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## CONFLICT OF INTEREST – SELF DEALING

California Law

By Jennifer A. Becker

### **California Housing Finance Agency v. Hanover/California Management and Accounting Center, Inc.** (2007) 148 Cal. App. 4th 682

*The Fourth District upholds a substantial jury verdict against an attorney for a public entity based on legal malpractice, breach of fiduciary duty, and violations of a statute prohibiting self-dealing by public employees. The Court also rejected a statute of limitations defense.*

Schienze was California Housing Finance Agency's director of insurance and McWhirk served as CHFA's general counsel and later outside counsel.

Schienze set up mortgage insurance programs that allowed lenders and loan servicers to pay premiums monthly. Schienze and McWhirk then created Hanover/California Management and Accounting Center, Inc. to provide CHFA insurance premium processing services. McWhirk incorporated HC, acted as its legal counsel, and served as president and chief executive officer during the time he also served as CHFA's outside counsel. McWhirk operated HC from his residence, arranged for his domestic partner to manage its operations, and hid his involvement in HC by having a third party pose as a sole owner.

Without disclosing their interest in HC, Schienze and McWhirk influenced CHFA to enter into a contract with HC whereby HC would collect monthly premiums from lenders and loan

servicers and forward the premiums to CHFA, after deducting HC's "operating costs." Schienze drafted the one-sided HC contract, which eventually allowed HC to retain the entire premium. In one two-year period, HC skimmed approximately six million dollars. Schienze and McWhirk operated the scheme for years, and it was only discovered after Schienze retired and his replacement discovered the HC contract in a stack of papers Schienze had left behind.

After conducting an investigation, CHFA filed suit against Schienze, McWhirk, and HC for, among other things, legal malpractice, breach of fiduciary duty, and violation of Government Code § 1090. A jury found McWhirk liable for over six million dollars in damages and the court ordered restitution and other relief.

### ***McWhirk's Attorney-Client Relationship with CHFA***

On appeal McWhirk contended that he was outside counsel to a different agency, and not to CHFA itself. The court found that the written contract between McWhirk and “the California Housing Finance Agency, a political subdivision of the State of California, doing business as the California Housing Loan Insurance Fund” established that McWhirk’s relationship was with CHFA because the use of a fictitious business name does not create a separate legal entity.

### ***McWhirk's Duties to CHFA***

The court also found that McWhirk's argument that his status as an independent contractor negated any role as a fiduciary patently frivolous. Whether an attorney serves as an employee, as general counsel, or as an independent contractor, the attorney owes the client fiduciary duties as a matter of law.

### ***Statute of Limitations***

McWhirk contended that the jury should have considered the statute of limitations as it applied to each cause of action. The Court of Appeal held that the trial court properly instructed the jury that when a defendant is guilty of having fraudulently concealed the facts on which a cause of action depends, the statute of limitations is tolled until after the plaintiff discovers or ought to have discovered these facts.

McWhirk also argued that the jury should have been instructed that CHFA had a duty to investigate when it received facts that would arouse

suspicion in a reasonably prudent person, and that it should be charged with the knowledge a reasonably diligent investigation would uncover. The Court of Appeal held that this principle does not apply in the context of a continuing fiduciary relationship because the degree of diligence required in discovering wrongdoing by the fiduciary is diminished. The plaintiff is entitled to a presumption of reliance on the fiduciary and the tolling effect of nondisclosure or concealment will continue absent unusual circumstances that should put the plaintiff on notice. This judicially created doctrine is to disarm a defendant who, by deception, has caused a claim to become stale and a plaintiff dilatory.

The Court of Appeal also found proper the instruction on the “last overt act” doctrine as it applied to the civil conspiracy claims against McWhirk and Schienle. The statute of limitations does not begin to run on a civil conspiracy claim until one of the participants completes the last overt act in furtherance of the conspiracy. McWhirk and Schienle relied on case law that held that acts after the completion of a scheme to hide it are not in furtherance of a conspiracy. The court disagreed with McWhirk’s and Schienle’s contention that the last overt act was the creation of the contract. While the contract facilitated the scheme the primary aim was to skim mortgage insurance premiums due CHFA and the last act was not completed until defendants received the last insurance premium.

### ***Government Code § 1090***

Government Code § 1090 precludes individuals connected to a governmental body from contracting with that body.

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McWhirk contended that § 1090 did not apply to him because he was an independent contractor and not in one of the positions set forth in the statute. The Court of Appeal held that for purposes of § 1090 there was no need to make a distinction between an employee and independent contractor, because the statute does not seek to hold a public entity vicariously liable for harm to third parties. Rather, it pertains to self-dealing by a public servant. To achieve the aim of the statute, it should be interpreted broadly and the court should disregard the technical relationship. Precedent establishes that § 1090 may apply to an outside attorney in a position of influence over the public agency. The Court concluded that an attorney whose official capacity carries the potential to exert “considerable” influence over the contracting decisions of a public agency is subject to § 1090, regardless of whether he or she would be considered an independent contractor under common-law tort principles.

*Comment:* McWhirk used his position to loot a public agency of its entitlement to funds. It is not surprising that the court would not give him the benefit of the technical defenses he raised.