EDITORIAL & OPINION

GUEST COMMENTARY BY PHIL DIAMOND AND JEFF LERMAN

Civil plaintiffs now armed with 'powerful new weapon'

State supreme court has changed the ground rules for disputes including fraud claims

Courts administer two separate systems of justice: the criminal system (in which convicted criminals go to jail and/or pay fines), and the civil system (in which successful plaintiffs are awarded monetary damages).

It used to be that, in the civil system, the range of possible outcomes was fairly predictable: The plaintiff (the person who sues) either wins or loses; each side pays its own legal fees (unless there is a contract or statute to the contrary); and if the plaintiff wins, the defendant is obligated to pay plaintiff money damages to compensate for the loss. "Punitive" damages are rarely awarded, and only when it is proven by clear and convincing evidence that the defendant has done something really bad.

The California Supreme Court, however, has now blurred the lines between the criminal and civil justice systems, and added a powerful new weapon to the arsenals of civil plaintiffs.

THE SIRY INVESTMENT CASE

On July 21, 2022, the Supreme Court issued its decision in SIRY Investment, L.P. v. Saeed Farkhondehpour, et al. (2022 WL 2840312). The SIRY Investment case involved a limited partnership formed to renovate and lease a commercial building.

One of the limited partners (plaintiff) sued the general partner and the three other limited partners, claiming, among other things, that the general partner and other limited partners improperly diverted rental income from the property for their own benefit, resulting in the underpayment of cash distributions to plaintiff.

In addition to the usual requests for damages, plaintiff also asked for attorney's fees and treble damages under Penal Code Section 496. That Code Section provides as follows:

(a) Every person who … receives any property that … has been obtained in any manner constituting theft .., knowing the property to be so … obtained, or who conceals, … withholds, or aids in concealing… or withholding any property from the owner, knowing the property to be so … obtained, shall be punished by imprisonment in a county jail for not more than one year, or imprisonment ….(c) Any person who has been injured by a violation of subdivision (a) … may bring an action for three times the amount of actual damages, if any, sustained by the plaintiff, costs of suit, and reasonable attorney's fees. (Emphasis added.)

"Theft" is in turn defined by Penal Code Section 484 as follows:

(a) Every person who shall feloniously … take … the personal property of another, or who shall fraudulently appropriate property which has been entrusted to him or her, or who shall knowingly and designedly, by any false or fraudulent representation or pretense, defraud any other person of money… is guilty of theft.

The trial court entered judgment for the plaintiff, including an award of attorney's fees and treble damages under Section 496.

On appeal, the Supreme Court held that, on the facts of this case, Section 496(c) was applicable, and the award of treble damages and attorney's fees was proper. The court said,

"We … find that section 496(c) applies concerning the conduct at issue in the present case. The unambiguous relevant language covers fraudulent diversion of partnership funds. Defendants' conduct

See **PLAINTIFFS** page 27

PLAINTIFFS

continued from page 26

falls within the ambit of section 496(a): They "receive[d]" "property" (the diverted partnership funds) belonging to plaintiff, having "obtained" the diverted funds "in [a] manner constituting theft." … Defendants also conceal[ed]" or "withh[e]ld[ ]" those funds (and/or aided in concealing or withholding them) from plaintiff…. They did all of this "knowing" the diverted funds were "so … obtained."

(SIRY Investment, L.P. v. Saeed Farkhondehpour, et al., supra, at p. 13)

The court went on to note that, in order for Section 496 to apply, plaintiff has to prove criminal intent under the statute.

However, the court's language implies that criminal intent is proven merely by showing intentional misconduct, as opposed to innocent or inadvertent misrepresentations or unfulfilled promises, or "innocent breach of contract." (Id.)

The ground rules have changed for disputes including fraud claims.

With this decision, the ground rules for disputes involving fraud claims have been dramatically changed, as follows:

■ There is now a legal basis for an award of attorney's fees, regardless of whether such fees are provided for in a contract.

■ The right to attorney's fees under Section 496(c) is one-way (i.e., to a prevailing plaintiff only), as contrasted with the typical "prevailing party" language found in contracts that include a right to recover attorney's fees in disputes between the parties.

■ There is also now a legal basis for an award of treble damages (i.e., the amount of actual damages is tripled), without having to prove a right to punitive damages.

■ Although the right to receive punitive damages must be proven by clear and convincing evidence, the right to receive treble damages need be proven by only the same "preponderance of evidence" standard as applies to the rest of the plaintiff's case.

WHAT DOES THIS MEAN FOR BUSINESS DISPUTES?

The Siry Investment case involved a dispute between the owners of a real estate limited partnership – but its holding is not limited to that fact pattern. In every business dispute (whether it's between partnership owners, between a business and a vendor, between a corporation and a shareholder, or otherwise), as long as there is a claim of fraud, there is now a risk that the losing defendant could be on the hook for attorney's fees (even if not provided for in a contract) and treble damages (without the need to prove the basis for such damages by clear and convincing evidence).

The stronger the basis of the fraud claim, the greater the potential risk for the defendant. That risk will need to be considered by business defendants in settlement negotiations, and should provide a strong incentive for all business owners always to conduct themselves in a manner that could never be later construed to be fraudulent.

Phil Diamond (philipdiamond@comcast.net) is a real estate attorney, Of Counsel to Lerman Law Partners LLP,. He is also a mediator and arbitrator through his independent practice, Diamond Dispute Resolution. Diamond is also a licensed real estate broker, commercial landlord and developer. Jeff Lerman (jeff@lermanlaw.com), co-founder of Lerman Law Partners LLP and a real estate investor and real estate broker. He is past president of the Marin County Bar Association.

Contributions encouraged

The *North Bay Business Journal* welcomes written opinions from readers on business, political and social issues of interest to the local business community. Opinions should be no more than 700 words in length and make a point, take a stand or urge a call to action. The *Business Journal* also welcomes short letters to the editor in response to items that have appeared in prior issues.

E-mail to news@busjrnl.com or mail to North Bay Business Journal, 427 Mendocino Ave., Santa Rosa, CA 95401. Include your name, phone number, address, title, company/organization and fax number if applicable.

Sonoma Media Investments LLC

For advertising information,
call: 707-521-5270

Got a news story suggestion? Contact a reporter directly, or Editor Anthony Borders at 951- 212-2528 or Anthony.borders@busjrnl.com

Subscribe: Annual $50 for a year (50 regular issues and 1 special issue); $80 for two years. Go to www.nbbj.com and go to subscribe.

Reprints: Reprints of articles and lists are available. Call 707-521-4244 for more information.

Corrections: As part of a commitment to accuracy, The North Bay Business Journal will correct substantial errors. If you believe an error has been reported, please contact Editor Anthony Borders at 951-212-2518 or email at Anthony.borders@busjrnl.com

Book Of Lists Issue: Included in annual subscription.

The *North Bay Business Journal* (ISSN 1530-1192) (USPS 006-756), Copyright © 2022 by the North Bay Business Journal is published weekly (including one special issue in January (Book of Lists)), except the third week in December by Sonoma Media Investments, LLC, 427 Mendocino Ave., Santa Rosa, CA 95401. Businesses and Editorial Offices: 427 Mendocino Ave., Santa Rosa, CA 95401; Accounting and Circulation Offices: Lorez Bailey, 427 Mendocino Ave., Santa Rosa, CA 95401. Call 707-521-5270 to subscribe. Periodicals postage is paid at Santa Rosa, CA, and additional mailing offices.