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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION TWO

TOKAI INTERNATIONAL HOLDINGS, INC., Plaintiff and Appellant, v. PAUL HASTINGS, LLP, Defendant and Respondent.	B282299 (Los Angeles County Super. Ct. No. BC630144)

APPEAL from a judgment of the Superior Court of Los Angeles County. William F. Fahey, Judge. Reversed.

Kozberg & Bodell and Gregory Bodell for Plaintiff and Appellant.

Sidley Austin, Theodore N. Miller and Joshua E. Anderson for Defendant and Respondent.

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A Delaware corporation retained a law firm to conduct due diligence and provide legal advice regarding its acquisition of a Japanese holding company that owned the stock of several subsidiary corporations. The acquisition agreement contained a clause under which the Japanese parent company selling the Japanese holding company agreed to indemnify the "Buyer" and its "Affiliates" for the "cost to correct any violations" of the environmental laws by the holding company "or its Subsidiaries." To reduce tax liability for the acquisition, the Delaware corporation created its own Japanese subsidiary and assigned its rights to buy the Japanese holding company to its new subsidiary. The deal went through. Many years later, the Delaware corporation sued the law firm for malpractice. The trial court sustained a demurrer to the lawsuit without leave to amend on the ground that the Delaware corporation was not injured by any malpractice regarding the acquisition (because its Japanese subsidiary was the buyer) and thus lacked standing. We conclude that this ruling was partly incorrect and reverse the trial court's judgment.

FACTS AND PROCEDURAL BACKGROUND

I. Facts

A. *Scripto*

Between 1956 and 1990, Scripto-Tokai Corporation (Scripto) made pens and other writing implements in a factory on land it owned in Monrovia, California. Scripto's manufacturing process involved or generated toxic chemicals that had two environmental impacts: (1) some chemicals leaked into, and thereby contaminated, the soil and groundwater near the factory, and (2) some of the factory's waste was disposed of in a hazardous

materials disposal site called Omega in Whittier, California (along with waste from other companies).

After the factory closed, Scripto sold the Monrovia property. However, Scripto remained potentially liable for the environmental impact of the factory in three ways: (1) it agreed to indemnify the buyer of the Monrovia property for the costs of any environmental cleanup; (2) it was "identified" as "a potentially responsible party" for cleanup of the Monrovia property by the California Regional Water Quality Control Board (the Board), although the Board only ordered Scripto to monitor the Monrovia property's groundwater and has yet to order any cleanup; and (3) it signed a consent decree in 2000 to settle an action by the United States Environmental Protection Agency regarding the Omega site (which had been designated a Superfund site), and in that decree agreed to pay some of the costs of cleanup (but, unlike companies that had disposed of greater amounts of toxic chemicals, was not responsible for conducting the cleanup).

B. *Sale of the Holding Company*

1. *Holding Company*

By 2005, Scripto was owned by a Japanese corporation called Tokai Corporation (the Holding Company). The Holding Company owned a number of other companies. The Holding Company was itself owned by Itochu Enex Co., Ltd. (Itochu), another Japanese corporation.

2. *Stock Purchase Agreement*

In June 2005, Itochu signed a Stock Purchase Agreement (Agreement) with plaintiff Tokai International Holdings, Inc. (plaintiff), a Delaware Corporation. In the Agreement, Itochu agreed to sell the Holding Company's stock to plaintiff in

exchange for $3.5 billion yen. As pertinent to this appeal, Itochu also agreed to "*defend, indemnify and hold harmless Buyer and its Affiliates* and the [Holding] Company and its Subsidiaries . . . *from and against any Damages arising out of, relating to or resulting from* . . . the costs incurred in performing any remediation completed prior to the third anniversary of the Closing Date in order to bring any real property now or previously owned or operated . . . by the [Holding] Company or its Subsidiaries (collectively, 'Other Real Property') into compliance with Environmental Laws or *the estimated cost to correct any violations of Environmental Law by the [Holding] Company or its Subsidiaries and/or the presence of Hazardous Materials on any Other Real Property for which the [Holding] Company or any of its Subsidiaries is legally responsible* as determined prior to the third anniversary of the Closing Date by an investigator mutually agreeable to the parties . . . ." (Italics added.)[1]

The Agreement elsewhere defines an "Affiliate" as "a Person that directly or indirectly, through one or more intermediaries, controls, is controlled by or is under common control with, such Person." Itochu's liability for indemnity was capped at $900 million yen.

3. *Assignment of Rights under the Agreement*

Soon after the Agreement was signed, plaintiff learned that the acquisition would have fewer adverse tax consequences in Japan if the entity acquiring the Holding Company was *itself* Japanese. So plaintiff formed Tokai International Holdings

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[1] This recitation incorporates an amendment to the original Agreement.

(Japan) (the Japanese Subsidiary) in Japan, and on September 15, 2005, signed a second amendment to the Agreement in which plaintiff "assign[ed] its rights and delegate[d] its duties under the . . . Agreement to" the Japanese Subsidiary.

C. *Relationship with Paul Hastings*

Prior to the acquisition, plaintiff had retained defendant Paul Hastings, LLP (Paul Hastings), a law firm, to conduct due diligence and to provide legal advice with respect to plaintiff's "intended acquisition" of the Holding Company. Paul Hastings had retained an outside contractor to investigate the possible environmental liabilities of properties associated with the Holding Company and its subsidiaries that were outside the United States but had itself investigated the liabilities of properties within the United States.

II. Procedural Background

A. *Complaint*

In August 2016, plaintiff sued Paul Hastings for legal malpractice.[2] In the operative first amended complaint, plaintiff alleged that Paul Hastings breached its duty of professional competence by: (1) not disclosing the "details" of a January 2005 letter to Scripto from one of its attorneys indicating that the Board had "hinted that it may require soil remediation or some form of groundwater remediation" at the Monrovia property; (2) performing inadequate due diligence of the environmental liabilities stemming from the Omega disposal site; (3) performing

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[2] Plaintiff and Paul Hastings had signed a tolling agreement back in 2011, and Paul Hastings has not argued that the lawsuit was untimely notwithstanding that agreement.

inadequate due diligence of the environmental liabilities stemming from the Monrovia property; (4) inadequately explaining the "potential ramifications or scope of liability" for any environmental remediation of the Monrovia property; (5) negotiating an indemnity provision with Itochu that was inadequate because it was capped at $900 million yen and had to be invoked within three years of the closing date; and (6) not advising plaintiff to invoke the indemnity provision before it expired.

Notwithstanding the multifarious breaches of duty alleged, plaintiff only alleged two injuries: (1) a "material[] reduc[tion]" in "the value of and return on its investment in" the Holding Company or the acquisition, and (2) its failure to invoke the indemnity clause, which leaves plaintiff—rather that Itochu—with the potential to pay $2 million "and perhaps much more" to remediate the environmental damage at the Monrovia property. Accordingly, plaintiff was suing for "damages . . . believed to exceed" $3 million.

B. *Demurrer*

Paul Hastings demurred on the ground that plaintiff lacked standing to sue because both of the alleged injuries were suffered by the Japanese Subsidiary, not by plaintiff. After full briefing and argument, the trial court sustained the demurrer without leave to amend. The court ruled that plaintiff could not recover for the losses suffered by the Japanese Subsidiary or through the Japanese Subsidiary's acquisition of the Holding Company because plaintiff was merely a shareholder of the Japanese Subsidiary and, as such, could not itself sue for losses suffered by the Japanese Subsidiary, which was a separate corporate entity. The court further ruled that plaintiff lacked standing to complain

about its ill-advised failure to invoke the Agreement's indemnity clause because (1) plaintiff had "assigned away its indemnity rights, including its rights as an '[A]ffiliate,'" and (2) Scripto was "the entity responsible for the environmental remediation costs."

C. *Judgment and Appeal*

After the trial court entered judgment, plaintiff filed this timely appeal.

DISCUSSION

Plaintiff argues that the trial court erred in sustaining Paul Hastings's demurrer without leave to amend. In reviewing such an order, we ask two questions: (1) was the demurrer properly sustained and, if so, (2) was leave to amend properly denied? The first question requires us to ""determine whether the complaint states facts sufficient to constitute a cause of action."" (*Centinela Freeman Emergency Medical Associates v. Health Net of California, Inc.* (2016) 1 Cal.5th 994, 1010.) In so doing, we independently "'examine the complaint . . . to determine whether it alleges facts sufficient to state a cause of action.'" (*Lee v. Hanley* (2015) 61 Cal.4th 1225, 1230.) We accept as true "all material facts properly pled" in the operative complaint (*Winn v. Pioneer Medical Group, Inc.* (2016) 63 Cal.4th 148, 152) as well as all materials properly "subject to judicial notice" (*Evans v. City of Berkeley* (2006) 38 Cal.4th 1, 20). The second question "requires us to decide whether ""there is a reasonable possibility that the defect [in the operative complaint] can be cured by amendment."" (*McClain v. Sav-On Drugs* (2017) 9 Cal.App.5th 684, 695, review granted June 14, 2017, S241471.)

Plaintiff's sole claim is one for legal malpractice. To state such a claim, a plaintiff must allege "(1) the duty of the attorney to use such skill, prudence, and diligence as members of his or

her profession commonly possess and exercise; (2) a breach of that duty; (3) a proximate causal connection between the breach and the resulting injury; and (4) actual loss or damage resulting from the attorney's negligence." (*Coscia v. McKenna & Cuneo* (2001) 25 Cal.4th 1194, 1199.) A malpractice claim has an implicit, fifth element as well—namely, that the injury caused by the malpractice is an injury *suffered by the plaintiff*. (*Martin v. Bridgeport Community Assn., Inc.* (2009) 173 Cal.App.4th 1024, 1031-1032; *Fladeboe v. American Isuzu Motors Inc.* (2007) 150 Cal.App.4th 42, 54-55 (*Fladeboe*); Code Civ. Proc., § 367 ["Every action must be prosecuted in the name of the real party in interest"].) This last "standing" element may be challenged on demurrer. (*Martin*, at p. 1031; *Cloud v. Northrop Grumman Corp.* (1998) 67 Cal.App.4th 995, 1004.)

Here, plaintiff alleges two injuries stemming from Paul Hastings's alleged malpractice and thus two potential bases for standing: (1) the environmental liabilities Paul Hastings did not uncover or disclose regarding Scripto caused the Japanese Subsidiary to pay too much for the Holding Company, such that the value of plaintiff's investment was reduced; and (2) Paul Hastings's failure to urge plaintiff to invoke the indemnity clause means that plaintiff may be paying for environmental remediation costs that could have otherwise been shifted to Itochu.

Plaintiff lacks standing to assert the first injury. That is because plaintiff assigned away all of its rights in the Agreement to the Japanese Subsidiary. "'An assignment carries with it *all* the rights of the assignor.' [Citations.]" (*Searles Valley Minerals Operations Inc. v. Ralph M. Parsons Service Co.* (2011) 191 Cal.App.4th 1394, 1402, italics added; *Essex Ins. Co. v. Five Star*

Dye House, Inc. (2006) 38 Cal.4th 1252, 1264; Civ. Code, § 1084 ["The transfer of a thing transfers also all its incidents, unless expressly excepted"].) Although plaintiff, even after the assignment, agreed to be a guarantor of the Agreement by "remain[ing] liable for the obligations of the" Japanese Subsidiary "under the . . . Agreement," plaintiff did not reserve any rights under that Agreement. Thus, any injury that plaintiff suffered as a result of the Japanese Subsidiary entering into a "bad deal" was not an injury it suffered directly, but instead an injury it suffered as a *shareholder* of the Japanese Subsidiary. However, because "a corporation is a legal entity . . . distinct from its shareholders," a shareholder does not have standing to sue on its "own behalf for a wrong done by a third [party] to the corporation on the theory that such wrong devalued [its] stock." (*Grosset v. Wenaas* (2008) 42 Cal.4th 1100, 1108 & fn. 5; *Eisenberg v. Hughes* (9th Cir. 2001) 1 Fed.Appx. 752, 756 [applying this rule to a corporation's malpractice action]; cf. *Jones v. H. F. Ahmanson & Co.* (1969) 1 Cal.3d 93, 106-107 [minority shareholder has standing to sue for injury inflicted upon her by majority shareholders].) This rule applies even when a purported plaintiff is the *sole* shareholder. (*Vinci v. Waste Management, Inc.* (1995) 36 Cal.App.4th 1811, 1815; *Fladeboe*, *supra*, 150 Cal.App.4th at p. 56.)

Plaintiff resists this conclusion with two arguments. First, plaintiff asserts that the only reason it created the Japanese Subsidiary in the first place—and thus ended up as a shareholder rather than a direct participant in the acquisition—is because Paul Hastings messed up in advising it about the tax consequences of the deal. However, plaintiff cites no authority in support of its proposition that "two malpractice wrongs make a

standing right," and we decline to create an exception out of whole cloth to the otherwise clear distinction in the law of standing between a corporation and its shareholders. Second, plaintiff points to the variety of types of malpractice it alleges Paul Hastings committed. However, plaintiff only alleges that this malpractice proximately caused two types of injury, and we are confined to examining the sufficiency of those alleged injuries. (See *Landmark Screens, LLC v. Morgan, Lewis & Bockius, LLP* (2010) 183 Cal.App.4th 238, 248 ["The [causation] and [damages] elements cannot be overlooked"].)

Plaintiff nevertheless has standing to assert the second injury—that is, the loss of a right to invoke the indemnity clause. We start and end with the clause's plain language. (*Rosen v. State Farm General Ins. Co.* (2003) 30 Cal.4th 1070, 1074; *Carr Business Enterprises, Inc. v. City of Chowchilla* (2008) 166 Cal.App.4th 14, 20 ["An indemnity agreement is to be interpreted according to the language and contents of the contract"].) That plain language grants plaintiff the right to seek indemnity from Itochu: The clause obligates Itochu to "defend, indemnify and hold harmless Buyer and its Affiliates" "from and against any Damages arising out of, relating to or resulting from" "the estimated cost to correct any violations of Environmental Law by the [Holding] Company or its Subsidiaries and/or the presence of Hazardous Materials on any Other Real Property for which the [Holding] Company or any of its Subsidiaries is legally responsible." Although the Buyer is the Japanese Subsidiary, plaintiff is an "Affiliate" of the Japanese Subsidiary because plaintiff "controls" the Japanese Subsidiary. As a result, plaintiff has the right to invoke the indemnity clause.

The trial court's contrary ruling rested on two findings—namely, (1) that plaintiff had "assigned away its indemnity rights, including its right as an '[A]ffiliate,'" and (2) Scripto was "the entity responsible for the environmental remediation costs." Neither finding squares with the language of the indemnity clause. The assignment had the effect of changing the identity of the "Buyer": Instead of plaintiff, it was the Japanese Subsidiary. This means that the indemnity clause reached the "Buyer and its Affiliates"—namely, the Japanese Subsidiary and any entity that "directly or indirectly . . . controls" it. As the sole shareholder of the Japanese Subsidiary, plaintiff controls it. This analysis refutes the notion that plaintiff, in assigning away its rights as a Buyer, somehow also assigned away its rights as an Affiliate. And although Scripto may be the entity liable to the Board for any remediation, that fact does not preclude indemnity because the indemnity clause allows the "Buyer *and its Affiliates*" to seek indemnity for "the estimated cost to correct any violations of Environmental Law by the [Holding] Company *or its Subsidiaries* . . . on any Other Real Property for which the [Holding] Company *or any of its Subsidiaries is legally responsible*." (Italics added.) Because Scripto is a subsidiary of the Holding Company, plaintiff—as an Affiliate—may seek indemnity for the estimated costs of remediating violations for which Scripto is legally responsible.

Paul Hastings offers two further arguments in defense of the trial court's ruling. First, it contends that plaintiff could not invoke the indemnity clause because it never alleged that Scripto had been found to be "legally responsible" for correcting any violations of the "Environmental Law." This contention misreads the clause. The clause provides that the determination of "legal[]

responsibil[ity]" was to be made "by an investigator mutually agreeable to the parties." Because the investigator must be selected by both parties, that selection necessarily occurs *after* the indemnity clause has been raised with Itochu. Plaintiff is here alleging that Paul Hastings was negligent for not urging it to raise the clause with Itochu. Second, Paul Hastings posits that we cannot construe the Agreement to permit plaintiff to fall within the definition of "Affiliate" because doing so will lead to an absurd result—namely, that it would allow, for example, "Tokai Panama S.A." (one of the Holding Company's subsidiaries) to "seek indemnification from Itochu for liabilities of Tokai of Canada Limited, even if Tokai Panama S.A. had nothing to do with those liabilities and no connection to Tokai of Canada Limited" and would allow multiple Affiliates to obtain double and triple recoveries from Itochu. We must avoid interpreting contracts in a way that leads to an absurd result (*Salton Bay Marina, Inc. v. Imperial Irrigation Dist.* (1985) 172 Cal.App.3d 914, 933), but our construction of the Agreement will not lead to the results Paul Hastings portends. The first alleged absurdity Paul Hastings points to deals with the right of the Holding Company's subsidiaries to seek indemnity for one another's environmental liabilities; in this case, however, we are dealing with the indemnity sought by the "Buyer and its Affiliates," and we divine nothing absurd about allowing the Japanese Subsidiary or its sole shareholder to seek indemnity for cleanup costs associated with the Holding Company and its subsidiaries. And the potential for double or triple recovery is one that can be addressed should it arise; here, it has not. We will not ignore the plain language of a contract to avoid hypothetical scenarios that

may or may not lead to absurd results where the language as applied in this case leads to an entirely rational result.

DISPOSITION

The judgment is reversed. Plaintiff is entitled to its costs on appeal.

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_____, J.
HOFFSTADT

We concur:

_____, Acting P. J.
ASHMANN-GERST

_____, J.
CHAVEZ