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COURT OF APPEAL, FOURTH APPELLATE DISTRICT

DIVISION ONE

STATE OF CALIFORNIA

MERLE LADNER ADAMS et al.,

Plaintiffs and Appellants,

v.

FISERV, ISS et al.,

Defendants and Respondents.

D051778

(Super. Ct. No. GIC837421)

APPEAL from a judgment of the Superior Court of San Diego County, Richard E.L. Strauss, Judge. Reversed.

Plaintiffs, 48 elderly individuals, brought this action against Fiserv ISS for: (1) breach of fiduciary duty; (2) fraudulent concealment; (3) aiding and abetting fraud; (4) violation of Corporations Code section 25504.1; and (5) violation of Business and Professions Code section 17200. (All undesignated statutory references are to the Business and Professions Code.) They appeal a judgment entered against them after the trial court sustained Fiserv's demurrer to their claims without leave to amend, contending that their

allegations were sufficient to state the asserted causes of action. We agree and reverse the judgment.

FACTUAL AND PROCEDURAL BACKGROUND

In accordance with the principles governing our review of a ruling sustaining a demurrer, the following factual recitation is taken from the allegations of Plaintiffs' fourth amended complaint. (*Moore v. Regents of University of California* (1990) 51 Cal.3d 120, 125.)

Starting in 1995, Daniel Heath (Heath), Denis O'Brien and Larre Schlarmann, with the assistance of Attorney David Small (collectively, the Heath Defendants), offered and sold unqualified, nonexempt securities in numerous fraudulent entities to California investors, targeting funds held in individual retirement accounts (IRAs) of elderly investors. The Heath Defendants operated a Ponzi scheme, enticing new investors to invest in the fraudulent entities and using the incoming principal to pay initial investors artificially high returns. Investment money came into the scheme through the sale of promissory notes in Heath's company, Private Capital Management, Inc. (PCM), which, in turn, lent the money to fraudulent entities controlled by the Heath Defendants.

Fiserv successfully bid to become the custodial trustee for hundreds of IRAs seized by the Securities and Exchange Commission, including some of the Plaintiffs' accounts. At that time, Fiserv allegedly knew that the promissory notes in Plaintiffs' accounts were not allowable securities, but allowed the investments nonetheless. Thereafter, Fiserv allegedly knew about the fraudulent scheme and that the Heath Defendants were self-dealing in

Plaintiffs' accounts and substantially assisted in the scheme by mismanaging Plaintiffs' accounts and violating its own internal policies.

The Securities and Exchange Commission shut down the Heath Defendants' fraudulent scheme in March 2004. Plaintiffs filed this action in October 2004 and added Fiserv as a defendant to its first amended complaint in March 2005. Thereafter, the trial court ruled on a series of demurrers filed by Fiserv. As relevant to this appeal, the trial court sustained, without leave to amend, Fiserv's demurrer to Plaintiffs' causes of action for breach of fiduciary duty, violation of Corporations Code section 25504.1 and violation of section 17200 as alleged in their second amended complaint. The trial court allowed Plaintiffs leave to amend their causes of action for fraudulent concealment and aiding and abetting fraud, but ultimately concluded that Plaintiffs' fourth amended complaint did not adequately plead these causes of action and entered a judgment in Fiserv's favor. Plaintiffs timely appealed.

DISCUSSION

I. *Standard of Review*

We review an order sustaining a demurrer without leave to amend de novo (*Blank v. Kirwan* (1985) 39 Cal.3d 311, 318), assuming the truth of all properly pleaded facts as well as facts inferred from the pleadings, and give the complaint a reasonable interpretation by reading it as a whole and its parts in context. (*Palacin v. Allstate Ins. Co.* (2004) 119 Cal.App.4th 855, 861.) However, we give no credit to allegations that merely set forth contentions or legal conclusions. (*Financial Corp. of America v. Wilburn* (1987) 189 Cal.App.3d 764, 768-769.) A complaint will be construed "liberally . . . with a view to substantial justice between the parties." (Code Civ. Proc., § 452.) If the complaint states any

possible legal theory, the trial court's order sustaining the demurrer must be reversed. (*Palestini v. General Dynamics Corp.* (2002) 99 Cal.App.4th 80, 86.) Whether a plaintiff will be able to prove its allegations is not relevant. (*Alcorn v. Anbro Engineering, Inc.* (1970) 2 Cal.3d 493, 496 (*Alcorn*).

II. Analysis

A. Breach of Fiduciary Duty

A subset of Plaintiffs who held IRA accounts with Fiserv (the IRA Plaintiffs), alleged in the second amended complaint that Fiserv, as the custodial trustee of their IRA accounts, breached fiduciary duties owed to them. They contend that the trial court erroneously sustained Fiserv's demurrer to this claim because they alleged facts sufficient to show that Fiserv owed them a fiduciary duty. We agree.

The IRA Plaintiffs alleged in their second amended complaint that Fiserv concealed material facts affecting the value of their investments with the Heath Defendants and that had they known these facts, they would not have invested with the Heath Defendants. Relying on *Brown*, the trial court concluded that the IRA Plaintiffs failed to explain why their relationship with Fiserv gave rise to a duty to disclose and sustained the demurrer without leave to amend. (*Brown, supra*, 45 Cal.App.4th 333.) The IRA Plaintiffs contend that *Brown* is distinguishable because the Plan documents imposed on Fiserv disclosure duties related to the management of their own investments, particularly, that Fiserv had a duty to disclose that the Heath Defendants were directing their IRA funds into prohibited transactions and fraudulent securities. We reject this argument as review of the Plan documents reveals that Fiserv owed no such duties.

To plead a cause of action for breach of fiduciary duty, a plaintiff must show the existence of a fiduciary relationship, its breach, and damage caused by the breach. (*Pierce v. Lyman* (1991) 1 Cal.App.4th 1093, 1101.) "The key factor in the existence of a fiduciary relationship lies in control by a person over the property of another." (*Vai v. Bank of America* (1961) 56 Cal.2d 329, 338.) "[B]efore a person can be charged with a fiduciary obligation, he must either knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law." (*Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 221, superseded by statute on another ground as noted in *Californians for Disability Rights v. Mervyn's, LLC* (2006) 39 Cal.4th 223, 227.)

Fiserv contends, and we agree, that the duties of a directed IRA custodian are limited by the terms of the parties' written agreement. (*Brown v. California Pension Adm'rs & Consultants, Inc.* (1996) 45 Cal.App.4th 333, 337-338 (*Brown*) ["express provisions in the documents governing the business relationship between the parties limited the duties of the trustee and the administrator"]; *Van de Kamp v. Bank of America* (1988) 204 Cal.App.3d 819, 860 ["duty as [an] agent is limited to the scope of the agency set forth in the parties' agreement"].) Accordingly, to determine whether a fiduciary relationship existed between the IRA Plaintiffs and Fiserv, we must review the documents that created their relationship.

Here, the IRA Plan and Trust Agreement (the Plan) governing the parties' relationship expressly provided for the creation of a "trust" and stated that the Plan qualified as a retirement plan under section 408 of the Internal Revenue Code (26 U.S.C. § 408). IRAs are "special deposits that constitute a trust relationship wherein the [trustee] owes a fiduciary

duty to the depositor." (*Masi v. Ford City Bank and Trust Co.* (7th Cir. 1985) 779 F.2d 397, 401; *Richelle L. v. Roman Catholic Archbishop* (2003) 106 Cal.App.4th 257, 271 [a fiduciary relationship is a recognized legal relationship such as trustee and beneficiary].) None of the documents creating the relationship specifically provided that Fiserv owed no fiduciary duties to the IRA Plaintiffs. Rather, the Plan impliedly recognized the existence of a fiduciary relationship as the indemnification provision contained therein expressly provided that it did not relieve Fiserv from any liability for breach of fiduciary duty.

Accordingly, as a custodial trustee, Fiserv owed its customers a fiduciary duty under its own contract. Although section 408 of the Internal Revenue Code also recognizes that an IRA creates a trust (26 U.S.C. § 408(a)), the IRA Plaintiffs need not rely on this statute to create a private cause of action.

Fiserv asserts that *Brown* conclusively disposed of the IRA Plaintiffs' claim for breach of fiduciary duty. (*Brown, supra*, 45 Cal.App.4th 333.) In *Brown*, investors in self-directed IRAs sued the custodial trustee and administrator of their IRAs alleging that the defendants failed to notify them that a borrower of their funds had defaulted in payment to *other investors*. They argued that had they been informed of the borrower's failure to pay, they would not have made further unsecured loans to him. (*Id.* at pp. 338-339.) The trial court sustained the defendants' demurrer to the cause of action for breach of fiduciary duty and the appellate court affirmed because the agreements between plaintiffs and defendants limited the administrator's contractual and common law duties, absolving it of any duty to investigate, select or monitor plaintiffs' IRA investments or notify them of the poor performance of similar investments held by other customers. (*Id.* at pp. 346-348.)

Fiserv correctly notes that the relevant provisions of the documents signed by the IRA Plaintiffs are substantially identical to those examined in *Brown*, to wit, that (1) as the custodial trustee Fiserv: (a) was not acting as the IRA Plaintiffs' investment advisor; (b) had no duty to question the IRA Plaintiffs' directions regarding the purchase, retention, or sale of any asset; and (2) each the IRA Plaintiffs had the "sole authority and discretion" to select and to direct the investment of all assets in his or her account and accepted "full and sole responsibility for the success or failure of any selection made." (*Brown, supra*, 45 Cal.App.4th at pp. 340-342.)

Here, however, the IRA Plaintiffs are not seeking to hold Fiserv liable for its failure to inform them about defaults in other investors' accounts. Rather, the IRA Plaintiffs allege that Fiserv mismanaged their accounts by, among other things: (1) inaccurately reporting account values to conceal the repeated defaults and delinquent interest payments of the Heath Defendants' related investments; (2) improperly calculating required minimum distributions, thereby concealing that the Heath Defendants' investors had insufficient funds in their accounts and making more funds available to the Heath Defendants to take from investors; (3) backdating statements to mislead the IRA Plaintiffs as to their true account values; (4) commingling investors' funds; and (5) continuing to allow reinvestments in the Heath Defendants' securities even after it acknowledged that the Heath Defendants were engaged in the sale of unlawful securities.

In light of the fact that, the Plan expressly provided that Fiserv would: (1) establish and maintain a separate account in the name of each participant; (2) distribute the account in accordance with certain minimum distribution requirements; and (3) that the assets entrusted

under the Plan were not to be commingled with other property "except in a common trust fund or common investment fund," the IRA Plaintiffs have adequately alleged that Fiserv breached fiduciary duties owed to them and that these breaches caused their damages. Accordingly, the trial court erred in sustaining Fiserv's demurrer to this cause of action.

B. Fraudulent Concealment

The IRA Plaintiffs alleged in their fourth amended complaint that Fiserv concealed material facts affecting their investments with the intent to deceive and defraud and induce their reliance and had they known these facts they would not have continued to purchase or hold any Heath securities. Specifically, the IRA Plaintiffs allege that Fiserv failed to disclose the following material facts: (1) the Heath Defendants, as the IRA Plaintiffs' designated financial representative, was an interested party that was engaging in fraudulent transactions in their accounts; and (2) the Heath securities held by them defaulted and/or failed to make distributions into their accounts.

Relying on *Brown*, the trial court concluded that the IRA Plaintiffs failed to explain why their relationship with Fiserv gave rise to a duty to disclose and sustained the demurrer without leave to amend. (*Brown, supra*, 45 Cal.App.4th 333.) The IRA Plaintiffs contend that *Brown* is distinguishable because the Plan documents imposed on Fiserv disclosure duties related to the management of their own investments, particularly, that Fiserv had a duty to disclose that the Heath Defendants were directing their IRA funds into prohibited transactions and fraudulent securities.

To recover for fraudulent concealment, a plaintiff must plead and prove that the defendant had a duty to disclose the fact to the plaintiff. (*Lovejoy v. AT&T Corp.* (2004) 119

Cal.App.4th 151, 157-158.) Here, the Plan documents limited Fiserv's liability by providing that it had no duty to question the directions of the IRA Plaintiffs or their authorized agents regarding the purchase, retention or sale of any asset and could not be held liable for transmitting or not transmitting "any information of any kind and from wherever derived concerning the authorized agent or concerning any investment." This disclaimer is sufficiently broad to bar the IRA Plaintiffs' assertion that Fiserv had a duty to disclose its alleged knowledge regarding the Heath Defendants' nefarious conduct. The disclaimer, however, does not bar the allegation that Fiserv had a duty to disclose that the Heath securities held by the IRA Plaintiffs defaulted and/or failed to make distributions into their accounts. Rather, the Plan documents imposed a duty upon Fiserv to furnish annual reports to the IRA Plaintiffs concerning the status of their account and a statement of the assets. Accordingly, because the IRA Plaintiffs sufficiently alleged that Fiserv fraudulently concealed information that it had a duty to disclose, the trial court erred in sustaining the demurrer to the fraudulent concealment claim.

C. Aiding and Abetting Fraud

A civil aiding and abetting cause of action "necessarily requires a defendant to reach a conscious decision to participate in tortious activity for the purpose of assisting another in performing a wrongful act. A plaintiff's object in asserting such a theory is to hold those who aid and abet in the wrongful act responsible as joint tortfeasors for all damages ensuing from the wrong. [Citation.]" (*Howard v. Superior Court* (1992) 2 Cal.App.4th 745, 749.) Liability for aiding and abetting an intentional tort arises if the defendant substantially assists or encourages another party to act, with the knowledge that the other party's conduct

constitutes a breach of duty. (*Casey v. U.S. Bank Nat. Assn.* (2005) 127 Cal.App.4th 1138, 1144 (*Casey*)). Significantly, "a defendant can only aid and abet another's tort if the defendant knows what 'that tort' is." (*Id.* at p. 1146.) In other words, "the defendant must have acted to aid the primary tortfeasor 'with knowledge of the object to be attained.' [Citation.]" (*Ibid.*)

In their fourth amended complaint, Plaintiffs alleged that Fiserv aided and abetted the Heath Defendants' fraud. The trial court sustained Fiserv's demurrer to this claim on the ground Plaintiffs failed to allege that Fiserv had actual knowledge of the primary wrong committed by the Heath Defendants. To analyze the sufficiency of Plaintiffs' claim, we must first identify precisely the fraud for which Plaintiffs seek to hold Fiserv liable. (*Casey, supra*, 127 Cal.App.4th at p. 1149.) We must then ascertain whether Plaintiffs have alleged generally that Fiserv had actual knowledge of the specific primary violation. (*Id.* at p. 1148, citing *Neilson v. Union Bank of California, N.A.* (C.D.Cal. 2003) 290 F.Supp.2d 1101, 1120 (*Neilson*)).

Here, Plaintiffs seek to hold Fiserv liable for a Ponzi scheme that the Heath Defendants were allegedly perpetrating. Generally, a Ponzi scheme involves using new investor money to pay artificially high dividends to original investors to thereby attract new investors, generally without any revenue-operating activity other than the continual raising of new funds. (Black's Law Dictionary (8th ed. 2004) p. 1198, col. 2.) Specifically, the complaint alleged that the scheme consisted of the Heath Defendants telling Plaintiffs that their funds would be invested in asset-backed corporate promissory notes when, in reality, the Heath Defendants used Plaintiffs' money to make unsecured advances to fraudulent

entities that the Heath Defendants controlled or to pay initial investors artificially high returns and entice new investors.

Reviewing the complaint as a whole and assuming the truth of all pleaded facts and inferences therefrom, we conclude Plaintiffs have adequately alleged that Fiserv had actual knowledge of the Ponzi scheme being perpetrated by the Heath Defendants. Although Plaintiffs dedicated over 40 pages of allegations to Fiserv's role in the fraudulent scheme, we briefly summarize some facts generally showing Fiserv's actual knowledge that the Heath Defendants were defrauding investors.

Namely, Plaintiffs alleged that Fiserv had actual knowledge that the Heath Defendants targeted seniors with promises that their investments would be safe and earn secure investment returns. However, Fiserv's compliance manager, Kirk Merritt, schemed with Heath to create a shell limited liability company (PCM Fixed Income Fund LLC) to pass through and disguise PCM's illiquid promissory notes so that the prohibited security could be held in the IRA Plaintiffs' IRAs.

Fiserv executed subscription agreements for PCM Fixed Income Fund referring to the investments as secured corporate notes. Investors also received a brochure that described PCM Notes as secured corporate notes, when in fact the business entities that PCM lent money to were Heath's fraudulent entities, either non-existent or operating at significant losses with negative equities.

Although Heath supposedly had 16 different investments, Fiserv commingled most of Plaintiffs' funds into the PCM Fixed Income Fund investment and incoming investors funds were always funneled through PCM even where an IRA statement identified one of the other

private placements offerings from Heath. Even where Fiserv was purchasing one of Heath's other investments for its customer, all checks Fiserv issued to Heath were for the PCM Fixed Income Fund.

Fiserv knew that the Heath Defendants were disqualified persons engaging in self-dealing in Plaintiffs' IRAs and that the Heath related securities were private debt instruments issued by Heath. Merritt also knew that the Heath Defendants were the servicing agents for PCM Fixed Income Fund, but falsely represented that another company was the servicing agent to conceal the Heath Defendants' self-dealing in Plaintiffs' IRAs.

Fiserv knew that PCM Fixed Income Fund was limited to 35 or fewer qualified investors, but its own documents and customer records revealed that Heath had oversubscribed the fund by more than \$63 million and pocketed the excess for himself. Despite this knowledge and Heath's admission that of the \$60,000,000 investment only about \$15-20 million was left, Fiserv purchased more PCM Fixed Income Fund securities for Plaintiffs' accounts.

Fiserv had actual knowledge that Heath defaulted on the securities held in Plaintiffs' IRAs, at the same time that Heath was taking in additional retirement funds to make purchases in the same securities and that Heath was pocketing the investment moneys or redirecting the new investment moneys into other customer accounts that were in default to delay revelation of the fraudulent investment scheme. Fiserv allegedly knew that PCM Fixed Income Fund was a fraudulent security and that the Heath Defendants were defrauding Plaintiffs.

Fiserv substantially assisted in the scheme by, among other things, commingling investors' funds internally and with the Heath Defendants' accounts. It also worked in concert with the Heath Defendants to conceal the scheme by falsely attributing account statements to computer errors when email communications between it and the Heath Defendants revealed that the errors were actually due to the Heath Defendants' mismanagement and inaccurate reporting of investor funds.

Although Plaintiffs never directly allege that Fiserv knew the Heath Defendants were running a Ponzi scheme and stealing investor funds, "this is the net effect of allegations[.]" (*Neilson, supra*, 290 F.Supp.2d at p. 1121.) Whether Plaintiffs will be able to prove their allegations is not relevant at this stage of the litigation. (*Alcorn, supra*, 2 Cal.3d at p. 496.)

Fiserv relies heavily on *Casey*, arguing that Plaintiffs' allegations are insufficient. *Casey*, however, is distinguishable because the defendant was a bank and the *Casey* court relied on California banking law, making it clear that a bank's knowledge of suspicious account activities, even money laundering, does not give rise to tort liability. (*Casey, supra*, 127 Cal.App.4th at p. 1151.) Nonetheless, *Casey* also makes clear that if a plaintiff can allege that the banks knew that its account holders (fiduciaries of a corporation) were stealing corporate funds and knowingly assisted them in laundering this stolen money, such allegations would suffice to state a claim for aiding and abetting the theft or breach of fiduciary duty. (*Id.* at pp. 1151-1152.)

Here, Plaintiffs have alleged that Fiserv knew the funds in the IRAs belonged to them and giving them the benefit of reasonable inferences from their factual allegations, they have sufficiently alleged actual knowledge that the Heath Defendants were taking the funds for

the Heath Defendants' own purposes. Accordingly, the trial court erred in sustaining the demurrer to the aiding and abetting fraud cause of action.

D. Violation of Corporations Code section 25504.1

Corporations Code section 25504.1 imposes liability on persons who "materially assists" certain violations of the Corporations Code "with [the] intent to deceive or defraud[.]" The trial court sustained Fiserv's demurrer to this cause of action on the ground Plaintiffs failed to allege that Fiserv acted with the necessary intent. We disagree.

Corporations Code section 25401 prohibits material misrepresentations or omissions in the offer or sale of a security. Among other things, Plaintiffs alleged that the Heath Defendants falsely represented that their investments were safe, secured and liquid corporate notes that paid a guaranteed return of 5.5 percent to 8 percent per year. They also alleged that all defendants materially assisted each other in violating Corporations Code section 25401 with the intent to deceive or defraud Plaintiffs.

This conclusory allegation, when read in conjunction with Plaintiffs other allegations that Fiserv executed subscription agreements containing false information, failed to maintain prospectuses for PCM Fixed Income Fund, backdated statements, miscalculated Required Minimum Distributions and knew that the Heath investments were prohibited transactions, adequately alleges a claim for liability under Corporations Code section 25504.1.

E. Violation of section 17200

Section 17200 prohibits unlawful competition, including an "unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising[.]" (§ 17200.) It is broad in scope and embraces "anything that can properly be called a

business practice and that at the same time is forbidden by law.' [Citations.]" (*Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163, 180.) Section 17200 borrows violations of federal, state or local laws by making them independently actionable as unfair competitive practices. (*State Farm Fire & Casualty Co. v. Superior Court* (1996) 45 Cal.App.4th 1093, 1102-1103.)

Plaintiffs' second amended complaint alleged a violation of section 17200, seeking redress for Fiserv's "unlawful and fraudulent mismanagement of [their] investment accounts." Plaintiffs alleged that they suffered injury because Fiserv inaccurately reported their accounts, failed to timely settle trades causing lost interest, falsified Required Minimum Distributions and commingled their accounts.

Relying on this court's decision in *Bowen v. Ziasun Technologies, Inc.* (2004) 116 Cal.App.4th 777 (*Bowen*), the trial court sustained Fiserv's demurrer to this claim because section 17200 did not apply to "securities transactions." (*Id.* at p. 788.) In *Bowen*, the plaintiff alleged that defendant had sold him its stock and the stock of other publicly traded companies by making misstatements and omissions of material fact and failing to disclose that it was using the investors' funds to perpetrate a pyramid or Ponzi scheme. (*Id.* at p. 779.)

Plaintiffs claim the trial court erred because their section 17200 claim pertains to Fiserv's mismanagement of their accounts after it received their investments, not the buying or selling of securities. In other words, Plaintiffs assert that the trial court erroneously relied on *Bowen* because their section 17200 claim against Fiserv does not pertain to a transaction in securities. We agree.

In *Bowen*, this court concluded that section 17200 does not pertain to securities transactions because of the comprehensive regulatory umbrella of the Securities and Exchange Commission over such transactions. (*Bowen, supra*, 116 Cal.App.4th at pp. 786-789 & fn. 9.) Other courts, however, have noted that the holding in *Bowen* is limited to securities transactions, i.e., the buying or selling of a security, as that was what was at issue there, and claims merely implicating a securities transaction are not barred. (*Overstock.com, Inc. v. Gradient Analytics, Inc.* (2007) 151 Cal.App.4th 688, 715 [claims arose from allegedly defamatory stock reports]; *Strigliabotti v. Franklin Resources, Inc.* (ND Cal. 2005) 2005 WL 645529 [claims arose from alleged scheme to overcharge investors in the management of securities].) (Unpublished federal decisions may be considered as persuasive authority. (*Lam v. Ngo* (2001) 91 Cal.App.4th 832, 841, fn. 5).) Here, Plaintiffs' section 17200 claim addresses Fiserv's alleged mismanagement of their accounts and is not barred. As Fiserv's demurrer to this cause of action was limited to whether Plaintiffs had stated facts sufficient to constitute a cause of action based on *Bowen*, we do not address any other possible challenges to this claim.

Finally, at oral argument Fiserv suggested that this cause of action and the cause of action for violation of Corporations Code section 25504.1 failed to state a cause of action as to those Plaintiffs that did not have a customer relationship with it. Fiserv, however, did not demur to these causes of action on this ground and it did not argue this issue on appeal; accordingly, we decline to address this issue.

DISPOSITION

The judgment is reversed and the trial court is directed to enter an order overruling Fiserv's demurrers to the challenged causes of action. Plaintiffs are entitled to recover their costs on appeal.

McINTYRE, J.

WE CONCUR:

HALLER, Acting P. J.

McDONALD, J.