advice to any plaintiff. There is not a single recitation of fact showing that Fareed Farukhi or Gilbert Vasquez gave plaintiffs any investment advice, were privy to any confidences of plaintiffs, or in fact did any work at all for plaintiffs. Every statement or action identified in the complaint is alleged to have been made or performed by Zamin Farukhi, and no one else.

While plaintiffs no doubt wish to impose fiduciary liability on all defendants, there is no legal basis for attributing Zamin Farukhi's actions to the other defendants, nor would a finding that Zamin Farukhi was plaintiffs' fiduciary automatically extend that relationship to the other defendants. Allegations of conspiracy do not suffice to state the claim, as "a nonfiduciary cannot conspire to breach a duty owed only by a fiduciary." *Kidron v. Movie Acquisition Corp.* (1995) 40 Cal. App. 4th 1571, 1597. To state a claim for breach of fiduciary duty, plaintiffs have to allege facts showing that fiduciary duties exist and are owed to plaintiffs by each individual defendant, which they have failed to do.

V. PLAINTIFFS' CONSTRUCTIVE FRAUD CLAIMS FAILS TO STATE A CLAIM

Constructive fraud is "a unique species of fraud applicable only to a fiduciary or confidential relationship." *Salahutdin v. Valley of California, Inc.* (1994) 24 Cal. App.4th 555, 562. A constructive fraud claim allows conduct insufficient to constitute actual fraud to be treated as such where the parties

stand in a fiduciary relationship. *See, e.g., Estate of Gump* (1991) 1 Cal. App. 4th 582, 601.

Accordingly, a party who is not in a fiduciary relationship with the plaintiff cannot be held liable for conspiracy to commit constructive, as opposed to actual, fraud. *Younan v. Equifax Inc*. (1980) 111 Cal.App.3d 498, 515-517 (insurance claims investigation company and company's employee not liable for conspiracy to commit constructive fraud because fiduciary duty was owed only by insurer itself); *Skarbrevik v. Cohen, England & Whitfield* (1991) 231 Cal. App. 3d 692, 711("an attorney will not be liable for conspiracy to commit constructive fraud where that charge rests on a fiduciary duty of disclosure owed only by the client").

The elements of constructive fraud are straightforward:

(1) existence of a confidential or fiduciary relationship;

(2) a misleading statement or omission in breach of a fiduciary duty; and

(3) justifiable reliance resulting in injury (causation).

(Civ. Code, § 1573; *Byrum v. Brand* (1990) 219 Cal.App.3d 926, 937; *Odorizzi v. Bloomfield School Dist.* (1966) 246 Cal.App.2d 123, 129. Though constructive fraud does not require intentional deception,[3] the analysis of plaintiffs' constructive fraud claims herein unquestionably points to the same pleading defect raised above: to wit, plaintiffs have failed to allege a single material misrepresentation or suppression of fact where a duty to disclose existed. Moreover, plaintiffs are obliged to plead this aspect of their fraud case with particularity as well, a task they have blithely disregarded. Nowhere is an effort made to show how each individual defendant is a fiduciary of each plaintiff. Without belaboring the point, plaintiffs' decision to lump all defendants together does not comport with the requirement that they state all elements of fraud with particularity. *See Lazar v. Superior Court*, *supra*, at p. 645. As a practical matter, plaintiffs have to plead and prove that all defendants were fiduciaries, and have not done so; therefore, plaintiffs have not alleged sufficient facts to support their cause of action for constructive fraud. *See, e.g.*, Civ. Code, § 1573; *Byrum v. Brand*, *supra*, at p. 937; *Odorizzi v. Bloomfield School Dist.*, *supra*, at p. 129.

[3] *See, e.g., Mary Pickford Co. v. Bayly Bros., Inc.* (1939) 12 Cal.2d 501.

VI. PLAINTIFFS MAKE NO ALLEGATIONS OF WRONGDOING BY DEFENDANTS FAREED FARUKHI OR GILBERT VASQUEZ

The Fifth Amended Complaint is devoid of any allegation that defendants Fareed Farukhi or Gilbert Vasquez interacted with any plaintiff in any way. It contains no allegations against them other than the perfunctory statement that, at some unknown time, "by virtue of the Individual Defendants' positions within APP, they had access to undisclosed adverse information about its business operations, operational trends, finances, and business prospects." (FFAC, ¶12) It does not allege what their positions were at APP, when they assumed those positions, how long they held those positions, or what representations they are alleged to have made (or neglected to have made) during their tenure at APP.

The Fifth Amended Complaint also fails to allege what role, if any, Fareed Farukhi or Gilbert Vasquez played in any alleged misrepresentations made to any plaintiff, and instead merely relies on conclusory allegations, made on information and belief, that "it is appropriate to treat the Individual Defendants collectively as a group and to presume that the materially false, misleading and incomplete information conveyed . . . was the result of the collective actions of the Individual Defendants." (Id., ¶14). There is no basis for the complaint's statement that it would be "appropriate" to treat the defendants collectively as a single actor other than plaintiffs' "belief" that this is so.

Plaintiffs were ordered to plead their fraud allegations with particularity. Half-hearted allegations of "collective action" by the individual defendants do not satisfy that standard any more than they suffice to state a conspiracy. In the absence of any allegations that show that defendants Fareed Farukhi or Gilbert Vasquez engaged in actionable fraudulent conduct, no cause of action for any variety of fraud may lie against them. Plaintiffs are not entitled to do an end-run around their pleading obligations by relying on superficial allegations about agency and lumping all defendants together as if they were interchangeable.

VII. PLAINTIFFS ACCOUNTING MALPRACTICE CLAIMS ARE BASELESS

As a member of a skilled profession, accountants are retained by their clients as experts. *Lindner v. Barlow, Davis & Wood* (1962) 210 Cal.App.2d 660, 665. As experts, they have "a duty to exercise the ordinary skill and competence of members of their profession." *Id.*

An action for professional malpractice must arise out of a breach of the duties of "reasonable care and confidence." *See Gagne v. Bertran* (1954) 43 Cal.2d 481. The elements of a cause of action for accounting malpractice are as follows:

(1) The existence of the duty of the accountant to "use such skill, prudence, and diligence as other members of his profession commonly possess and exercise";

(2) Breach of that duty (i.e., an inexcusable miscalculation);

(3) a "proximate causal connection between the negligent conduct and the resulting injury" (i.e., a *material* miscalculation); and

(4) actual damage resulting from the negligence.

Mattco Forge, Inc. v. Arthur Young & Co. (1997) 52 Cal.App.4th 820, 833 (quoting *Budd v. Nixen* (1971) 6 Cal.3d 195, 200).

In the case at bar, plaintiffs make no allegations that defendants made any errors in their bookkeeping, financial statement preparation, tax return preparation, or financial and accounting advice, but claim rather that defendants rendered deficient investment advice in connection with their investments in APP, and "overbilled" them for all services rendered during the entire tenure of their relationships with defendants.

With regard to Plaintiffs' undefined allegations of "overbilling," the claimed damages have no connection to any duty to "use such skill, prudence, and diligence as other members" of the accounting profession "commonly possess and exercise." *See Mattco Forge, Inc. v. Arthur Young & Co.*, *supra*, at p. 833. Indeed, plaintiffs' allegations of overbilling are never explained other than in a cursory manner which alleges "block billing" and "gross overbilling." (FFAC, ¶63). Plaintiffs do not allege that defendants charged them for work that was not done, or charged them more than plaintiffs were contractually bound to pay, but simply make conclusory allegations that they were "overbilled" for almost two decades, and suddenly have discovered – despite having never disputed any bill prior to filing this lawsuit – that all of the bills submitted by defendants somehow "overbilled" them. We have found no reported case where such "overbilling" has giving rise to a professional negligence claim, and respectfully submit that no caselaw supports such a claim.

VIII. PLAINTIFFS' ACCOUNTING FOR SECRET PROFITS CLAIM IS BASELESS

A. Plaintiffs Have No Right to an Accounting

A complaint for an accounting in equity will not lie where it appears from the complaint itself that no accounting is necessary or if there exists a remedy at law. *St. James Church v. Sup. Ct.* (1955) 135 Cal.App.2d 352, 359. To entitle a plaintiff to an accounting "he must allege facts showing that a liability exists, the amount of which would be shown if the accounting were had." *San Pedro Lumber Co. v. Reynolds* (1896) 111 Cal. 588, 596-597. Where no right to an accounting is shown, an accounting may not be compelled. *Baxter v. Krieger* (1958) 157 Cal.App.2d 730, 732.

Plaintiffs here have alleged no relationship that would require an accounting. Plaintiffs' unsupported allegations that defendants received "secret gains, payments, kickbacks, finder's fees, and credit card referral fees from Habib American Bank and possibly other entities and individuals relating to APP" demonstrates nothing other plaintiffs' penchant for unsupported calumny and rank speculation, and does not provide a basis for defendants to account for any historical dealings they have had over an unspecified number of years with either Habib American Bank, or other entities and individuals who plaintiffs believe "possibly" might exist. Plaintiffs have not tied any of the alleged "secret profits" to amounts that would rightfully be due to any plaintiff, and as a matter of law have thus failed to allege the requisite element that a liability exists that could give rise to an accounting for "secret profits."

///

///

///

///

///

///

///

///

///

IX. CONCLUSION

Based upon the foregoing, moving defendants respectfully request that their demurrer be sustained without leave to amend and that this Honorable Court dismiss the 5th Amended Complaint with prejudice.

DATED: November 15, 2011

CALLAHAN & BLAINE, APLC

By: _____
Robert S. Lawrence

Attorneys for Defendants, M. ZAMIN FARUKHI; GILBERT R. VASQUEZ; M. FAREED FARUKHI; VASQUEZ FARUKHI & CO., FARUKHI & COMPANY, LLP; VASQUEZ FARUKHI & CO.; FARUKHI & COMPANY, LLP; VASQUEZ FARUKHI & CO., LLP; and FARUKHI & COMPANY

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER

G:\Clients\2943\2943-02\Pld\DEMURRER to FIFTH AMENDED COMPLAINT\Defendants Demurrer 5th Amended Complaint FINAL111511.wpd