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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

JOSEPH HOURANY et al., Plaintiffs and Respondents, v. GLENN TAXMAN et al., Defendants and Appellants.	B271343 (Los Angeles County Super. Ct. No. KS019541)

APPEAL from an order of the Superior Court of Los Angeles County, Robert A. Dukes, Judge. Affirmed.

Jeffer Mangels Butler & Mitchell, Mark S. Adams, Joseph J. Mellema and Susan Allison for Defendants and Appellants.

Chang & Coté, Steven J. Coté and Rodney W. Bell for Plaintiffs and Respondents.

INTRODUCTION

Attorney Glenn Taxman and his law firm, Much Shelist (collectively, Taxman), appeal an order under Civil Code section 1714.10[1] allowing Joseph and Veronique Hourany and Urvashi Sura to amend their complaint against Taxman's clients, Rahul and Yogesh Paliwal and their related entities, to add allegations that Taxman conspired with the Paliwals to fraudulently induce the Houranys and Sura to invest over $1 million in the Paliwals' ailing real estate venture. Taxman argues the proposed amended complaint failed to satisfy the prima facie pleading requirement section 1714.10, subdivision (a), imposes on civil conspiracy claims against an attorney. Taxman also raises several other arguments, including that he cannot defend himself without violating the attorney-client privilege, that the claims by the Houranys and Sura are derivative, and that the statute of limitations, laches, the litigation privilege, and the agent-immunity rule all bar the conspiracy claim against him.

We conclude that, because the allegations against Taxman fall within the statutory exceptions to section 1714.10, subdivision (a), the proposed conspiracy claim against Taxman is exempt from the statute's prima facie, prefiling pleading requirement. Therefore, we affirm.

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1 Undesignated statutory references are to the Civil Code.

FACTUAL AND PROCEDURAL BACKGROUND

A. *The Investment*

The Houranys and Sura allege that, between 2005 and 2011, they made a series of investments totaling $1.12 million in Indus-Chino Hills, L.P., a limited partnership formed to develop commercial real estate. Rahul Paliwal was the president of the limited partnership's sole general partner, Indus Manager Corp. (IMC),and he and his father, Yogesh Paliwal, were either IMC's sole or majority shareholders. The Houranys and Sura allege they made, and continued to maintain, their investments in the partnership because of the Paliwals' misrepresentation that the venture was safe and financially sound and their false promise the Houranys and Sura they would have positions on IMC's board of directors if they made large enough investments. Without the knowledge or approval of the Houranys and Sura, however, the Paliwals subsequently sold partnership real estate and took out ill-advised, unauthorized loans secured by partnership property. Throughout, the Paliwals concealed the partnership's dire financial straits and sought additional capital from the Houranys, Sura, and others to conceal the losses.

B. *The Houranys and Sura Sue the Paliwals and Petition Under Section 1714.10 To Sue Taxman*

In December 2015 the Houranys and Sura filed this action against the Paliwals, the partnership, and IMC, alleging, among other things, the Paliwals made false promises and concealed material facts about the venture in order to convince the Houranys and Sura to invest. The Houranys and Sura subsequently filed a verified petition under section 1714.10

seeking leave to amend their complaint to add conspiracy allegations against Taxman, who acted as outside counsel for the partnership and IMC.

In their petition, proposed amended complaint, and supporting declarations, the Houranys and Sura asserted that Taxman conspired with the Paliwals to fraudulently induce them to make and maintain investments in the partnership. Regarding Taxman and his law firm, the Houranys and Sura allege that Much Shelist prepared the marketing materials the Paliwals used to solicit investments from them and that the materials omitted "the disastrous past financial performance" of the venture and "downplay[ed] or concealed" the fact that the partnership had already lost millions of dollars. They also allege attorneys at Much Shelist prepared two memoranda, dated April 20, 2010 and January 12, 2011 and attached as exhibits to the petition, confirming the Paliwals' illusory promises that Joseph Hourany and Sura would receive seats on IMC's board of directors. The memoranda stated Joseph Hourany and Sura, as board members, would have voting rights regarding substantial sales of, or encumbrances on, partnership property. Rahul Paliwal gave the two memoranda to the Houranys and Sura in order to induce them to make, and retain, their investments and to encourage them to make additional investments.

The Houranys and Sura in fact continued to invest money in the partnership, believing, based in part on the memoranda from Much Shelist, they were members of IMC's board of directors and had voting rights over major partnership transactions. The Houranys and Sura allege, however, that Taxman facilitated subsequent encumbrances on, and sales of, partnership property, without their knowledge or approval and

contrary to the representations and assurances in the memoranda. These unauthorized, undisclosed transactions and fraudulently induced investments allowed the partnership to maintain operations, and Taxman and his law firm to continue collecting fees, despite their unlawful conduct.

The Houranys and Sura also allege that in 2012 Taxman personally loaned the partnership $185,000 at an interest rate between 22 and 30 percent, again without disclosing the loan to, or obtaining the approval of, the board of IMC or the Houranys and Sura, and collected over $55,000 in interest payments from the partnership. The Houranys and Sura further allege Much Shelist charged the partnership $18,500 in "fees" in connection with the personal loan from Taxman.

The Houranys and Sura allege they retained counsel to investigate the partnership when they finally learned of an unauthorized sale of partnership property in September 2014. In response to counsel's inquiries, Taxman made various misrepresentations to further conceal the fraud. In April 2015 counsel for the Houranys and Sura threatened to file a lawsuit if their "numerous serious questions" were not "satisfactorily answered." In September 2015 Taxman finally produced a one-page financial document, which revealed the shares owned by the Houranys and Sura were worth a fraction of their original capital investment.

C. *The Trial Court Grants the Petition*

The trial court granted the petition. The court found the Houranys and Sura had satisfied the prima facie pleading requirement prescribed by section 1714.10, subdivision (a), because there was a reasonable probability of prevailing on the

merits against Taxman. The court rejected Taxman's arguments that the action was on behalf of the partnership for damage done to the partnership and therefore derivative and that, under *McDermott, Will & Emery v. Superior Court* (2000) 83 Cal.App.4th 378 (*McDermott*), he could not defend against the action without violating the attorney-client privilege, which IMC held and would not waive. The court acknowledged that, "[a]lthough a misappropriation of funds and loss in value of investments is typically derivative," the Houranys and Sura alleged they were induced to invest based on false promises they would have positions on the board of directors. The court ruled that, because the Paliwals "were able to misappropriate the proceeds" as a result of the inducement, "there is sufficient information . . . to characterize this suit as a direct action as opposed to derivative." Therefore, the court concluded, because the action was not derivative, the principle of *McDermott* did not apply. Taxman timely appealed.[2]

DISCUSSION

Although the Houranys and Sura sought and obtained a prefiling order pursuant to section 1714.10, they argue they did not need to because their proposed action against Taxman is not subject to the statute's pleading requirement. They contend the

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[2] An order under section 1714.10 is appealable. (§ 1714.10, subd. (d); *Klotz v. Milbank, Tweed, Hadley & McCloy* (2015) 238 Cal.App.4th 1339, 1349.)

exceptions listed in section 1714.10, subdivision (c), apply to their claims. The Houranys and Sura are correct.[3]

A. *Section 1714.10 and Its Exceptions*

Originally enacted in 1988, "'[s]ection 1714.10 was intended to weed out the harassing claim of conspiracy that is so lacking in *reasonable foundation* as to verge on the *frivolous*.'" (*Rickley v. Goodfriend* (2013) 212 Cal.App.4th 1136, 1148; see *Central Concrete Supply Co., Inc. v. Bursak* (2010) 182 Cal.App.4th 1092, 1098.) In relevant part, section 1714.10, subdivision (a), provides: "No cause of action against an attorney for a civil conspiracy with his or her client arising from any attempt to contest or compromise a claim or dispute, and which is based upon the attorney's representation of the client, shall be included in a complaint or other pleading unless the court enters an order allowing the pleading that includes the claim for civil conspiracy to be filed after the court determines that the party seeking to file the pleading has established that there is a reasonable probability that the party will prevail in the action."[4]

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[3] "'We review the trial court's interpretation of section 1714.10 de novo.'" (*Stueve v. Berger Kahn* (2013) 222 Cal.App.4th 327, 330; accord *Central Concrete Supply Co., Inc. v. Bursak* (2010) 182 Cal.App.4th 1092, 1098.) In making its "prepleading determinations" pursuant to section 1714.10, "the trial court is not weighing conflicting evidence, determining credibility or drawing inferences." (*Burtscher v. Burtscher* (1994) 26 Cal.App.4th 720, 726.)

[4] The Houranys and Sura do not argue section 1714.10 does not apply because under subdivision (a) their claims against Taxman do not "arise[] from any attempt to contest or

In 1989 the California Supreme Court decided *Doctors' Co. v. Superior Court* (1989) 49 Cal.3d 39 (*Doctors' Co.*), which reversed an order overruling a demurrer to a conspiracy claim against attorneys for helping their client breach a statutorily imposed duty. (*Id.* at p. 45.) The Supreme Court applied what courts have referred to as the "'agent's immunity rule,'" which "establishes that 'an agent is not liable for conspiring with the principal when the agent is acting in an official capacity on behalf of the principal.'" (*Berg & Berg Enterprises, LLC v. Sherwood Partners, Inc.* (2005) 131 Cal.App.4th 802, 817 (*Berg*); see *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 512; *Favila v. Katten Muchin Rosenman* LLP (2010) 188 Cal.App.4th 189, 208.) The Supreme Court in *Doctors' Co.* stated, "A cause of action for civil conspiracy may not arise . . . if the alleged conspirator, though a participant in the agreement underlying the injury, was not personally bound by the duty violated by the wrongdoing and was acting only as the agent or employee of the party who did have that duty." (*Doctors' Co.*, at p. 44.) The Supreme Court, however, noted two "*other* sets of circumstances" in which an attorney could be liable for conspiring with a client. (*Id.*, at p. 46.) "For example, an attorney who conspires to cause a client to violate a statutory duty peculiar to the client may be acting not only in the performance of a professional duty to serve the client but also in furtherance of the attorney's own financial gain." (*Ibid.*) The Supreme Court also stated that claims "against an attorney for conspiring with his or

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compromise a claim or dispute." As discussed, they argue only that section 1714.10 does not apply because of the exceptions in subdivision (c).

her client to cause injury by violating the attorney's own duty to the plaintiff" were potentially viable. (*Id.* at p. 47.)

Shortly after the Supreme Court decided *Doctors' Co.*, the Legislature amended section 1714.10 to add subdivision (c), which codified the two exceptions to the agent's immunity rule articulated by the Supreme Court. These exceptions apply where: ". . . (1) the attorney has an independent legal duty to the plaintiff, or (2) the attorney's acts go beyond the performance of a professional duty to serve the client and involve a conspiracy to violate a legal duty in furtherance of the attorney's financial gain." (§ 1714.10, subd. (c); see *Berg*, *supra*, 131 Cal.App.4th at p. 818.)

As the court noted in *Pavicich v. Santucci* (2000) 85 Cal.App.4th 382, 395 (*Pavicich*), however, this amendment created an unusual situation: The exceptions appeared to swallow the rule. "[T]he problem with section 1714.10 [as amended] is that it excludes from its scope what is essentially an element of a conspiracy cause of action . . . i.e., *that he or she owes a duty to plaintiff recognized by law*." (*Pavicich*, at p. 395.) Thus, in effect, "a plaintiff who can plead a viable claim for conspiracy against an attorney need not follow the petition procedure outlined in the statute as such a claim necessarily falls within the stated exceptions to its application." (*Berg*, *supra*, 131 Cal.App.4th at p. 818.) In other words, under the amended statute, "it appears that the pleading hurdle would only apply to attorney/client conspiracy causes of action which are not viable in any event." (*Pavicich*, at p. 394.)

Since *Pavicich*, numerous courts have similarly recognized the anomalous result created by subdivision (c); namely, that the exceptions capture all viable attorney-client conspiracy claims, so

that only those claims that would fail in any event remain subject to the pleading hurdle in subdivision (a). (See, e.g., *Rickley v. Goodfriend*, *supra*, 212 Cal.App.4th at pp. 1150-1151; *Favila v. Katten Muchin Rosenman LLP*, *supra*, 188 Cal.App.4th at pp. 209-210; *Central Concrete Supply, Co., Inc*, *supra*, 182 Cal.App.4th at p. 1100; *Panoutsopoulos v. Chambliss* (2007) 157 Cal.App.4th 297, 304-305; *Berg*, *supra*, 131 Cal.App.4th at p. 818.) In effect, a court applying section 1714.10 must "'initially determine whether the pleading falls either within the coverage of the statute or, instead, within one of its stated exceptions.'" (*Stueve v. Berger Kahn* (2013) 222 Cal.App.4th 327, 331.) "This determination pivots, in turn, on whether the proposed pleading states a viable claim for conspiracy against the attorney. [Citation.] For all intents and purposes, this is the determinative question." (*Berg*, at p. 818.)

B. *The First Exception Applies*

The first exception in section 1714.10, subdivision (c), applies where an attorney owes an "independent legal duty" to the plaintiff. Relevant here, "an attorney has an independent legal duty to refrain from defrauding nonclients." (*Klotz v. Milbank, Tweed, Hadley & McCloy* (2015) 238 Cal.App.4th 1339, 1351 (*Klotz*); accord, *Rickley v. Goodfriend, supra,* 212 Cal.App.4th at p. 1151; see *Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2003) 107 Cal.App.4th 54, 71 [because "'an attorney may not, with impunity, either conspire with a client to defraud or injure a third person," an attorney has a duty "not to defraud another, even if that other is an attorney negotiating at arm's length"'].) Thus, "a lawyer communicating on behalf of a client with a nonclient may not knowingly make a

false statement of material fact to the nonclient [citation], and may be liable to the nonclient for fraudulent statements made during business negotiations." (*Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 291.)

This exception captures allegations a corporation and its attorney conspired to conceal material facts from potential investors. (See *Klotz*, *supra*, 238 Cal.App.4th at p. 1351; *Rickley v. Goodfriend*, *supra,* 212 Cal.App.4th at p. 1151, *Pavicich*, *supra*, 85 Cal.App.4th at pp. 397-398.) By participating in such an alleged conspiracy, the attorneys have "engaged in conduct beyond the provision of legal services, and violated an independent duty." (*Klotz*, at p. 1352.) In addition, "'where an "attorney gives his client a written opinion with the intention that it be transmitted to and relied upon by [a third party] in dealing with the client[,] . . . the attorney owes the [third party] a duty of care in providing the advice because [that party's] anticipated reliance upon [the opinion] is 'the end aim of the transaction.'"'" (*Rickley v. Goodfriend*, at pp. 1151-1152.)

The Houranys and Sura pleaded such acts of conspiratorial conduct and concealment between Taxman and his clients. The Houranys and Sura allege Much Shelist lawyers prepared marketing materials that induced their investments by concealing losses and misrepresenting the financial state of the partnership. They also allege Much Shelist lawyers prepared two memoranda in particular that confirmed Joseph Hourany and Sura had been, or would be, given positions on IMC's board of directors and would have rights to oversee and vote on substantial sales of, or indebtedness on, partnership property. The Houranys and Sura allege Taxman and his clients prepared and used the memoranda to induce them to make, or retain, their

investments in the partnership, and to reassure them that Taxman and his clients would honor their promises. The Houranys and Sura further allege Taxman facilitated transactions "in direct breach of [the] promises" in the memoranda, including selling and encumbering partnership real estate without giving them notice of the transactions or an opportunity to review and approve them. The allegations describe the type of fraud Taxman owed the Houranys and Sura a duty not to commit. (See *Klotz*, *supra*, 238 Cal.App.4th at p. 1351.) The first exception to section 1714.10 applies to the proposed claims by the Houranys and Sura against Taxman and his firm.

C. *So Does the Second Exception*

The proposed action also fits within the second exception in section 1714.10, subdivision (c): where "the attorney's acts go beyond the performance of a professional duty to serve the client and involve a conspiracy to violate a legal duty in furtherance of the attorney's financial gain." The "financial gain" component of this exception requires that, "through the conspiracy, the attorney derived economic advantage over and above monetary compensation received in exchange for professional services actually rendered on behalf of a client." (*Berg*, *supra*, 131 Cal.App.4th at p. 836; see *Klotz*, *supra*, 238 Cal.App.4th at p. 1351 ["[t]his exception does not apply to fees charged, even where the fees were excessive or the services unnecessary"].) The plaintiff must allege more than merely charging exorbitant fees for legitimate, professional legal work.

And here there is more. The Houranys and Sura allege, as part of the conspiracy, Taxman personally loaned his client, the

partnership, $185,000 at a high interest rate, receiving over $55,000 in interest payments, all without disclosure to, or approval of, the Houranys, Sura, or the board. They further allege Much Shelist facilitated the unauthorized loan in exchange for a $18,500 fee. Such acts went beyond performing legal services and resulted in financial gains separate and apart from fees for professional legal work.

Taxman addresses these two exceptions only briefly, in connection with his argument that the agent's immunity rule bars the Houranys and Sura's claims. Taxman asserts "the first exception is not applicable" because the "Petition does not allege that [Taxman and his firm] owe them an independent duty." While the Houranys and Sura may not have used the word "duty" in their petition, whether such a duty arose is a question of law, to be determined by the court based on the alleged facts. (See *Nalwa v. Cedar Fair, L.P.* (2012) 55 Cal.4th 1148, 1154.) As discussed, the Houranys and Sura pleaded facts giving rise to a duty by Taxman and his firm to refrain from defrauding nonclients.

As for the second exception, Taxman argues "the fact that [he and his firm] drafted memoranda *for the client Partnership entity*, ***not*** [the Houranys and Sura], did not at all 'go beyond the performance of a professional duty.'" Perhaps, but the Houranys and Sura allege Taxman and his firm did more than that. As discussed, the Houranys and Sura allege Taxman and his firm made an unauthorized and usurious loan, prepared private placement memoranda and marketing materials that concealed or misrepresented material facts, and facilitated transactions that breached the representations and assurances in those memoranda. The Houranys and Sura also allege that, while

Taxman and lawyers in his firm ostensibly prepared the memoranda "for the client," Rahul Paliwal gave the memoranda to the Houranys and Sura to induce them to invest in the partnership.

Taxman argues the loan he made to the partnership was not "illegal, fraudulent, or even harmful to the Partnership" because the loan "*saved* the Partnership" from losing the property and was based on terms negotiated by another lender who had backed out at the last minute. According to Taxman, notwithstanding the loan's "high interest rate," the conflict-of-interest implications of his conduct, and nondisclosure to the board, he actually "did a favor for the Partnership" by making the loan. Taxman claims he graciously gave the partnership some "free" extensions before he began charging his client higher default interest rates and extension fees. Taxman also asserts it makes no difference that he and his clients concealed the loan because, even if the loan had been disclosed to the board and the Houranys and Sura, the other board members may have overruled and outvoted the Houranys and Sura if they objected. Taxman, however, cites no authority for the proposition that an attorney's allegedly undisclosed, unethical, and usurious financial transactions with a client can be absolved by the approval of alleged coconspirators. At a minimum, Taxman's assertions create issues of fact and credibility, which cannot be resolved at the prepleading stage. (See *Burtscher v. Burtscher* (1994) 26 Cal.App.4th 720, 726 ["[i]n making such prepleading determinations, the trial court . . . is performing a 'gatekeeping' function, filtering out frivolous allegations of conspiracy but without subjecting them to the 'fact adjudicative screen' that would violate the right to a jury trial"].)

Because the proposed action falls within the two exceptions in subdivision (c), the prefiling pleading requirement of section 1714.10, subdivision (a), did not apply to the proposed conspiracy claims against Taxman and his firm. And, given the anomalous structure of section 1714.10, the Houranys and Sura necessarily pleaded a prima facie conspiracy claim against Taxman and his firm. (See *Berg*, *supra*, 131 Cal.App.4th at p. 818 ["a plaintiff who can plead a viable claim for conspiracy against an attorney need not follow the petition procedure outlined in [section 1714.10] as such a claim necessarily falls within the stated exceptions to its application"]; accord *Rickley v. Goodfriend*, *supra*, 212 Cal.App.4th at p. 1151.) Either way, section 1714.10 does not bar the conspiracy claims.

DISPOSITION

The order is affirmed. The Houranys and Sura are to recover their costs on appeal.

SEGAL, J.

We concur:

PERLUSS, P. J. BENSINGER, J. *

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*Judge of the Los Angeles Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.