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8 SUPERIOR COURT OF THE STATE OF CALIFORNIA

9 FOR THE COUNTY OF SANTA BARBARA

10 COOK DIVISION

11 THE SCHLINGER FOUNDATION, a California )  
not for profit foundation, )

12 Plaintiff, )

13 v. )

14 BLAIR SMITH, an individual; et al. )

15 Defendants. )  
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CASE NO. 01128281

**PLAINTIFF SCHLINGER  
FOUNDATION'S TRIAL BRIEF**

**[Assigned to the Honorable Rodney S.  
Melville, Dept. SM2]**

Trial Date: February 26, 2006  
Time: 1:30 p.m.  
Dept. SM 2

1 Plaintiff, The Schlinger Foundation, a California not for profit corporation, (“the  
2 Foundation”) submits the following Trial Brief:

3 **I.**  
4 **OVERVIEW**

5 This case has two major elements. First, it deals with a loss to the Foundation through  
6 intentional acts of self-dealing by its directors in the total sum of \$11,235,565.97. Second, it  
7 deals with losses caused by incompetence and breaches of fiduciary duties totaling \$40,978,573.  
8 For the most part, these staggering losses were incurred between April of 2000 and December of  
9 2001. These losses were not the result of bad luck or bad advice. To the contrary, they were the  
10 result of deliberate choices to rid the Foundation of prudent professionals, and to follow the  
11 entreaties of unscrupulous scoundrels.

12 **II.**  
13 **PARTIES AND COUNSEL**

14 The Foundation is represented by Scott B. Campbell and Fred Furst of Rogers, Sheffield  
15 & Campbell, LLP.

16 Defendants Evert I. Schlinger, Jr.,(hereinafter “Pete”), individually; Pete as “Presiding  
17 Almoner” of Living Waters; Cathy McDonald, Pete’s wife, individually; and the Office of the  
18 Presiding Almoner of Living Waters and His Successors, a corporation sole are represented by  
19 Edward Bialack.

20 Defendants Evert I. Schlinger, Sr.(hereinafter “Evert”), and Timothy Pettinger, a/k/a  
21 Timotheus benHarold barAbba, House of Pettinger, individually, are represented by Anthony  
22 Gordon.

23 The Attorney General of the State of California is named as an indispensable party  
24 pursuant to Corporations Code § 5233(c). The Attorney General of the State of California  
25 consents to the jurisdiction of this Court in this case and to the relief sought against the other  
26 named defendants.

27 Plaintiff Foundation has taken defaults against (1) Geoffrey Thayer, a/k/a Geoffrey  
28 benRichard barAbba House of Thayer, an individual; (2) Geoffrey Thayer, as Presiding Almoner

1 of Christian Almshouse; (3) E. Marie Thayer, an individual; (4) E. Marie Thayer, as Presiding  
2 Almoner of the Christian Almshouse; (5) the Office of the Presiding Almoner of the Christian  
3 Almshouse and his Successors, a corporation sole; (6) Timothy Pettinger, as Trustee of the Faith  
4 Works Mission Sacred Trust; (7) Timothy Pettinger, as Trustee of the Living Waters Sacred  
5 Trust; (8) the Office of the Presiding Almoner of Holy Ground and his Successors, a corporation  
6 sole; and, (9) Blair Smith, a/k/a Blair benGerald barAbba House of Smith, an individual. The  
7 Foundation will prove-up its case against these defaulted defendants in this trial.

8 **III.**  
9 **FACTS**

10 A. Warnings

11 The Schlinger Foundation, a California non-profit corporation, was created in 1986,  
12 capitalized with UPS stock owned by William and Esther Schlinger. The Foundation was  
13 originally managed by William and Esther’s sons, Warren and Evert Schlinger. In late 1995,  
14 Warren and Evert split the Foundation into two equal non-profit corporations, the Schlinger  
15 Foundation (Plaintiff herein) and the Warren and Katherine Schlinger Foundation. Evert became  
16 president of Plaintiff Foundation and sat on its Board with his wife Marion and eldest son, Pete.

17 Evert is a famed entomologist, now retired after having been head of the Entomology  
18 Department at Berkeley. Evert’s other pursuits, racehorses and oil wells, were not successful.  
19 Among those unsuccessful pursuits was the formation of a company called TexCal Resources,  
20 Inc. with defendant Blair Smith, in 1991. That enterprise, managed by Smith, lost hundreds of  
21 thousands of dollars of Evert’s personal funds before failing altogether in the mid-1990’s.

22 Notwithstanding Smith’s lack of qualifications and previous business failure, Evert  
23 caused the Foundation to hire Smith as the Foundation’s investment advisor. Although paid a  
24 salary by the Foundation, Smith’s principal compensation came in the form of commissions paid  
25 by the entities for whom he obtained Foundation funds.

26 Smith’s advisory activities were confined to introducing the Foundation to companies  
27 created by “reverse mergers” by Tim Halter of the Halter Financial Group (“HFG”). A “reverse  
28 merger” is a process by which a small privately owned company in merged into an asset-less

1 publicly traded “shell” corporation, with the end result being a small publicly traded company.  
2 Smith arranged deals between the Foundation and G-Air Holding, Inc., The Leather Factory,  
3 Inc., Karts International, Inc. and Centratex of Louisiana, Inc., all of whom were HFG clients.  
4 The G-Air Holding, Inc. and The Leather Factory, Inc. transactions resulted in a modest return  
5 for the Foundation. The Foundation ultimately lost in excess of \$20,000,000 on the Karts  
6 investments and \$2,100,000 on its loan to Centratex of Louisiana.

7 Smith’s lack of qualifications and conflict of interest (taking commissions from the loans  
8 made by the Foundation) were evident, and were the subject of board meetings and written  
9 warnings by board members Henry Logan and Pete. These warnings had no effect on Evert. At  
10 his behest, the Foundation continued to use Smith as its financial advisor until 2001.

11 The board members issuing the warnings were particularly concerned with the  
12 implications of the Foundation’s aggressive diversification into high risk loans, after the  
13 California Attorney General’s Office (“AG”) began an audit of the Foundation on May 27, 1998.  
14 The AG’s audit was focused on the risk investments, and the failure of the Foundation to have  
15 sufficient outside directors on its board. Ironically, Evert did not perceive the fact of the AG  
16 audit as a warning or as cause for positive reform.

17 Warnings were coming from sources other than board members and the AG. Between  
18 1996 and June, 2000, the Foundation’s tax advisor, Verva Enoch repeatedly warned Evert, orally  
19 and in writing, that Foundations were prohibited from making risky investments and engaging in  
20 self-dealing transactions. These warnings likewise had no effect on Evert. Concerned that the  
21 Foundation refused to follow her advice, Ms. Enoch “fired” the Foundation as a client in June,  
22 2000. The Foundation hired Thomas Raffa & Associates as its CPA later that year. By  
23 December, 2001, Thomas Raffa & Associates had also “fired” the Foundation as a client, for the  
24 same reasons as Ms. Enoch had.

25 B. Evert’s Embezzlement of \$293,760

26 In July 1999, Smith introduced Evert to Thayer. Thayer, a former attorney, gave seminars  
27 on the use of corporations sole as religious, tax free, entities. Thayer met with Evert, Pete and  
28 Marion in Santa Ynez, and Evert attended three of Thayer’s seminars, including one that year in

1 Hawaii.

2 In the fall of 1999, Evert sought a raise from the Foundation. The raise was granted, but  
3 it was explicitly conditioned on terminating Smith and obtaining qualified financial advisors in  
4 his stead. Smith was terminated by letter dated December 29, 1999.

5 Late in 1999, Evert left for a long scientific expedition during which his wife (and fellow  
6 board member) Marion discovered, for the first time, that, in addition to the loan on their farm,  
7 she and Evert owed \$850,000 in unsecured debt, including \$210,000 spread among 29 credit  
8 cards. This discovery was seminal in that it caused Marion to realize that she had been wrong to  
9 trust Evert's financial judgment. From that moment on, Marion resolved to act independently on  
10 the board of the Foundation.

11 Upon his return, Evert learned that Marion had written to Smith to inform him of the  
12 board's decision to terminate him. Evert was angry and soon thereafter sent a new offer of  
13 employment to Smith. On learning this, Henry Logan demanded a special meeting of the board.  
14 That meeting was held on February 7, 2000. In it, the board voted to prohibit Evert from making  
15 any new investments for the Foundation without board approval.

16 Despite the vote, Evert circulated a memo to the board 3 days later, seeking approval for  
17 the purchase of 153,000 shares of Gulf-Air Inc. stock. He stated:

18 Tom Cooper told me that we had an option to buy 153,000 shares of Gulf-Air Inc. stock  
19 (the precursor to Gulfstream International, Inc.) at the same price (\$1.92/share) that  
20 Continental Air based their loan of \$23,000,000 on in 1999. He indicated that we should  
21 have opted (or not) before January 1, 2000, however he was aware of my absence from  
22 November '99 through Feb. 2000, and would like to offer this option again if the  
23 Foundation was still interested.

24 On February 20, 2000, the board met. Evert's request for approval to do the deal was  
25 declined.

26 After a private strategy meeting with Smith and Thayer on March 3, 2000, Evert revisited  
27 the stock purchase issue at the Foundation's March 4, 2000 Board meeting. Again, Evert's  
28 proposal failed to gain approval.

On March 8, 2000, four days after his second motion to authorize the purchase of the  
stock was defeated, Evert stole \$293,760 from the Foundation, wired the money to Camino Coin

1 company to purchase untraceable gold coins, and used the gold to buy the 153,000 shares of  
2 Gulf-Air stock from Smith.

3 On April 19, 2000, while reviewing the Foundation's bank statements in anticipation of  
4 the upcoming April 21 Board meeting, Marion saw that \$293,760 of the Foundation's funds had  
5 been wired to Camino Coin Company. Knowing that \$293,760 was the price Evert had wanted  
6 to pay for 153,000 shares of Gulf-Air stock, she contacted Tom Cooper to see if Evert had used  
7 the gold to purchase the stock from him. Cooper informed her he had not sold stock to Evert.  
8 Upon looking into the matter, however, he informed Marion that company records showed that  
9 Smith owned 153,000 shares of its stock.

10 Marion confronted Evert with her discovery that evening. Evert turned to Smith and  
11 Thayer for help. In an April 20, 2000 letter faxed to both of them Evert wrote:

12 Thanks for the input yesterday. It was most useful and helpful. However, when I got  
13 home last night, Marion presented me with the two enclosed faxes. One from her to  
14 Gulfstream, and Gulfstream's response. I'm afraid now that she has blown the whistle on  
15 me and our general understanding of what's happened and as you said she called Camino  
16 Coin Co, Tom Cooper, Paul Halme, James Dillon and has now already told all of our  
17 Board members what I and Blair did!

18 We talked until 2 a.m., after I got home at 11 p.m., about this whole thing, and I shall  
19 prepare my defense for the meeting tomorrow evening.

20 As I see it, Blair had a legal right to sell his stock to anyone he chose, and we had a legal  
21 right to buy it. Again, as I said, I still believe my CEO fiduciary responsibility was to  
22 assess the tie vote of the issue and I chose to buy it anyway.

23 As a result of her trying to find out who got the money from Camino Coin, I told her it  
24 was Blair's money for his stock and he got his money from them.

25 Again as far as I see it, Blair, you can have all the money from the sale of stock, but I  
26 would like you to consider paying the \$90,000 back to the foundation for Gaylene's part  
27 of the loan to close it out. Apparently, Henry/Helen/Marion feel that at least you could  
28 and should do that much for our Foundation. That would still leave you with over  
\$200,000 to do something else with.

I shall be away from the phone (and don't [illegible]) from now until I call you sometime  
Friday morning from somewhere. OK!

Marion informed fellow board members Henry and Helen Logan of what she had  
discovered. Henry Logan, a corporate attorney with more than 50 years experience, conceived of  
a damage-control plan whereby Evert would resign and Marion would be paid to manage the  
Foundation, and prepared the requisite documents. The morning of April 21, 2000, Henry Logan

1 invited Evert to come over to his house to discuss the situation. Henry showed Evert the  
2 documents he had prepared, and told Evert that he should resign. Evert would not agree to  
3 resign.

4 After leaving the meeting with Henry, Evert called Smith and Thayer for strategy advice.  
5 Thayer suggested that Evert prepare an agenda for the meeting that would not allow a discussion  
6 of his perfidy to be had until after all the other transactions he wanted approved were decided.  
7 Thayer told Evert to fire the Board of Directors if any of them attempted to deviate from the  
8 agenda. Evert also called Pete and Dr. Vincent to insist that they attend the meeting, in person.

9 At the board meeting on the evening of April 21, 2000, the Logans immediately raised the  
10 subject of Evert's embezzlement and fraud along with the necessity of his resigning or being  
11 fired. As planned, Evert thereupon "fired" the entire Board of Directors. The following day,  
12 April 22, 2000, Evert invited Pete and Dr. Vincent back on the board.

13 With all corporate power in Evert's hands, the Foundation quickly:

- 14 a. Approved an additional \$4,000,000 to Karts;
- 15 b. Ratified the Gulf Air Inc. stock purchase;
- 16 c. Amended its bylaws to reduce the number of directors from 7 to 3;
- 17 d. Raised Evert and Pete's compensation;
- 18 e. Fired Verva Enoch as CPA for the Foundation; and,
- 19 f. Hired Thayer as the Foundation's general counsel.

20 In firing Henry and Helen Logan and Marion Schlinger from the board, and in firing  
21 Verva Enoch, Evert got rid of the directors and tax professionals who, in good faith, had been  
22 warning Evert that what he was doing was unlawful. In hiring Thayer, and ratifying the  
23 transactions involving Smith, Evert was surrounding himself with "yes men." Having  
24 consciously chosen to ignore the warnings and fire those who gave the warnings, Evert should  
25 not be heard to complain he is the unwitting victim of bad advice.

26 C. The Use of Fake Churches

27 Thayer, touting his background as biblical scholar and former attorney, told Pete, Evert  
28 and Smith that corporations sole could be used to create one's own religious organization to

1 which tax-exempt donations could be made. This led to a plan whereby all of the assets of the  
2 Foundation would be transferred to a number of corporations sole controlled by Evert, Pete,  
3 Thayer and Smith.

4 Thayer already had Christian Almshouse, as his personal corporation sole. In fact, the  
5 legal services he provided to the Foundation were paid for in the form of “donations” to Christian  
6 Almshouse. The Foundation “donated” \$405,834 directly to Christian Almshouse for Thayer’s  
7 legal services and it was also the source of an additional \$158,688 paid to Christian Almshouse  
8 by Living Waters, and of \$27,283 paid to Christian Almshouse by Karts<sup>1</sup>.

9 Smith was initially the “Almoner” of a corporation sole called “Faith Works Mission.”  
10 Karts “donated” \$350,000 in gold to Faith Works Mission as an “honorarium” given to Smith in  
11 recognition of his services in obtaining the \$4,000,000 May 17, 2000 financing facility. Smith,  
12 through his new corporation sole, First Fruits Mission, received \$500,000 in September 2000  
13 and \$100,000 in October, 2000 from monies invested in Karts by the Foundation.

14 Pete and Evert were concerned about the possibility of the AG bringing legal proceedings  
15 against them and preventing them from having access to Foundation monies to defend  
16 themselves. To protect them, Thayer created a fake entity called “Faith Works Mission Sacred  
17 Trust” (dedicated to providing monies to “Christians oppressed by the secular legal system”) and  
18 named Pettinger as its trustee. Thayer also prepared documents whereby control of Faith Works  
19 Mission (the corporate sole) was shifted from Smith to Evert. On August 29, 2000, after these  
20 documents were in place, Evert and Pete stole \$1,300,000 from the Foundation, bought gold  
21 coins with the money, and had the gold taken to a safe in Pettinger’s garage. The Defendants  
22 refer to this money as the “legal defense fund.”

23 By the fall of 2000, Evert was still nearly \$1,500,000 in debt and Marion was suing for  
24 divorce. To solve these problems without alerting Marion to the further misuse of Foundation  
25 monies, Thayer, Evert and Pete created two new corporations sole. The first of these, Living  
26

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27 <sup>1</sup> Thayer has since been convicted of federal wire fraud charges arising from actions  
28 that occurred concurrently with these events. At his deposition in this case, Thayer refused to  
answer any questions relating to corporate sole scheme, asserting his 5th Amendment rights.

1 Waters, was owned by Pete. The second, Holy Ground, was owned by Evert. Thayer created  
2 Living Waters and Holy Ground. On September 20, 2000 Thayer sent the articles of  
3 incorporation to Evert and Pete. Thayer's cover letter explained how the corporation soles would  
4 obtain monies from the Foundation through grant requests, and noted that "[w]hatever is granted  
5 will be granted to the corporation sole and handled by yourselves [*i.e.* Pete and Evert] privately."

6 In an October 9, 2000, letter written to Thayer, Evert laid out the scheme. First, he was  
7 under pressure from Marion but did not want her to know he was using Foundation monies to  
8 fund the divorce and pay off their creditors. He wrote:

9 "We now have only 2 weeks . . . to get our farm deal on line by getting \$250,000 - cash  
10 to Marion . . . This money will need to come from 'Living Waters' as an unsigned (?)  
cashiers check- since Marion as yet doesn't know who is buying the farm!"

11 "As soon as Pete can obtain a checking account for 'Living Waters'(?), I shall send him  
12 \$300,000 from S. Foundation as gift."

13 Evert then asked Thayer to prepare one or more grant requests as a pretext for funding the  
14 scheme:

15 "Both Pete and I need to have proposals in hand for our 'sole' transfers etc. a.s.a.p.  
16 Could I ask you to prepare at least a 'dummy' proposal(s) for us soon?"

17 Finally, Evert needed some money for himself, so he wrote:

18 "Concerning other needs for 'Holy Ground' I would like for the S.F. to give \$250,000 to  
19 this sole before the end of the year - so it needs a proposal to the S.F."

20 Pete did not open an account for Living Waters in time, so Evert caused the Foundation  
21 to "donate" \$300,000 to Christian Almshouse. Thayer/Christian Almshouse, kept \$50,000 of  
22 the "donation" and forwarded the rest, via Christian Almshouse check, to Marion and Evert  
Schlinger as the down payment for Living Waters' purchase of the Schlinger's farm.

23 Beginning in January 2001, Evert and Pete caused the Foundation to "donate" \$7,345,000  
24 to Living Waters. Of that sum, \$2,000,000 was used to purchase Ev's Santa Ynez Farm. The  
25 balance of the money was intended to be used to fund the operation of the farm through Holy  
26 Ground, solely owned by Evert. Pete, instead, squandered the money and lost the farm.

27 To complete the ruse, Living Waters paid \$2,000,000 (via cashier's check as planned) to  
28 Evert and Marion for the purchase of the farm. Simultaneously with the close of the farm

1 purchase, Living Waters entered into a contract with Holy Ground to allow Evert to live on the  
2 farm for the rest of his life, with all expenses to be paid in gold by Living Waters (funded by the  
3 Foundation).

4 D. Karts, Pettinger and the Foundation's Loss of \$20,200,000

5 Karts International, Inc. was a go-cart company created in 1996 by HFG by reverse  
6 merger with a publicly held "shell" corporation.

7 On March 15, 1996, the Foundation made a \$2,000,000 unsecured loan to Karts and  
8 bought or was issued stock in Karts. On April 8, 1996, Evert Schlinger invested individually and  
9 invested as trustee of trusts that had been created for his sons Brian and Pete Schlinger. Evert's  
10 brother Warren also invested. On July 10, 1996, the Foundation purchased 300,000 shares of  
11 Karts stock from Tim Halter of HFG for \$600,000. On August 28, 1997, the Foundation agreed  
12 to convert \$1,000,000 of the \$2,000,000 debt owed by Karts into 250,000 shares of Karts stock.  
13 On June 3, 1999 the Foundation loaned \$1,500,000 to Karts (unsecured) and on June 30, 1999, it  
14 purchased \$500,000 in preferred stock. On July 6, 1999, Evert purchased more Karts stock as  
15 trustee of the Brian Schlinger Trust.

16 In early 2000, Smith informed the Foundation that its loans to and investments in Karts  
17 would soon be lost, as Karts' senior secured lender, KBK, was set to foreclose. The Foundation  
18 agreed to invest \$3,000,000 in series A preferred stock and make a secured loan of an additional  
19 \$1,000,000. This transaction would come to be known as the May 17, 2000 financing facility.

20 The May 17, 2000 financing gave the Foundation 3 of Karts' Board of Directors' 4 seats,  
21 thereby giving the Foundation complete control of Karts. In June, 2000, the Foundation voted its  
22 preferred shares and placed Smith, Pettinger and Thayer on the Karts Board. Smith then  
23 assumed the role of President of Karts, and Thayer became Karts' "Counsel for Legal Affaires."

24 In September 2000, after learning that all the monies it had spent previously on Karts was  
25 in danger of being lost, the Foundation invested an additional \$5,500,000 in the company.  
26 Within a few weeks of the \$5,500,000 investment, Karts, was again out of money<sup>2</sup>. On  
27

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28 <sup>2</sup> Karts' net loss for the year 2000 was \$6,823,000.

1 November 28, 2000, the Foundation invested an additional \$1,100,000 in Karts preferred stock.

2 The evidence will show that these investments violated the defendants' fiduciary duties to  
3 the Foundation in that:

- 4 1. They were made without competent advice;
- 5 2. They were made without due diligence;
- 6 3. They were made in a speculative, unproven company;
- 7 4. They violated the "excess business holdings" rule;
- 8 5. They were made when the directors knew Karts was losing money; and,
- 9 6. They were made after the directors had been told that Karts had defrauded the  
10 Foundation.

11 In December, 2000, the Foundation gave all of its Karts preferred stock to Living Waters.

12 Following this gift, Thayer advised the Foundation to stop loaning to or investing in  
13 Karts. Smith resigned from his position at Karts, and Pettinger took over as President of Karts.  
14 The evidence will show that in January, 2001, Pete, Pettinger and Evert agreed to continue to  
15 provide financing to Karts by laundering money from the Foundation (done on Evert's authority)  
16 through Living Waters (Pete's fake church) then through a fake business called "Morgan Creek  
17 Company" (Pettinger's fictional company) that, in turn, would "loan" money to Karts (at that  
18 time being run by Pettinger as an appointee of the Foundation). An additional \$5,000,000 of the  
19 Foundation's money was invested in Karts in this fashion.

20 Karts failed completely in June of 2002.

21 Pettinger's role as "trustee" for the \$1,300,000 stolen by Pete and Evert and placed in  
22 Pettinger's garage as gold, his role as holder of Smith's gold, his role as seller of all the gold, his  
23 role in laundering the Foundation's monies from it to Living Waters to Morgan Creek to Karts,  
24 and his role as Board member, employee and then President of Karts, not only place him squarely  
25 in the middle of the conspiracy to embezzle from and convert the assets of the Foundation, but  
26 make it probable that he knows what became of the Foundation's \$20,200,000 laundered through  
27 Karts.

28 \\\

1 E. The Foundation's Loss of \$10,091,302 on Loans to Centratex of Louisiana, Zyan  
2 Communications, IPAXS, Inc.

3 In October, 1999, without investigation, due diligence, or professional advice, the  
4 Foundation, at Smith's behest, loaned \$2,100,000 to Centratex of Louisiana, Inc. Centratex  
5 ultimately defaulted on the loan. The Foundation sued Centratex and its owners and their related  
6 entities. The Foundation obtained a favorable arbitration award and obtained from the owners all  
7 that could be obtained. The Foundation's net loss from this investment was \$1,732,101.

8 On June 12, 2000, without investigation, due diligence, or professional advice, the  
9 Foundation loaned \$4,000,000 to a company called Zyan Communications, Inc. Within a year,  
10 Zyan was bankrupt. Including interest, the Foundation lost \$5,597,676 on this loan.

11 On July 25, 2000, without investigation, due diligence, or professional advice, the  
12 Foundation invested \$2,000,000 in a company called IPAXS, Inc. Within a year, IPAXS was  
13 bankrupt. Including interest, the Foundation lost \$2,761,525 on this transaction.

14 Evert and Pete's dereliction of their fiduciary duties to the Foundation with respect to  
15 these three loans caused \$10,091,302 in damages.

16 **IV.**  
17 **DISCUSSION**

18 A. Fiduciary Duties, Duty to Account, Burden of Proof, Adverse Presumptions

19 A fiduciary duty arises whenever trust and confidence are reposed in the integrity and  
20 fidelity of another. California law is that the assets of a charitable corporation are impressed with  
21 a trust, and members of the board of directors are essentially trustees. *Lynch v. John M. Redfield*  
22 *Foundation* (1970) 9 Cal.App.3d 293, 88 Cal.Rptr. 86; *American Center for Education, Inc. v.*  
23 *Cavnar* (1978) 80 Cal.App.3d 476, 486, 145 Cal.Rptr. 736, 742; *People v. State of California v.*  
24 *Larkin* (N.D. Cal. 1976) 413 F.Supp. 978. Moreover, a corporate officer or director indisputably  
25 owes a fiduciary duty to the corporation. *People v. Threestar* (1985) 167 Cal.App.3d 747, 758,  
26 213 Cal.Rptr. 510, 516.

27 Defendants each owed fiduciary duties to the Foundation. Evert was the President and  
28 Chairman of the Board of Directors of the Foundation. Pete was the Chief Financial Officer and

1 also on the Board of Directors. Thayer was the Foundation's general counsel. Smith was the  
2 Foundation's financial advisor. Pettinger was appointed by the Foundation to manage Karts.

3 As a consequence of their fiduciary relationships, Defendants bear the burden of fully  
4 justifying their conduct and completely accounting for their deeds. *Smith v. Tele-*  
5 *Communication, Inc.* (1982) 134 Cal.App.3d 338, 345, 184 Cal.Rptr. 571, 575; *Pelton v. Wells*  
6 *Fargo Bank* (1982) 132 Cal.App.3d 496, 501-502, 183 Cal.Rptr. 188, 191-192; *Van de Kamp v.*  
7 *Bank of America, N.T.S.A.* (1988) 204 Cal.App.3d 819, 834-835, 251 Cal.Rptr. 530, 533-534. In  
8 particular, as a fiduciary to the corporation, a director has the burden of justifying his conduct  
9 and giving an account of his stewardship. *Credit Managers Ass'n of So. Cal. v. Superior Court*  
10 (1975) 51 Cal.App.3d 352, 360-362, 124 Cal.Rptr. 242, 247-249.

11 That burden includes a full accounting, which requires showing that every disbursement  
12 made was proper. *Miller v. Miller* (1963) 217 Cal.App.2d 538, 544, 31 Cal.Rptr. 618, 622;  
13 *Haddock v. Haddock* (1961) 190 Cal.App.2d 151, 165-166, 11 Cal.Rptr. 865, 872 . Where there  
14 has been a failure or refusal to keep true, clear, and full accounts of all dealings concerning the  
15 fiduciary relationship, all presumptions will be against the fiduciary. *Raymond v. Independent*  
16 *Growers, Inc.* (1955) 133 Cal.App.2d 154, 161, 284 P.2d 57, 61; *In re McCabe's Estate* (1948)  
17 87 Cal.App.2d 430, 435, 197 P.2d 35, 38; *Bone v. Hayes* (1908) 154 Cal. 759, 766-767, 99 P.  
18 172, 175. The duty to account requires a complete bookkeeping system of accounts sufficient to  
19 establish that all expenditures were correct, just and necessary, and preservation of receipts,  
20 vouchers and other original documents. *The Law of Trusts and Trustees* § 962 (Rev 2d. ed.).

21 The duty also places the burden on the fiduciaries to establish that what they did was fair  
22 for the Foundation. The case of *Remillard Brick Co. v. Remillard-Dandini Co.* (1952) 109  
23 Cal.App.2d 405, at 420-421 states the law as follows:

24 The United States Supreme Court has clearly established these principles. In *Pepper v.*  
25 *Litton*, 308 U.S. 295, at page 306, 60 S.Ct. 238, at page 245, 84 L.Ed. 281, the court,  
26 unanimously, stated the following: 'A director is a fiduciary. [Citing a case.] So is a  
27 dominant or controlling stockholder or group of stockholders. [Citing a case.] Their  
28 powers are powers in trust. [Citing a case.] Their dealings with the corporation are  
subjected to rigorous scrutiny and where any of their contracts or engagements with the  
corporation is challenged the burden is on the director or stockholder not only to prove  
the good faith of the transaction but also the show its inherent fairness from the viewpoint  
of the corporation and those interested therein. [Citing a case.] . . .' Referring directly to  
the duties of a director the court stated 308 U.S. at page 311, 60 S.Ct. at page 247: 'He

1 who is in such a fiduciary position cannot serve himself first and his *cestuis* second. He  
2 cannot manipulate the affairs of his corporation to their detriment and in disregard of the  
3 standards of common decency and honesty. He cannot by the intervention of a corporate  
4 entity violate the ancient precept against serving two masters. He cannot by the use of the  
5 corporate device avail himself of privileges normally permitted outsiders in a race of  
6 creditors. He cannot utilize his inside information and his strategic position for his own  
7 preferment. He cannot violate rules of fair play by doing indirectly through the  
8 corporation what he could not do directly. He cannot use his power for his personal  
9 advantage and to the detriment of the stockholders and creditors no matter how absolute  
10 in terms that power may be and no matter how meticulous he is to satisfy technical  
11 requirements. For that power is at all times subject to the equitable limitation that it may  
12 not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the  
13 exclusion or detriment of the *cestuis*. Where there is a violation of those principles, equity  
14 will undo the wrong or intervene to prevent its consummation.'

15 It is inconceivable that the defendants herein can prove the inherent fairness of the  
16 transactions at issue:

17 1. Evert took \$293,760 from the Foundation in direct contravention of the  
18 orders of the Board of Directors. He used that money to buy gold to give to Smith for the  
19 purchase of stock that had no market, and which the Foundation had decided not to do,  
20 and he did so in secrecy. The Foundation received no benefit from the transaction at all;

21 2. Evert took \$300,000 from the Foundation. Of that sum, he gave \$50,000  
22 to Thayer, and had the balance paid to himself. The Foundation received no benefit from  
23 the transaction at all;

24 3. Evert took \$7,345,000 from the Foundation and gave it to Pete. Of that  
25 sum, \$2,000,000 was paid to Evert. The balance of the funds were spent by Pete. The  
26 Foundation received no benefit from the transaction at all;

27 4. Evert, Pete, Thayer, Smith and Pettinger took \$1,300,000 from the  
28 Foundation as a gift to a church which they knew to be fake. They did so to hide the  
money and use it for their own purposes. They have failed to return the money to the  
Foundation. The Foundation got no benefit from the monies at all;

1 Evert, Pete, Thayer, Smith and Pettinger put \$10,600,000 of the  
2 Foundations' funds into Karts in the year 2000, at a time they knew Karts was losing  
3 money, and at a time when Thayer had advised them they had been defrauded. All of the  
4 money was lost. The Foundation received no benefit from the transactions at all; and,

1           6.       Evert, Pete and Pettinger took \$5,000,000 of the \$7,345,000 wired to  
2       Living Waters; and, after laundering the money through “Morgan Creek”, loaned it to  
3       Karts. The Foundation received no benefit from the transactions at all.

4       B.       Conversion

5       The evidence will show that to fund these and other unlawful transactions, Defendants  
6       converted 441,784 of shares of United Parcel Service stock owned by the Foundation and  
7       diverted the proceeds to fund the defalcations identified above. As a consequence, the  
8       Foundation lost the appreciation of those shares and the dividends which would have been paid  
9       on them. The damages from the conversion of the shares are \$41,063,903.

10       Shares of corporate stock are subject to an action in conversion. *Mears v. Crocker First*  
11       *Nat. Bank of San Francisco* (1948) 84 Cal.App.2d 637, 644, 191 P.2d 501; *Payne v. Elliot*  
12       (1880) 54 Cal. 339. The measure of damages is the highest market value of the converted stock  
13       at any time before trial. Civil Code § 3336; *Friedman v. Renz* (1939) 31 Cal.App.2d 71, 73. 87  
14       P.2d 386, 387. Here, that figure is \$87.53 per share.

15       Identifiable funds also can be converted. *Fischer v. Machado* (1996) 50 Cal.App.4th  
16       1069, 58 Cal.Rptr.2d 213; *Weiss v. Marcus* (1975) 51 Cal.App.3d 590, 124 Cal.Rptr. 297;  
17       *Haigler v. Donnelly* (1941) 18 Cal.2d 674, 681-682, 117 P.2d 331, 335-336. Where there is an  
18       unlawful taking by a fiduciary, money entrusted to the fiduciary is recoverable in an action for  
19       conversion. *Watson v. Stockton Morris Plan Co.* (1939) 34 Cal.App.2d 393, 407, 93 P.2d 855.

20       Here, Evert and Pete, as fiduciaries, had control of the account in which the UPS stock of  
21       the Foundation was held. They used their access to that account to sell 441,784 of shares of  
22       United Parcel Service stock to generate \$25,538,568. Of that sum, \$293,760 was given to Smith  
23       (as gold coins); \$50,000 was given to Thayer; \$2,250,000 was given to Evert; \$5,345,000 was  
24       given to Pete; \$1,300,000 was given to Evert, Pete, Thayer, Smith and Pettinger; and, the balance  
25       was unlawfully placed with Karts. Thus, both the stock used to generate the monies and the  
26       funds so generated are identifiable and subject to an action for conversion.

27       The gold coins purchased with Foundation monies (the Smith transaction and the Evert,  
28       Pete, Thayer, Smith and Pettinger \$1,300,000 transaction) are personal property of the

1 Foundation that has been converted and which may be recovered in an action for conversion.

2 A cause of action for conversion supports an award of exemplary damages. *Krieger v.*  
3 *Pacific Gas & Electric Co.* (1981) 119 Cal.App.3d 137, 148, 173 Cal.Rptr. 751; *Cyrus v.*  
4 *Haveson* (1977) 65 Cal.App.3d 306, 316, 135 Cal.Rptr. 246, 253. The Schlinger Foundation  
5 respectfully submits that Defendants' willful misappropriation of its assets and charitable funds  
6 warrants punitive damages.

7 C. Constructive Fraud

8 As fiduciaries of the Plaintiff Foundation, Defendants engaged in conduct by which they  
9 personally benefitted as follows:

10 1. Smith received \$100,000 on or about November 15, 1997 from monies loaned to  
11 Centratex;

12 2. Smith received \$205,000 on or about June 30, 1999 from monies loaned to Karts;

13 3. Smith received 293,760 in gold coins directly from the Foundation on or about  
14 March 8, 2000;

15 4. Smith received \$350,000 from Karts, which was by then a subsidiary of the  
16 Foundation, in June, 2000, from monies given to Karts by the Foundation;

17 5. Smith received \$500,000 from Karts, which was by then a subsidiary of the  
18 Foundation, in September, 2000, from monies given to Karts by the Foundation;

19 6. Smith received \$100,000 from Karts, which was by then a subsidiary of the  
20 Foundation, in October, 2000, from monies given to Karts by the Foundation;

21 7. Between March of 2000 and December of 2001, Thayer received \$155,834  
22 directly from the Foundation, as gifts;

23 8. Thayer received \$158,688.90 of Foundation monies, indirectly through Living  
24 Waters between January 2001 and January, 2004;

25 9. Thayer received \$27,283.07 of Foundation monies, indirectly through the  
26 Foundation's de facto subsidiary, Karts, between June 2000 and June, 2001;

27 10. Evert, Pete, Thayer and Pettinger received \$1,300,000 directly from the  
28 Foundation, as a gift in August, 2000;

1           11.     In November, 2000 Evert received \$250,000 indirectly from the Foundation via  
2 monies donated to Christian Almshouse as a gift in October, 2000;

3           12.     In March, 2001 Evert received \$2,000,000 indirectly from the Foundation via  
4 monies donated to Living Waters as a gift in January, 2001;

5           13.     Pete received \$7,345,000 indirectly from the Foundation via monies donated to  
6 Living Waters as a gift in 2000 and 2001 (of which \$2,000,000 was given to Evert);

7           14.     Pete received \$7,345,000 indirectly from the Foundation via monies donated to  
8 Living Waters as gifts in 2000 and 2001 (of which \$2,000,000 was given to Evert);

9           15.     Pete received \$450,000 directly from the Foundation on February 26, 2001; and,

10          16.     Pettinger received \$4,985,132 indirectly from the Foundation via monies donated  
11 to Living Waters as gifts in 2000 and 2001.

12           Constructive fraud consists in any breach of duty which, without an actual fraudulent  
13 intent, gains an advantage to the person in fault, or anyone claiming under him, by misleading  
14 another to his prejudice, or to the prejudice of anyone claiming under him. Civil Code § 1573.  
15 Constructive fraud comprises all acts, omissions and concealments involving a breach of legal or  
16 equitable duty, trust, or confidence, and resulting damage to another. *Efron v. Kalmanovitz*  
17 (1964) 226 Cal.App.2d 546, 559-560, 38 Cal.Rptr. 148, 157. Any transaction by which the party  
18 owing a fiduciary duty secures any advantage is presumptively fraudulent, and the presumption  
19 casts the burden on the party gaining an advantage to show fairness and good faith in all respects.  
20 *Boyd v. Bevilacqua* (1967) 247 Cal.App.2d 272, 290, 55 Cal.Rptr. 610, 622; *Solon v.*  
21 *Lichtenstein* (1952) 39 Cal.2d 75, 82, 244 P.2d 907, 911. Specifically, dealings of corporate  
22 directors with the corporation are subject to rigorous scrutiny, and burden is on the director, not  
23 only to prove the good faith of the transaction, but also to show its inherent fairness from the  
24 viewpoint of the corporation. *Efron v. Kalmanovitz*, 226 Cal.App.2d at 556, 38 Cal.Rptr. at 154-  
25 155, *citing Pepper v. Litton* (1939) 308 U.S. 295, 306, 60 S.Ct. 238, 84 L.Ed. 281. For  
26 constructive fraud based on nondisclosure of a material fact, the traditional fraud elements of  
27 representation and falsity need not be shown. The plaintiff also does not need to show that the  
28 defendant's failure to disclose was intentional. *Byrum v. Brand* (1990) 219 Cal.App.3d 926,

1 938-939, 268 Cal.Rptr. 609, 618.

2 D. Actual Fraud

3 The elements of actual fraud, are: (1) misrepresentation; (2) knowledge of falsity; (3)  
4 intent to defraud; (4) justifiable reliance; and (5) resulting damage. *Anderson v. Deloitte &*  
5 *Touche* (1997) 56 Cal.App.4th 1468, 1474, 66 Cal.Rptr.2d 512. Those elements are met in this  
6 case.

7 On February 10, 2000, Evert made the following misrepresentation to the Foundation:

8 Tom Cooper told me that we had an option to buy 153,000 shares  
9 of Gulf-Air Inc. stock (the precursor to Gulfstream International,  
10 Inc.) at the same price (\$1.92/share) that Continental Air based  
11 their loan of \$23,000,000 on in 1999. He indicated that we should  
12 have opted (or not) before January 1, 2000, however he was aware  
13 of my absence from November '99 through Feb. 2000, and would  
14 like to offer this option again if the Foundation was still interested.

15 Evert knew his representation was false and made it with the intent of inducing the  
16 Foundation to approve the payment of \$293,760 for the G-Air Holdings Corporation stock. In  
17 truth, the Foundation had no option to buy 153,000 shares of Gulf-Air Inc. stock at \$1.92/share,  
18 or any price, from Gulf-Air Inc., and Tom Cooper had made no such offer. Rather, Smith had  
19 offered his stock in G-Air Holdings Corporation to Evert at \$1.92/share. In reliance on Evert's  
20 statements, in April, 2000, the Foundation ratified Evert's use of Foundation monies to purchase  
21 the G-Air Holdings Corporation stock. Had it known the truth, it would not have done so.

22 The measure of damages for a fiduciary's intentional misrepresentation is not confined to  
23 actual or out-of-pocket losses. *Fragale v. Faulkner* (2003) 110 Cal.App.4th 229, 235, 1  
24 Cal.Rptr.3d 616, 621. The out-of-pocket measure restores the plaintiff to the financial position it  
25 enjoyed prior to the fraudulent transaction, awarding the difference in the actual value between  
26 what the plaintiff gave and what it received. *Id.*, 110 Cal.App.4th at 236, 1 Cal.Rptr.3d at 621.  
27 The benefit-of-the-bargain measure places a defrauded plaintiff in the position it would have  
28 enjoyed had the false representations to it been true, awarding it the difference in value between  
what it actually received and what it was fraudulently led to believe it would receive. *Id.* Civil  
Code § 3333 provides:

For the breach of an obligation not arising from contract, the  
measure of damages, ..., is the amount which will compensate for

1 all the detriment proximately caused thereby, whether it could have  
2 been anticipated or not.

3 The Foundation lost nearly \$293,760 as a result of Evert's actual fraud.

4 E. Self-Dealing Transactions in Violation of Corporations Code § 5233

5 Defendants engaged in “self-dealing” transactions in violation of Corporations Code §  
6 5233. Corporations Code § 5233(a) provides:

7 Except as provided in subdivision (b), for the purpose of this  
8 section, a self-dealing transaction means a transaction to which the  
9 corporation is a party and in which one or more of its directors has  
10 a material financial interest and which does not meet the  
11 requirements of paragraph (1)(2), or (3) of subdivision (d). Such a  
12 director is an ‘interested director’ for the purpose of this section.<sup>3</sup>

13 Corporations Code § 5233(c) allows an action under the statute to be brought by the  
14 corporation as long as the Attorney General is joined as an indispensable party.

15 Subsection (h) of Corporations Code § 5233 authorizes the Court to make any order  
16 appropriate to remedy the self-dealing:

17 If a self-dealing transaction has taken place, the interested director  
18 or directors shall do such things and pay such damages as in the  
19 direction of the court will provide an equitable and fair remedy to  
20 the corporation, taking into account any benefit received by the  
21 corporation and whether the interested director or directors acted in  
22 good faith and with intent to further the best interest of the  
23 corporation. Without limiting the generality of the foregoing, the  
24 court may order the director to do any or all of the following:

- 25 (1) Account for any profits made from such transaction, and pay  
26 them to the corporation;
- 27 (2) Pay the corporation the value of the use of any of its property
- 28

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29 <sup>3</sup>Neither the exception as set forth in subdivision (b), nor the requirements of paragraphs  
30 (1)-(3) of subdivision (d), are met with respect to the transactions at issue in this case.

31 Among other things, transactions conducted in violation of the “interested person  
32 limitation” of Corporations Code § 5227 constitute self-dealing, thereby triggering the remedies  
33 of Corporations Code § 5233(h). *California Civil Practice Business Litigation* § 21:12. As part  
34 of the Nonprofit Corporation Law, Corporations Code § 5227 (a) provides “ ... not more than 49  
35 percent of the persons serving on the board of any corporation may be interested persons.”  
36 “Interested persons” are defined in subdivision (b) of the statute to include, among others, any  
37 person compensated by the corporation for services rendered within the previous 12 months,  
38 excluding any reasonable compensation paid to a director as director, and various stated relatives  
of such a person.

1 used in such transaction; and

2 (3) Return or replace any property lost to the corporation as a result  
3 of such transaction, together with any income or appreciation lost  
4 to the corporation by reason of such transaction, or account for any  
5 proceeds of sale of such property, and pay the proceeds to the  
6 corporation together with interest at the legal rate. The court may  
award prejudgment interest to the extent allowed by Section 3287  
or 3288 of the Civil Code. In addition, the court may, in its  
discretion, grant exemplary damages for a fraudulent or malicious  
violation of this section.

7 The acts of self-dealing are set forth in part IV. C., above. The evidence shows that the  
8 Foundation lost \$11,235,565.97 as a result of those acts.

9 F. Unlawful Distributions in Violation of Corporations Code § 5410

10 Distributions were made from the Plaintiff Foundation in violation of Corporations Code  
11 § 5410. Corporations Code § 5410, part of the Nonprofit Corporations Law, as pertinent,  
12 provides, “No corporation shall make any distribution.” The fundamental premise behind the  
13 prohibition of a nonprofit distributing profits to its members is that doing so would defeat the  
14 essential purpose of its public benefit character. *See, People v. Sinai Temple* (1971) 20  
15 Cal.App.3d 614, 99 Cal.Rptr. 603.

16 Corporations Code § 5420 provides for liability of anyone who receives a distribution for  
17 the amount of the distribution, plus interest:

18 **Action to recover distribution**

19 (a) Any person who receives any distribution is liable to the  
20 corporation for the amount so received by such person with interest  
thereon at the legal rate on the judgment until paid.

21 ...

22 Subdivision (b) of the statute provides that the suit may be brought by the corporation.  
23 Corporations Code § 5420(b) also authorizes the recovery of punitive damages for the benefit of  
24 the corporation against any director, officer, member or other person who with intent to defraud,  
caused, received, or aided and abetted in the making of any distribution.

25 Corporations Code Corporations Code § 5237 separately provides for liability of directors  
26 of a corporation who approve the making of a distribution, and sets forth the measure of  
27 damages:

1 (a) Subject to the provisions of Section 5231,<sup>4</sup> directors of a  
2 corporation who approve any of the following corporate actions  
shall be jointly and severally liable to the corporation for:

3 (1) The making of any distribution.

4 ...  
(c) Suit may be brought in the name of the corporation to enforce  
the liability:

5 (1) Under paragraph (1) of subdivision (a) against any or all  
6 directors liable to the persons entitled to sue under subdivision (b)  
of Section 5420.

7 ...  
8 (d) The damages recoverable from a director under this section  
9 shall be the amount of the illegal distribution, or if the illegal  
10 distribution consists of property, the fair market value of that  
11 property at the time of the illegal distribution, plus interest thereon  
from the date of the distribution at the legal rate on judgments until  
paid, together with all reasonably incurred costs of appraisal or  
other valuation, if any, of that property, ...

12 Corporations Code § 5049 provides that a, “[d]istribution’ means the distribution of any  
13 gains, profits or dividends to any member as such. As used in this section, ‘member’ means any  
14 person who is a member as defined in Section 5056 and any person who is referred to as a  
15 member as authorized by subdivision (a) of Sections 5332, 7333 and 9332.” Corporations Code  
16 § 5056(a) defines a member to mean any person, who, among other things, has the right to vote  
17 for the election of directors.

18 Defendants individually received unlawful distributions as set forth in part IV. C., above.  
19 Under Corporations Code § 5420, Defendants are each liable for their receipt of the unlawful  
20 distributions. Under these facts, the Foundation is entitled to prejudgment interest and punitive  
21 damages against the named defendants.

22 Pete and Evert are also liable under Corporations Code § 5420 for punitive damages for  
23 causing and aiding in the making of the unlawful distributions with an intent to defraud.

24 Under Corporations Code §5237, Pete and Evert are also liable for approving the making  
25 of those unlawful distributions. They are each liable under that statute for the amount of all  
26 unlawful distributions approved by them, which total \$11,235,565.97.

27 \\\

28 \_\_\_\_\_  
<sup>4</sup>Corporations Code § 5231 does not apply here.

1           G.     Civil Conspiracy under California law

2           Defendants engaged in a conspiracy that encompassed actual and constructive fraud upon  
3 the Foundation, conversion of its assets and monies, and breaches of fiduciary duties by its  
4 officers and directors. Each defendant is jointly and severally liable to the Foundation for harm  
5 caused by the intentional torts each of them committed in furtherance of the conspiracy.

6           By participating in a civil conspiracy, each co-conspirator incurs tort liability co-equal  
7 with the immediate tortfeasors. *Applied Equipment Corp. v. Litton Saudi Arabia Limited* (1994)  
8 7 Cal.4th 503, 510-511, 869 P.2d 454, 457, 28 Cal.Rptr.2d 475, 476. The elements of conspiracy  
9 are the formation and operation of a conspiracy and damage resulting to plaintiff from an act  
10 done in furtherance of the common design. *Id.*

11           The agreement of a conspirator may be inferred from the nature of the acts done, the  
12 relation of the parties, the interests of the alleged conspirators and other circumstances. Tacit  
13 consent as well as express approval will suffice. *Sprague v. Equifax, Inc.* (1985) 166 Cal.App.3d  
14 1012, 1028, 213 Cal.Rptr. 69, 79. A conspiracy may be proved by direct or circumstantial  
15 evidence, or by both. *People v. Curtis* (1951) 106 Cal.App.2d 321, 325, 235 P.2d 51, 53. Acts  
16 and declarations of each conspirator in furtherance of the conspiracy may be considered as  
17 evidence against all parties to the conspiracy. *People v. Levy* (1935) 8 Cal.App.2d Supp. 763,  
18 769, 50 P.2d 509, 511. A statement by a conspirator pursuant to the conspiracy is admissible  
19 against a co-conspirator. California Evidence Code § 1223. Once a defendant's participation in  
20 a conspiracy is shown, it is presumed to continue unless he proves that he effectively withdrew  
21 from the conspiracy. *People v. Crosby* (1962) 58 Cal.2d 713, 730, 375 P.2d 839, 850, 25  
22 Cal.Rptr. 847, 858. Mere failure to continue previously active participation does not constitute  
23 withdrawal. There must be an affirmative and bona fide rejection or repudiation of the  
24 conspiracy, communicated to the co-conspirators. *Id.* Even if a defendant proves he withdrew  
25 effectively, he remains liable for acts committed in furtherance of the conspiracy until the date of  
26 withdrawal. *People v. Sconce* (1991) 228 Cal.App.3d 693, 703, 279 Cal.Rptr. 59, 65.

27           Here there is overwhelming proof of a conspiracy among the defendants. Some of the  
28 landmarks of the conspiracy include: (i) the plan to fire the outside directors after the theft of the

1 \$293,760 was discovered; (ii) the creation and use of corporation soles posing as religious  
2 organizations for Thayer (Christian Almshouse), Smith (initially Faith Works Mission then First  
3 Fruits Mission), Pete (Living Waters), Evert (Holy Ground) and for all of them and Pettinger  
4 (Faith Works Mission); (iii) the explicit agreement to transfer the assets of the Foundation to a  
5 corporate sole to avoid Attorney General supervision; (iv) the plan to transfer \$1,300,000 in gold  
6 to Pettinger's safe in Texas for the collective use of the conspirators; (v) the plan to use  
7 Foundation monies to purchase Evert's farm; (vi) the plan to use Foundation monies to pay Evert  
8 to live on the farm and to pay him for his expenses in farming it; (vii) the placement of Thayer,  
9 Smith and Pettinger on the board of Karts; and, (viii) the sending of Foundation money by Evert,  
10 to Pete acting as Living Waters, who, in turn, sent it to Pettinger acting as Morgan Creek, who, in  
11 turn sent it to Karts (where Pettinger received it while acting as an officer and director of that  
12 company).

#### 13 H. Aiding and Abetting Intentional Torts

14 Defendants aided and abetted each other's breaches of fiduciary duties, conversion of  
15 Foundation assets and funds, and fraudulent acts towards the Foundation. Liability is imposed  
16 on one who aids and abets the commission of an intentional tort if the person (a) knows the  
17 other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to  
18 the other to so act; or (b) gives substantial assistance to the other in accomplishing a tortious  
19 result and the person's own conduct separately considered constitutes a breach of duty to the  
20 third person. *Saunders v. Superior Court* (1994) 27 Cal.App.4th 832, 845-846, 33 Cal.Rptr.2d  
21 438, 446. One who knowingly aids and abets a fiduciary to make secret profits may be held  
22 liable jointly with the fiduciary for such secret profits. *Fink v. Weisman* (1933) 129 Cal.App.305,  
23 317, 18 P.2d 961, 965.

24 Some of the ways the defendants aided and abetted each other's intentional torts were:

25 1. Thayer and Smith gave advice to Evert on how to avoid being fired for misusing  
26 \$293,760 of the Foundation's money, and get rid of the outside directors who were objecting to  
27 that and other transactions;

28 2. Thayer drafted the Articles of Incorporation for Faith Works Mission, Christian

1 Almshouse, Living Waters, and Holy Ground, as well as the various amendments to those  
2 articles;

3 3. Thayer wrote various letters in furtherance of the corporate sole scheme;

4 4. Pettinger stored the \$1,300,000 in gold that had been purchased with Foundation  
5 monies and thereafter transported it to a gold dealer and sold it; and,

6 5. Pete signed a contract with Evert to provide Evert with funds for life to enable  
7 him to live for free on the farm.

8 I. Racketeer Influenced and Corrupt Organizations Act (“RICO”).

9 Plaintiff Schlinger Foundation also has civil claims for relief for substantive violations of  
10 18 U.S.C. § 1962(c) of the Racketeer Influenced and Corrupt Organizations Act (“RICO”) and  
11 for conspiracy under 18 U.S.C. § 1992(d) to commit such RICO violations. Jurisdiction for civil  
12 RICO is concurrent. *Tafflin v. Levitt*, 493 U.S. 455 (1990). 18 U.S.C. §1962(c) provides in  
13 pertinent part:

14 It shall be unlawful for any person employed by or associated with  
15 any enterprise engaged in, or the activities of which affect,  
16 interstate or foreign commerce, to conduct or participate, directly  
or indirectly, in the conduct of such enterprise’s affairs through a  
pattern of racketeering activity ...

17 The essential elements of a claim for a substantive violation of RICO under section 18  
18 U.S.C. 1962(c) are that:

- 19 (a) a person  
20 (b) employed by or associated with  
21 (c) an enterprise  
22 (d) that is engaged in or affects interstate or foreign commerce  
23 (e) conducted or participated in the conduct of the enterprise’s affairs  
24 (f) through a pattern of racketeering activity  
25 (g) while acting with the necessary mens rea (*i.e.*, intent to defraud)  
26 (h) resulting in injury to the plaintiff’s business or property.

27 Each Defendant is a “person” within the meaning of 18 U.S.C. § 1961(3). Defendants  
28 were “employed by or associated with” Plaintiff within the meaning of 18 U.S.C. § 1962(c).  
Plaintiff is an “enterprise” within the meaning of 18 U.S.C. § 1961(4). Plaintiff is engaged in  
interstate commerce and its activities affect interstate commerce. In violation of 18 U.S.C. §  
1962(c), Defendants conducted or participated, directly or indirectly, in the affairs of the

1 Schlinger Foundation through a pattern of racketeering activity. 18 U.S.C. § 1961 defines a  
2 “racketeering act[.]” to include wire fraud in violation of 18 U.S.C. § 1343. In furtherance of  
3 their scheme to defraud Plaintiff, Defendants used and caused to be used the interstate wire  
4 facilities in violation of 18 U.S.C. § 1343. “Wire fraud has three elements: a scheme to defraud,  
5 use of the wires in furtherance of the scheme, and the specific intent to defraud.” *United States v.*  
6 *McNeil* (9<sup>th</sup> Cir. 2003) 320 F.3d 1034, 1040.

7 Defendants’ predicate racketeering acts were related each other, and amounted to and  
8 posed a threat of continuing criminal activity. *H.J., Inc. v. Northwestern Bell Tel. Co.* (1989) 492  
9 U.S. 229, 109 S.Ct. 2893. Defendants’ conduct consisted of criminal acts that had the same or  
10 similar purposes, results, participants, victim, methods of commission and other distinguishing  
11 characteristics, and were not isolated events. *Id.*, 492 U.S. at 240, 109 S.Ct. at 2901. The  
12 conduct occurred over a substantial period of time, and, undeterred, would have continued. *Id.*,  
13 492 U.S. at 241-242, 109 S.Ct. at 2902.

14 In violation of 18 U.S.C. § 1962(d), Defendants also conspired to violate 18 U.S.C. §  
15 1962(c). 18 U.S.C. § 1962 makes it a substantive RICO violation “for any person to conspire to  
16 violate any of the provisions of subsection (a), (b) or (c) of this section.” The elements of a  
17 RICO conspiracy [specifically, to violate section 1962(c)] under section 1962(d) are that:

- 18 (a) a person
- 19 (b) conspired to violate section 1962(c)
- 20 (c) injury to the plaintiff’s business or property
- 21 (d) by reason of
- 22 (e) overt acts in furtherance of the conspiracy.

23 By reason of Defendants’ violations of 18 U.S.C. § 1962, the Foundation suffered injury  
24 to its business and its property within the meaning of 18 U.S.C. § 1964(c). Pursuant to 18 U.S.C.  
25 § 1964(c), Plaintiff is entitled to recover threefold its actual damages, costs of suit and attorney  
26 fees.

27 Plaintiff’s damages from Defendants’ racketeering acts are at least \$11,235,565.97.  
28 Trebled those damages are \$33,706,697.91.

J. Investment Losses Incurred in Violation of Applicable Standards of Conduct

As we describe in part III. D., above, Defendants caused the Foundation to invest

1 \$20,200,000 in Karts. Karts was never a viable enterprise, and by June, 2002, the Foundation's  
2 entire investment was lost.

3 Plaintiff Foundation's other investments fared no better. Its October 1997 \$2,100,000 (on  
4 which Smith received a \$100,000 commission) loan to Centratex was a complete loss. Its June,  
5 2000 loan of \$4,000,000 to Zyan Communications, Inc. was a complete loss. Zyan was bankrupt  
6 in less than 12 months. Plaintiff Foundation's July, 2000 investment of \$2,000,000 in IPAXS  
7 Inc. was a complete loss. It, too, was bankrupt within the year.

8 The common thread for all of these investments were: 1) no investigation or due diligence  
9 was done before making the investments; 2) no trained advisors were employed to analyze the  
10 investments or the Foundation's portfolio; 3) each investment was speculative in the extreme; 4)  
11 most resulted in gain to Smith; and, 5) all were complete losses to Plaintiff Foundation.

12 In sum, Defendants imprudently caused the Schlinger Foundation to incur investment  
13 losses in highly speculative, start up companies. The total losses from these investments, with  
14 pretrial interest are:

- 15 1. Karts (without including Living Waters and Morgan Creek monies) --  
16 \$23,095,713;
- 17 2. Karts (including Living Waters and Morgan Creek monies) -- \$30,064,773;
- 18 3. Zyan Communications -- \$5,815,323;
- 19 4. IPAXS -- \$2,896,520; and,
- 20 5. Centratex of Louisiana, Inc. -- \$2,201,957.

21 The total damages suffered by the Foundation from these investments is \$40,978,573.

22 These investments were made in violation of applicable standards of care. There is a  
23 specific statute prohibiting speculative investments by a nonprofit corporation. The more  
24 generally applicable standard of care, that of a prudent investor, also was violated by Defendants.  
25 This is all the more so given the heightened duties that exist when making investments in start-  
26 ups, or venture capital-type investments, even if those investments were otherwise appropriate.

27 1. Statutory Anti-speculation Investment Standard

28 Corporations Code § 5240 requires that all investments by a nonprofit corporation be

1 non-speculative and conservative. Under subdivision (a), the statute expressly applies to “all  
2 assets held by the corporation for investment.” Subdivision (b)(1) of § 5240 provides that, in  
3 investing the board shall, “*Avoid speculation, looking instead to the permanent disposition of*  
4 *the funds, considering the probable income, as well as the probable safety of the corporation’s*  
5 *capital.*” [Emphasis supplied]. This statute sets forth a standard of care which should apply to  
6 satisfy that element of Plaintiff’s common law causes of action such as negligence and breach of  
7 fiduciary duty. *See, Crusader Ins. Co. v. Scottsdale Ins. Co.* (1997) 54 Cal.App.4th 121, 123-  
8 125, 62 Cal.Rptr.2d 620, 623.

9           2.       *Prudent Investor Standard*

10           The Foundation’s directors also were required to comply with the “prudent investor”  
11 standard set forth in Probate Code Probate Code § 18506.<sup>5</sup> This standard of care is consistent  
12 with a trustee’s standard of care. Law Revision Commission Comment to the 1990 Edition,  
13 which added § 18506 to the Probate Code (“The standard of care in subdivision (a) is consistent  
14

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15           <sup>5</sup>       **§ 18506. Standard of Care**

16           (a) When investing, reinvesting, purchasing, acquiring,  
17 exchanging, selling and managing property, appropriating  
18 appreciation, and delegating investment management for the  
19 benefit of an institution, *the members of the governing board*  
20 *shall act with the care, skill, prudence, and diligence under the*  
21 *circumstances then prevailing that a prudent person acting in a*  
22 *like capacity and familiar with these matters would use in the*  
23 *conduct of an enterprise of like character and with like aims to*  
24 *accomplish the purposes of the institution.* In the course of  
25 administering the fund pursuant to this standard, individual  
26 investments shall be considered as part of an overall investment  
27 strategy.

28           (b) In exercising judgment under this section, the members of the  
governing board shall consider the long- and short-term needs of  
the institution in carrying out its educational, religious, charitable,  
or other eleemosynary purposes, its present and anticipated  
financial requirements, expected total return on its investment with  
respect to institutional funds, the appropriateness of a reasonable  
proportion of higher risk investment with respect to institutional  
funds as a whole, income, growth, and long-term net appreciation,  
as well as the probable safety of funds. (Emphasis supplied.)

1 with the general standard of care provided by Section 16040”) [now set forth in Probate Code §§  
2 16040 and 16047]. These standards require the exercise of reasonable care, skill, and caution.

3 This standard of conduct is consistent with California law that the assets of a charitable  
4 corporation are impressed with a trust and members of the board of directors are essentially  
5 trustees. *E.g., Lynch v. John M. Redfield Foundation* (1970) 9 Cal.App.3d 293, 88 Cal.Rptr. 86;  
6 *American Center for Education, Inc. v. Cavnar* (1978) 80 Cal.App.3d 476, 486, 145 Cal.Rptr.  
7 736, 742; *People v. State of California v. Larkin* (N.D. Cal. 1976) 413 F.Supp. 978.

8 This standard of care is substantively the same Prudent Investor Rule set forth in § 227 of  
9 the Restatement (Third) of Trusts. Among other things, they require: the exercise of reasonable  
10 care, skill and caution; conformance with fundamental fiduciary duties of loyalty and  
11 impartiality; prudence in deciding whether and how to delegate authority and in the selection and  
12 supervision of agents; and incurring only costs that are reasonable in amount and appropriate to  
13 the investment responsibilities. “Care” and “skill” require that reasonable consideration be given  
14 to the formulation and implementation of an appropriate investment strategy. Comment d to §  
15 227. “Caution” requires that investments be made with a view both to safety of the capital and  
16 to securing a reasonable return, and also calls for the prudent management of risk. Comment e to  
17 § 227. Sound diversification is fundamental to managing risk. *Id.*

18 3. *Heightened Responsibilities for Start-up, Venture Capital Investments*

19 Failure to diversify sufficiently when investing in emerging growth corporations is a  
20 breach of the fiduciary’s duty to exercise caution in selecting investments. Illustration 12 to §  
21 227 of the Restatement.

22 A fiduciary has a duty to use care, skill, and caution in deciding to proceed with a  
23 program of venture capital investing, because the duty of prudence extends to the implementation  
24 of that course of action. Comment p to § 227. Diversification is an important consideration in  
25 such programs. If, rather than relying on pooling arrangements, the trustee decides to undertake  
26 the venture capital program directly through purchasing and holding the shares of a suitable mix  
27 of promising companies as trust assets, then it is essential that the quality of that process measure  
28 up. This means that due care, skill and caution must be exercised not only in the selection and

1 supervision or monitoring of the manager, but also in designing the extent, operating conditions,  
2 and other terms of the delegation. In each aspect and stage of these procedures, the fiduciary has  
3 the duty, measured by the standard of a prudent investor, reasonably to ascertain that the  
4 necessary competence is brought to bear on the decisions and activities involved. A fiduciary  
5 who departs from more conservative strategies to pursue a venture capital program must cope  
6 with the special risks and burdens encountered in relatively inefficient markets. Otherwise, it is  
7 imprudent to proceed, even if the resources and other circumstances of the portfolio would  
8 otherwise justify venture capital investments.

9 K. Prejudgment Interest

10 California Civil Code § 3287(a) provides that, “Every person who is entitled to recover  
11 damages certain or capable of being made certain by calculation, and the right to recover which is  
12 vested in him upon a particular day, is entitled also to recover interest thereon from that day, ...”.  
13 The reasonable value of money wrongfully taken or detained is the legal rate of interest thereon.  
14 *Gray v. American Surety Co. of New York* (1955) 129 Cal.App.2d 471, 277 P.2d 436. The legal  
15 rate of interest is seven (7%) percent per annum. California Constitution, Article 15, Section 1.  
16 Seven (7%) percent is the rate of prejudgment interest applied in California. *North River Ins. Co.*  
17 *v. American Home Ins. Co.* (1989) 210 Cal.App.3d 108, 133-134, 257 Cal.Rptr. 129, 116-117;  
18 *McConnell v. Pac. Mut. Life Ins. Co. of Calif.* (1962) 205 Cal.App.2d 469, 482, 24 Cal.Rptr. 5,  
19 13. Even though a demand is not for a specific sum, interest may be recovered under Civil Code  
20 § 3287 where the amount of damages is capable of being calculated. *Worthington Corp. v. El*  
21 *Chicoto Ranch Properties, Ltd.* (1967) 255 Cal.App.2d 316, 323, 63 Cal.Rptr. 203, 208. The  
22 fact that defendants’ conduct has rendered an accounting necessary also does not render a claim  
23 unliquidated. *Pizer v. Brown* (1955) 133 Cal.App.2d 367, 373-374, 283 P.2d 1055, 1059-1060.  
24 No evidence is necessary to establish a plaintiff’s right to the legal rate of interest as damages for  
25 the wrongful detention of his money. *Sears, Roebuck and Co. v. Blade* (1956) 139 Cal.App.2d  
26 580, 294 P.2d 140, 149.

27 L. Inference from Invocation of Fifth Amendment

28 Thayer was deposed in this matter after he had already been convicted of wire fraud.

1 Rather than answer any substantive questions, Thayer asserted his Fifth Amendment rights. The  
2 Foundation intends to introduce passages from Thayer's deposition into evidence.

3 The trier of fact may draw inferences adverse to a defendant from the defendant's  
4 invocation of the Fifth Amendment privilege against self-incrimination in a civil proceeding.  
5 *Avant! Corp. v. Superior Court* (2000) 79 Cal.App.4th 876, 885-886, 94 Cal.Rptr.2d 505;  
6 *Keating v. Office of Thrift Supervision* (9<sup>th</sup> Cir. 1995) 45 F.3d 322, 326; *Baxter v. Paligiano*  
7 (1976) 425 U.S. 308, 318, 96 S.Ct. 1551, 1558.

8 DATED: February 22, 2007

ROGERS, SHEFFIELD & CAMPBELL, LLP

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10 By:

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Scott B. Campbell, Attorneys for Plaintiff  
THE SCHLINGER FOUNDATION

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