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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION TWO

FORECAST MORTGAGE
CORPORATION et al.,

Plaintiffs and Appellants,

v.

O'MELVENY & MYERS, LLP et al.,

Defendants and Respondents.

E054238

(Super.Ct.No. CIVRS1100739)

OPINION

APPEAL from the Superior Court of Riverside County. Joseph R. Brisco, Judge.

Reversed with directions.

Richard G. Anderson and Jeff W. LeBlanc for Plaintiffs and Appellants.

Irell & Manella, Harry A. Mittleman, Iian Jablon, and Glenn K. Vanzura for
Defendants and Respondents.

In a previous action, Forecast Mortgage Corporation and Previti Realty Fund, L.P.
(collectively Forecast) filed a cross-complaint against K. Hovnanian Enterprises

(Hovnanian), alleging that the “plain language” of their contract with Hovnanian obligated Hovnanian to assume certain liabilities.

Eventually, that action was settled. Forecast then filed this action against O’Melveny & Myers, LLP and Peter Healy (collectively O’Melveny), who had drafted the contract, alleging that O’Melveny negligently *failed to include* a provision obligating Hovnanian to assume the identical liabilities.

The trial court sustained a demurrer, without leave to amend, ruling that under the sham pleading doctrine Forecast could not contradict its allegations in the previous action.

Forecast appeals. We will conclude that Forecast could reasonably and honestly take the position, in litigation against Hovnanian, that there was an unambiguous assumption provision; then, after spending time and effort to defend that position and ultimately settling the case, it could reasonably and honestly take the position, in litigation against O’Melveny, that there was no unambiguous assumption provision. Under these circumstances, the inconsistency does not carry with it the onus of untruthfulness, and hence the sham pleading doctrine does not apply.

The trial court did not err, because Forecast did not argue below that the sham pleading doctrine did not apply. Nevertheless, we will hold that Forecast is entitled to amend.

I

FACTUAL BACKGROUND

Consistent with the applicable standard of review (see part IV, *post*), the following facts are taken from the operative complaint, supplemented by matters of which the trial court took judicial notice.

O'Melveny represented Forecast in connection with the sale of certain real property and other assets to Hovnanian. O'Melveny negotiated and drafted a set of agreements for the purchase and sale of the assets (collectively the sale agreement).

The sale agreement was supposed to provide that Hovnanian would assume certain "pre-existing liabilities and expenses." O'Melveny, however, negligently failed to include "the necessary clause for the assumption of the pre-existing liabilities" in the sale agreement.

The sale closed in 2002.

In 2008, Hovnanian sued Forecast, claiming that it had mistakenly assumed the liabilities on "Pre-Closing Homes." These were defined as liabilities in connection with homes that had already been sold to third parties prior to the 2002 closing. Thus, they were among the preexisting liabilities that Hovnanian was supposed to assume.

Initially, O'Melveny represented Forecast in the litigation against Hovnanian (the underlying action). In 2009, however, Forecast replaced O'Melveny with Bingham McCutchen LLP (Bingham).

In 2010, Forecast — through Bingham — filed a third amended cross-complaint (the previous cross-complaint) in the underlying action. The previous cross-complaint repeatedly alleged that Hovnanian’s claims ran counter to the “plain language” of the sale agreement. For example, it alleged that:

1. “Hovnanian’s allegations regarding its contractual obligations run afoul of the *plain language* set forth within the ‘*four corners*’ of the [sale agreement].” (Italics added.)

2. “[T]he *plain language* of the [sale agreement] *expressly* obligated Hovnanian to assume the Pre-Closing Claims” (Italics added.)

3. “[T]he *terms* of the [sale agreement] meant that Hovnanian was ‘assuming the liabilities’ for the Pre-Closing claims” (Italics added, other italics and boldface omitted.)

4. “. . . Hovnanian seeks to rewrite its *plain and unambiguous* contractual obligations No such language appears anywhere within the four corners of the [sale agreement].” (Italics added.)

The underlying action was settled, but only after Forecast incurred \$700,000 in legal fees, over \$400,000 of which was paid to O’Melveny.

II

PROCEDURAL BACKGROUND

In 2011, Forecast filed this action against O’Melveny. O’Melveny announced its intention of filing a demurrer. After a “meet and confer,” the parties stipulated that

Forecast could and would file an amended complaint. O'Melveny reserved its right to demur to the amended complaint.¹

Forecast duly filed an amended complaint. O'Melveny responded by filing a demurrer. It argued that Forecast's allegation that O'Melveny had negligently failed to provide for the assumption of the preclosing liabilities was contradicted by the allegations in the previous cross-complaint that the sale agreement *did* provide for the assumption of the preclosing liabilities.

In opposition to the demurrer, Forecast argued that it was not bound by the allegations of the previous cross-complaint because the previous cross-complaint had been drafted by O'Melveny. Alternatively, in the event that the demurrer was sustained, Forecast also requested leave to amend. However, it did not indicate *how* it would amend.

In reply, O'Melveny pointed out that, in fact, it had *not* drafted the previous cross-complaint. Rather, as the previous cross-complaint showed on its face, it had been drafted by Bingham, after O'Melveny had already been substituted out of the case.

The trial court sustained the demurrer without leave to amend. It then entered judgment accordingly.

¹ Forecast complains that at no time during the meet and confer did O'Melveny raise any of the issues that it raised in its subsequent demurrer. This assertion, however, is not supported by any citation to the record. Accordingly, we disregard it. (See Cal. Rules of Court, rule 8.204(a)(1)(C).)

III

REQUESTS FOR JUDICIAL NOTICE

Both Forecast and O’Melveny have filed requests for judicial notice. We reserved our ruling on those requests for consideration with the merits of the appeal.

O’Melveny, as it did in the trial court, has requested judicial notice of the previous cross-complaint. And Forecast, as it did in the trial court, has not objected. The trial court already took judicial notice of this document. Accordingly, we take the requested judicial notice. (Evid. Code, § 452, subd. (d), 459, subd. (a)(1).)

Forecast has requested judicial notice of the sale agreement, which it claims was an exhibit to the previous cross-complaint (although the sale agreement is not attached to any of the copies of the previous cross-complaint that have been filed in this case).

O’Melveny has objected, on the ground that the trial court was never asked to take — and did not take — such judicial notice. We decline to take the requested judicial notice, but only because, as will be seen, we do not need to do so in order to resolve this case. (See *Duronslet v. Kamps* (2012) 203 Cal.App.4th 717, 737.) Hence, our denial is without prejudice to any renewed request in connection with any further litigation.

IV

THE APPLICATION OF THE SHAM PLEADING DOCTRINE

A. *Standard of Review.*

A demurrer should be sustained when “[t]he pleading does not state facts sufficient to constitute a cause of action.” (Code Civ. Proc., § 430.10, subd. (e).)

“We review a trial court’s order sustaining a demurrer de novo. [Citation.]” (*Estate of Moss* (2012) 204 Cal.App.4th 521, 535.) “We assume the truth of the properly pleaded factual allegations, facts that reasonably can be inferred from those expressly pleaded, and matters of which judicial notice has been taken. [Citation.]” (*Vitkievicz v. Valverde* (2012) 202 Cal.App.4th 1306, 1311.)

“If we determine the facts as pleaded do not state a cause of action, we then consider whether the court abused its discretion in denying leave to amend the complaint. [Citation.] It is an abuse of discretion for the trial court to sustain a demurrer without leave to amend if the plaintiff demonstrates a reasonable possibility that the defect can be cured by amendment. [Citation.]’ [Citation.]” (*Bank of America, N.A. v. Mitchell* (2012) 204 Cal.App.4th 1199, 1204.) However, “[s]uch a showing can be made for the first time to the reviewing court’ [Citation.]” (*Gomes v. Countrywide Home Loans, Inc.* (2011) 192 Cal.App.4th 1149, 1153-1154.)

B. *Analysis.*

The trial court sustained the demurrer on the ground that Forecast was alleging that the sale agreement did not provide for the assumption of the preclosing claims, yet Forecast had “judicially admitted” that the sale agreement *did* provide for the assumption of the preclosing claims.

““Where a verified complaint contains allegations destructive of a cause of action, the defect cannot be cured in subsequently filed pleadings by simply omitting such allegations without explanation.” [Citations.] “In such a case the original defect

infects the subsequent pleading so as to render it vulnerable to a demurrer.” [Citation.] . . .” [Citation.]” (*Hendy v. Losse* (1991) 54 Cal.3d 723, 742-743.)

This is sometimes called the “sham pleading” doctrine. (E.g., *Deveny v. Entropin, Inc.* (2006) 139 Cal.App.4th 408, 425 [Fourth Dist., Div. Two].) “The purpose of the doctrine is to enable the courts to prevent an abuse of process. [Citation.] The doctrine is not intended to prevent honest complainants from correcting erroneous allegations or to prevent the correction of ambiguous facts. [Citation.]” (*Hahn v. Mirda* (2007) 147 Cal.App.4th 740, 551.)

According to one leading treatise, “[i]t is unclear whether facts pleaded . . . in a *different* lawsuit are conclusive on the pleader in the present action[.]” (1 Weil & Brown, Cal. Practice Guide: Civil Procedure Before Trial (The Rutter Group 2011) ¶ 7:48.16, p. 7(I)-27.) On one hand, *Katz v. Feldman* (1972) 23 Cal.App.3d 500 held that “while a party may not allege inconsistent facts in his pleading in the same case [citations], inconsistent allegations in separate actions create, at the most, only ‘evidentiary admissions,’ which, *if verified*, can be used by the adversary only to impeach the pleader or to rebut his contentions as unfounded in fact. [Citations.]” (*Id.* at p. 504; see generally 4 Witkin, Cal. Procedure (5th ed. 2008) Pleading, § 453, p. 586.) On the other hand, there is at least one case holding that allegations in a previous action may be deemed conclusive under the sham pleading doctrine. (*Cantu v. Resolution Trust Corp.* (1992) 4

Cal.App.4th 857, 877-879.)² Rather than attempt to resolve this split of authority, we will assume, without deciding, that the latter position is correct.

The sham pleading doctrine “is reserved, however, for the extreme case, and it may not be indiscriminately applied; it ‘must be taken together with its purpose, which is to prevent amended pleading which is only a sham, when it is apparent that no cause of action can be stated truthfully.’ [Citations.]” (*Amarel v. Connell* (1988) 202 Cal.App.3d 137, 144.)

For example, in *Avalon Painting Co. v. Alert Lumber Co.* (1965) 234 Cal.App.2d 178 (*Avalon*), Avalon cross-complained against the manufacturer (Synkoloid) and the retailer (Alert) of allegedly defective paint. (*Id.* at pp. 180-181.) The only causes of action that Avalon asserted against Alert were for breach of warranty. Avalon’s original cross-complaint alleged that Alert was Synkaloid’s agent (*id.* at p. 181); however, its amended cross-complaint omitted this allegation. (*Id.* at pp. 181-182.) The trial court sustained a demurrer without leave to amend. (*Id.* at p. 182.)

² In contrast to the sham pleading doctrine, the doctrine of judicial estoppel clearly *can* apply to allegations in a previous lawsuit. Forecast, however, is not judicially estopped by its allegations in the underlying action, because those allegations were never adopted by any tribunal. (See *Swahn Group, Inc. v. Segal* (2010) 183 Cal.App.4th 831, 845.)

As far as we know, no California court has attempted to reconcile the sham pleading doctrine with the doctrine of judicial estoppel — and we have no ambition to become the first. Nevertheless, the two doctrines are obviously related, and it would be odd if the outcome were different under one than under the other.

The appellate court began by noting that, if Alert was indeed Synkaloid's agent, it could not be held liable for the alleged breach of warranty. (*Avalon, supra*, 234 Cal.App.2d at p. 182.) It held, however, that Avalon was not bound by its previous allegation of agency:

“The pleadings before us . . . pose a real question as to whether respondent was one of many retailers selected to sell Synkoloid products as a separate and independent entity or an entity which was in the relationship of an agent to Synkoloid, in the legal connotation and implication of that relationship. A Ford dealer or retailer may in a layman's view be an agent of the Ford Motor Co., but he is not an agent in the legal sense of that relationship. [Citation.]

“While the existence of agency is generally considered a question of fact, [citation] it is also true that the term ‘agent’ is a conclusion based on a study of all the evidence concerning the relationship of the parties involved; [citations].

“[W]e are dealing with an allegation of agency which amounts to a conclusion of law and is not only subject to differing constructions but it is one which in the original pleadings was coupled with an allegation that the party or parties in question were retailers and other facts indicating that Synkoloid, the original source, sold its products only through certain outlets.

“This is not a situation in which the omission, substitution, or contradiction of an original allegation carries with it the onus of untruthfulness. Indeed, the cases show that the determination of the existence of agency may be a complex and difficult task. A final

conclusion can be reached on the decisive fact in question only after evidence has been taken.” (*Avalon, supra*, 234 Cal.App.2d at p. 184.)

The court concluded: “Rules of pleading are conveniences to promote justice and not to impede or warp it. We do not question the rule that all allegations of fact in a verified complaint which are subsequently omitted or contradicted are still binding on the complainant. The rule is valid and useful, but it does not exist in a vacuum and cannot be mechanically applied. It is a good rule to defeat abuses of the privilege to amend and to discourage sham and untruthful pleadings. It is not a rule, however, which is intended to prevent honest complainants from correcting erroneous allegations of generic terms which may have legal implications but which are also loosely used by laymen or to prevent correction of ambiguous facts.” (*Avalon, supra*, 234 Cal.App.2d at p. 185.)

Callahan v. City and County of San Francisco (1967) 249 Cal.App.2d 696 (*Callahan*) is also relevant. In *Callahan*, the plaintiff was allegedly injured in a traffic accident. (*Id.* at p. 698.) In her initial complaint, the only defendant was the driver; it alleged that he had engaged in “wilful misconduct” by racing. (*Id.* at pp. 698-699.) In her subsequent amended complaint, however, the only defendant was the city that owned the property where the accident occurred; it alleged a dangerous condition of public property. (*Ibid.*) The trial court sustained a demurrer without leave to amend. (*Id.* at p. 699.)

On appeal, the city argued that the allegation of willful misconduct was fatal to the plaintiff's claim against it. (*Callahan, supra*, 249 Cal.App.2d at p. 699.) The appellate court, however, observed:

“The verified allegations may be considered by the court at a hearing of the demurrer to a later pleading. [Citations.] [¶] But the rule must be taken together with its purpose, which is to prevent amended pleading which is only a sham, when it is apparent that no cause of action can be stated truthfully. [Citation.] . . . The allegation of wilful misconduct was not against the city, of course, which was not even a party at the time, but was against [the driver]. It was necessary, under the guest law, in order to state a cause of action against [the driver], that he be charged with wilful misconduct [Citation.] The allegation of wilful misconduct under the guest law is but an allegation of a conclusion. [Citations.] . . .

“The allegation of reckless disregard for the possible result has to do with something mental or subjective on the part of the driver. [Citations.] Whether plaintiff would have been able to prove her allegations against [the driver], we shall never know. . . . It would be unfair to give the city the benefit, at the pleading stage, of assuming that these generic allegations against another may be taken as proved. [Citation.] If the city were entitled to this benefit, plaintiff would have been put to an election which the law does not impose upon her. If by an allegation of wilful misconduct she stated a cause under the guest law, she would take the risk of ruling out her action against the city; if, on

the other hand, she failed to make this allegation, she would have no cause against the driver.” (*Callahan, supra*, 249 Cal.App.2d at pp. 699-700.)³

Avalon and, even more so, *Callahan* are on point here. Forecast’s inconsistent allegations do not carry with them the “onus of untruthfulness.” There is obviously a genuine question as to whether the sale agreement — by its “plain language” or otherwise — obligated Hovnanian to assume the liability for the preclosing claims. Ultimately, like agency in *Avalon* and willful misconduct in *Callahan*, this is a legal conclusion.⁴ It is perfectly understandable that, in litigation against Hovnanian, Forecast would take the position that the sale agreement did have this effect, and then, in litigation against O’Melveny, that it did not. Like the plaintiff in *Callahan*, it should not be forced to elect — particularly at the pleading stage — between two potentially liable defendants. The fact that Forecast has had to incur significant effort and expense in defending against Hovnanian is sufficient to demonstrate that its allegations in this action are not sham or in bad faith.

³ The court also went on to hold that the allegation of willful misconduct by the driver was not actually inconsistent with the plaintiff’s cause of action against the city. (*Callahan, supra*, 249 Cal.App.2d at pp. 700-701.)

⁴ Forecast argues that the sham pleading doctrine does not apply to legal conclusions at all. Once again, while there is some support for this position (see *Herman v. Los Angeles County Metropolitan Transportation Authority* (1999) 71 Cal.App.4th 819, 823, fn. 5; *Berman v. Bromberg* (1997) 56 Cal.App.4th 936, 948-949, there is also some contrary authority. (See *Hendy v. Losse, supra*, 54 Cal.3d at p. 743.) Therefore, rather than rest our opinion on this point, we will assume that the sham pleading doctrine can apply to a legal conclusion.

Citing our opinion in *Deveny v. Entropin, Inc., supra*, 139 Cal.App.4th 408, O'Melveny argues that the "application of the sham pleading rule requires the inconsistent pleader to explain the inconsistency." However, when "the proposed . . . amended complaint 'does not carry with it "the onus of untruthfulness" . . . , and . . . the sham pleading rule is inapplicable . . . , . . . there [i]s no need . . . to explain the reasons for the amended pleading" (*Berman v. Bromberg, supra*, 56 Cal.App.4th at p. 949.) In both *Avalon* and *Callahan*, the appellate court was able to determine simply from the circumstances, without an explanation, that the onus of untruthfulness was absent.

We do not mean to fault the trial court in any way. In the proceedings below, Forecast did not cite *Avalon*, *Callahan*, or, indeed, *any* case law dealing with the sham pleading doctrine. Thus, it forfeited the contention that the doctrine did not apply. Instead, it put all its chips on the argument that the underlying cross-complaint had been drafted by O'Melveny. The factual premise of this argument, however, was blatantly false. Thus, it is hardly surprising that the trial court sustained the demurrer.

The law is well established, however, that a plaintiff may claim for the first time on appeal that it can amend its complaint so as to state a good cause of action. Accordingly, Forecast now claims that it could amend its complaint so that, instead of alleging that O'Melveny negligently *omitted* the necessary assumption provision, it would allege that O'Melveny negligently *drafted* the necessary assumption provision. O'Melveny responds that this, too, would contradict the allegations of the underlying cross-complaint, which stated (among other things) that "the *plain language* of the [sale

agreement] *expressly* obligated Hovnanian to assume the Pre-Closing Claims”

(Italics added.) For the reasons already discussed, however, the sham pleading doctrine does not bar Forecast from contradicting these allegations.

We therefore conclude that the judgment must be reversed.

V

DISPOSITION

The judgment is reversed. The trial court is directed to enter a new order within 10 days of the issuance of the remittitur granting Forecast leave to amend within 10 days of the trial court’s order.

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RICHLI
Acting P. J.

We concur:

KING
J.

CODRINGTON
J.