

PROFESSIONAL LIABILITY UPDATE

ATTORNEY-CLIENT CONSPIRACY ATTORNEY CLIENT-PRIVILEGE

By Jennifer A. Becker

Favila v. Katten Muchin Rosenman, LLP (2010) 188 Cal.App.4th 189

The Fourth District holds that attorneys who participate in fraudulent misrepresentations violate an independent duty and may be held liable for conspiracy with their client. A shareholder derivative action may be precluded by the attorney-client privilege, but courts need to carefully examine questions of waiver and should not dismiss an action when it is likely the client may eventually waive the privilege in the course of the litigation.

Katten Muchin attorney Gavin Galimi represented Motion Graphix which was owned by Richard Corrales and Raleigh Souther. Corrales agreed to sell 80% percent of his shares to the company and Corrales and Souther signed an agreement that incorporated a term sheet they prepared providing Corrales access to software code, certain clients, and a 20% ownership of Motion Graphix. A dispute arose over access to the software code and Corrales contacted Galimi who responded that he could not interfere in disputes between Corrales and Souther. Corrales died and his shares in Motion Graphix passed to the Estate.

Souther contacted Galimi to incorporate a new company, Get Flipped, and to assist with the sale of Motion Graphix's assets to Get Flipped. Souther sent the Estate a letter drafted by Katten Muchin attorney James Thompson stating a majority of Motion Graphix's shareholders had voted to sell the company's assets to Get Flipped for a nominal sum. Thompson then assisted in dissolving Motion Graphix.

The Estate filed a complaint asserting claims including conversion, breach of fiduciary duty, fraud, and breach of contract against Souther, Get Flipped, and subsequently named Galimi and Katten Muchin as Doe Defendants. Katten Muchin demurred, contending the complaint lacked specific allegations against Galimi or the firm. The trial court sustained both demurrers without leave to amend but without prejudice to the Estate filing a petition under California's attorney-client civil conspiracy statute, Civil Code § 1714.10

The Estate filed a §1714.10 petition to allow it to file a first amended complaint asserting a conspiracy claim against Galimi, Thompson, and Katten Muchin, as well as leave to file causes of action for conversion, breach of fiduciary duty, and fraud. The Estate alleged that Souther and Galimi formulated a scheme to defraud the Estate by incorporating Get Flipped and selling Motion Graphix's assets to it for a price grossly below market. The Estate alleged the defendants falsely stated a majority of shareholders had approved the sale. Galimi was

aware, based on Corrales' contact with him after the agreement was signed, that Corrales never received the software code or payment and thus the stock transfer was never completed. Even if the Estate was only a 20% shareholder, the sale violated the Corporations Code. The Estate alleged Thompson participated in the fraudulent scheme after Galimi left Katten Muchin by drafting Souther's letter knowing the Estate was still the majority shareholder or knowing of the purported Corporations Code violations. The trial court denied the petition and motion

Attorney-Client Civil Conspiracy

A civil conspiracy is the formation of a group of two or more persons who have agreed to a common plan or design to commit a tortious act. The conspiring defendants must have actual knowledge that a tort is planned, concur in the tortious scheme with knowledge of its unlawful purpose, and intend to aid in its commission. The defendant need not join the conspiracy at the time of its inception; everyone who enters into such a common design is in law a party to every act previously or subsequently done by any of the others in pursuance of it.

Civil conspiracy is not an independent tort. The major significance of a conspiracy cause of action is that each participant in the wrongful act is responsible as a joint tortfeasor for all damages resulting from the wrong regardless of the degree of his activity. Conspiracy is merely a mechanism for imposing vicarious liability; not a substantive basis for liability. Each member of the conspiracy becomes liable for all acts done by others pursuant to the conspiracy, and for all damages.

Section 1714.10 establishes pre-filing procedural requirements before a civil conspiracy claim can be asserted against an attorney based on an attorney-client relationship. It was enacted to prevent the assertion of conspiracy claims against attorneys as a tactical ploy, particularly in actions against

insurance companies. The provisions were intended to screen out meritless cases at an early stage by requiring the plaintiff to demonstrate a probability of success on the merits.

Its original purpose was rendered moot when the Supreme Court held that there was no actionable claim for conspiracy to violate the Insurance Code against an attorney retained by an insurance company to assist in the defense of an insured against a third-party claim. An attorney, as an agent of the insurance company, is entitled to immunity because the attorney is not personally bound by the duty violated by the wrongdoing and is acting only as the agent or employee of the party who does have that duty.

The statute was amended in 1991 to limit its protection to claims arising from any attempt to contest or compromise a claim and to create an exception for two situations: where the attorney causes a client to violate a statutory duty for the attorney's own financial gain and when the attorney violates his or her independent duty to the plaintiff.

The net effect of the Supreme Court decision and the amendments to § 1714.10 is to render that section all but meaningless. If the plaintiff seeks to assert a conspiracy claim against an attorney based on the violation of a duty owed by the client, but not the attorney, and the attorney was acting within the scope of his or her professional responsibilities, the claim has no merit. A petition under § 1714.10 will be denied, but a demurrer without leave to amend would probably be sustained as well. Thus, § 1714.10 is merely an additional procedural safeguard against meritless claims.

An attorney conspiracy claim against an attorney based on fraud or virtually any other common law tort theory falls within the exception to the statute and the statute serves no screening function. Plaintiffs can bypass the statute even when the claims come within its terms by negating the agency immunity rule, for

example alleging the attorney was acting outside his professional capacity and for his own personal gain.

The Supreme Court has held that an attorney has “an independent legal duty” not to defraud individuals engaged in business transactions with his or her client. Thus Souther’s alleged fraudulent scheme, in which the attorneys allegedly participated, sufficiently alleges a violation of an attorney’s independent legal duty and an exception to the statute applies.

Even if the exception did not apply, the Estate could amend the complaint to allege that the attorneys participated in the fraud by sending letters expressly misrepresenting that the sale had been approved so that the Estate would not try to block the sale.

Attorney Client Privilege

The trial court found that a companion derivative action filed by the Estate as successor to Corrales’ shares was precluded by, among other things, the attorney-client privilege. The court found that the attorney client privilege transferred to Get Flipped when it acquired Motion Graphix and there was no showing that the crime-fraud exception applied.

The Court of Appeal remanded the case to determine if the attorney-client privilege precluded the derivative action. Precedent established that although a shareholder in a derivative action “stands in the shoes” of the corporation, this does not apply to the attorney-client privilege. The corporation, not the shareholder, is the holder of the privilege and the only party who can waive the privilege. Thus, the filing of a derivative action against outside counsel does not result in a waiver of the corporation's attorney-client privilege. A legal malpractice derivative action is barred if an attorney is foreclosed from disclosing the very communications that are alleged to constitute a breach of duty.

California does not follow a case-by-case approach to this analysis because the public policy protecting the attorney client privilege is strong. The only exception is where the corporation waives the privilege or the privilege otherwise no longer exists. The trial court was instructed resolve several difficult questions involving the attorney-client privilege in the context of an asset sale followed immediately by a corporate dissolution.

First, the trial court had to resolve whether or not Get Flipped acquired Motion Graphix’s privilege when it acquired the company's assets. Pursuant to the Evidence Code, a successor to a corporation no longer in existence becomes the holder of the extinct corporation’s attorney-client privilege. By contrast, the sale of the corporation’s assets generally does not also transfer the privilege absent a merger or transfer of control of the corporation holding the privilege. The Court of Appeal held that the trial court's conclusion the privilege transferred to Get Flipped with the sale of Motion Graphix’s assets was incorrect and did not resolve the waiver question.

The second question was whether the privilege was extinguished when Motion Graphix dissolved. However, a dissolved corporation continues to exist for various purposes, and a person authorized to act on the dissolved corporation’s behalf during the wind-up process should be able to control the privilege.

The third question involved the crime-fraud exception. The proponent must make a prima facie showing that, from the perspective of the client, the services of the attorney were sought to aid in committing or attempting to commit a crime or fraud.

A demurrer premised on the inability of the attorney to defend himself due to the attorney-client privilege requires the court to speculate about the ability of the attorney to defend without disclosure of privileged

communications. The Court of Appeal cautioned that the trial court should consider the possibility that as the litigation continues the client will waive the privilege or that evidence will support an exception. Thus, the trial court should not dismiss the case but conditionally stay further proceedings and defer consideration of such motions.

Comment: This case is one of a line of cases imposing liability against attorneys for their independent duty not to engage or participate in fraud in the course of providing professional services. As a practical matter, courts are reluctant to allow attorneys to use the attorney-client privilege as a shield against liability to third parties. This opinion offers trial courts a practical solution to avoid outright dismissal of cases against attorneys until it is clear that attorney-client privilege issues will preclude a defense.