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Attorney for Plaintiffs
JEFFREY LIN, FAN ZHOU, YUE LIN ZHOU, and LI GANG YANG

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

JEFFREY LIN, an individual; FAN ZHOU, an individual; YUE LIN ZHOU, an individual; and LI GANG YANG, an individual;

Plaintiffs,

vs.

DRAGON GATE OR LLC an Oregon corporation; XIAO LI, an individual; CHANG XU JIANG, an individual, and DOES 1 through 10,

Defendants.

Case No.: 8:15-CV-00996-PSG-JC
Judge: Hon. Philip S. Gutierrez

PLAINTIFFS' MEMORANDUM OF CONTENTIONS OF LAW AND FACT

Final Pretrial Conf.: Aug. 29, 2016
Time: 2:30 p.m.
Courtroom: 800 – Roybal
Trial: Sept. 13, 2016

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1 practices through deceptive and misrepresentations in soliciting investors and business partners,
2 including Plaintiffs and subsequently embezzling money and co-mingling funds therefrom.

3 7. Rescission: Plaintiffs' consent to the Operating Agreement for the LLC was obtained
4 through fraud with the connivance of the Defendants.

5 **B. Elements Required to Establish Plaintiffs' Claims**

6 1. Fraud. The cause of action for fraud requires the following elements: a)
7 misrepresentation (false representation, concealment, or non-disclosure); b) knowledge of falsity; c)
8 intent to defraud (i.e., to induce reliance); d) justifiable reliance; and (e) resulting damage. *Engalla v.*
9 *Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 974; California Civil Jury Instructions
10 (CACI) 1900 Intentional Misrepresentation.
11

12 2. Breach of Fiduciary Duty. The cause of action for breach of duty requires the
13 following elements: a) existence of a fiduciary relationship; b) its breach; and c) damage proximately
14 caused by that breach. *Knox v. Dean* (2012) 205 Cal.App.4th 417, 432; CACI 4100 Breach of
15 Fiduciary Duty. Whether a fiduciary duty exists is generally a question of law and whether the
16 defendant's breach of that duty towards the plaintiff is a question of fact. *Marzec v. Public Employees'*
17 *Retirement System* (2015) 236 Cal.App.4th 889, 915. Examples of relationship that impose a
18 fiduciary obligation to act on behalf of and for the benefit of another are 'a joint venture, a
19 partnership, or an agency' and there is a strong public interest in 'ensuring that corporate officers,
20 managers, directors, majority shareholders and others are faithful to their fiduciary obligations to
21 minority shareholder.' *Cleveland* 209 Cal.App.4th at 1339; *Meister v. Mensinger* (2014) 230
22 Cal.App.4th 381, 395. Fiduciary duty involves duties of loyalty, reasonable care, and good
23 faith and fair dealing. *California Revised Uniform Limited Liability Company Act* (California
24 Corporations Code 17701 et seq.); *Wolf v. Superior Court* (2003) 107 Cal.App.4th 25, 29.
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1 3. Breach of Contract. The cause of action for breach of contract requires the following
2 elements: a) the existence of a contract; b) plaintiff's performance or excuse for non-performance; c)
3 defendant's breach; and d) damages to plaintiff therefrom. *Acoustics, Inc. v. Trepte Construction Co.*
4 (1971) 14 Cal.App.3d 887, 913; CACI 303 Breach of Contract.

5 4. Conversion: The cause of action for conversion requires the following elements: a)
6 plaintiff's ownership or right to possession of the property at the time of the conversion; the
7 defendant's conversion by a wrongful act or disposition of property rights; and damages. *Shopoff &*
8 *Cavallo LLP v. Hyon* (2008) 167 Cal.App.4th 1489, 1507; CACI 2100 Conversion. It is not necessary
9 that there be a manual taking of the property; it is only necessary to show an assumption of control or
10 ownership over the property, or that the alleged converter has applied the property to his own use. *Id.*
11 Conversion is a strict liability tort; the foundation of the action rests neither in the knowledge nor the
12 intent of the defendant; instead, the tort consists in the breach of an absolute duty. *Id.*

13 5. Accounting. The cause of action for accounting requires the following elements: a)
14 existing relationship between plaintiff and defendant that requires an accounting and b) some balance
15 due that can be ascertained only by accounting. *Teselle v. McLaughlin* (2009) 173 Cal.App.4th 156,
16 179.

17 6. Unfair Business Practices. The cause of action for unfair business practices is
18 provided for by statute and prohibits any of the following types of business wrongs: (1) an unlawful
19 business act or practice; (2) an "unfair" business act or practice; (3) a "fraudulent" business act or
20 practice; (4) "unfair, deceptive, untrue or misleading advertising"; and (5) any act prohibited by
21 Sections 17500-17577.5. California Business and Professions Code Sections 17200 et seq. Each of
22 these five wrongs operates independently from the others. *State Farm Fire & Cas. Co. v. Superior*
23 *Court* (1996) 45 Cal.App.4th 1093, 1102. Intent is irrelevant as plaintiff is not required to show that
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1 the defendant actually intended to injure anyone. *State Farm Fire & Cas. Co.*, 45 Cal. App. 4th at
2 1102.

3 7. Rescission. The cause of action for rescission of contract is provided for by statute
4 pursuant to California Civil Code 1688 et seq under which a party to a contract may rescind the
5 contract where (1) the consent of the party rescinding was obtained through fraud, exercised by or
6 with the connivance of the party as to whom he rescinds, or of any other party to the contract jointly
7 interested with such party; (2) if the consideration for the obligation of the rescinding party fails, in
8 whole or in part, through the fault of the party as to whom he rescinds; or (3) if the consideration for
9 the obligation of the rescinding party, before it is rendered to him, fails in a material respect from
10 any cause. Civil Code 1689(b); (1572 and 1573 (defining fraud). Plaintiffs' consent to the Operating
11 Agreement for the LLC was obtained through fraud with the connivance of the Defendants.
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14 **C. Brief Description of Key Evidence In Support of Each of the Claims**

15 1. Fraud. Key evidence in support includes but are not limited to the following:

- 16 • Defendants represented that the Operating Agreement between Plaintiffs and
17 Defendants would establish an LLC (Oki Outlets LLC) for the purpose of owning
18 and operating Oki Sushi and Bento Restaurant ("Restaurant").
- 19 • A different LLC was established previously involving defendants and Wenzhong
20 Lin ("Lin") to own and run Restaurant; this was not disclosed to plaintiffs.
- 21 • Wenzhong Lin stated to plaintiff Jeffrey Lin that Wenzhong had paid almost
22 \$300,000 to defendants for the rights to Restaurant.
- 23 • Wenzhong Lin and his family has managed and ran the Restaurant since it first
24 opened. Wenzhong and his family have paid themselves "salaries/wages", signed
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1 checks, withdrew monies, and paid personal expenses against and from the bank
2 account of LLC without restriction.

- 3
- 4 • Defendants represented that they would contribute \$150,000 to LLC for 50% share
5 interest thereof (while Plaintiffs would contribute \$150,000 for the other 50%
6 share). Defendants have not contributed the amount required. Plaintiffs have
7 contributed \$150,000 for their 50% share interest of LLC.

8 2. Breach of Fiduciary Duty. Key evidence in support includes but are not limited to the
9 following:

- 10
- 11 • Defendants Xiao Li and Chang Xu Jiang signed the Operating Agreement for
12 defendant Dragon Gate OR LLC – who acts as the managing member of the LLC.
13 Xiao Li and Chang Xu Jiang assumed the duty as managers of the Restaurant.
 - 14 • Within one week after plaintiffs wired their \$150,000 contributions into the LLC's
15 bank account in January 2014, defendants 1) transferred the monies in the LLC
16 account to their own account not related to LLC business; 2) withdrew monies in
17 the LLC account for their personal or separate business not related to LLC
18 business; and 3) wrote checks to pay expenses for their separate business not
19 related to the LLC. The bank account for the LLC was reduced to less than \$3,000
20 after the above-described transfers, withdrawals, and check issuances by the
21 defendants. The bank account was then closed in March 2014.
 - 22 • Defendant Chang Xu Jiang withdrew monies from the LLC account for his own
23 self interests unrelated to LLC business.
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- 1 • Defendants withdrew monies after the opening of the Restaurant for their personal
- 2 interests and causing the checks of the LLC to be bounced several times for
- 3 insufficiency of funds.
- 4 • Defendants allowed Wenzhong Lin and his family to withdraw monies and use
- 5 funds of LLC for their personal interests unrelated to the LLC.
- 6 • Defendants failed to maintain proper receipts, documentations, receipts, and
- 7 records for the expenditures and accounts of the LLC.
- 8 • Defendants co-mingled the funds of LLC with those of their personal and separate
- 9 accounts.
- 10 • Defendants failed to respond to communication and request by Plaintiffs for LLC
- 11 records and for meeting of LLC meebbers.
- 12
- 13

14 3. Breach of Contract. Key evidence in support includes but are not limited to the
15 following:

- 16 • Defendants failed to contribute \$150,000 as required of them under the Operating
- 17 Agreement to fund the LLC.
- 18 • Defendants had already sold, transferred, or otherwise promised the rights to LLC
- 19 to Wenzhong Lin and his family, this rendering 50% share interest to Plaintiffs
- 20 impossible.
- 21 • Defendants failed to provide LLC records upon request by plaintiffs as required
- 22 under the Operating Agreement.
- 23 • Defendants failed to set up in-store cameras and access thereto as required by the
- 24 Operating Agreement.
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- 1 • Defendants failed to call for and participate in meeting of LLC members upon
- 2 request by Plaintiffs.
- 3 • Defendants failed to maintain and keep records of the LLC as required under the
- 4 Operating Agreement.
- 5

6 4. Conversion. Key evidence in support includes but are not limited to the following:

- 7 • LLC profits which were withdrawan, transferred, and/or used by Defendants for
- 8 Defendants' own personal benefits, in excess of at least \$100,000. Half of LLC's
- 9 profits belong to Plaintiffs.
- 10 • LLC funds were withdrawan, transferred, and/or used by Defendants for
- 11 Defendants' own personal benefits, in excess of at least \$150,000. These funds
- 12 belong to the LLC, which Plaintiffs own 50% interest and rights thereto..
- 13

14 5. Accounting. Key evidence in support includes but are not limited to the following:

- 15 • Plaintiffs have made multiple requests for the full set of accounting records of the
- 16 LLC. Defendants and failed and refused to comply.
- 17 • Defendants are managing members or managers of the LLC and as such, owe a
- 18 fiduciary duty to plaintiffs to maintain, report, and produce records of the LLC.
- 19 • Tax records for the LLC obtained by Plaintiffs through independent discovery
- 20 show unreported and unaccounted amount of at least \$90,000.
- 21 • Bank records of the LLC also show unauthorized and improper withdrawals by
- 22 defendants against the account of LLC in excess of \$200,000.
- 23 • Defendants failed and refused to produce daily/weekly/monthly/quarterly/periodic
- 24 cash register or sales receipts or report.
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- Defendants provided a version of tax records different than those obtained independently by plaintiffs.

6. Unfair Business Practices. Key evidence in support includes but are not limited to the following:

- Defendants incorporated a separate entity to own and run Restaurant before the execution of the Operating Agreement and failed to notify Plaintiffs of such fact.
- Defendants promised installation and access of in store camera to Plaintiffs as inducement of contributing \$150,000 but failed to do so.
- Defendants assumed role of managing member and manager, but failed to maintain accounting records, invoices, or time sheets. Defendants withdrew and transferred monies repeatedly from LLC account to themselves for their own personal benefit.

7. Rescission. Key evidence in support includes but are not limited to the following:

- Defendants obtained Plaintiffs' consent for the Operating Agreement and to contribute \$150,000 through fraud. Specifically, Defendants failed to disclose:
 - 1) Defendants already created a different LLC with Wenzhong Lin (who has ran and managed the Restaurant since its opening);
 - 2) Defendants sold the Restaurant to Wenzhong Lin and his family or otherwise had an agreement for Lin to own and manage the Restaurant;
- Defendants had no intent to contribute \$150,000 to the LLC. Defendants withdrew all of the monies contributed by plaintiffs within a week of the wire to pay for Defendants' other expenses unrelated to the LLC. Defendants did not and have not wired or deposited \$150,000 into LLC's account.

- Defendants had no intent to perform on the Operating Agreement. Defendants failed to keep LLC records – including accounting, operational, sales, and corporate documents. Defendants failed to install in-store cameras to enable Plaintiffs to observe the Restaurant. Defendants failed to manage the LLC, instead allowing Wenzhong Lin and his family to withdraw cash, write LLC checks, and use funds of LLC for Lin’s own personal benefit.

D. Summary Statement of the Counterclaims and Affirmative Defenses Defendants Have Pleaded and Plan to Pursue

Defendants have not sought any counterclaims. Defendants have asserted eleven affirmative defenses as follows: 1) failure to state a cause of action; 2) failure to mitigate; 3) lack of subject matter jurisdiction (on the basis that the Operating Agreement requiring engagement of mediation); 4) lack of damages; 5) good faith; 6) unclean hands; 7) equitable estoppel; 8) laches; 9) statute of limitations; 10) standing; and 11) set off.

E. Elements Required to Establish Defendants’ Counterclaims and Affirmative Defenses

1. Failure to state a cause of action: this defense is commonly known as demurrer in California and provided for in Federal Rules of Civil Procedure 12(b)(6). *See Dawson v. Wilheit* (1987) 735 P.2d 93.

2. Failure to mitigate: this defense provides that a plaintiff injured by a breach of contract or a tort has a duty to take reasonable steps to mitigate those damages. *Shaffer v. Debbas* (1993) 17 Cal.App.4th 33, 41.

3. Lack of subject matter jurisdiction: provides a case may not be heard before a court who does not jurisdiction over the subject matter of the lawsuit. *Fed R. Civ. P.* 12(g)(2), (h)(3).

4. Lack of damages: this defense provides that no recovery is permitted by plaintiff has

1 suffer no harm.

2 5. Good faith: this affirmative defense seek to negate the mens rea requirement of a
3 claim or to assert good faith reliance on the advice of an outside professional to negate liability. *See*
4 *e.g. United States v. Exxon Corp.* 94 F.R.D. 246 (D.D.C. 1981).

5 6. Unclean hands: this defense provides that plaintiff is not entitled to relief because
6 he/she have committed some sort of wrongdoing or is himself liable for an offense.

7 7. Equitable estoppel: this defense provides that where plaintiff stated or promised to act
8 regarding some matter for which defendant is sued for, and defendant relied on such promise but
9 plaintiff failed to honor such promise, then plaintiff is not able to recover based on principle of
10 fairness and equity.

11 8. Laches: this defense requires showing of unreasonable delay by the plaintiff in
12 bringing the claim. Because this defense is ordinarily applied only to claims for equitable relief, it is
13 not available to claims for legal relief.

14 9. State of limitations: this defense is based on statutes and code sections limiting the
15 period of time to assert the defense. However, a statute of limitations defense must be specifically
16 pleaded but citation of the specific section o the law. *See California Code of Civil Procedure* section
17 458; 3 Witkin, Cal. Procedure (2d ed. 1971) section 939.

18 10. Standing: this defense requires the showing that plaintiff does not qualify or involve
19 sufficient interest to bring the lawsuit at hand.

20 11. Set off: this defense is an equitable defense to the whole or a portion of plaintiff's
21 claim by offsetting or deducting liabilities owed by defendant to plaintiff with liabilities owed by
22 plaintiff to defendant.

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27 **F. Brief Description of Key Evidence In Support of Defendants' Counterclaims and**
28 **Affirmative Defenses**

1 Defendants' affirmative defenses have little if any factual or legal basis. Plaintiffs did not
2 commit any wrongful conduct, were diligent in seeking information about the status of the LLC,
3 performed on their contractual obligations, and timely brought the lawsuit when they discovered
4 misrepresentations and wrongful conducts by defendants.
5

6 Defendants presented the following arguments during various time of the case leading up to
7 trial: that they did not contribute \$150,000 in money to the LLC but rather through purchase of
8 equipments and other services; that they lent money to the LLC and the withdrawals by them were
9 merely repayments to themselves; and that it was a misunderstanding between Wenzhong Lin and
10 plaintiffs. However, defendants were requested (on numerous occasions) to produce records
11 evidencing any loans by them to the LLC, and purchase of equipments by them. They have produced
12 no such records or records of receipts to substantiate 99% of the alleged expenses. Further,
13 defendants asserted lack of subject matter jurisdiction on the basis that the Operating Agreement
14 called for mediation of disputes for parties. Plaintiffs agreed and participated in one round of
15 mediation; however, when plaintiffs agreed to participated in second round of mediation, the
16 defendants were not willing to take part.
17
18

19 **G. Identification of Anticipated Evidentiary Issues**

20 Plaintiffs anticipate defendants to seek to introduce evidence not previously requested by
21 plaintiffs but not produced defendants during discovery. Plaintiffs would object to the introduction,
22 use, and entrance of any such evidence. At this time, Plaintiffs anticipate objections by both parties
23 as to some of the proposed exhibits sought to be used at trial.
24

25 **H. Identification of Any Issues of Law Germane to the Case**

26 Except for the matters raised above, Plaintiffs do not anticipate any dispute regarding issues
27 of law germane to the case at this time.
28

1 **II. BIFURCATION OF ISSUES**

2 Punitive damages are available on Plaintiffs’ fraud, breach of fiduciary duty claims, and
3 conversion claims. *Michelson v. Hamada* (1994) 29 Cal.App.4th 1566, 1582. However, there is no
4 agreement by the parties to bifurcate the amount of punitive damages from the case in chief.

5 **III. JURY TRIAL**

6 The case is a court trial. None of the parties has demanded a jury trial.

7 **IV. ATTORNEY’S FEES**

8 The Operating Agreement of the LLC provides for attorney fees to the prevailing party in any
9 dispute involving members of the LLC. Cal Civil Code 1717 (attorney fee permissible via
10 agreement between parties). Further, attorney fees is provided for under Calif Code of Civ.
11 Procedure 1021.5 for actions rising out of unfair business practices. Cal. Civil Code section 3333
12 also provides for compensation of all detriment proximately caused by breach of fiduciary obligation,
13 whether it could have been anticipated or not.
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16 **V. ABANDONMENT OF ISSUES**

17 None by Plaintiffs.
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22 Date: August 8, 2016

LAW OFFICES OF PETER C. CHEN

23
24 By: /s/ Peter C. Chen
25 Peter C. Chen, Esq.
26 *Attorney for Plaintiffs*
27
28