182 Cal.App.2d 354, 6 Cal.Rptr. 31

AUTOMATIC VENDING COMPANY (a Corporation), Respondent,
v.
BESSIE JANE WISDOM, Appellant.

Civ. No. 9913.
District Court of Appeal, Third District, California.
June 30, 1960.

HEADNOTES

(1a, 1b)
Contracts § 115--Price.
In an action by a vending machine company for breach of a contract for a concession to place a cigarette vending machine in defendant's restaurant, the fact that the contract gave the vending machine company the power to change the commission rates on written notice did not make it illusory, lacking in mutuality of obligation or void, but imposed a duty on the company to exercise its discretion in good faith and in accordance with fair dealings and to fix the commissions in such amount as the object of the contract was reasonably worth.

See **Cal.Jur.2d,** Contracts, § 109; **Am.Jur.,** Contracts, § 71.

(2)
Contracts § 115--Price.
Generally, an agreement providing that the price to be paid, or other performance to be rendered, shall be left to the will and discretion of one of the parties is not enforceable, since the party having such discretion makes no real promise to pay or to perform.

(3)
Contracts § 97--Consideration--Promise for Promise.
An illusory promise is no promise at all and is not sufficient consideration for a return promise.

(4)
Contracts § 115--Price.
The fact that one of the parties to a contract reserves the power to vary the price or other performance is not fatal if the exercise of that power is subject to prescribed or implied limitations.

(5)
Contracts § 115--Price.
An agreement that the price shall be fixed by an interested party is valid if his interest is known and there is no bad faith.

(6)
Contracts § 156--Interpretation--Terms Implied--Fair Dealing.
Where a contract confers on one party a discretionary power affecting the other's rights, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing.

(7)
Damages § 82--Measure--Breach of Contract.
In an action for breach of a contract for a concession to place a cigarette vending machine in defendant's restaurant, it was not error to accept a method of computing damages that did not take into account plaintiff's costs of doing business where the evidence showed that such costs were fixed and would not diminish because of loss of the right to place one of its cigarette vending machines in defendant's cafe.

(8)
Damages § 72--Measure--Breach of Contract.
Though generally, one will not be permitted to recover gross profits, in the event of breach of contract, an award of gross profits may be allowed to plaintiff where the expenses of operating his business are fixed and would have continued in an equal amount even if the contract had not been breached by defendant.

See **Cal.Jur.2d,** Damages, § 134.

(9a, 9b)
Damages § 49--Attorney Fees.
Respondent was entitled to attorney fees on appeal from the judgment in an action for breach of a contract which provided for reasonable attorney fees expended in enforcing the contract in the event of its breach, and the appellate court fixed such fees without referring the matter to the trial court where it was able to determine a reasonable amount therefor.

(10)

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Attorneys § 101--Contracts for Compensation--Services Covered.
A contract for a reasonable attorney's fee in enforcing its provisions embraces an allowance for legal services rendered on appeal as well as during the trial.

See **Cal.Jur.2d,** Attorneys at Law, § 180 et seq.; **Am.Jur.,** Attorneys at Law, § 159 et seq.

SUMMARY

APPEAL from a judgment of the Superior Court of Yolo County. C. C. McDonald, Judge. Affirmed, with allowance of attorneys' fees on appeal.

Action for damages for breach of contract. Judgment for plaintiff affirmed.
COUNSEL
Clifford R. Lewis for Appellant.
Devlin, Diepenbrock & Wulff for Respondent.

WARNE, J. pro tem.*

Defendant appeals from a judgment for plaintiff in an action for damages for breach of contract.

Respondent is engaged in the business of selling and dispensing cigarettes by means of automatic vending machines. Defendant leases and operates a cafe. On February 27, 1958, respondent and appellant entered into a written contract whereby appellant granted to respondent a three-year concession for the sale of cigarettes on her premises by means of cigarette vending machines. The provisions of the contract insofar as they are pertinent to the issues presented on this appeal are as follows:

"1) In consideration of the payment of any advance commission ***356** hereunder, or the payment of the commissions hereinafter set forth, I/we hereby grant to you, Automatic Vending Company, a corporation, for a period of three (3) years from the date shown hereon, an exclusive concession for the sale of cigarettes in and about my/our place of business located at 2816 W. Capitol Av. West Sacramento, California, known as Bessie Jane Wisdom, DBA Last Chance Cafe.

....

"6) You are to pay me/us the following rates of commission for the said exclusive concessions:

"On Monthly sales 1000 packages or over ... 8% on all sales

"On Monthly sales 700 to 1000 packages ... 7%

"On Monthly sales 400 to 700 packages ... 5%

"On Monthly sales 100 to 400 packages ... 4%

"7) I/we agree that you may change the above cigarette commission rates upon written notice to me/us and I/we further agree to accept your count as to the amount of cigarettes sold on my/our premises.

"8) No commissions shall be paid hereunder by you to me/us until all of the advance commissions, if any, heretofore paid by you have been repaid to you in full, and thereafter said commission shall be paid to me/us monthly. I/we shall not assign this contract or any part thereof, without your written consent, during the term hereof."

Concurrently with the execution of this agreement respondent paid appellant $200 as an advance commission. In January of 1959, appellant demanded that respondent pay to her larger commissions than those provided for in the contract, which respondent refused to do. On January 28, 1959, appellant repudiated the contract and demanded that respondent remove its cigarette vending machine from her premises. Respondent did so and on March 8, 1959, filed this suit to recover damages for loss of profits which it would have earned during the remaining 25 months' life of the contract.

The undisputed testimony of one John Wojcik, vice president of the respondent corporation, shows that the total sales from the cigarette vending machine on appellant's premises during the 12 months immediately prior to appellant's breach of the contract averaged 1,389 packs monthly; that its average gross profit per package of cigarettes was $.076567; that its net profit is determined by deducting from its gross profit a commission paid to appellant of $.02 per package of cigarettes sold and sales tax paid in the amount of $.01 per package sold which resulted in a net profit to appellant of $.04657 ***357** per package of cigarettes sold. In arriving at his estimate of respondent's loss by reason of appellant's breach, the witness multiplied the number of packages sold each month by the average profit per pack, and then multiplied this figure by the number of months (25) which the contract had to run at the time of breach, which totaled $1,617 (the amount of damages found by the trial court). The witness testified, however, that he had not subtracted from the computed profits any amount representing the respondent's cost of doing business, because respondent's costs were fixed and would not be diminished by reason of the loss of appellant's account; that even if as many as 20 accounts were lost respondent's cost of doing business would not be affected; and that no special trip had to be made to service appellant's account because it is located on a route taken by one of respondent's men every day.

([1a]) Appellant first contends that the contract is illusory, lacks mutuality of obligation, and is void since in effect it gave respondent the discretionary power to vary the commissions which defendant would receive. We feel that this contention is without merit.
([2]) The general rule is that: "An agreement that provides that the price to be paid, or other performance to be rendered, shall be left to the will and discretion of one of the parties is not enforceable. This is because the party having such discretion makes no real promise to pay or to perform. ([3]) An illusory promise is no promise at all and is not a sufficient consideration for a return promise. ([4]) But the fact that one of the parties reserves the power of varying the price or other performance is not fatal if the exercise of this power is subject to prescribed or implied limitations, as that the variation must be in proportion to some objectively determined base or must be reasonable." (1 Corbin on Contracts, § 98, p. 311.) ([5]) But, as stated in *California Lettuce Growers, Inc. v. Union Sugar Co.*, 45 Cal.2d 474, 484 [289 P.2d 785, 49 A.L.R.2d 496]: " 'When a contract does not determine the amount of the consideration, nor the method by which it is to be ascertained, *or when it leaves the amount thereof to the discretion of an interested party*, the consideration must be so much money as the object of the contract is reasonably worth.' Professor Williston says 'Even an agreement that the price shall be fixed by an interested party is valid if his interest is known and there is no bad faith.' (1 Williston on Sales (rev. ed.) §§ 167, pp. 434-435; see Civ. Code, §§ 1729, 1655, 1656.) (Emphasis added.) ***358**

([6]) "... [W]here a contract confers on one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing. (Civ. Code, §§ 1655, 1656; *Universal Sales Corp. v. California etc. Mfg. Co.*, 20 Cal.2d 751, 771 [128 P.2d 665]; *Brogdex Co. v. Walcott*, 123 Cal.App.2d 575 [267 P.2d 28]; *Brawley v. Crosby etc. Foundation, Inc.*, 73 Cal.App.2d 103 [166 P.2d 392].)" We feel that the principles of law as above stated are applicable to the construction of the contract in question. ([1b]) Such being the applicable law, the power given to the Automatic Vending Company to change the commission rates upon written notice would impose a duty upon it to exercise that discretion in good faith and in accordance with fair dealings and fix the commissions in such amount as the object of the contract is reasonably worth. Therefore, it cannot be said that the contract in question is illusory, lacks mutuality of obligation, or is void.
([7]) Appellant also contends that the court erred in accepting the method of computation of damages as offered by respondent, because that method did not deduct a proportionate amount of the respondent's costs of doing business. As hereinabove noted, the testimony shows that the respondent's costs of doing business were fixed and would not diminish because of the loss of the right to place one of its cigarette vending machines in appellant's cafe. ([8]) While the general rule is that one will not be permitted to recover gross profits, in the event of a breach of the contract, nevertheless under certain circumstances as where, for example, "... plaintiff's expenses of operating his business are fixed and would have continued in an equal amount even if the contract had not been breached by the defendant, an award of gross profits may be allowed to the plaintiff, since, in such a situation, the gross profits involved would also constitute the net profits which the plaintiff would have earned under the agreement." (14 Cal.Jur.2d, Damages, § 134; see also *Phalanx Air Freight, Inc. v. National etc. Freight Corp.*, 104 Cal.App.2d 771, 775 [232 P.2d 510]; *Walpole v. Prefab Mfg. Co.*, 103 Cal.App.2d 472, 482-483 [230 P.2d 36].)

By awarding respondent damages based on gross profits, less one cent sales tax per pack and the amount of commission appellant would have received under the provisions of paragraph six of the contract, the court impliedly found that plaintiff's expenses, including servicing, repairing and buying equipment would not have been greater had the contract not ***359** been breached. (*Walpole v. Prefab Mfg. Co., supra.*) The evidence fully supports such implied finding. We find no merit in appellant's contention.

For the reasons stated we have concluded that the judgment must be affirmed.

([9a]) Respondent requests that it be allowed to move the trial court for an order fixing reasonable attorneys' fees for services on appeal and that the amount of the attorneys' fees so found be included in the judgment conditional upon an affirmance. In the event of a breach thereof the contract in question provides for reasonable attorneys' fees expended in enforcing it. The trial court fixed the sum of $400 as reasonable attorneys' fees for services rendered in that court. ([10]) " 'A contract for a reasonable attorney's fee in enforcing its provisions embraces an allowance for legal services rendered upon appeal as well as during the trial.' " (*Dankert v. Lamb Finance Co.*, 146 Cal.App.2d 499, 503-504 [304 P.2d 199].) ([9b]) Accordingly, respondent is entitled to attorneys' fees on this appeal, and since it appears to us that $250 is a reasonable sum to be allowed for that purpose, there is no necessity for referring the matter to the trial court.

The judgment is affirmed, and appellant is ordered to pay to respondent additional attorneys' fees on this appeal in the sum of $250.

Van Dyke, P. J., and Schottky, J., concurred. ***360**

Footnotes

* Assigned by Chairman of Judicial Council.

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174 F.Supp.2d 202
United States District Court,
D. New Jersey.

DUNKIN' DONUTS INCORPORATED, Plaintiff,
v.
Anand S. PATEL, Dipak R. Patel, Kelido, Inc., Anuja, Inc., and Kvell, Inc. Defendants.

No. 00–2493 (JAG). | Oct. 31, 2001.

Franchiser brought action against franchisees, alleging breach of franchise agreements and seeking attorneys' fees and costs. Franchiser moved for summary judgment and to strike report of defendants' expert. The District Court, Greenaway, J., adopted the report and recommendation of Haneke, United States Magistrate Judge, which held that (1) language of franchise agreements clearly entitled franchiser to fees and costs, and (2) expert witness's reports failed to meet requirements of rules governing expert disclosure and admission of expert testimony.

Motions granted.

West Headnotes (13)

[1] **Federal Civil Procedure**
Contract Cases in General

A court can grant summary judgment on an issue of contract interpretation if contractual language being interpreted is subject to only one reasonable interpretation; if a contract can reasonably be interpreted in two different ways, then contracting party is not entitled to summary judgment in breach of contract action.

1 Cases that cite this headnote

[2] **Federal Civil Procedure**
Contract Cases in General

Where a contract is unambiguous, it is appropriate for the court to determine its meaning as a matter of law at the summary judgment stage.

1 Cases that cite this headnote

[3] **Costs**
Contracts

Under clear language of franchise agreement, franchiser was entitled to judgment for attorneys' fees expended pursuing enforcement of franchisee standards for health, sanitation, and safety, following franchisees' failure to cure violations after notice and opportunity to cure.

[4] **Contracts**
Trade and Business

A franchiser is free to establish health, sanitation, and safety standards that exceed those of the municipality in which the franchised store is located.

[5] **Federal Civil Procedure**
Evidentiary Matters

The test of an expert witness report is whether it is sufficiently complete, detailed and in compliance with the rules governing expert disclosure so that surprise is eliminated, unnecessary depositions are avoided, and costs are reduced. Fed.Rules Civ.Proc.Rule 26(a)(2)(B), 28 U.S.C.A.

8 Cases that cite this headnote

[6] **Federal Civil Procedure**
Evidentiary Matters

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An expert witness report must provide the substantive rationale for the expert's opinions in detail with respect to the basis and reasons for the proffered opinions, and must explain factually why and how the witness has reached them. Fed.Rules Civ.Proc.Rule 26(a)(2)(B), 28 U.S.C.A.

[7] **Federal Civil Procedure**
Evidentiary Matters

Purpose of expert witness report is to avoid disclosure of sketchy and vague expert information. Fed.Rules Civ.Proc.Rule 26(a)(2)(B), 28 U.S.C.A.

3 Cases that cite this headnote

[8] **Federal Civil Procedure**
Evidentiary Matters

If an expert witness does not have information concerning previous cases in which he or she testified or was deposed, that should be revealed in expert witness report. Fed.Rules Civ.Proc.Rule 26(a)(2)(B), 28 U.S.C.A.

[9] **Evidence**
Nature and Admissibility

Out-of-court statements offered for the truth of the matter asserted are presumptively inadmissible hearsay.

[10] **Federal Civil Procedure**
Weight and Sufficiency

Genuine issues of material fact cannot be raised by speculation and conclusory allegations.

6 Cases that cite this headnote

[11] **Contracts**
Trade and Business

Franchisees' claim, that franchiser's inspections for health, sanitary, and safety violations of franchise agreement were motivated by desire to retaliate for franchisees' failure to support a franchisee-owned cooperative off-premises bakery, had no bearing on whether franchisees breached terms of franchise agreement; alleged ulterior motive was irrelevant where there was valid ground for inspections.

[12] **Federal Civil Procedure**
Failure to Respond; Sanctions

Expert witness's certification and memorandum failed to comply with rule governing expert disclosure; documents did not set forth basis and reasons for opinions, but relied on observations made by others, and documents failed to list all publications authored by expert over past ten years, did not indicate his compensation for his study and/or testimony, did not list any other cases in which expert testified within past four years, were not supported by any treatises or authoritative documents, contained no exhibits, and lacked expert's signature. Fed.Rules Civ.Proc.Rule 26(a)(2)(B), 28 U.S.C.A.

2 Cases that cite this headnote

[13] **Evidence**
Necessity and Sufficiency

Expert witness's certification and memorandum regarding franchiser's inspections of franchise locations were not based upon sufficient facts and data and so were not admissible under rule governing admission of expert testimony; expert did not demonstrate knowledge of franchise health, sanitation, and safety standards but inappropriately focused on requirements of New Jersey law, expert was not present during franchiser's inspections, and expert's opinions were not supported by any treatises or authoritative documents regarding practices. Fed.Rules Evid.Rule 702, 28 U.S.C.A.

Attorneys and Law Firms

***204** John J. Jacko, III, Buchanan Ingersoll, PC, Philadelphia, PA, Robert L. Zisk, David E. Worthen, Roland B. Ninomiya, Schmeltzer, Aptaker & Shepard, PC, Washington, DC, for Dunkin' Donuts.

Gerald A. Marks, Marks & Associates, Red Bank, NJ, for Defendants.

Opinion

GREENAWAY, District Judge.

This matter having come before the Court on Plaintiff's motion for summary judgment on Counts I, II, and III of Plaintiff's Complaint; and the Honorable G. Donald Haneke, United States Magistrate Judge, having issued a Report and Recommendation, pursuant to Fed.R.Civ.P. 72(b) and L. Civ. R. 72.1(a)(2), recommending that Plaintiff's motion be granted; and said Report and Recommendation having been filed on September 18, 2001; and the time in which to object to the Report and Recommendation having expired; and no objection having been filed by either party; and it appearing that the recommended disposition of a dispositive motion such as a motion to remand is reviewed *de novo, see In re U.S. Healthcare,* 159 F.3d 142, 145–46 (3d Cir.1998); *Temptations, Inc. v. Wager,* 26 F.Supp.2d 740, 743 (D.N.J.1998); *see also* Fed.R.Civ.P. 72(b); and this Court having conducted a *de novo* review of the parties' submissions and the Report and Recommendation; and good cause appearing,

IT IS on this 31st day of October, 2001,

ORDERED that the Report and Recommendation of Magistrate Judge Haneke is adopted as the opinion of this Court;

IT IS FURTHER ORDERED that Plaintiff's motion for summary judgment on Counts I, II, and III is GRANTED;

IT IS FURTHER ORDERED that a copy of this Order be served on all parties within seven (7) days of the date of this Order.

REPORT AND RECOMMENDATION

HANEKE, United States Magistrate Judge.

Presently before the Court is Plaintiff's Motion for Summary Judgment on Counts ***205** I, II, and III of the Complaint.1 Also before this Court is Plaintiff's Motion to Strike the Certification and Memorandum of William James filed by Defendants in opposition to Plaintiff's Motion for Summary Judgment. These matters have been referred to me by the Honorable Joseph A. Greenaway, Jr. for an appropriate Report and Recommendation pursuant to Loc. Civ. R. 72.1(a)(2) and Fed.R.Civ.P. 72(b). I have considered all the papers. Oral argument has not been requested by counsel. For the reasons expressed below, I respectfully recommend that both the Motion for Summary Judgment and the Motion to Strike the Certification and Memorandum of William James be granted.

Background

Motion for Summary Judgment

This is a Motion filed by the Plaintiff, Dunkin' Donuts Incorporated ("Dunkin" ') seeking summary judgment on Counts I, II, and III of the Complaint. These counts allege that Defendants breached their respective Franchise Agreements with Plaintiff by violating Plaintiff's standards for health, sanitation, and safety as set forth in the Franchise Agreements between the parties. Subsequent to suit being filed, Defendants cured the violations that existed at their respective Dunkin' Donut shops. In that regard, Plaintiff now seeks payment of its attorneys' fees and costs under the terms of the Franchise Agreements which Plaintiff alleges Defendants have refused to pay.

a. *Statement of Material Facts as to which there is no*

genuine issue.

Plaintiff is the franchiser of the Dunkin' Donuts franchise system. Dunkin' franchisees are licensed to operate under the Dunkin' Donuts systems, which involves the production, merchandising, and sale of doughnuts and related products using a specially designed building with special equipment, layouts, products, standards, and specifications.

Defendant, Anuja, Inc., is a Dunkin' Donut franchisee for a doughnut shop located at 752 Hamilton Street, Somerset, New Jersey (the "Hamilton Street Shop") pursuant to a franchise agreement dated June 1, 1998 (the "Hamilton Street Franchise Agreement").

Defendants, Anand S. Patel, Dipak R. Patel, and Kelido, Inc., are Dunkin' Donuts franchisees for a doughnut shop located at 30 Lafayette Avenue, Morristown, New Jersey (the "Lafayette Street Shop") pursuant to a franchise agreement dated October 12, 1989 (the "Lafayette Avenue Franchise Agreement").

Defendant, Kvell, Inc., is a Dunkin' Donuts franchisee for a doughnut shop located at 135 West Main Street, Somerville, New Jersey (the "West Main Street Shop") pursuant to a franchise agreement dated August 21, 1998 (the "West Main Street Franchise Agreement").

Plaintiff provides each of its franchisees a set of manuals and guidelines (the "Manuals") which set forth in detail the procedures, methodology, and standards applicable to the operation of a Dunkin' Donuts shop. These documents provide detailed and specific guidance and standards for shop maintenance and appearance; food preparation, presentation, and service; customer service standards; and cleanliness and sanitation.

***206** The Franchise Agreements between the parties contain language as well as acknowledgments and agreements by Defendants concerning the maintaining of Dunkin's standards for health, sanitation and safety. The applicable paragraphs of the Hamilton Street and West Main Street Franchise Agreements state:

> 5.0 FRANCHISEE understands and acknowledges that every detail of the Dunkin' Donuts System is important to DUNKIN' DONUTS, to FRANCHISEE and to other Dunkin' Donuts franchisees, in order to develop and maintain high and uniform standards of quality, cleanliness, appearance, service, facilities, products and techniques to increase the demand for Dunkin' Donuts products and to protect and enhance the reputation and goodwill of DUNKIN' DONUTS....
>
> 5.1 ... FRANCHISEE shall operate the Dunkin' Donuts Shop so as to maximize Gross Sales and maintain all standards of the Dunkin' Donuts system. In connection therewith, FRANCHISEE further agrees:
>
> 5.1.1 To use all materials, ingredients, supplies, papers goods, uniforms, fixtures, furnishings, signs, equipment, methods of exterior and interior design and construction and methods of product preparation and delivery prescribed by or which conform to DUNKIN' DONUTS' standards and specifications; and to carry out the business covered by this Agreement in accordance with the operational standards and specifications established by DUNKIN' DONUTS and set forth in DUNKIN' DONUTS' operating manuals and other documents as they presently exist or shall exist in the future or as may be otherwise disclosed to DUNKIN' DONUTS franchisees from time to time.
>
> ....
>
> 5.1.6. To maintain, at all times and at FRANCHISEE'S expense, the interior and exterior of the Dunkin' Donuts Shop and all fixtures, furnishings, signs and equipment in the highest degree of cleanliness, orderliness, sanitation and repair, as reasonably required by DUNKIN' DONUTS.

The Lafayette Avenue Franchise Agreement contains provisions substantively identical to these provisions.

The Franchise Agreements provide also for a twenty-four hour cure period for any violation of Plaintiff's standards for health, sanitation, and safety.2 The Franchise Agreements also specify that the Franchisee shall pay to Dunkin' all damages, costs, and expenses, including attorneys' fees, incurred by Dunkin' as a result of any breach of the Franchise Agreement by franchisee and for failure to cure after notice.3

On April 11, 2000, the Hamilton Street and Lafayette Avenue Shops were inspected by a Dunkin' representative. Numerous standards violations were identified relating to health, sanitation, and safety. Also on April 11, 2000, the same Dunkin' ***207** representative hand-delivered to the Hamilton Street and Lafayette Shops notices to cure listing the violations and requesting that the deficiencies be cured immediately. On April 13, 2000, the Dunkin' representative reinspected these two shops and numerous standards violations remained uncured.4

On April 13, 2000, the West Main Street Shop was inspected by a Dunkin' representative. Several standards violations were identified relating to health, sanitation, and safety.5 On the same day, the representative hand-delivered to the West Main Street Shop a notice to cure and requested that the deficiencies be cured immediately.

On April 17, 2000, the Dunkin' representative re-visited the West Main Street Shop and found that some standards violations remained uncured.

On May 23, 2000, Plaintiff filed suit seeking to enjoin Defendants from violating Dunkin's standards at all three shops. On August 7, 2000, Plaintiff withdrew its motion for a preliminary injunction after additional inspections of the three shops, which were conducted after suit was started, revealed that Defendants had now cured the deficiencies identified in the April, 2000 inspections. However, despite the terms of the Franchise Agreements, Plaintiff alleges that Defendants have refused to pay Dunkin' the attorneys' fees and costs it has incurred in bringing and prosecuting this action. Plaintiff also contends that as a result of that refusal, it continues to incur fees and costs, including those associated with the present motions.

In their opposition papers to the summary judgment motion, Defendants assert that "Dunkin' began conducting a campaign of false and harassing alleged 'health and safety' inspections in April, 2000 which were designed to establish a record of poor operation which would ultimately be used as a basis for terminating all of Plaintiffs' [sic] franchises." Defendants assert they were "further victimized" by this action and that they were "unfairly accused of violating" Plaintiff's healthy and safety standards.

Defendants submitted with their opposition papers a Certification of William James, dated May 30, 2001, and a Memorandum from Mr. James to Defendants' counsel, dated June 26, 2000. In his Certification and Memorandum, Mr. James states that in his professional opinion as a New Jersey State Registered Environmental Health Specialist, Dunkin's inspections and findings were conducted by "non-qualified personnel" and were "inaccurate and based on critically flawed practice and procedure." Mr. James states further that in his "professional opinion, all three locations ... were all operating in compliance with New Jersey Law ... at the time they were allegedly 'inspected' for sanitary violations by Dunkin' Donuts' unqualified personnel. Based on a review of the reports, it could not be shown that they were not operating property [sic], *but I was not there at that time and cannot say that* ***208** *there were no conditions that did not comply.*"6 (emphasis added).

Mr. James claims that (1) Dunkin's temperature measurements were done without proper thermometer calibration and are therefore "inclusive and unreliable"; (2) Dunkin's detection of mouse feces was "inconclusive" because Dunkin's inspectors relied only upon visual observation and did not use a black light to identify mouse urine;7 (3) Dunkin's "standards ... evidence a lack of understanding of the state requirements and food safety issues" regarding proper temperature storage of cream cheese; (4) Dunkin's requirement that thermometers be sanitized in solution before using is contrary to New Jersey law; and, (5) when he inspected the shops in question, the trash container lids were in place. Mr. James does not address the other health and safety violations found by Dunkin's inspectors.

In his Certification submitted with Defendants' opposition papers, Defendant Dipak R. Patel ("Patel") asserts that he was told by another franchisee prior to the April inspections that the franchisee was told he should approach Defendant to purchase all his locations because "Dunkin' was going to 'force Dipak out.' " Defendant Patel also asserts that at about the same time, he was told "from another source that Dunkin' had decided to put us on an 'exit strategy.' " Defendant Patel contends that Dunkin' is engaging in unfair tactics to economically retaliate for his "failure to support a franchisee owned cooperative off-premises bakery."

Defendants assert that questions of fact do exist as to (1) the accuracy of the inspections that provided the basis for Plaintiff's actions; (2) the "unfair and harassing inspection procedures employed"; and, (3) whether the inspections and the motion for summary judgment were brought in bad faith with the intent to interfere with Defendants' contractual rights and protections afforded franchisees under the New Jersey Franchise Practice Act, N.J.S.A. 56:10–1, et seq.8

In its reply to Defendants' opposition papers, Plaintiff argues that Mr. James is not competent to testify as to the conditions of the three shops during the time of Plaintiff's inspections since, as he admits, he was not present during any of those inspections. Plaintiff argues also that Mr. James' Certification is flawed in that it addresses whether Defendants' shops were in compliance with New Jersey's health regulations. However, Plaintiff asserts that it is permitted to set stricter standards of health and safety than those of the State. Plaintiff further contends that Mr. James fails to refute the substantial photographic and other evidence supporting Plaintiff's Motion for Summary Judgment, which evidence "demonstrates incontrovertibly that Defendants' shops were not in compliance with Dunkin's standards in April 2000."

Motion to Strike Certification and Memorandum of William James

Plaintiff has also filed a Motion to Strike the Certification

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and Memorandum of William ***209** James, which documents were submitted by Defendants in their opposition papers to the summary judgment motion. Plaintiff's basis for this motion is that the Defendants did not comply with the disclosure requirements of Federal Rule of Civil Procedure 26(a)(2)(B), and that neither document satisfies the requirements of Federal Rule of Evidence 702 that expert testimony be based upon "sufficient facts and data" and helpful to the trier of fact.

The Scheduling Order entered in this action required Defendants to serve Plaintiff with copies of their expert reports by January 31, 2001. Defendants did not do so. Discovery closed on February 28, 2001. The Scheduling Order also specified that expert reports "shall contain the information required by Federal Rule of Civil Procedure 26(a)(2)(B)." Although Defendants did attach Mr. James' June 26, 2000 memorandum to their July 5, 2000 brief in opposition to Plaintiff's Motion for a Preliminary Injunction,9 Plaintiff alleges that the memorandum did not comply with the requirements of Federal Rule of Civil Procedure 26(a)(2)(B) or with Federal Rule of Evidence 702.

Applicable Law

The Summary Judgment Standard

"A party against whom a claim ... is asserted ... may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof." Fed.R.Civ.P. 56(b). The Rule also sets forth the standard for granting such a motion, stating that the motion for summary judgment shall be granted if

> the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed. R. Civ. Pro. 56(c).

Basically, the Rule directs the Court to decide, after reviewing the pleadings, affidavits, depositions, documents, and interrogatory answers put forth by both parties, whether a reasonable jury, applying relevant law, could return a verdict in the nonmoving party's favor. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248–52, 254, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). If the answer to that inquiry is no, then the motion for summary judgment must be granted. *Id.*

It is important to note, though, that if there is a dispute over facts that do not go to the substantive law at issue, the facts are not "material" under the Rule. In other words, disputes over facts that are irrelevant or unnecessary to proving the case will not defeat a motion for summary judgment. *Id.* at 248, 106 S.Ct. 2505. Additionally, when analyzing and drawing inferences from the facts presented, the Court must resolve those inferences in favor of the non-moving party. *Luden's, Inc. v. Local Union No. 6 of Bakery, Confectionery & Tobacco Workers' Int'l Union of America,* 28 F.3d 347, 353 (3d Cir.1994).

Th Rule also states that when a motion for summary judgment is made and properly supported, the party against whom the summary judgment is sought

> may not rest upon the mere allegations or denials of [that party's] pleading, but [that party's] response, by affidavits ... must set forth specific facts showing that there is a genuine issue for trial. If ***210** the adverse party does not so respond, summary judgment if appropriate, shall be entered against the adverse party.

Fed.R.Civ.P. 56(e).

The Courts have clarified this portion of the Rule by stating that the burden of proof for a summary judgment motion shifts during the motion process. First, the moving party bears the burden of showing that, according to the pleadings and discovery materials presented, summary judgment is appropriate under Rule 56. *Celotex Corp. v. Catrett,* 477 U.S. 317, 330, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The burden then shifts to the non-moving party to show, by affidavit or otherwise, that a genuine issue of material facts remains. *Id.* Courts have noted, however, that it is not the Court's obligation to sift through the record searching for a genuine issue of material fact. Rather, it is the parties' obligation to show the absence or existence of such an issue. *See, e.g., Jackson v. Finnegan, Henderson, Farabow, Garrett & Dunner,* 101 F.3d 145, 154 (D.C.Cir.1996).

Moreover, a party does not raise a genuine issue of material fact by speculation and conclusory allegations. *Trap Rock Indus. v. Local 825, Int'l Union of Operating Eng'rs,* 982 F.2d 884, 890 (3d Cir.1992) (stating that the non-moving party "may not rest upon mere allegations, general denials, or ... vague statements") (omission in original); *Sterling Nat'l Mortgage Co. v. Mortgage Corner, Inc.*, 97 F.3d 39, 45 (3d Cir.1996) (holding that the plaintiff was obliged to come forward with evidence sufficient to raise a triable issue and that "[m]ere speculation about the possibility of the existence of such facts" did not suffice).

The Breach of Contract Issue

The terms of a Franchise Agreement, like the terms of any contract, govern any dispute that arises regarding the contract or its application.

[1] [2] A court "can grant summary judgment on an issue of contract interpretation if the contractual language being interpreted is subject to only one reasonable interpretation." *Emerson Radio Corp. v. Orion Sales, Inc.*, 253 F.3d 159, 164–65 (3d Cir.2001) (internal quotation marks omitted). "Where ... a contract is unambiguous, it is appropriate for the court to determine its meaning as a matter of law at the summary judgment stage." *LeJeune v. Bliss–Salem, Inc.*, 85 F.3d 1069, 1073 (3d Cir.1996). If a contract can reasonably be interpreted in two different ways, then a contracting party is not entitled to summary judgment in breach of contract action. *American Flint Glass Workers Union v. Beaumont Glass Co.*, 62 F.3d 574, 581 (3d Cir.1995).

[3] Further, in *Dunkin' Donuts Inc. v. Priya Enter., Inc.*, 89 F.Supp.2d 319 (E.D.N.Y.2000), a case similar to the one at bar, the court held that a Dunkin' Donuts' franchisee's failure to cure violations of Dunkin' Donuts' standards for health, sanitation, and safety after notice and an opportunity to cure was a breach of the franchise agreement. *Id.* at 322. The court held that "Dunkin' Donuts ... established that, under the clear language of the franchise agreement, it is entitled to a judgment for the attorney's fees it has expended pursuing this case." *Id.* at 322.

[4] Moreover, a franchiser is free to establish health, sanitation, and safety standards that exceed those of the municipality in which the franchised store is located. *See, e.g., Baskin–Robbins, Inc. v. A. Ender, Ltd.*, No. CV–N–99–206–ECR, 1999 WL 1318498, at *3 (D.Nev. Sept.10, 1999) (holding that the franchiser's health standards were higher than those of the county health department in which the ***211** store was located and recognizing that the franchiser was "entitled, under its contracts, to insist on stricter standards," especially given that it did business on a national scale).

Certification and Memorandum of William James

Fed.R.Civ.P. 26(a)(2), subtitled, "Disclosure of Expert Testimony," states, in pertinent part, that

> (B) Except as otherwise stipulated or directed by the court, this disclosure shall, with respect to a witness who is retained or specially employed to provide expert testimony in the case ... be accompanied by a written report prepared and signed by the witness. The report shall contain a complete statement of all opinions to be expressed and the basis and reasons therefor; the data or other information considered by the witness in forming the opinions; any exhibits to be used as a summary of or support for the opinions; the qualifications of the witness, including a list of all publications authorized by the witness within the preceding ten years; the compensation to be paid for the study and testimony; and a listing of any other cases in which the witness has testified as an expert at trial or by deposition within the preceding four years.

Fed.R.Civ.P. 26(a)(2)(B).

[5] [6] [7] "The test of a report is whether it [is] sufficiently complete, detailed and in compliance with the Rules so that surprise is eliminated, unnecessary depositions are avoided, and costs are reduced." *Reed v. Binder*, 165 F.R.D. 424, 429 (D.N.J.1996). An expert report under Rule 26 "is intended to set forth the substance of the direct examination of the expert witness," and must "disclose the data and other information considered by the expert." Advisory Committee Notes to the 1993 Amendments to Rule 26. To satisfy the Rule, "the report must provide the substantive rationale in detail with respect to the basis and reasons for the proffered opinions. It must explain factually why and how the witness has reached them." *Hilt v. SFC, Inc.*, 170 F.R.D. 182, 185 (D.Kan.1997). "[T]he purpose of the reports is to avoid the disclosure of 'sketchy and vague' expert information." *Sierra Club v. Cedar Point Oil Co.*, 73 F.3d 546, 571 (5th Cir.1996).

[8] Furthermore, if an expert witness does not have information concerning previous cases in which he or she testified or was deposed, that should be revealed. *Hilt*, 170 F.R.D. at 185.

Fed.R.Evid. 702 states:

> If scientific, technical or other specialized knowledge will assist the trier of fact to under the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

Analysis

Summary Judgment Motion

Plaintiff asserts that no genuine issue of material fact exists since Defendants breached their Franchise Agreements by failing to maintain the Hamilton Street Shop, Lafayette Avenue Shop, and West Main Street Shop in compliance with Plaintiff's standards for health, sanitation and safety as set forth in the Franchise Agreements and Manuals. Plaintiff further asserts that the Franchise Agreements expressly require that Defendants pay Plaintiff's attorneys' fees and costs ***212** incurred as a result of Defendants' breach and their failure to cure the violations timely.

As stated, under the Franchise Agreements, Defendants are required to maintain their shops in compliance with Plaintiff's standards, including those standards for health, sanitation and safety. If violations of standards are observed, Defendants are entitled to written notice and twenty-four hours to cure the violations, as stated in the Franchise Agreements. If the violations are not cured after the cure period expires, then Defendants are in breach of the Franchise Agreements.

In this case, Dunkin' representatives inspected Defendants' shops and observed numerous standards violations. While some of these violations have been disputed by the Defendants in their opposition papers,[10] many have not. Although the Defendants cured these violations as of August, 2000, Plaintiff alleges they refused to pay the attorneys' fees and costs Plaintiff has incurred, and continues to incur, in instituting and prosecuting this action. The Franchise Agreements expressly provide that if the franchisee fails to cure a default, following the appropriate notice and within the applicable time period, then the franchisee is to pay the attorneys' fees, costs, and expenses incurred by Dunkin' as a result of the failure to cure.

[9] [10] As far as Defendants' assertions that they are being unfairly targeted by Dunkin' in retaliation for their refusal to support an off-premises bakery, these assertions are based upon hearsay and speculation. Out-of-court statements offered for the truth of the matter asserted are "presumptively inadmissible" hearsay. *United States v. Saada,* 212 F.3d 210, 221 n. 12 (3d Cir.2000). Genuine issues of material fact cannot be raised by speculation and conclusory allegations. *Trap Rock Indus.,* 982 F.2d at 890.

[11] Further, Defendants' claim that Dunkin' inspections were retaliation for Defendants' refusal to support a franchisee-owned cooperative off-premises bakery was previously addressed by this Court when it dismissed Defendants' Counterclaim with prejudice in March, 2001.[11] In addition, Dunkin's motives in conducting its inspections have no bearing on whether Defendants' breached their Franchise Agreement with Plaintiff by failing to properly maintain the three shops. Other federal courts have addressed and rejected this argument. *See, e.g., McDonald's Corp. v. Robertson,* 147 F.3d 1301, 1309 (11th Cir.1998) (rejecting the franchisee's argument that McDonald's termination of the franchise agreement for health and safety violations was merely an excuse for McDonald's real motive to relocate the store and declaring that "[e]ven assuming, *arguendo,* that this allegation is correct ..., we find that the Robertsons' failure to comply with McDonald's QSC and food safety standards constituted a material breach of the franchise agreement sufficient to justify termination, and thus, it does not matter whether McDonald's also possessed an ulterior, or improper motive for terminating the ... franchise agreement"); ***213** *Major Oldsmobile, Inc. v. Gen. Motors Corp.,* No. 93 Civ. 2189, 1995 WL 326475, 1995 U.S. Dist. LEXIS 7418, at *26–27 (S.D.N.Y. May 31, 1995) (defendant's alleged ulterior motive in terminating contract was "legally irrelevant" where it also had valid grounds for the termination), *aff'd,* 101 F.3d 684 (2d Cir.1996); *but see Gen. Motors Corp. v. New A.C. Chevrolet, Inc.,* 263 F.3d 296, 319 (3d Cir.2001) (stating that while *Major Oldsmobile* states the correct rule regarding private contracts, the New Jersey Franchise Practices Act, N.J.S.A. 56:10–1, et seq., requires a franchiser terminate a franchise agreement with good cause, but that "New Jersey law offers no clear answer" on whether good cause requires an inquiry into whether the franchiser acted in good faith and without a "pretextual motive," and declaring that this argument was irrelevant anyway since the defendant "failed to furnish record evidence sufficient to create a genuine issue as to whether GM acted in good faith").

Certification and Memorandum of William James

[12] Both Mr. James' Certification and the Memorandum of June 26, 2000, fail to comply with Rule 26(a)(2)(B) in numerous ways. First, neither document sets forth the basis and reasons for the opinions contained therein. Mr. James' opinion that Dunkin' representatives did not properly calibrate their thermometers is based upon observations made by "[f]ranchise management and employees." Similarly, Dunkin's representative's identification of mouse feces is based upon what Defendants' employees reported to be only visual observations of feces. Second, neither of Mr. James' documents includes a list of all publications authored by him over the past ten years; they do not indicate his compensation for his study and/or testimony; nor do they list any other cases in which he has testified as an expert or by deposition within the past four years. Further, the June 26, 2000 Memorandum lacks Mr. James' signature.

[13] Furthermore, the documents are not admissible under Federal Rule of Evidence 702, which governs the admission of expert testimony. The two documents, both of which challenge the validity of Dunkin's inspections, are not "based upon sufficient facts and data" as required by the Rule, because Mr. James has not demonstrated knowledge of Dunkin's health, sanitation, and safety standards. His Certification and Memorandum focus on whether Defendants' shops were in compliance with the requirements of New Jersey law. However, the issue is whether Defendants' shops met Plaintiff's standards. Moreover, as Mr. James acknowledges, not only was he not present during Dunkin's inspections, he states that "[b]ased on a review of the reports, it could not be shown that they [the three shops] were not operating property [sic], but I was not there at that time and cannot say that there were no conditions that did not comply."

Moreover, Mr. James' opinions in his Certification and Memorandum are not supported by any treatises or authoritative documents in which standard practices are set forth for thermometer calibrations, determining internal food temperatures, or that black lights must be used to accurately determine the existence of mouse feces. Mr. James simply states in his Certification that he is "fully familar with all form [sic] of food handling sanitation methodologies and techniques and have set forth a full listing of my health inspection credentials." Similarly, Mr. James states in his Memorandum of June 26, 2000, that in his "professional opinion" the shops in question "are operating in compliance with New Jersey Law ... and [their] operations are conducted in accordance *with what is considered to be good public health* ***214** *and food safety standards.*" (emphasis added).

Additionally, although Mr. James does attach a resume to his Certification listing his health inspector credentials and employment history, the other requirements of Rule 26(a)(2)(B) are not met: there are no exhibits identified "to be used as a summary of or support for the opinions"; there is no list of publications authorized by Mr. James within the preceding ten years; there is no mention of the compensation paid to Mr. James for his study and testimony; and there is no list of any other cases in which Mr. James testified as an expert within the preceding four years.

Since discovery closed on February 28, 2001, and given that Defendants never designated Mr. James an expert, Plaintiff does not now have an opportunity to learn the factual bases for the opinions contained in Mr. James' Certification and June 26, 2000 Memorandum. In addition, information concerning Mr. James' compensation for his study and testimony is relevant regarding bias. Further, a listing of previous cases in which Mr. James has testified as an expert would allow Plaintiff to locate that testimony since it might be relevant to this case.

Mr. James' Certification and Memorandum also do not meet the requirements of Federal Rule of Evidence 702 because they are not based upon "sufficient facts or data" in that they fail to establish that Mr. James has any familiarity with Plaintiff's health, sanitation, and safety standards. Instead, both documents focus on whether Defendants' shops were in compliance with the New Jersey State Health Code. However, the issue is whether Defendants' shops met Plaintiff's standards.

Defendants, in their opposition papers to the Motion to Strike, argue that this motion is both "substantively illogical and procedurally defective." Defendants argue that the motion is "substantively illogical" because it was not possible for Mr. James to be present during Plaintiff's April 2000 inspections of the shops. However, the central issue in this case is whether Defendants' shops met Dunkin's standards. Indeed, instead of addressing Plaintiff's arguments that Mr. James' Certification and Memorandum do not meet the requirements of Federal Rule of Civil Procedure 26(a)(2)(B) and Federal Rule of Evidence 702, their opposition papers merely reiterate

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Mr. James' findings, which had been set forth in their opposition papers to the summary judgment motion.

Lastly, Defendants' claim that the Motion to Strike is procedurally defective in that Plaintiff cannot "piggy-back" it onto its original Motion for Summary Judgment. Defendants assert that "[i]nstead of sending its motion [sic] Defendants' counsel as a new and separate motion, Plaintiff chose to treat the motion in the nature of a reply, which it cannot do as the subject of the motion is totally different from its original summary judgment motion." However, it is this argument that is illogical and unsupported.

CONCLUSION

For the foregoing reasons, I recommend that Plaintiff's Motion for Summary Judgment on Counts I, II, and III and its Motion to Strike the Certification and Memorandum of William James be granted.

Sept. 18, 2001.

Footnotes

1 Plaintiff has stated that should this motion be granted, it will dismiss the remaining counts of the Complaint, which allege trademark infringement and dilution, and unfair competition, and that this matter will be resolved in its entirety.

2 The express provision in the Franchise Agreements states:

> A twenty-four (24) hour cure period shall apply to the violation of any law, regulation, order or DUNKIN' DONUTS standard relating to health, sanitation or safety ....

3 The Franchise Agreement provides:

> If FRANCHISEE fails to cure a default, following notice, within the applicable time period set forth ... [herein], FRANCHISEE shall pay to DUNKIN' DONUTS all damages, costs and expenses, including, without limitation, interest at eighteen percent (18%) per annum, or the highest permissible rate, and reasonable attorneys' fees incurred by DUNKIN' DONUTS as a result of any such default ....

4 At the Hamilton Street Shop, the violations consisted of the walk-in freezer being littered with cornmeal and other debris; bagels being stored without proper covering; beverage lids being stored on dirty trays; employees not wearing hats; cleaning products being placed next to food items; the men's restroom sink being dirty; and the premises being generally unclean. At the Lafayette Avenue Shop, milk was stored in uncovered containers; sugar was kept in a filthy container; an employee's water bottle was in the ice machine in direct contact with ice used to serve customers; and liquid was stored in unmarked bottles.

5 At the West Main Street Shop, food products were not dated; the ice scoop was stored in the ice machine; and the sanitizer was at an inadequate level of concentration.

6 Mr. James' inspections were done of all three shops on June 23, 2000. He also inspected the Lafayette Avenue Shop again on June 26, 2000.

7 Mr. James certifies that a "black light is a basic and standard field test instrument utilized by professional food safety inspectors."

8 Defendants do not elaborate as to what these protections are in their opposing brief. In fact, other than citing some common case law on the summary judgment standard, Defendants cite no other law or other authority in any of its opposition papers to support its position.

9 That motion was withdrawn by Plaintiff on August 6, 2000, since by that time Defendants had cured the violations.

10 Even if I were not recommending that the Certification and Memorandum of William James be stricken, many of the violations found by Dunkin' representatives were not even disputed by Mr. James.

11 Defendants' Counterclaim had alleged that Dunkin's inspections "were biased, unfair, unobjective and conducted for purposes of economic retaliation because of Defendants' unwillingness to recommend to other franchisees the implementation of a cooperative off premises bakery facility...."

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161 Cal.App.4th 906
Court of Appeal, Second District, Division 3, California.

EMPLOYERS REINSURANCE COMPANY et al., Petitioner,
v.
The SUPERIOR COURT of Los Angeles County, Respondent;
Thorpe Insulation Company, Real Party in Interest.

No. B200959. | April 3, 2008. | As Modified April 22, 2008.

Synopsis

Background: Asbestos company brought suit against its liability insurers, seeking declaratory relief that some current and future asbestos suits against it should be considered "non-products" claims not subject to policy limits, and moved in limine to preclude insurers from introducing "course of performance" evidence to show meaning of policies. The Superior Court, Los Angeles County, No. JCCP4458, Carolyn B. Kuhl, J., granted motion. Insurers petitioned for writ of mandate.

Holdings: The Court of Appeal, Croskey, J., held that:
[1] course of performance evidence is relevant to insurance contract interpretation;
[2] evidence of performance under policy by people who did not draft or negotiate policy was relevant to show policy's meaning; but
[3] evidence of course of performance after subsequent settlement agreement was not relevant to show terms of original policy.

Petition granted in part and remanded with directions.

West Headnotes (28)

[1] **Insurance**
Premises and operations hazards

A manufacturer's or service provider's liability insurance policy claims for injuries arising while a work activity is in progress fall within "non-products coverage" or "operations coverage."

[2] **Insurance**
Products and completed operations hazards

A manufacturer's or service provider's liability insurance policy claims for injuries arising once the product has been completed and sent to market fall within "products coverage" or "completed operations coverage."

[3] **Insurance**
Premises and operations hazards
Insurance
Products and completed operations hazards

"Non-products" liability coverage or "operations coverage" is complementary and not overlapping to "products coverage" or "completed operations coverage"; products coverage takes over where operations coverage leaves off.

[4] **Appeal and Error**
Rulings on admissibility of evidence in general

The abuse of discretion standard of review applies to any ruling by a trial court on the admissibility of evidence.

3 Cases that cite this headnote

[5] **Appeal and Error**
Abuse of discretion

Under the abuse of discretion standard of review, a trial court's ruling will not be disturbed, and reversal of the judgment is not required, unless the trial court exercises its discretion in an arbitrary, capricious, or patently absurd manner that results in a manifest miscarriage of justice.

10 Cases that cite this headnote

[6] **Appeal and Error**
Cases Triable in Appellate Court
Appeal and Error
Rulings on admissibility of evidence in general

The abuse of discretion standard of review, rather than de novo review, applied to trial court's exclusion of "course of dealing" evidence in interpretation of asbestos company's liability insurance contracts; trial court did not rule in favor of company on any of its causes of action or the insurers' affirmative defenses, and made no rulings regarding interpretation of the liability policies.

2 Cases that cite this headnote

[7] **Insurance**
Policies considered as contracts
Insurance
Application of rules of contract construction

Although insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply.

[8] **Insurance**
Intention

The mutual intention of the contracting parties at the time the contract is formed governs an insurance contract.

[9] **Insurance**
Intention
Insurance
Language of policies

In interpreting an insurance contract, the Court of Appeal ascertains the intention of the parties solely from the written contract if possible, but also considers the circumstances under which the contract was made and the matter to which it relates.

[10] **Insurance**
Construction as a whole

In interpreting an insurance contract, the Court of Appeal considers the contract as a whole and interprets the language in context, rather than interpreting a provision in isolation.

4 Cases that cite this headnote

[11] **Insurance**
Plain, ordinary or popular sense of language

In interpreting an insurance contract, the Court of Appeal interprets words in accordance with their ordinary and popular sense, unless the words are used in a technical sense or a special meaning is given to them by usage.

[12] **Insurance**
Ambiguity in general

An insurance policy provision is ambiguous if it is capable of two or more reasonable constructions.

[13] **Evidence**
Grounds for admission of extrinsic evidence
Insurance
Ambiguity in general

In determining if an insurance policy provision is ambiguous, the Court of Appeal considers not only the face of the contract but also any extrinsic evidence that supports a reasonable interpretation.

3 Cases that cite this headnote

[14] **Insurance**
Ambiguity in general

Even apparently clear insurance policy language may be found to be ambiguous when read in the context of the policy and the circumstances of the case.

[15] **Insurance**
Reasonable expectations
Insurance
Favoring coverage or indemnity; disfavoring forfeiture

If insurance policy language is ambiguous, an interpretation in favor of coverage is reasonable only if the coverage that would result from such a construction is consistent with the insured's objectively reasonable expectations.

[16] **Evidence**
Latent ambiguity

Extrinsic evidence can be offered not only where it is obvious that a contract term is ambiguous, but also to expose a latent ambiguity.

5 Cases that cite this headnote

[17] **Evidence**
Grounds for admission of extrinsic evidence

Extrinsic evidence is admissible when relevant to prove a meaning to which the language of a contract is reasonably susceptible.

3 Cases that cite this headnote

[18] **Contracts**
Construction by Parties

Course of performance evidence can be used not only to interpret an ambiguity, but also to reveal one in language otherwise thought to be clear. West's Ann.Cal.C.C.P. § 1856(c).

1 Cases that cite this headnote

[19] **Contracts**
Construction by Parties

When a contract is ambiguous, a construction given to it by the acts and conduct of the parties with knowledge of its terms, before any controversy has arisen as to its meaning, is entitled to great weight, and will, when reasonable, be adopted and enforced by the court. West's Ann.Cal.C.C.P. § 1856(c).

1 Cases that cite this headnote

[20] **Contracts**
Intention of Parties
Contracts
Construction by Parties

In interpreting a contract, it is the duty of the court to give effect to the intention of the parties where it is not wholly at variance with the correct legal interpretation of the terms of the contract, and a practical construction placed by the parties upon the instrument is the best evidence of their intention. West's Ann.Cal.C.C.P. § 1856(c).

2 Cases that cite this headnote

[21] **Contracts**
Construction by Parties

The principle of "practical construction" applies only to acts performed under the contract before any dispute has arisen.

[22] **Insurance**
Construction by parties; course of conduct or prior dealings

The rules relating to course of performance as extrinsic evidence used for contract interpretation are equally applicable to insurance policy interpretation. West's Ann.Cal.C.C.P. § 1856(c).

[23] **Insurance**
Construction by parties; course of conduct or prior dealings

Course of performance evidence may be used to interpret insurance policies, even if the performing parties are not the same people who drafted or negotiated the policy contract. West's Ann.Cal.C.C.P. § 1856(c).

[24] **Insurance**
Construction by parties; course of conduct or prior dealings
Insurance
Admissibility

Evidence of course of performance of asbestos company and its excess liability insurers after insurers entered into interim agreement on costs of defense and indemnity for personal injury actions was not relevant to show that asbestos claims were "products" claims subject to policy limits under the original liability policies, even though asbestos company was not party to agreement, since after agreement parties handled claims pursuant to agreement rather than policies; insurers reserved their rights to subsequently contend that payments they made were not actually due under policies, and one expressly reserved right to argue that asbestos claims were not products claims. West's Ann.Cal.C.C.P. § 1856(c); West's Ann.Cal.Com.Code § 1303.

See 2 Witkin, Cal. Evidence (4th ed. 2000) Documentary Evidence, § 85; Annot., The parol evidence rule and admissibility of extrinsic evidence to establish and clarify ambiguity in written contract (1971) 40 A.L.R.3d 1384; Wegner et al., Cal. Practice Guide: Civil Trials and Evidence (The Rutter Group 2007) ¶ 8:3115.10 (CACIVEV Ch. 8E-G).

2 Cases that cite this headnote

[25] **Contracts**
Construction by Parties

Course of performance evidence is admissible only to interpret the contract under which the parties were performing. West's Ann.Cal.C.C.P. § 1856(c).

[26] **Insurance**

Construction by parties; course of conduct or prior dealings
Insurance
Admissibility

Evidence of course of performance of asbestos company and its primary liability insurers after parties entered into settlement on costs of defense and indemnity for personal injury actions was not relevant to show that asbestos claims were "products" claims subject to policy limits under the original liability policies, since after settlement asbestos company and insurers handled claims pursuant to the settlement rather than pursuant to the policies themselves; settlement expressly stated that it was not a policy interpretation and should not be used in any court to interpret policies. West's Ann.Cal.C.C.P. § 1856(c).

[27] **Insurance**
Construction by parties; course of conduct or prior dealings
Pretrial Procedure
Motions in limine; preclusion of evidence, argument, or reference

The Court of Appeal would not exclude evidence of course of performance between asbestos company and its liability insurers on the basis that insurers would be unable to prove that asbestos company understood it was accepting performance in a way that interpreted the policies to have no non-products coverage for asbestos suits, since that argument was not a basis for the asbestos company's motion in limine in the trial court; insurers were never required to establish a foundation for the admissibility of the disputed evidence. West's Ann.Cal.C.C.P. § 1856(c); West's Ann.Cal.Com.Code § 1303.

1 Cases that cite this headnote

[28] **Pretrial Procedure**
Motions in limine; preclusion of evidence, argument, or reference

Trial court acted within its discretion in declining, on motion in limine, to reach issue of whether insurers' interpretation of liability policies to exclude "non-products" coverage of asbestos suits was unreasonable as a matter of law, preventing admission of course of performance evidence to support that interpretation; even though asbestos company's showing on motion in limine contained the relevant policy language, company never specifically identified any asbestos suits, or types of asbestos suits, that it believed fell within scope of non-products coverage. West's Ann.Cal.C.C.P. § 1856(c); West's Ann.Cal.Com.Code § 1303.

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Opinion

CROSKEY, J.

***911** In this case, we consider the use of "course of performance" evidence in the interpretation of contracts of insurance and conclude that such evidence is relevant and may be used for such purpose. However, such evidence is only admissible when the performance was pursuant to the contract to be interpreted, not a subsequent settlement agreement such as the one we have in this case. **[1] [2] [3]** Thorpe Insulation Company ("Thorpe"), a distributer and installer of asbestos insulation products, was sued in numerous personal injury actions. Thorpe had many insurance policies, both primary and excess, issued by different insurance companies (the "insurers").1 Thorpe tendered the asbestos claims to the insurers, and there followed some thirty years of negotiations, settlement agreements, claims handling agreements, reservations of rights, and payments of defense costs and indemnity, resulting in the exhaustion or near-exhaustion of Thorpe's $180 million in insurance coverage. Nearly all of Thorpe's insurance policies provided coverage for both "products" (or "completed operations") claims and "non-products" (or "operations") claims.2 The individual policies' aggregate limits of liability apply to products claims but not ***912** non-products ****738** claims. In other words, non-products claims would not exhaust a policy. When the insurers' paid Thorpe's claims, they charged the payments against policy limits, treating all of the asbestos suits as products claims. When its policies were nearly exhausted, and asbestos suits continued to be filed against Thorpe, Thorpe brought the instant suit against its insurers, seeking declaratory relief that at least some of the current and future asbestos suits against it should be considered non-products claims.3

The insurers took the position that, over the past thirty years, the parties had all assumed that asbestos claims were products claims which exhausted aggregate limits, and that, in fact, Thorpe had obtained millions of dollars in payments from its excess insurers based on this very assumption. Thorpe sought and obtained summary adjudication of the insurers' affirmative defenses of waiver, estoppel, laches, and ratification. That ruling is not at issue in this writ proceeding. Thorpe also moved, in limine, to preclude the insurers from introducing the parties' thirty-year course of handling the asbestos claims as evidence of the *meaning* of the insurance policies. The trial court granted the motion, and the insurers sought writ review. We issued an order to show cause,4 and now grant the petition in part.

FACTUAL AND PROCEDURAL BACKGROUND

According to the operative complaint, Thorpe "is a California company that installed, repaired, maintained, removed and displaced asbestos materials at industrial facilities. It has been subject to thousands of asbestos bodily injury lawsuits resulting from these historical operations." In the asbestos suits, the underlying plaintiffs "seek ... recovery of damages from Thorpe resulting from their alleged injurious exposure to asbestos at industrial facilities serviced by Thorpe. The [underlying] plaintiffs seek recovery against Thorpe on various theories of recovery, including premises liability, negligence, and failure to warn." In 1978, Thorpe began submitting asbestos claims to its primary insurers.

In 1984, Thorpe and ten of its primary insurers entered into a Claims Handling and Settlement Agreement (the "1984 Agreement"). The stated purpose of the 1984 Agreement was to "clarify among" the parties to the agreement the "apportionment of defense and indemnification of Thorpe ... under any of the carriers' policies arising out of numerous lawsuits charging Thorpe with liability for damages to individuals resulting from exposure to asbestos ***913** products." The 1984 Agreement states that it "is the result of a compromise accord and is a compromise settlement of disputed claims. It is the product of arms length negotiations, is not intended to nor shall it be construed as the admission of the existence of a policy or as a policy interpretation, and shall not be used in any Court or Arbitration to create, **739 prove or interpret the obligations under general liability or other liability policies." It further stated that "[i]t is the purpose of this Agreement to achieve, between Thorpe and its insurers, the most efficient and economical defense of Thorpe in such asbestos cases without prejudice to later assertion by any of such parties of claims against each other, or against third persons, pursuant to the several reservations of rights ... contained in this Agreement." The agreement allocated the costs of defense and indemnification among the insurers. It then provided, "Upon payment of policy limits or aggregate limits by any insurer that is a party to this Agreement, ... Thorpe shall assume that particular insurer's obligation under this Agreement," with an express reservation of rights against any excess carrier or other primary carrier. The parties reserved all rights against each other, in the event it is ultimately determined by California case law or statute that the responsibility of insurers in asbestos cases shall be "determined on the manifestation, as distinguished from the exposure theory, or any other theory substantially different from the allocation theory of this Agreement."5 It appears that the 1984 Agreement was intended to be final with respect to the parties to the agreement, except in the event of a change in law. Finally, the 1984 Agreement provided that, except as expressly modified, "all terms and conditions of all policies written by the insurers for Thorpe remain in effect without alter[ ]ation by this Agreement."

The parties operated under the 1984 Agreement, with the primary insurers charging the asbestos claim costs against their aggregate policy limits. In other words, all of the asbestos claims were treated as products claims that exhausted the policies. As the primary policies were exhausted, Thorpe turned to its first layer of excess insurers for coverage.

In 1998, seven of Thorpe's first level excess carriers entered into an Interim Excess Insurance Claims Handling Agreement (the "1998 Agreement"). The excess carriers' execution of the 1998 Agreement was intended "to adopt by way of compromise and accord without prejudice or waiver of their respective positions in this and other matters, an interim mechanism for allocating the responsibility for Defense Costs and Indemnity Payments." Under the 1998 Agreement, each signatory excess insurer "expressly reserve[d] any rights and defenses that it may have against any person or entity that is or is not a Party to this Agreement with respect to any asbestos-related *914 litigation or the Asbestos–Related Cases [against Thorpe], including the right to assert the applicability of any policy interpretation, policy defense, or other defense with respect to asbestos-related litigation or Asbestos–Related Cases [against Thorpe] against such person or entity." A further reservation of rights paragraph again indicates that the excess carriers reserve all rights "to seek reallocation, reimbursement, declaratory relief, contribution, indemnity or any other relief" from any party or non-party to the agreement. The 1998 Agreement provides that nothing in the agreement "shall be construed to operate so as to alter, amend or waive any of the terms, conditions, exclusions, provisions, or obligations of any applicable policy of insurance." The 1998 Agreement specifically provides that, except as expressly stated, the Agreement does not modify the insurance policies. The 1998 Agreement sets forth a method **740 by which defense costs and indemnity payments are to be shared among the parties to the agreement. Significantly, the 1998 Agreement considers an excess insurer's policy to be implicated when the underlying primary policy is "contend[ed to] have been exhausted." That is to say, the 1998 Agreement does not appear to require an actual determination that a primary policy has been exhausted in order to implicate the relevant excess policy, but only that the primary insurance "claims to be exhausted by the payment of claims." Under the 1998 Agreement, the obligations of any first level excess insurer that is a party to the agreement shall cease once that insurer's aggregate policy limits have been exhausted.

On November 4, 1998, Chicago Insurance Company ("Chicago"), an excess insurer who was a party to the 1998 Agreement, and is a party to this action, responded to Thorpe's request for defense and indemnity. Chicago sent Thorpe a letter advising Thorpe of its "general position concerning the claims and to provide Thorpe with an outline of Chicago's intended actions in responding to these claims." Chicago denied coverage, but nonetheless indicated it had entered into the 1998 Agreement to participate in the adjustment and settlement of the claims, with the full reservation of its rights. Specifically, Chicago indicated that it "reserve[d] its right to contend that some or all of the subject claims, including claims previously settled by Thorpe's primary insurers, do not arise out of the Completed Operations/Products exposures and therefore may still be covered under one or more of the underlying primary policies."

Thorpe was not a party to the 1998 Agreement, but was provided with a copy. On December 8, 1998, Thorpe acknowledged receipt of the agreement and noted, "Of course, Thorpe reserves all of its rights under the policies."

In August 1999, Thorpe wrote to two of its primary carriers, which had been parties to the 1984 Agreement, but are not parties to the instant action, arguing that those carriers should be handling certain asbestos claims—***915** specifically, those for negligent installation of asbestos insulation—as non-products claims that were not subject to aggregate policy limits. Thorpe specifically challenged those insurers' claims of policy exhaustion, on the basis that negligent installation claims are not subject to aggregate policy limits. Indeed, Thorpe demanded that those carriers "immediately reimburse the excess carriers for the sums that they have paid for the defense and indemnification of the underlying actions." On September 21, 1999, Thorpe filed suit against those insurers and sought a declaratory judgment that non-products coverage applied to negligent installation claims. The suit proceeded to arbitration, where, in 2002, an award was entered in favor of the insurers. In March 2005, in apparent response to an inquiry by its excess insurers, Thorpe allegedly represented that it would not seek non-products coverage against them.

On November 14, 2005, Thorpe filed its initial complaint in this matter. Thorpe alleged that the insurers' policies contained aggregate limits, if at all, only for products and/or completed operations claims. Thorpe alleged that some of the policies defined "completed operations" in a manner that was indecipherably ambiguous.6 Thorpe sought a declaration that the insurers have the burden of establishing each underlying claim is a products or completed operations claim in order for ****741** that claim to be charged against the policy's aggregate limits.7

The trial court found it appropriate to hold several "phased" trials, each addressed to discrete matters. The first trial, scheduled for May 2008, is to be devoted to policy interpretation.

***916** In February 2007, Thorpe filed a first amended complaint, adding causes of action for damages for breach of contract and for bad faith, among others. Thorpe specifically alleged that the insurers' intentional mischaracterization of the asbestos claims as products claims rather than non-products claims constituted bad faith. However, Thorpe has indicated that its action is limited only to currently pending and future asbestos suits. That is, Thorpe is not seeking relief for any mischaracterization of *former* suits as products claims.8

In February 2007, Thorpe filed a motion for summary adjudication of the insurers' affirmative defenses of waiver, estoppel, ratification and laches. Thorpe also filed a motion in limine to exclude evidence of the parties' post-contract course of performance in the policy interpretation trial.9 Thorpe's motion in limine was based on three arguments: (1) course of performance evidence is not relevant to the interpretation of standard form contracts, and, in fact, should have no place in the interpretation of insurance policies; (2) much of the course of performance evidence which the insurers were likely to introduce was the product of the 1984 and 1998 Agreements, which specifically state they are not to be used for policy interpretation; and (3) the insurers' interpretation of the contracts was unreasonable.

The insurers' opposition to the motion for summary adjudication stated that the insurers "have never argued that their policies ****742** do not provide for so-called 'operations' coverage for certain types of claims. Rather, the [i]nsurers' position, which we believe is supported by the policy language and the parties' nearly three decades of agreement, is that claims based on the inherently dangerous nature of asbestos products do not fall within such coverage." The insurers argued that Thorpe knew of the existence of the "operations" theory since at least 1984, but nonetheless treated all asbestos claims as products claims subject to aggregate policy limits. The insurers argued that Thorpe's handling of the claims, including the 1984 and 1998 Agreements, reflected an understanding that asbestos claims were products claims. The insurers further argued that Thorpe's treatment of the asbestos claims as products claims enabled Thorpe to receive $150 million in excess ***917** coverage to which it otherwise might not have been entitled. On the basis of Thorpe's history of handling the insurance claims as products claims, the insurers argued that triable issues of fact existed as to its affirmative defenses of laches, waiver, estoppel, and ratification. The insurers supported their opposition with three volumes of exhibits, reflecting Thorpe's history of handling the asbestos claims.

In opposition to the motion in limine, the insurers argued that: (1) course of performance evidence is admissible to aid in the interpretation of *all* contracts, including form insurance policies; (2) the 1984 and 1998 Agreements are no bar, because the parties' performance was based on the insurance policies, not the agreements, and, in any event, the excess carriers were not parties to the 1984 Agreement and Thorpe was not a party to the 1998 Agreement; (3) the policies are reasonably susceptible of the insurers' interpretation; and (4) the evidence is admissible to rebut Thorpe's allegation that the policy language is ambiguous. The insurers also argued that all extrinsic evidence should be provisionally admitted, and ultimately allowed if it supports a reasonable interpretation of the contract.10 The insurers incorporated into their opposition the exhibits and declarations accompanying their opposition to the motion for summary adjudication.11

After a hearing, the court granted both the motion for summary adjudication and the motion in limine. As to the motion in limine, the court granted it on two bases. First, the court noted that evidence of course of performance, while generally relevant, is only relevant if it *predates* any controversy. As the 1984 Agreement indicated ****743** the existence of a controversy in 1984, no course of performance evidence after that date would be relevant. Second, the court indicated that course of performance evidence is only relevant if it sheds light on the intention of the parties at the time of contracting. Reasoning that the individuals who negotiated the insurance contracts were not the same individuals who performed under them, the court concluded the ***918** course of performance evidence was not relevant. The court specifically declined to reach the issue of whether the insurers' interpretation of the policies was reasonable.

The insurers filed a timely petition for writ of mandate, challenging only the grant of the motion in limine, not the grant of summary adjudication. We issued an order to show cause.

ISSUES FOR RESOLUTION

It is important to recognize that the trial court's ruling on the motion for summary adjudication of the insurers' affirmative defenses is not before us. We are therefore not concerned with the issues of: whether Thorpe's failure for twenty years to assert non-products coverage against the insurers constitutes laches; whether Thorpe's acceptance of $150 million in excess coverage estops it from asserting the primary policies were not exhausted; whether Thorpe's assertion that it would not pursue the non-products theory against the excess insurers constitutes waiver of the right to assert that theory; and so forth. The *only* issue with which we are concerned in this proceeding is whether the court erred in concluding the claims handling history of the parties is not relevant to the issue of *policy interpretation.*

Preliminarily, we conclude that course of performance evidence is generally admissible in the context of interpretation of insurance policies, even standard form policies. We further conclude that the admissibility of course of performance evidence does not depend on the individual performing being the individual who had negotiated the contract. We therefore conclude the trial court erred in its alternative conclusion that course of performance evidence was inadmissible in this case for that reason.

However, course of performance evidence is relevant to the issue of contract interpretation only when the course of performance is attributable to the parties' understanding of the contract. In this case, the 1984 and 1998 Agreements, not the policies, governed the bulk of the parties' performance. Therefore, we conclude the trial court did not err in excluding evidence of performance following the 1984 Agreement. As it is not clear whether the insurers seek the admission of evidence of performance predating the 1984 Agreement, we direct the trial court to vacate its order granting the motion in limine in its entirety and to enter an order granting the motion in limine only to the extent of evidence of course of performance evidence following the 1984 and 1998 Agreements.

***919** *DISCUSSION*

1. *Standard of Review*

[4] [5] "The abuse of discretion standard of review applies to any ruling by a trial court on the admissibility of evidence." (*People v. Guerra* (2006) 37 Cal.4th 1067, 1113, 40 Cal.Rptr.3d 118, 129 P.3d 321.) "Under this standard, a trial court's ruling will not be disturbed, and reversal of the judgment is not required, unless the trial court exercised its discretion in an arbitrary, capricious, or patently absurd manner that resulted in a manifest miscarriage of justice." (*Ibid.*)

****744 [6]** The insurers suggest that de novo review is the appropriate standard, on the basis that the trial court's exclusion of an entire category of evidence is akin to a ruling on a general demurrer or a motion for judgment on the pleadings. We disagree. The trial court did not rule on the motion on limine in favor of Thorpe on any of its causes of action or the insurers' affirmative defenses. The court made no rulings regarding the interpretation of the insurance policies. The court simply concluded that certain evidence that would be proffered by the insurers on the issue of contract interpretation was inadmissible for that purpose. The abuse of discretion standard applies.

2. *General Rules of Insurance Policy Interpretation*

[7] [8] [9] [10] [11] [12] [13] [14] [15] "Although insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply. [Citations.] Thus, the mutual intention of the contracting parties at the time the contract was formed governs. [Citations.] We ascertain that intention solely from the written contract if possible, but also consider the circumstances under which the contract was made and the matter to which it relates. [Citations.] We consider the contract as a whole and interpret the language in context, rather than interpret a provision in isolation. [Citations.] We interpret words in accordance

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with their ordinary and popular sense, unless the words are used in a technical sense or a special meaning is given to them by usage. [Citations.] [¶] A policy provision is ambiguous if it is capable of two or more reasonable constructions. [Citations.] In determining if a provision is ambiguous, we consider not only the face of the contract but also any extrinsic evidence that supports a reasonable interpretation. [Citation.] Even apparently clear language may be found to be ambiguous when read in the context of the policy and the circumstances of the case. [Citations.] [¶] If policy language is ambiguous, an interpretation in favor of coverage is reasonable only if it is consistent with the objectively reasonable expectations of the insured. [Citation.] Thus, the court must determine whether the coverage under the policy that would result from such a construction is ***920** consistent with the insured's objectively reasonable expectations. [Citation.]" (*London Market Insurers v. Superior Court* (2007) 146 Cal.App.4th 648, 655–656, 53 Cal.Rptr.3d 154.)

3. *General Rules Governing Admissibility of Course of Performance Evidence*

[16] [17] Extrinsic evidence can be offered not only "where it is obvious that a contract term is ambiguous, but also to expose a latent ambiguity." (*Southern Pacific Transportation Co. v. Santa Fe Pacific Pipelines, Inc.* (1999) 74 Cal.App.4th 1232, 1241, 88 Cal.Rptr.2d 777.) Such evidence is admissible when " 'relevant to prove a meaning to which the language of the instrument is reasonably susceptible.' " (*Ibid.*)

[18] The use of "course of performance" evidence as extrinsic evidence is acknowledged in case law and was ultimately codified in Code of Civil Procedure section 1856. (Cal. Law Revision Com. com., reprinted at 20A West's Ann.Code of Civ. Proc., (2007 ed.) foll. § 1856, p. 11.) As with all extrinsic evidence, course of performance evidence can be used not only to interpret an ambiguity, but also to reveal one in language otherwise thought to be clear. (*Ibid.*)

While the parol evidence rule provides that terms set forth in an integrated writing "may not be contradicted by evidence of any prior agreement or of a contemporaneous ****745** oral agreement," (Code Civ. Proc., § 1856, subd. (a)), the statute goes on to provide that the terms set forth in an integrated writing "may be explained or supplemented by course of dealing or usage of trade or by course of performance." (Code Civ. Proc., § 1856, subd. (c).) The Law Revision Commission comments note that "[i]t is expected that the courts will look to the definition[ ] in Commercial Code Section[ ] 1205 ... for guidance in interpreting the meaning of the term[ ] ... 'course of performance.' " (Cal. Law Revision Com. com., reprinted at 20A West's Ann.Code of Civ. Proc., (2007 ed.) foll. § 1856, p. 11.) The referenced California Uniform Commercial Code section was subsequently renumbered to section 1303. It defines a "course of performance" as "a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection." (Cal.Com.Code, § 1303, subd. (a).)

Not only is a course of performance relevant "in ascertaining the meaning of the parties' agreement," it may "supplement or qualify the terms of the ***921** agreement," (Cal.Com.Code, § 1303, subd. (d)) or "show a waiver or modification of any term inconsistent with the course of performance." (Cal.Com.Code, § 1303, subd. (f); see *Wagner v. Glendale Adventist Medical Center* (1989) 216 Cal.App.3d 1379, 1388, 265 Cal.Rptr. 412 [conduct antithetical to a term of a written contract which induces the other party to rely on the conduct can amount to a modification of the contract].)

[19] [20] [21] The rationale for the admission of course of performance evidence is a practical one. "[W]hen a contract is ambiguous, a construction given to it by the acts and conduct of the parties with knowledge of its terms, before any controversy has arisen as to its meaning, is entitled to great weight, and will, when reasonable, be adopted and enforced by the court. [Citation.] The reason underlying the rule is that it is the duty of the court to give effect to the intention of the parties where it is not wholly at variance with the correct legal interpretation of the terms of the contract, and a practical construction placed by the parties upon the instrument is the best evidence of their intention." (*Universal Sales Corp. v. Cal. etc. Mfg. Co.* (1942) 20 Cal.2d 751, 761–762, 128 P.2d 665.) "The conduct of the parties after execution of the contract and before any controversy has arisen as to its effect affords the most reliable evidence of the parties' intentions." (*Kennecott Corp. v. Union Oil Co.* (1987) 196 Cal.App.3d 1179, 1189, 242 Cal.Rptr. 403.) "This rule of practical construction is predicated on the common sense concept that 'actions speak louder than words.' Words are frequently but an imperfect medium to convey thought and intention. When the parties to a contract perform under it and demonstrate by their conduct that they knew what they were talking about the courts should enforce that intent." (*Crestview Cemetery Assn. v. Dieden* (1960) 54 Cal.2d 744, 754, 8 Cal.Rptr. 427, 356 P.2d 171.) "The principle of 'practical construction' applies only to acts performed under the contract before any dispute has arisen." (*Warner Constr. Corp. v. City of Los Angeles*

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(1970) 2 Cal.3d 285, 296, 85 Cal.Rptr. 444, 466 P.2d 996.)

4. *General Admissibility of Course of Performance Evidence to Interpret the Insurance Policies at Issue*

[22] Since insurance policies "are still contracts to which the ordinary rules of ****746** contractual interpretation apply," (*London Market Insurers v. Superior Court, supra,* 146 Cal.App.4th at p. 655, 53 Cal.Rptr.3d 154), it is apparent that the rules relating to course of performance as extrinsic evidence are equally applicable to insurance policy interpretation.12 The trial court, however, concluded that course of performance evidence is not admissible to interpret the insurance policies in this case. The trial court reasoned that since the main goal of contract interpretation is to determine the intent of the parties at the time of ***922** contracting, course of performance evidence is not relevant unless it can be shown that the individuals who performed were also the individuals who had negotiated the contracts.13

[23] We conclude the trial court was mistaken. Preliminarily, we note that the parties have not cited, nor has independent research disclosed, any authority that expressly limits the admissibility of course of performance evidence in this fashion.14 In any event, we find that this limitation is not required by the rationale that justifies the admission of course of performance evidence. The very purpose of the admission of course of performance is the commonsense belief that when the parties perform under a contract, without objection or dispute, they are fulfilling their understanding of the terms of the contract. This is true *regardless* of the actual language of the contract, as long as the parties' interpretation is reasonable. If the parties to a contract have, for years, harmoniously performed the contract in a way that reflects a particular, reasonable, understanding of the terms of the contract, that performance is relevant to determining the meaning of the contract. It should not matter whether the parties' agents who originally drafted the contract participated in the performance, or have long since left the scene. Indeed, if parties harmoniously performed for years under a particular understanding of the contract, there is no reason why that performance should be considered irrelevant to the meaning of the contract even if the contract was drafted by the parties' predecessors-in-interest or was a pre-printed standard form contract. Moreover, under California Uniform Commercial Code section 1303, course of performance evidence can supplement, qualify, or modify contrary terms in the contract. This would be largely undermined if course of performance evidence could only be considered when limited to the performance of the individual who drafted or negotiated the contract on behalf of the party. In this case, the parties to the insurance contracts are the insurers and Thorpe, not the particular individuals who may have actually negotiated or ***923** signed the policies ****747** on behalf of those entities. Similarly, the parties whose performance is at issue are the insurers and Thorpe, not the individuals who handled the claims on their behalf. It is their performance which is relevant. The trial court abused its discretion to the extent it concluded that all course of performance evidence is inadmissible unless it was the performance of the very individuals who had actually negotiated or executed the contract on behalf of the parties.

5. *Course of Performance Evidence After the 1984 and 1998 Agreements*

With respect to the impact of the 1984 and 1998 Agreements, the trial court reasoned that the evidence was inadmissible because course of performance evidence is only relevant to the extent it occurred *prior* to the existence of a dispute, and the 1984 Agreement evidenced a dispute existent as of that time. We conclude that the trial court's conclusion was correct, although for a more basic reason than the existence of a dispute. Specifically, after the 1984 and 1998 Agreements, the actions of the parties were taken in conformity with the 1984 and 1998 Agreements, not the insurance policies. As the point is more readily apparent with respect to the 1998 Agreement, we consider that agreement first.

[24] Thorpe's first-layer excess carriers entered into the 1998 Agreement, which was denominated an "interim" agreement whose express purpose was to adopt "an interim mechanism for allocating" the costs of defense and indemnity among the excess carriers without having any effect on their rights. Under the 1998 Agreement, excess carriers agreed to begin payment when the applicable primary policies "claim[ed]" to be exhausted by the payment of claims. The 1998 Agreement repeatedly reserved the rights of the excess insurers, specifically including the rights to "seek reallocation, reimbursement, declaratory relief, contribution, indemnity or any other relief" from any party or non-party to the 1998 Agreement. Indeed, at the same time that Chicago informed Thorpe that it had signed the 1998 Agreement and would be performing under it, Chicago expressly informed Thorpe that it "reserve[d] its right to contend that some or all of the subject claims, including claims previously settled by Thorpe's primary insurers, do not arise out of the Completed Operations/Products exposures and therefore may still be covered under one or more of the underlying primary policies."

[25] Thorpe was not a party to the 1998 Agreement, but was provided a copy.15 Thereafter, Thorpe informed the excess carriers when the underlying primary ***924** policies claimed exhaustion, and the excess carriers performed their obligations. The insurers now contend that this performance was actually performance *under* the excess policies themselves, and is therefore course of performance evidence relevant to the interpretation of the policies.16 They argue that Thorpe obtained ****748** tens of millions of dollars in excess coverage proceeds based on the shared understanding that all of the asbestos claims against Thorpe were products claims. But it is apparent that Thorpe obtained the excess coverage proceeds because the excess insurers had agreed among themselves to make those payments while reserving all of their rights to subsequently contend the payments were not, in fact, due under the policies. Indeed, Chicago *expressly reserved* to itself the right to argue that the asbestos claims *were not* products claims, while it nonetheless paid them. For Chicago to now contend that its payment of those claims reflected a shared understanding with Thorpe that the claims *were* products claims is disingenuous at best.

The 1998 Agreement appears to be an effort by Thorpe's insurers to promptly pay the asbestos claims with the understanding that the ultimate liability for those claims—whether held by the excess carriers, primary carriers, Thorpe itself, or a third party—would be resolved at a later date. Thorpe's acceptance of those payments cannot in any way be used to interpret the insurance policies, as, from that point on, the excess carriers were acting pursuant to the 1998 Agreement and *not* under the policies themselves.17

A similar conclusion follows with respect to the 1984 Agreement, between Thorpe and ten of its primary carriers. Unlike the 1998 Agreement, the 1984 was not an "interim" agreement, but an actual *settlement* between the insurers and Thorpe. The 1984 Agreement provided that it "is the result of a compromise accord and is a compromise settlement of disputed claims. It is the product of arms length negotiations, is not intended to nor shall it be construed as the admission of the existence of a policy or as a policy ***925** interpretation, and shall not be used in any Court or Arbitration to create, prove or interpret the obligations under general liability or other liability policies."

[26] It is apparent that the claims handling conduct between Thorpe and its primary carriers following the 1984 Agreement was taken pursuant to the 1984 Agreement, not the policies themselves. The parties had resolved their differences regarding the claims and reached an agreement under which the primary insurers would pay their policy limits and no more; their subsequent conduct was governed by that agreement. The insurers argue that, at the time of the 1984 Agreement, there was no dispute over whether asbestos claims were products or non-products claims, so the 1984 Agreement is actually *further* evidence of the parties' conduct, which simply reflects an unspoken understanding that asbestos claims were to be treated as products claims. We disagree. The 1984 Agreement expressly states that it is *not* a policy interpretation and shall *not* be used in any court to interpret the policies. It therefore cannot be considered to be evidence of the parties' interpretation of the policies. As the agreement cannot be considered for policy interpretation, we similarly conclude that conduct *pursuant to* the agreement cannot be considered for the purpose of policy interpretation.18

****749** We note that both the 1984 and the 1998 Agreements appear to have been entered into as part of a good faith effort to pay the claims of numerous injured third parties, without requiring litigation over the precise scope of each insurer's duty. This private resolution of the issues apparently resulted in the prompt payment of nearly $180 million to injured individuals, for which the parties are to be commended. This conduct, however, was clearly accomplished by means of the 1984 and 1998 Agreements, and was not simply a product of Thorpe and its insurers harmoniously performing under a joint understanding of the underlying policies.19 It therefore is inadmissible for policy interpretation.

6. *Course of Performance Prior to the 1984 Agreement*

It is unclear whether the insurers wish to rely on any course of performance evidence prior to the 1984 Agreement.20 In the insurers' opposition to ***926** the motion for summary adjudication of their affirmative defenses, they argued that Thorpe knew of the existence of the "non-products" theory of coverage since "at least 1984," and appeared to rely largely on performance following that date. In their writ petition, however, the insurers argue that there were many years of "course of performance" evidence that predated the 1984 Agreement.

[27] Relying on the insurers' assertion that Thorpe knew of the existence of the "non-products" theory in 1984, Thorpe argues that any course of performance evidence prior to that date would be inadmissible, in that the insurers would be unable to prove that Thorpe *understood* that it was accepting performance in a way that interpreted the policies to have no non-products coverage for asbestos suits. (See Cal. Comm.Code § 1303, subd. (a) [course of performance evidence requires the party accepting performance to do so "with knowledge of the nature of the performance"].) We disagree. While it may ultimately be the case that the insurers could not establish

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this prerequisite for admissibility, Thorpe did not bring its motion in limine on this basis, so the insurers were never required to establish the foundation for the admissibility of pre–1984 course of performance evidence. Pre–1984 course of performance evidence therefore cannot be excluded on this basis.

[28] Thorpe also contends that no course of performance evidence is admissible on the issue of whether certain asbestos suits fall within the non-products coverage of the insurance policies, on the basis that the insurers' interpretation of their policies to exclude such coverage is not reasonable as a matter of law. The trial court expressly declined to reach this issue. We do not disagree. The entire first phase of the trial is to be occupied with this issue; it cannot be resolved in passing on a motion in limine. In any event, Thorpe's showing on the motion in limine was wholly inadequate to enable a court to make this determination. While ****750** Thorpe's motion for summary adjudication did contain the relevant policy language, Thorpe never identified with any specificity any asbestos suits, or types of asbestos suits, that it believed fell within the scope of the non-products coverage of its policies. Thorpe seems to take the position that since it is theoretically possible to conceive of an asbestos suit that falls within non-products coverage, the insurers' position is necessarily unreasonable. But without knowing anything about the nature of the underlying suits at issue, it is impossible to determine whether the insurers' position that the suits *against Thorpe* do not fall within non-products coverage is reasonable.21 Thorpe has therefore failed in establishing this alternative basis for excluding course of performance evidence.

*927 *DISPOSITION*

The petition for writ of mandate is granted in part. The trial court is directed to vacate its order granting the motion in limine, and enter a new and different order consistent with the views expressed in this opinion. The parties are to bear their own costs in this writ proceeding.

We Concur: KLEIN, P.J., and KITCHING, J.

Parallel Citations

161 Cal.App.4th 906, 08 Cal. Daily Op. Serv. 3935, 2008 Daily Journal D.A.R. 4833

Footnotes

1 The insurance companies that are parties to this writ proceeding are: Employers Reinsurance Company; Westport Insurance Company; Transcontinental Insurance Company; Maine Bonding and Casualty Company; Allstate Insurance Company, solely as successor-in-interest to Northbrook Excess and Surplus Insurance Company, formerly Northbrook Insurance Company; Argonaut Insurance Company; Middlesex Mutual Insurance Company; Associated International Insurance Company; Chicago Insurance Company; Central National Insurance Company of Omaha; Motor Vehicle Casualty Company; Granite State Insurance Company; and National Union Fire Insurance Company of Pittsburgh, PA.

2 A manufacturer or service provider can incur liability both while work is in progress and after completion. Claims for injuries arising while an activity is in progress fall within "non-products" or "operations" coverage. Claims for injuries arising once the product has been completed and sent to market fall within "products" or "completed operations" coverage. The coverages are complementary and not overlapping. Products coverage takes over where operations coverage leaves off. (*Fibreboard Corp. v. Hartford Accident & Indemnity Co.* (1993) 16 Cal.App.4th 492, 500–501, 20 Cal.Rptr.2d 376.)

3 Moreover, Thorpe sought a declaration that the insurers had the burden to prove that any underlying claim was a products claim that was subject to their policies' aggregate limits.

4 This proceeding was temporarily stayed following Thorpe's filing a petition in bankruptcy. The insurers have obtained an order from the bankruptcy court permitting this writ petition to proceed.

5 The "any other theory" language appears to relate only to theories of allocation. The parties do not suggest that the "any other theory" language could, or should, be read to include the "non-products" theory of coverage.

6 Thorpe cited to *United States Elevator Corp. v. Associated Internat. Ins. Co.* (1989) 215 Cal.App.3d 636, 263 Cal.Rptr. 760 as authority that purportedly found the definition in certain of the insurers' policies to be indecipherably ambiguous. In that case, the insured had been sued for negligent servicing of elevators, and the issue was whether those claims fell within the products/completed operations clause of the insurance policy. The policy language excluded from completed operations those operations " 'for which the classification stated in the policy or in the Company's manual specifies "including completed operations [.]" ' " (*Id.* at pp. 643–644, 263 Cal.Rptr. 760, italics omitted.) Evidence ultimately indicated that the referenced

"Company's manual" was not a manual of either the insured or the insurer, but, in fact, a manual prepared by the Insurance Service Office, "a statistical gathering organization which prepares insurance rates and forms." (*Id.* at p. 644, 263 Cal.Rptr. 760.) The trial court expressly found that this provision to be indecipherable, and, on appeal, there was no argument that this finding was not supported by substantial evidence. (*Id.* at p. 648, 263 Cal.Rptr. 760.) We are not certain what relevance this opinion has to Thorpe's assertion that claims arising from asbestos installation activity fall outside the scope of products/completed operations coverage.

7 In this writ proceeding, the insurers argue that Thorpe previously took the position that asbestos suits constituted products claims and is now arguing that asbestos suits constitute non-products claims. As alleged in Thorpe's complaint, however, there is no clear dichotomy. Thorpe is currently contending that *some* asbestos suits constitute non-products claims. Thorpe does not clearly identify which suits it contends constitute non-products claims; it argues that this should be the insurers' burden.

8 Specifically, the record before us reflects that Thorpe indicated to the trial court that it had not yet decided whether to seek damages for the misallocation of suits that already had been resolved, and the proceedings giving rise to this writ petition proceeded on the basis that Thorpe was not seeking such damages. The record also demonstrates, however, that Thorpe believed that the damages causes of action added by its first amended complaint would encompass claims for damages arising from the mischaracterization of former suits, should Thorpe later choose to proceed on that basis.

9 As the insurers had not yet filed an answer to the first amended complaint, the parties stipulated that the motion for summary adjudication and motion in limine were nonetheless "procedurally ripe" and could proceed. As discussed below, the insurers argue in this writ proceeding that the motion in limine was premature, in that discovery had not been completed. Thorpe argues that the stipulation that the motion was "procedurally ripe" undermines this argument. It does not; the stipulation pertained only to the consideration of these motions prior to a responsive pleading having been filed to the operative complaint.

10 In the instant writ proceeding, the insurers argue that the motion in limine was premature, in that the motion was a "highly irregular attempt to exclude large swaths of unspecified evidence a year before trial." The insurers did not oppose the motion in limine on this basis. In their response in support of the writ petition, the insurers state that they had, in fact, argued "that 'Thorpe's motion should be denied as premature." The quoted argument stated, in full, "[i]n the alternative [to denying the motion on the merits], Thorpe's motion should be denied as premature so that the Court may provisionally admit and review all credible evidence of the parties' course of performance." While the insurers did note, *parenthetically,* that Thorpe's motion was made "without any discovery," and "before the parties even have an opportunity to fully discover just what th[e] evidence is," the insurers never made an argument, with any citation to authority, that the motion in limine should be denied as premature.

11 The insurers argue that the trial court's ruling on the motion in limine barred "three decades' worth of relevant evidence, sight unseen." As the insurers had incorporated by reference the exhibits in support of their opposition to the motion for summary adjudication, the trial court had before it three volumes of such evidence.

12 Thorpe does not pursue in this proceeding its earlier argument that course of performance evidence is simply inapplicable to the interpretation of insurance policies.

13 The trial court also found significant on this point the fact that the policies were standard form policies. The insurers argue that this is factually incorrect, and that some of the policies at issue were not standard form policies. We need not address the factual dispute as we conclude the trial court erred in its interpretation of the law.

14 Thorpe relies on a footnote in *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 274 Cal.Rptr. 820, 799 P.2d 1253, which reads as follows: "[B]oth the insurers and [the insured] have requested that we take judicial notice of documents allegedly indicating the view the other has taken of the CGL policies in connection with litigation and activities unrelated to this case. Because our focus here is on the intent of the parties at the time the policies were formed, the evidence contained in these documents is immaterial to our decision." (*Id.* at pp. 823–824, fn. 9, 274 Cal.Rptr. 820, 799 P.2d 1253.) This footnote appears to be in response to the parties' efforts to use their opponents' statements in other cases as a basis for judicial estoppel, not a discussion of the admissibility of the parties' own course of performance under the insurance policies there at issue.

15 The fact that Thorpe was not a party to the 1998 Agreement is not relevant. We are here concerned with whether the history of claims handling after the 1998 Agreement constitute a "course of performance" under the insurance policies such that it can be used for policy interpretation. As the post–1998 claims handling constituted a course of performance under the 1998 Agreement, not the insurance policies, it cannot be used for policy interpretation, regardless of whether Thorpe was a party to the 1998 Agreement.

16 The insurers' argument considers Thorpe's thirty-year history of claims handling as an indivisible whole that the insurers contend should be used for policy interpretation as a whole. The insurers are, in this respect, overstating their case. Course of performance evidence is admissible only to interpret the contract under which the parties were performing. To the extent Thorpe's course of

performance under the excess policies is relevant, it would be relevant only to the interpretation of the excess policies.

17 Again, we are concerned only with the insurers' attempt to use Thorpe's course of conduct as course of performance evidence to interpret the insurance policies. We do not consider whether Thorpe's acceptance of these excess payments estops it from asserting the payments were not owed.

18 We do not consider whether Thorpe's present assertion that some asbestos claims are non-products claims is, in any way, barred by, or a breach of, the 1984 Agreement.

19 Indeed, the insurers' position describes the lengthy claims history as decades of "negotiations, representations and agreements." This is not simple performance under a joint understanding of the policies.

20 It is also unclear whether the insurers seek to rely on any course of performance evidence *after* the 1984 Agreement, but not attributable to it or the 1998 Agreement—for example, claims practices with respect to insurers that were not parties to those agreements.

21 In any event, we note that the opinion in *Fibreboard Corp. v. Hartford Accident & Indemnity Co., supra,* 16 Cal.App.4th at pp. 500–502, 20 Cal.Rptr.2d 376, rejected an insured's claim that asbestos suits based on failure to warn and several other theories fell within non-products coverage. While this authority does not control the issue in this case, it suggests that the insurers' position is not so unreasonable as to be rejected outright in the course of a motion in limine.

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640 F.3d 1034
United States Court of Appeals,
Ninth Circuit.

The FACEBOOK, INC.; Mark Zuckerberg, Plaintiffs–Appellees,
Divya Narendra; Cameron Winklevoss; Tyler Winklevoss, Intervenors,
v.
PACIFIC NORTHWEST SOFTWARE, INC.; Wayne Chang; Winston Williams, Defendants.
The Facebook, Inc.; Mark Zuckerberg, Plaintiffs–Appellees,
v.
ConnectU, Inc., fka ConnectU, LLC, Defendant–Appellee,
and
Cameron Winklevoss; Tyler Winklevoss; Divya Narendra, Defendants–Appellants,
and
Pacific Northwest Software, Inc.; Wayne Chang; Winston Williams, Defendants.
The Facebook, Inc.; Mark Zuckerberg, Plaintiffs–Appellees,
v.
ConnectU, Inc., fka ConnectU, LLC, Defendant–Appellee,
and
Cameron Winklevoss; Tyler Winklevoss; Divya Narendra, Defendants–Appellants,
and
Pacific Northwest Software, Inc.; Wayne Chang; Winston Williams, Defendants.

Nos. 08–16745, 08–16873, 09–15021. | Argued and Submitted Jan. 11, 2011. | Filed April 11, 2011. | Amended May 16, 2011.

Synopsis

Background: Operator of social networking website filed state court action alleging that competitor unlawfully collected e-mail addresses of operator's registered users and then sent solicitation e-mail to those persons. After removal, and dismissal of some claims, 2008 WL 4793665, the United States District Court for the Northern District of California, James Ware, J., granted operator's motion to enforce settlement agreement, and competitor appealed.

Holdings: On denial of rehearing en banc, the Court of Appeals, Kozinski, Chief Judge, held that:
[1] settlement agreement did not lack any necessary terms;
[2] settlement agreement effected release of competitor's claim that operator violated federal securities laws; and
[3] parties' confidentiality agreement precluded competitor's principals from introducing evidence of what operator said during settlement talks.

Affirmed.

West Headnotes (7)

[1] Compromise and Settlement
Making and Form of Agreement

Under California law, settlement agreement between operator of social networking website and competitor did not lack any necessary terms, even though it required that parties execute several additional agreements, including stock purchase agreement, stockholders agreement, and confidential mutual release agreement, where agreement specified that operator would determine form and documentation of acquisition of competitor's shares consistent with stock and cash for stock acquisition, and called for parties to grant each other "mutual releases as broad as possible."

1 Cases that cite this headnote

[2] Contracts
Certainty as to Subject-Matter

Under California law, a term may be "material" in one of two ways: it may be a necessary term, without which there can be no contract, or it may be an important term that affects the value of the bargain; while the omission of the former would render the contract a nullity, a contract that omits terms of the latter type is enforceable, so long as the terms it does include are sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages.

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1 Cases that cite this headnote

[3] **Contracts**
Certainty as to Subject-Matter
Contracts
Terms implied as part of contract

California allows parties to delegate choices over terms in contracts, so long as the delegation is constrained by the rest of the contract and subject to the implied covenant of good faith and fair dealing.

[4] **Compromise and Settlement**
Construction of Agreement

When adversaries in roughly equivalent bargaining position and with ready access to counsel sign settlement agreement, court will enforce agreement's clear terms.

4 Cases that cite this headnote

[5] **Compromise and Settlement**
Causes of action merged or barred in general

Settlement agreement between operator of social networking website and competitor effected release of competitor's principals' claim that operator violated federal securities laws by misleading them into believing shares they were to receive were worth more than they actually were, where case involved sophisticated parties, parties had engaged in discovery, competitor was represented by counsel and valuation expert, settlement agreement granted "all parties" "mutual releases as broad as possible," and competitor represented and warranted that it had "no further right to assert" and "no further claims against" operator. Securities Exchange Act of 1934, § 29(b), 15 U.S.C.A. § 78cc(b).

1 Cases that cite this headnote

[6] **Contracts**
Restriction of competition

Confidentiality agreement entered into prior to private mediation of dispute between operator of social networking website and competitor precluded competitor's principals from introducing in support of their securities fraud claims against operator any evidence of what operator said, or did not say, regarding value of its shares during mediation.

1 Cases that cite this headnote

[7] **Securities Regulation**
Contracts in violation of regulations

Confidentiality agreement entered into prior to private mediation of dispute between operator of social networking website and competitor, which precluded competitor's principals from introducing in support of their securities fraud claims against operator any evidence of what operator said regarding value of its shares during mediation, did not violate provision of Securities Exchange Act prohibiting waivers of non-compliance. Securities Exchange Act of 1934, § 29(a), 15 U.S.C.A. § 78cc(a).

1 Cases that cite this headnote

Attorneys and Law Firms

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James E. Towery, Alison P. Buchanan and Jill E. Fox, Hoge, Fenton, Jones & Appel, Inc., San Jose, CA, for the defendant-appellee.

Appeal from the United States District Court for the Northern District of California, James Ware, District Judge, Presiding. D.C. No. 5:07–cv–01389–JW.

Before: ALEX KOZINSKI, Chief Judge, J. CLIFFORD WALLACE and BARRY G. SILVERMAN, Circuit Judges.

Opinion

ORDER

The opinion is amended as follows:

> Page 4909, Lines 20–24 Replace <The district court excluded this evidence under its Alternative Dispute Resolution (ADR) Local Rule 6–11, which it read to create a "privilege" for "evidence regarding the details of the parties' negotiations in their mediation."> with <The district court excluded this evidence under its Alternative Dispute Resolution (ADR) local rule on "confidential information," which it read to create a "privilege" for "evidence regarding the details of the parties' negotiations in their mediation." A local rule, like any court order, can impose a duty of confidentiality as to any aspect of litigation, including mediation. *See* N.D. Cal. ADR L.R. 6–12(a); *see also* 28 U.S.C. § 652(d).>

The petition for rehearing en banc is denied. *See* Fed. R.App. P. 35, 40. No further petitions for rehearing or rehearing en banc may be filed.

OPINION

KOZINSKI, Chief Judge:

Cameron Winklevoss, Tyler Winklevoss and Divya Narendra (the Winklevosses) claim that Mark Zuckerberg stole the idea for Facebook (the social networking site) from them. They sued Facebook and Zuckerberg (Facebook) in Massachusetts. Facebook countersued them and their competing social networking site, ConnectU, in California, alleging that the Winklevosses and ConnectU hacked into Facebook to purloin user data, and tried to steal users by spamming them. The ensuing litigation involved several other parties and gave bread to many lawyers, but the details are not particularly relevant here.

The district court in California eventually dismissed the Winklevosses from that case for lack of personal jurisdiction. It then ordered the parties to mediate their dispute. The mediation session included ConnectU, Facebook and the Winklevosses so that the parties could reach a global settlement. Before mediation began, the participants signed a Confidentiality Agreement stipulating that all statements made during mediation were privileged, non-discoverable and inadmissible "in any arbitral, judicial, or other proceeding."

***1037** After a day of negotiations, ConnectU, Facebook and the Winklevosses signed a handwritten, one-and-a-third page "Term Sheet & Settlement Agreement" (the Settlement Agreement). The Winklevosses agreed to give up ConnectU in exchange for cash and a piece of Facebook. The parties stipulated that the Settlement Agreement was "confidential," "binding" and "may be submitted into evidence to enforce [it]." The Settlement Agreement also purported to end all disputes between the parties.

The settlement fell apart during negotiations over the form of the final deal documents, and Facebook filed a motion with the district court seeking to enforce it. ConnectU argued that the Settlement Agreement was unenforceable because it lacked material terms and had been procured by fraud. The district court found the Settlement Agreement enforceable and ordered the Winklevosses to transfer all ConnectU shares to Facebook. This had the effect of moving ConnectU from the Winklevosses' to Facebook's side of the case.

The Winklevosses appeal.

A. Because ConnectU switched sides, it no longer had any interest in appealing the district court's order. The Winklevosses sought to intervene after the district court entered judgment enforcing the Settlement Agreement. The court denied the motion as unnecessary, holding that they were "already parties to the[ ] proceedings to enforce the Settlement Agreement" and "may appeal that Judgment." In fact, the Winklevosses had earlier been dismissed from the case. But, by ruling that they were "already" parties, the district court implicitly granted them intervention nunc pro tunc. *See Beckman Indus., Inc. v. Int'l Ins. Co.,* 966 F.2d 470, 474–75 (9th Cir.1992). They therefore have standing to appeal. *See Marino v. Ortiz,* 484 U.S. 301, 304, 108 S.Ct. 586, 98 L.Ed.2d 629 (1988) ("[T]hose [litigants who] properly become parties [ ] may appeal an adverse judgment....").

B. The Settlement Agreement envisioned that Facebook would acquire all of ConnectU's shares in exchange for cash and a percentage of Facebook's common stock. The parties also agreed to grant each other "mutual releases as broad as possible," and the Winklevosses represented and warranted that "[t]hey have no further right to assert against Facebook" and "no further claims against Facebook & its related parties."

Facebook moved to enforce the Settlement Agreement, and also asked the district court to order ConnectU and the Winklevosses to sign more than 130 pages of documents, including a Stock Purchase Agreement, a ConnectU Stockholders Agreement and a Confidential Mutual Release Agreement. Facebook's deal lawyers claimed that the terms in these documents were "required to finalize" the Settlement Agreement, and its expert dutifully opined that they were "typical of acquisition documents."

[1] [2] The Winklevosses argue that if these terms really are "required" and "typical," then they must be material, and their absence from the Settlement Agreement renders it unenforceable. *See Weddington Prods., Inc. v. Flick,* 60 Cal.App.4th 793, 71 Cal.Rptr.2d 265, 279–80 (1998). But a term may be "material" in one of two ways: It may be a necessary term, without which there can be no contract; or, it may be an important term that affects the value of the bargain. Obviously, omission of the former would render the contract a nullity. *See Citizens Utils. Co. v. Wheeler,* 156 Cal.App.2d 423, 319 P.2d 763, 769–70 (1958) (arms-length acquisition of a private company's shares ***1038** couldn't proceed because price was omitted from the contract). But a contract that omits terms of the latter type is enforceable under California law, so long as the terms it does include are sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages. *See Elite Show Servs., Inc. v. Staffpro, Inc.,* 119 Cal.App.4th 263, 14 Cal.Rptr.3d 184, 188 (2004); 1 B.E. Witkin, *Summary of California Law, Contracts* § 137 (10th ed. 2005) [hereinafter *Witkin on Contracts*]; *cf. Terry v. Conlan,* 131 Cal.App.4th 1445, 33 Cal.Rptr.3d 603, 612–13 (2005). This is not a very demanding test, and the Settlement Agreement easily passes it: The parties agreed that Facebook would swallow up ConnectU, the Winklevosses would get cash and a small piece of Facebook, and both sides would stop fighting and get on with their lives.

[3] The Settlement Agreement even specifies how to fill in the "material" terms that the Winklevosses claim are missing from the deal:

> *Facebook will determine* the form & documentation of the acquisition of ConnectU's shares [ ] consistent with a stock and cash for stock acquisition. (emphasis added).

California allows parties to delegate choices over terms, so long as the delegation is constrained by the rest of the contract and subject to the implied covenant of good faith and fair dealing. *See Cal. Lettuce Growers, Inc. v. Union Sugar Co.,* 45 Cal.2d 474, 289 P.2d 785, 791 (1955); *see also* 1 *Witkin on Contracts* § 139. Delegation isn't necessary for a contract like the Settlement Agreement to be enforceable, as the court may fill in missing terms by reference to the rest of the contract, extrinsic evidence and industry practice. *See* 1 *Witkin on Contracts* § 139; *Sterling v. Taylor,* 40 Cal.4th 757, 55 Cal.Rptr.3d 116, 152 P.3d 420, 428–29 (2007). But the clause quoted above leaves no doubt that the Winklevosses and Facebook meant to bind themselves and each other, even though everyone understood that some material aspects of the deal would be papered later.

The Winklevosses' contractual delegation is valid because the Settlement Agreement obligates Facebook to draw up documents "consistent with a stock and cash for stock acquisition." And, if Facebook should draft terms that are unfair or oppressive, or that deprive the Winklevosses of the benefit of their bargain, the district court could reject them as a breach of the implied covenant of good faith and fair dealing. *See* 1 *Witkin on Contracts* § 798. The district court got it exactly right when it found the Settlement Agreement enforceable but refused to add the stack of documents drafted by Facebook's deal lawyers.

C. After signing the Settlement Agreement, Facebook notified the Winklevosses that an internal valuation prepared to comply with Section 409A of the tax code put the value of its common stock at $8.88 per share. The Winklevosses argue that Facebook misled them into believing its shares were worth four times as much. Had they known about this valuation during the mediation, they claim, they would never have signed the Settlement Agreement. The Winklevosses charge Facebook with violating Rule 10b–5, and they seek rescission of the Settlement Agreement under Section 29(b) of the Securities Exchange Act of 1934 (the Exchange Act).

Rule 10b–5 prohibits fraud, whether by commission or omission, "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b–5. We assume, without deciding, that a party negotiating an exchange of shares to settle a lawsuit could violate Rule 10b–5 by misstating or hiding ***1039** information that would materially change the other side's evaluation of the settlement. *Cf. Green v. Ancora–Citronelle Corp.,* 577 F.2d 1380, 1382–83 (9th Cir.1978); *Foster v. Fin. Tech., Inc.,* 517 F.2d 1068, 1071–72 (9th Cir.1975).

Section 29(b) renders voidable "[e]very contract made in violation of any provision of [the securities laws] or of any rule or regulation thereunder, and every contract ... the performance of which involves [such a] violation." 15 U.S.C. § 78cc(b); *see Mills v. Elec. Auto–Lite Co.,* 396 U.S. 375, 387–88, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970). If Facebook violated Rule 10b–5, the Winklevosses would be entitled to rescission of the Settlement Agreement. *See Mills,* 396 U.S. at 387–88, 90 S.Ct. 616; *Royal Air Props., Inc. v. Smith,* 312 F.2d 210, 213 (9th Cir.1962).

The Winklevosses are sophisticated parties who were locked in a contentious struggle over ownership rights in one of the world's fastest-growing companies. They engaged in discovery, which gave them access to a good deal of information about their opponents. They brought half-a-dozen lawyers to the mediation. Howard Winklevoss—father of Cameron and Tyler, former accounting professor at Wharton School of Business and an expert in valuation—also participated. A party seeking to rescind a settlement agreement by claiming a Rule 10b–5 violation under these circumstances faces a steep uphill battle. *See Petro–Ventures, Inc. v. Takessian,* 967 F.2d 1337, 1341–42 (9th Cir.1992); *see also Harsco Corp. v. Segui,* 91 F.3d 337, 343–44 (2d Cir.1996); *Locafrance U.S. Corp. v. Intermodal Sys. Leasing, Inc.,* 558 F.2d 1113, 1115 (2d Cir.1977); *cf. Mergens v. Dreyfoos,* 166 F.3d 1114, 1117–18 (11th Cir.1999) (applying Florida law).

[4] In *Petro–Ventures,* we distinguished between buyers of securities in the context of "an exclusively business relationship," 967 F.2d at 1341, and those "acting in the adversarial setting that is characteristic of litigation," *id.* at 1342. When adversaries "in a roughly equivalent bargaining position and with ready access to counsel" sign an agreement to "establish[ ] a general peace," we enforce the clear terms of the agreement. *Id.* (citing *Locafrance,* 558 F.2d at 1115). Parties involved in litigation know that they are locked in combat with an adversary and thus have every reason to be skeptical of each other's claims and representations. *See Mergens,* 166 F.3d at 1118; *cf. Goodman v. Epstein,* 582 F.2d 388, 403–04 (7th Cir.1978) (holding that parties signing a release of claims have a "duty of inquiry"); *Moseman v. Van Leer,* 263 F.3d 129, 133–34 & n. 3 (4th Cir.2001) (same). They can use discovery to ferret out a great deal of information before even commencing settlement negotiations. They can further protect themselves by requiring that the adverse party supply the needed information, or provide specific representations and warranties as a condition of signing the settlement agreement. *See Harsco,* 91 F.3d at 344. Such parties stand on a very different footing from those who enter into an investment relationship in the open market, where it's reasonable to presume candor and fair dealing, and access to inside information is often limited. There are also very important policies that favor giving effect to agreements that put an end to the expensive and disruptive process of litigation. *See, e.g., Franklin v. Kaypro Corp.,* 884 F.2d 1222, 1229 (9th Cir.1989) ("[I]t hardly seems necessary to point out that there is an overriding public interest in settling and quieting litigation."). We analyze the Winklevosses' securities claims in light of these inhospitable principles.

Release of claims. The Settlement Agreement grants "all parties" "mutual releases ***1040** as broad as possible"; the Winklevosses "represent and warrant" that "[t]hey have no further right to assert against Facebook" and "no further claims against Facebook & its related parties." The Winklevosses maintain that they didn't discover the facts giving rise to their Rule 10b–5 claims until after they signed these releases. They argue that the releases don't foreclose their challenge to the Settlement Agreement because Section 29(a) of the Exchange Act precludes a mutual release of unknown securities fraud claims arising out of negotiations to settle a pending lawsuit. *See* 15 U.S.C. § 78cc(a) (voiding "[a]ny condition, stipulation, or provision binding any person to waive compliance with" the securities laws).

[5] *Petro–Ventures* dealt with just such a settlement agreement. 967 F.2d at 1338–39. We held that parties possessing roughly equivalent bargaining strength could release *all* claims arising out of the transaction that gave rise to the litigation, even though they hadn't yet discovered some of the securities claims when they signed the settlement. *Id.* at 1342. Such a release is valid if it "is unambiguous in conveying the intent of the parties to release all unknown claims." *Id.* The Settlement Agreement the parties negotiated granted "releases as broad as possible." As sophisticated litigants, the Winklevosses or their counsel should have been familiar with *Petro–Ventures* and understood that the broadest possible release includes both known and unknown securities claims. An agreement meant to end a dispute between sophisticated parties cannot reasonably be interpreted as leaving open the door to litigation about the settlement negotiation process. *See Petro–Ventures,* 967 F.2d at 1342 (discussing the parties' "intent to end their various disputes ... once and for all" (ellipses in original)). A release in such an agreement would be useless to end litigation if it couldn't include claims arising from the settlement negotiations. *Cf. Sander v. Weyerhaeuser,* 966 F.2d 501, 503 (9th Cir.1992).

The Winklevosses point out that Facebook's alleged securities law violations took place in connection with the

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settlement itself, whereas the unknown securities claim in *Petro–Ventures* arose out of facts that occurred prior to the settlement. This is a distinction without a difference: Both here and in *Petro–Ventures* the parties gave up securities law claims they didn't know they had. If the release is effective in the one case, there's no principled reason it shouldn't be effective in the other. The district court correctly concluded that the Settlement Agreement meant to release claims arising out of the settlement negotiations, and that the release was valid under section 29(a).

Securities fraud claims. In any event, the Winklevosses' securities fraud claims fail on the merits. The Winklevosses make two related claims: that Facebook led them to believe during the settlement negotiations that its shares were worth $35.90, even though Facebook knew that its shares were, in fact, worth only $8.88; and that Facebook failed to disclose material information, namely the $8.88 tax valuation, during the negotiations.

In support of these claims, the Winklevosses proffered evidence of what was said and not said during the mediation. The district court excluded this evidence under its Alternative Dispute Resolution (ADR) local rule on "confidential information," which it read to create a "privilege" for "evidence regarding the details of the parties' negotiations in their mediation." A local rule, like any court order, can impose a duty of confidentiality as to any aspect of litigation, including mediation. *See* N.D. Cal. ADR L.R. 6–12(a); *see also* ***1041** 28 U.S.C. § 652(d). But privileges are created by federal common law. *See* Fed.R.Evid. 501. It's doubtful that a district court can augment the list of privileges by local rule. *Cf. In re Grand Jury Subpoena Dated Dec. 17, 1996,* 148 F.3d 487, 491–93 (5th Cir.1998) (examining whether a federal statute created an evidentiary privilege). In any event, the parties used a private mediator rather than a court-appointed one. *See* N.D. Cal. ADR L.R. 3–4(b) ("A private ADR procedure may be substituted for a Court program if the parties so stipulate and the assigned Judge approves."). Their mediation was thus "not subject to the ... ADR Local Rules," including Local Rule 6–11. *Id.*

[6] Nevertheless, the district court was right to exclude the proffered evidence. The Confidentiality Agreement, which everyone signed before commencing the mediation, provides that:

> All statements made during the course of the mediation or in mediator follow-up thereafter at any time prior to complete settlement of this matter are privileged settlement discussions ... and are nondiscoverable and inadmissible for any purpose including in any legal proceeding.... *No aspect of the mediation shall be relied upon or introduced as evidence in any arbitral, judicial, or other proceeding.* (emphasis added).

This agreement precludes the Winklevosses from introducing in support of their securities claims any evidence of what Facebook said, or did not say, during the mediation. *See Johnson v. Am. Online, Inc.,* 280 F.Supp.2d 1018, 1027 (N.D.Cal.2003) (enforcing a similar agreement). The Winklevosses can't show that Facebook misled them about the value of its shares or that disclosure of the tax valuation would have significantly altered the mix of information available to them during settlement negotiations. Without such evidence, their securities claims must fail. *See In re Daou Sys., Inc.,* 411 F.3d 1006, 1014 (9th Cir.2005); *see also McCormick v. Fund Am. Cos.,* 26 F.3d 869, 876 (9th Cir.1994).

The Winklevosses argue that if the Confidentiality Agreement is construed to defeat their Rule 10b–5 claims, it is void under section 29(a) of the Exchange Act as an invalid waiver. But section 29(a) "applie[s] only to express waivers of non-compliance," *Levy v. Southbrook Int'l Invs., Ltd.,* 263 F.3d 10, 14, 18 (2d Cir.2001), with the "substantive obligations imposed by the Exchange Act," *Shearson/Am. Express, Inc. v. McMahon,* 482 U.S. 220, 228, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987). The Confidentiality Agreement merely precludes both parties from introducing evidence of a certain kind. Although this frustrates the securities claims the Winklevosses chose to bring, the Confidentiality Agreement doesn't purport to limit or waive their right to sue, Facebook's obligation not to violate Rule 10b–5 or Facebook's liability under any provision of the securities laws. *See McMahon,* 482 U.S. at 230, 107 S.Ct. 2332.

[7] Even if we were to construe the Confidentiality Agreement as a waiver of the Winklevosses' 10b–5 claims, it wouldn't violate section 29(a). *Petro–Ventures* expressly considered a section 29(a) argument in the context of a global settlement agreement between sophisticated parties engaged in litigation. 967 F.2d at 1341–43. The court distinguished an earlier case, *Burgess v. Premier Corp.,* 727 F.2d 826 (9th Cir.1984), which had applied section 29(a) to preclude the waiver of unknown claims by plaintiffs who were "not acting in the adversarial setting that is characteristic of litigation." *Petro–Ventures,* 967 F.2d at 1342. *Petro–Ventures* held that "a totally different situation occurs where a plaintiff has affirmatively acted to release ***1042** another party from any possible liability in connection with a transaction in securities." *Id.* In such situations, the parties

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are "not so concerned with protecting their rights as investors as they [are] with establishing a general peace." *Id.* We are bound by *Petro–Ventures* to conclude that the Confidentiality Agreement did not violate section 29(a). *Cf. Locafrance,* 558 F.2d at 1115.

* * *

The Winklevosses are not the first parties bested by a competitor who then seek to gain through litigation what they were unable to achieve in the marketplace. And the courts might have obliged, had the Winklevosses not settled their dispute and signed a release of all claims against Facebook. With the help of a team of lawyers and a financial advisor, they made a deal that appears quite favorable in light of recent market activity. *See* Geoffrey A. Fowler & Liz Rappaport, *Facebook Deal Raises $1 Billion,* Wall St. J., Jan. 22, 2011, at B4 (reporting that investors valued Facebook at $50 billion—3.33 times the value the Winklevosses claim they thought Facebook's shares were worth at the mediation). For whatever reason, they now want to back out. Like the district court, we see no basis for allowing them to do so. At some point, litigation must come to an end. That point has now been reached.

AFFIRMED.

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196 Cal.App.3d 1179, 242 Cal.Rptr. 403

KENNECOTT CORPORATION, Plaintiff and Respondent,
v.
UNION OIL COMPANY OF CALIFORNIA et al., Defendants and Appellants

No. D005277.
Court of Appeal, Fourth District, Division 1, California.
Dec 9, 1987.

[Opinion certified for partial publication.[1]]

SUMMARY

The trial court granted a lessor's motion for summary judgment adjudicating the lessees' surrender of their rights to produce steam from the land in question effectively eliminated any interests held by the lessees in the land. While the lessor was producing steam and minerals under its original lease, and before the right to produce steam from the land was assigned to the lessees, the waste residues were deposited into brine ponds. The cost of disposing of the wastes in those brine ponds as required by water quality control agencies and liability for such costs prompted the lessees to surrender to the lessor their interests. However, the lessor averred the surrender was ineffective. The lessees considered the surrender divested them of their interests in the land. Thereafter, a federal court adjudicated the lessor solely responsible to pay those costs. The lessees then decided the surrender was indeed ineffective and reasserted claims to the lease. The lessor sued to quiet title to the leasehold free and clear of those reasserted interests. (Superior Court of Imperial County, No. 58986, Henry Wien, Judge.)

The Court of Appeal affirmed. It held that in obtaining rights to produce steam from the land, underlying which were mineral deposits and geothermal formations, the lessees had acquired a *profit à prendre*, that is, an incorporeal hereditament which automatically extinguishes when surrendered and returned to the estate out of which it was carved. Thus, it held the lessees' profit interests automatically were extinguished upon their recordation of the surrender of their interests in the leased premises to the lessor; there was nothing for the lessor to accept or to reject. It further held that even though the lessor had rejected such surrender, the assignment of rights to the lessees provided that the right to surrender was unqualified, and that upon its exercise the lessor must accept the right or interest so surrendered. (Opinion by Butler, J., with Kremer, P. J., and Huffman, J.,*

HEADNOTES

Classified to California Digest of Official Reports

(1a, 1b, 1c, 1d)
Oil and Gas § 11--Leases--Profit à Prendre-- Assignment of Rights to Produce Steam From Land--Surrender of Interests.
The lessees of rights to produce steam from land, underlying which were mineral deposits and geothermal formations, acquired a *profit à prendre* under such assignment of rights, that is, an incorporeal hereditament which automatically extinguishes when surrendered and returned to the estate out of which it was carved. Thus, the lessees' profit interests automatically were extinguished upon their recordation of a surrender of their interests in the leased premises to the lessor; there was nothing for the lessor to accept or to reject. Even though the lessor rejected such surrender, the assignment of rights to the lessees provided that the right to surrender was unqualified, and that upon its exercise the lessor must accept the right and interest so surrendered.

(2)
Oil and Gas § 11--Leases--Profit à Prendre.
The owner of land has the exclusive right on his land to drill for and produce oil. This right inhering in the owner by virtue of his title to the land is a valuable right which he may transfer. The right when granted is a *profit à prendre,* a right to remove a part of the substance of the land. A *profit à prendre* is an interest in real property in the nature of an incorporeal hereditament.

[See **Cal.Jur.3d,** Oil and Gas, § 63; **Am.Jur.2d,** Gas and Oil, § 66 et seq.]

(3)
Real Property § 3--Estates and Interests--Profit à Prendre-- Definition.
A *profit à prendre* is the right to make some use of the soil of another, such as a right to mine metals, and it carries with it the right of entry and the right to remove and take from the land the designated products or profit

and also includes the right to use such of the surface as is necessary and convenient for exercise of the profit.

(4)
Real Property § 3--Estates and Interests--Profit à Prendre--Surrender and Abandonment.
As recognized by Civ. Code, § 1952.4 (agreement for exploration for or removal of natural resources is not lease of real property within meaning of Civil Code sections governing rights and obligations of landlords and tenants with respect to termination, surrender and abandonment), the rules governing surrender and abandonment of possessory leaseholds are expressly inapplicable to a *profit à prendre.* The right to surrender a profit interest is a unilateral right vested in the lessee. This right to surrender may be exercised unilaterally by the lessee regardless of the consent of the lessor.

(5)
Mines and Minerals § 6--Transfer and Conveyances--Leases--Termination.
A mineral lease is not analogous to a lease in the ordinary sense, but to an option; that is to say it is so far unilateral that it could be at any time terminated by the lessees.

(6)
Oil and Gas § 11--Leases--Profit Interest in Geothermal Resources.
A profit interest in geothermal resources is not an ordinary leasehold interest at all. Rather, it is a means by which a party may explore for and extract resources until it chooses in its sole discretion to surrender its right to do so. Upon the unilateral exercise of that surrender right, the geothermal interest automatically extinguishes and merges into the estate out of which it was carved.

(7)
Landlord and Tenant § 136--Termination--Surrender--Consent.
If the lessee surrenders a lease by the method set forth in a surrender clause, the surrender is effective without any additional consent of the lessor, unless the surrender clause specifically states otherwise.

(8)
Contracts § 28--Construction and Interpretation--Intentions of Parties.
To give effect to the intentions of the parties at the time of contracting, the conduct of the parties after execution of the contract and before any controversy has arisen as to its effect affords the most reliable evidence of the parties' intentions.

COUNSEL
Gray, Cary, Ames & Frye, Jay W. Jeffcoat, Merrill F. Storms, Jr., MacDonald, Halsted & Laybourne, Dennis Keeley, Thomas S. Kidde, Michael Lee McQueen and Mark C. Allen III for Defendants and Appellants.
Jones, Day, Reavis & Pogue, Allyn O. Kreps, Joanne M. Frasca, Scott D. Bertzyk, Pinney & Caldwell and Michael A. Ralston for Plaintiff and Respondent. ***1182**

BUTLER, J.

The Imperial Irrigation District (IID) owns land in the Imperial Valley underlying which are mineral deposits and geothermal formations capable of producing steam convertible into electric energy. IID as lessor leased 280 acres of such land to a lessee for production of steam and minerals. The lessee assigned the leasehold interest to Imperial Thermal Products (ITP). ITP then assigned to Southern Pacific Land Company (Southern) its rights to produce steam from the land and to dispose of the wastes from such production. Southern later assigned those rights such that Union Oil Company (Union), Mono Power Company (Mono) and Southern eventually became the owners of undivided one-third interests in the steam. While ITP was producing steam and minerals under the original lease, the waste residues were deposited into brine ponds. The cost of disposing of the wastes in these brine ponds as required by water quality control agencies and liability for such costs prompted Union, Southern and Mono to surrender to ITP their interests. ITP averred the surrender was ineffective. Union and its fellow owners considered the surrender divested them of their interests in the land. Three years later, a federal court adjudicated ITP solely responsible to pay those costs. Union, Southern and Mono then decided the surrender was indeed ineffective and reasserted claims to the lease. Kennecott Corporation (Kennecott), ITP's successor, sued to quiet title to the leasehold free and clear of those reasserted interests. The court granted Kennecott's motion for summary judgment, adjudicating that the surrender effectively eliminated any interests held by Union, Southern or Mono. We affirm.

I

In 1961, the Imperial Irrigation District as lessor leased 280 acres of land to Joseph I. O'Neill, Jr., and Ashmun and Hilliard, a partnership (the O'Neill Group) as lessees for the purpose of drilling for, extracting and processing "all steam and thermal energy" as well as minerals and chemical elements whether solid, liquid or gas. The lease was for the term of 10 years and thereafter so long as steam or minerals were produced in commercial quantities but not longer than 99 years. The lease provided in paragraph 22(b): "Lessee shall have the right at any time prior to or after default hereunder, upon payment of the sum of One Hundred Dollars ($100.00) to Lessor, to quitclaim and surrender to Lessor all right, title and interest of Lessee in and to the Leased Lands or to any parcel or parcels thereof containing 40 acres or any multiple thereof; and thereupon all rights and obligations of the parties hereto one to the other shall cease and terminate as to the Leased Lands or such parcel or parcels thereof so quitclaimed and surrendered, save and except as to accrued royalty obligations of Lessee then payable, or damage to persons or property resulting from operations of ***1183** Lessee on, in or under the Leased Lands or such parcel or parcels thereof so quitclaimed and surrendered, and save and except for the provisions of Sections 4, 5 and 7 of this Lease, as to which Lessee shall remain liable to Lessor."[2]

The O'Neill Group and Shell Oil Company conducted geothermal operations on the land. To prevent brine waste residues from flowing into the Salton Sea, they built ponds to capture the brine generated from their operations. The O'Neill Group as lessees assigned to ITP its leasehold interest in 1966. ITP operated the existing wells on the land to 1972 and then assigned to Southern all of its "right, title and interest ... in said leased premises in and to all steam and thermal energy" produced from the land. We refer to the document assigning this interest in the lease as "the assignment." The right to extract minerals was excluded. The assignment gave Southern the right upon 60 days notice to IID, ITP and other royalty holders: "to surrender the leased premises, or any portion or portions thereof to Imperial Thermal. Subject to the provisions of Section 9, upon expiration of said sixty (60) day period, Southern shall surrender and assign to Imperial Thermal and Imperial Thermal shall accept the right and interest of Southern in the leased premises, or portion or portions thereof, as the case may be, to be so surrendered. Upon surrender of such right and interest, Southern shall be relieved of, and Imperial Thermal shall assume, all obligations thereafter arising under the Lease, as amended pursuant to paragraphs (a) and (b) of Section 14, said Assignment of Overriding Royalty Interest dated December 20, 1961 and the Cypher Agreement, with respect to said surrendered right and interest."[3]

January 30, 1973, Southern assigned a one-third undivided interest to Mono giving Mono the right to surrender in whole or in part the one-third undivided interest upon 90 days notice with the option to Southern to reacquire the one-third from Mono. Upon the surrender, Mono is relieved of all obligations. The parties stipulated Phillips Petroleum Company (Phillips) acquired from Southern an undivided one-third interest. This assignment is not in the record.

In 1976, the California Regional Water Quality Control Board (Board) found ITP in violation of regulations for maintenance of the brine ponds and ordered construction of facilities permanently to protect discharge of brine into the Salton Sea or to remove and relocate the brine waste residue to approved locations. ITP, Southern, Mono and Phillips agreed to share equally the cost of the corrective work up to $50,000. In December 1976, ***1184** Phillips assigned its one-third undivided interest to Southern and ITP, one-sixth each. In 1978, through assignments of interests, Union became the holder of a 50 percent interest as lessee in the leased land and Mono and Southern each then held an undivided 25 percent. Union was designated operator of the leased land and by May 1981, completed drilling two geothermal wells and performed maintenance on the brine ponds.

In August of 1980, ITP agreed to sell to Bear Creek Mining Company (Bear Creek) all of its lessee interest in the lease and its rights under the assignment made by ITP to Southern as well as other mineral and geothermal rights in other lands subject to liability except for the brine ponds. ITP was required under the sale agreement to indemnify Bear Creek from brine pond liabilities.

In May of 1981, the pot began to boil. The Board scheduled a May 20, 1981, public hearing concerning cleanup of the brine ponds. Union, Southern and Mono decided to surrender their interests to ITP to avoid potential cleanup liability. May 12, 1981, the Board submitted a proposed order finding ITP, Union, Southern and Mono to be dischargers of brine into the ponds. The ponds contain hazardous materials. The Salton Sea laps at the foot of the pond dikes, and the ponds contain some 262,000 tons of salt. The Board proposed prohibiting further discharge into the ponds and use of the ponds for waste storage, requiring removal of waste and setting time limits for removal of the salt. The next day, May 13, 1981, Union, on behalf of itself and Southern and Mono, gave notice of intention to surrender their interests in the leased premises: "Pursuant to Paragraph 8 of said Assignment and Agreement dated September 7, 1972, Union Oil Company of California, Southern Pacific Land Company and Mono Power Company hereby notify you of their intent to surrender the following portion of the leased premises to Imperial Thermal Products, Inc. effective as specified in said Assignment and Agreement:

"*Township 11 South, Range 13 East, SBM* Section 14: N/2, SE/4, SW/4, SE/4; and Section 23: NW/4." May 20, 1981, the Board issued its permanent order identical to the proposed order. June 9, 1981, ITP acknowledged receipt of the surrender notice advising Union ITP "rejects this attempted release and will treat any effort to consummate such a release as being null and void."[4] June 17, 1981, Union as operator petitioned the Board for ***1185** review of its order to eliminate Union, Southern and Mono as dischargers liable for waste removal costs. ITP responded asking Union's petition be dismissed, claiming the Board had no power to adjudicate the responsibilities of the parties for cost of waste removal.

July 13, 1981, 60 days after notice of intent so to do, Union, Southern and Mono, consistent with procedural requirements under the assignment, recorded a surrender of the lands covered by the assignment. August 6, 1981, ITP wrote to Union the surrender was deemed to be ineffective, Union, Southern and Mono were responsible for the brine ponds and the surrender was rejected. ITP assigned to Bear Creek all of its interests in the leased premises and Bear Creek merged with Kennecott in 1982.

ITP brought the long-simmering dispute over the brine ponds to the courts in April 1983 by filing a complaint for declaratory relief in the United States District Court for the Central District of California seeking a declaration that Union, Southern and Mono were responsible in whole or in part for the cost of the brine pond cleanup estimated at $6 million. ITP earlier cleaned the ponds responsive to a Board order. The defendants answered; both sides asked for summary judgment. ITP lost. May 25, 1984, the court held ITP solely responsible for the cleanup expense incurred responsive to the Board's order. Some jawboning occurred between Union and Kennecott people concerning Union's continuing interest in the surrendered lease following the declaratory relief action. November 26, 1984, Union articulated its position in a letter to the State Lands Commission. The letter notes the 1972 agreement between ITP and Southern bifurcated subsurface interests; ITP retained mineral rights; Southern acquired geothermal rights; the brine ponds were the residue of mineral development; thus, the federal court properly held ITP responsible for the cleanup; Southern, Union and Mono had no right to or interest in mineral development. Union asserted ITP's rejection of the surrender effectively retained lease interests in them. Responding, Kennecott then filed its complaint to quiet title and for declaratory relief and asked the court to adjudicate Kennecott the sole owner of the leased premises free and clear of any claim of Union, Southern or Mono. Kennecott recorded January 10, 1985, a repudiation of rejection of partial surrender of lease asserting ITP's mistaken belief Union, Southern and Mono continued to have duties under the lease and the rejection of attempted surrender was wholly ineffective. The court granted Kennecott's motion for summary judgment and denied cross-motions for summary judgment of Union, Southern and Mono. They appeal. We affirm.

II

The parties stipulated there is no triable issue of material fact and the case should be adjudicated by the court one way or the other by way of ***1186** summary judgment. Alternatively, they agreed their stipulation of facts could be deemed an adjudication of issues without substantial controversy and deemed established at trial. We have taken our statement of facts from the stipulation and agree with Union, Southern and Mono (collectively, for ease of reference, hereinafter Union) the sole issue on appeal is whether these undisputed facts established, as a matter of law, Union surrendered the leasehold estate to ITP.

III[5]

([1a]) Union's interest acquired under the assignment is a *profit a prendre*. ([2]) "The owner of land has the exclusive right on his land to drill for and produce oil. This right inhering in the owner by virtue of his title to the land is a valuable right which he may transfer. The right when granted is a profit *a prendre*, a right to remove a part of the substance of the land. A profit *a prendre* is an interest in real property in the nature of an incorporeal hereditament." (*Dabney-Johnston Oil Corp.* v. *Walden* (1935) 4 Cal.2d 637, 649 [52 P.2d 237].)

([3]) A *profit a prendre* has been defined as the "right to make some use of the soil of another, such as a right to mine metals, and it carries with it the right of entry and the right to remove and take from the land the designated products or profit and also includes right to use such of the surface as is necessary and convenient for exercise of the profit." (Black's Law Dict. (5th ed. 1979) p. 1090, citing *Costa Mesa Union Sch. Dist. v. Security First Nat. Bk.* (1967) 254 Cal.App.2d 4 [62 Cal.Rptr. 113]; see 3 Witkin, Summary of Cal. Law (8th ed. 1973) Real Property, § 544, pp. 2216-2217; *Dabney* v. *Edwards* (1935) 5 Cal.2d 1, 11 [53 P.2d 962, 103 A.L.R. 822]; *Callahan* v. *Martin* (1935) 3 Cal.2d 110, 118 [43 P.2d 788, 101 A.L.R. 871]; *Gerhard* v. *Stephens* (1968) 68 Cal.2d 864, 878, fn. 7 [69 Cal.Rptr. 612, 442 P.2d 692] [profits are incorporeal hereditaments which automatically extinguish when surrendered and return to the estate out of which they were carved].) ([4]) The rules governing surrender and abandonment of possessory leaseholds are expressly *inapplicable* to a *profit a prendre*. Civil Code section 1952.4 provides: "An agreement for the exploration for or the removal of natural resources is not a lease of real property within the meaning of Sections 1951 to 1952.2, inclusive" (which govern the rights and obligations of landlords and tenants with respect to termination, surrender and abandonment). The Law Revision Commission comment to section 1952.4 further states: "An agreement for the exploration for or the removal of natural resources, such as the so-called oil and gas lease, has been characterized by ***1187** the California Supreme Court as a *profit a prendre* in gross. [Citation.] These agreements are distinguishable from leases generally. ..."

This distinction derives from the nature of a mineral lease which normally requires the lessee to pay the lessor either a minimum royalty or a percentage of production for each acre of property subject to the profit. Since the lessee remains obligated to pay minimum royalties for so long as it holds an interest in the property (which typically is for an indefinite term), most mineral leases include a surrender clause which enables the lessee *unilaterally* to quitclaim its interest, and thereby avoid paying any further royalties on land that proves to be unproductive.[6]

The genesis of this unilateral surrender right is obvious: if acceptance were required for surrender of a profit interest to be effective, in the normal course a lessor always would withhold acceptance in order to continue receiving minimum royalty payments on unproductive property which would be difficult, if not impossible, to relet.

Our courts consistently have recognized that the right to surrender a profit interest is a *unilateral* right vested in the lessee.[7] ([5]) Indeed, one California court commented: "[a mineral lease] is not analagous [*sic*] to a lease in the ordinary sense, *but to an option; that is to say that it is so far unilateral that it could be at any time terminated by the lessees* ...." (*Scheel v. Harr* (1938) 27 Cal.App.2d 345, 352 [80 P.2d 1035], italics added.)

([6]) A profit interest in geothermal resources is not an ordinary leasehold interest at all. Rather, it is a means by which a party may explore for ***1188** and extract resources until it chooses in its sole discretion to surrender its right to do so. Upon the unilateral exercise of that surrender right, the geothermal interest automatically extinguishes and merges into the estate out of which it was carved. (*La Laguna Ranch Co. v. Dodge, supra*, 18 Cal.2d 132, 140 ["the surrender of the leasehold interest by the lessees constituted a termination of the *profit a prendre* and the leasehold"].)

([1b]) As Union's interests in the 280 acres automatically were extinguished upon recordation of the surrender, there simply was nothing for ITP to accept or to reject. Union's reliance upon authority requiring acceptance of a physical abandonment of a possessory leasehold estate is misplaced.

([7]) It is well established that if the lessee surrenders a lease by the method set forth in a surrender clause, the surrender is effective without any additional consent of the lessor, unless the surrender clause specifically states otherwise. In *Title Ins. etc. Co. v. Amalgamated Oil Co.* (1923) 63 Cal.App. 29, 33 [218 P. 71], the lessee deposited in the lessor's mailbox a quitclaim deed and the $10 required by the surrender clause of the lease, but the lessor "never accepted said tender or deed." Nevertheless, the court found there had been an effective surrender: "It is not seriously contended by the appellant that these acts of the defendant did not work a forfeiture of the lease. We are of the opinion that they did, and that the lease became forfeited at the time of the deposit of said sum of ten dollars for the lessor." (*Id.* at p. 34.)

Similarly, in *Superior Oil Co. v. Dabney* (1948) 147 Tex. 51 [211 S.W.2d 563], the oil, gas and mineral lease provided: "'Lessee may at any time execute and deliver to Lessor or to the depository above named or place of record a release or releases covering any portion of [*sic*] portions of the above described premises and thereby surrender this lease as to such portion or portions and be relieved of all obligations as to the acreage surrendered."' (At p. 563.) In *Superior Oil*, the lessee subsequently delivered a release to the lessors which surrendered all portions of the leased premises except for an 18-acre parcel. The release contained blank spaces for signature by the lessors which the lessors declined to sign. In a letter to the lessee dated one month after the date of the release, the lessors rejected the purported surrender and took the position the lessee was under a positive and unequivocal obligation to begin drilling on the leased premises.

Despite the lessors' actions, the court found there had been a valid surrender: "The release of July 12, 1946 was properly executed by the lessee and tendered to the lessors. Spaces for the signature of the lessors were provided at the end of the instrument. As has been stated, the lessors ***1189** declined to sign. These circumstances do not at all deprive the instrument of its effectiveness as a release. All that was required under the wording of the lease was that the lessee execute and deliver a release to the lessors. This was done, and thereupon the release became fully effective." (*Superior Oil, supra*, at p. 566.)

([1c]) Here, Union claims ownership based upon ITP's recordation of the rejection, arguing this constitutes a refusal to accept the surrender. However, paragraph 8 of the 1972 assignment provides that the right to surrender is unqualified, and that upon its exercise, ITP "*shall accept* the right and interest ... so surrendered." (Italics added.) Therefore, ITP had no election to reject the surrender under the 1972 assignment and the trial court so held. Indeed, this was precisely Union's position in the federal court action following execution of the surrender. "Our position was that ITP did not have the right to reject. They had a contractual obligation to accept. And therefore our position was that ... we had attempted a valid and proper surrender."[8]

IV

Even if paragraph 8 of the 1972 assignment is ambiguous as to whether an affirmative act of acceptance by ITP is required for the surrender to be effective, rules of contract interpretation lead to the conclusion the parties did not so construe the assignment.

([8]) Civil Code section 1636 provides that a contract must be interpreted to give effect to the intentions of the parties at the time of contracting. The conduct of the parties after execution of the contract and before any controversy has arisen as to its effect affords the most reliable evidence of the parties' intentions. (See, e.g., *United California Bank* v. *Maltzman* (1974) 44 Cal.App.3d 41, 49 [118 Cal.Rptr. 299]; *Spott Electrical Co. v. Industrial Indem. Co.* (1973) 30 Cal.App.3d 797, 808 [106 Cal.Rptr. 710]; *Salton Bay Marina, Inc. v. Imperial Irrigation Dist.* (1985) 172 Cal.App.3d 914, 936 [218 Cal.Rptr. 839] [A court "is required to give 'great weight' to the ***1190** conduct of the parties in interpreting the instrument before any controversy arose"].)

([1d]) The conduct by Union following recordation of the surrender through late 1984 permits only one interpretation of paragraph 8 of the 1972 assignment - that no affirmative act of acceptance on the part of ITP was intended by the parties to be necessary for the surrender to be effective. For three years after recordation of the surrender, Union consistently asserted to ITP, IID and Kennecott that the surrender was effective, that ITP had no right to reject the surrender, and that ITP's purported rejection was ineffective. Further, since recordation of the surrender, Union has made no use of the 280 acres for any purpose and, until recently, failed to object to any of Kennecott's numerous assertions of ownership or exploration activities undertaken in reliance on its belief of ownership. Even ITP, which executed the rejection, did not contend that its affirmative acceptance was necessary for a surrender to be effective. Rather, as indicated in ITP's August 6, 1981, transmittal letter to Union enclosing a copy of the rejection, ITP recorded the rejection solely because Union, Southern and Mono "are responsible for the ponds located on the Property, and they cannot evade this responsibility by the purported 'partial surrender.'"

Finally, any other interpretation would render the purpose of paragraph 8 of the 1972 assignment virtually meaningless as the lessor at any time could withhold an affirmative act of acceptance, thereby defeating the right to surrender such property back. Civil Code section 1641, which provides that each clause of a contract is to be given effect, if possible, rules out such an interpretation that effectively would nullify the surrender provision of the 1972 assignment.

V, VI*

....

VII

Union admits relinquishment of the 280 acres when it appeared to carry substantial liability. Now that the storm has subsided and the sea is calm, Union seeks to sail the sea even though it canceled its ticket. While "heads I win, tails you lose" may be useful in Las Vegas, we decline to let Union play that game. ***1191**

Judgment affirmed.
Kremer, P. J., and Huffman, J.,* concurred. ***1192**

Footnotes

1 Pursuant to California Rules of Court, rules 976.1 and 976(b), this opinion is certified for publication with the exception of sections V and VI.

* Assigned by the Chairperson of the Judicial Council. concurring.)

2 Sections 4, 5 and 7 of the lease concern matters not relevant to issues on this appeal.

3 Section 9, section 14(a) and (b) and the other documents referred to in this part of the lease are not relevant to the issues on appeal.

4 To remind the reader, paragraph 8 of the 1972 ITP-Southern assignment gives the right upon 60 days notice to Southern to surrender and assign any portion of the leased premises and "upon [such] surrender ... Southern shall be relieved of, and [ITP] shall assume, all obligations thereafter arising under the Lease ... with respect to said surrendered right and interest."

5 We acknowledge sections III and IV repeat and paraphrase parts of Kennecott's opening brief.

6 (See, e.g., *Pimentel v. The Hall-Baker Co.* (1939) 32 Cal.App.2d 697, 700 [90 P.2d 588] [the lease "contained the usual quitclaim clause permitting the lessee to quitclaim all or any portion of the leased property to the lessor and thereby be released from all or a proportionate part of its drilling obligations, depending on the amount of land quitclaimed"]; *La Laguna Ranch Co.* v. *Dodge* (1941) 18 Cal.2d 132, 140 [114 P.2d 351, 135 A.L.R. 546] ["Ordinarily, however, such oil and gas leases contain clauses permitting the lessee to cease operations and to surrender the lease if he no longer considers it possible to continue operations profitably"]; see also, *La Laguna, supra*, at p. 145, Carter, J., dis. ["It must be remembered that as between the lessor and lessees the right to terminate the lease is a right pertaining solely to the lessees. It is an option they may exercise without regard to the lessor's desires"]; see also *George* v. *Weston* (1938) 26 Cal.App.2d 256, 262-263 [79 P.2d 110]; *Clark v. Elsinore Oil Co.* (1934) 138 Cal.App. 6, 17 [31 P.2d 476]; *Sheehan* v. *Vedder* (1930) 108 Cal.App. 419, 428 [292 P. 175]; 47 Cal.Jur.3d (3d ed. 1979) Oil and Gas, § 126, pp. 531-532.)

7 Because the right to surrender may be exercised unilaterally by the lessee regardless of the consent of the lessor, California courts have held that a lease containing such a clause lacks mutuality of obligations and *cannot* be specifically enforced by the lessee. (See, e.g., *Sturgis v. Galindo* (1881) 59 Cal. 28; *Pimentel* v. *The Hall-Baker Co., supra*, 32 Cal.App.2d 697, 701-702.) Thus, Union's argument that ITP's wrongful refusal to accept the surrender gave them a claim for specific performance under the 1972 assignment is patently incorrect.

8 We do not construe this language in paragraph 8 to require an affirmative act of acceptance by ITP for the surrender to be effective. The sentence "Southern shall surrender ... and Imperial Thermal shall accept the right and interest ... so surrendered," as used in paragraph 8, simply indicates that, upon the surrender of any or all of the leased premises, ITP has no discretion to do anything other than take back the property so surrendered. Since there is no ambiguity in this language, the plain meaning of those words must be given effect. (Civ. Code, § 1638; see *Blue Cross of Northern California v. Cory* (1981) 120 Cal.App.3d 723, 734 [174 Cal.Rptr. 901] ["A contractual obligation defined by the imperative auxiliary 'shall' is ordinarily understood to be mandatory and unconditional"].) The surrender, as a matter of law, terminated the *profit a prendre* and there was nothing to accept or to reject.

* See footnote 1, *ante*, page 1179.

* Assigned by the Chairperson of the Judicial Council.

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110 Cal.App.4th 1451
Court of Appeal, Third District, California.

MAZDA MOTOR OF AMERICA, INC., Plaintiff and Respondent,
v.
CALIFORNIA NEW MOTOR VEHICLE BOARD, Defendant and Appellant;
David J. Phillips Buick–Pontiac, Inc., Real Party in Interest and Appellant.

No. C039922. | July 31, 2003.

Synopsis

Background: Motor vehicle dealer petitioned the New Motor Vehicle Board, asking for hearing to resolve dispute with distributor over sale of dealership to third party. Distributor moved to strike the petition on jurisdictional grounds. After Board denied motion to strike, distributor petitioned for writ of mandate and prohibition. The Superior Court, Sacramento County, No. 01CS01045, Talmadge R. Jones, J., granted the petition. Dealer and Board appealed.

[Holding:] The Court of Appeal, Hull, J., held that Board lacked jurisdiction to hear dispute as it was essentially request for adjudication.

Affirmed.

West Headnotes (7)

[1] **Appeal and Error**
Cases Triable in Appellate Court

The Court of Appeal reviews de novo a decision based on the interpretation of the scope of a statute.

[2] **Antitrust and Trade Regulation**
Powers, functions, jurisdiction, and authority

New Motor Vehicle Board lacked jurisdiction to hear dealership transfer dispute between motor vehicle dealer and distributor, as dealer's request was not for investigation or discipline but rather for adjudication that franchise transfer was approved and that distributor's failure to recognize or consent to transfer violated statutes. West's Ann.Cal.Vehicle Code §§ 3050(a), (c)(2), 11713.3(d).

See 2 Witkin, Summary of Cal. Law (9th ed. 1988) Agency and Employment, § 6; 7 Witkin, Summary of Cal. Law (9th ed. 1988) Constitutional Law, §§ 109A, 530; 8 Witkin, Summary of Cal. Law (9th ed. 1988) Constitutional Law, § 884; 3 Witkin, Cal. Procedure (4th ed. 1997) Actions, § 308; 9 Witkin, Cal. Procedure (4th ed. 1997) Administrative Proceedings, § 109; Cal. Jur. 3d, Administrative Law, § 155.

2 Cases that cite this headnote

[3] **Statutes**
Meaning of Language
Statutes
Existence of ambiguity
Statutes
Giving effect to entire statute

In determining legislative intent and a statute's purposes, the Court of Appeal looks first to the statutory language, giving significance to every word and phrase; when the language is clear, it looks no further and enforces the statute according to its terms.

[4] **Antitrust and Trade Regulation**
Powers, functions, jurisdiction, and authority

The New Motor Vehicle Board is a quasi-judicial administrative agency of limited jurisdiction; it does not have plenary authority to resolve any and all disputes which may arise between a franchisor and a franchisee. West's Ann.Cal.Vehicle Code § 3050(a).

1 Cases that cite this headnote

[5] **Antitrust and Trade Regulation**
Powers, functions, jurisdiction, and authority

New Motor Vehicle Board's jurisdiction to preside over claims is limited by its statutory authorization. West's Ann.Cal.Vehicle Code § 3050(a).

[6] **Antitrust and Trade Regulation**
Powers, functions, jurisdiction, and authority
Constitutional Law
Encroachment on Judiciary

When the New Motor Vehicle Board's activities exceed its authorization, the Board violates the judicial powers clause of the California Constitution. West's Ann.Cal. Const. Art. 6, § 1; West's Ann.Cal.Vehicle Code § 3050(a).

[7] **Statutes**
Giving effect to entire statute

The court rejects interpretations that render particular terms of a statute mere surplusage or devoid of meaning.

Attorneys and Law Firms

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Manning, Leaver, Bruder & Berberich, Robert D. Daniels, Los Angeles, and Christian J. Scali for Real Party in Interest ****868** and Appellant David J. Phillips Buick–Pontiac, Inc.

Peter K. Welch for amicus curiae for California Motor Car Dealers Association on behalf of Real Party in Interest and Appellant David J. Phillips Buick–Pontiac, Inc.

Alvarado, Smith & Sanchez, Maurice Sanchez and Michael P. Norton, Irvine, for Plaintiff and Respondent.

Opinion

HULL, J.

This case centers on a jurisdictional issue, namely, whether a dispute between plaintiff Mazda Motor of America, Inc. (Mazda), and one of its dealerships, real party in interest David J. Phillips Buick–Pontiac, Inc. (Phillips), should be resolved by the California New Motor Vehicle Board (the Board) or the courts. We agree with the trial court that this dispute is not within the limited jurisdictional scope of the Board and therefore affirm the judgment.

FACTS AND PROCEDURAL HISTORY

Mazda is a licensed motor vehicle distributor in California, and Phillips is a licensed Mazda dealer.

Phillips entered into an agreement to sell its Mazda dealership to a third party. The franchise agreement required "Mazda's prior written consent, which shall not be unreasonably withheld," to transfer ownership of the Phillips dealership. This contract provision parallels the statutory provisions of Vehicle Code section 11713.3, subdivisions (d)(1) and (e). (Further undesignated statutory references are to the Vehicle Code.)

Under both the franchise agreement and statutory provisions (§ 11713.3, subd. (d)(2)(A)), Phillips was required to give Mazda written notice of a ***1454** transfer of the dealership. The statutory scheme makes it unlawful for a distributor to fail to notify the franchisee of approval or disapproval of the transfer within 60 days after receiving notice and application for approval of the transfer. (§ 11713.3, subd. (d)(2)(B).) If the franchisee does not receive notice of disapproval within that time, the transfer is deemed approved. (*Ibid.*)

Phillips submitted an application to Mazda for approval of the transfer. Mazda disapproved the application, explaining why the transferee was not an acceptable dealer candidate to Mazda.

Controversy ensued. Phillips contended that Mazda's disapproval notice was beyond the 60–day period, and therefore the transfer had to be deemed accepted. Mazda countered that the application was incomplete until additional materials it requested had been received, which occurred less than 60 days before it sent the disapproval notice.

Phillips filed a petition with the Board pursuant to section 3050, subdivision (c). This statute is central to the issues in this appeal, and we therefore set out its provisions in full. The statute states that the Board shall "[c]onsider any matter concerning the activities or practices of any person applying for or holding a license as a new motor vehicle dealer, manufacturer, manufacturer branch, distributor, distributor branch, or representative pursuant to Chapter 4 (commencing with Section 11700) of Division 5 [of the Vehicle Code] submitted by any person. A member of the board who is a new motor vehicle dealer may not participate in, hear, comment, advise other members on, or decide any matter considered by the board pursuant to this subdivision that involves a dispute between a franchisee and franchisor. After that consideration, the board may do any one, or any combination of, the following:

****869** "(1) Direct the [Department of Motor Vehicles (DMV)] to conduct investigation of matters that the board deems reasonable, and make a written report on the results of the investigation to the board within the time specified by the board.

"(2) Undertake to mediate, arbitrate, or otherwise resolve any honest difference of opinion or viewpoint existing between any member of the public and any new motor vehicle dealer, manufacturer, manufacturer branch, distributor branch, or representative.

"(3) Order the [DMV] to exercise any and all authority or power that the department may have with respect to the issuance, renewal, refusal to renew, suspension, or revocation of the license of any new motor vehicle dealer, manufacturer, manufacturer branch, distributor, distributor branch, or representative as that license is required under Chapter 4 (commencing with Section 11700) of Division 5."

***1455** In its petition to the Board, Phillips alleged that "[c]ertain controversies and differences of opinion have arisen between petitioner and respondent, primarily relating to a change in ownership of the shares of petitioner's corporate stock." Citing various statutory provisions, Phillips asserted four claims: (1) Mazda's disapproval of the transfer was given more than 60 days after receipt of the information, and therefore the transfer must be deemed approved as a matter of law; (2) consent to the transfer was unreasonably withheld because of the delay in notifying the parties of the need for additional information; (3) consent to the transfer was unreasonably withheld because it was based on a plan to terminate the franchise if its present principal sought to transfer his interest and cease to be the active dealer; and (4) Mazda's refusal to consent to the transfer was unreasonable under all of the circumstances.

In its prayer for relief, Phillips asked the Board to hold a hearing to adjudicate matters involving the unlawful activities of respondent, and to determine that (a) the sale "ha[d] been deemed approved by Mazda by operation of law and that Mazda's refusal to recognize said automatic approval violates ... section 11713.3"; (b) Mazda's refusal to consent to the transfer "[was] unreasonable as a matter of law due to Mazda's delay and thus violates ... section 11713.3"; (c) Mazda's refusal to consent also "[was] unreasonable as a matter of law because it constitutes implementation" of an illegal plan to phase out the dealership if transferred "and thus violate [d] ... sections 11713.2 and 11713.3"; and (d) Mazda's refusal further "[was] unreasonable under all the facts and circumstances, and thus violate [d] ... section 11713.3."

The petition also sought attorney fees and costs.
Mazda filed a motion with the Board to strike the petition on the grounds that attorney fees and costs can be awarded only by a court. (See § 11726 [court may award damages, attorney fees, and injunctive relief].) Mazda also contended the Board should exercise its discretion not to hear the petition, arguing that the superior court had jurisdiction to determine Phillips's claims and was a better forum for this dispute. In a supplemental brief, Mazda contended the Board did not have jurisdiction under section 3050, subdivision (c) to resolve disputes between licensees, and cited this court's decision in *Hardin Oldsmobile v. New Motor Vehicle Bd.* (1997) 52 Cal.App.4th 585, 60 Cal.Rptr.2d 583 (*Hardin).*

Phillips amended its petition to eliminate its request for attorney fees and costs. In opposition to the motion to strike, Phillips contended, in part, that the Board and the ****870** courts have concurrent jurisdiction over the type of claims asserted in the petition, and therefore the Board was an appropriate forum.

***1456** The administrative law judge denied the motion to strike. The judge held, among other things, that "*Hardin* does not limit the Board's authority to hear Petitioner's claims with allegations based on ... sections 11713.2 and 11713.3. Petitioner's claims are precisely the types of claims which this Board has particular knowledge and expertise to hear."

Mazda filed a petition for writ of mandate and prohibition in superior court, seeking to compel the Board to set aside its order denying the motion to strike and to grant the motion. After a hearing, the court, relying on *Hardin,* determined that "[t]here is no statutory authority permitting the Board to exercise jurisdiction over the matter at issue here: a petition filed by a dealer against a manufacturer/distributor asking the Board to rule that the latter improperly refused its consent to a transfer of ownership." The court granted the petition, issuing a writ of mandate ordering the Board to dismiss the petition and writ of prohibition requiring the Board to decline jurisdiction to hear and to decide the claims raised in the petition.

The Board and Phillips appeal from the ensuing judgment.

DISCUSSION

[1] The trial court's decision to grant Phillips's petition turned on its conclusion that there was no statutory basis for the Board's jurisdiction over a transfer dispute between a distributor and dealer. We review de novo a decision based on the interpretation of the scope of a statute. (*Burden v. Snowden* (1992) 2 Cal.4th 556, 562, 7 Cal.Rptr.2d 531, 828 P.2d 672; *Beverly v. Anderson* (1999) 76 Cal.App.4th 480, 483–484, 90 Cal.Rptr.2d 545.)

[2] The Board, Phillips, and amicus curiae California Motor Car Dealers Association contend that section 3050, subdivision (c) confers jurisdiction on the Board to consider Phillips's claims, which assert violations of sections 11713.2 and 11713.3 that arise from a dispute between Mazda, a distributor, and Phillips, a dealer, over Mazda's refusal to consent to the transfer of a dealership. We disagree.

[3] In determining legislative intent and a statute's purposes, we look first to the statutory language, giving significance to every word and phrase. (*DuBois v. Workers' Comp. Appeals Bd.* (1993) 5 Cal.4th 382, 387–388, 20 Cal.Rptr.2d 523, 853 P.2d 978.) When the language is clear, we look no further and enforce the statute according to its terms. (*Ibid.*)

Various provisions of section 3050 lead us to conclude that not every dealer-distributor dispute is within the province of the Board.

[4] [5] [6] *1457 Section 3050, subdivision (a), which defines the Board's rulemaking authority, indicates that the Board does not have unlimited jurisdiction, by providing that the Board shall "[a]dopt rules and regulations ... *governing those matters that are specifically committed to its jurisdiction.*" (Italics added; see *Miller v. Superior Court* (1996) 50 Cal.App.4th 1665, 1675, 58 Cal.Rptr.2d 584.) As we reaffirmed in *Hardin,* " '[t]he Board is a quasi-judicial administrative agency of limited jurisdiction. [Citation.] It does not have plenary authority to resolve any and all disputes which may arise between a franchisor and a franchisee.' " (*Hardin, supra,* 52 Cal.App.4th at pp. 590–591, 60 Cal.Rptr.2d 583; *Ri–Joyce, Inc. v. New Motor Vehicle Bd.* (1992) 2 Cal.App.4th 445, 455, 3 Cal.Rptr.2d 546.) The Board's jurisdiction to preside over claims is limited ****871** by its statutory authorization. (*Hardin, supra,* 52 Cal.App.4th at pp. 597–598, 60 Cal.Rptr.2d 583; *BMW of North America, Inc. v. New Motor Vehicle Bd.* (1984) 162 Cal.App.3d 980, 994, 209 Cal.Rptr. 50.) Where the Board's activities exceed its authorization, the Board violates the judicial powers clause of the California Constitution (Cal. Const., art. VI, § 1). (*Hardin, supra,* 52 Cal.App.4th at p. 598, 60 Cal.Rptr.2d 583.)

In arguing that the Board has jurisdiction over this dispute, the Board and Phillips point to the broad introductory language of section 3050, subdivision (c), which provides that the Board shall "[c]onsider *any* matter concerning the activities or practices of *any* person applying for or holding a license as a new motor vehicle dealer, ... [or] distributor ... submitted by *any* person." (Italics added.)

However, in *Hardin,* we determined that this language does not define the Board's jurisdictional scope. We concluded instead that the Board's jurisdiction was limited and that the subsequent subparagraphs of section 3050, subdivision (c), which set forth the scope of the Board's authority, best indicated the limited jurisdiction conferred by section o3050, subdivision (c). "Broadly defined, the phrase '[c]onsider any matter concerning the activities or practices of any person applying for or holding a license as a new motor vehicle ... manufacturer [or distributor] submitted by any person' (Veh.Code, § 3050, subd. (c)), would include consideration of criminal actions and labor disputes. No one, including, most importantly, the Legislature that wrote it, would argue those matters fall under the jurisdiction of the Board; hence, the meaning of the phrase is limited. The best indication of the scope of the limitation is found in the remainder of the subdivision in which the Board is given authority to investigate the activities, resolve any honest

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differences of opinion or viewpoint with members of the public, and order the Department of Motor Vehicles to exercise its licensing authority over a malefactor." (*Hardin, supra,* 52 Cal.App.4th at p. 590, 60 Cal.Rptr.2d 583.)

As we noted in *Hardin,* the authority described in section 3050, subdivision (c) was granted when the Board was formed in 1967. ***1458** (*Hardin, supra,* 52 Cal.App.4th at p. 590, 60 Cal.Rptr.2d 583.) The Board's function was regulation and discipline of licensees in the manner of other occupational licensing boards. (See *University Ford Chrysler–Plymouth, Inc. v. New Motor Vehicle Bd.* (1986) 179 Cal.App.3d 796, 800, 224 Cal.Rptr. 908 (*University Ford*); *American Motors Sales Corp. v. New Motor Vehicle Bd.* (1977) 69 Cal.App.3d 983, 986, 138 Cal.Rptr. 594.) The Board was intended as an industry response to problems with the practices of its members (*Toyota of Visalia, Inc. v. Department of Motor Vehicles* (1984) 155 Cal.App.3d 315, 322–323, 202 Cal.Rptr. 190, disapproved on another ground in *Kazensky v. City of Merced* (1998) 65 Cal.App.4th 44, 53–54, fn. 3, 76 Cal.Rptr.2d 356), and its authority under section 3050, subdivision (c) therefore focused on investigation and discipline of licensees and dispute resolution with members of the public, not adjudication of disputes between licensees.

Comprehensive amendments to the Vehicle Code gave the Board the power to adjudicate certain dealer-distributor disputes. Specifically, in 1973, the Legislature "empowered the Board to resolve disputes involving '(1) whether there is "good cause" to terminate or to refuse to continue a franchise [citation]; (2) whether there is "good cause" not to establish or relocate a motor vehicle dealership in a "relevant market area" [citation]; (3) delivery and ****872** preparation obligations [citation]; and (4) warranty reimbursement [citation].' [Citation.] Thus, the Board no longer only sat in 'judgment upon new car dealers in such matters as eligibility and qualifications for a license, regulation of practices, discipline for rule violations, and the like. [The additional statutes gave the Board] the added power to intrude upon the contractual rights and obligations of dealers and their product suppliers, entities whose respective economic interests are in no way identical or coextensive, frequently not even harmonious." (*Tovas v. American Honda Motor Co.* (1997) 57 Cal.App.4th 506, 512–513, 67 Cal.Rptr.2d 145.)

To accomplish these goals, the legislation added subdivision (d) to section 3050, which gave the Board the power to hear and decide these specific dealer protests. (Stats.1973, ch. 996, § 14, subd. (d), p.1967.) Sections 11713.2 and 11713.3, specifying unlawful acts by manufacturers and distributors, became part of the code in the same legislation. (Stats.1973, §§ 29–30, pp. 1976–1977 [these sections were enacted as §§ 11713.1 and 11713.2, respectively].)

As we pointed out in *Hardin,* these amendments highlight the limited jurisdiction of the Board under its original enabling legislation. "If the Board already had plenary authority in all matters pursuant to the enabling legislation in 1967, including the authority to consider any matter and resolve disputes between franchisors and franchisees, it would not have been necessary for the Legislature to give the Board jurisdiction, in 1973, over franchise disputes." (*Hardin, supra,* 52 Cal.App.4th at p. 590, 60 Cal.Rptr.2d 583.)

***1459** In addition to the types of franchisor-franchisee disputes that may come before the Board under section 3050, subdivision (d), other types of disputes between franchisors and franchisees may fall within the jurisdiction of the Board under section 3050, subdivision (c). For example, a violation of section 11713.2 or 11713.3 may be grounds for discipline, e.g., suspension or revocation of a license. This power is alluded to in the introductory language of section 3050, subdivision (c), which states that the Board may consider matters concerning the activities or practices of licensees "pursuant to Chapter 4 (commencing with Section 11700) of Division 5 submitted by any person." Subdivision (c)(3) of the statute directly authorizes such action by providing that the Board may order DMV to take disciplinary action against "the license of any new motor vehicle dealer, manufacturer, manufacturer branch, distributor, distributor branch, or representative as that license is required under Chapter 4 (commencing with Section 11700) of Division 5." (See also § 11705, subd. (a)(10) [violations of sections 11713.2 and 11713.3 may be grounds for discipline].)

[7] The recusal provision of section 3050, subdivision (c) recognizes that the Board may in addition consider some dealer-distributor disputes. The subdivision prohibits dealer members on the Board from participating in "any matter considered by the board pursuant to this subdivision that involves a dispute between a franchisee and franchisor." If the Board cannot consider a matter involving a dispute between a franchisee and a franchisor under section 3050, subdivision (c), the recusal provision is meaningless. We reject interpretations that render particular terms of a statute mere surplusage or devoid of meaning. (*City of San Jose v. Superior Court* (1993) 5 Cal.4th 47, 55, 19 Cal.Rptr.2d 73, 850 P.2d 621.)

However, the statutory authorization in section 3050, subdivision (c) does not extend to *all* disputes between dealers and manufacturers. As we determined in *Hardin,* ****873** the scope of the Board's jurisdiction over such disputes is limited by the regulatory and disciplinary actions it may take, described in the numbered subparagraphs of section 3050, subdivision (c). *(Hardin, supra,* 52 Cal.App.4th at p. 590, 60 Cal.Rptr.2d 583.) It is conceivable that a dispute between a franchisee and franchisor over transfer of a dealership could give rise to a petition that asserts violations of sections 11713.2 and 11713.3 and calls for an investigation or disciplinary action of the distributor pursuant to section 3050, subdivisions (c)(1) and (3). Such a petition would be within the Board's section 3050, subdivision (c) jurisdiction, as outlined in *Hardin.*

But that is not the posture of the case before us. Phillips did not request that the Board order DMV to investigate the matter or direct DMV to discipline Mazda by suspending or revoking its license. Instead, it sought an adjudication that the franchise was deemed approved and that Mazda's refusal ***1460** to recognize or consent to the transfer violated sections 11713.2 and 11713.3. Phillips, in essence, petitioned the Board to effectuate the transfer by ordering it approved and finding Mazda's failure to consent to it unlawful. The relief Phillips requested had everything to do with vindicating Phillips and accomplishing the sale of the dealership but nothing to do with licensee discipline. The petition therefore was not within the grant of authority to the Board under section 3050, subdivision (c).

The only subsection of section 3050 that gives the Board the authority to adjudicate disputes is subdivision (c)(2), which allows the Board to "[u]ndertake to mediate, arbitrate, or otherwise resolve any honest difference of opinion or viewpoint existing between any member of the public and any new motor vehicle dealer, manufacturer, manufacturer branch, distributor branch, or representative." Citing *Ray Fladeboe Lincoln–Mercury, Inc. v. New Motor Vehicle Bd.* (1992) 10 Cal.App.4th 51, 12 Cal.Rptr.2d 598 (*Ray Fladeboe*), Phillips argues that it is a "member of the public" and therefore this provision is applicable to its dispute with Mazda.

In *Ray Fladeboe,* the court accepted a similar contention without any analysis of the statutory language. (*Ray Fladeboe, supra,* 10 Cal.App.4th at pp. 54–56, 12 Cal.Rptr.2d 598.) However, we rejected this interpretation in *Hardin,* stating that "[T]he legal authorization to resolve 'any honest difference of opinion or viewpoint' relates to differences of opinion or viewpoint the licensee has with a 'member of the public.' [Citation.] Again, this circumscribing language reveals a legislative intent to limit the ambit of honest differences of opinion or viewpoint over which the Board may preside. When referring to licensees, section 3050 specifically so states and exhaustively lists those licensees ('applicant for, or holder of, a license as a new motor vehicle dealer, manufacturer, manufacturer branch, distributor, distributor branch, or representative'). The legislative authorization in section 3050 to resolve differences of viewpoint, however, does not say it extends to traditional litigation between licensees; it limits the authorization to differences of opinion or viewpoint between a licensee and a member of the public." (*Hardin, supra,* 52 Cal.App.4th at p. 591, 60 Cal.Rptr.2d 583.)

The Board and amicus curiae attempt to avoid a head-on collision with *Hardin.* They suggest that because the alleged violations of sections 11713.2 and 11713.3 could lead the Board to order the DMV to conduct an investigation or take disciplinary action pursuant to section 3050, subdivisions (c)(1) and (3), the Board had jurisdiction to consider the petition and determine whether to take these courses of action. In other words, regardless of whether the petition requested the Board ****874** to do something other than take disciplinary action, the Board has jurisdiction to consider the petition and take such action.

***1461** We cannot agree. As we have explained, the essence of the petition was an effort to effectuate transfer of the dealership by Board adjudication. Beyond the fact that Phillips alleged violations of sections 11713.2 and 11713.3, the petition had nothing to do with investigation or discipline of licensees. Under *Hardin,* the Board's jurisdiction under section 3050, subdivision (c) is not determined solely by whether or not the petitioner has asserted violations of statutes referenced in the subdivision but also depends on the nature of the petition, that is, whether it seeks adjudication or discipline. Here, Phillips understandably had no interest in the suspension or revocation of its supplier's license, and did not seek that relief.

Contrary to the Board's suggestion, the relief requested was not the result of "inartful pleading." In conformance with regulations promulgated by the Board, the petition requested in clear terms that the Board resolve a dispute pursuant to section 3050, subdivision (c)(2). California Code of Regulations, title 13, section 554, provides that "[a]ny person, including a board member, concerned with activities or practices" of any licensee "may file a written petition with the board requesting that the board consider such matter and take action thereon." The petition is required to recite, among other things, "[i]f the petitioner desires that the board mediate, arbitrate or resolve a difference between the petitioner and respondent ... [and to] describe the relief or disposition of the matter which petitioner would consider acceptable." (Cal.Code Regs., tit. 13, § 555, subd. (d).)

Phillips's petition made such a recitation. It named Mazda as respondent and alleged that "[c]ertain controversies and differences of opinion have arisen between petitioner and respondent, primarily relating to a change in ownership of the shares of petitioner's corporate stock." Phillips requested the Board to "adjudicate" the matter, that is, resolve the difference between Phillips and Mazda, and award the relief Phillips considered acceptable, a determination that the transfer was automatically approved and Mazda's failure to recognize or consent to the transfer was unlawful.

Nothing in the petition indicated that Phillips sought disciplinary action against Mazda. Instead, by its own terms, the petition invoked only the jurisdiction afforded the Board to resolve differences under section 3050, subdivision (c)(2). But, as we have explained, that section does not extend the Board's jurisdiction to disputes involving a dealer and distributor. The statute authorizes the Board to resolve only disputes that involve members of the public.

Phillips petitioned the Board to consider a dealer-distributor dispute that was not within its jurisdiction. The trial court therefore properly issued a writ ordering the Board to dismiss the petition and to decline to entertain the claims raised in it.

***1462** In light of our disposition of this case, we need not reach Mazda's contention that section 11726 mandates that the claims raised in Phillips's petition be directed exclusively to the superior court. Additionally, we deny Mazda's request for judicial notice of a ruling by the Board in another matter. (Evid.Code, § 459.)

DISPOSITION

The judgment is affirmed. Mazda shall recover its costs on appeal.

We concur: BLEASE, Acting P.J., and RAYE, J.

Parallel Citations

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147 F.3d 1301
United States Court of Appeals,
Eleventh Circuit.

McDONALD'S CORPORATION, Plaintiff–Counter–defendant–Appellee,
v.
Roger ROBERTSON, Marilyn Robertson, trading as McDonald's Restaurant, Defendants–Counter–claimants–Appellants.

No. 97–3308. | July 28, 1998.

Franchisor brought trademark infringement action against franchisees after franchisor terminated franchise agreement. The United States District Court for the Middle District of Florida, No. 97-1189-CIV-J-10C, Ralph W. Nimmons, Jr., J., granted franchisor's motion for preliminary injunction. Franchisees appealed. The Court of Appeals, Marcus, Circuit Judge, held that: (1) franchisor's termination of agreement was likely justified; (2) franchisor was likely to prevail on its infringement claim; and (3) district court was not required to hold evidentiary hearing on motion for preliminary injunction.

Affirmed.

Carnes, Circuit Judge, concurred specially and filed opinion.

West Headnotes (14)

[1] **Federal Courts**
Preliminary injunction; temporary restraining order

The Court of Appeals reviews a district court's order granting or denying a preliminary injunction for abuse of discretion.

8 Cases that cite this headnote

[2] **Injunction**
Grounds in general; multiple factors

A district court may grant injunctive relief if the movant shows the following: (1) substantial likelihood of success on the merits; (2) irreparable injury will be suffered unless the injunction issues; (3) the threatened injury to the movant outweighs whatever damage the proposed injunction may cause the opposing party; and (4) if issued, the injunction would not be adverse to the public interest.

268 Cases that cite this headnote

[3] **Injunction**
Extraordinary or unusual nature of remedy
Injunction
Clear showing or proof

A preliminary injunction is an extraordinary and drastic remedy not to be granted unless the movant clearly established the burden of persuasion as to the four requisites.

241 Cases that cite this headnote

[4] **Trademarks**
Infringement in general

To obtain preliminary injunctive relief in claim against former franchisee for trademark infringement, franchisor must show that it properly terminated franchise agreement. Lanham Trade–Mark Act, § 32(1)(a), 15 U.S.C.A. § 1114(1)(a).

24 Cases that cite this headnote

[5] **Trademarks**
Duration of consent; post-termination use

The Lanham Act's requirement that a franchisor demonstrate that unauthorized trademark use occurred to prevail on the merits of a trademark infringement claim against a franchisee necessitates some type of showing that the franchisor properly terminated the contract purporting to authorize the trademarks' use, thus resulting in the unauthorized use of trademarks by the former franchisee. Lanham Trade–Mark Act, § 32(1)(a), 15 U.S.C.A. § 1114(1)(a).

30 Cases that cite this headnote

[6] **Trademarks**
Infringement in general

Franchisees likely infringed restaurant franchisor's trademarks, for preliminary injunction purposes, by continuing to use franchisor's trademarks after franchisor had terminated franchise agreement, even though franchisor's alleged ulterior motive for termination was to move restaurant to another nearby location; several inspections of franchisees' restaurant had disclosed quality and food safety violations, which was a material breach of agreement. Lanham Trade–Mark Act, § 32(1)(a), 15 U.S.C.A. § 1114(1)(a).

21 Cases that cite this headnote

[7] **Contracts**
Option to renew or terminate contract

A franchisor's right to terminate a franchisee exists independently of any claims the franchisee might have against the franchisor.

2 Cases that cite this headnote

[8] **Contracts**
Option to renew or terminate contract

The franchisor has the power to terminate the relationship where the terms of the franchise agreement are violated.

2 Cases that cite this headnote

[9] **Trademarks**
Infringement in general

Loss of franchisor's goodwill caused by former franchisees' unauthorized trademark use constituted irreparable injury that favored grant of preliminary injunction. Lanham Trade–Mark Act, § 32(1)(a), 15 U.S.C.A. § 1114(1)(a).

23 Cases that cite this headnote

[10] **Federal Courts**
Interlocutory, Collateral and Supplementary Proceedings and Questions

On appeal from grant of plaintiff's motion for preliminary injunction, Court of Appeals had jurisdiction to review district court's denial of defendant's request for evidentiary hearing on motion. Fed.Rules Civ.Proc.Rule 65, 28 U.S.C.A.

3 Cases that cite this headnote

[11] **Injunction**
Right or necessity

Where facts are bitterly contested and credibility determinations must be made to decide whether injunctive relief should issue, an evidentiary hearing must be held on a motion for preliminary injunction. Fed.Rules Civ.Proc.Rule 65, 28 U.S.C.A.

6 Cases that cite this headnote

[12] **Injunction**
Right or necessity

Where material facts are not in dispute, or where facts in dispute are not material to the preliminary injunction sought, district courts generally need not hold an evidentiary hearing on the motion for preliminary injunction. Fed.Rules Civ.Proc.Rule 65, 28 U.S.C.A.

6 Cases that cite this headnote

[13] **Trademarks**
Hearing and determination

In franchisor's trademark infringement action against former franchisees, district court was not required to hold evidentiary hearing on franchisor's motion for preliminary injunction; no real controversy existed over whether franchisees committed material breaches that justified termination of franchise agreement, and franchisees had ten days to provide affidavits and other evidence showing a material issue of fact. Lanham Trade–Mark Act, § 32(1)(a), 15 U.S.C.A. § 1114(1)(a); Fed.Rules Civ.Proc.Rule 65, 28 U.S.C.A.

16 Cases that cite this headnote

[14] **Injunction**
Right or necessity

District court is not required to hold evidentiary hearing on motion for preliminary injunction in cases in which irreparable injury is presumed. Fed.Rules Civ.Proc.Rule 65, 28 U.S.C.A.

6 Cases that cite this headnote

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Appeal from the United States District Court for the Middle District of Florida.

Before CARNES and MARCUS, Circuit Judges, and MILLS*, Senior District Judge.

Opinion

MARCUS, Circuit Judge:

This appeal arises out of the district court's entry without an evidentiary hearing of a preliminary injunction enjoining defendant-appellants Roger and Marilyn Robertson from continuing to run a McDonald's restaurant previously franchised to them by plaintiff-appellee McDonald's Corporation. On appeal the Robertsons challenge the district court's denial of their motion for an evidentiary hearing on McDonald's motion for preliminary injunction. Additionally, the defendants argue that the district court erred in entering the preliminary injunction because, according to the Robertsons, McDonald's did not demonstrate that it had the right to terminate the Robertsons' franchise agreement, and thus, McDonald's is not likely to succeed on the merits of its case. Because no issues of material fact were in controversy when the district court ruled on the motion for preliminary injunction, we find that the district court acted well within its discretion and did not err in declining to hold an evidentiary hearing. We also conclude that, based on this record, the district court ***1303** properly found that McDonald's established all of the prerequisites necessary for a preliminary injunction. Consequently, we affirm.

I.

A detailed recitation of the operative facts is necessary to understanding our holding. McDonald's operates a well-known worldwide fast food business. Although it owns several of its own stores, McDonald's also sells franchises. By contract, all of McDonald's franchisees must operate their McDonald's restaurants in compliance with the "McDonald's System," a series of business practices and procedures employed, in part, to ensure uniform restaurant and food quality at all McDonald's locations.

A.

On September 1, 1971, the Robertsons acquired the McDonald's franchise restaurant located at 4227 Blanding Boulevard in Jacksonville, Florida. The Robertsons operated the Blanding Boulevard restaurant without incident for many years, and, on July 23, 1989, shortly before the parties' original franchise agreement was due to expire, the parties entered into a new twenty-year franchise agreement, consisting of a franchise letter agreement, a license agreement, and an operator's lease to the real property upon which the restaurant is located. Among other provisions, the 1989 license agreement required the Robertsons to operate their franchise in accordance with quality, safety, and cleanliness ("QSC") standards prescribed by the agreement and by McDonald's business and policy manuals. McDonald's QSC standards govern a wide array of its franchisees' business affairs, including, and of particular relevance to this case, the procedures to be followed in preparing, cooking, storing, and serving food, and the cleanliness and maintenance of the physical structure.

The franchise agreement plainly gave McDonald's the right to inspect the Robertsons' franchise "at all reasonable times" for compliance with McDonald's QSC standards. Additionally, it allowed McDonald's to terminate the contract if, among other contingencies, the Robertsons failed to operate the restaurant in compliance with McDonald's QSC standards. The franchise agreement and the lease contained cross-termination provisions under which, if the franchise agreement were terminated, the lease likewise would be terminated and McDonald's would receive a right to possession. Finally, the documents provided that the Robertsons would not acquire any interest in a restaurant business similar to that of McDonald's and within ten miles of the Robertsons' franchise for eighteen months after termination of the agreement.

B.

On October 3, 1997, McDonald's filed an amended complaint against the Robertsons, alleging claims for trademark infringement, dilution and false designation of origin in violation of the Lanham Act, misappropriation of trade secrets, and breach of the covenant not to compete. The amended complaint also sought a declaratory judgment terminating the franchise agreement and ejecting the Robertsons from the disputed premises. With its amended complaint McDonald's contemporaneously filed an application for a preliminary injunction. McDonald's supported this application, which sought preliminary injunctive relief on McDonald's trademark infringement and non-competition covenant claims, with the thirteen-page affidavit of Kathy Grass, a McDonald's Business Consultant in McDonald's Tampa Bay Region. Upon receiving McDonald's motion for preliminary injunction, the district court entered an order on October 6 scheduling the motion for a hearing on October 17 limited to oral argument. Additionally, the October 6 order stated, "Any materials the Defendants wish to submit in opposition to the Plaintiff's application must be filed with the Court by 5:00 p.m. on Thursday, October 16, 1997." The Robertsons filed a motion for expedited discovery and sought an evidentiary hearing on McDonald's motion for preliminary injunction. By order dated October 14, 1997, the district court denied both motions but ordered McDonald's to produce certain business manuals incorporated into the franchise agreement. On October 16,1997, the Robertsons filed their opposition to McDonald's motion for preliminary injunction. They opposed McDonald's motion with, among other materials, ***1304** the affidavit of Roger Robertson ("Robertson").

C.

Based on the affidavits of Grass and Robertson, as well as other relevant evidence, the record reveals the following undisputed facts. As a Business Consultant, Grass serves as the liaison between certain McDonald's franchisees and McDonald's and ensures that the franchisees consistently comply with McDonald's QSC standards. In her capacity as a McDonald's Business Consultant, Grass had conducted several QSC audits on the Robertsons' restaurant. Through 1994, McDonald's had rated the Robertsons' restaurant generally satisfactory in terms of QSC compliance.

On February 24, 1995, McDonald's conducted an unannounced food safety audit of the Robertsons' franchise. Notably, the audit disclosed that the Robertsons' restaurant was producing undercooked meat patties, meat patties showing pink or red interiors, and meat patties with an average internal temperature nine degrees below the internal temperature required by McDonald's to reduce the risk of bacteria. Additionally, the audit revealed that the Robertsons' restaurant had failed to complete and maintain daily food safety checklists in accordance with McDonald's standards, and it had failed to maintain the shake machine refrigeration temperature at 38 degrees or lower. McDonald's reviewed the findings of the inspection with Mr. Robertson and sent him a written summary of the results, advising him of the deficiencies and recommending corrective action.

Approximately one month later, on March 21, 1995, McDonald's conducted an announced follow-up audit. The Robertsons had failed to remedy some of the deficiencies identified in the February 24 food safety audit. The inspection also disclosed additional problems. Among others, the audit revealed the following: (1) cooked meat and poultry products were being held in staging cabinets at eight and three degrees below McDonald's prescribed temperatures, respectively, raising the risk of bacteria growth; (2) equipment, including a meat staging cabinet, was not maintained in good, clean, and operable condition and repair and in compliance with McDonald's standards; and (3) towels were not being sanitized.

On September 12, 1995, the Robertsons failed still another food safety audit.1 The auditors found several sanitation and food-handling violations, including the following: (1) the sundae machine refrigeration temperature was maintained twelve degrees above the maximum McDonald's recommended temperature, increasing the risk of bacteria growth; (2) the equipment was not kept in good, clean, and operable condition and repair (the sundae machine had bugs in it); and (3) the staff failed to maintain and use clean and sanitized towels in the grill area, thereby increasing the potential for cross-contamination. The Robertsons' restaurant also failed an audit for similar reasons on March 7, 1996. Among other deficiencies, this audit cited the Robertsons for failure to store raw vegetable, fish, and cheese products properly, failure to maintain equipment in a good, clean, and operable condition and repair, failure to maintain and monitor proper holding times for product, improper sanitation practices, which, McDonald's found, posed "serious public health concerns," failure to maintain various aspects of the restaurant in an acceptable condition, failure to maintain grill integrity, failure to maintain and use clean, sanitized towels in the grill and lobby areas, failure to meet finished product standards, and failure to provide timely customer service.

Twelve days later, on March 19, 1996, two McDonald's representatives visited the Robertsons and advised them that McDonald's had purchased property approximately one block away from their restaurant for the purpose of building a new restaurant. McDonald's told the Robertsons that the new location would be "much better" in terms of visibility, ease of access and physical condition.

On October 3, 1996, McDonald's conducted a "short restaurant visit" to the Robertsons' ***1305** restaurant. The Robertsons received their only passing grade since 1994—an overall mark of "C." The visit revealed no significant QSC problems.

On October 31, 1996, McDonald's offered the Robertsons the opportunity to close their restaurant and to take the franchise at the new location. Because of the increased rent and service fees applicable to the new franchise, the Robertsons declined the offer. In response to the Robertsons' concerns, McDonald's offered to guarantee the Robertsons' income at the new location up to $100,000 per year. The Robertsons also declined this offer. On December 11, 1996, McDonald's offered to purchase the Robertsons' franchise for $300,000. Again, the Robertsons refused.

On February 19, 1997, McDonald's conducted still another unannounced inspection of the Robertsons' restaurant. This audit disclosed many of the same deficiencies uncovered during earlier audits, including, among others, improper sanitation practices that posed "serious public health concerns." Additionally, McDonald's found that the Robertsons' store failed to store raw Canadian bacon and biscuit products properly. Also, the audit revealed that the walk-in refrigerator contained several items with expired freshness codes that should have been removed and destroyed. On March 3, after several unsuccessful attempts to reach Mr. Robertson by telephone, McDonald's provided Robertson with a written summary of the restaurant visit. Grass requested that the Robertsons design an action plan for improving operations. On April 18, 1997, McDonald's again undertook an unannounced visit of the Robertsons' restaurant. Once again McDonald's found numerous sanitation, hygiene, food-handling, and QSC violations. Indeed, Grass observed the same deficiencies identified during the February 19 visit. Grass testified in her affidavit that she asked Robertson whether he had created an action plan for improving operations, but he replied that he had not. Grass also discussed the Robertsons' failure to have a manager certified in food safety through successful completion of the McDonald's ServSafe (or equivalent) food safety course.

On May 28, 1997, McDonald's delivered a "Notice of Default" to the Robertsons, informing them that their continued failure to comply with QSC standards constituted a material breach of the franchise agreement. The notice provided the Robertsons with a cure period of sixty days. Additionally, it advised the Robertsons that McDonald's would conduct an unannounced comprehensive evaluation after the sixty-day period to determine whether the restaurant had achieved satisfactory QSC ratings and an acceptable evaluation of food safety. Finally, the notice provided that if McDonald's found that the Robertsons had raised the operating standards to comply with McDonald's minimum standards, the Robertsons would need to maintain satisfactory operations levels throughout the following twenty-four month period to cure the default.

During the sixty-day cure period, Grass visited the

Robertsons' store on two additional occasions. Both times she again observed numerous sanitation and other food safety violations. After the cure period expired, on August 26, 1997, along with other McDonald's employees, Grass visited the Robertsons' store to conduct an unannounced comprehensive graded restaurant evaluation. During this visit, McDonald's agents recorded, among others, the following violations: (1) undercooked meat patties and meat patties with an internal temperature thirteen degrees below the required internal temperature for the safe cooking of raw meat, increasing the risk of bacteria growth; (2) improper handling of raw eggs and the failure to sanitize utensils used in the preparation of egg product, creating the risk of salmonella and cross-contamination; (3) failure to use separate Hutzler color-coded spatulas for raw and cooked egg product, posing the risk of salmonella and cross-contamination; (4) routine use of bare and unwashed hands instead of sanitized serving tools to handle food products; (5) failure to supply clean and sanitized towels for use in the grill area; (6) failure to follow sanitary procedures for washing, rinsing, and sanitizing utensils; (7) storage of dishes in a rusted shopping cart; (8) failure to cover meat and chicken patties in the freezer, increasing the risk of freezer burn and cross-contamination; (9) failure to maintain a McNugget holding cabinet properly, which shut off without ***1306** warning or notice, creating the risk that cooked chicken would drop below its safe holding temperature; (10) failure to maintain the grill used in cooking meat patties, which shut off without warning or notice, posing the risk that meat patties would be undercooked; (11) failure to set the timer for the correct cooking time for meat patties, resulting in the preparation of undercooked meat patties; (12) failure to have a manager certified in the ServSafe food safety course; and (13) failure to meet other QSC standards, resulting in poor food quality and service. During the August 26 audit, McDonald's also performed an annual Playplace safety survey in which it reviewed the condition of the children's play area that was part of the Robertsons' restaurant. This inspection revealed the existence of exposed play structure piping that was not covered with padding, hard, sharp plastic tie-down strips on padding that were protruding, "very dirty" plastic balls in the children's ball crawl area, loose and torn netting throughout the structure, dirty and torn surface padding, and the presence of a free-standing unguarded eight-foot high pole. McDonald's concluded that these deficiencies posed risks to children of serious injury and strangulation.

On September 24, 1997, McDonald's sent the Robertsons a Notice of Franchise Termination, which advised the Robertsons that their franchise contract had been terminated, effective at the close of the restaurant on September 24. The Robertsons refused to surrender possession of the premises and continued to operate the restaurant as a McDonald's, using various trade names and trademarks registered to McDonald's.

Finally, in reviewing the uncontested facts, we note that in his affidavit, Robertson did not in any way contest the accuracy of the inspection findings. Rather, he contended that the alleged violations were not serious and that they served as a pretext for McDonald's real reason for ending the franchise agreement—that McDonald's wanted the restaurant to occupy the different and better space at the end of the block.

D.

At the hearing on October 17, McDonald's withdrew its request for injunctive relief on its claim for breach of the non-competition covenant. Instead, McDonald's focused on its trademark infringement claim. The district court found that McDonald's was entitled to the relief sought and entered a preliminary injunction enjoining the Robertsons from using any of McDonald's trademarks, trade names, service marks, and trade dress, using any signs or printed goods bearing McDonald's names and marks, occupying and operating the McDonald's restaurant premises located at 4227 Blanding Boulevard, and using, duplicating, or disclosing any of McDonald's materials received by operation of the franchise letter agreement. Additionally, the district court required the Robertsons to return all materials received by operation of the franchise letter agreement. Finally, the district court made the preliminary injunction effective upon the posting of a $300,000 bond by McDonald's. McDonald's posted the required bond. The Robertsons then appealed the orders of the district court.

II.

[1] We review a district court's order granting or denying a preliminary injunction for abuse of discretion. *See Baker v. Buckeye Cellulose Corp.*, 856 F.2d 167, 169 (11th Cir.1988) (citing *United States v. Jefferson County*, 720 F.2d 1511, 1519 (11th Cir.1983)).

A.

[2] [3] A district court may grant injunctive relief if the movant shows the following: (1) substantial likelihood of success on the merits; (2) irreparable injury will be suffered unless the injunction issues; (3) the threatened injury to the movant outweighs whatever damage the proposed injunction may cause the opposing party; and (4) if issued, the injunction would not be adverse to the public interest. *See All Care Nursing Service, Inc. v. Bethesda Memorial Hospital, Inc.,* 887 F.2d 1535, 1537 (11th Cir.1989) (citing *Baker,* 856 F.2d at 169 (citing *Jefferson County,* 720 F.2d at 1519)). In this Circuit, "[a] preliminary injunction is an extraordinary and drastic remedy not to be granted unless the movant clearly established the 'burden of persuasion' " as to the four requisites.2 *Id.* (citations omitted). The ***1307** Robertsons challenge the district court's findings only as they relate to the likelihood of success on the merits and the threat of irreparable injury.3 We therefore address each in turn.

1. *Likelihood of Success on the Merits*

[4] McDonald's probability of success on the merits at trial depends on the validity of its trademark infringement claim. This Circuit has held that in order to prevail on a trademark infringement claim, a plaintiff must show that its mark was used in commerce by the defendant without the registrant's consent and that the unauthorized use was likely to deceive, cause confusion, or result in mistake. *See Burger King Corp. v. Mason,* 710 F.2d 1480, 1491 (11th Cir.1983) (citing 15 U.S.C. § 1114(1)(a)), *cert. denied,* 465 U.S. 1102, 104 S.Ct. 1599, 80 L.Ed.2d 130 (1984). Our research, however, has not revealed any case where this Court has addressed the appropriate preliminary injunction standard for evaluating whether the defendant acted without the registrant's authorization where the defendant is a franchisee who claims that the registrant unlawfully terminated its franchise agreement.

Other Circuits, as well as district courts in this Circuit, however, have considered the question. In *S & R Corp. v. Jiffy Lube International, Inc.,* 968 F.2d 371 (3d Cir.1992), for example, the Third Circuit reviewed a district court's denial of a preliminary injunction against a Jiffy Lube franchisee. Alleging that the franchisor had breached its contractual obligations to maintain the quality of its other franchises in the area, the franchisee had stopped paying royalties to Jiffy Lube but had continued to operate its stores under the name "Jiffy Lube." The franchisee filed suit against Jiffy Lube, claiming breach of the franchise agreements. Concurrently, because of the franchisee's failure to pay royalties, Jiffy Lube instituted franchise agreement termination proceedings against the franchisee's three stores. Jiffy Lube then filed a motion for preliminary injunctive relief against the franchisee, seeking to prevent the franchisee from further use of its trademark. The district court denied Jiffy Lube's motion because it concluded that the termination dispute between the parties precluded a determination of Jiffy Lube's likelihood of success on the merits. The Third Circuit found that the district court erred in failing to address the termination dispute and held that a franchisor's right to terminate a franchisee exists independently of any claims the franchisee might have against the franchisor. Thus, the Third Circuit found, a franchisor is entitled to preliminary injunctive relief "if it can adduce sufficient facts indicating that its termination of [the franchisee's] franchises was proper." *Id.* at 375.

In *Computer Currents Publishing Corp. v. Jaye Communications, Inc.,* 968 F.Supp. 684 (N.D.Ga.1997), the district court considered a case where a magazine publisher brought a trademark infringement action against a former licensee and sought a preliminary injunction enjoining the former licensee from using the magazine publisher's trademarks. Citing *Jiffy Lube,* the court held, "[I]n order to satisfy the first prerequisite for a preliminary injunction [likelihood of success on the ***1308** merits], plaintiffs must demonstrate that, under the terms of the Agreement, they were entitled to terminate the Agreement immediately based on defendant's conduct." *Id.* at 688.

In *Burger King Corp. v. Hall,* 770 F.Supp. 633 (S.D.Fla.1991), however, another district court in this Circuit found the question of alleged wrongful franchise contract termination irrelevant to a motion for preliminary injunction seeking to enjoin a former franchisee from continuing to use the franchisor's trademarks. Rather, the court determined, "[A] terminated franchisee's remedy for wrongful termination is an action for money damages, and not the continued unauthorized use of its franchisor's trademarks." *Id.* at 638. For support, this opinion, which was issued prior to, and thus, without the benefit of *Jiffy Lube,* relied on *Burger King Corp. v. Austin,* Case, 805 F.Supp. 1007 (S.D.Fla.1990), and *Cle–Ware Rayco, Inc. v. Perlstein,* 401 F.Supp. 1231, 1234 (S.D.N.Y.1975). *Cle–Ware Rayco,* in turn, simply found that the franchisee's argument that his compliance with the franchise agreement was excused by the franchisor's prior alleged breach of the franchise agreement "has little relevance on [sic] the immediate question of whether the defendant can continue to use the [trademark]." *Id.* at 1234.

[5] In considering this issue for the first time, we find that the Lanham Act's requirement that a franchisor demonstrate that *unauthorized* trademark use occurred to prevail on the merits of a trademark infringement claim against a franchisee necessitates some type of showing that the franchisor properly terminated the contract purporting to authorize the trademarks' use, thus resulting in the *unauthorized* use of trademarks by the former franchisee. Consequently, we are persuaded by the Third Circuit's analysis and conclude that the district court correctly required McDonald's to make a showing that it properly terminated the franchise agreement.

[6] We further find that the district court correctly concluded on the record before it that McDonald's had made a substantial showing of a likelihood of success on the merits of its claim. The record reflects that the parties did not disagree that McDonald's had conducted numerous inspections of the Robertsons' restaurant. And Robertson acknowledged that these evaluations "questioned the procedures involving cleaning, sanitizing and procedural control," Robertson Aff. ¶ 5, and that he "had a few QSC Reports in 1995 that McDonald's alleged did not meet its standards." Robertson Aff. ¶ 6. He further did not contest the fact that the audits in 1996 and 1997 turned up additional deficiencies. Indeed, nothing in Robertson's affidavit alleged that McDonald's findings during these visits were not accurate.4 The closest Robertson's affidavit came to suggesting that the inspection findings were fabricated or exaggerated was the statement, "I became increasingly surprised by these findings, since I was operating my restaurant in the same manner and according to the same high standards for food, safety, and service that I had maintained for the past twenty six years as a McDonald's owner/operator." Robertson Affidavit at ¶ 17. Even this statement, however, does not amount to a denial of McDonald's allegations that the Robertson's restaurant failed to meet McDonald's QSC standards during numerous visits by McDonald's. Moreover, the statement is contradicted by McDonald's food safety audit findings in 1995 and 1996, which the Robertsons do not dispute, that the Robertsons' restaurant had some serious food safety problems well before McDonald's proposed moving the Robertsons' restaurant.

[7] [8] Robertson instead focuses on the fact that McDonald's sought to secure his agreement to move to a new location, and the Robertsons rejected the offer. Thus, Robertson suggests, although the food safety issues identified by the numerous inspections ***1309** and audits were really not that important to McDonald's, McDonald's nonetheless used the Robertsons' alleged food safety deficiencies as "an excuse" for terminating the Robertsons' franchise agreement because McDonald's wanted to make more money by moving the Robertsons' McDonald's to another nearby location. Even assuming, *arguendo,* that this allegation is correct, however, we find that the Robertsons' failure to comply with McDonald's QSC and food safety standards constituted a material breach of the franchise agreement sufficient to justify termination, and thus, it does not matter whether McDonald's also possessed an ulterior, improper motive for terminating the Robertsons' franchise agreement. *See Original Great American Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd.,* 970 F.2d 273, 279 (7th Cir.1992) (citing *Patton v. Mid–Continent Systems, Inc.,* 841 F.2d 742, 750 (7th Cir.1988)) ("The fact that the Cookie Company may ... have treated other franchisees more leniently is no more a defense to a breach of contract than laxity in enforcing the speed limit is a defense to a speeding ticket.... Liability for breach of contract is strict."). Indeed, "a franchisor's right to terminate a franchisee exists independently of any claims the franchisee might have against the franchisor. The franchisor has the power to terminate the relationship where the terms of the franchise agreement are violated." *Jiffy Lube,* 968 F.2d at 375.

In the instant case, the district court correctly found preliminarily that the repeated alleged and unchallenged violations of McDonald's QSC and food safety standards resulted in a material breach of the franchise agreement by the Robertsons. First, in the franchise contract, the Robertsons agreed that "[t]he foundation of the McDonald's System and the essence of [the franchise contract] is the adherence by [the Robertsons] to standards and policies of [McDonald's] providing for the uniform operation of all McDonald's restaurants within the McDonald's System." They also acknowledged the importance of uniformity of food specifications, preparation methods, quality and appearance, facilities, and service. The QSC and food safety standards produced by McDonald's constitute some of the "standards and policies" with which McDonald's franchisees must comply. Thus, continued violation of these standards appears to constitute a material breach of the franchise agreement. Moreover, as the district court noted, as a world-wide fast food chain, McDonald's has a clear interest in securing a uniform product and service of high quality at all of its locations. McDonald's also has a strong legal interest in avoiding disputes stemming from the cleanliness and safety of its products. Accordingly, there can be no real doubt that repeated and continued serious violations5 of the QSC and safety standards, such as those alleged by McDonald's and unchallenged by the Robertsons, constituted material breaches of the franchise agreement warranting termination. Thus, the district court correctly found that McDonald's had a substantial likelihood of succeeding on the merits of its trademark infringement claim, as there was no dispute that the Robertsons continued to use the McDonald's trademarks, and that such use was unauthorized and was likely to have resulted in confusion.

2. *Irreparable Injury*

[9] The Robertsons also contend that the district court erred in finding irreparable injury because, in other types of actions, district courts in this Circuit have held that loss of goodwill does not constitute irreparable injury. The Robertsons also argue that any harm considered by the district court was speculative, and thus, not sufficiently concrete to warrant entry of a preliminary injunction. Again, we disagree.

First, the cases the Robertsons cite from the district courts in this Circuit do not compel the conclusion the Robertsons propound. In *Salsbury Lab., Inc. v. Merieux Lab., Inc.,* 735 F.Supp. 1537 (M.D.Ga.1987), for example, a former lab employee allegedly improved upon the plaintiff lab's vaccine formula, which was a trade secret. The plaintiff ***1310** lab sought to enjoin the defendant lab from continuing to use the improved vaccine, alleging that it would suffer lost profits and damage to its reputation. The district court found that these contentions did not state irreparable harm. The instant case is substantially different. Whereas the plaintiff in *Salsbury* stood to suffer injury as a result of competition from another lab that allegedly misappropriated trade secrets, an injury that could be compensated fully by looking to the defendant lab's profits, McDonald's faces damage to its own reputation and loss of customers caused by the Robertsons' distribution of an allegedly inferior (and possibly dangerous) product held out to be McDonald's. Customers would believe that they were eating McDonald's sanctioned products when they consumed improperly cooked and unsanitarily maintained food products from the Robertsons' store. We can conceive of no realistic way to determine the damages under these circumstances.

Moreover, trademark actions "are common venues for the issuance of preliminary injunctions," *Foxworthy v. Custom Tees, Inc.,* 879 F.Supp. 1200, 1219 (N.D.Ga.1995) (citation omitted), and this Circuit has held that "a sufficiently strong showing of likelihood of confusion [caused by trademark infringement] may by itself constitute a showing of ... [a] substantial threat of irreparable harm."6 *E. Remy Martin & Co. v. Shaw–Ross Int'l Imports,* 756 F.2d 1525, 1530 (11th Cir.1985); *see also Power Test Petroleum Distributors v. Calcu Gas,* 754 F.2d 91, 95 (2d Cir.1985) (Irreparable harm exists in a trademark case when the moving party "shows that it will lose control over the reputation of its trademark pending trial."); *Foxworthy,* 879 F.Supp. at 1219 ("When a plaintiff makes a *prima facie* showing of trademark infringement, irreparable harm is ordinarily presumed.") (citation omitted). Obviously, in this case, such a substantial likelihood of confusion—indeed, a certainty of confusion—of the Robertsons' substandard products with McDonald's certified products exists. Consequently, the district court correctly concluded that McDonald's made a sufficient showing of irreparable injury to justify entry of the preliminary injunction.

Finally, the Robertsons' citation of a laundry list of cases purportedly supporting their contention that McDonald's claimed harm was speculative and thus insufficient to constitute irreparable injury, is inapposite. For example, the Robertsons cite *Church v. City of Huntsville,* 30 F.3d 1332, 1337 (11th Cir.1994), for the proposition that "a party has standing to seek injunctive relief only if the party alleges, and ultimately proves, a real and immediate—as opposed to a merely conjectural or hypothetical—threat of *future* injury." *Church* involved a challenge by Huntsville's homeless population to certain alleged policies of the city resulting in the arrest and harassment of homeless individuals merely because they were homeless. The Court considered the question of whether homeless individuals who had not been arrested or harassed had standing to challenge the alleged policy. In that context, the Court made the statement quoted above. Quite simply, *Church* is not relevant here. There has never been any doubt that McDonald's has standing to file suit against the Robertsons and to seek a preliminary injunction against them. In short, we find that the district court did not abuse its discretion in entering the preliminary injunction against the Robertsons.

B.

[10] Nor do we find that the district court's decision not to conduct an evidentiary hearing on the motion for preliminary injunction warrants reversal.7 As we noted previously, ***1311** the district court entered the challenged preliminary injunction without first holding an evidentiary hearing. Rather, the district court considered the written materials submitted and conducted oral argument on the motion. Citing Rule 65(a), Fed.R.Civ.P., the Robertsons appeal the district court's decision not to conduct an evidentiary hearing. Specifically, they contend that the district court was required to hold an evidentiary hearing for two independent reasons: (1) "conflicting material record evidence exist[ed]," and (2) the district court allegedly determined that a presumption of irreparable harm existed, thus necessitating an evidentiary hearing.

In making their argument, the Robertsons first note that Rule 65(a)(1), Fed.R.Civ.P., provides, in relevant part, "No preliminary injunction shall be issued without notice to the adverse party." They then cite to a footnote in *Granny Goose Foods, Inc. v. Brotherhood of Teamsters,* 415 U.S. 423, 94 S.Ct. 1113, 39 L.Ed.2d 435 (1974), for the proposition that "[t]he notice required by Rule 65(a) before a preliminary injunction can issue implies a hearing in which the defendant is given a fair opportunity to oppose the application and to prepare for such opposition." Appellants' Initial Br. at 29 (citing *Granny Goose,* 415 U.S. at 432 n. 7, 94 S.Ct. 1113). Finally, they argue that "a fair opportunity to oppose the application" necessitates an evidentiary hearing, as opposed to the type of "hearing" the district court held in the instant case. *Id.* at 29.

Several problems with the Robertsons' argument exist. First, *Granny Goose* does not stand for the proposition that all opponents of preliminary injunctions are entitled to evidentiary hearings. Rather, as stated above, the purpose of Rule 65's notice requirement is to provide the party opposing the preliminary injunction with a "fair opportunity to oppose the application and to prepare for such opposition." *Granny Goose,* 415 U.S. at 432 n. 7, 94 S.Ct. 1113. So long as these goals are met, Rule 65 does not require an evidentiary hearing. Indeed, if the Robertsons were correct, no preliminary injunction could ever issue without an evidentiary hearing. This is plainly wrong. *See All Care Nursing Service, Inc. v. Bethesda Memorial Hospital, Inc.,* 887 F.2d 1535, 1538 (11th Cir.1989) ("An evidentiary hearing is not always required before issuance of a preliminary injunction.").

We consider, therefore, the circumstances under which an evidentiary hearing under Rule 65 is necessary. Previously, we have stated, "Where the injunction turns on the resolution of bitterly disputed facts, ... an ***1312** evidentiary hearing is normally required to decide credibility issues." *All Care Nursing Service,* 887 F.2d at 1538 (citing *Forts v. Ward,* 566 F.2d 849, 851 (2d Cir.1977)). In *All Care Nursing Service,* the plaintiffs, several temporary nursing agencies, filed suit against the defendant hospitals and other health care providers. The parties agreed that a nationwide shortage of nurses existed at the time. Thus, the defendants decided to develop a program under which certain of the temporary service agencies would be designated "preferred agencies." Each participating hospital agreed to give first consideration to the preferred agencies in the staffing of temporary nurses. Among other bases for determining which agencies would be "preferred," the defendant hospitals strongly considered price. Additionally, the agencies had to agree to rebate a percentage of their gross yearly income to the defendants and not to compete with the hospitals in the hiring of nurses. The plaintiff nursing agencies sued for alleged violations of the Sherman Act and sought and received a preliminary injunction enjoining the defendants from establishing maximum price standards to which agencies must adhere, from substantially interfering with the management or manner in which the individual agencies employ their nurses, and from requiring them to contribute any portion of their income in order to be considered as providers of temporary nurses. Before entering the injunction, the district court provided the defendants with two days' notice of the hearing, in which only oral argument was permitted. Additionally, the district court permitted the parties to file written affidavits and submissions in support of their respective positions. We determined that the trial court abused its discretion in failing to hold an evidentiary hearing because the parties had submitted conflicting affidavits that "placed in serious dispute issues central to appellees' claims." *All Care Nursing Service,* 887 F.2d at 1539. Additionally, in recognition of the complexity of the facts and the number of parties before the court in *All Care Nursing Service,* we stated, "A two-day notice, coupled with thirty minutes for oral presentations can hardly be said to constitute a meaningful opportunity to oppose appellees' motion for preliminary injunction. The court thus determines that under the facts of this case appellants were deprived of a fair and meaningful opportunity to oppose appellees' motion." *Id.* at 1538.

[11] [12] Conversely, in *Kaimowitz v. Orlando,* 122 F.3d 41 (11th Cir.1997), *amended,* 131 F.3d 950 (11th Cir.1997), we held that the district court did not err in declining to hold an evidentiary hearing on the plaintiff's motion for preliminary injunction where the preliminary injunction sought bore no relationship whatsoever to the underlying action. Because this recital effectively exhausts this Court's jurisprudence on the question of when it is necessary to hold an evidentiary hearing on a motion for preliminary injunction, we have considered cases from other Circuits for additional guidance. Based on review of these cases, certain principles are apparent. First, as noted in *All Care Nursing Service,* where facts are bitterly contested and credibility determinations must be made to decide whether injunctive relief should issue, an evidentiary hearing must be held. *See All Care Nursing Service,* 887 F.2d 1535; *Forts v. Ward,* 566 F.2d 849, 851 (2d Cir.1977) (quoting *Dopp v. Franklin National Bank,* 461 F.2d 873, 879 (2d Cir.1972) (quoting *Sims v. Greene,* 161 F.2d 87, 88 (3d Cir.1947))) (" 'Generally, of course, a judge should not resolve a factual dispute on affidavits or depositions, for then he is merely showing a preference for "one piece of paper to another." ' "); *Campbell Soup Co. v. Giles,* 47 F.3d 467, 470 (1st Cir.1995) (quoting *SEC v. Frank,* 388 F.2d 486, 491 (2d Cir.1968)) ("[W]hen the parties' competing versions of the pertinent factual events are in sharp dispute, such that the propriety of injunctive relief hinges on determinations of credibility, 'the inappropriateness of proceeding on affidavits [alone] attains its maximum.' "); *Elliott v. Kiesewetter,* 98 F.3d 47, 53 (3d Cir.1996) (citing *Professional Plan Examiners* *of New Jersey, Inc. v. Lefante,* 750 F.2d 282, 288 (3d Cir.1984)) ("A district court cannot issue a preliminary injunction that depends upon the resolution of disputed issues of fact unless the court first holds an evidentiary hearing."); *Ty, Inc. v. GMA Accessories, Inc.,* 132 F.3d 1167, 1171 (7th Cir.1997) (citing *Medeco Security Locks, Inc. v. Swiderek,* 680 F.2d 37, 38 (7th Cir.1981)) ("If genuine issues of material fact are created by the ***1313** response to a motion for a preliminary injunction, an evidentiary hearing is indeed required."). Second, where material facts are not in dispute, or where facts in dispute are not material to the preliminary injunction sought, district courts generally need not hold an evidentiary hearing. *See Maryland Casualty Co. v. Realty Advisory Board on Labor Relations,* 107 F.3d 979, 984 (2d Cir.1997); *Elliott,* 98 F.3d at 53–54 (quoting *Bradley v. Pittsburgh Board of Ed.,* 910 F.2d 1172, 1175–76 (3d Cir.1990)) (" '[A] decision [to enter an order] may be based on affidavits and other documentary evidence if the facts are undisputed and the relevant factual issues are resolved.' "); *Ty, Inc.,* 132 F.3d at 1171 ("[A]s in any case in which a party seeks an evidentiary hearing, he must be able to persuade the court that the issue is indeed genuine and material and so a hearing would be productive....").

Between these extremes falls the category of cases where " 'there is little dispute as to raw facts but much as to the inferences to be drawn from them.' " *Jackson v. Fair,* 846 F.2d 811, 819 (1st Cir.1988) (quoting *Frank,* 388 F.2d at 490–91). Thus, the First Circuit has adopted an approach to determine whether an evidentiary hearing is necessary that "leave [s] the balancing between speed and practicality versus accuracy and fairness to the sound discretion of the district court." *Id.* In *Jackson,* the plaintiff, a prisoner who had been released from a mental hospital to corrections officials, filed a motion for a preliminary injunction requiring him to be sent back to the mental hospital in which he had previously been incarcerated. The court noted that the parties did not dispute the basic events; they agreed, for example, that the plaintiff had swallowed a bedspring after his transfer from the mental hospital to the corrections facility. They characterized the degree of the plaintiff's illness differently, however, and they disagreed over whether the corrections facility offered adequate care. The court found that although these questions were factual, they could best be answered by witnesses with medical expertise. Noting that the plaintiff had failed to identify at the preliminary injunction stage what evidence he planned to offer that might dispute the defendants' documentary evidence, the court held that the district court did not err in declining to hold an evidentiary hearing.

[13] We find based on the record here that this case falls into the second category of cases identified above—that is, material facts are not in dispute, or the disputed facts are not material to the preliminary injunction sought. In this case no real controversy exists over whether the Robertsons engaged in repeated QSC and food safety violations. Because these violations constituted a material breach of the franchise agreement sufficient to justify termination, we conclude that no evidentiary hearing was required in this matter. The Robertsons had ten days to provide affidavits and other evidence showing a material issue of fact regarding whether the Robertsons' restaurant actually had committed the infractions described by McDonald's. Thus, they had sufficient and fair notice. Rather than contending that they had not engaged in unsanitary QSC and food safety procedures, however, the Robertsons conceded the violations and argued that the termination was instead motivated by McDonald's desire to open a new restaurant down the block. Because any ulterior, improper motive McDonald's may have had to terminate the contract is irrelevant where a legitimate reason for doing so exists under the contract, the Robertsons' filing created no material issues of fact relating to the propriety of entering the injunction and was therefore insufficient to warrant an evidentiary hearing.

Additionally, the Robertsons contend that the district court presumed irreparable injury, so, under this Court's precedent, it was therefore required to conduct an evidentiary hearing. We note that the Robertsons did not raise this issue below. Consequently, their argument fails. *See Royals v. Tisch,* 864 F.2d 1565, 1568 n. 6 (11th Cir.1989).

[14] Nevertheless, even if the Robertsons had timely raised this point, it would lack merit. First, the holding in *Baker v. Buckeye Cellulose Corp.,* 856 F.2d 167 (11th Cir.1988), the case on which the Robertsons principally rely in making this argument, is, by its own language, limited to the facts of that case. In *Baker,* the plaintiff, who alleged violations of Title VII against her employer, ***1314** sought a preliminary injunction against her employer barring the employer from engaging in certain actions the plaintiff viewed as retaliatory. Without a hearing of any type, the district court denied the preliminary injunction because it found that the plaintiff had failed to make a showing of irreparable injury. This Court reversed, finding that irreparable injury is presumed in Title VII cases in this Circuit. Although the Court made the general statement, "[W]here there is a presumption of irreparable harm, as in this case, the court should conduct an evidentiary hearing before granting or denying the motion," *id.* at 169, the opinion nonetheless evinces an intent to limit the holding to the facts of the case. Indeed, even after stating that irreparable harm is presumed in Title VII cases, the Court stated, "*On the facts of this case,* we hold that the district court erred in not conducting an evidentiary hearing to determine whether [the defendant] could overcome [the] presumption [of irreparable injury], or whether [the plaintiff] had met the other requirements...."8 *Id.* at 169 (emphasis added).

Baker is also distinguishable from the case at hand. In *Baker,* the district court failed to enter a preliminary injunction, apparently based solely on the plaintiff's failure to prove irreparable harm. *Baker,* 856 F.2d at 170. In the instant case, however, the district court did not presume irreparable injury; rather, it actually found irreparable harm, noting, "There is no present dispute concerning the probability that consumers will confuse the Plaintiff's products with those presently served by the Defendants—the parties are using identical trademarks. Where, as here, the likelihood of confusion is particularly strong, the loss of reputation, trade and goodwill potentially flowing from the continued infringement justifies a *finding of irreparable injury.*" District Court Order at 10 (emphasis added). Thus, the district court was not required to hold an evidentiary hearing.

III.

We therefore conclude that the district court did not err in denying the Robertsons' motion for evidentiary hearing and in granting McDonald's motion for preliminary injunction. Accordingly, the judgment of the district court must be, and is, AFFIRMED.

CARNES, Circuit Judge, concurring specially:

I join all of the Court's well written and persuasive opinion in this case, except the part about whether a franchisor seeking to have a franchisee enjoined from continuing to use a trademark under a now terminated agreement must show that its termination of the agreement was proper. Resolution of that issue of first impression in this circuit is not necessary to the disposition of this appeal. As the Court holds, this franchisor has shown (or made a substantial showing, which is the applicable standard at this stage) that it was within its rights to terminate the agreement. Given that holding, it matters not at all to the disposition of this appeal whether a franchisor must show proper termination in order to be entitled to stop the franchisee's continuing use of a trademark, i.e., we need not decide what we might have done if the termination had been improper. Accordingly, all of the Court's comments about that issue are dicta. *See, e.g., United States v. Eggersdorf,* 126 F.3d 1318, 1322 n. 4 (11th Cir.1997); *United States v. Maza,* 983 F.2d 1004, 1008 n. 8 (11th Cir.1993).

Dicta has its place and serves some purposes. *See, e.g., Combs v. Plantation Patterns,* 106 F.3d 1519, 1524, 1527, 1532–38 (11th Cir.1997) (using dicta in an attempt to clarify confusion caused by dicta in another ***1315** opinion, but leaving it up to the reader to decide if the attempt was successful), *cert. denied,* 522 U.S. 1045, 118 S.Ct. 685, 139 L.Ed.2d 632 (1998). Somewhat like statements in a law review article written by a judge, or a judge's comments in a lecture, dicta can be used as a vehicle for offering to the bench and bar that judge's views on an issue, for whatever those views are worth. The persuasiveness of the rationale given can increase the weight accorded those views, but the fact that the views are formed and put forward in a context of a case in which they do not matter will always subtract from the weight given them.

It is the nature of judges, like most human beings, to be more cautious, deliberative, and judicious—characteristics that should be brought to bear in deciding important issues—when what they say makes a difference to someone before them. It is one thing to offer a view on an abstract or hypothetical question, to put forward a speculative comment, but quite another to decide an issue that will affect the competing interests of the parties in an actual case before the court. Deciding real issues presented by real parties in real time focuses judicial decision making in ways that making speculative pronouncements about hypothetical questions cannot.

Views expressed in dicta are less reliable than those embodied in holdings for another reason. Unlike judicial holdings, dicta does not carry with it the added assurance of having survived what for the judiciary amounts to a kind of peer review. Dicta in a panel decision may be subject to comment, criticism, or disapproval by another member of that same panel, but it is effectively insulated from en banc or Supreme Court review. No matter how strongly other members of the Court are convinced that a panel's dicta is wrong, any suggestion that the whole Court grant rehearing to correct it will be met, quite properly, with the response that it is only dicta, that the issue addressed is not actually presented, and so it would be an improper use of en banc resources to examine and comment upon it. *See* Fed. R.App. P. 35(a) (en banc rehearing is not favored and should not be ordered except when necessary for uniformity of decisions or when a question of exceptional importance is involved). Much the same is true of review by the Supreme Court, which grants certiorari only to review lower court holdings that are essential to the judgment in a case. *See, e.g., Rogers v. United States,* 522 U.S. 252, 118 S.Ct. 673, 677, 139 L.Ed.2d 686 (1998) (dismissing as improvidently granted

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a writ of certiorari because the issue upon which it was granted was not fairly presented by the record); *Ticor Title Ins. Co. v. Brown,* 511 U.S. 117, 121, 114 S.Ct. 1359, 1361–62, 128 L.Ed.2d 33 (1994) (dismissing writ as improvidently granted where "it is not clear that our resolution of the constitutional question will make any difference even to these litigants").

For these reasons, among others, dicta in our opinions is not binding on anyone for any purpose. Because of considerations having to do with the first word in that court's name, Supreme Court dicta may be a different matter insofar as "inferior courts" such as our own and the district courts are concerned. *See, e.g., United States v. City of Hialeah,* 140 F.3d 968, 974 (11th Cir.1998); *Peterson v. BMI Refractories,* 124 F.3d 1386, 1392 (11th Cir.1997) ("Dicta from the Supreme Court is not something to be lightly cast aside."). But dicta in our opinions cannot establish either the law of the circuit, or even the law of the case. *See, e.g., United States v. Dayton,* 981 F.2d 1200, 1202 (11th Cir.1993); *Great Lakes Dredge & Dock Co. v. Tanker Robert Watt Miller,* 957 F.2d 1575, 1578 (11th Cir.1992).

As the Court's opinion in this case points out, the two district courts in this circuit that have addressed (in published opinions) the issue in question have reached opposite conclusions concerning it. That might tempt us to express our views on the subject in order to "provide guidance," but we cannot decide in this appeal which district court's view is the correct one. We can decide nothing more than that which is necessary to decide this appeal. Moreover, that two district court judges have differed over the question establishes it is one which is sufficiently difficult to cause reasonable jurists to disagree, and that argues in favor of withholding our views until the issue is squarely presented in ***1316** an appeal which depends upon resolution of the issue.

Whether to include in an opinion dicta on related but unnecessary issues is a matter within the sound discretion of each judge, to be exercised on a case by case basis, and I intend no criticism of my two colleagues in this instance. Instead, I have written separately to explain why I have chosen not to join their dicta.

Parallel Citations

41 Fed.R.Serv.3d 455, 47 U.S.P.Q.2d 1545, 11 Fla. L. Weekly Fed. C 1676

Footnotes

* Honorable Richard Mills, Senior U.S. District Judge for the Central District of Illinois, sitting by designation.

1 Failure of a food safety audit denotes failure to meet McDonald's minimum operational standards.

2 The Robertsons argue that the preliminary injunction entered in this case altered the *status quo* and thus was a mandatory injunction. Appellants' Initial Br. at 15–16; Appellants' Reply Br. at 1–4. They cite *Martinez v. Mathews,* 544 F.2d 1233, 1243 (5th Cir.1976), for the proposition, "Mandatory preliminary relief, which goes well beyond simply maintaining the status quo pendente lite, is particularly disfavored, and should not be issued unless the facts and law clearly favor the moving party." Appellants' Reply Br. at 3. The Robertsons' attempt to characterize as mandatory the injunction at issue, which prohibits the Robertsons from operating the Blanding Boulevard restaurant and from using McDonald's trademarks, is incorrect. Nor do any of the cases the Robertsons cite tend to support their contention that the injunction is a mandatory one. Rather, the preliminary injunction here falls into the category of prohibitory injunctions. *See Meghrig v. KFC Western, Inc.,* 516 U.S. 479, 116 S.Ct. 1251, 134 L.Ed.2d 121 (1996) (stating that a mandatory injunction orders a party to "take action" and a prohibitory injunction "restrains" a party from further action).

3 Citing the possibility of harm to the public resulting from the possible consumption of an unsafe product, the district court found that the balance of harms and the public interest favored entering the preliminary injunction. Although the Robertsons do not voice objections to these conclusions, we nonetheless note in passing that the record amply supports the district court's finding.

4 During the oral argument on the motion for preliminary injunction, the district court asked counsel for the Robertsons to cite the portion of the affidavit disagreeing with the accuracy of the inspection reports. Counsel conceded, "We didn't make that crystal clear in the affidavit." He attempted to save his case by continuing, "I mean we'll do so now.... I'll state unequivocally, the Robertsons dispute the accuracy of those findings." Because attorneys' statements at oral argument do not constitute record evidence, the only evidence in the record does not deny McDonald's contentions that the Robertsons' restaurant experienced numerous deficiencies.

5 While the Robertsons argue that the alleged violations were not "serious," it is difficult for the Court to conceive of substantially more serious violations than those that could jeopardize the health of the Robertsons' patrons, such as the cited undercooking of meat patties, practices resulting in possible cross-contamination of food products, and the presence of bugs in the food preparation

equipment.

6 Indeed, in a different section of their brief, the Robertsons concede "that once the District Court concluded that McDONALD'S had proven that it was reasonably likely to succeed on its trademark infringement claim, the District Court should have presumed that irreparable injury existed." Appellants' Initial Br. at 36 n. 6.

7 McDonald's contends that this Court lacks jurisdiction to review the district court's denial of the Robertsons' request for an evidentiary hearing. Specifically, they argue that the October 14 order denying the evidentiary hearing on the preliminary injunction motion is not a final order, and, as an order issued separately from the order entering the preliminary injunction, is distinct from the preliminary injunction and not reviewable as a part thereof. We find no merit to this argument. First, there can be no doubt that the Court has jurisdiction over the appeal of the order entering the preliminary injunction. Indeed, even McDonald's concedes that 28 U.S.C. § 1292(a)(1) authorizes such an appeal. Appellee's Br. at ix. Second, the order granting the preliminary injunction is obviously inextricably intertwined with the order denying an evidentiary hearing on the preliminary injunction. We cannot fully address the question of whether the district court erred in granting the preliminary injunction without considering whether the district court was bound to conduct an evidentiary hearing. That the district court delivered its rulings in two different documents does not, as McDonald's suggests, necessarily render the orders unrelated. Indeed, it is difficult to conceive of what other period would constitute the appropriate time to appeal the order denying the evidentiary hearing on the preliminary injunction if not during the appeal of the order granting the preliminary injunction. Nor does *Gould v. Control Laser Corp.*, 650 F.2d 617 (5th Cir. Unit B 1981), the case McDonald's cites in support of the proposition that the Court does not have jurisdiction over the October 14 order, prevent the Court from exercising jurisdiction over the denial of the evidentiary hearing. Specifically, McDonald's cites to footnote 7 of that case, which states, in relevant part, "A litigant's right to appeal interlocutory injunctions only goes to the injunction itself, and he cannot force consideration of the merits of the underlying case except as necessary to review the injunction.... It is true that in reviewing interlocutory injunctions we may look to otherwise nonappealable aspects of the order, ... but we cannot examine the merits of the summary judgments at this time...." Plainly, this footnote does not bar the Court from considering the denial of the evidentiary hearing along with its review of the entry of the preliminary injunction. Indeed, the language of the footnote itself supports the proposition that the ruling on the evidentiary hearing may be considered along with the entry of preliminary injunction. Moreover, this Court has plainly stated, "[T]he scope of the court's jurisdiction [on appeal of a preliminary injunction] is limited to matters directly related to the [grant] of injunctive relief." *Kaimowitz v. Orlando,* 122 F.3d 41, 43 (11th Cir.), *amended,* 131 F.3d 950 (11th Cir.), *cert. denied,* 523 U.S. 1138, 118 S.Ct. 1842, 140 L.Ed.2d 1092 (1998). For the reasons already noted, denial of the motion for evidentiary hearing on the motion for preliminary injunction is "directly related to the [grant] of injunctive relief." *Id.* Consequently, we reject McDonald's jurisdictional argument and proceed to the merits of the Robertsons' claim that they were entitled to an evidentiary hearing.

8 The Robertsons also cite to *Kaimowitz v. Orlando,* 122 F.3d 41, *amended,* 131 F.3d 950 (11th Cir.1997). It likewise fails to support the Robertsons' contention that the district court was required to hold an evidentiary hearing where the district court had presumed irreparable injury. The Court recently amended the original opinion in *Kaimowitz* to delete the sentence on which the Robertsons rely. Specifically, the sentence in question previously read, "Generally, evidentiary hearings are required prior to the issuance or denial of a motion for preliminary injunction only where there is a presumption of irreparable harm, as in a Title VII employment discrimination case." The sole authority relied upon for this deleted statement was *Baker.* Consequently, we disagree with the Robertsons' contention that this Circuit has held that in all cases where irreparable harm is to be presumed, an evidentiary hearing must be held.

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58 Cal.App.4th 44, 67 Cal.Rptr.2d 850, 121 Ed. Law Rep. 261, 97 Cal. Daily Op. Serv. 7835, 97 Daily Journal D.A.R. 12,550

DOUGLAS V. SHAW, Plaintiff and Respondent,
v.
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, Defendant and Appellant.

No. C021828.
Court of Appeal, Third District, California.
Oct 2, 1997.

SUMMARY

A public university professor brought a declaratory relief action against the university, claiming that the university had no right to alter its patent policy so as to reduce the percentage of net royalties payable to plaintiff. Under a patent agreement executed by plaintiff when he was hired, he had agreed to assign all inventions and patents to the university, and the agreement referred to the university's patent policy, under which the university would pay plaintiff 50 percent of the net royalties from such inventions and patents. Plaintiff filed his action after the university instituted a new patent policy providing for a sliding scale system for compensating the assigning employee. The trial court granted plaintiff's motion for summary judgment. (Superior Court of Yolo County, No. 71730, Thomas E. Warriner, Judge.)

The Court of Appeal affirmed. It held that there was no material issue of disputed fact as to whether the patent agreement was valid, and the parties to it clearly intended to incorporate the patent policy. The policy was not a mere statement of personnel policy; having made the policy a part of its written agreement with plaintiff, the university could not unilaterally revise it as to him. The court further held that plaintiff did not lack the ability to enforce the agreement simply because of his public employee status. When a public employer chooses to enter into a written contract with its employee, assuming the contract is not contrary to public policy, the employer cannot later deny the employee the means to enforce that agreement. (Opinion by Scotland, J., with Sims, Acting P. J., and Sparks, J., concurring.)

HEADNOTES

Classified to California Digest of Official Reports

(1a, 1b)
Mandamus and Prohibition § 18--Mandamus--Subjects of Control-- Contract Rights--Public University Professor's Rights Under Employment Contract.
In a declaratory relief action by a public university professor against the university, claiming that the university had no right to alter its patent policy so as to reduce the percentage of net royalties payable to plaintiff, the trial court did not err in failing to apply the standard of review for a mandamus action, and instead applying a straightforward contract analysis. It is true that the university's administrative decisions regarding its faculty were properly reviewed by writ of mandate. However, plaintiff was not challenging an administrative decision by the university; rather, he was seeking an interpretation of his existing written contract with the university. As a general rule, mandamus is not an appropriate remedy for enforcing a contractual obligation against a public entity.

(2)
Appellate Review § 55--Presenting and Preserving Questions in Trial Court--Adherence to Theory of Case--Exceptions.
Generally a party may not raise a new contention on appeal. An exception exists, however, in cases where a new point of law is decided after the trial or where the new theory presents a question of law to be applied to undisputed facts in the record. Application of this rule is discretionary with the reviewing court.

(3a, 3b, 3c, 3d)
Public Officers and Employees § 25-- Compensation--Fixing and Altering Amount--Employer's Unilateral Alteration of Royalty Payment Agreement.
In a declaratory relief action by a public university professor against the university, claiming that the university had no right to alter its patent policy so as to reduce the percentage of net royalties payable to plaintiff, the trial court did not err in granting summary judgment for plaintiff. Under a patent agreement executed by plaintiff when he was hired, he agreed to assign all inventions and patents to the university, and the agreement referred to the university's patent policy, under which the university would pay plaintiff 50 percent of the net royalties from such inventions and patents. There was

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no material issue of disputed fact as to whether the patent agreement was valid, and the parties to it clearly intended to incorporate the patent policy. The policy was not a mere statement of personnel policy; having made the policy a part of its written agreement with plaintiff, the university could not unilaterally revise it as to him.

(4)
Summary Judgment § 4--Propriety--As Determined by Character of Action-- Declaratory Relief Action.
Pursuant to Code Civ. Proc., § 1060, an action for declaratory relief is appropriate to determine the legal rights and duties of the parties to a written contract, and where the only cause of action is for declaratory relief, a motion for summary judgment is likewise appropriate.

(5)
Contracts § 28--Construction and Interpretation--Intention of Parties.
Under the traditional rules governing interpretation of contracts, the overriding goal is to give effect to the parties' mutual intentions as of the time of contracting. Where the language is clear and explicit and does not lead to absurd results, the intent is ascertained from the written terms alone.

(6)
Contracts § 28--Construction and Interpretation--Intention of Parties-- Objective Intent.
Although under Civ. Code, §§ 1636, 1638, the intent of the parties determines the meaning of the contract, the relevant intent is "objective"-that is, the objective intent as evidenced by the words of the instrument-not a party's subjective intent. The true intent of a contracting party is irrelevant if it remains unexpressed.

[See 1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 684.]

(7)
Employer and Employee § 4--Contracts of Employment--Right of Public Employee to Enforce Contract.
A professor at a public university, notwithstanding his status as a public employee, did not lack the legal means to enforce a patent agreement, executed at the time he was hired, under which he would assign his inventions and patents to the university and the university would pay him 50 percent of the royalties from those inventions and patents. Public employees may sometimes be employed without a written contract, but when the public employer chooses instead to enter into a written contract with its employee, assuming the contract is not contrary to public policy, the employer cannot later deny the employee the means to enforce that agreement.

COUNSEL
P. Martin Simpson, Jr., James E. Holst, John F. Lundberg, Robert Barnes, Arnold, White & Durkee, Gerald P. Dodson and James F. Valentine for Defendant and Appellant.
Miller, Starr & Regalia, Marvin B. Starr and Lynne M. Yerkes for Plaintiff and Respondent. ***47**

SCOTLAND, J.

This case involves a dispute over a policy of the Regents of the University of California (the University) which provides that, as a condition of employment by the University, an employee must assign to the University any of the employee's inventions and patents conceived in the course of employment; as consideration for the assignment, the employee will get a percentage of those net royalties and fees received by the University for a patented invention.

When Associate Professor Douglas V. Shaw was hired by the University to teach and do research, the patent policy specified that employees would get 50 percent of the net royalties and fees received from their inventions. The University later revised the policy to reduce this percentage. When the University announced it would pay Shaw the reduced percentage for his patented inventions conceived after the policy change, Shaw brought this action, seeking a declaration that he is entitled to 50 percent of the net royalties and fees.

The University appeals from the judgment entered in Shaw's favor following an order granting summary judgment on his complaint for declaratory relief. According to the University, the patent policy in effect at the time Shaw was hired was not part of the patent agreement signed by Shaw as a condition of his employment; rather, it is a personnel policy that the University may modify unilaterally at any time.

We shall affirm the judgment. As we shall explain, the patent agreement between Shaw and the University is a contract which incorporates the terms of the patent policy in effect at the time Shaw was hired. Although the University is entitled to revise its patent policy, it cannot do so with respect to Shaw because of its written agreement with him, specifying that he would receive 50 percent of the net royalties and fees from his inventions patented by the University.

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Facts and Procedural Background

Shaw was hired in 1986 to teach and do research in the department of pomology at the University of California, Davis. Pomology is the science of the cultivation of fruits. In recent years, Shaw has concentrated his research on the genetics of strawberries.

At the time he became a member of the University faculty, Shaw was asked to sign a single-page, two-sided University form document entitled ***48** "State Oath of Allegiance and Patent Agreement." The document contains (1) a half-page "State Oath of Allegiance," (2) a half-page "Patent Agreement," and (3) the "University Policy Regarding Patents" (the Patent Policy).

The Patent Policy begins on one side of the document and continues onto the next side. It states that the University, "in administering intellectual property rights for public benefit, desire[s] to encourage and assist members of the faculties, employees, and others associated with the University in the use of the patent system with respect to their discoveries and inventions in a manner that is equitable to all parties involved."

The Patent Policy provides that "[a]n agreement to assign inventions and patents to the [University] ... shall be mandatory for all employees, for persons not employed by the University but who use University research facilities and for those who receive grant or contract funds through the University." It also provides that exceptions to this assignment requirement may be authorized when "the mission of the University is better served" thereby.

As to those who have agreed to assign their inventions to the University, the Patent Policy states that "[t]he [University] agree[s], for and in consideration of said assignment of patent rights, to pay annually to the named inventor(s), the inventor(s)' heirs, successors, or assigns 50 percent of the net royalties and fees received by [the University]."

The patent agreement obligates the signatory to inform the University promptly of "every possibly patentable device, process, plant or product, hereinafter referred to as 'invention,' " which the signatory may conceive in the course of University employment. Should the University deem the invention patentable, the signatory promises thereafter "to assign to University all rights, title and interest" in the invention.

Directly under the title of the patent agreement appear the words: "Please read the Patent Policy on reverse side and above." The first paragraphs of the patent agreement state: "This agreement is made by me with The Regents of the University of California, a corporation, hereinafter called 'University,' in part consideration of my employment, and of wages and/or salary to be paid to me during any period of my employment, by University, and/or my utilization of University research facilities. [¶] By execution of this agreement, I understand I am not waiving any rights to a percentage of royalty payments received by University, as set forth in University Policy Regarding Patents, hereinafter called 'Policy.' " ***49**

Shaw signed the patent agreement on February 25, 1986.

At or near the time he assumed his position at the University, Shaw also received a pamphlet from the University entitled "Patent Practices at the University of California." It summarizes the Patent Policy and states that, in exchange for their agreement to assign patents to the University, employees shall receive 50 percent of net royalties and fees received by the University for their inventions.

The Revised Patent Policy and Shaw's Inventions

In 1989, the University announced its intention to revise the Patent Policy to reduce the percentage of royalties it would pay to inventors.

In written memoranda to the University, Shaw objected to the application of a revised Patent Policy to individuals who, like him, had signed the patent agreement under the then existing Patent Policy.

In April 1990, the University officially revised its Patent Policy to reduce an inventor's share of net royalties and fees from a flat rate of 50 percent to a sliding scale in which the inventor would receive 50 percent of the first $100,000, 35 percent of the next $400,000, and 20 percent of any additional net royalties and fees. The University's president announced that the creation of this sliding scale "responds to internal criticisms of the present system and to concerns that-particularly in a public institution-the goal of such a policy should be to provide support and incentives for further productive research rather than the highest earnings for individual inventors." In the University's view, its 1990 Patent Policy increases the percentage of royalties that can be used to fund additional research and "is much more in line with what most of the other universities in the states do."

In December 1992, Shaw (as coinventor with two other University professors) disclosed to the University his invention of six new strawberry cultivars. The University informed Shaw that these inventions "will be governed by the UC Patent Policy at the time of the disclosure," i.e., by the 1990 Patent Policy which calculates an inventor's share of net royalties on declining sliding scale.

Shaw objected and argued the University should instead "meet its obligation under the Patent Agreement that [Shaw] signed" to pay inventors 50 percent of the net royalties. The University declined, asserting that the Patent Policy is not a contract but merely a "personnel policy grounded in the employment relationship" and the University "may prospectively change its ***50** personnel policies unilaterally," provided it gives advance notice to employees of its intent to do so.

The University directed Shaw to execute an assignment of his interest in the patents of the six strawberry cultivars. The assignment provided that net royalties for the new plants would be divided in accordance with the "benefits stipulated for the inventor in the 'University of California Patent Policy' revised effective April 16, 1990, which document is made by reference a part hereof and in fulfillment of the Assignor's Patent Agreement with the University of California ...." When Shaw refused to sign the assignment, the University agreed to modify its terms to provide that consideration for the assignment includes a share of net royalties in accordance with "the applicable University of California Patent Policy," so as to preserve the parties' respective positions on what policy should apply.

The Lawsuit

Shaw then brought this action, seeking a declaration that, (1) in consideration for his execution of the patent agreement, the University agreed to distribute to him 50 percent of the net royalties and fees accruing from any invention he might conceive, and (2) the University may not unilaterally modify the terms of the patent agreement without Shaw's written consent.

Shaw moved for summary judgment on the grounds that (1) absent the patent agreement, the University has no right or interest in any of Shaw's inventions; (2) in the text of the patent agreement, Shaw expressly reserves his rights to "a percentage of royalty payments received by University, as set forth in the University Policy Regarding Patents"; (3) the University may not unilaterally modify the patent agreement's terms without his consent; and (4) Shaw continues to own those patent rights which he did not waive, i.e., 50 percent of the net royalties and fees with respect to any invention.

In opposition to Shaw's motion, the University did not challenge Shaw's statement of undisputed facts; it opted instead to supplement the record with further undisputed facts of its own. The University also argued in pertinent part that (1) because Shaw's employment is governed by statute, not contract, he can maintain no contract action against the University; (2) the "Patent Policy" in effect at the time Shaw signed the patent agreement is not a contract and thus may be changed unilaterally by the University, so long as Shaw received notice of the new policy and a reasonable time within which to decide whether to continue under the new policy or to seek different employment; (3) the patent agreement operates as a complete transfer of Shaw's rights in all as-yet-uninvented plants or processes to the University; and (4) the University has done nothing to modify the patent agreement. ***51**

The trial court granted Shaw's motion for summary judgment and issued a statement of decision. The court found that Shaw had presented a prima facie case establishing that the patent agreement constitutes an enforceable contract with the University; that the patent agreement must be interpreted in accordance with the Patent Policy set forth on the same document; and that the University's 1990 modification of the Patent Policy cannot effectively modify the parties' patent agreement, in light of Shaw's objection. Accordingly, the court held, the patent agreement must be construed to require the University to pay Shaw 50 percent of the net royalties and fees received by the University for all inventions disclosed by Shaw.

The trial court entered judgment in favor of Shaw, and this appeal ensued.

Discussion

I

([1a]) The University begins its argument on appeal by advancing a theory that it admits was not raised before the trial court. Characterizing Shaw's complaint as "a challenge to the administrative decisions of a state agency in establishing its policies," the University claims the trial court erred in applying "a straightforward contract analysis" rather than the standard of review for a mandamus action, i.e., that the University's decision to revise its Patent Policy must be upheld so long as it is not arbitrary, capricious, or entirely lacking in evidentiary support.

To support this argument, the University relies principally on the decision in *Bunnett v. Regents of University of California* (1995) 35 Cal.App.4th 843 [41 Cal.Rptr.2d 567], which was issued after the entry of judgment in this case.

([2]) Generally, a party may not raise a new contention on appeal. (*Ernst v. Searle* (1933) 218 Cal. 233, 240-241 [22 P.2d 715]; *In re Marriage of Moschetta* (1994) 25 Cal.App.4th 1218, 1227 [30 Cal.Rptr.2d 893].) An exception exists, however, in cases where a new point of

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law is decided after the trial (*Fisher v. City of Berkeley* (1984) 37 Cal.3d 644, 654, fn. 3 [209 Cal.Rptr. 682, 693 P.2d 261]) or where the new theory "presents a question of law to be applied to undisputed facts in the record." (*Hoffman-Haag v. Transamerica Ins. Co.* (1991) 1 Cal.App.4th 10, 15 [1 Cal.Rptr.2d 805].) Application of this rule is discretionary with the reviewing court. (*In re Marriage of Moschetta, supra*, 25 Cal.App.4th 1218, 1227; see 9 Witkin, Cal. Procedure (3d ed. 1985) Appeal, § 322, p. 332.)

([1b]) We shall consider, but reject, the University's claim of error. While it is true the University's administrative decisions regarding its faculty are ***52** properly reviewed by writ of mandate (e.g., *McGill v. Regents of University of California* (1996) 44 Cal.App.4th 1776, 1785 [52 Cal.Rptr.2d 466] [denial of tenure]; *Bunnett v. Regents of University of California, supra*, 35 Cal.App.4th at pp. 847-848 [denial of professor's application to enroll in early retirement incentive program]), Shaw does not challenge an administrative decision of the University. He seeks an interpretation of his existing written contract with the University.

As a general proposition, mandamus is not an appropriate remedy for enforcing a contractual obligation against a public entity. (*California Teachers Assn. v. Governing Board* (1984) 161 Cal.App.3d 393, 399 [207 Cal.Rptr. 659]; *Wenzler v. Municipal Court* (1965) 235 Cal.App.2d 128, 132 [45 Cal.Rptr. 54].) Thus, the trial court correctly applied contract principles in resolving the parties' dispute over the patent agreement.

II

A motion for summary judgment "shall be granted if all the papers submitted show that there is no triable issue as to any material fact and that the moving party is entitled to judgment as a matter of law." (Code Civ. Proc., § 437c, subd. (c).)

The University does not contend that there are material issues of triable fact. Rather, the parties' chief disagreement concerns the legal effect of the patent agreement. This poses a legal question which we consider de novo on appeal. (*Parsons v. Bristol Development Co.* (1965) 62 Cal.2d 861, 865 [44 Cal.Rptr. 767, 402 P.2d 839] [where the interpretation of written instrument does not turn on the credibility of extrinsic evidence, it poses a pure question of law].)

([3a]) We first consider whether Shaw has demonstrated that he is entitled to a declaration on summary judgment that the patent agreement is an enforceable agreement which entitles him to 50 percent of the net royalties and fees from his strawberry cultivars.

([4]) An action for declaratory relief is appropriate to determine the legal rights and duties of the parties to a written contract. (Code Civ. Proc., § 1060.) Where, as here, the only cause of action is one for declaratory relief, a motion for summary judgment likewise is appropriate. (*National Exhibition Co. v. City and County of San Francisco* (1972) 24 Cal.App.3d 1, 11 [100 Cal.Rptr. 757]; *Michelman v. Frye* (1965) 238 Cal.App.2d 698, 702 [48 Cal.Rptr. 142].)

([3b]) The written patent agreement, signed by Shaw, contains all the essential elements of a contract: "(1) parties capable of contracting; (2) their ***53** consent; (3) a lawful object; and (4) a sufficient cause or consideration. (Civ. Code, § 1550.)" (*Marshall & Co. v. Weisel* (1966) 242 Cal.App.2d 191, 196 [51 Cal.Rptr. 183].) The University's statement of undisputed facts raises no issue of material fact as to whether the patent agreement is a valid agreement.

([5]) To resolve the parties' dispute concerning the meaning and effect of the patent agreement, we resort to the traditional rules governing interpretation of contracts, which "teach us that the overriding goal of interpretation is to give effect to the parties' mutual intentions as of the time of contracting.... Where contract language is clear and explicit and does not lead to absurd results, we ascertain intent from the written terms and go no further." (*Ticor Title Ins. Co. v. Employers Ins. of Wausau* (1995) 40 Cal.App.4th 1699, 1707 [48 Cal.Rptr.2d 368], citations and fn. omitted.)

([3c]) By its terms, the patent agreement embodies Shaw's promises to disclose any inventions he may create in the future so that the University may "examine[] ... and determine rights and equities therein in accordance with the Policy" and, if the University "desires ... to seek patent protection thereon," to assign his interest in the invention to the University.

The clear language of the patent agreement does not, as the University argues, effect a contemporaneous and "complete transfer of plaintiff's rights to the University." Accordingly, the University's reliance upon cases in which the parties' agreement so provides is misplaced. (E.g., *Cubic Corp. v. Marty* (1986) 185 Cal.App.3d 438, 444, 448 [229 Cal.Rptr. 828] [invention agreement provided that all inventions by employee "shall be the sole and exclusive property" of the employer] and *Treu v. Garrett Corp.* (1968) 264 Cal.App.2d 432, 433 [70 Cal.Rptr. 284] [same].)

We turn now to the critical issue: Does the patent agreement entitle Shaw to 50 percent of the net royalties of any invention that he may create and thereafter assign to the University?

It is undisputed that the text of the patent agreement itself contains no provision identifying what percentage, if any, of net royalties shall be paid to an employee who creates a patentable invention in the course of University employment. It also is undisputed that the Patent Policy, which is printed on the same document as the patent agreement signed by Shaw, contains an agreement by the University to pay 50 percent of the net royalties to an inventor who has assigned an invention to the University.
Shaw contends that the patent agreement incorporates the Patent Policy and its 50 percent royalty provision. We agree. ***54**
"A contract may validly include the provisions of a document not physically a part of the basic contract.... 'It is, of course, the law that the parties may incorporate by reference into their contract the terms of some other document. [Citations.] But each case must turn on its facts. [Citation.] For the terms of another document to be incorporated into the document executed by the parties the reference must be clear and unequivocal, the reference must be called to the attention of the other party and he must consent thereto, and the terms of the incorporated document must be known or easily available to the contracting parties.' " (*Williams Constr. Co. v. Standard-Pacific Corp.* (1967) 254 Cal.App.2d 442, 454 [61 Cal.Rptr. 912]; accord, *Baker v. Aubry* (1989) 216 Cal.App.3d 1259, 1264 [265 Cal.Rptr. 381], and *King v. Larsen Realty, Inc.* (1981) 121 Cal.App.3d 349, 357 [175 Cal.Rptr. 226].)
The contract need not recite that it "incorporates" another document, so long as it "guide[s] the reader to the incorporated document." (Compare *Baker v. Aubry, supra*, 216 Cal.App.3d at p. 1264 with *Chan v. Drexel Burnham Lambert, Inc.* (1986) 178 Cal.App.3d 632, 644 [223 Cal.Rptr. 838].)

Our review of the patent agreement persuades us that, when Shaw signed the agreement, the parties intended it to incorporate the Patent Policy. The patent agreement (1) directs Shaw to "Please read the Patent Policy on reverse side and above," and (2) states that, in signing the patent agreement, Shaw is "not waiving any rights to a percentage of royalty payments received by University, *as set forth in University Policy Regarding Patents*[.]" (Italics added.)

Not only is reference to the Patent Policy " 'clear and unequivocal,' " and its terms " 'easily available to the contracting parties' " (*Williams Constr. Co. v. Standard-Pacific Corp., supra*, 254 Cal.App.2d at p. 454), the language we have italicized above expressly defines the "percentage of royalty payments received by [the] University" that Shaw may expect to receive on his invention as that which is "set forth in" the Patent Policy, i.e., 50 percent of net royalties and fees.[1]
We are unconvinced by the University's assertion that it "did not intend to incorporate the Patent Policy as part of the Patent Agreement." ([6]) Although the intent of the parties determines the meaning of the contract (Civ. Code, §§ 1636, 1638), the relevant intent is "objective"-that ***55** is, the objective intent as evidenced by the words of the instrument, not a party's subjective intent. (*Beck v. American Health Group Internat., Inc.* (1989) 211 Cal.App.3d 1555, 1562 [260 Cal.Rptr. 237].) Nothing in the patent agreement hints at what the University now claims was its long-held desire that the Patent Policy's inventor royalty provision not be incorporated into the patent agreement.[2] The true intent of a contracting party is irrelevant if it remains unexpressed. (211 Cal.App.3d 1555, 1562; see also *City of Mill Valley v. Transamerica Ins. Co.* (1979) 98 Cal.App.3d 595, 603 [159 Cal.Rptr. 635].)

In the trial court, the University argued that it is not bound by the terms of the pre-1990 Patent Policy because that document is not a contract. Documents which are not contracts may be incorporated into a contract, however. (See, e.g., *Baker v. Aubry, supra*, 216 Cal.App.3d at pp. 1262, 1264 [document deemed incorporated was New York Stock Exchange Rules] and *King v. Larsen Realty, Inc., supra*, 121 Cal.App.3d at pp. 353, 357 [documents deemed incorporated were bylaws of realtors' association and arbitration manual].)

([7]) We find no merit in the University's suggestion that, as a public employee who is employed pursuant to statute, not contract, Shaw has no vested contractual right in his terms of employment, such terms being subject to change by the University.

In each of the two cases upon which the University relied for this proposition, the public employee bringing a contract action had no written contract with his public employer. (*Kemmerer v. County of Fresno* (1988) 200 Cal.App.3d 1426, 1431-1432 [246 Cal.Rptr. 609] [civil service employee had no contract of employment which included an implied covenant of good faith and fair dealing]; *Gabe v. County of Clark* (9th Cir. 1983) 701 F.2d 102, 103 [county policy which changed employee's status to "at will" cannot affect the status of her employment without her knowledge].)

When a public employer chooses instead to enter into a written contract with its employee (assuming the contract is not contrary to public policy), it cannot later deny the employee the means to enforce that agreement.

([3d]) We also reject the University's argument that the Patent Policy is a mere personnel policy which it may modify unilaterally. Although the University is entitled to revise its Patent Policy, it cannot do so with respect ***56** to Shaw because of its written agreement with him. The University prepared, and Shaw signed, a patent agreement whose references to the Patent Policy are so direct as to indicate the parties' intent to incorporate the policy's thenexisting terms into the patent agreement, including the University's promise to pay Shaw 50 percent of the net royalties of any patentable invention. Whether, absent the incorporation, the Patent Policy would constitute a mere statement of personnel policy is immaterial. Having made the Patent Policy a part of its written agreement with Shaw, the University may not unilaterally revise it as to him.

In sum, we conclude that the patent agreement signed by Shaw incorporates the Patent Policy, and the University may not refuse to allocate the 50 percent net royalty payments attributable to Shaw's inventions in accordance with the terms of the document.

Disposition

The judgment is affirmed. The University shall pay Shaw's costs on appeal.

Sims, Acting P. J., and Sparks, J.,* concurred.

Appellant's petition for review by the Supreme Court was denied December 23, 1997. ***57**

Footnotes

Judge of the Yolo Municipal Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

Retired Associate Justice of the Court of Appeal, Third District, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

1 In 1990, the University revised the patent agreement to include the following: "I also understand and agree that the University has the right to change the Policy at any time, including the percentage of net royalty payments paid to me."

2 The University asks us to take judicial notice of its standing order No. 100.4 (mm); the University Bulletin, volume 11, No. 39; minutes of the University Board of Patents meeting on April 29, 1963; and various United States patents issued in or before 1989. (Evid. Code, §§ 452, subds. (b), (c) and 459, subd. (a).) As these documents are not pertinent to our analysis, we deny the request. (Evid. Code, § 454, subd. (a)(1).)

* Retired Associate Justice of the Court of Appeal, Third District, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

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111 Cal.App.4th 784
Court of Appeal, Sixth District, California.

Dale WOLSCHLAGER, Plaintiff and Respondent,
v.
FIDELITY NATIONAL TITLE INSURANCE COMPANY et al., Defendants and Appellants.

No. H025147. | July 29, 2003. | As Modified Aug. 27, 2003.

Synopsis

Background: Insured brought action against title insurer, and it petitioned to compel arbitration. The Superior Court, Santa Cruz County, No. CV143329, denied petition. Insurer appealed.

Holdings: The Court of Appeal, Rushing, P.J., held that:
[1] insurer's preliminary report sufficiently incorporated the policy's arbitration clause by reference making it binding on the insured, and
[2] the insurer did not waive the right to arbitration.

Reversed.

West Headnotes (14)

[1] **Alternative Dispute Resolution**
Scope and standards of review

To the extent that the extrinsic evidence is undisputed, the Court of Appeal reviews an arbitration agreement de novo to determine whether it is legally enforceable.

[2] **Alternative Dispute Resolution**
Scope and standards of review

On the question of waiver of an arbitration agreement, the Court of Appeal will affirm if the trial court's decision is supported by substantial evidence.

1 Cases that cite this headnote

[3] **Alternative Dispute Resolution**
Contractual or consensual basis

The right to arbitration depends upon contract.

[4] **Alternative Dispute Resolution**
Nature and form of proceeding

A petition to compel arbitration is simply a suit in equity seeking specific performance of the contract.

5 Cases that cite this headnote

[5] **Alternative Dispute Resolution**
Evidence

Absent a clear agreement to submit disputes to arbitration, courts will not infer that the right to a jury trial has been waived.

[6] **Insurance**
Effect of acceptance and approval

The insured's approval and acceptance of the conditions set forth in the preliminary title report creates a binding contract with the title insurer based on the terms set forth in the report and any materials that are incorporated therein by reference. West's Ann.Cal.Ins.Code, § 12340.11.

5 Cases that cite this headnote

[7] **Insurance**
Requisites and validity

Title insurer's preliminary report sufficiently incorporated the policy's arbitration clause by reference, and, thus, the clause bound the insured, even though the insured approved the report without seeing the policy and the insurer could easily have attached the policy to the report; the report told the insured to read the policy and specified the form available from office issuing the report, the incorporation was both clear and unequivocal, and even if the insured did not know about the arbitration clause, the policy with the clause was easily available to him.
See 1 Witkin, Summary of Cal. Law (9th ed. 1988) Contracts, § 684; 4 Witkin, Summary of Cal. Law (9th ed. 1988) Real Property, § 216; 6 Witkin, Cal. Procedure (4th ed. 1997) Proceedings Without Trial, § 492; 3 Miller & Starr, Cal. Real Estate (3d. ed. 2001) § 7:173 et seq.
9 Cases that cite this headnote

[8] **Contracts**
Matters annexed or referred to as part of contract

A contract may validly include the provisions of a document not physically a part of the basic contract.

[9] **Contracts**
Matters annexed or referred to as part of contract

The parties may incorporate by reference into their contract the terms of some other document.

11 Cases that cite this headnote

[10] **Contracts**
Matters annexed or referred to as part of contract

For the terms of another document to be incorporated into the document executed by the parties, the reference must be clear and unequivocal and must be called to the attention of the other party, he must consent thereto, and the terms of the incorporated document must be known or easily available to the contracting parties.

16 Cases that cite this headnote

[11] **Alternative Dispute Resolution**
Validity

A defendant need not specify that document incorporated into the contract contains an arbitration clause in order to make the incorporation valid; all that is required is that the incorporation must be clear and unequivocal and that the plaintiff can easily locate the incorporated document.

15 Cases that cite this headnote

[12] **Alternative Dispute Resolution**
Waiver or Estoppel

Waiver of the right to compel arbitration may be found where the party seeking arbitration has (1) previously taken steps inconsistent with an intent to invoke arbitration, (2) unreasonably delayed in seeking arbitration, or (3) acted in bad faith or with willful misconduct. West's Ann.Cal.C.C.P. § 1281.2(a).

1 Cases that cite this headnote

[13] **Insurance**
Waiver or estoppel

Title insurer did not waive right to arbitration by failing to inform the insured of the arbitration clause during a long claims and negotiations process and by failing to raise the issue either prior or subsequent to the insured's complaint until he sought discovery; the insurer did not unreasonably delay or act inconsistently with the right to arbitration, although it failed to raise arbitration as an affirmative defense in the answer, the insured had a copy of the policy and was represented by counsel, and since the parties did not substantively engage in the litigation process, there was no appreciable prejudice to the insured. West's Ann.Cal.C.C.P. § 1281.2(a).

1 Cases that cite this headnote

[14] **Insurance**
Waiver or estoppel

In order to find a waiver by the insurer of the right to arbitration, an insured must prove that the insurer engaged in conduct designed to mislead policyholders. West's Ann.Cal.C.C.P. § 1281.2(a).

1 Cases that cite this headnote

Attorneys and Law Firms

****181 *786** William A. O'Connell for Defendants and Appellants.

Tom N. Brown for Plaintiff and Respondent.

Opinion

***787** RUSHING, P.J.

Plaintiff Dale Wolschlager purchased a title insurance policy (Policy) from defendant Fidelity National Title Insurance Company on the basis of a preliminary report he received and approved. The preliminary report did not state that the Policy he would receive contained an arbitration clause; however, the Policy he received after the close of escrow did in fact have one. When defendant denied plaintiff's subsequent claim, plaintiff filed suit and the defendant petitioned to compel arbitration. The trial court denied the petition. In this appeal, we are presented with the question of whether an arbitration clause found in a title insurance policy, which policy is incorporated by reference into the preliminary report, binds an insured who sees neither the policy nor the arbitration clause prior to approving the preliminary report. We hold that because the preliminary report sufficiently incorporated the arbitration clause by reference, the plaintiff is bound by the agreement to arbitrate. Therefore, we reverse the order denying the petition to compel arbitration.

FACTUAL AND PROCEDURAL BACKGROUND

Prior to the close of escrow on his house, plaintiff sought to purchase title insurance from defendant. As is customary, plaintiff received a preliminary report1 from defendant which he read and approved. Included in the preliminary report was an "Exhibit A," which contained selected portions of the proposed policy to be issued. The Policy itself was not attached. The selected policy provisions in Exhibit A do not include or make reference to any arbitration provisions and there are no arbitration provision anywhere in the preliminary report itself. However, Exhibit A does not purport to contain all of the provisions of the Policy, and the first page of the preliminary report states, in regular font, "Copies of the policy forms should be read. ****182** They are available from the office which issued this Report."

Approximately one month after escrow had closed, the plaintiff received the full Policy, which contained an arbitration clause.2 Some time later, the plaintiff discovered that a $27,000 lien encumbered the property he had purchased, although neither the preliminary report nor the Policy had made reference to the lien. On April 27, 2001, plaintiff, through his attorney, filed a claim with defendant. On May 30, 2001, defendant sent plaintiff's attorney a ***788** "preliminary denial" letter. Subsequently, defendant's attorney communicated directly with plaintiff several times regarding his claim without either the consent or knowledge of plaintiff's counsel. After these discussions failed to resolve the matter, defendant sent the plaintiff a formal denial letter on August 31, 2001. The formal denial letter informed plaintiff that if he believed that the defendants claim determination had been incorrect, he could seek review by the California Department of Insurance. At no time during their interactions did the defendant or its attorney inform the plaintiff that his policy contained an arbitration clause or that he could seek to arbitrate the matter. Nor did defendant subsequently make reference to the arbitration clause when informed that plaintiff would be filing a bad faith suit, when served with the suit, or even in filing their answer. It was not until the plaintiff served his discovery requests on June 28, 2002, that defendant first expressed its intention to seek arbitration.

On July 5, 2002, defendant formally demanded that plaintiff submit the controversies raised in the complaint to arbitration. After plaintiff refused, the defendant filed a petition to compel arbitration in the trial court. In denying the petition, the court explained, "Binding a party to a mandatory arbitration provision requires that a party has been clearly and unequivocally informed of the arbitration provision. Here a reference to or incorporation of additional documents which were not attached—or not presented to the party, I should say, nor immediately available to a party and certainly were not attached to the documents, the original documents at the time of signing an agreement, without some specific note or some specific warning of ADR provisions that would be contained in these referenced documents is inadequate to bind that party. I would also note that the plaintiff has not waived his ability to object to the arbitration clause by failing to raise any objection after receiving the policy. Plaintiff has objected at the first opportunity, namely when the defendant raised the issue by demanding arbitration. [ ] ... The defendants have not waived their right to demand arbitration by failing to advise the plaintiff of arbitration rights in their rejection letter. This may be evidence of bad faith perhaps, but its not a waiver.... I would also note that this decision is not based on any finding of improper defense attorney communications with the plaintiff and the decision is not based on any theory that there was an adhesion contract." This appeal ensued.

DISCUSSION

Under Code of Civil Procedure section 1281.2, a court shall order parties "to arbitrate the controversy if it determines that an agreement to arbitrate the controversy ****183** exists, unless it determines that: [ ] (a) The right to compel arbitration has been waived by the petitioner; or [ ] (b) Grounds exist for revocation of the agreement." Here the trial court's findings were two-fold. ***789** While it determined that neither party's actions amounted to waiver, it held that no binding agreement to arbitrate existed between them in the first instance.

[1] **[2]** To the extent that the extrinsic evidence is undisputed, we review the arbitration agreement de novo to determine whether it is legally enforceable. (*Mercuro v. Superior Court* (2002) 96 Cal.App.4th 167, 174, 116 Cal.Rptr.2d 671.) However, on the question of waiver, we will affirm if the trial court's decision is supported by substantial evidence. "If it is not, we may decide the issue as a matter of law. [Citations.]" (*Guess?, Inc. v. Superior Court* (2000) 79 Cal.App.4th 553, 557, 94 Cal.Rptr.2d 201; see also *Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 983, 64 Cal.Rptr.2d 843, 938 P.2d 903.)

Enforceability of the Arbitration Clause

[3] **[4]** **[5]** "The right to arbitration depends upon contract; a petition to compel arbitration is simply a suit in equity seeking specific performance of that contract. [Citations.]" (*Engineers & Architects Assn. v. Community Development Dept.* (1994) 30 Cal.App.4th 644, 653, 35 Cal.Rptr.2d 800.) Absent a clear agreement to submit disputes to arbitration, courts will not infer that the right to a jury trial has been waived. (*Titan Group, Inc. v. Sonoma Valley County Sanitation Dist.* (1985) 164 Cal.App.3d 1122, 1129, 211 Cal.Rptr. 62.) Therefore, as did the trial court, we must first determine whether the parties, in fact, have an enforceable agreement to arbitrate their controversy. In making this determination, we apply general California contract law. (*Rice v. Dean Witter Reynolds, Inc.* (1991) 235 Cal.App.3d 1016, 1023, 1 Cal.Rptr.2d 265, disapproved on another point in *Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal.4th 394, 407, 58 Cal.Rptr.2d 875, 926 P.2d 1061; *Chan v. Drexel Burnham Lambert, Inc.* (1986) 178 Cal.App.3d 632, 637, 223 Cal.Rptr. 838.)

Defendant contends that the only actual contract between the parties is the Policy itself because the preliminary report is nothing more than an offer. Defendant further contends that plaintiff cannot challenge the enforceability of the arbitration clause in the Policy because he never objected to any of the terms therein even after receiving the Policy. " ' " 'It is a general rule that the receipt of a policy and its acceptance by the insured without an objection binds the insured as well as the insurer and *he cannot thereafter complain that he did not read it or know its terms.* It is a duty of the insured to read his policy.' " [Citations.]' [Citation.]" (*Chase v. Blue Cross of California* (1996) 42 Cal.App.4th 1142, 1155, 50 Cal.Rptr.2d 178.) However, unlike a health or liability insurance policy, as was involved in *Chase,* a title insurance policy has a one-time premium and remains in effect so long as the insured owns the property. A purchaser may not cancel the policy and switch to another carrier without forfeiting his premium.

[6] ***790** The process of obtaining title insurance, therefore, contemplates the receipt of a title report before the close of escrow, setting forth the "conditions upon which the issuer is willing to issue its title policy." (Ins.Code, § 12340.11.) The insured's approval and acceptance of the conditions set forth in the preliminary report create a binding contract based on the terms set forth in the report and any materials that are incorporated therein by reference. ****184** (*Ibid.*) Therefore, whether plaintiff was bound by an arbitration clause depends directly on whether that term was set forth in the preliminary report or incorporated therein by reference.

[7] [8] [9] [10] Because it is undisputed that the preliminary report does not itself contain an arbitration clause, the critical question is whether the arbitration clause was sufficiently incorporated into the preliminary report by reference to bind the plaintiff contractually. " 'A contract may validly include the provisions of a document not physically a part of the basic contract.... "It is, of course, the law that the parties may incorporate by reference into their contract the terms of some other document. [Citations.] But each case must turn on its facts. [Citation.] For the terms of another document to be incorporated into the document executed by the parties the reference must be clear and unequivocal, the reference must be called to the attention of the other party and he must consent thereto, and the terms of the incorporated document must be known or easily available to the contracting parties." ' [Citations.]" (*Shaw v. Regents of University of California* (1997) 58 Cal.App.4th 44, 54, 67 Cal.Rptr.2d 850.)

In *King v. Larsen Realty, Inc.* (1981) 121 Cal.App.3d 349, 175 Cal.Rptr. 226 (*King*), the appellant realtors, in applying to the real estate board, contracted to abide by its bylaws. One of the bylaws required appellants to arbitrate as set forth in the California Association of Realtors Arbitration Manual. In finding that the arbitration provisions were incorporated into their contract by reference, the court in *King* observed that appellants had read the bylaws requiring arbitration, enjoyed familiarity with the arbitration manual having referred thereto on occasion, and that it was readily available to both appellants. (*Id.* at p. 353, 175 Cal.Rptr. 226.)

In *Chan v. Drexel Burnham Lambert Inc.* (1986) 178 Cal.App.3d 632, 641, 223 Cal.Rptr. 838 (*Chan),* the court distinguished *King* factually to find that the arbitration provisions were not sufficiently incorporated by reference where the contract did not clearly refer to and identify "the incorporated document wherein the arbitration clause appeared." (*Id.* at p. 642, 223 Cal.Rptr. 838.) *Chan* involved a stockbroker who, as part of an application to be a securities agent, had agreed to abide by the statutes and rules of the three stock trading organizations to which his application would be submitted. One of the stock trading organizations promulgated a rule requiring arbitration. Because the application did not specifically identify the rule where the arbitration clause was located by name, the court found the reference amorphous, and held that ***791** because the contract did not guide the reader to the incorporated document, it failed to "*clearly and unequivocally* " refer to the incorporated document. (*Id.,* at p. 643, 223 Cal.Rptr. 838.)

Here, the preliminary report referred to the Policy a number of times. Specifically, the first page of the report stated, "The printed Exceptions and Exclusions from coverage of said Policy or Policies are set forth in Exhibit A attached. Copies of the Policy forms should be read. They are available from the office which issued this Report." The report also listed the form of Policy of Title Insurance contemplated by the Report as C.L.T.A. Coverage Policy 1990. Unlike in *Chan,* where the document signed by the appellant referred generally to a number of different documents incorporated by reference, the Preliminary Report specifically identifies the document incorporated as the policy, lists the form which is contemplated and tells the recipient ****185** where they can find the policy. This incorporation was both clear and unequivocal.

"In addition to the reference being clear and unequivocal, *Williams Constr. Co. v. Standard–Pacific Corp.* [(1967)] 254 Cal.App.2d [442,] 454, [61 Cal.Rptr. 912], requires the terms of the incorporated document be known or easily available to the party to be bound." (*Chan, supra,* 178 Cal.App.3d at p. 644, [223 Cal.Rptr. 838], fn. omitted.) There was no substantive dispute that plaintiff did not actually know about the arbitration clause. Although the defendant contends that plaintiff's counsel admitted knowledge of the arbitration clause, counsel's awareness of the clause after the claim arose is not relevant to the question of whether plaintiff knew about it at the time he entered into the contract. However, even if plaintiff did not know about the arbitration clause, the Policy with the clause was easily available to him. The preliminary report identified the Policy by name and directed the plaintiff to where he could inspect it. Nothing further was needed to bind the plaintiff.

[11] Plaintiff argues, and the trial court agreed, that because the right to a jury trial is a substantive right, plaintiff was entitled to some kind of specific warning in the preliminary report that by accepting it he was agreeing to give up his rights. There is no authority requiring the defendant to specify that the incorporated document contains an arbitration clause in order to make the incorporation valid. All that is required is that the incorporation be clear and unequivocal and that the plaintiff can easily locate the incorporated document. Additionally, plaintiff is correct that defendant could easily have attached the entire Policy instead of only selected portions. While defendant's choice to not do so may create an inference useful to the substance of the plaintiff's bad faith case, it does not prevent the formation of a valid agreement to arbitration.

The trial court erred in concluding that there was no enforceable agreement to arbitrate between the plaintiff and the defendant.

792** ***Waiver
In denying the petition to compel arbitration, the trial court specified that its decision was not based on any finding of waiver because there was no factual basis for finding waiver. While in general arbitration is a highly favored means of settling disputes (*Doers v. Golden Gate Bridge etc. Dist.* (1979) 23 Cal.3d 180, 189, 151 Cal.Rptr. 837, 588 P.2d 1261), it is beyond dispute that a trial court may deny a petition to compel arbitration if it finds the moving party has waived that right. (Code Civ. Proc., § 1281.2, subd. (a); *Davis v. Continental Airlines, Inc.* (1997) 59 Cal.App.4th 205, 211, 69 Cal.Rptr.2d 79.) We will affirm the trial court's findings if they are supported by substantial evidence. (*Engalla v. Permanente Medical Group, Inc., supra,* 15 Cal.4th at p. 983, 64 Cal.Rptr.2d 843, 938 P.2d 903)

[12] [13] " 'There is no single test for waiver of the right to compel arbitration, but waiver may be found where the party seeking arbitration has (1) previously taken steps inconsistent with an intent to invoke arbitration, (2) unreasonably delayed in seeking arbitration, or (3) acted in bad faith or with willful misconduct. [Citations.]' [Citation.]" (*Berman v. Health Net* (2000) 80 Cal.App.4th 1359, 1363, 96 Cal.Rptr.2d 295.) Plaintiff contends that the trial court's decision that there was no waiver was not supported by substantial evidence. Specifically, plaintiff asserts that defendant never informed plaintiff of the arbitration clause despite a long claims and negotiations process and that defendant ****186** failed to timely raise the issue either prior or subsequent to the filing of the complaint.

[14] In order to find a waiver by the insurer of the right to arbitration, an insured must prove that defendant engaged in "conduct *designed* to mislead policyholders." (*Chase v. Blue Cross of California, supra,* 42 Cal.App.4th at p. 1157, 50 Cal.Rptr.2d 178.) "Such a requirement balances the enhanced duty of the insurer as a contracting party against the strong public policy in favor of arbitration. Furthermore, the court's focus when evaluating an allegation of forfeiture should be on the subjective intent of the insurer. Such focus is consistent with a finding of bad faith and the imposition of a penalty in the form of forfeiture." (*Ibid.*) Conduct designed to mislead can include failure to "timely or meaningfully ... apprise its insureds of their rights to arbitration...." (*Davis v. Blue Cross of Northern California* (1979) 25 Cal.3d 418, 421, 158 Cal.Rptr. 828, 600 P.2d 1060 [insurer waived right to arbitrate where it failed to advise policyholders of the procedure for initiating arbitration and arbitration clause was placed obscurely in the policy]; see also *Sarchett v. Blue Shield of California* (1987) 43 Cal.3d 1, 15, 233 Cal.Rptr. 76, 729 P.2d 267 (*Sarchett*) [waiver found where conduct of an insurer, who had reason to know that insured was unaware of arbitration rights but failed to inform the insured of his rights, was designed to mislead].)

***793** Here, the defendant's conduct was somewhat questionable. Defendant did not affirmatively notify the plaintiff of the right to arbitrate the controversy either before or after it formally denied the claim. Additionally, when defendant wrote to the plaintiff to deny the claim, it advised him of his right to seek redress with the Department of Insurance, but failed to make any mention of the right to arbitrate the controversy. However, unlike in *Davis,* the arbitration clause here was not obscure, it was presented in bold in a document which was both properly incorporated by reference into the terms of the parties' agreement and actually in plaintiff's possession at the time he filed his claim. Further, unlike *Sarchett* the defendant had no reason to know that plaintiff was unaware of his arbitration rights. Plaintiff was represented by counsel initially during the claims process and plaintiff's counsel admitted knowing about the clause since the time plaintiff first provided him with a copy of the Policy.

Nor can we say that defendant unreasonably delayed or acted inconsistently with the right to demand arbitration. Although defendant failed to raise arbitration as an affirmative defense in their answer to the complaint, it demanded arbitration as soon as plaintiff served his first discovery. Since it did not substantively engage in the litigation process, there was no evidence of any appreciable prejudice to plaintiff. (*Van Ness Townhouses v. Mar Industries Corp.* (9th Cir.1988) 862 F.2d 754, 758 [the right to arbitrate is waived when its proponent, with knowledge of an existing right to compel arbitration, acts inconsistently with the right, thereby causing prejudice to the other party].) Given the totality of the circumstances, substantial evidence supported the trial court's finding on the question of waiver. Therefore waiver does not provide a basis for denying the petition to compel arbitration.

DISPOSITION

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The order denying the petition to compel arbitration is reversed. The matter is remanded so that the trial court may enter its order granting the petition to compel ****187** arbitration and staying the matter pending arbitration.

WE CONCUR: PREMO and ELIA, JJ.

Parallel Citations

111 Cal.App.4th 784, 03 Cal. Daily Op. Serv. 7909, 2003 Daily Journal D.A.R. 9841

Footnotes

1 " 'Preliminary report', ... [is a] report[ ] furnished in connection with an application for title insurance and [is an] offer[ ] to issue a title policy subject to the stated exceptions set forth in the report [ ] and such other matters as may be incorporated by reference therein.... Any such report shall not be construed as, nor constitute, a representation as to the condition of title to real property, but shall constitute a statement of the terms and conditions upon which the issuer is willing to issue its title policy, if such offer is accepted." (Ins.Code, § 12340.11.)

2 Paragraph 13 of the "Conditions and Stipulations," found at page 4 of 12, states in relevant part, "**ARBITRATION**—Unless prohibited by applicable law, either the Company or the Insured may demand arbitration pursuant to the Title Insurance Arbitration Rules of the American Arbitration Association...."

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