IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

JOHNNY W. FERNEAU, *Plaintiff/Appellant*,

v.

KRISTINE WILDER, et al., *Defendants/Appellees*.

No. 1 CA-CV 22-0328
FILED 8-08-2023

Appeal from the Superior Court in Maricopa County
No. CV2017-000131
The Honorable Daniel G. Martin, Judge

AFFIRMED

COUNSEL

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OPINION

Vice Chief Judge Randall M. Howe delivered the opinion of the court, in which Presiding Judge Samuel A. Thumma and Judge Anni Hill Foster joined.

H O W E, Judge:

¶1 Johnny Ferneau appeals the trial court's orders removing him as a director of Total Accountability Systems I, Inc. ("TAS") and sanctioning him by dismissing his complaint against Kristine Wilder, TAS, BCWC Management & Consulting, LLC ("BCWC"), and Kristine Wilder Life Holdings, LLC ("KWLH") (collectively "Defendants"). Ferneau argues that the trial court erred because he did not engage in "fraudulent conduct" under A.R.S. § 10–3810(A), which he contends includes only actual fraud and not constructive fraud. He also argues that the dismissal of his complaint as a discovery sanction was not appropriate.

¶2 We reject Ferneau's first argument because "fraudulent conduct" under A.R.S. § 10–3810(A) includes both actual and constructive fraud, and Ferneau's or his agents' deletion of TAS business emails, at a minimum, constituted constructive fraud. We also reject Ferneau's second argument because his improper litigation conduct of deleting hundreds of business emails warranted the dismissal of his complaint. Because we reject these arguments and the other arguments discussed below, we affirm the trial court's orders.

FACTS AND PROCEDURAL HISTORY

¶3 This appeal arises out of a contentious dispute between co-directors of TAS, a marijuana dispensary, resulting in the trial court sanctioning Ferneau several times for improper litigation conduct, ultimately leading to the dismissal of his claims as a sanction for deleting relevant TAS emails spanning several years. The court also applied A.R.S. § 10–3810(A) to remove Ferneau as a TAS director, finding that he defrauded the company. The litigation has been hard-fought over many years.

¶4 Wilder and Ferneau served as directors of TAS, an Arizona non-profit corporation that holds a certificate to operate a medical

marijuana dispensary. BCWC, which Ferneau formed, managed TAS's dispensary. KWLH managed TAS's cultivation facility. In January 2017, Ferneau sued Defendants, alleging that Wilder converted his interest in TAS and falsified documents. Ferneau sought an accounting, a receivership, an injunction against Wilder managing TAS, and a declaratory judgment declaring his and Wilder's respective rights in TAS. After substantial litigation for more than a year, Ferneau amended his complaint to add allegations of breach of the implied duty of good faith and fair dealing, constructive fraud, abuse of process, and a request for a constructive trust.

¶5 As particularly relevant here, Ferneau also alleged that Wilder had denied him access to TAS's books and records, including access to TAS's email account ("Account"). The Account was used for official communications, including communications with the Arizona Department of Health Services.

¶6 Wilder countered that she did not have access to the Account. Instead, she requested that Ferneau provide her the access information to the Account. Ferneau refused to provide the access information, declaring that "[y]ou will never get the password from us." Because Ferneau did not provide access information to the Account, Wilder created a new email account to conduct TAS's official business. Defendants also informed the trial court that they were concerned that Ferneau would destroy the emails in the Account. At an October 2017 pretrial conference, the trial court reminded the parties of their duty to preserve relevant evidence.

¶7 In April 2018, Ferneau moved to disqualify TAS's counsel, alleging that counsel had improperly communicated with and taken directions from Wilder. He also sought an order that Wilder could not invoke the attorney-client privilege against him, a co-director. The court denied Ferneau's motions, finding they were a "little more than ill-advised and unfounded litigation strategy designed to bring pressure to bear on TAS." The court also awarded attorneys' fees to TAS as a sanction. It cautioned Ferneau "against further conduct that does not serve to advance the orderly determination of this dispute, as such conduct may result in the imposition of significantly greater sanctions than those imposed here, up through and including dismissal of the [c]omplaint."

¶8 About five months later, TAS and KWLH moved for sanctions against Ferneau, seeking dismissal of the complaint and attorneys' fees. They argued that Ferneau had failed to disclose his relationship with non-parties who had been financing him to advance positions antithetical

to TAS's interests. In August 2019, the court found that Ferneau had "concealed a clear conflict of interest as to his (and his former attorney's) relationship with [non-parties]." It found that Ferneau had thus violated his fiduciary duties to TAS, violated the court's receivership order by willfully obstructing proceedings, and violated the court's first sanctions order, prohibiting "further conduct that does not serve to advance the orderly determination of this dispute." Although denying the request that Ferneau's complaint be dismissed as a sanction, the court sanctioned Ferneau by awarding TAS's reasonable attorneys' fees and costs "incurred in this matter, to the extent such fees and/or costs [had] not previously been awarded." *See* A.R.S. § 12–349(A)(3).

¶9 As the litigation progressed, access to the Account remained important because, among other reasons, TAS was involved in other litigation. This time, Ferneau responded to requests for access information to the Account by saying that he had forgotten the password and that his attempts to reset the password were going "into a black hole." Defendants attempted different ways to gain access to the Account but failed. Wilder then sought a court order compelling Ferneau to disclose the access information to the Account. In January 2021, after oral argument, the trial court ordered Ferneau to disclose the access information to the Account by 3 p.m. the next day.

¶10 Ferneau then disclosed the access information to the Account. When Defendants accessed the Account, which had been used to conduct official TAS business for about four years, it contained several dozen emails, but only four emails in the sent folder and no emails in the primary inbox that predated October 2020, several years after Ferneau had filed this case. Defendants asked about the rest of the emails, and Ferneau's counsel informed them that Ferneau or his son had "deleted emails from" the Account "and that is why there are not a lot of emails." Defendants then sought an order to show cause why Ferneau should not be held in contempt, removed as a director of TAS, and sanctioned with the dismissal of his complaint.

¶11 At the evidentiary hearing on the request, Ferneau did not dispute that the Account previously had "hundreds of emails in it" and that most of the emails were missing. He testified, however, that he had been deleting emails from a different account and not the Account at issue. Nor had he asked anyone else to delete emails from the Account. Ferneau had hired a computer forensic expert to recover the emails from the Account. The expert testified that he could recover only a few of the deleted emails from the Account.

¶12 Reviewing the record before the joint application, the trial court noted that Ferneau "ha[d] not only engaged in multiple instances of sanctionable conduct, he also ha[d] been explicitly warned as to the potential consequences of continuing to engage in such conduct." Reviewing the evidence provided at the hearing, the trial court found that Ferneau's testimony "lack[ed] credibility and [was] wholly unpersuasive." It found that Ferneau had access to the Account and that he had intentionally deleted the contents of the Account, either personally or in concert with third parties. Thus, Ferneau's spoliation of the emails in the Account constituted "fraudulent activity vis-à-vis TAS, the corporation toward which Mr. Ferneau owe[d] a fiduciary duty." The court also found that Ferneau's removal as a director of TAS was in TAS's best interests because Ferneau had engaged in "solely self-serving" conduct that was harmful to TAS. It therefore removed Ferneau as a director of TAS under A.R.S. § 10–3810(A).

¶13 The court also dismissed Ferneau's complaint as a sanction. It found that Ferneau's "persistent misconduct ha[d] severely prejudiced all Defendants, especially TAS," and that his refusal to provide the access information to the Account and then the deletion of its contents constituted "flagrant bad faith." It also found that he had "been repeatedly warned about the consequences of his actions, to no avail," and that the lesser sanctions imposed had not deterred him from engaging in "self-centered and egregious misconduct designed to harm" Defendants. Finally, it acknowledged that public policy favored the resolution of claims on their merits but found that Ferneau had waived his right to have his claims decided on the merits by repeatedly engaging in egregious conduct. Thus, it dismissed Ferneau's amended complaint with prejudice. After awarding Wilder and KWLH attorneys' fees and costs, and entry of a final judgment, Ferneau timely appealed. This court has jurisdiction under A.R.S. § 12–2101(A)(1).

DISCUSSION

¶14 Ferneau contends that the trial court erred in removing him as a director of TAS and dismissing his complaint as a sanction. We address each challenge below.

I. Removal as a Director of TAS

¶15 Ferneau argues that the trial court erred in removing him as a director of TAS because he did not engage in "fraudulent conduct." He also argues that "fraudulent conduct" under A.R.S. § 10–3810(A) includes only

actual fraud and not constructive fraud. This court reviews the interpretation and application of statutes de novo but will not disturb a trial court's factual findings unless clearly erroneous. *First Fin. Bank, N.A. v. Claassen*, 238 Ariz. 160, 162 ¶ 8 (App. 2015). When interpreting a statutory provision, this court gives words "their ordinary meaning unless it appears from the context or otherwise that a different meaning is intended." *Ariz. ex. rel. Brnovich v. Maricopa Cnty. Cmty. Coll. Dist. Bd.*, 243 Ariz. 539, 541 ¶ 7 (2018) (quoting *State v. Miller*, 100 Ariz. 288, 296 (1966)). Thus, "[w]e interpret statutory language in view of the entire text, considering the context and related statutes on the same subject." *Nicaise v. Sundaram*, 245 Ariz. 566, 568 ¶ 11 (2019).

¶16 Under A.R.S. § 10–3810(A), courts may remove a director of a non-profit corporation from office if (1) "[t]he director engaged in fraudulent conduct or intentional criminal conduct with respect to the corporation" and (2) "[r]emoval is in the best interests of the corporation." The ordinary meaning of fraud includes both actual fraud and constructive fraud. *In re McDonnell's Estate*, 65 Ariz. 248, 252 (1947) ("Fraud is generally classified under two major headings, actual and constructive."). The legislature "is presumed to be aware of existing statutes and case law when it passes a statute." *Staples v. Concord Equities, L.L.C.*, 221 Ariz. 27, 33 ¶ 28 (App. 2009). The legislature did not explicitly limit fraudulent conduct in A.R.S. § 10–3810(A) to actual fraud. *See U.S. v. Turkette*, 452 U.S. 576, 580 (1981) ("In determining the scope of a statute, we look first to its language. If the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'") (citation omitted). We therefore assume that the Arizona Legislature knew that fraudulent conduct included both actual and constructive fraud and intended that fraudulent conduct under A.R.S. § 10–3810(A) include both actual and constructive fraud. Arizona courts have followed this interpretation in a similar context. *See Green v. Lisa Frank, Inc.*, 221 Ariz. 138, 155–56 ¶¶ 52–54 (App. 2009) (stating that "[f]raud may be either actual or constructive" when analyzing "fraudulent conduct" under A.R.S. § 10–809(A), a related statute with identical language in substance to A.R.S. § 10–3810(A)).

¶17 "Constructive fraud is a breach of legal or equitable duty which, without regard to moral guilt or intent of the person charged, the law declares fraudulent because the breach tends to deceive others, violates public or private confidences, or injures public interests." *Dawson v. Withycombe*, 216 Ariz. 84, 107 ¶ 72 (App. 2007) (internal citation and quotation marks omitted). Constructive fraud "does not require a showing of intent to deceive or dishonesty of purpose." *Id*. It does, however, require

"a fiduciary or confidential relationship" and that the breacher of the duty "induce[d] justifiable reliance by the other to his detriment." *Id*. (internal citations omitted).

¶18 Substantial evidence supports the trial court's finding that Ferneau engaged in constructive fraud and that his removal was in TAS's best interests. Ferneau, as a director of TAS, owed a fiduciary duty to TAS not to engage in conduct harmful to it. TAS reasonably relied on Ferneau's representation that it was preserving the emails in the Account. TAS could have acted earlier and tried other means to preserve the emails but did not because of Ferneau's representation. Ferneau's spoliation of the emails harmed TAS because it lost four years' worth of business emails. Ferneau has thus shown no error.

¶19 Purporting to cite "the published legislative history for this statute," Ferneau argues that the statute requires actual common law fraud and not constructive fraud. Not so. The text Ferneau quotes is a drafting committee comment of a section of the Arizona State Bar describing the standard, not any legislative declaration. Even then, the text quoted does not support the argument that this statute requires common law fraud, not constructive fraud. Ferneau is correct that the state bar section comment provides that "only egregious conduct should warrant a [non-profit corporations] director's removal by judicial proceedings." But Ferneau fails to show that the trial court could not find his conduct to be egregious. Ferneau also argues that the trial court lacked evidence to conclude that he deleted the emails. But Ferneau, through his attorney, admitted that he or his son had deleted emails from the Account, "and that is why there [were] not a lot of emails." And the court found Ferneau's testimony that he had been deleting emails from a different email account not credible. Thus, Ferneau's arguments fail.

¶20 Next, Ferneau argues that the trial court erred in permanently removing him as a director of TAS. Although Ferneau raises this argument for the first time on appeal, in exercise of our discretion, we will address his argument. *Adams v. Valley Nat'l Bank of Ariz.*, 139 Ariz. 340, 342 (App. 1984). Relying on A.R.S. § 10–3810(B), he contends that courts cannot remove directors for a period that exceeds five years. Under that provision, "[t]he court that removes a director may *bar* the director from serving on the board for a period prescribed by the court, but in no event may the period exceed five years." A.R.S. § 10–3810(B) (emphasis added). Subsection B limits the period when a court bars a director from serving on the board after he or she is removed. The trial court here only removed Ferneau as a director. It

did not bar him from serving on the TAS's board permanently or for any set period. Thus, Ferneau has shown no error.

II. Dismissal of the Complaint

¶21 Ferneau argues that the trial court erred in dismissing his complaint because he did not violate a court order. He contends that even if he did violate an order, case-ending sanctions were not appropriate. This court reviews the imposition of sanctions for an abuse of discretion. *Lisa Frank, Inc.*, 221 Ariz. at 153 ¶ 40. "Whether a trial court has the discretion to impose the sanction of dismissal depends on whether the specific facts and circumstances of the case are sufficiently extreme to warrant such a sanction." *Id*.

¶22 Before reaching whether case-ending sanctions were appropriate, we must first determine whether Ferneau actually engaged in improper conduct. Ferneau argues that he did not violate the court's order that he provide the access information to the Account because he did so timely. Although Ferneau ultimately provided the access information to the Account as the court ordered in January 2021, he or his agents destroyed the evidence—the emails and their contents—before he disclosed it to Defendants. Ferneau had an affirmative duty to preserve relevant evidence within his control. *See* Ariz. R. Civ. P. 37(g) (providing that a party "has a duty to take reasonable steps to preserve electronically stored information relevant to an action"); Ariz. R. Civ. P. 34(a)(1) (authorizing a party to seek production of specified "items in the responding party's possession, custody, or control"); *McMurtry v. Weatherford Hotel, Inc.*, 231 Ariz. 244, 260 ¶ 51 (App. 2013). As a result, the trial court did not err in finding that Ferneau engaged in conduct that warranted sanctions.

¶23 In determining whether dismissal is a proper sanction for discovery violations under Arizona Rule of Civil Procedure ("Rule") 37(g), the most relevant factors for a trial court to consider are:

> (1) prejudice to the other party, both in terms of its ability to litigate its claims and other harms caused by the disobedient party's actions; (2) whether the violations were committed by the party or by counsel; (3) whether the conduct was willful or in bad faith and whether the violations were repeated or continuous; (4) the public interest in the integrity of the judicial system and compliance with court orders; (5) prejudice to the judicial system, including delays and the burden placed on the trial court; (6) efficacy of lesser

> sanctions; (7) whether the party was warned that violations would be sanctioned; and (8) public policy favoring the resolution of claims on their merits.

Lisa Frank, Inc., 221 Ariz. at 154 ¶ 45.

¶24 The trial court did not err in dismissing the complaint because substantial evidence supports the court's finding that the factors favored dismissal. The first three factors favored dismissal because Ferneau continuously and willfully prevented Defendants from accessing the Account. Ferneau never disclosed the access information to the Account under Rule 26.1. Despite several requests over an extended period from Defendants for information on how to access the Account, Ferneau failed to provide the access information, claiming at times that he, too, could not access the Account. Yet when ordered to provide Defendants with the access information to the Account, Ferneau provided the access information within 24 hours. His acts—delaying access to the Account and either deleting its content or having the content deleted before doing so—prejudiced Defendants because it harmed them by delaying the resolution of this case and impairing TAS's ability to defend and bring claims in other litigation it was involved in.

¶25 As to the fourth and fifth factors, Ferneau failed to heed the trial court's warnings. When, as here, a party is reminded of its duty to preserve relevant evidence, and that party fails to honor that duty in bad faith, the public interest in the integrity of the judicial system is compromised and weighs in favor of sanctioning that party. In October 2017, the trial court warned Ferneau against the spoliation of relevant evidence. And again in June 2018, the trial court warned Ferneau against engaging in conduct that did not serve to advance the orderly determination of this dispute. He engaged in warned-against-conduct, delaying the resolution of this dispute and causing unnecessary expenses. Ferneau's conduct also harmed the trial court's integrity by bringing before it a "win at all costs" mentality despite several warnings that actions deriving from such mentality would lead to severe sanctions.

¶26 The next two factors also favored dismissal. Ferneau was warned that his conduct could lead to the dismissal of his complaint. He was also sanctioned several times. TAS was awarded attorneys' fees and costs as a sanction against Ferneau at least twice throughout this litigation. Along with the sanctions, he was warned that if his conduct persisted, the sanctions would become more severe. Neither the warnings nor the sanctions deterred Ferneau from engaging in conduct harmful to

Defendants. Thus, because lesser sanctions did not deter Ferneau from continuously engaging in warned-against-conduct in the past, lesser sanctions would not have been efficient. Finally, even though public policy favors deciding cases on the merits, Ferneau waived his right to be heard further by engaging in egregious conduct of delaying the resolution of this dispute and deleting hundreds of business emails from the Account. The trial court therefore did not err in dismissing Ferneau's complaint as a sanction.

III. Attorneys' Fees and Costs on Appeal

¶27 Ferneau requests attorneys' fees and costs under A.R.S. §§ 12–341 and 12–341.01. We deny his request because he was not successful on appeal. TAS requests attorneys' fees and costs under A.R.S. § 12–349. But TAS does not identify the subsection under which it seeks its award. Nor does TAS provide any argument on the issue. As the party seeking fees under § 12–349, TAS must show, by a preponderance of the evidence, that Ferneau's claims fall within one of the specific subsections of § 12-349(A). *See In re Estate of Stephenson*, 217 Ariz. 284, 289 ¶ 28 (App. 2007). We therefore deny its request for fees on this basis. *See id*. As a prevailing party, however, TAS is entitled to its costs incurred in this appeal upon compliance with Arizona Rule of Civil Appellate Procedure 21. Wilder and KWLH request attorneys' fees and costs under A.R.S. §§ 12–341.01 and 12 –349. Because (1) this action arises out of a contract as to Wilder and KWLH, and (2) Wilder and KWLH were successful on appeal, they may recover reasonable attorneys' fees and taxable costs upon compliance with Arizona Rule of Civil Appellate Procedure 21.

CONCLUSION

¶28 We affirm.

AMY M. WOOD • Clerk of the Court
FILED: JT