1 2 3 4 5 6 7 8 9	THE RESTIS LAW FIRM, P.C. William R. Restis, Esq. (SBN 246823) 550 West C Street, Suite 1760 San Diego, California 92101 +1.619.270.8383 +1.619.752.1552 william@restislaw.com Attorneys for Plaintiff [Additional Counsel Listed On Signature Page]	ELECTRONICALLY FILED Superior Court of California, County of San Diego 12/27/2017 at 03:47:00 PM Clerk of the Superior Court By E- Filing, Deputy Clerk	
10	SUPERIOR COURT FOR THE STATE OF CALIFORNIA		
11	COUNTY OF SAN DIEGO		
12	KARL BECK , individually and on behalf of all other similarly situated California residents,	Case No: 37-2017-00037524-CU-BT-CTL	
13	Plaintiff,	<u>CLASS ACTION</u>	
14	V.		
15	POINT LOMA PATIENTS	PLAINTIFF'S REPLY IN SUPPORT OF MOTION PURSUANT TO CALIFORNIA	
16	CONSUMER COOPERATIVE CORPORATION, A California	CORPORATIONS CODE §§ 12603-12607	
17	Corporation, ADAM KNOPF , an Individual, JUSTUS H. HENKES IV , an	FOR: (1) PRODUCTION OF RECORDS;	
18	Individual, 419 CONSULTING INC., a California Corporation, GOLDEN	(2) APPOINTMENT OF INDEPENDENT	
19	STATE GREENS LLC, a California LLC, FAR WEST MANAGEMENT,	ACCOUNTANT; and	
20	LLC, a California LLC, FAR WEST OPERATING, LLC, a California LLC, FAR WEST STAFFING, LLC, a	(3) AWARD OF ATTORNEY FEES AND COSTS	
21	FAR WEST STAFFING, LLC, a California LLC, and DOES 1-50,	Date: January 5, 2018	
22		Time: 9:00 a.m. Judge: Hon. Joel R. Wohlfeil	
23	Defendants.	Ctrm: C-73	
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I. <u>INTRODUCTION</u>

Plaintiff's Motion to enforce his inspection request and appoint an independent accountant is guided by the old adage: *sunlight is the best disinfectant*. As Defendants surely know, the sale of marijuana is ordinarily a crime. But under narrow, tightly regulated circumstances, California law does not consider the sale of medicinal marijuana to be a criminal offense. And central to that regulation is that no profit be generated from cannabis transaction(s).

Yet Plaintiff Karl Beck ("Plaintiff") alleges that San Diego's largest marijuana dispensary, defendant Point Loma Patients Consumer Cooperative Corporation (the "PLPCC") is receiving millions of dollars in monthly revenues servicing approximately 1,000 retail patrons per day. Compl., ¶¶ 1, 37. Plaintiff alleges the PLPCC's sale of marijuana generates millions of dollars in revenue *beyond* the *actual expenses* of a single retail storefront. Compl., ¶¶ 1, 37-40, 86-87.

As a California medical marijuana cooperative, PLPCC revenues are required to be spent exclusively for the benefit of its member patrons, *i.e.*, Plaintiff and the Class. More precisely, the dispensary's profits are to be returned to Plaintiff and the Class as "patronage distributions." CAL. CORP. CODE §§ 12201, 12243-44. As discussed below, there is a clear mechanism for the PLPCC to operate non-profit: refund excess revenues to Plaintiff and the Class in the form of patronage distributions. The Corporations Code provides a long-established procedure and formula to zero out profits by returning them to the members of the cooperative *pro rata*.

Yet the Individual Defendants refuse to do that. In order to appear compliant with clear California law, the Individual Defendants needed to find something to do with all that money. Compl., ¶¶ 39-40, 86-87. Around the time the PLPCC opened its doors in early 2015, the Individual Defendants began forming the "Shell Companies": defendants 419 Consulting Inc., Golden State Greens LLC, Far West Management, LLC, Far West Operating, LLC, and Far West Staffing, LLC. Compl., ¶¶ 25-27; Declaration of [Defendant] Adam Knopf ISO Defendants' Joint Opposition to Plaintiff's Motion Pursuant to California Corporations Code §§ 12603-12607

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("Knopf Decl.") ¶¶ 32-38, 43-44. The Individual Defendants are the sole directors, executive officers, and shareholders of each of the Shell Companies. Compl., ¶¶ 23-24, 35; Knopf Decl., ¶¶ 32-38, 43-44.

To hide revenues, and maintain the appearance of a non-profit dispensary, the Individual Defendants caused the PLPCC to pay the various Shell Companies for services such as "Staffing," "Management," "Operating," "Consulting" and "Marketing." Compl., ¶¶ 39-40, 43, 47, 49, 86-87; Knopf Decl., ¶¶ 32-38, 43-44. The Shell Companies serve no independent business function apart from PLPCC's medical marijuana business. Compl., ¶¶ 28, 36; Knopf Decl., ¶¶ 35-38, 44. They have no facilities or offices except the PLPCC's storefront dispensary building and Defendant Henkes' accounting office in La Jolla. Compl., ¶¶ 28, 36; Knopf Decl., Exs. 10-14. The Shell Companies don't offer products or services to the public, and their only customer is the PLPCC. Compl., ¶¶ 28, 36; cf. Knopf Decl., ¶¶ 40, 46 (declaring that certain of the Shell Companies are "free to provide their services" to anyone, but failing to declare that they actually "provide their services" to anyone besides the PLPCC). In addition, Mr. Henkes doesn't hold himself out for business as an accountant; his only "clients" are the PLPCC and the Shell Companies. Id., ¶ 4.

Through the Shell Companies, the Individual Defendants have paid themselves handsomely (in *cash*) through an apparent criminal enterprise that puts every Class member unknowingly in the middle of for-profit marijuana sales.

This is the backdrop of Plaintiff's Motion to have a licensed, independent professional review Defendants' records. Under Corporations Code § 12201, the only thing Plaintiff must demonstrate for the Court to grant relief is that he made a lawful demand, and that Defendants' refusal was "without justification." As admitted by Defendants' counsel in an email to the undersigned, Plaintiff is a member patron of the PLPCC. Declaration of William R. Restis in support of Motion pursuant to California Corporations Code §§ 12603-12607 ("Restis Decl.") ¶ 15, Ex. 13 ("I can confirm that at one point Mr. Beck was a member.") And since Plaintiff

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submitted a lawful demand under the Corporations Code (Id., ¶¶ 11, 13; Exs. 9, 11), that should end the inquiry and Plaintiff's Motion should not have been necessary.

Although the Corporations Code is clear that the rights of cooperative members to inspect corporate records "may not be limited by contract or the articles or bylaws," Defendants continue to insist the PLPCC's bylaws provide "justification" to refuse Plaintiff's lawful demand. Cf. CAL. CORP. CODE § 12583 with Opp. at § V.

Similarly, Defendants spend over ten (unsupported) pages boot-strapping ad hominem attacks and procedural barriers that simply do not exist. See Opp. at § III.A&B (arguing that Plaintiff should have filed a writ of mandamus, and must submit "summary judgment" evidence of facts that Defendants concede). But these are all makeweight arguments designed to paper over the fact that Defendants' refusal of Plaintiff's inspection request was manifestly without justification. The Court should summarily reject Defendants' arguments and grant Plaintiff's Motion in its entirety.

II. THE PLPCC BYLAWS ARE VOID AS IN VIOLATION OF LAW

The Corporations Code and California's medical marijuana laws do not permit the Individual Defendants to create "associate memberships" that have no voting rights, no proprietary rights in any cooperative assets, and no rights to patronage distributions.

A. THE BYLAWS VIOLATE THE CORPORATIONS CODE

"It has long been understood that the distinguishing characteristic of a cooperative enterprise is the obligation of the enterprise to distribute what may be called its 'excess receipts' (or 'net margins') on a patronage basis." Affiliated Foods, Inc. v. Commissioner, 128 T.C. 62, 86

As noted in the Complaint and Motion, Plaintiff contests the authenticity of the bylaws as being drafted in response to Plaintiff's records request. Even though on notice of this, Defendant Knopf's declaration authenticating the bylaws does not state they were in effect when Plaintiff became a PLPCC member patron or otherwise refute Plaintiff's allegation that they were drafted specifically in anticipation of this lawsuit. See Knopf Decl., ¶¶ 11-12. For this reason, Plaintiff's discussion of the bylaws does not concede they apply to him.

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(2007) citing ISRAEL PACKEL, LAW OF COOPERATIVES, at 248-249 (3d ed. 1956) (emphasis added) ("PACKEL"). Because a cooperative:

is run for the benefit of those who do business with it and not for the purpose of making a profit for the organizers, the idea is that, periodically, any surplus, or amount in excess of the break-even point from doing business with patrons, will be returned to the patrons on the basis of their dealings with the cooperative.

Id. Patronage distributions actually constitute "a downward adjustment in the price of the product the cooperative sells or the service it furnishes to its patrons." Anaheim Union Water Co. v. Franchise Tax Bd., 26 Cal. App. 3d 95, 101 (1972) (citing cases and treatises); United States v. Miss. Chem. Co., 326 F.2d 569, 573 (5th Cir. 1964) ("[P]atronage dividends are in reality rebates on purchases or deferred payments on sales.") (citing cases).

But the "associate memberships" the Individual Defendants claim to have created for the PLPCC cause the dispensary to lose its "distinguishing characteristic" as a cooperative. Affiliated *Foods*, 128 T.C. at 86. This is because a cooperative must be "democratically controlled" and "not organized to make a profit for themselves, as such, or for their members, as such, but primarily for their members as patrons." CAL. CORP. CODE § 12201 (emphasis added). To accomplish this statutory objective. "It like earnings and savings of the business must be used for the general welfare of its members or equitably distributed to members in the form of cash, property, credits, or services." Id.

But how can the PLPCC be "democratically controlled" if the Individual Defendants are the only "members" with voting rights? See Opp. at p. 7:13-20 (describing the bylaws). How can the "earnings and savings" of the PLPCC be "equitably distributed to members" and thereby ensure the PLPCC does not "make a profit" if the PLPCC's only "members" are the Individual Defendants? Id. And how can the Individual Defendants be the only "members" entitled to "patronage distributions" if they are not actually "patrons" of the PLPCC? Id.; cf. CAL. CORP. CODE § 12243(a)(1) ("'[P]atrons' are those who purchase those types of goods from, or use those types of services of, the corporation.") (emphasis added); *Id.*, § 12243(a)(2) ("Patronage' of a patron is

services furnished by, the corporation.")

measured by the volume or value, or both, of a patron's purchases of products from, and use of

To ask these questions is to answer them. The associate memberships the Individual Defendants claim they implemented for the PLPCC violate the requirements of the Corporations Code and are therefore void. CAL. CORP. CODE § 12331(c) (cooperative corporation bylaws may only contain provisions that are not "in conflict with law").

Even if the Individual Defendants can create "associate memberships" with no right to patronage distributions, the Corporations Code is clear that **the rights of cooperative members to inspect corporate records "may not be limited by contract or the articles or bylaws."** *Id.*, § 12583. To this, Defendants' opposition is glaringly silent. *See San Diego Puppy, Inc. v. City of San Diego*, 2014 U.S. Dist. LEXIS 128237, at *10 (S.D. Cal. Sept. 11, 2014) ("Plaintiff fails to respond to this argument and therefore concedes it through silence.")

B. THE BYLAWS VIOLATE MEDICAL MARIJUANA LAWS

The associate memberships created by the Individual Defendants are void for another reason as well. Corporations Code § 12201 provides that a cooperative corporation may operate only "[s]ubject to any other provision of law of this state applying to the particular ... line of activity...." Defendants concede that the PLPCC is not merely a cooperative corporation, it is a cooperative corporation whose sole purpose is *to sell medical marijuana*. Opp. at p. 2:9-17.

Accordingly, Defendants must comply with medical marijuana laws, including the *explicit* prohibition regarding the sale of marijuana for-profit. *See* HEALTH AND SAFETY CODE § 11362.765(a); CAL. ATTY GEN & DEPT. OF JUSTICE *Guidelines for the Security and Non-Diversion of Marijuana Grown for Medical Use* (the "*Guidelines*") § IV.A.1&B.1 (emphasizing the non-profit requirement for medical marijuana cooperatives and that they must "<u>follow strict rules on ...</u> distribution of earnings").²

² The *Guidelines* are available at https://oag.ca.gov/news/press-releases/atty-general-brown-issues-medical-marijuana-guidelines-law-enforcement-and. The *Guidelines* are cited as authoritative by nearly every California appellate court interpreting California's medical marijuana laws. *E.g.*,

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Defendants don't seem to realize that their whole theory of defense is that the Individual Defendants are entitled to, and in fact do, treat the PLPCC as their own for-profit corporation. Their defense admits the very for-profit medical marijuana business Plaintiff alleges. This is because the PLPCC cannot be non-profit if all the profits are retained by the two Individual Defendants, as the sole *de facto* shareholders of a medical marijuana business. *See* Knopf Decl., ¶ 12(d) (admitting that the Individual Defendants are the only shareholders of the PLPCC, the only owners of PLPCC assets, and the only parties entitled to "surplus allocations and distributions"); *cf.* PACKEL, § 56 at p. 259 ("[A]s representatives of the cooperative *in a fiduciary capacity*, [directors and officers] should not enter into transactions with the cooperative in bad faith or without full disclosure, for the purpose of making personal profits.") (emphasis added). Thus, the bylaws are "in conflict with law" and void. CAL. CORP. CODE § 12331(c).

Patronage distributions serve the critical purpose of ensuring the *bona fides* of Defendants' medical marijuana cooperative. They ensure that profits are not retained by the owners of the enterprise, and that all members transacting with the cooperative are purchasing marijuana *legally*. *Cf.* CAL. CORP. CODE § 12603 (Cooperative members are entitled to inspection "for a purpose reasonably related to such person's interests as a member.") (emphasis added).

III. "SUMMARY JUDGMENT" EVIDENCE IS UNNECESSARY

Defendants spend approximately half their brief complaining that Plaintiff has not submitted "summary judgment" type evidence to substantiate his right to inspection. Opp. at § III.B. But the only thing Plaintiff must establish is that Defendants "refus[ed] a lawful demand for inspection under this chapter [of the Corporations Code.]" CAL. CORP. CODE § 12606(a).

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People v. Jackson, 10 Cal. App. 4th 525, 536 (2012); People v. Anderson, 232 Cal. App. 4th 1259, 1277-78 (2015); People v. Solis, 217 Cal. App. 4th 51, 57 (2013).

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Plaintiff submitted both his lawful demand and Defendant's refusal to the Court. Restis Decl., ¶¶ 11-15, Exs. 9, 11-13.³

Even so, Defendants argue that "Plaintiff has submitted no evidentiary support" that he is a member patron of the PLPCC. Opp. at p. 7:5-12 (arguing that Plaintiff should have submitted an "identification card" and "evidence that he purchased or acquired medical marijuana from PLPCC"). Defendants intentionally ignore the verified *email from their counsel of record to Plaintiff's counsel acknowledging that Plaintiff is a member*. Restis Decl., ¶ 15, Ex. 13 (Austin to Restis: "I can confirm that at one point Mr. Beck was a member. I can not confirm whether he is still a member because I have not reviewed all board actions subsequent to his initial membership.") Could there be a more makeweight argument?

Defendants stretch even further, complaining that Plaintiff's Motion relies on the allegations of the Complaint, which they characterize as "speculative" and "conclusory." Opp. at p. 9:11-19. But even if Defendants are correct, Mr. Knopf's declaration provides all the evidence necessary to support Plaintiff's right to inspection.

Defendants submit the declaration of Individual Defendant Adam Knopf purportedly to provide an innocent explanation for Defendants' business practices. But Defendant Knopf *admits* that the Individual Defendants: (1) own and control the PLPCC and each of the Shell Companies (Knopf Decl., \P 2, 8, 15, 22, 32-33), (2) each of these Shell Companies (except – purportedly – 419 Consulting Inc.) is intimately involved in PLPCC's medical marijuana business (*id.*, \P 17, 31, 35-38), (3) the Individual Defendants cause the PLPCC to pay the Shell Companies (*i.e.*, *themselves*) out of the PLPCC (*id.*, \P 37), and (4) that there is no money left in the PLPCC to pay patronage distributions. *Id.*, \P 26. These facts only reinforce the allegations of the Complaint!

³ In effect, Defendants argue that Plaintiff should be required to go through discovery and evidentiary motion practice to establish that PLPCC members are *entitled to discovery*. Defendants' argument frustrates the clear objective of the Corporations Code, which is to deputize each cooperative member with a simple, cost effective procedure to uncover wrongdoing impacting their interests.

What is notable about defendant Knopf's declaration is that he never plainly states under penalty of perjury that the Individual Defendants are not profiting off the sale of medical marijuana. *Cf. Solis*, 217 Cal. App. 4th at 59 (holding that the owner of a dispensary who retained \$80,000 in income from medical marijuana sales was not entitled to a medical marijuana defense because he was working for profit). Mr. Knopf does not dispute that the PLPCC services approximately 1,000 patrons daily and generates millions of dollars in monthly revenue – despite claiming intimate knowledge of the "day to day operations" of the PLPCC. Knopf Decl., ¶ 29. In fact, Defendant Knopf says nothing about the PLPCC's revenue, only that there are "significant operating costs." *Id.*, ¶¶ 24-25.

And Defendant Knopf merely declares that the PLPCC has not paid patronage distributions because it "has not been in a position to do so since opening." Knopf Decl., ¶ 26. "Not in a position" is the loosest sworn statement imaginable, raising more questions than it answers. Far from providing an innocent explanation, Defendant Knopf's declaration confirms that Plaintiff's Complaint is on the mark and sufficiently establishes "good cause."

IV. THE RECORDS FROM ALL DEFENDANTS SHOULD BE INSPECTED AND THE PLPCC SHOULD PAY

Defendants argue that Plaintiff (or the independent accountant) is only entitled to look at the books of the PLPCC, not the Shell Companies or the Individual Defendants. Defendants argue that "Plaintiff attempts to sidestep the direct membership requirement by suggesting that the non-PLPCC entity defendants may be 'subsidiaries' of PLPCC and thus fall within the 'subsidiary' provision of section 12603-12607." Opp. at p. 5:10-13 (relying on Knopf declaration that the PLPCC holds no ownership interests in the Shell Companies or vice versa).

But Plaintiff never alleges that the Individual Defendants are subsidiaries. Instead, he alleges that the Individual Defendants set up the Shell Companies to create the appearance of independent, arms-length enterprises that were merely being compensated for services rendered.

⁴ Even though Defendant Henkes is the PLPCC and Shell Companies' *accountant*, he failed to submit a declaration at all. *See* Knopf Decl., ¶¶ 8, 15, 22.

Compl., ¶ 39. Defendants did not attempt to respond to Plaintiff's *actual* argument, that an independent accountant can be appointed to "<u>investigate the property, funds and *affairs*" of the PLPCC. CAL. CORP. CODE 12606(a) (emphasis added). The same section states that "[a]ll officers and agents of the corporation shall produce to the inspectors or accountants so appointed all books and documents in their custody or power." *Id.*, § 12606(b).</u>

Defendants have no response to this because the "affairs" of the PLPCC certainly include <u>admitted</u> payments to the Shell Companies for key aspects of the PLPCC's medical marijuana business. *See* Knopf Decl., ¶¶ 17, 35-38, 43 (admitting that the PLPCC pays every Shell Company except 419 Consulting Inc. for *at least* "staffing," "management services," and brand licensing).⁵

And as stated in Plaintiff's Motion, the costs of the independent audit should be paid by the PLPCC because it is a use of cooperative funds "for the general welfare of its members." CAL. CORP. CODE § 12201.

V. <u>A WRIT OF MANDAMUS IS PROCEDURALLY IMPROPER</u>

Defendants' *number one* argument is that Plaintiff should have brought this petition as a writ of mandamus. Opp. at III.A. But Defendants concede that Corporations Code § 12606 is silent as to how this Court should "enforce" Plaintiff's pre-litigation inspection request. Opp. at p. 3:24-28. Instead, Defendants argue that mandamus "can be inferred" from "reading the [Corporations Code] as a whole." *Id.* But their only case is from 1909, and holds that mandamus will only issue when "there is not a plain, speedy, and adequate remedy, in the ordinary course of law." *Miller v. Imperial Water Co. No. 8*, 156 Cal. 27, 29 (1909).

This acknowledges that mandamus is an "extraordinary legal remedy ... supplementing deficiencies of common law, and will ordinarily be issued where legal duty is established and *no other means exists for enforcing it.*" *Dowell v. Sup. Ct.*, 47 Cal. 2d 483, 486-87 (1956) (emphasis

⁵ Defendants fail to explain why the PLPCC needs to outsource its staffing and management when the PLPCC can merely hire its own employees, and the Individual Defendants manage the PLPCC regardless. Given the additional transaction costs associated with four seemingly superfluous entities, the only explanation is that *the Shell Companies can accomplish objectives that the PLPCC cannot*, namely hiding profits from regulators and PLPCC members.

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added). Here, there is an adequate legal remedy as provided by the Corporations Code, which was raised in Plaintiff's Complaint and this Motion. *See also* CAL. CIV. PROC. CODE § 307 ("There is in this State *but one form of civil actions* for the enforcement or protection of private rights and the redress or prevention of private wrongs.") (emphasis added); *id.*, § 422.10 ("The pleadings allowed in civil actions are complaints, demurrers, answers, and cross-complaints.").

Bottom line: if the Court thinks this cause should be brought *via* mandamus, Plaintiff can proceed as the Court instructs. But Defendants are already claiming that Plaintiff's attorney's fees are "astronomical" and "grossly inflated." Opp. at p. 11:22-23, 26. Their proposed "solution" would mean *significantly* more work for the Court and the parties, revealing that Defendants' true motive is to keep their finances a mystery. The Court should now rule on the merits.

VI. <u>PLAINTIFF'S ATTORNEYS' FEES ARE REASONABLE</u>

Plaintiff's requested attorneys' fees are reasonable for the reasons stated in Plaintiff's Motion (which do not include the 20+ hours necessary to reply and prepare for oral argument). Because this Court is more than equipped to assess the quality of work product before it, Plaintiff will not further burden it with additional briefing on this issue.

VII. CONCLUSION

Defendants' opposition reveals two Individual Defendants who are *desperately* trying to prevent inquiry into the details of their medical marijuana business by an independent expert. The question is why. After all, the PLPCC is a *cooperative* selling a highly regulated, controlled substance that is normally illegal. If there is nothing to hide, Defendants would have volunteered their records when Plaintiff originally asked for them. And in response to Plaintiff's Motion, innocent defendants would have *at least* provided *some* evidence that they are not illegally profiting off the sale of medical marijuana. But instead, Defendants proffer ridiculous and patently false excuses, imagined procedural and evidentiary obstacles, and a declaration that admits key allegations of the Complaint.

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The Court should grant Plaintiff's Motion in its entirety.

1	I	Respectfully submitted,
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