NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

ARI-NBCC 2, LLC. et al., Plaintiffs and Appellants, v. ARGUS REALTY INVESTORS, L.P. et al., Defendants and Respondents.	G050164 (Super. Ct. No. 30-2012-00615393-CU-SL-CXC) O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, Gail Andrea Andler, Judge. Requests for judicial notice. Judgment reversed. Requests granted in part and denied in part.

Slater Hersey & Lieberman, Mark K. Slater, Jonathan P. Hersey and Scott B. Lieberman for Plaintiffs and Appellants.

TencerSherman and Philip C. Tencer for Defendants and Respondents.

*   *   *

This appeal arises out of a judgment entered following the sustaining of a demurrer to plaintiffs' second amended (operative) complaint without leave to amend. The appealing plaintiffs include six Delaware limited liability companies (ARI-NBCC 2, LLC, ARI-NBCC 16, LLC, ARI-NBCC 24, ARI-NBCC 25, ARI-NBCC 36, LLC, and ARI-NBCC 37, LLC), one Oregon limited liability company (Pine Meadows Townhomes, LLC), two individuals (Irene Kochendorfer and Peter Rill), two trustees (Steven K. Oshita, as Trustee for the Steven K. Oshita Revocable Living Trust and Candace Graham, as Trustee of the Candace Graham 2004 Trust) and two co-trustees (Kenneth Slater, as co-Trustee of the Bernice A. Slater Living Trust, and David Boggini, as co-Trustee of the Bernice A. Slater Living Trust).

In 2007 and 2008, plaintiffs purchased tenant-in-common (TIC) interests in a commercial business complex in Phoenix, Arizona (Property). The purchases were part of an Internal Revenue Code section 1031 exchange, which allowed plaintiffs to defer capital gains on taxes on the sale of other real estate assets they owned. The Property did not perform as well as anticipated and the Property was foreclosed upon and sold. In 2012, plaintiffs sued, among others, defendants Argus Realty Investors, LP, Argus Realty, LLC, ARI-Northgate Blackhawk Corporate Center, LLC (the Company), ARI Commercial Properties, Inc., ARI Financial Services, Inc., Richard Gee, Timothy E. Snodgrass, and Maxwell B. Drever. Only these named defendants are involved in this appeal. As against them, plaintiffs alleged causes of action for securities fraud under California and Arizona law, fraud, misrepresentation, negligence, and financial elder abuse.

The trial court sustained defendants' demurrer to the operative complaint without leave to amend, in part, on the basis that all causes of actions against defendants were barred by the applicable statutes of limitations. On appeal, plaintiffs contend, among other things, that they timely filed their original complaint and adequately complied with the delayed discovery rule. Although we disagree, we reverse the judgment of dismissal and grant plaintiffs leave to amend. As a result, we do not address plaintiffs' contentions regarding the alternative grounds upon which the court sustained the demurrer.

We deny plaintiffs' request for judicial notice of the records of the Arizona office of the Corporation Commission regarding its Certificate of Registration for the Company because it is irrelevant to our decision. But we grant plaintiffs' motion for judicial notice of Exhibit O to the Private Placement Memorandum (PPM).

FACTS AND PROCEUDRAL BACKGROUND

The following facts are taken from plaintiffs' operative complaint and the PPM, of which the trial court took judicial notice.

Under the PPM, dated July 30, 2007, with supplements dated July 30, 2007 and October 2007, the Company offered "undivided [TIC] interests in the Property . . . to certain investors." The PPM contained risk warnings throughout that among other things, the venture "is highly speculative and involves substantial risks." The projections in the PPM "are forward-looking . . . based . . . on . . . current expectations and projections about future events[, which] . . . are subject to risks, uncertainties and assumptions about the Property . . . ." Though the Company believed its expectations to be reasonable, it could not "assure . . . that its expectations will be attained or that any deviations will not be material." In bold, it warned, "any projections and representations, written or oral, which do not conform to those contained in this Memorandum must be disregarded, and their use is a violation of law. The information . . . in this Memorandum . . . is based upon specified assumptions. If these assumptions are incorrect, these projections also would be incorrect. No representation or warranty can be given that the estimates, opinions or assumptions made in this Memorandum will prove to be accurate." (Boldface omitted.)

The PPM warned, "the Company, the Property Manager and their Affiliates will be subject to certain conflicts of interest and will receive substantial compensation in connection with this Offering." The leasing commission for the property manager was to be "equal to $7.5% of the value of any new lease entered into during the term of the Property Management Agreement (which rate may be increased in accordance with the standard area market rate at the time of lease signing) . . . ." The PPM also contained a section describing the fees to be paid to the Company and its Affiliates.

Investors were advised, "The purchase price to be paid . . . exceeds the aggregate appraisal value of the Property. The Company intends to purchase the Property for $51,357,000 . . . , plus additional carrying costs, due diligence expenses, and other fees and expenses incurred in the acquisition and financing of the Property. . . . The Company intends to acquire proceeds from the sale of all the Interests, together with the Loan, equal to $58,240,000. The purchase price for Interests is determined unilaterally by the Company and likely does not reflect the current market value of the Property, and is not based on an arm's length negotiation with the Purchasers or supported by an appraisal of the Property. . . . Purchasers . . . should not anticipate or expect that the price paid for their investment is reflective of the fair market value of the Property on a stand-alone basis." (Boldface and italics omitted.)

The PPM went on to warn of specific "Risk Factors," including those related to real estate, TICs, operations, private offering and liquidity, taxes, and miscellaneous items. "Investors are invited to ask questions of, and obtain more information from, the Company about the terms and conditions of this Offering, the Company, the Property, the Property Manager, the Interests, and any other relevant matters, including, but not limited to, additional information necessary or desirable to verify the accuracy of the information in this Memorandum. The Company will provide the information to the extent the Company has such information or can obtain it without unreasonable effort or expense."

The property manager was to prepare and submit to the TICs an annual operating budget. The TICs were deemed to have accepted the budget unless they specifically objected in writing to a budget item. If they did not approve the budget, they were required to "negotiate in good faith with the Property Manager and the other [TICs] to obtain an acceptable Budget." For items considered "operational expenditures, as opposed to capital expenditures, the Property Manager [was] entitled to oversee and supervise the operation of the Property using the prior year's Budget until the approval is obtained. The Property Manager [had to] provide the [TICs] with such information regarding the Budget as may be, from time to time, reasonably requested by the [TICs]. The Property Manager [could] at any time submit a revised Budget to the [TICs] for approval by a majority thereof."

Defendants began promoting TIC sales in the Property sometime after August 31, 2007. Various plaintiffs purchased TIC interest from September 21, 2007 through February 19, 2008, relying on, among other things, the Offering Materials (the Property brochure, the PPM, and the PPM Supplements).

In October 2008, defendants joined forces with Thompson National Properties (TNP), which became the property manager and took exclusive control over the Property and the management duties from defendant ARI Commercial, Inc. Shortly thereafter, TNP began sending updates about the Property to plaintiffs. TNP blamed the recession for the decreased operating income of the Property, predicted future improvement, and reported stable or increasing property value. Sometime after August 2011, debt servicing stopped and collection proceedings ensued.

In April 2012, after the lenders had filed a complaint and summons in the Arizona superior court, Breakwater Equity Partners (Breakwater), a loan work out company, was retained to attempt to renegotiate the loan. Breakwater's "summary revealed a number of facts about the TIC investments which [p]laintiffs had not been aware of and could not have been aware of due to [defendants'] and TNP's control of information and omissions and misrepresentations concerning the Property, its operations, and value."

In particular, the summary "revealed that the Property was not valued or performing as . . . [d]efendants and TNP had indicated. Contradicting TNP's appreciating or stable value of approximately $55 million, the . . . [s]ummary revealed 'The current [December 2011] lender appraisal is $16.6MM. [Breakwater] estimated an as-is value range of $17.7MM to 19.4MM based on current data and valuation metrics.' "The . . . [s]mmary further alerted [p]laintiffs to defendants' failure to pay debt service since approximately August 2011 and to the notice of default and notice of trustee's sale." It also "revealed that (i) [p]laintiffs were paying an 'inordinately high leasing commission of 7.5%'; (ii) '2012 budgeted operating expenses [were] significantly more than comparable property types in the area . . .'; and (iii) the structure of the TIC investments, with all of the fees and commissions paid to the . . . defendants, was such that it would render a reasonable return on investment very unlikely." Before this summary, plaintiffs "were not aware of any facts that made them suspicious of the veracity of the . . . [d]efendants' representations with respect to the TIC investments," or their qualifications or omissions. The property sold at foreclosure in June 2012 and plaintiffs lost their investments.

Plaintiffs sued defendants in November 2012 for violations of California and Arizona securities fraud statutes, fraud and deceit, intentional and negligent misrepresentation, negligence, constructive fraud, negligence, constructive fraud, and financial elder abuse. The case was consolidated with seven other cases related to defendants' sale of TIC interests in other properties. Defendants demurred to the complaint, in part, on the ground all the causes of action were time barred. The trial court agreed and sustained the demurrer with leave to amend, noting plaintiff had to allege specific facts demonstrating when and how the discovery of the claim was made and why it could not be made earlier with due diligence.

Plaintiffs filed a first amended complaint containing the same causes of action. A month later, pursuant to stipulation, they filed the operative complaint, adding a new plaintiff but making no substantive changes. Among other things, plaintiffs alleged the Offering Materials contained numerous misrepresentations and omissions, which were false when made. These included representations: the property was "institutional-grade Commercial real estate" and the investment was "'reliable[and] stable,'" with projections showing annual returns of at least 6 percent, when defendants' "records showed . . . (14 of 30) [of programs sponsored by defendants] were not meeting projected [net operating income] as of December 31, 2006"; the brokerage commission would be paid by the sellers but were actually paid by the investors through assumed debt; the TIC interests would only be sold to suitable investors yet were knowingly sold to unsuitable ones; the property manager would collect fees at or below market rates, including a 7.5 percent leasing commission on new leases, which however exceeded that charged for comparable commercial properties in the area; and, other than what was stated, defendants did not know of anything that would cause the financial information they provided not to indicate future operations, even as the fees, costs, commissions and the marked-up purchase price made "a reasonable return on the TIC investment incredibly difficult."

Defendants again demurred and repeated their argument that plaintiffs' claims were barred by the applicable statutes of limitations. In support of their demurrer, defendants requested judicial notice of the PPM. Plaintiffs opposed the request because the exhibits to the PPM and other relevant documents had been omitted.

The court granted the request for judicial notice notwithstanding the lack of attached exhibits and sustained the demurrer without leave to amend, in part, on the ground the causes of actions were time-barred: "As with past iterations of the complaints in these cases, plaintiffs appear to be relying on the discovery rule to toll the statute. Plaintiffs were previously admonished that plaintiffs need to allege facts to show when the discovery was made, the manner in which it was made, and the reasons why it could not have been made earlier. Plaintiffs were required to demonstrate the inability to discover earlier, despite reasonable diligence. The court admonished then, and finds now, that plaintiffs' conclusory allegations are not sufficient. Under [*Grisham v. Philip Morris U.S.A., Inc.* (2007) 40 Cal.4th 623 (*Grisham*)], plaintiffs were obligated to plead with specificity regarding diligence. Plaintiffs have failed to do so and therefore they have not been able to plead around the statutes of limitations, resulting in a number of claims being time barred."

DISCUSSION

1. Standard of Review

A demurrer is used to test the sufficiency of the factual allegations of the complaint to state a cause of action. (Code Civ. Proc., § 430.10, subd. (e).) The facts pled are assumed to be true and the only issue is whether they are legally sufficient to state a cause of action. "In reviewing the sufficiency of a complaint against a general demurrer, we are guided by long-settled rules. 'We treat the demurrer as admitting all material facts properly pleaded, but not contentions, deductions or conclusions of fact or law. [Citation.] We also consider matters which may be judicially noticed.' [Citation.]

Further, we give the complaint a reasonable interpretation, reading it as a whole and its parts in their context. [Citation.] When a demurrer is sustained, we determine whether the complaint states facts sufficient to constitute a cause of action. [Citation.] And when it is sustained without leave to amend, we decide whether there is a reasonable possibility that the defect can be cured by amendment: if it can be, the trial court has abused its discretion and we reverse; if not, there has been no abuse of discretion and we affirm. [Citations.] The burden of proving such reasonable possibility is squarely on the plaintiff." (*Blank v. Kirwan* (1985) 39 Cal.3d 311, 318 (*Blank*).)

2. Applicable Statutes of Limitations

The limitations periods for security fraud in California and Arizona are, respectively, two years of discovery or five years after the wrongful transaction, whichever expires first (Corp. Code, § 25506, subd. (b)), and two years from discovery (Ariz. Rev. Stat., § 44-2004(B)). Actions for fraud and deceit, intentional misrepresentation, and constructive fraud must be filed within three years of discovery. (Code Civ. Proc., § 338, subds. (a), (d).) A two-year statute of limitations applies to negligent misrepresentation and negligence. (See *Ventura County Nat. Bank v. Macker* (1996) 49 Cal.App.4th 1528, 1530 [essence of a cause of action for negligent misrepresentation "is negligence, not fraud" and thus the applicable statute of limitations is two years]; Code Civ. Proc., § 339.) And the applicable statute governing financial elder abuse is Welfare and Institutions Code section 15657.7 [four years after discovery], not Code of Civil Procedure section 338 [three years]. The longest applicable statute of limitations is thus four years.

In their complaint, plaintiffs admitted reviewing the Offering Materials, including the risk warnings, before making an investment decision. They made their investments no later than February 19, 2008. Plaintiffs did not file their original complaint until November 2012, over four years later. Plaintiffs' claims are thus time-barred unless the delayed discovery rule applies.

3. Delayed Discovery

"Generally speaking, a cause of action accrues at 'the time when the cause of action is complete with all of its elements.' [Citations.] An important exception to the general rule of accrual is the 'discovery rule,' which postpones accrual of a cause of action until the plaintiff discovers, or has reason to discover, the cause of action." (*Fox v. Ethicon Endo-Surgery, Inc*. (2005) 35 Cal.4th 797, 806-807.) "A plaintiff has reason to discover a cause of action when he or she 'has reason at least to suspect a factual basis for its elements.' [Citations.] Under the discovery rule, suspicion of one or more of the elements of a cause of action, coupled with knowledge of any remaining elements, will generally trigger the statute of limitations period." (*Id*. at p. 807.) "The discovery rule only delays accrual until the plaintiff has, or should have, inquiry notice of the cause of action." (*Ibid*.) "The discovery rule . . . allows accrual of the cause of action even if the plaintiff does not have reason to suspect the defendant's identity." (*Ibid*.)

"California law recognizes a general, rebuttable presumption, that plaintiffs have 'knowledge of the wrongful cause of an injury.' [Citation.] In order to rebut that presumption, '"[a] plaintiff whose complaint shows on its face that his claim would be barred without the benefit of the discovery rule must specifically plead facts to show (1) the time and manner of discovery *and* (2) the inability to have made earlier discovery despite reasonable diligence." [Citation.] In assessing the sufficiency of the allegations of delayed discovery, the court places the burden on the plaintiff to "show diligence"; "conclusory allegations will not withstand demurrer."'" (*Grisham, supra*, 40 Cal.4th at p. 638.)

In their operative complaint, plaintiffs denied knowledge of facts that would make them question the reliability of defendants' representations regarding their qualifications or the TIC investments. On appeal, plaintiffs maintain they "had no reason to suspect injury and wrongful cause until April 2012." But these are conclusory statements insufficient to overcome the sustaining of defendants' demurrer.

Plaintiffs contend they "specifically pled they became suspicious of wrongdoing in April 2012 when they received the Breakwater [s]ummary informing them of high leasing commissions, the 'very unlikely' occurrence of promised returns given the investment's structure, and the Property's value." They claim the "court's ruling does not address what should have put [them] on notice of their injury or its wrongful cause." Plaintiffs confuse the cases to which the discovery applies with the pleading requirements necessary in order to attain the benefits of the discovery rule. Although the discovery rule delays accrual of a claim until a plaintiff has or should have inquiry notice, in order rebut the presumption a plaintiff has knowledge of an injury's wrongful cause, the plaintiff must specifically plead facts showing, among other things, """the inability to have made earlier discovery despite reasonable diligence.""" (*Grisham, supra*, 40 Cal.4th at p. 638.) Plaintiffs failed to allege the necessary facts.

Plaintiffs assert mere underperformance of an investment during a recession does not put a plaintiff on inquiry notice, and they were continually assured of the viability of the investment. They also claim defendants' "fiduciary duties excused any duty to inquire until April 2012" and that fraud in concealing a cause of action tolls the statute of limitations where a plaintiff's reliance is reasonable, which usually is a question of fact. But because the timeliness of plaintiffs' claims depended upon the delayed discovery rule, they were required to plead facts showing an *inability* to have discovered the wrongful causes of their injuries sooner *notwithstanding* their exercise of due diligence. They did not. None of their contentions address this failure.

Plaintiffs maintain that the allegations of conspiracy tolled the statutes of limitations until the 2012 foreclosure, when they first sustained damages due to the loss of their investments. (*Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 511 [elements of conspiracy include damages].) But they argue in their opening brief that defendants collected "substantial upfront fees" and continued to collect "excessive fees." The operative pleading also alleged plaintiffs assumed a loan from which an additional $1 million was paid to defendants for a brokerage commission that was supposed to have been paid by defendants. These representations demonstrate plaintiffs were damaged at the time of purchase and every month after that until the time of the foreclosure.

Plaintiffs failed to meet their burden of alleging the necessary facts for the delayed discovery rule to apply. The trial court correctly sustained the demurrer.

4. Leave to Amend

Generally, a trial court abuses its discretion to sustain a demurrer without leave to amend if there is any reasonable possibility the pleading defect can be cured by amendment (*Temescal Water Co. v. Dept. Public Works* (1955) 44 Cal.2d 90, 107) and leave to amend is usually liberally permitted (*Angie M. v. Superior Court* (1995) 37 Cal.App.4th 1217, 1227). A request for leave to amend and the showing necessary to cure the defects may be made for the first time on appeal. (Code Civ. Proc., § 472c, subd. (a); *Rakestraw v. California Physicians' Service* (2000) 81 Cal.App.4th 39, 43.) Here, plaintiffs requested leave to amend in the trial court, in their opening brief on appeal, and during oral argument.

From the record, it appears that counsel did not expect the demurrer to be sustained again. To some extent, it is understandable if counsel was surprised. The court had previously denied defendants' request to take judicial notice of the PPM. "Regarding all Demurrers, the court **denies** any request for **judicial notice** of the **PPM** as it was not attached to the complaint, and the Court is not persuaded by the arguments that it would be appropriate to consider it in connection with these motions." This time around, however, the court granted defendants' request for judicial notice of the PPM, stating: "The consideration of the PPM has a significant impact on certain aspects of this ruling."

In fact, the allegations in the operative complaint had been significantly expanded, albeit not to the court's satisfaction with regard to allegations "to demonstrate the inability to discover earlier, despite reasonable diligence." Nonetheless, the operative complaint does have allegations that debt service on the property stopped after August 2011 and the investors hired a work out company to renegotiate the loan. The loan work out company issued its first summary around April 24, 2012, and it was this summary that revealed a number of facts about the investments about which plaintiffs had not been aware. The operative complaint further alleges: "Prior to April 24, 2012, [p]laintiffs . . . were not aware of any facts that made them suspicious of the veracity of the ARI [d]efendants' representations." It also alleges defendants sent quarterly updates to [p]laintiffs in an attempt to lull them into believing that the economy was the cause of any issues with the TIC investments. The original complaint was filed on November 30, 2012.

Plaintiffs opposed judicial notice of the PPM, arguing: "Defendants only supply part of the PPM, excluding relevant portions and other documents . . . . As before, the [c]ourt should decline to take judicial notice." In light of the totality of the circumstances here, where there are significant allegations of misrepresentations, a showing to the trial court of how the complaint may be amended and a reasonable possibility further allegations about an inability to discover the alleged misrepresentations earlier may be gleaned from the attachments to the PPM, we conclude plaintiffs should be given another opportunity to amend in order to plead the necessary facts demonstrating their “““inability to have made earlier discovery despite reasonable diligence.””” (*Grisham*, *supra*, 40 Cal.4th at p. 638.)

DISPOSITION

The judgment of dismissal is reversed and remanded for further proceedings. Plaintiffs’ request for judicial notice of the records of the Arizona office of the Corporation Commission regarding its Certificate of Registration pertaining to the Company is denied. Plaintiffs request for judicial notice of Exhibit O to the PPM is granted. The parties shall bear their own costs on appeal.

RYLAARSDAM, ACTING P. J.

WE CONCUR:

MOORE, J.

THOMPSON, J.