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Suing Lawyers for Conspiring With Their Clients Just Got Easier

By Timothy D. Reuben

"[J]ust by receiving an e-mail you get sucked into a conspiracy and you can be sued for being in a conspiracy. You know what[?] People cc lawyers with e-mails all the time."

— Judge Mary Ann Murphy
Los Angeles County Superior Cou

Sadly, it is now easier to sue lawyers for conspiring with their clients based on the 2nd District Court of Appeal's ruling in Favila v. Katten Muchin Rosenman, 2010 DJDAR 14093. Now, Katten Muchin Rosenman and two of its partners, Gavin Galimi and James Thompson, are potentially liable for conspiracy to defraud and on the hook in a separate derivative suit for allegedly conspiring to engineer an asset sale "for a price grossly below market." And all this resulted from an e-mail Galimi received from the client.

As is often the case, unfortunate facts lead to problematic law, and so it was here. Richard Corrales, an inventor of valuable photographic and imaging technology, formed a corporation in 2000 named Motion Graphix and brought in Raleigh Souther as a 49 percent co-owner of the company. In 2004, the corporation retained Katten Muchin as corporate counsel; however, in 2005 the two shareholders had a falling out. Corrales and Souther settled, with Corrales agreeing to continue to receive 20 percent of the corporation's gross profits and obtaining other rights, while Souther was to receive 80 percent of Corrales's stock and became the "majority partner and shareholder for Motion Graphix." Galimi drafted the release agreement. Shortly thereafter, Corrales complained to Galimi that Souther was not holding up his part of the deal. Galimi properly responded that he had a "duty to Motion Graphix, as counsel to Motion Graphix, and not to you or Souther as individuals. I'm not in a position to address disputes between the two of you." Corrales died without the dispute being settled, and his estate (the plaintiff in this case) took over his position in connection with Motion Graphix.

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In 2006, Souther emailed Galimi and accountant Joan Green, stating: "So, damn the torpedoes, let's incorporate Get Flipped Inc. [wholly owned by Souther] and sell the M[otion] G[raphix] assets over and dissolve [it] as quick as possible. As far as [Corrales's] estate wanting the 20 percent gross, gross of what we can say, I think if we can use Joan's valuation for the shares at the time [Corrales] signed them over, we can offer that up as payment for his share after we dissolve the company. I realize this doesn't get me out of a possible personal lawsuit with Corrales estate, but that nasty business can be dealt with after we dissolve the company...I'll follow with a list of assets I want [Get Flipped] to purchase from [Motion Graphix]."

Souther then incorporated Get Flipped as Motion Graphix's sole shareholder, and as president of Motion Graphix, he sold its assets to Get Flipped for $5000, an amount obviously far less than the reasonable value. He sent a letter to the Corrales' estate explaining that "a majority" of Motion Graphix shareholders voted for the transaction. Katten Muchin represented Motion Graphix in this blatantly unfair transaction.

Big surprise: Corrales' estate sued Souther, Get Flipped, and the lawyers, contending among other things, that the lawyers participated in the fraudulent scheme. But under Civil Code Section 1714.10, before suing a lawyer for conspiring with his client, a party is required to make a showing "that there is a reasonable probability that the party will prevail" and obtain a court order allowing the pleading. So Judge Mary Ann Murphy required the estate to file supporting papers with evidence. Meanwhile, Galimi (who had left the firm) filed a sanctions motion against the estate under Code of Civil Procedure Section 128.7. Judge Murphy ultimately denied the estate's petition, finding that "the Estate had not met its burden under [S]ection 1714.10 to establish a reasonable probability it would prevail." She granted Galimi's sanctions motion, stating that the "complaint does not provide a basis for holding Galimi for conspiracy to do anything alleged in the complaint or any other theory of liability."

Interestingly, the estate also filed a parallel stockholder derivative action, seeking to sue the attorneys for malpractice on behalf of Motion Graphix. Judge Murphy also sustained a demurrer to this lawsuit, holding that the estate did not have standing because the corporation was dissolved, and alternatively that even if the estate did have standing, no derivative suit against outside counsel for malpractice would be proper since outside counsel could not properly defend itself unless the corporation had waived the attorney/client privilege. The estate appealed.

The Court of Appeal reversed the trial court's orders. First, Justice Dennis Perluss, writing for a unanimous panel (Justices Laurie Zelon and Frank Jackson concurring), opined that as a result of a 1989 Supreme Court case, Doctors' Co. v. Superior Court (1989) 49 Cal. 3d 39 and subsequent legislative changes, Section 1714.10 had become "practically meaningless." The opinion traces the history of Section 1714.10, including the Legislature's efforts to amend the statute after the Doctors opinion. Doctors found that lawyers are not liable if the "agent's immunity rule" applies - in other words, where the lawyers were acting only as agents and did not personally owe any duty to the plaintiff. The Legislature's amendments to the statute following Doctors were ineffective at providing any real protection to lawyers and "at best" provide an additional procedural hoop for plaintiffs suing lawyers for conspiracy. The court here ruled that a trial court "in effect is in the same position as it would be in ruling on a demurrer" so that there is really "no preliminary evaluation of the merits of the case." That is not so good for lawyers.

The Court of Appeal also ruled that there is standing to bring a derivative suit for a dissolved corporation. Thus, the trial court had to examine whether the crime/fraud exception to the attorney-client privilege had waived the corporation's attorney client privilege with Katten Muchin. The derivative claim was reinstated subject to that determination.

Obviously, a much larger factual record will be developed in this case, but Souther's e-mail to Galimi, who was corporate counsel, outlining a plan to transfer corporate assets away to a new company owned only by Souther in the context of the falling out that had occurred between Souther and Corrales does suggest that Galimi may have been aiding Souther. Souther repeatedly used the word "we" when discussing his plan. Perhaps Galimi personally took no further part in the plan, but the firm did represent Motion Graphix in the suspicious asset sale for only $5000.

There is a lesson here for lawyers: beware of e-mails from clients! And if there is a dispute between two shareholders in a close corporation, that situation is fraught with risk for corporate counsel. And finally, if a lawyer receives an e-mail that makes it appear that his or her role is compromised, take measures for self protection!